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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

July 15, 1970

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SUMMARY AND OUTLOOK

Nonfinancial

Real GNP is estimated to have edged up in the second quarter, after two quarters of decline, and the rise in the GNP deflator apparently slowed appreciably.^{1/} The better performance of real GNP reflected mainly an ending of the cutback in inventory investment and some step-up in consumer expenditures. A somewhat faster growth in real GNP seems likely this quarter, with final sales expected to continue strong and the rate of increase in the deflator to moderate further.

The recent performance of key monthly measures has been mixed. Industrial production declined in June but less than in May. Since the peak in July 1969, the index has fallen about 3-1/2 per cent. Further curtailment in output of both business equipment and defense in June was a major contractive influence, as in the preceding months. Output of consumer goods increased in June, however, with production of automobiles, consumer staples and television higher. Retail sales apparently rose slightly in June, and for the quarter as a whole were well above the first quarter. Most important has been recovery in auto sales--in June sales of domestic cars had risen to an 8.6 million annual rate, a high for the year. The average rate of increase in book value of business

^{1/} We expect to have for the Supplement the official Commerce estimates of second quarter GNP, along with the revisions for the past three years that are made available each July.

inventories for April and May was less than in the first quarter. On a GNP basis, however, after the valuation adjustment, inventory investment is estimated to show little change in the second quarter.

Although the unemployment rate declined to 4.7 per cent in June, demands for labor continued weak. Hiring of summer workers was below usual in almost all industries, and seasonally adjusted nonfarm employment registered another sizable decline. Apparently reflecting the reduction in job opportunities, fewer youths entered the labor force than last June and the total labor force declined considerably. Initial claims for unemployment insurance have declined further through early July while continued claims have changed little.

The Chicago teamster's strike was settled early in July, with wage increases amounting to approximately 13 per cent per year over a three year period. As had been agreed earlier, the national contract was modified in line with the Chicago settlement.

Farm and food prices declined in June for the third successive month, after allowance for seasonal influences. Wholesale industrial commodity prices have continued to rise, but there has been increasing evidence of a lessening of upward pressures in this area also. The number of commodity subgroups reporting price increases was smaller than in any month since last August, while price declines were more widespread than earlier. Prices of nonferrous metals, which has risen very sharply over the past two years, are now generally under downward pressure. Moreover, supply and demand imbalances have apparently resulted in a shading of actual prices below list for a number of commodities.

Outlook. A further--and larger--rise in real GNP is expected in the present quarter. Recent data point to continued strength in consumer spending, a bottoming out in residential construction outlays and a faster rise in State and local expenditures. The projected GNP path for subsequent quarters also remains essentially the same as presented in the June 23 Chart Show. Some gradual recovery in inventory accumulation, sustained growth in consumer spending, and rising residential construction activity should serve to bolster aggregate demand. But probable declines in business fixed investment and defense outlays are expected to limit the upswing. On balance, growth is projected to be well below potential resource availability; unemployment is likely to edge up and price increases to moderate somewhat.

Financial

Conditions in financial markets during the past several weeks have been dominated by the rather dramatic down-turn in bond yields and heavy net attrition of commercial paper. Major factors in the yield turn around--which has run to as much as 5/8 of a percentage point in some series--have been a shift of investor sentiment about prospects inflation and real growth, and an abatement of concerns about immediate liquidity problems. It is now widely assumed in the market that private demands for credit are likely to moderate somewhat over the months ahead and that monetary policy will be on the expansive side. As these changed expectations have developed, institutional investors have increased their bond buying to lock up high yields. Meanwhile, stock prices declined on balance early in the period but most recently have recovered much of this loss.

The net run-off of commercial paper, although focused selectively on a relative small number of issuers, was much larger than anticipated. In the main, industrial and finance company issuers forced out of the paper market have refinanced at commercial banks, with a consequent sharp rise in bank loans around mid-year. The lion's share of the funds shifted out of commercial paper appears to have flowed back to banks in response to the higher rates being paid on 30-89 day CD's, but demands for other market securities have also risen. Among other things, this has helped keep yields on Treasury bills from advancing seasonally, despite the large volume of Treasury tax bill financing in the period.

Securities market outlook. Over the weeks ahead, demands on securities markets will be sizable. The Treasury, in particular, must refinance \$5.6 billion of publicly-held August maturities. And there is a chance that this operation will be enlarged by several billion dollars to cover the bulk of the Treasury's remaining third quarter needs for new money. In the corporate bond market, the forward calendar suggests that new issue volume will remain very heavy, although dropping from the second quarter when the very large AT&T issue was marketed. In the municipal bond market, with yields recently off substantially, there is a chance that previously unsatisfied borrowers will add to volume.

These large credit needs will tend to limit further interest rate declines over the near-term, but if incoming evidence on the developing state of the economy should appear to confirm the changed expectations, interest rates may well fall further. Over the longer

run, as the rate of inflation subsides, we would expect bond yields to work lower in any event.

Banking outlook. Demands for bank credit will depend heavily on developments in the commercial paper market. While this market has performed better in recent days, there appears to be a continuing in some degree of investor withdrawals from paper issued by lesser name firms and firms linked to parent companies whose condition has come under question. Consequently, the possibility of some further shrinkage in commercial paper over the weeks ahead cannot be ruled out. In most instances, banks will probably be willing to meet demands arising from such shrinkage, given the availability of funds from 30-89 day CD's.

Because of the special demands for bank credit being created by the commercial paper run-off, it is difficult to gauge the more general strength of business loan demands. In June, business borrowing grew less rapidly than in May, although some of this may have reflected larger loan repayments from the proceeds of capital market financing. Given the modest nature of the projected third quarter upturn in economic activity and the large volume of anticipated capital market financings, business loan growth unrelated to commercial paper seems likely to remain relatively moderate.

On the liability side, growth of large bank CD's can be expected to remain rapid, although the rate of increase should decline as the quarter progresses. To some extent such inflows will probably be used to substitute for high cost Euro-dollars and foreign official time deposits and perhaps also for commercial paper issued by bank

affiliates -- even though current cost comparisons in the latter case are not unfavorable. Inflows of consumer-type time and savings deposits have held up well following mid-year interest crediting and are likely to remain better as the quarter progresses.

Non-bank thrift institutions. The fact that non-bank thrift institutions have not come under serious pressure from withdrawals following mid-year interest crediting represents an important further step in rebuilding of liquidity at these institutions. Although rates on thrift accounts are still substantially below yields on market securities, several factors have apparently contributed to the better performance of thrift accounts -- increased over-all consumer savings, the desire for insured readily cashable assets, and the restrictions on minimum denominations of Treasury and Federal agency securities. With the mid-year disintermediation threat fading, savings and loan associations in particular are likely to increase loan commitments, and by mid-summer commitments made earlier should begin to show up in larger mortgage acquisitions.

Balance of Payments

The very large "over-all adjusted deficits" in April and May and in most of June were partly offset by a surplus of more than half a billion dollars in the last few days of June. Nevertheless, the second-quarter accounts will show a deficit on this basis, seasonally adjusted, of about \$2-1/4 billion according to very preliminary data, substantially exceeding the first-quarter deficit of \$1.4 billion. (These are quarterly amounts, not annual rates; SDR allocation is

excluded as well as certain special transactions. Virtually the same picture is given by the liquidity deficit adjusted for changes in "nonliquid" foreign official assets and other special transactions.) Without seasonal adjustment, the deficit in the first half as a whole was about \$3-1/2 billion. Settlement for the half year required net official reserve transactions of close to \$5 billion, since liabilities to commercial banks abroad (as reported by banks in the United States, including the liabilities of foreign bank branches and agencies in this country to banks abroad) declined by about \$1-1/2 billion.

The causes of the worsening in the over-all balance in the second quarter -- when the trade surplus was improving slightly -- remain conjectural. Evidently private capital movements were heavily adverse in the second quarter. We assume that these outflows included movements of private funds from the United States into Euro-dollars, German marks, and Canadian dollars. The return flow in late June, concentrated as it was near the end of the quarter, is thought likely to have included substantial window-dressing movements by U.S. corporations subject to OFDI direct investment controls.

The large size and variability of these flows make any effort at precise projection of the balance of payments in coming months an unprofitable exercise. Some further gradual improvement in net exports of goods and services is expected. But presumably deficits will continue to be large until significant changes occur in the attractiveness of U.S. equities to foreigners, in speculative attitudes toward strong currencies such as the German mark, and in relative interest rates.

Euro-dollar interest rates, though down now to the 9 per cent level again for 3-month money and below 8 per cent for call money, continue to show unusually wide spreads over rates on U.S. Treasury bills and Federal funds. High though Euro-dollar rates are in relation to U.S. rates (and also to U.K. rates), money market rates in Germany are even higher.

The fiscal policy measures taken in Germany last week were followed today by small reductions (effective July 16) in the Bundesbank's Lombard rate and discount rate. It is to be hoped that some additional easing of German monetary policy lies ahead. Data on German new orders through May just released show some further easing of demand at the factory level. German industry's order backlogs, however, remain very large, and wage increases apparently are continuing to exert inflationary pressure in the German economy.

July 14, 1970

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SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1970				Per Cent Change*		From
	Mar.	Apr.	May	June	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	82.8	82.9	82.6	82.1	-0.5	-0.8	2.0
Unemployment rate (%)	4.4	4.8	5.0	4.7	--	--	[3.4] ^{4/}
Insured unempl. rate (%)	2.7	3.2	3.6	3.7	--	--	[2.1] ^{4/}
Nonfarm employment, payroll (mil.)	71.3	71.2	70.9	70.7	-0.3	-0.8	0.5
Manufacturing	19.9	19.8	19.6	19.5	-0.6	-2.4	-3.9
Nonmanufacturing	51.3	51.4	51.3	51.2	-0.2	-0.2	2.2
Industrial production (57-59=100)	171.1	170.2	169.1	168.6	-0.3	-1.5	-2.9
Final products, total	169.7	168.8	167.9	167.8	-0.1	-1.1	-1.7
Consumer goods	162.0	163.0	163.5	163.9	0.2	1.2	1.5
Business equipment	198.0	193.0	189.0	187.4	-0.8	-5.4	-4.9
Materials	171.7	171.7	170.1	169.2	-0.5	-1.5	-4.0
Capacity util. rate, mfg.	79.6	78.8	77.7	77.1	--	--	[84.7] ^{4/}
Wholesale prices (57-59=100) ^{1/}	116.6	116.6	116.8	117.0	0.2	0.3	3.4
Industrial commodities (FR)	114.7	115.1	115.5	115.6	0.1	0.8	4.0
Sensitive materials (FR)	115.7	116.6	116.9	115.9	-0.9	0.2	3.2
Farm products, foods & feeds	118.8	117.6	117.0	117.5	0.4	-1.1	1.7
Consumer prices (57-59=100) ^{1/ 5/}	133.2	134.0	134.6	n.a.	0.4	1.6	6.2
Food	131.6	132.0	132.4	n.a.	0.3	0.7	7.0
Commodities except food	120.8	121.6	122.3	n.a.	0.6	1.6	4.1
Services	152.3	153.4	154.1	n.a.	0.5	2.3	8.0
Hourly earnings, pvt. nonfarm (\$)	3.18	3.19	3.19	3.21	0.6	0.9	5.6
Hourly earnings, mfg. (\$)	3.31	3.32	3.34	3.36	0.6	1.5	5.7
Weekly earnings, mfg. (\$)	132.72	132.65	132.96	133.68	0.5	0.7	3.4
Net spend. weekly earnings, mfg. (3 dependents 57-59 \$) ^{1/ 5/}	86.22	85.35	86.07	n.a.	0.8	0.3	-1.4
Personal income (\$ bil.) ^{2/ 5/}	783.3	801.3	793.5	n.a.	-1.0	2.0	7.2
Retail sales, total (\$ bil.)	29.8	30.5	30.3	30.4	0.1	1.8	3.3
Autos (million units) ^{2/}	7.3	7.5	7.8	8.6	11.2	17.6	-3.6
GAAF (\$ bil.) ^{3/}	8.0	8.5	8.3	8.3	-0.6	2.8	3.4
12 leaders, composite (1963=100) ^{5/}	148.4	148.5	147.3	n.a.	-0.8	-2.3	-3.4
Selected leading indicators:							
Housing starts, pvt. (thous.) ^{2/ 5/}	1,392	1,215	1,200	n.a.	-1.2	-8.1	-21.7
Factory workweek (hours)	40.2	40.0	39.8	39.8	0.0	-1.0	-2.2
Unempl. claims, initial (thous.) ^{5/}	268	326	314	312	0.5 ^{6/}	-16.5 ^{6/}	-56.5 ^{6/}
New orders, dur. goods, (\$ bil.) ^{5/}	28.6	28.7	29.6	n.a.	3.3	-0.2	-1.4
Machinery & equipment ^{5/}	6.0	6.1	6.2	n.a.	1.6	-6.4	-3.8
Common stock prices (41-43=10)	88.65	85.95	76.06	75.59	-0.6	-14.7	-23.8

* Based on unrounded data. ^{1/} Not seasonally adjusted. ^{2/} Annual rates.^{3/} Gen'l. merchandise, apparel, and furniture and appliances. ^{4/} Actual figures.^{5/} Per cent change calculated to May 1970. ^{6/} Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	1969		Averages		1970	1970
	QIII	QIV	QI	QII	June	Week ended July 1
Interest rates, per cent						
Federal funds	8.98	8.94	8.56	7.88	7.60	7.23
3-mo. Treasury bills	7.02	7.36	7.21	6.67	6.68	6.43
3-mo. Federal agencies	7.63	7.92	7.72	7.09	7.04	6.88
3-mo. Euro-dollars	10.89	10.48	9.26	8.87	9.39	9.00
3-mo. finance co. paper	7.74	7.89	7.94	7.41	7.55	7.54
4-6 mo. commercial paper	8.49	8.63	8.55	8.16	8.20	8.25
Bond buyer municipals	6.00	6.40	6.35	6.81	6.96	6.79
Aaa corporate-new issues	7.75	8.32	8.45	8.94	9.11	9.02
20-year Treasury bonds	6.34	6.71	6.78	7.14	7.34	7.19
FHA mortgages, 30-year	8.38	8.53	9.25	n.a.	n.a.	--

	1969		1970		
	QIII	QIV	QI	QII	June
Change in monetary aggregates (SAAR, per cent)					
Total reserves	-9.3	1.4	-2.9	2.1	-0.9
Nonborrowed reserves	-4.8	-0.1	-0.4	3.6	4.8
Credit proxy	-9.4	0.1	0.6	6.0	5.8
Credit proxy + nondep. funds	-4.3	2.0	0.5	6.7	7.4
Money supply	--	1.2	3.8	4.6	-0.6
Time and savings deposits	-13.3	--	0.4	13.8	8.4
Deposits at S&L's and MSB's	2.1	1.4	1.9	6.7	6.1
Bank credit, end-of-month	-0.8	4.8	-0.4	4.4	1.2
Treasury securities	-11.4	-20.5	-12.3	25.4	4.5
Other securities	-7.2	4.5	9.5	11.5	11.3
Total loans	3.1	10.0	-0.7	-1.3	-1.7
Business	7.0	7.7	-4.5	1.9	4.6

	1969		1970		
	QIII	QIV	QI	QII	June
Change in millions of dollars					
Commercial Paper (SA)	3,329	3,151	3,185	2,803	-294
Bank related (NSA)	1,350	1,614	2,224	1,035	3

	1968	1969		1970		
	1st Half	Half-I	June	QI	QII	June
New security issues (NSA, \$ mil.)						
Total corp. issues	10,882	13,572	2,530	7,977	9,825e	3,225e
Public offerings	7,515	10,360	3,941	6,724	8,525e	2,725e
State and local government bond offerings	7,956	6,435	737	4,049	3,696e	1,075e
Fed. sponsored agency debt (change)	2,556	3,605	1,021	3,714	1,518e	704e
Fed. gov't. debt (change)	4,229	-12,371	-8,587	1,981	-6,286e	-3,047e

n.a. - Not available.

SAAR - Seasonally adjusted annual rate.

e - Estimated.

NSA - Not seasonally adjusted.

p - Preliminary.

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 U.S. Balance of Payments
 In millions of dollars; seasonally adjusted

	1968 Year	1969 Year	1 9 7 0 ^P		
			I	Apr.*	May*
<u>Goods and services, net</u> ^{1/}	<u>2,499</u>	<u>1,950</u>	<u>885</u>		
Trade balance ^{2/}	624	638	515	185	249
Exports ^{2/}	33,588	36,473	10,200	3,410	3,585
Imports ^{2/}	-32,964	-35,835	-9,685	-3,225	-3,336
Service balance	1,875	1,312	370		
<u>Remittances and pensions</u>	-1,122	-1,191	-330		
<u>Govt. grant & capital, net</u>	-3,975	-3,828	-837		
<u>U.S. private capital</u>	<u>-5,412</u>	<u>-5,374</u>	<u>-1,557</u>		
Direct investment	-3,208	-3,070	-1,304		
Foreign securities	-1,255	-1,494	-159	-66	61
Banking claims	253	-541	156	-103	-277
Other	-1,202	-269	-250		
<u>Foreign capital</u>	<u>9,409</u>	<u>12,554</u>	<u>1,693</u>		
Official foreign, liquid	-3,101	-525	3,014	-342	381
Official reserve holders, nonliquid	2,340	-996	-425	70	133
Other official foreign, nonliquid	-19	259	-66		
Foreign commercial banks, liquid	3,387	9,434	-1,717	947	-363
New direct investment issues ^{3/}	2,144	1,029	155		
U.S. corporate stocks	2,096	1,565	-85	8	-198
Other	2,562	1,788	817		
<u>U.S. monetary reserves (inc.-)</u>	<u>-880</u>	<u>-1,187</u>	<u>481</u>	<u>431</u>	<u>754</u>
Gold stock	1,173	-967	-44	1	2
Special drawing rights	--	--	-53	-6	1
IMF gold tranche	-870	-1,034	-253	67	150
Convertible currencies	-1,183	814	831	369	601
<u>Errors and omissions</u>	-514	-2,924	-337		
<u>BALANCES (deficit -) ^{4/}</u>					
Official settlements, S.A.			-3,070		
" " , N.S.A.	1,641	2,708	-2,808	-159	-1,268
Liquidity, S.A.			-1,765		
" " , N.S.A.	171	-7,221	-1,675	-1,010	-707
Adjusted over-all, S.A.			-1,353		
" " , N.S.A.	-1,746	-6,726	-1,271	-1,106	-905
Financed by: ^{5/}					
Liab. to comm. banks	3,387	9,434	-1,537	947	-363
Official settlements	-1,641	-2,708	2,808	159	1,268

* Only exports and imports are seasonally adjusted.

^{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/} Excludes initial allocation of SDRs on January 1, 1970; total \$867 million, quarterly S.A., \$217 million.

^{5/} Minus sign indicates decrease in net liabilities. Data not seasonally adjusted.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. We now estimate that the second quarter increase in GNP will be \$11.5 billion (in current dollars), as compared with a \$7.4 billion actual increase in the first quarter. This is a slightly larger second quarter gain than we had projected in the last Greenbook, with most of the difference accounted for by a somewhat larger rise in consumer outlays than had been anticipated earlier.

Price increases apparently have moderated about as we had expected and the rise in the GNP implicit price deflator is still estimated at 4.5 per cent, down appreciably from the 5.2 per cent annual rate (excluding the retroactive Federal pay raise) in the first quarter. As a result, real GNP apparently turned the corner, rising slightly in the second quarter after declining at an annual rate of 3 per cent in the first quarter.

CHANGES IN GNP AND RELATED ITEMS, 1970
(Seasonally adjusted annual rates)

	First Quarter	Second Quarter	
		Projection of 6/17/70	Current Projection
(Billions of dollars)			
GNP	7.4	9.9	11.5
Final sales	14.4	10.6	12.2
Personal consumption	10.9	10.7	12.1
Residential construction	- 1.4	- .8	- .7
Business fixed investment	1.5	1.0	1.0
Net exports	.3	0.4	0.5
Federal purchases	.0	- 2.7	- 2.7
State and local purchases	2.9	2.1	2.1
Inventory change	- 6.9	- .8	- .8
-----Per Cent-----			
Real GNP	- 3.0	- .4	.3
GNP deflator	5.2 ^{1/}	4.5	4.5

^{1/} Including effect of the retroactive Federal pay raise, 6.2 per cent.

The increase of \$1-1/2 billion in our estimate of consumer expenditures resulted in part from progressive improvement in unit sales of domestic autos over the past several months as well as strong sales of imported cars. Sales for June were at an 8.6 million annual rate, and for the quarter as a whole the rate averaged just under 8 million units rather than the 7.6 million projected earlier. Also, sales of most types of nondurable goods held up well over the past 2 months. Expenditures in most other sectors of the economy were about in line with our previous projections.

Given the assumption of continued moderate monetary expansion--with the money supply growing at around a 4 per cent annual rate--our projections for the remainder of 1970 and the first half of 1971 remain essentially unchanged from those presented in the June 23 Chart Show. While uncertainties remain about the fate and timing of some Administration tax and expenditures proposals, it appears likely that an increase in estimated outlays and a reduction in the estimate for receipts will result in a budget deficit of \$8.4 billion (NIA basis) rather than \$5.9 billion for fiscal 1971. These changes are expected to have little or no impact on purchases of goods and services for fiscal 1971 as a whole.

Recent information has suggested some minor adjustments in a few sectors which tend to reduce slightly the projected GNP increase for the remainder of the year. Defense purchases may not decline as rapidly as expected in the second half of 1970, although this will likely be made up by a somewhat faster pace of decline early next year. On the other hand, delays are now anticipated in the delivery of some 747 jets to foreign customers and this is expected to hold down net exports in the second half of this year. But with these deliveries bunched in early 1971, net exports should then rise sharply, particularly since an increase now also seems likely in agricultural exports.

On balance, then, a moderate gain in consumer spending, a bottoming out in construction activity and the resumption of more normal growth of State and local outlays are expected to bring an improved rate of overall real growth in the third quarter, particularly if the downward

adjustment in inventories is largely behind us, as now appears to be the case. A further small pick-up in the rate of real growth is expected later this year as construction activity gains expansive momentum. But with investment likely to join defense as a declining sector, the real rate of growth throughout the projected period is expected to remain well below our expanding potential to produce. Some further increase in unemployment and a moderate but steady reduction in inflationary pressures continue in prospect.

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 Proj.	1970				1971	
			I	Projected			Projected	
				II	III	IV	I	II
Gross National Product	932.1	978.8	959.6	971.1	984.8	999.6	1015.2	1030.1
Final purchases	924.1	978.2	958.9	971.1	984.3	998.6	1013.7	1028.1
Private	709.5	755.8	737.7	750.5	761.3	773.6	785.5	796.4
Excluding net exports	707.4	752.1	734.7	747.0	757.5	769.3	780.2	791.1
Personal consumption expenditures	576.0	616.5	600.4	612.5	622.0	631.9	641.9	653.0
Durable goods	89.8	92.1	89.4	92.0	93.0	94.0	94.8	95.8
Nondurable goods	243.6	261.0	255.4	259.5	263.0	266.9	271.1	276.0
Services	242.6	263.4	255.6	261.0	266.0	271.0	276.0	281.2
Gross private domestic investment	139.4	136.0	135.0	134.5	136.0	138.4	139.8	140.1
Residential construction	32.2	30.3	30.2	29.5	29.5	31.9	34.3	35.6
Business fixed investment	99.2	105.1	104.0	105.0	106.0	105.5	104.0	102.5
Change in business inventories	8.0	0.6	0.8	0.0	0.5	1.0	1.5	2.0
Nonfarm	7.8	0.4	0.4	0.0	0.5	1.0	1.5	2.0
Net exports of goods and services	2.1	3.7	3.0	3.5	3.8	4.3	5.3	5.3
Gov't. purchases of goods & services	214.6	222.5	221.2	220.6	223.0	225.0	228.2	231.7
Federal	101.9	99.7	102.3	99.6	99.0	98.0	97.7	97.7
Defense	79.2	76.0	78.9	76.6	75.3	73.2	71.9	70.8
Other	22.7	23.7	23.3	23.0	23.7	24.8	25.8	26.9
State & local	112.7	122.7	118.9	121.0	124.0	127.0	130.5	134.0
Gross national product in constant (1958) dollars	727.5	727.2	724.3	724.7	727.7	732.2	737.7	743.3
GNP implicit deflator (1958 = 100)	128.1	134.6	132.5	134.0	135.3	136.5	137.6	138.6
Personal income	747.2	799.7	778.6	797.8	806.0	816.5	828.5	840.5
Wages and salaries	509.9	544.9	532.4	541.1	549.0	557.0	565.5	573.5
Disposable income	629.7	680.2	660.4	677.0	687.6	695.8	705.4	715.1
Personal saving	37.6	46.7	43.5	47.8	48.8	46.8	46.2	44.6
Saving rate (per cent)	6.0	6.9	6.6	7.1	7.1	6.7	6.5	6.2
Corporate profits before tax	93.8	82.9	85.6	83.0	81.0	82.0	82.0	83.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	201.5	199.7	198.7	200.8	198.1	201.2	206.7	210.0
Expenditures	192.0	207.0	198.4	210.4	209.2	210.1	212.0	215.5
Surplus or deficit (-)	9.5	-7.3	0.3	-9.6	-11.1	-8.9	-5.3	-5.5
High employment surplus or deficit (-)	5.3	1.1	6.2	-3.1	-1.7	3.1	10.2	11.0
Total labor force (millions)	84.2	86.0	85.8	85.7	86.1	86.5	86.9	87.3
Armed forces "	3.4	3.2	3.3	3.2	3.2	3.1	3.1	3.0
Civilian labor force "	80.7	82.8	82.4	82.5	82.9	83.4	83.8	84.3
Unemployment rate (per cent)	3.5	4.9	4.1	4.8	5.1	5.4	5.6	5.8
Nonfarm payroll employment (millions)	70.3	71.1	71.1	70.9	71.1	71.3	71.6	72.0
Manufacturing	20.2	19.7	20.0	19.6	19.5	19.6	19.6	19.6
Industrial production (1957-59=100)	172.8	170.3	170.7	169.3	170.0	171.0	172.2	173.7
Capacity utilization, manufacturing (per cent)	83.7	78.0	79.8	77.9	77.3	76.8	76.5	76.5
Housing starts, private (millions A.R.)	1.47	1.31	1.25	1.20	1.33	1.45	1.55	1.60
Sales new domestic autos (millions, 'A.R.)	8.46	7.95	7.35	7.95	8.15	8.35	8.45	8.60

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1969	1970 Proj.	1970				1971	
			I	II	III	IV	Projected	I
-----Billions of Dollars-----								
Gross National Product	66.4	46.7	7.4	11.5	13.7	14.8	15.6	14.9
Inventory change	0.7	-7.4	-6.9	-0.8	0.5	0.5	0.5	0.5
Final purchases	65.7	54.1	14.4	12.2	13.2	14.3	15.1	14.4
Private	51.4	46.3	11.5	12.8	10.8	12.3	11.9	10.9
Excluding net exports	51.8	44.7	11.2	12.3	10.5	11.8	10.9	10.9
Net exports	-0.4	1.6	0.3	0.5	0.3	0.5	1.0	0.0
Government	14.3	7.9	2.9	-0.6	2.4	2.0	3.2	3.5
GNP in constant (1958) dollars	19.9	-0.3	-5.5	0.4	3.0	4.5	5.5	5.6
Final purchases	19.6	6.2	0.5	1.4	2.2	4.2	5.3	5.3
Private	18.3	10.7	2.2	3.7	1.9	4.0	4.7	3.9
-----In Per Cent Per Year-----								
Gross National Product	7.7	5.0	3.1	4.8	5.6	6.0	6.2	5.9
Final purchases	7.7	5.9	6.1	5.1	5.4	5.8	6.0	5.7
Private	7.8	6.5	6.3	6.9	5.8	6.5	6.2	5.5
Personal consumption expenditures	7.3	7.0	7.4	8.1	6.2	6.4	6.3	6.9
Durable goods	7.8	2.6	-4.4	11.6	4.3	4.3	3.4	4.2
Nondurable goods	5.6	7.1	10.8	6.4	5.4	5.9	6.3	7.2
Services	8.9	8.6	8.5	8.4	7.7	7.5	7.4	7.5
Gross private domestic investment	10.4	-2.4	-19.2	-1.5	4.5	7.1	4.0	0.9
Residential construction	6.6	-5.9	-17.7	-9.3	0.0	32.5	30.1	15.2
Business fixed investment	11.7	5.9	5.9	3.8	3.8	-1.9	-5.7	-5.8
Gov't. purchases of goods & services	7.1	3.7	5.3	-1.1	4.3	3.6	5.7	6.1
Federal	2.4	-2.2	0.0	-10.6	-2.4	-4.0	-1.2	0.0
Defense	1.5	-4.0	-1.5	-11.7	-6.8	-11.2	-7.1	-6.1
Other	5.6	4.4	3.5	-5.1	12.2	18.6	16.1	17.1
State & local	11.9	8.9	10.0	7.1	9.9	9.7	11.0	10.7
GNP in constant (1958) dollars	2.8	0.0	-3.0	0.3	1.6	2.5	3.0	3.0
Final purchases	2.8	0.9	0.3	0.8	1.2	2.3	2.9	2.9
Private	3.3	1.9	1.5 ^{1/}	2.6	1.3	2.7	3.2	2.6
GNP implicit deflator*	4.7	5.1	6.2 ^{1/}	4.5	4.0	3.5	3.2	2.8
Personal income	8.6	7.0	5.8	9.9	4.1	5.2	5.9	5.8
Wages and salaries	9.7	6.9	5.6	6.5	5.8	5.8	6.1	5.7
Disposable income	6.7	8.0	8.0	10.1	6.3	4.8	5.5	5.5
Corporate profits before tax	3.0	-11.6	-25.4	-12.2	-9.6	4.9	0.0	7.3
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.3	-0.9	-9.0	4.2	-5.4	6.3	10.9	6.4
Expenditures	5.8	7.8	3.5	24.2	-2.3	1.7	3.6	6.6
Nonfarm payroll employment	3.5	1.1	1.7	-1.1	1.1	1.1	1.7	2.2
Manufacturing	2.0	-2.5	-2.0	-8.0	-2.0	2.1	0.0	0.0
Industrial production	4.4	-1.4	-2.8	-3.3	1.7	2.4	2.8	3.5
Housing starts, private	-2.7	-10.9	-32.1	-16.0	43.3	36.1	27.6	12.9
Sales new domestic autos	-1.9	-6.0	-38.2	32.3	10.1	9.8	4.8	7.1

* Based on deflators calculated to three decimals.

^{1/} Excluding effects of Federal pay increase, 5.2 per cent per year in 70-I.

Industrial production. Industrial production was down 0.3 per cent in June, following an 0.6 per cent decline in May, and at 168.6 was about 3-1/2 per cent below last summer's high. Output of consumer goods rose further, but production of business and defense equipment and some materials continued to decline. Reductions in output of business equipment were widespread, as in the two previous months. However, truck assemblies which had declined 20 per cent from the end of 1969 to April, advanced rapidly in May and June in response to a pick-up in sales and the possibility of an auto industry strike in September. Production of business equipment was down 4.5 per cent from this March and 6.5 per cent from the September-October peak for that series, prior to the G.E. strike. Since last fall, output of defense products has declined 15 per cent and even more from last summer.

Auto assemblies rose 4.5 per cent in June and were at an annual rate of 8.4 million units, the highest since the start of the year. Industry production schedules for the third quarter indicate an annual rate of about 8.5 million units. Output of television sets rose sharply in June from the very low May level and production of consumer staples increased. But output of furniture declined and production of appliances was cut back from the record April-May high.

Among materials, output of iron and steel was about unchanged last month, but production of construction materials, paper products and industrial chemicals continued to decline. Output of coal was curtailed by strikes and production of rubber products recovered following settlement of labor disputes.

INDUSTRIAL PRODUCTION
Per Cent Changes

	May 1970 to June 1970	July 1969 to June 1970
Total Index	- .3	- 3.4
Consumer goods	.2	- .3
Durables	.5	- 5.6
Autos	4.5	- 8.8
Home goods	- 1.1	- 4.2
Nondurable	.2	1.6
Business equipment	- 1.8	- 4.8
Defense equipment	- .8	-19.4
Materials	- .5	- 4.1
Construction	- 1.3	- 4.1
Metal goods	.0	- 7.8
Nondurable	- .7	- 1.8

Retail sales. Advance data indicate that retail sales edged up in June, following an 0.7 per cent decline in May. However, revised data show a very strong rise of 2-1/2 per cent in April, which served to raise the level of sales for the quarter as a whole. The resulting quarter to quarter increase in sales--the largest in two years--apparently reflects the substantial additions to income in April and May attributable to retro-active increases in Social Security benefits and in Federal pay. Sales relative to disposable income were a bit lower than in the first quarter. It should also be noted that retail prices of goods increased somewhat more rapidly in April and May than earlier this year, and in real terms retail volume was still below the peak in the third quarter of 1968.

Durable goods sales rose 3.0 per cent from the first to the second quarter, as automotive sales recovered and the broad lumber, building material, hardware and farm equipment group increased significantly for the first time since early 1969. Gains in nondurable goods sales were smaller than in the first quarter, but the increase of 1.7 per cent was still well above the average quarterly increase for 1969. Sales at department stores advanced 3.3 per cent.

RETAIL SALES

	Billions of dollars (Seasonally adjusted)			Per cent change		
	1969	1970		1969	1970	
	IV Q	I Q	II Q	IV Q	I Q	II Q
Total	29.5	29.8	30.4	.9	1.0	2.1
Durable	9.3	9.1	9.3	.6	-2.5	3.0
Automotive	5.6	5.3	5.4	1.0	-5.2	3.2
Furniture & appl.	1.4	1.4	1.4	-.1	5.1	-1.1
Nondurable	20.2	20.7	21.0	1.1	2.5	1.7
Food	6.4	6.7	6.7	1.5	3.6	.5
Dept. stores	3.1	3.1	3.2	-.1	.6	3.3
Real*	24.0	24.0	24.1	-.3	-.3	..8

* Deflated by all commodity CPI.

Unit auto sales and stocks. Unit sales of new domestic autos in the first ten days in July were at an annual rate of 7.9 million units, down 8 per cent from the 8.6 rate of June and 1 per cent below a year ago. Sales in the first 6 months of 1970 were at an annual rate of 7.6 million units.

Dealer's stocks of new domestic autos declined slightly further during June and at the end of the month represented 51 days supply, compared with 69 days on January 31 and 50 days on June 30, 1969.

Consumer credit. Consumer instalment credit outstanding rose at a seasonally adjusted annual rate of \$5.0 billion in May, the largest advance since February. The increase was still well below the quarterly gains of 1969, however, which averaged \$8.1 billion.

Both extensions and repayments of instalment debt showed unusually large increases in May; the most sizable gains were in non-automotive consumer goods--where both extensions and repayments reached new records--and in personal loans. Although extensions of auto credit moved up to their highest point since last November, repayments exceeded extensions for the fourth time in the past 6 months.

CONSUMER INSTALMENT CREDIT EXTENSIONS
(Billions of dollars, seasonally adjusted annual rates)

	Total	Automobile	Other Consumer Goods	Personal Loans
1969 - QI	100.7	32.4	31.5	34.6
QII	104.4	33.0	33.6	35.2
QIII	103.5	32.0	33.3	35.9
QIV	102.5	31.9	33.5	35.1
1970 - QI	102.2	30.0	35.5	34.6
April	101.9	30.9	34.1	34.7
May	108.0	31.1	38.2	36.6

Manufacturers' new orders. In May, manufacturers' new orders rose 2.6 per cent, with a 3.3 per cent increase for durables and a 1.9 per cent rise for nondurables. All but one of the major market groups were above lows reached in March or April.

The April-May average was slightly above the first quarter for durables and below it for nondurables. Most of the increase in durables occurred in the automotive group, and in an associated rise in steel ordering. There was some increase in the soft goods portion of the home goods and apparel group, and there was a rise in construction materials that was attributable to a large atomic reactor order in May. Orders for defense products and for other capital goods, taking April and May together, declined from the first quarter average.

CHANGES IN VALUE OF MANUFACTURERS' NEW ORDERS
(Seasonally adjusted, changes in averages of monthly data,
millions of dollars)

	I Q 1970 from IV Q 1969	April-May 1970 from I Q 1970
Manufacturing, total	-1,973	- 97
Durable	-2,027	56
Nondurable	54	-153
Selected groups:		
Home goods and apparel	- 67	33
Household durables	- 39	- 7
Defense products	- 392	- 60
Capital equipment	- 280	-264
Automotive equipment	- 557	227
Construction materials	- 290	51
Iron and steel	- 294	194

The recent leveling-off in the dollar value of durables orders-- which becomes a slight decline in real orders, after account is taken of price increases--contrasts with the fairly strong recovery in orders after a decline of roughly the same magnitude during the early 1967 economic slowdown. In 1967, manufacturing output resumed its rise in the third quarter,

NEW ORDERS FOR DURABLE GOODS
(Per cent change, seasonally adjusted monthly averages)

	Current dollars	Constant dollars
I Q 1967 from IV Q 1966	- 6.6	- 7.1
April-May 1967 from I Q 1967	3.3	3.2
I Q 1970 from IV Q 1969	- 6.5	- 7.6
April-May 1970 from I Q 1970	.2	- .7

Shipments of both durable and nondurable goods increased in May. The backlog of durable goods orders declined another 1 per cent, and the ratio of the backlog to the month's shipments declined to 2.97, the lowest point since early 1965.

Inventories. Book value of business inventories declined at a \$3.4 billion annual rate in May, according to preliminary data, after having risen at an \$11 billion rate in April. The May inventory declines may reflect the impact of strikes on production and deliveries, but they also brought inventories more in line with sales.

The revised April rate of inventory increase is almost double that reported a month ago; upward adjustments were made in both manufacturing and wholesale figures. The April-May average rate is below the first-quarter rate, but the rise in wholesale prices was also slowing in the second quarter, so that the valuation adjustment is also likely to be smaller.

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

	1970			
	Q I	April-May average	April	May Prel.
Manufacturing and trade, total	4.7	3.9	11.1	- 3.4
Manufacturing, total	4.1	5.2	10.3	.1
Durable	2.9	2.2	5.1	- .7
Nondurable	1.2	3.0	5.2	.8
Trade, total	.6	- 1.3	.8	- 3.5
Wholesale	1.9	.1	1.2	- 1.0
Retail	- 1.3	- 1.4	- .4	- 2.5
Durable	- 2.3	- .8	- .7	- 1.0
Automotive	- 1.8	.6	.2	.9
Nonautomotive	- .5	- 1.4	- .9	- 1.9
Nondurable	1.0	- .6	.3	- 1.5

In manufacturing, the incidence of inventory declines (or slower growth) in May was widespread. With the end of the steel hauling strike, there was a much smaller increase in primary metals inventories, while durables goods manufacturers continued to cut materials stocks. In addition, there were sharp declines in stocks at apparel, household goods, and automotive manufacturers. At retail, except for auto dealers and a slight increase at food stores, all groups reported declines.

Manufacturers' and wholesalers' sales recovered in May from April's strike-affected lows and thus inventory-sales ratios declined. May retail sales were off a little, and the retail ratio was unchanged. Decreases in ratios at nonautomotive outlets were offset by an increase at auto dealers, where May's stocking-up reflected anticipation of increased sales and perhaps the uncertainties of the forthcoming contract negotiations as well. The order backlog at durables manufacturers declined more than their inventories, and the already high inventory-backlog ratio rose further.

INVENTORY RATIOS

	1967			1970		
	March	April	May	March	April	May (prel.)
Inventories to sales:						
Manufacturing and trade, total	1.60	1.59	1.59	1.59	1.60	1.58
Manufacturing, total	1.78	1.80	1.79	1.76	1.80	1.76
Durable	2.09	2.13	2.11	2.16	2.19	2.12
Nondurable	1.40	1.41	1.41	1.29	1.34	1.31
Trade, total	1.38	1.38	1.37	1.40	1.39	1.38
Wholesale	1.23	1.22	1.22	1.21	1.25	1.21
Retail	1.48	1.48	1.47	1.53	1.49	1.49
Durable	2.08	2.05	2.02	2.19	2.14	2.15
Automotive	1.61	1.54	1.51	1.76	1.73	1.79
Nonautomotive	2.74	2.77	2.74	2.80	2.72	2.63
Nondurable	1.20	1.21	1.21	1.23	1.20	1.21
Inventories to unfilled orders, durable manufacturing	.675	.681	.681	.768	.781	.789

Cyclical indicators. In May, the preliminary leading and coincident composite indexes fell, while the preliminary lagging composite rose slightly. The leading composite has declined 3.2 per cent over the six months of slowdown since November; this is slightly more than in the first six months of the 1960-61 recession, and contrasts with a 2-1/2 per cent increase over six months of slowdown in the first half of 1967.

COMPOSITE CYCLICAL INDICATORS
1963 = 100

	12 Leading Indicators	5 Coincident Indicators	6 Lagging Indicators
1969: November	152.1	173.5 (H)	198.2
December	152.1	173.4	200.5 (H)
1970: January	149.7	172.9	199.6
February	150.8	173.2	198.8
March	148.4	173.2	197.8
April	148.5	173.3	197.7
May (prel.)	147.3	171.7	198.1

(H) Current high value.

Although orders for machinery and equipment rose in May, there was a substantial decline in contracts and orders for plant and equipment because of reductions in construction contracts. Other series declining were the manufacturing workweek, industrial materials prices, common stock prices, and the ratio of price to unit labor cost. Series increasing were durable goods orders, initial claims for unemployment insurance (inverted), and housing permits.

In June, the workweek was unchanged, the preliminary common stock price index was about unchanged, the preliminary materials price index declined, and initial unemployment claims increased (Inverted).

Construction and real estate. Seasonally adjusted new construction put in place changed little in June. However, there was a 2 per cent downward revision in April and May and the annual rate for June, at \$85.8 billion was 6 per cent below a year earlier--11 per cent in real terms--and the lowest since September of 1968.

With housing starts down further in May (the latest month for which data are available), private residential construction outlays continued to drop in June and were a fifth under the peak in April of 1969. Private nonresidential construction and public construction expenditures apparently remained at or slightly above their reduced May rates.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	June 1970 (\$ billions) ^{1/}	Per cent change from	
		May 1970	June 1969
Total	85.8	--	- 6
Private	59.0	- 1	- 6
Residential	26.2	- 3	-17
Nonresidential	32.8	--	+ 4
Public	26.8	+ 1	- 6
Federal	3.3	+ 5	- 8
State and local	23.5	--	- 6

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

In the overall market for shelter, a surprising development has been the relatively low rate of mobile home shipments. Through May, such shipments averaged no more than 380,000 units on a seasonally

adjusted annual rate basis, compared with a record 413,000 for 1969 as a whole and earlier trade expectations of a substantially higher total this year. The trucking strike reportedly impeded shipments from mobile home manufacturers earlier this year. In addition, as in the case of the conventional home market, it may be that high monthly carrying costs and uncertainty about future employment prospects have served to weaken retail demand.

Within the regular home market, seasonally adjusted sales by speculative builders in May were holding above the exceptionally low rate reached last March with some resultant improvement in builders' stock/sales ratios from earlier advanced positions. But average prices of those homes sold by builders remained appreciably below prices of homes still available for sale, as well as below sales prices prevailing at this time last year, reflecting continued price resistance by potential home-buyers. In the market for existing homes, on the other hand, average prices of units sold continued about 7 per cent above a year earlier.

Labor market. Although the unemployment rate declined in June, there was no indication of strengthening labor demand. Hiring was below normal levels in most industries, and seasonally adjusted nonfarm payroll employment again showed a sizable decline. On the other hand, initial claims for unemployment benefits have edged down in recent weeks--indicating fewer layoffs and a slower increase of unemployment from this

cause--and total insured unemployment has about leveled off after rising steeply in April and May.

The entire decline in the unemployment rate to 4.7 per cent in June, from 5.0 per cent in May, occurred among adult women, whose rate had jumped sharply in May. The rate for adult men was unchanged at 3.5 per cent--its highest level since early 1965, and up sharply from a low of 1.9 per cent in the first quarter of 1969.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1969	1970		
	Q IV	Q I	Q II	June
Total	3.6	4.1	4.8	4.7
Adult men	2.2	2.7	3.4	3.5
Adult women	3.7	4.1	4.7	4.5
Teenagers	12.2	13.7	14.9	14.6
Insured unemployed	2.3	2.6	3.5	3.7

Payroll employment. Nonfarm payroll employment declined by 270,000 in June compared with a drop of 185,000 in May (both months strike adjusted). Employment declines were widespread, with all major industry groups down except transportation, and State and local governments. Manufacturing employment declined 130,000 in June (following a 165,000 cut in May, both strike adjusted), with reductions of 20,000 or more in transportation equipment and machinery. Construction employment was below a year earlier in May and June for the first time in several years.

In the second quarter of 1970, total nonfarm employment registered its first quarterly decline since the 1960-61 recession. With employment growth dampened in service industries and halted in trade, advances in the nonindustrial sector were no longer sufficient to offset large and widespread declines in the goods-producing industries. Recent employment reductions probably reflect in part a lagged response to the earlier easing of demands and have been associated with a resumption of productivity growth both in manufacturing and in the private nonfarm economy.

AVERAGE MONTHLY CHANGES IN NONFARM PAYROLL EMPLOYMENT*
(Seasonally adjusted, in thousands)

	December 1969- March 1970	March- April 1970	April- May 1970	May- June 1970
Total	99	21	-185	-271
Industrial	-80	-151	-161	-191
Manufacturing	-89	-146	-167	-130
Contract construction	- 4	- 1	- 4	- 64
Mining and transportation	13	- 4	10	3
Nonindustrial	179	172	-24	- 80
Trade	78	11	-15	- 11
Finance and service	48	35	19	- 22
Government	52	126	- 28	- 47

* Adjusted for changes resulting from the direct effects of large strikes.

The average workweek in manufacturing was unchanged at 39.8 hours in June, but was nearly one hour shorter than a year earlier, reflecting a cut of 0.7 hour in overtime hours at premium pay. In the durable goods sector, small declines in average hours in June in most industries were offset by a rise of more than one hour in transportation equipment.

Labor force. The labor force declined between May and June, reflecting a half a million smaller-than-expected rise in the teenage labor force. In addition to the relative unavailability of summer jobs, this change may have resulted from such noneconomic factors as an early survey week. Somewhat more than the usual numbers of high school students and graduates were probably unavailable for work because schools were still in session. Labor force participation for young workers is erratic and there could be a rebound in July.

At the same time, easing demand for labor may have dampened labor force participation somewhat for women, and in recent months their net labor force increase from a year earlier has been in better alignment with "normal" growth as projected on the basis of changes in population of working age and long-term trends in labor force participation rates. The large labor force rise for adult men reflects, in part, recent reductions in the Armed Forces.

CIVILIAN LABOR FORCE
(Change from a year earlier, in thousands)

	Total	Men 20 years and over	Women 20 years and over	Both sexes, 16 to 19 years
1969:				
III Q	2,212	566	1,295	351
IV Q	2,397	641	1,176	580
1970:				
I Q	2,299	722	1,054	523
IIQ	2,161	982	854	326
June	1,621	918	685	18

Productivity. Manufacturing productivity rose sharply in the first half of 1970 as reductions in employment and working hours continued larger than cuts in production. Output per manhour is estimated to have risen at an annual rate of 4.6 per cent from December to June, after declining at a 2 per cent annual rate between June and December of 1969.

Compensation per manhour in manufacturing rose at an estimated 6.0 per cent annual rate during the first half of 1970, with the advance dampened somewhat by further reductions in overtime work at premium pay and by employment declines in high-wage durable goods industries. Although the rise in compensation slowed, the sharp recovery of productivity growth was the prime factor in a marked slowing of the rise of unit labor costs in manufacturing.

PRODUCTIVITY AND UNIT LABOR COST ESTIMATES, MANUFACTURING
(Seasonally adjusted annual rates)

	Compensation per manhour	Output per manhour 1/	Unit labor costs 1/
Change from a year earlier:			
1968	6.8	2.5	4.1
1969	6.5	2.5	3.9
Change from 6 months earlier, annual rates:			
1969: June	5.6	2.9	2.7
December	6.6	-1.8	8.3
1970: June	5.9 ^{2/}	4.6	1.3 ^{2/}

1/ The pre-1970 output per manhour data have not been revised to reflect recent benchmark adjustments of the manhour data and are, therefore, subject to change.

2/ Estimated.

Adjustments in employment and hours in nonmanufacturing industries in the second quarter probably resulted in a resumption of productivity growth in the private nonfarm economy as a whole. The record of unit labor costs in the nonmanufacturing industries has been much worse than in manufacturing, reflecting poorer productivity performance and slightly larger wage gains. In 1969, for example, the estimated unit labor cost rise for the private nonfarm economy was about 6 per cent compared with 4 per cent in manufacturing. The bulk of the difference resulted from the virtual absence of productivity growth in nonmanufacturing industries as a whole.

Industrial relations. After nearly three months of strikes and lockouts, major trucking firms and 50,000 members of local teamster unions in Chicago agreed early in July to a new contract providing \$1.65 in wage increases over 36 months. This settlement triggered renegotiation of the national trucking agreement which had been ratified in mid-May by 450,000 teamsters and major trucking associations. The national contract, which originally had called for wage increases of \$1.10 over 39 months, now provides \$1.85 in wage increases, 20 cents more than in Chicago to compensate for the longer term of the national agreement. The master contract now provides an average annual wage increase of 12-1/2 per cent, with a first-year increase of 14 per cent. Fringe benefits are also higher in the new contract, and wage and fringe benefit costs will rise an average of about 13 per cent a year--about equal to the increases negotiated in construction settlements in

the first three months of this year and sharply higher than the 8 per cent average for all major contracts settled during that period.

Trucking firms are expected to ask the ICC for rate increases of 7-1/2 to 12-1/2 per cent a year to offset higher labor costs, and it is expected that increases will be granted. The new settlement will increase costs and prices throughout a wide range of industries supplying both producers and consumers. It is likely to have a significant impact on the CPI, as transportation costs have considerable influence on many retail prices, especially of food.

This large settlement has been widely publicized and is likely to influence other wage negotiations in both manufacturing and nonmanufacturing industries. It will add to pressure on union leaders for a similar large settlement in the automobile industry, where negotiations on a new contract begin this week.

Wholesale prices. In the last three months, a reversal in the upward trend of seasonally adjusted farm and food products prices at wholesale has slowed the rise in the wholesale price index. Furthermore, the rise in wholesale prices of industrial commodities shows some signs of moderating. The increase in June of 3.6 per cent (seasonally adjusted annual rate) in industrial commodity prices, although only slightly below the average for the first half of this year, was appreciably below the last half of 1969. Much of the rise in June was attributable to a sharp (7.8 per cent) advance in prices of cigarettes.

WHOLESALE PRICES
Seasonally adjusted percentage changes^{1/} at annual rates)

	June 1969 to Dec. 1969	Dec. 1969 to Mar. 1970	Mar. 1970 to June 1970	May 1970 to June 1970
All commodities	4.0 ^{2/}	4.4	1.2	1.2
Industrial	4.4	3.6	4.0	3.6
Farm products and processed foods and feeds	5.2	6.4	-10.0	-4.8

1/ Calculated by FRB on basis of available BLS month-to-month rounded percentage changes.

2/ Falls outside of the range of the two components because calculation was based on the available rounded month-to-month changes.

Moreover, signs of weakness are numerous in sensitive crude material prices. Nonferrous metal prices, for which increases had outstripped those of other materials over the last two years, are now falling. Increases in prices of copper and aluminum which were put into

effect this year by major producers recently have begun to give way. In June, nonferrous metals as a group declined for the first time since September 1968. Copper scrap prices (generally more volatile than copper ingot) fell, as did the prices of imported copper wirebar, brass, ingot, and tin.

Since the WPI pricing date (June 9), copper scrap has fallen further and primary lead has been reduced. The reduction in prices of copper in dealer markets here and in London has resulted in cuts in prices of brass mill products even though prices of domestic producers remain unchanged. Zinc prices (which have been supported recently by producers in Europe) are likely to drop. Aluminum products have been reported to be selling under list for some time. Most of the recent declines are attributable to diminished pressure from both domestic and world demand. Supplies also have improved as a result of greatly diminished strike activity.

Nonferrous metals are not a sufficiently important fraction of the cost of production of most finished goods to affect the over-all measures significantly. However, the reversal of trend among these volatile prices may be indicative of similar pressures developing in other wholesale markets, such as for steel.

The number of price increases in industrial product classes was fewer from May to June than in any month since last August. Out of 228 product classes 87 rose, a significantly lower proportion than in any of the first six months of 1970, and even further below the first halves of 1968 and 1969. The incidence of price declines in June was

the highest since July 1968. Of 13 major industry groups, 5 declined, and 2 were unchanged. Declines were mainly in materials prices, including lumber and plywood (reversing a rise in the previous two months), wastepaper, industrial chemicals, hides and skins, rubber, and wool, silk and synthetic textiles.

INDUSTRIAL WHOLESALE PRICES

(Per cent change at annual rates--not seasonally adjusted)

	Dec. 1968 to June 1969	June 1969 to Dec. 1969	Dec. 1969 to Mar. 1970	Mar. 1970 to June 1970	May 1970 to June 1970
Industrial commodities	3.6	4.3	4.2	3.1	1.0
Selected groups					
Fuels and power	5.5	2.1	.8	8.7	-5.5
Metals and products	9.0	10.0	10.3	6.6	3.7
Machinery and equip- ment	3.3	5.6	3.9	3.2	3.9
Lumber and wood products	-5.5	-11.2	-9.8	2.3	-7.9
Finished goods					
Consumer nonfoods	2.6	3.3	2.2	2.9	2.1
Producers equipment	2.7	6.1	3.9	2.3	1.9

Although a sharp increase in cigarette prices was a major factor in the June rise in the industrial average, there were several increases of more basic significance. Coal prices rose again, and were about one-third above a year earlier. Exports of coal are continuing to rise and, in view of low coal stockpiles at utilities, curbs are being suggested. Partly as a result of consumers shifting from coal to oil, residual oil prices also are climbing.

Prices of some important steel finished products and steel scrap also rose from May to June. This may be the last large increase for finished steel products this year, since most of the products included in the industry-imposed limitation to raise prices only once a year have now been raised.

The rise in finished goods slowed some in June from recent months, both for consumer and producer goods. The bulge in prices of producers' equipment in the second half of 1969 and in the opening months of this year has slackened off recently, and prices of agricultural equipment declined slightly in June.

Farm output prospects. Midyear surveys of farm production prospects indicate that substantial increases in supplies are likely by fall for the farm products under strong upward price pressure this summer--hogs, feed grains, and soybeans. In fact if production prospects are realized, farm prices of most of the major crops may be down to support levels by harvest and hog prices will be under downward pressure from substantially larger supplies. By September, hog slaughter is expected to be well above the small output of last fall and also to exceed the relatively large output of 1968. If producers carry out plans reported in late June, further expansion in pork supplies can be expected in 1971.

Expanded acreages of feed grains indicate that plentiful supplies of livestock feeds will be available for the 1970/71 feeding season. Larger output of cotton and oilseeds is in prospect but food grains have been cut to hold production in balance with prospective demand. More fresh vegetables and citrus fruits are in prospect but less deciduous fruits. Carryover stocks of most of the processed fruits and vegetables are large.

Throughout the first half of 1970, livestock food supplies were made up of record quantities of beef and broilers, more eggs than the year before, about the same amount of milk and reduced quantities of pork, veal and lamb. This mix of supplies is likely to persist until fall when expanding pork production will be added to livestock food supplies.

1970 CROP PRODUCTION
(Based on July 1 prospects)

	Acreage for Harvest		Production	
	Total	Per cent change from 1969	Total	Per cent change from 1969
	(Millions of acres)		(Millions of units)	
Total, 59 crops	288.7	.9	n.a.	--
Feed crops	175.1	3.3	310.7	3.1
Grains	112.4	4.5	181.1 tons	4.0
Hay	62.7	1.4	129.6 tons	2.0
Food grains	46.8	-8.3	45.6 tons	-7.4
Soybeans	41.6	1.9	n.a.	--
Cotton	12.1	2.0	n.a.	--
Other crops	13.0	1.5	n.a.	--

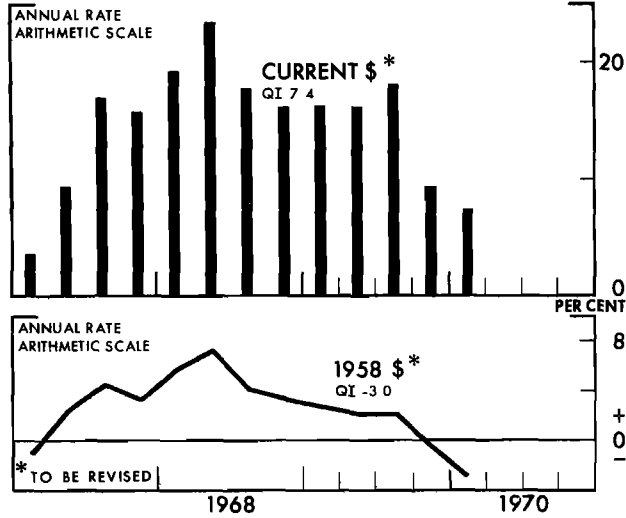
n.a. - Not available until August 1.

Source: U.S. Crop Report as of July 1, 1970. U.S.D.A.

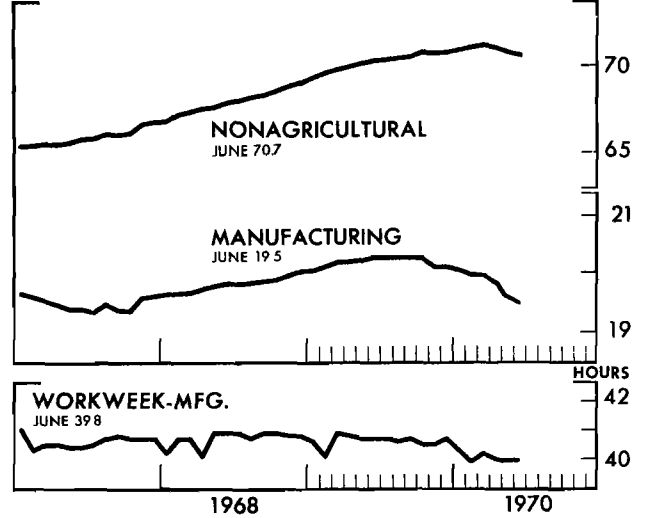
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

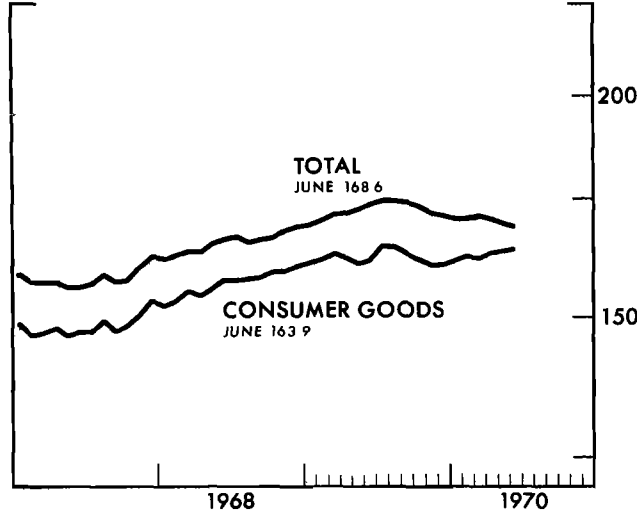
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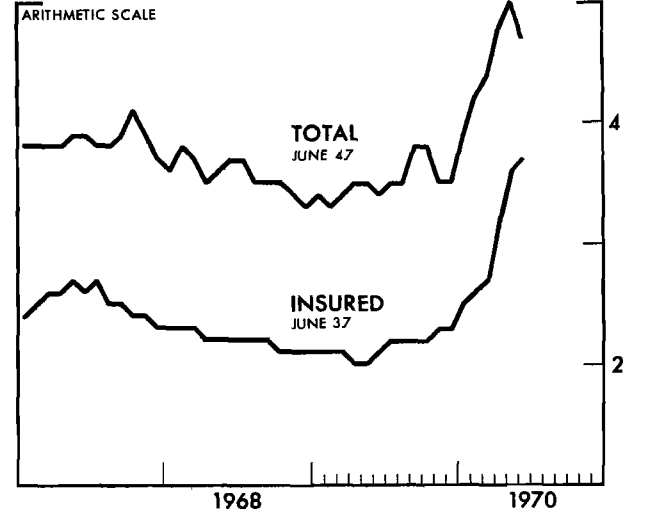
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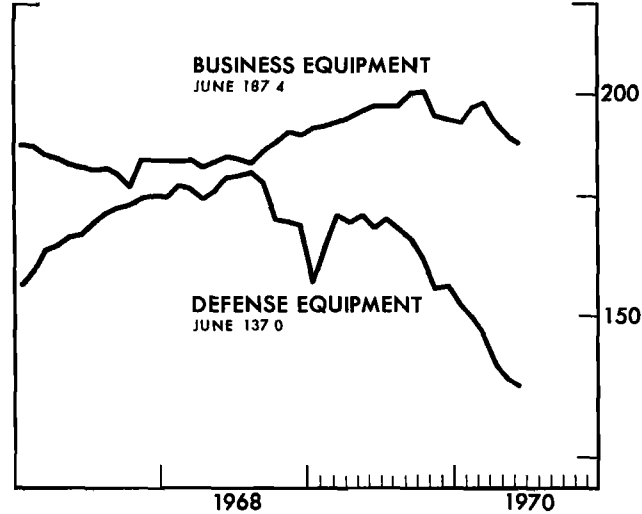
INDUSTRIAL PRODUCTION - I



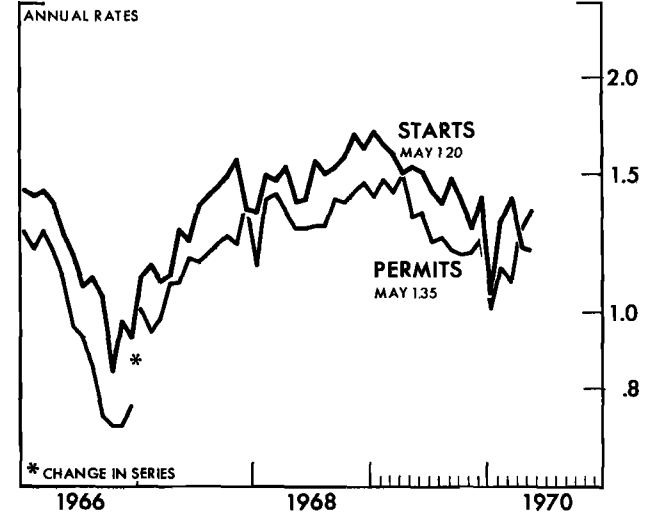
UNEMPLOYMENT RATES



INDUSTRIAL PRODUCTION - II

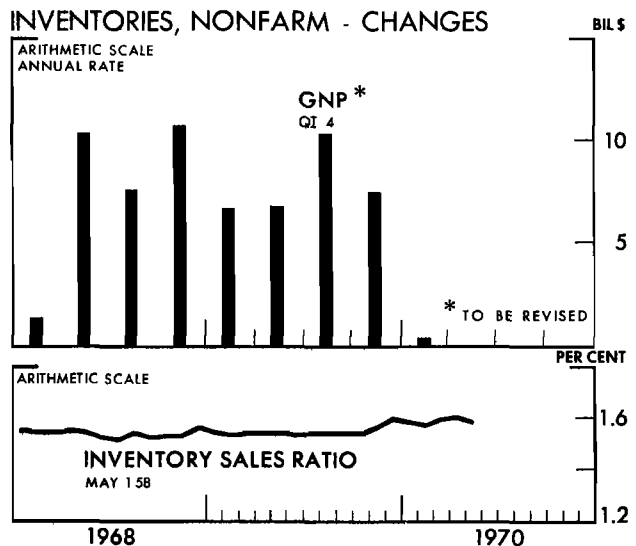
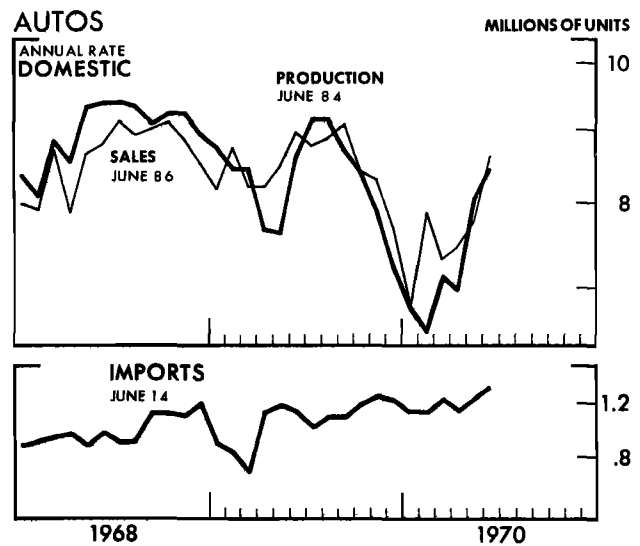
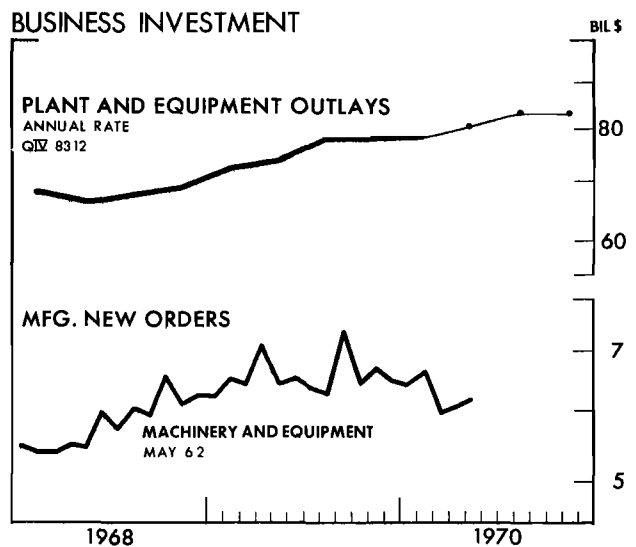
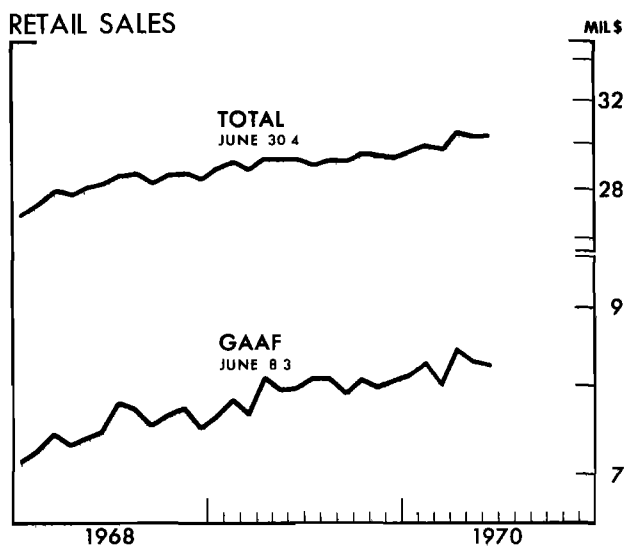
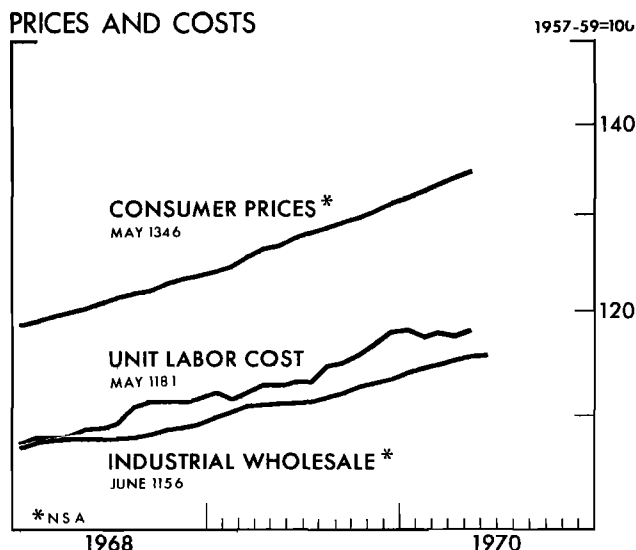
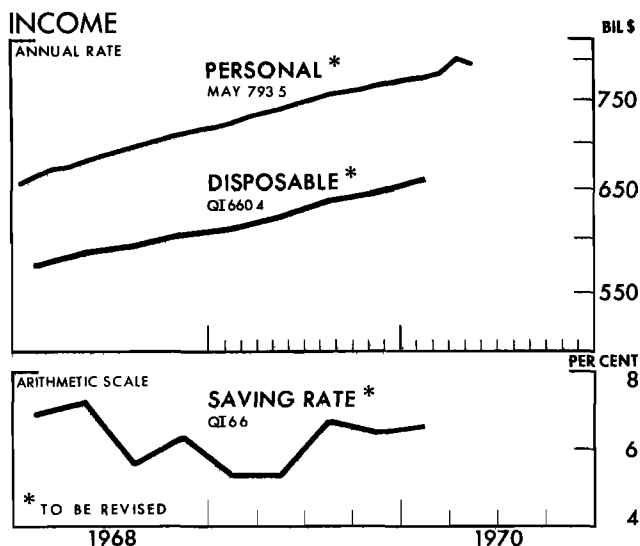


HOUSING



ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Monetary aggregates. A slight decline in the money stock was recorded in June, as private demand deposits edged downward while public currency holdings increased at a much slower pace than in May. The June decline followed a moderate advance in May and led to an annual rate of expansion for the second quarter as a whole of 4.6 per cent.

The money stock rose sharply again in late June and early July. In part, this increase was associated with the surge in bank lending to finance companies and nonfinancial businesses to refinance maturing commercial paper. In addition, cash items in process of collection increased much less than normally during the week ending July 1--presumably reflecting a cutback in bank borrowing in the Euro-dollar market as CD funds became available. Some buildup of precautionary balances also might have occurred in conjunction with the crunch in the commercial paper market.

Time and savings deposits at all commercial banks increased at a somewhat slower rate in June than in May, as the downtrend in outstanding large CD's, which began in May, was extended throughout most of June. Inflows into consumer-type deposits in June, on the other hand, appear to have continued at roughly the same rate as in other recent months. Indications are that savings deposit withdrawals following the interest-crediting period have been very modest.

Following suspension of ceiling rates on short-term CD's on June 24, the flow of CD funds was altered radically. During the week of July 1, weekly reporting banks alone sold nearly \$1.2 billion in new CD's and in the following week New York City and Chicago banks-- the only banks for which data are thus far available--reported further gains totaling more than \$400 million.

In addition to the growth in time deposits during June, a substantial rise also was recorded in U.S. Treasury deposits. Together, these inflows were more than sufficient to offset the drop in private demand deposits, and the unadjusted credit proxy rose moderately in June after declining in May. The credit proxy adjusted for nondeposit sources rose at a slightly faster pace over the month as many banks continued tapping nondeposit sources for funds until the suspension of the short-term CD ceilings. Beginning with the influx of CD money in the latter days of June, however, banks began cutting back on their nondeposit fund sources. This retrenchment primarily took the form of a sharp, greater than seasonal, reduction in Euro-dollar borrowings but commercial paper indebtedness also was reduced to some extent.

MONETARY AGGREGATES
(Seasonally adjusted percentage changes, at annual rates)^{1/}

	1970			
	QI	QIIp	May	June p
Money stock	3.8	4.6	3.5	- .6
Commercial bank time and savings deposits	.4	13.8	10.3	8.4
Member bank deposits	.6	6.0	-4.5	5.8
Member bank deposits plus nondeposit sources ^{2/}	.5	6.7	-1.2	7.4

^{1/} Based on monthly average of daily figures for deposits and monthly average of weekly figures for nondeposit funds.

^{2/} Includes all deposits subject to reserve requirements plus the following nondeposit sources: commercial paper issues by a holding company or bank affiliate; loans or participation in pools of loans sold under repurchase agreement to other than banks and other than banks' own affiliates or subsidiaries; Euro-dollars borrowed directly through brokers or dealers; liabilities to banks' own branches in U.S. territories and possessions; and liabilities to banks' own foreign branches.

NET CHANGE IN TIME AND SAVINGS DEPOSITS
(Billions of dollars, seasonally unadjusted)

	April 29-June 3 ^{1/}		June 3-July 1	
	Average 3 pre- ceding years	1970	Average 3 pre- ceding years	1970
<u>Weekly reporting banks</u>				
Total time and savings	.2	.3	-.7	1.9
Consumer-type	.6	.4	.4	.6
CD's	-.2	-.1	-.7	1.2
All other time	-.2	0	-.4	.1
<u>Country banks</u>				
Total time and savings	.6	.9	0	.5

^{1/} Dates are for 1970; comparable dates used for other years.

Bank credit. Total loans and investments at all commercial banks expanded at a 1.2 per cent annual rate in June, following an 8.5 per cent rate of growth during the previous month. For the second quarter as a whole, bank credit adjusted to include loans sold to affiliates rose at about a 5-1/2 per cent annual rate, twice the rate for the first quarter.

COMMERCIAL BANK CREDIT ADJUSTED
TO INCLUDE LOAN SALES TO AFFILIATES^{1/}
(Seasonally adjusted percentage changes, at annual rates)

	1969	1970			
	2nd half	QI	QII	May	June
Total loans & investments ^{2/}	1.5	2.7	5.4	8.5	1.2
U.S. Govt. securities	-16.0	-15.4	25.4	23.1	4.5
Other securities	- 3.6	10.8	11.5	6.5	11.3
Total loans ^{2/}	6.4	4.1	1.8	6.4	-1.7
Business loans ^{3/}	7.1	5.3	5.9	12.0	5.4

^{1/} Last Wednesday of month series.

^{2/} Includes outright sales of loans by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

^{3/} Includes outright sales of business loans by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

Net acquisitions of Treasury securities slowed substantially in June, as growth in U.S. Government securities was held down partly by bank sales of notes acquired in the mid-May Treasury financing. But the rate of growth in other investments was larger than in May, with the bulk of the increase in short-term municipals, representing principally New York City banks' purchases of notes sold by New York State.

Commercial and industrial loans, including loan sales, rose at about a 5-1/2 per cent annual rate in June--roughly the same as for the second quarter as a whole. The moderate rate of increase in business loans on average parallels the behavior of real economic activity and, in particular, the sluggishness of inventory investment.

Despite the rise in business loans, total loans declined in June, due to a sharp drop in security loans. Government security dealers cut back their inventory positions substantially after the May financing, and other security dealers also reduced their inventories in the late June bond market rally. Both real estate and consumer loans were unchanged from a month earlier, continuing the weakness in these categories evident since late last year. Finance company loans rose by about the same amount on a seasonally adjusted basis as a month earlier.

The June bank credit data, however, do not adequately reflect the substitution of bank loans for commercial paper that occurred late in June and early July following the sharp runoff of investor holdings in the commercial paper market and the suspension of Regulation Q ceilings on short-term CD's. The increase in total loans and investments at all weekly reporting banks in the week ending July 1 plus the increase at weekly reporters in New York and Chicago for the week ending July 8 amounted to nearly \$3.5 billion, or \$2.6 billion more than the average for the same groupings of banks in the corresponding two-week period of the preceding three years. About three-fifths of this increase appeared to reflect the transfer of borrowing away from the commercial paper market, with the remainder mainly accounted for by

bank underwriting of tax bills paid for on July 8 through full crediting to tax and loan accounts.

NET CHANGE IN SELECTED ASSETS OF WRB^{1/}
(Not seasonally adjusted, millions of \$)

	1970 June 24-July 8	Average ^{2/} 1967-69	Excess of 1970 over average
Total loans and investments	3,460	867	2,593
Finance company loans	1,167	93	1,074
Business loans	572	115	457
Investments	1,093	-188	1,281

Memorandum:

Decline in outstanding commercial paper ^{3/}	2,014p	n.a.	n.a.
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^{1/} Includes all weekly reporting banks for week ending July 1, and New York City and Chicago banks for week ending July 8 (other weekly reporting data for July 8 not available yet). Comparable data used for earlier years.

^{2/} Dates to comparable 1970 are used for 1967-69 average.

^{3/} Excludes bank-related commercial paper.

p Preliminary.

n.a. Not available.

Finance company loans jumped nearly \$1.1 billion during this two-week period, as many investors were reluctant to roll over maturing commercial paper of some companies who were then forced into using bank lines. Although bank loans to finance companies usually exhibit a brief bulge at mid-year, this year's rise was far greater than any previous one and was not offset as rapidly as usual although small repayments were made at New York City and Chicago banks in the week ending July 8. Some industrial concerns also were affected by the deterioration in the commercial paper market and had to finance at banks, but the rise in business loans at banks was a good deal smaller relative to past experience than that of loans extended to finance companies.

Other short-term credit markets. The Penn Central's request for reorganization under the Federal Bankruptcy Act and rumors of difficulty elsewhere in the commercial paper market--particularly among some financial subsidiaries of companies that have incurred losses--led to a sharp shrinkage in the amount of commercial paper outstanding around mid-year. The adjustment affected both dealer-placed and directly-placed paper. Whereas seasonally unadjusted data for May-June 1969 showed an increase of 2.6 per cent in total commercial paper outstanding, comparable 1970 figures show a decline of 6.1 per cent or \$2.4 billion. Only about half of this decline can be attributed to the average seasonal decrease.

COMMERCIAL AND FINANCE COMPANY PAPER
(In millions of dollars, not seasonally adjusted)

	1970		
	April ^{1/}	May ^{1/}	July 1 ^{2/}
	<u>Amounts outstanding</u>		
Total commercial and finance paper	37,881	39,589	37,192
Bank related	6,542	7,465	7,297
Nonbank related			
Placed through dealers	12,647	12,826	11,868
Placed directly	18,692	19,298	18,027
	<u>Net change</u>		
Total commercial and finance paper	802	1,708	-2,397
Bank related	109	923	-168
Nonbank related			
Placed through dealers	236	179	-958
Placed directly	457	606	-1,271

^{1/} End of month data.

^{2/} Weekly data. The end-of-month data when available will differ somewhat from the July 1 data because of the one day difference in dating. Moreover, the monthly figures will include bank-related data only through June 24. The quality of the new weekly series has been improved and is now consistent with the monthly statistics.

For the week ending July 1, 1970, which included large mid-year maturities, unadjusted data show a decline of \$930 million in dealer-placed paper and of \$1,349 million in directly-placed paper. This represents a one-week decrease of \$2,279 million or 5.8 per cent in commercial paper outstanding. Preliminary data for the week ending July 8 show little further changes in outstandings during that week.

Owing to resistance by investors, several dealers are willing to handle only top-grade paper or to operate only on a broker basis, thus forcing potential borrowers to turn to banks. A number of finance companies--with the exception of GMAC and some other highly regarded companies--also have had to turn to their banks. Thus the decline in commercial paper outstandings has been accompanied by increases in bank loans--sometimes secured by sales of accounts receivable--and by extension of additional lines of credit. In addition, the market situation appears to have forced a shortening of maturities for newly-issued finance company paper, but there is no clear indication that a comparable shift has occurred on the dealer side of the market.

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

	1969 Nov.-Dec. highs ^{1/}	June 19	July 10	Net change
<u>1-month</u>				
Commercial paper	9.25 (12/31)	8.25	8.38	.13
Finance paper	9.00 (12/31)	8.13	8.13	--
Bankers' acceptances	9.00 (12/31)	7.75	7.75	--
Treasury bill	7.54 (12/31)	6.06	6.15	.09
Certificate of deposit- new issue ^{2/}	6.25	6.25	7.75	<u>3/</u>
<u>3-month</u>				
Commercial paper	9.25 (12/31)	8.38	8.38	--
Finance paper	8.13 (12/31)	7.75	7.75	--
Bankers' acceptances	9.00 (12/31)	7.88	7.78	-.10
Treasury bill	8.00 (12/29)	6.70	6.55	-.15
Certificate of deposit- new issue ^{2/}	6.50	6.50	8.00	<u>3/</u>
<u>6-month</u>				
Bankers' acceptances	9.00 (12/31)	8.00	7.78	-.22
Treasury bill	8.09 (12/29)	6.96	6.68	-.28
Agency ^{2/}	8.70 (12/30)	7.90	7.42	-.48
<u>12-month</u>				
Prime municipals ^{2/}	6.25 (12/12)	5.40	4.90	-.50
Treasury bill	7.86 (11/24)	7.17	6.71	-.46
Agency ^{2/}	8.76 (12/30)	8.26	7.82	-.44

^{1/} Dates of highs in parentheses; latest date used if high occurred on more than one date.

^{2/} Investment yield basis.

^{3/} Not applicable as the Regulation Q ceiling on certificates of deposit of \$100,000 or more maturing in 30-89 days was in effect until June 24, 1970.

Source: Salomon Brothers & Hutzler's Bond Market Roundup except for: Treasury bill and certificate of deposit data, from the Federal Reserve Bank of New York; agency issue data, from the U.S. Treasury.

Rates on commercial paper maturing in 30 days or less have risen 1/8 of a per cent since June 19. Rates on other maturities of commercial and finance paper have remained unchanged, suggesting that market difficulties have affected mainly credit availability and the quantity of outstandings rather than interest rates. Issuers have shown a reluctance to raise their rates because of concern that such action would shed doubt on the status of their paper. Nevertheless, there are some indications of a new interest rate split within the market with "desirable" paper, in contrast to "prime" paper, now being quoted around 1/4 of a per cent higher in yield.

Although many customers appear to have moved out of the market entirely, the over-all stability of commercial paper rates reflects a generally good demand for top-grade paper as well as the unwillingness of borrowers and dealers to push paper aggressively in the present market environment. Nevertheless, there has been some widening in the yield spreads of commercial paper over Treasury bills and bankers' acceptances since June 19, as investors have shifted away from commercial paper to alternative short-term holdings.

Nonbank depository intermediaries. Available data suggest that withdrawals during the June-July reinvestment period were quite modest. Savings and loan associations in particular, including the sensitive West coast S&L's, incurred very small deposit outflows during the early part of the reinvestment period, and it is extremely unlikely that total outflows for the entire reinvestment period approached the

magnitude of those during 1969 or 1966. New York City mutual savings banks did not have quite as favorable a performance, but their experience during the reinvestment period, which was characterized by an abundance of gift promotion campaigns, nevertheless suggests only modest pressure on deposits.

**JUNE-JULY REINVESTMENT PERIOD
DEPOSIT FLOWS EXCLUDING INTEREST CREDITED
(Millions of dollars, not seasonally adjusted)**

	<u>Savings and Loan Associations</u>				
	1966	1967	1968	1969	1970
June grace days	- 900 ^e	-568	-610	-768	-463
First 3 business days in July <u>1/</u>	n.a.	n.a.	<u>-660</u>	<u>-803</u>	<u>-183</u>
Subtotal	n.a.	n.a.	-1,270	-1,571	-646
Total reinvestment period	-2,121	-593	-1,109	-1,506	n.a.
	<u>15 Largest New York City Mutual Savings Banks</u>				
June grace days	-228	-165	-232	-316	-236
Adjusted <u>2/</u>	-122	- 67	- 87	-166	-118
First 5 business days in July	- 31	- 56	- 18	-103	- 28
Total, adjusted <u>2/</u>	-153	- 11	-105	-269	-146
As per cent of deposits	-.99	-.07	-.58	-1.42	-.78

^{e/} Estimated by FHLB staff.

1/ Four business days in 1968. In 1970, some districts had a holiday on July 3, so for them the data represent only 2 business days.

2/ Adjusted for repayment of passbook loans made earlier to save interest.

Note: The reinvestment period encompasses the last three business days of June and the first ten calendar days of July.

Preliminary estimates indicate that deposit growth at thrift institutions during the month of June continued to be relatively strong. Indeed, deposit growth during the second quarter as a whole is estimated to have exceeded a 6 per cent seasonally adjusted annual rate for the first time since the first quarter of 1969. The recent strength in

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

	Mutual Savings Banks	Savings and Loan Associations	Both
1969 - QI	6.1	6.0	6.0
QII	4.3	3.7	3.9
QIII	2.0	2.1	2.1
QIV	3.3	.4	1.4
1970 - QI	2.6	1.5	1.9
QII	6.0	7.0	6.7
1969 - First half	5.3	4.9	5.0
Second half	2.7	1.3	1.7
1970 - First half <u>p/</u>	4.3	4.3	4.3
1970 - April*	6.6	8.6	8.0
May*	6.4	5.6	5.9
June <u>p/*</u>	4.8	6.8	6.1

p/ Preliminary.

* Monthly patterns may not be significant because of difficulties with seasonal adjustment.

deposit flows probably reflects increased consumer saving as well as increased hesitancy and uncertainty among some consumers about their own economic positions, with a consequent desire for safe and liquid assets. Even with the new higher rate ceilings, yields on thrift institution claims during the second quarter and currently were about as

unattractive relative to market securities as they were last year when deposit inflows were much smaller.

Savings and loan associations increased, advances from the FHLB increased, on net, by a fairly small amount during June--less than half of the year-earlier rate. As a consequence, FHLB System liquidity remained high--nearly \$2 billion--at midyear. The FHLB System, in its endeavors to issue a GNMA mortgage-backed security, has already arranged to acquire about \$300 million in mortgages. This amount has not all come out of S&L's own portfolios; the price at which the FHLB has agreed to purchase these mortgages was somewhat above the current market and S&L's have apparently acted to a degree like brokers by buying mortgages from other holders at the market price and in turn selling them to the FHLBanks at their higher price.

Mortgage market. With savings experience at the thrift institutions relatively favorable in recent weeks, new commitments for residential mortgages may have picked up somewhat further from the depressed levels recorded earlier this year, judging from both agency field reports and trade opinion. Mortgage commitment data for reporting private lenders, however, are not yet available for June.

Apparently reflecting the improved availability of mortgage funds from private sources, offers submitted in the July 13 auction of FNMA's forward commitments to purchase FHA and VA mortgages remained considerably below their weekly volume in the spring. Contributing to the lower volume of offers received by FNMA through its regular auction

has been increased activity in the subsidized FNMA-GNMA Tandem Plan, under which GNMA committed \$25 million during June to buy FHA home mortgages at above-market prices for later sale to FNMA at market prices. Also, as noted, a number of S&L's have been buying FHA and VA loans at market prices from mortgage companies for subsequent resale to the FHLBanks at higher administratively-determined prices.

FHA and VA mortgages, in general, have continued to play a significant role in the residential mortgage market so far in 1970. One reason is that their average yields have remained more attractive to lenders than returns available on conventional home loans, which are limited in many States by usury ceilings. During June, yields on FHA home loans remained more than 50 basis points higher than average returns on conventional home mortgages. Although the S&L's have traditionally specialized in conventional loans, the enhanced attractiveness of FHA and VA loans has caused these lenders to shift their investment patterns substantially. As a result, S&L net acquisitions of Government-underwritten mortgages through April-May continued to represent an unusually large share of their total net mortgage takings.

NET INCREASE IN S&L MORTGAGE PORTFOLIOS

	Total Net Increase (Billions of dollars)				FHA/VA as Per Cent of Total			
	QI	QII	QIII	QIV	QI	QII	QIII	QIV
1967	.3	2.1	2.6	2.3	3	5	11	13
1968	1.5	2.6	2.3	2.5	15	12	19	22
1969	2.2	3.2	2.4	1.6	22	20	19	19
1970	.6	1.2*			41	27*		

* Preliminary data for April-May.

For many home borrowers, Government-underwritten mortgages have been attractive because they require much lower average down-payments than conventional loans, although effective rates on FHA-insured loans, which include the insurance premium, are somewhat higher. However, the burden of monthly mortgage payments can be reduced for eligible lower-income families under FHA's Sec. 235 program.^{1/} As much as a sixth of all home loans underwritten by FHA so far this year have been insured under this relatively new program.

DWELLING UNITS WITH HOME MORTGAGES INSURED
BY THE FEDERAL HOUSING ADMINISTRATION

	Number		Sec. 235 as per cent of total
	Total	Sec. 235 ^{1/}	
1969 - I	112,584	1,594	1.4
II	115,196	3,157	2.7
III	136,409	5,688	4.2
IV	127,083	11,454	9.0
1970 - I	113,458	18,736	16.5
April	36,654	6,473	17.6

^{1/} See footnote 1 below.

^{1/} The Sec. 235(i) home ownership program helps to finance the construction or rehabilitation of 1-family dwellings for certain low-income borrowers. On these units, the HUD Secretary is authorized to make subsidy payments to the lender in an amount necessary to make up the difference between 20 per cent of the family's monthly income and the required monthly mortgage payment. However, in no case may the subsidy exceed the difference between (a) the scheduled payment under the mortgage for principal, interest, and FHA mortgage insurance premium and (b) the principal and interest payment that would be required if the mortgage bore an interest rate of 1 per cent.

In FNMA's latest auction, average yields on 6-month forward commitments to purchase Government underwritten home mortgages declined for the first time in nearly 3 months. Total offers received and accepted were both at relatively low levels for a bi-weekly auction period.

FNMA AUCTION

	Amount of total offers		Implicit private market yield on 6-month commitments
	Received	Accepted	
	(Millions of dollars)		(Per cent)
<u>Weekly Auction</u>			
1969 high	\$410 (6/16)	\$152 (9/8)	8.87 (12/29)
1970 high	705 (1/5)	151 (1/12)	9.36 (1/12)
May 11	269	102	9.07
18	300	136	9.13
25	290	145	9.18
June 1	224	114	9.24
<u>Bi-weekly Auction</u>			
1970 high	581 (1/26)	298 (1/26)	9.30 (6/15)
June 15	250	128	9.30
29	156	99	9.33
July 13	286	113	9.21

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.

Corporate and municipal securities markets. A strong, sustained rally in the corporate bond market during the latter part of June and early July has sent yields on new high-grade issues down about 60 basis points from the mid-June peak, despite continued heavy current

and forward calendars. Because of a growing belief that monetary policy and aggregate financial demands would ease, institutional investors, which earlier had been anxious to build liquidity and willing to invest only short-term, increased their bond purchases significantly.

Stock prices have fluctuated in a narrow range since mid-June, with trading volume on the NYSE averaging about 9 million shares--down substantially from the 15 million share average of the two-week period ending June 5. Reflecting some very recent improvement, as of July 10 the NYSE and AMEX indices were 7.3 per cent and 2.9 per cent, respectively, above their 1970 lows reached at the end of May.

BOND YIELDS AND STOCK PRICES

	New Aaa Corporate Bonds ^{1/}	Long-term State and Local Bonds ^{2/}	Stock Prices ^{3/}		
			NYSE	AMEX	
<u>1969</u>					
Low	6.90 (2/21)	4.82 (2/23)	49.31 (7/29)	25.97 (8/13)	
High	8.85 (12/5)	6.90 (12/18)	59.16 (5/16)	32.91 (1/3)	
<u>1970</u>					
Low	8.20 (2/27)	5.95 (3/12)	37.69 (5/26)	19.36 (5/26)	
High	9.30 (6/19)	7.12 (5/28)	52.36 (1/5)	27.02 (1/8)	
<u>Week of:</u>					
June	5	9.05	6.92	41.66	20.99
	12	9.23	7.03	40.54	20.72
	19	9.30	7.03	42.06	21.00
	26	9.14	6.86	40.02	20.22
July	3	9.02	6.79	39.64	19.95
	10	8.70	6.59	40.54	19.93

^{1/} With call protection (includes some issues with 10-year call protection).
^{2/} Bond Buyer (mixed qualities).
^{3/} Prices as of the day shown.

Public bond issues in June reached a total of slightly over \$1.9 billion, as the improved market situation in the latter part of the month permitted accelerations and reschedulings of previously postponed issues. Including the mammoth AT&T financing, public bond offerings in the second quarter of 1970 amounted to almost \$7 billion, a postwar record.

All indicators available to the staff suggest that bond financing in the public market will continue at relatively high levels through the third quarter of 1970 at least. July bond issues are expected to amount to approximately \$1.8 billion; and the staff estimates, on the basis of current schedulings, that public bond sales will be about \$1.5 billion in August, a month when a mid-summer slump in volume of offerings is usual. The September calendar already lists over \$1 billion in corporate bond issues, and the total for that month is likely to be close to the \$1.9 billion monthly average posted in the first half of 1970. Thus, the third quarter volume may be around \$5 billion.

CORPORATE SECURITY OFFERINGS
(Monthly or monthly averages, in millions of dollars)

	Bonds		Stocks	Total
	Public Offerings	Private Placements		
1969	1,061	468	700	2,229
1970 - QI	1,525	420	712	2,659
QII	2,308e ^{1/}	433e	533e	3,275e ^{1/}
QIII	1,700e	433e	600e	2,733e
June	1,925e	500e	800e	3,225e
July	1,800e	400e	700e	2,900e
August	1,500e	400e	500e	2,400e
September	1,800e	500e	600e	2,900e

e/ Estimated.

^{1/} The second quarter "Public offerings" and "Total" figures include \$1.5 billion AT&T offering. The monthly average for the second quarter "Public Bond Offerings" and "Total Security Offerings" excluding AT&T would be \$1,808(e) million and \$2,775(e) million, respectively.

While public bond offerings have been establishing new record levels in 1970, other components of total gross security offerings have not grown as fast. As for private placements, the staff estimates that total volume of takedowns in the second quarter was about the same as in the reduced January-March period. Since life insurance companies, which are a major investor in this market, are still planning forward commitments conservatively, takedowns are not expected to accelerate significantly in the immediate future. New stock issues, after having practically disappeared in late May, rebounded to an \$800 million monthly total in June. The second quarter volume, however, was only \$1.6 billion, one-fourth below the \$2.1 billion of new equity offerings in the first quarter of the year. If equity prices do not suffer further sharp deterioration, such as the market experienced in May, average monthly new stock issues in the third quarter of 1970 should return to a \$600-\$700 million range, which would result in equity offerings of approximately \$2.0 billion over the three-month period. Stock offerings by real estate investment companies, public utilities, and corporations wishing to protect bond ratings are providing a strong base of support to the equity total.

New long-term bond issues by State and local governments fell somewhat below the \$1.3 billion monthly average pace set in the first three months of 1970, as the Bond Buyer index rose steadily throughout the second quarter, remaining about 100 basis points above the 1970 low through much of May and June. The second quarter volume was about 10 per cent below that of the first quarter, despite the heavy April sales.

Reflecting the reduced supply of municipals and the generally improved atmosphere of the capital markets, yields began to drop sharply in late June, and by mid-July they were over 50 basis points below the 1970 peak. Although the market situation has improved, the forward calendar is building slowly. Interest rates are still high enough to deter small and low-rated borrowers, and dealers report that a number of issuers may be postponing long-term financing in the hope that rates will drop significantly in the next few months. Nevertheless, taking into consideration the pressing needs of many units, the staff estimates that July new issue volume will be \$1.1 billion, with the August total rising to about \$1.3 billion.

STATE AND LOCAL GOVERNMENT OFFERINGS
(Monthly or monthly averages, in millions of dollars)

1969 - Year	990
1970 - QI	1,349
QII	1,232e
QIII	1,250e
June	1,075e
July	1,100e
August	1,300e
September	1,300e

e/ Estimated.

Government securities market. The various factors that contributed to the decline in yields on high grade corporate and municipal bonds also caused a sharp rally in the market for U.S. Government notes and bonds during the last two weeks of June and the first week of July. Over this time, yields on intermediate term securities dropped around 35 basis points on average, while the average rate on long-term bonds fell about 60 basis points. These rates, however, are still considerably above their February-March 1970 lows, with the current 10-year rate of 7.50 per cent comparing with an earlier low of 6.90 per cent.

WEEKLY AVERAGE MARKET YIELDS ON U S GOVERNMENT AND AGENCY SECURITIES^{1/}
(Per cent)

	<u>Late 1969</u>	<u>1970</u>	<u>Week ending</u>			
	<u>Highs</u>	<u>Lows</u>	<u>June 23</u>	<u>June 30</u>	<u>July 7</u>	<u>July 14</u>
<u>Bills</u>						
1-month	7.54 (12/31)	6.22 (3/24)	6.08	6.07	6.24	6.16
3-month	8.08 (12/29)	6.08 (3/24)	6.66	6.45	6.56	6.56
6-month	8.09 (12/29)	6.18 (3/23)	6.91	6.69	6.54	6.67
1-year	7.86 (11/24)	6.20 (4/13)	7.14	6.98	6.77	6.71
<u>Coupons</u>						
3-year	8.51 (12/29)	6.87 (3/25)	7.91	7.82	7.60	7.59
5-year	8.33 (12/29)	7.05 (3/25)	7.92	7.82	7.64	7.63
7-year	7.77 (12/29)	6.98 (3/25)	7.90	7.79	7.66	7.66
10-year	8.05 (12/29)	6.90 (2/27)	7.87	7.74	7.54	7.52
20-year	7.14 (12/29)	6.55 (2/27)	7.36	7.22	6.94	6.95
<u>Agencies</u>						
6-month	8.70 (12/30)	7.17 (4/15)	7.87	7.80	7.42	7.41
1-year	8.87 (12/11)	7.46 (4/14)	8.25	8.16	7.93	7.80
3-year	8.55 (12/31)	7.75 (3/25)	8.32	8.30	8.22	8.16
5-year	8.47 (12/31)	7.78 (3/25)	8.42	8.42	8.30	8.29

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

In the short-term area, the 3-month bill is now bid at around 6.50 per cent, some 10 basis points below its level at the time of the last Committee meeting. Treasury bill yields had declined further in the latter part of June but more recently have tended to back up slightly. The Treasury auctioned \$2.5 billion of March tax anticipation bills on July 2 for payment on July 8, and announced a sale of \$2.25 billion of April tax bills on July 16 to be paid for on July 23.

In view of this large increase in supply and new competition from CD's, a sharper rebound in bill rates might have been expected. The relative strength in the bill market can be explained by the low Federal funds rates and by better than seasonal investor demand--partly reflecting a shift away from commercial paper. Consequently, total dealer inventories have stayed relatively low in recent weeks, although positions did increase in longer-term bills reflecting the Treasury tab auction, and also in short-term coupon issues in anticipation of the August refunding.

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

	June (daily average)	June 22	June 29	July 6	July 13
<u>Treasury securities</u>					
Total	<u>2,199</u>	<u>850</u>	<u>1,554</u>	<u>2,055</u>	<u>2,219</u>
Treasury bills (total)	<u>1,637</u>	<u>411</u>	<u>1,034</u>	<u>1,537</u>	<u>1,712</u>
Due in 92 days or less	333	-81	162	318	298
93 days or over	1,034	492	873	1,219	1,414
Treasury notes and bonds (total)	<u>562</u>	<u>439</u>	<u>520</u>	<u>518</u>	<u>507</u>
Due within 1 year	222	216	282	316	322
1-5 years	110	35	31	-15	-8
over 5 years	229	188	207	217	193
<u>Agency securities</u>					
Total	<u>614</u>	<u>633</u>	<u>721</u>	<u>706</u>	<u>622</u>
Due within 1 year	417	446	439	477	405
over 1 year	197	187	281	229	217

The market for Federal Agency securities has shared in the recent over-all rally in credit markets. The volume of net new money raised in the Agency market in recent months has continued to be much smaller than in the first quarter of this year and also has been less than in the same months of last year, as the following table indicates. Borrowing by the two housing credit agencies--FHLB and FNMA--has been running at much lower levels, as savings inflows to mortgage lenders have improved.

NET NEW BORROWING BY AGENCIES
(In millions of dollars)

	Q1	Q2	Apr.	May	June	July
1968	1,112	1,444	281	223	940	187
1969	1,194	2,411	841	549	1,021	794
1970	3,714	1,518 ^{e/}	628	186	704 ^{e/}	445 ^{e/}

Federal Finance. The Board staff now projects a budget deficit of \$9.9 billion in fiscal year 1971, about \$8.6 billion more than forecast by the Administration in its May 19 budget revisions and \$2.6 billion more than assumed for the chart show presented at the last FOMC meeting. The current staff budget estimate is compared to the chart show assumptions and the revised Administration forecast in the table below. The revisions made in the staff's fiscal assumptions since the

COMPARISON OF BUDGET PROJECTIONS

	Budget Bureau (May 19)	Staff Estimates	
		Last Greenbook (Chart show)	Current Greenbook
Receipts	204.3	200.3	199.4
Outlays	<u>205.6</u>	<u>207.6</u>	<u>209.3</u>
Deficit	-1.3	-7.3	-9.9

chart show have no effect on Federal purchases in the NIA accounts, as only grants, transfers and taxes are affected.

The Treasury deficit in the current fiscal year is thus expected to be substantially greater than was indicated by the Administration in its May budget estimates. Thus, the staff's estimate of fiscal 1971 receipts is nearly \$5.0 billion lower than the Administration's revised estimate, partly because of lower income assumptions. In addition, there seems little likelihood now that the tax on lead in gasoline and the highway user tax, which were proposed by the Administration, will be enacted by Congress as assumed in the Administration estimates (and by the Board staff at the time of the chart show).

The staff estimate of fiscal 1970 expenditures is about \$3.7 billion higher than the revised Administration estimate. The items included in the staff projections that account for the difference are: (1) a 5 per cent (\$.7 billion) social security benefit hike effective January 1971 and other social security reform measures (\$.8 billion) that have been approved by the House and are now under discussion in the Senate Committee; (2) larger appropriations (\$.4 billion) for direct grants for hospital construction as a result of recent Congressional action overriding a Presidential veto of a bill extending the Hill-Burton authorizations; (3) a projected delay in implementation of a proposed postal rate increase (a negative expenditure) and the retroactive feature included in the House and Senate versions of the proposed postal pay increase (totaling \$.7 billion); and (4) a higher level of outlays for interest payments (\$.5 billion) and for unemployment

insurance (\$.4 billion). Uncertainties exist in regard to the spending effect of other appropriations measures being considered by Congress, but the Administration may be able to achieve additional economy measures to offset possible increases initiated by Congress. No revisions have been made by the staff in the Budget Bureau's January estimate of defense outlays in fiscal 1971.

As for the fiscal year just completed, preliminary estimates indicate a Budget deficit of about \$3 billion, but official data will not be available until the end of July.

With regard to the Federal sector in the national income accounts, the staff projects a \$7.3 billion deficit in calendar 1970 and an \$7.7 billion deficit in fiscal 1971. The continuing shift toward deficit in the Federal sector account is expected to end in the third quarter of calendar 1970; thereafter the quarterly deficit is expected to fall gradually.

The shift toward deficit in the Federal budget during calendar 1970 is, to a large extent, the result of low levels of projected economic growth rather than discretionary changes in fiscal policy. Thus, despite the discretionary increases in spending included in the staff estimate for fiscal 1971, the high employment surplus will increase from \$.7 billion to \$10.6 billion from the first to the second

half of fiscal 1971.^{1/} By this measure, fiscal policy becomes more restrictive as the fiscal year progresses. The move toward restriction reflects the anticipated speed-up in estate and gift taxes (\$1.5 billion), the scheduled hike in social security taxes in January (\$5.8 billion) and increased revenues that would result from the economy growing at its potential.

The staff estimates that the end-of-July cash balance at the Treasury will be about \$6.4 billion. In its recent auction of tax bills the Treasury raised about \$2.5 billion and it has announced its intention to raise another \$2.25 billion in tax bills payable July 23. Further cash borrowing is expected in August, either in combination with the mid-month refinancing package for \$5.6 billion in publicly held notes and bonds or as a separate borrowing later in the month. As indicated in the last Greenbook supplement, gross Treasury borrowing in the third and fourth quarter of 1970 is expected to be somewhat larger than in recent years.

^{1/} Since the last Greenbook the estimate of the high employment surplus for the second half of fiscal 1971 has been lowered because of the changed budget assumption discussed above and also because the effect of recent Federal pay increases has been deleted in projecting the price deflator that is applied for future periods.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	June	July	Aug.	Sept.
<u>Borrowing operations</u>				
New cash raised				
Unspecified new borrowing	--	--	3.8	--
Weekly and monthly bills	.6	.5	.3	--
Tax bills	--	4.8	--	--
Coupon issues	--	--	--	--
Other (agency, debt repayment, etc.)	-3.7	- .1	- .9	-1.9
Total net borrowing from public	-3.1	5.2	3.2	-1.9
Plus: Other net financial sources ^{a/}	-1.8	.3	- .3	.2
Plus: <u>Budget surplus or deficit</u> (-)	6.9	-7.1	-3.0	2.5
Equals: <u>Change in cash balance</u>	2.0 ^{b/}	-1.6	- .1	.8
Memoranda: Level of cash balance end of period	8.0 ^{b/}	6.4	6.3	7.1
Derivation of budget surplus or deficit				
Budget receipts	23.3	12.9	15.2	19.6
Budget outlays	16.4	20.0	18.2	17.1

^{a/} Checks issued less checks paid and other accrual items.

^{b/} Actual.

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

	Fiscal	Calendar	Fiscal Year 1971		Calendar Quarters					
	Year 1970	Year 1970	Revised	F. R.	1970				1971	
	F. R. Board	F. R. Board	Budget ^{1/}	Board	I	IIe/	IIIe/	IVe/	Ie/	IIe/
Federal Budget										
(Quarterly data, unadjusted)										
Surplus/deficit	-3.0	-10.2	-1.3	-9.9	-3.5	8.5	-7.5	-7.7	-5.0	10.3
Receipts	194.5	194.2	204.3	199.4	44.3	59.3	47.8	42.8	46.5	62.3
Outlays	197.5	204.4	205.6	209.3	47.8	50.8	55.3	50.5	51.5	52.0
Means of financing:										
Net borrowing from the public ^{2/}	4.0	9.5		9.2	2.0	-6.3	6.5	7.3	3.0	-
Decreased in cash operating balance	-2.1	-.8		.7	-1.6	-1.1	.9	1.0	.4	-
Other ^{3/}	1.2	1.5	n.a.	-.1	3.1	-1.1	.2	-.7	1.5	-1.1
Cash operating balance, end of period	8.0	6.1		7.3	6.9	8.0	7.1	6.1	5.7	7.3
National Income Sector										
(Seasonally adjusted annual rate)										
Surplus/deficit	1.3	-7.3	n.a.	-7.7	.3	-9.6	-11.1	-8.9	-5.3	-5.5
Receipts	201.0	199.7	n.a.	204.0	198.7	200.8	198.1	201.2	206.7	210.0
Expenditures	199.8	207.0	208.3	211.7	198.4	210.4	209.2	210.1	212.0	215.5
High employment budget surplus/deficit ^{4/}	3.6	1.6	n.a.	5.7	6.2	-1.3	-1.7	3.1	10.2	11.0

e--projected

n.a.--not available

^{1/} Official Budget Revision: May 19, 1970

^{2/} Excludes effect of reclassification of \$1.6 billion of CCC certificates of interest, as of July 1, 1969. This reclassification increased Federal debt, but is not treated as borrowing from the public.

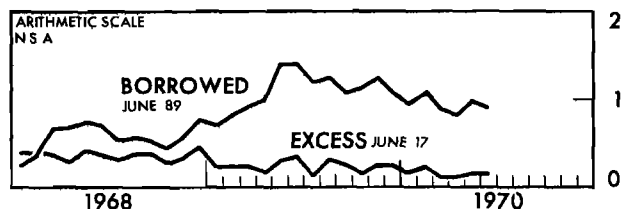
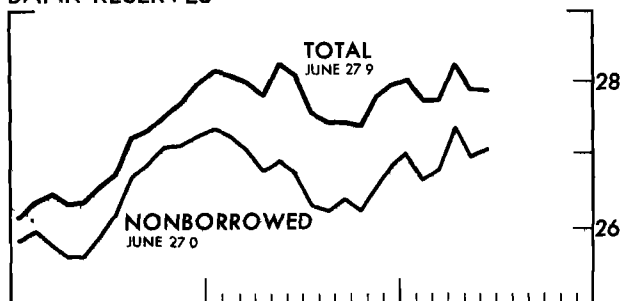
^{3/} Includes such items as deposit fund accounts and clearing accounts.

^{4/} Estimated by Federal Reserve Board Staff.

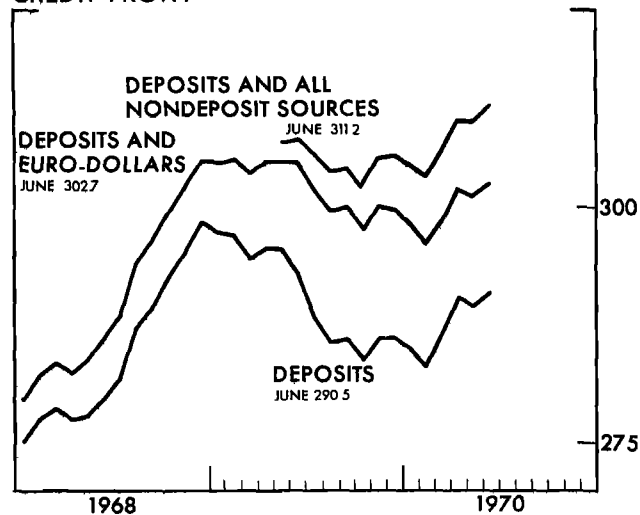
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

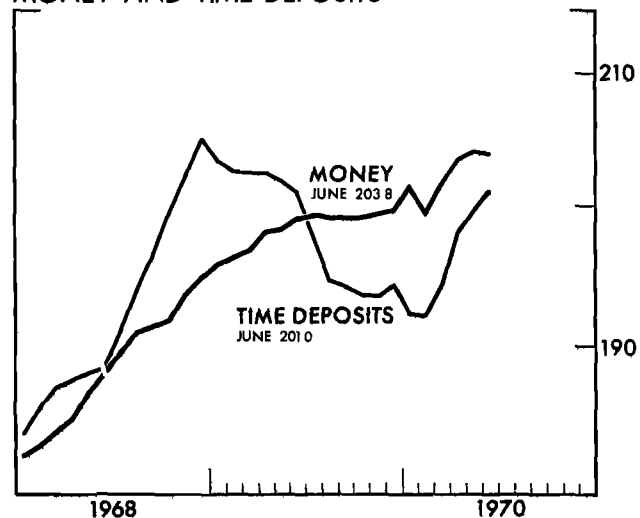
BANK RESERVES



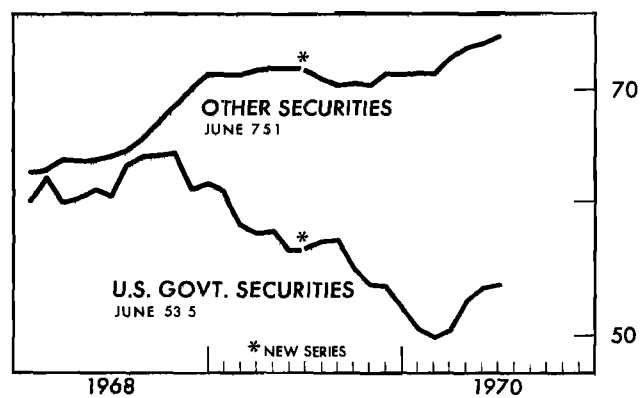
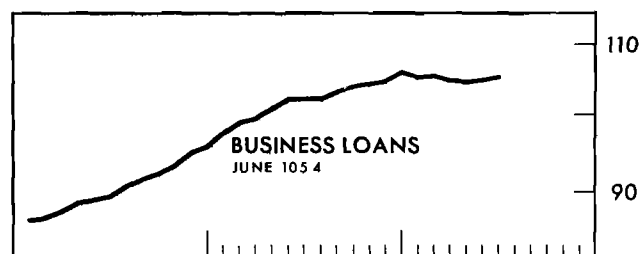
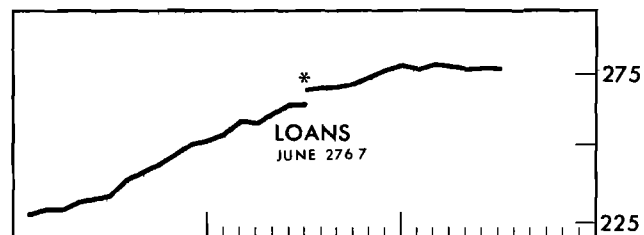
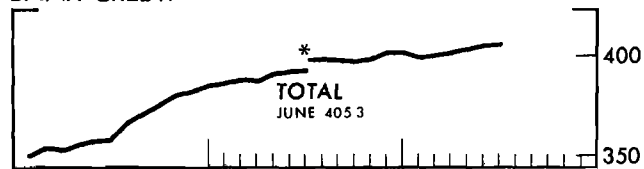
CREDIT PROXY



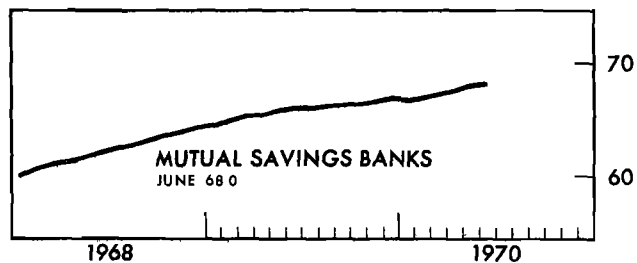
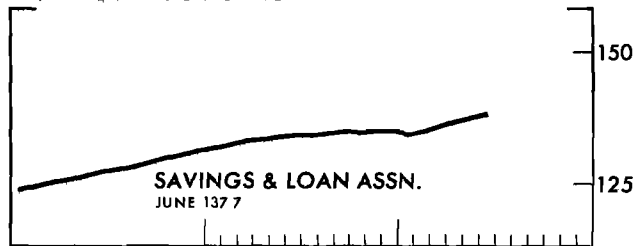
MONEY AND TIME DEPOSITS



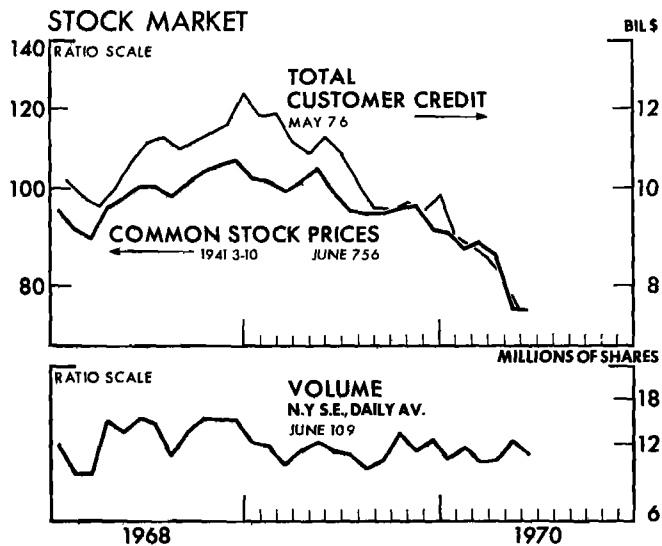
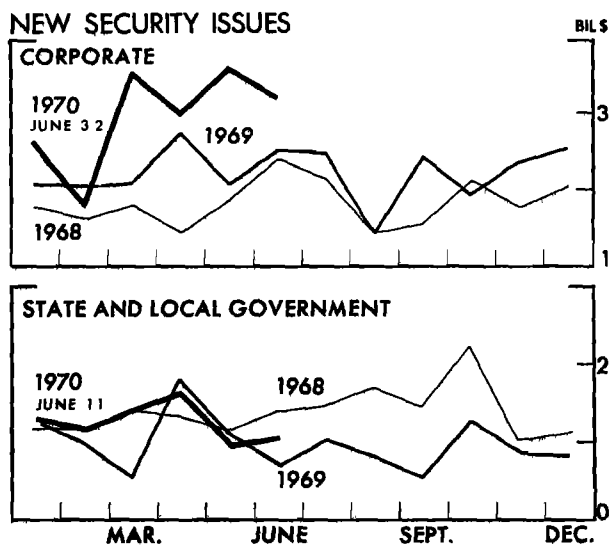
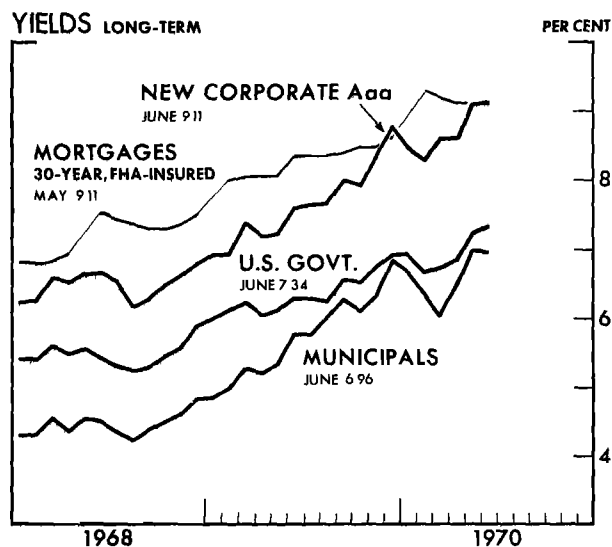
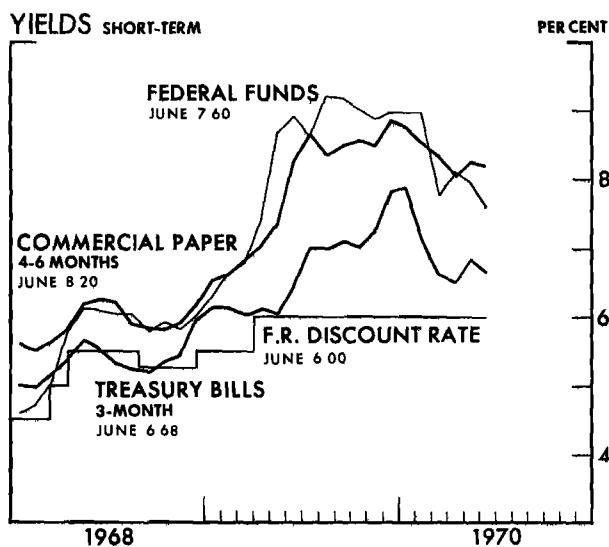
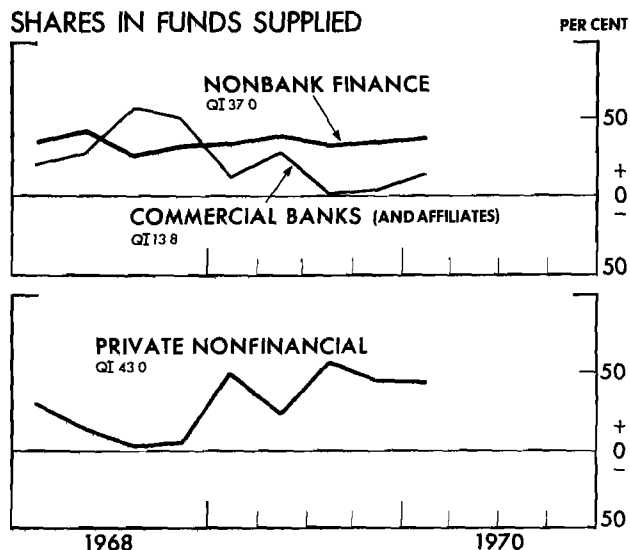
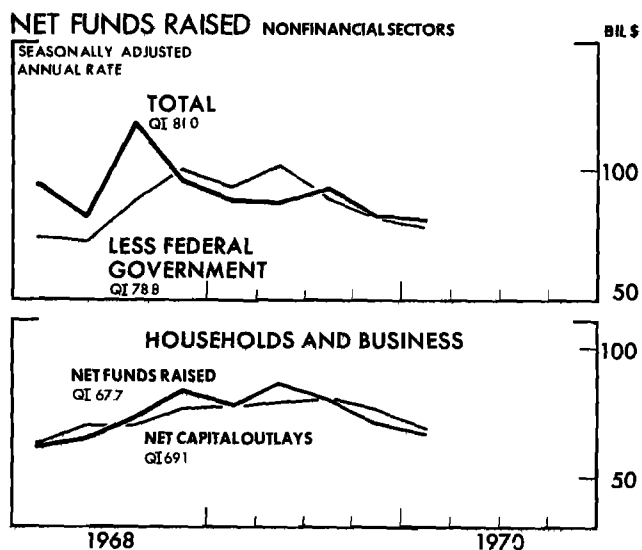
BANK CREDIT



SAVINGS ACCOUNTS



FINANCIAL DEVELOPMENTS - UNITED STATES



THE ECONOMIC PICTURE IN DETAIL

International Developments

U.S. balance of payments. The second-quarter liquidity deficit, seasonally adjusted and before special transactions or SDR allocations, was apparently about \$2-1/4 billion. This is still a preliminary estimate; the deficit would have been considerably greater if not for a very large inflow of funds reflected in a reduction in bank-reported liabilities to foreigners in the last few days of June. There was a resumption of large liquidity deficit in the first week of July, suggesting that the inflows at the end of June -- possibly to window-dress the direct investment reports to the OFDI -- were at least partly temporary.

As adjusted, the first quarter liquidity deficit was \$1.5 billion. For the first half of 1970 the deficit amounted to about \$3.8 billion, compared to about \$5 billion in the first half of 1969. The principal changes between the two first halves (based on partial data and projections of an inter-agency group) appear to have been an improvement in the balance on goods and services, a reduction in outflows of U.S. private capital -- recorded and unrecorded -- and a substantial decline in inflows of foreign private capital in non-liquid forms.

MEASURES OF OVER-ALL BALANCE, ADJUSTED
(millions of dollars; seasonally adjusted; deficit (-))

	Total	1 9 6 9				1 9 7 0	
		Q-1	Q-2	Q-3	Q-4	Q-1	Q-2 ^e
Liquidity basis <u>1/</u>	-6,593	-1,559	-3,427	-1,761	154	-1,497	-2,290
Official settlements basis <u>1/</u>	2,786	1,467	1,281	-420	458	-3,143	-2,287
Adjusted over-all basis <u>2/</u>	-6,648	-1,485	-3,524	-1,731	92	-1,426	-2,287
Memo: Special transactions							
Liquidity basis	-628	207	-374	-518	57	-268	790
Official settlements basis	-78	-14	34	-162	64	73	187

1/ Before special transactions and allocations of SDRs.

2/ The balance financed by official reserve transactions and changes in liabilities to foreign commercial banks, but adjusted to exclude special transactions and allocation of SDRs.

e/ June partly estimated.

As reported below, the trade balance has improved steadily since the middle of last year. On balance, changes in other current accounts (services, investment income, and military transactions) so far this year appear to be relatively minor, nor are major shifts expected in the year ahead though a gradual improvement is likely.

Outflows of U.S. private capital in the recorded categories were about \$1-1/4 billion in the first quarter of 1970, about the same as in the like period of 1969, but the second-quarter recorded outflow seems likely to be considerably less than the extraordinarily high \$2.2 billion in the second quarter of last year. The main difference -- according to the limited data available at this time -- is a reduction in net U.S. purchases of foreign securities to perhaps \$50 million in

the second quarter this year, as against net purchases of over \$500 million in last year's second quarter. High interest costs in the United States, and perhaps some action by the Canadian authorities to avoid even larger reserve gains by discouraging local government offerings in the United States, reduced new foreign bond issues to a trickle. American investors have also sharply curtailed their purchases of foreign equity securities.

Capital outflows by U.S. direct investors were very high in the first quarter (\$1.3 billion) and were probably reduced to \$1 billion or less in the second, which would be close to the amount in the second quarter of 1969. A re-survey of the companies' projected expenditures for plant and equipment abroad (confidential until published) suggests that the rise in 1970 over the 1969 amount will be closer to 15 per cent than the 20 per cent projected earlier in the year. However, this increase -- together with increasing difficulties in obtaining funds abroad -- is still expected to lead to larger direct investment capital outflows from the United States this year than last.

Last year, the errors and omissions entry was much larger than normal -- over \$3 billion in the first three quarters offset by a net reverse flow of \$0.1 billion in the fourth quarter, compared to a 1960-68 average of around \$800 million per year. It is generally assumed that the 1969 bulge contained substantial amounts of U.S. funds

shifted into more-attractive Euro-dollar deposits, or into German mark assets. If the transactions resulting in these flows were easily reversed when interest differentials or the speculative situation changed, they might properly be disregarded when computing the underlying deficit -- i.e., they might be counted "below the line." However, there are no signs of further reversal of the 1969 outflows since the final months of last year. Large new outflows, though on a smaller scale, seem to have developed in the second quarter of 1970, as interest rates remain somewhat higher abroad and revaluation possibilities have probably attracted funds to Canada and to Germany.

Inflows of private foreign capital, apart from liquid funds, have been drastically reduced so far this year. Foreign net liquidation of U.S. corporate stocks was about \$100 million in the first quarter, then, after a pause in April, net sales reached a peak of \$200 million in May. Indications are that there was only a small net sell-off in June. For the first six months of the year foreign transactions in U.S. equity securities resulted in net outflows of about \$350 million, compared with inflows of \$900 million in the first half of 1969.

The foreign market for debt issues of U.S. corporations has become extremely tight and is not likely to ease appreciably, given both strong competing demands for funds abroad and general uneasiness -- at least at the moment -- about the liquidity problems of U.S. corporations.

The deficit on the official settlements basis (seasonally adjusted and before certain special transactions) was reduced to about \$2.3 billion in the second quarter (according to preliminary data) from over \$3 billion in the first. In the previous quarter this balance was worsened by net repayment of \$1.5 billion in liquid liabilities to commercial banks abroad, whereas incomplete data for the second quarter indicate a reduction of only about \$150 million in such liabilities. This reflected a slowdown in the runoff of borrowings of U S. banks via their Euro-dollar branches; such borrowings were reduced (net) by \$1.1 billion in the first quarter, but changed very little in the second, with increases early in the quarter offset later, especially after the change in Regulation Q.

Total reserves of foreign monetary authorities appear to have increased as much in the second quarter as in the first, despite the slight lessening in the U.S. official settlements deficit. In the first quarter the BIS appears to have placed its net increase in dollar assets (derived largely from transactions with central banks) in the United States; but in the second quarter the BIS apparently shifted substantial amounts from the United States to the Euro-dollar market.

The counterpart of the \$5 billion official settlements deficit (unadjusted) of the United States in the first half of 1970 was large reserve gains by a number of countries. Net reserves of

the U.K. improved by \$2.3 billion, concentrated in the early months of the year. German gains were \$1.7 billion, largely in June, not including forward purchases of dollars. Canadian reserves increased by \$1.2 billion, mainly in the second quarter, and were invested in special U.S. Treasury issues; French reserves increased by about \$300 million. Offsetting these gains, Italian reserves declined by over \$600 million, despite massive Euro-dollar borrowings that came into Italian reserves.

Financing of the \$5 billion first-half deficit was accomplished mainly by reducing U.S. official holdings of foreign currencies -- principally sterling -- by \$1.8 billion, while foreign reserve holders increased their liquid and nonliquid assets held in the United States by about \$3.5 billion. On the whole, the composition of the reserve gainers, and the method of financing, have tended up to now to mitigate the tensions that might be associated with such large deficits.

U.S. foreign trade. In May, the export surplus increased as exports rose more than imports. For April-May together, the export surplus was at an annual rate of \$2.6 billion (balance of payments basis) compared with \$2.1 billion in the first quarter and \$1.5 billion in the last half of 1969.

The steady improvement in the trade balance since mid-1969 stems from an accelerated rate of increase in exports. Imports also rose over this period but at a more moderate rate. The expansion in

exports has been led by greater shipments of industrial materials -- steel, coal, aluminum, ferrous scrap and chemicals -- to foreign industrial countries where output has advanced sharply. Deliveries of commercial aircraft have also been much greater, bolstered by the beginning of deliveries of the new Boeing 747's. Exports of machinery have been relatively disappointing, particularly in view of the increase in fixed investment outlays abroad. Although exports of agricultural commodities have increased only slightly since mid-1969, the absolute level has been exceptionally high throughout this period. In the 12-months ended last June shipments of agricultural products are estimated to have totaled \$6.6 billion, the third largest amount for a comparable period.

By areas, about three-fourths of the increase in exports from the last half of 1969 to January-May 1970 was in shipments to Western Europe and Japan. There was a particularly large rise in exports to the EEC countries, principally Germany and France, and shipments to the United Kingdom were also up substantially. Exports to the Latin American countries also advanced this year but exports to Canada showed little change, reflecting the easing of demand in that country.

Imports have displayed surprising strength so far this year. In contrast to previous domestic economic slowdowns, the absolute level of imports has remained high relative to domestic output and

consumption. Higher prices for nonferrous metals and coffee, and perhaps purchases of foreign goods in anticipation of the imposition of restrictions on imports may partly explain the high level of imports. But there is probably also a shift of U.S. consumer and business demand toward the purchase of lower-cost goods, including imports, to offset pressures on incomes and profits. A corresponding shift in purchasing patterns probably also occurred in past slowdowns, but since imports of finished goods -- automobiles and other consumer goods in particular -- now have a greater weight than before, such a shift may be a more important element in maintaining imports.

Exports in April-May were at a \$42.0 billion annual rate (balance of payments basis), nearly 3 per cent greater than in the first quarter. The increase was principally in nonagricultural commodities; shipments of agricultural products rose only slightly above the very high amounts exported in the first quarter. The gain in nonagricultural commodities was broadly based. Deliveries of automotive equipment to Canada were larger as automotive output there rose to record levels, buoyed by the heavy U.S. demand for compact cars which make up a large portion of Canadian car output. Deliveries of commercial aircraft were also up strongly, principally because of a bunching in deliveries of the Boeing 747's in May. Deliveries of these aircraft are scheduled to be lower in the second half of the year.

Exports of industrial materials, particularly steel, ferrous scrap and coal, were all up sharply in response to continued strong demand in foreign industrial countries. Steel exports in May topped 900,000 tons -- an exceptionally high amount -- and the backlog of foreign orders suggests further gains in the immediate future. In the first five months of this year, exports of steel were at an annual rate of over 9 million tons compared with 5-1/2 million tons in calendar 1969. There has not been a commensurate increase in value, however, since much of the increase in tonnage consists of lower-priced semi-finished steel. The average unit-value of steel exports dropped to \$150 million a ton this year compared with the average \$170 per ton in 1969. Imports of steel in the first five months of the year were at an annual rate of 10-1/2 million tons; in 1969 imports totaled nearly 14 million tons. In contrast to the export pattern, however, there has been a shift toward higher-priced foreign steel; the unit-value in January-May 1970 was \$157 per ton; in 1969 it was \$125 per ton. Net imports of steel in January-May 1970 were valued at about \$200 million (annual rate) compared with \$800 million for the year 1969.

Exports of machinery, after falling in April, rose in May to the first quarter level. The gains in shipments of such products, however, have been relatively modest. With the estimated cutbacks in domestic plant and equipment expenditures from the earlier estimates, and continued high capacity-utilization rates in manufacturing abroad,

a more rapid rise in exports of machinery may materialize in the second half of this year.

Imports in April-May were at an annual rate of \$39.4 billion (balance of payments basis), less than 2 per cent above the rate in the first quarter. However, imports in May were very strong following three months in which imports were virtually unchanged. Despite the sharp rise in May, it is still expected that imports in the immediate future will increase only slightly. One reason for this expectation is the stabilization in prices of imported nonferrous metals and coffee. The decline in quotations on the London Metal Exchange, particularly for copper, and the announced reduction in domestic lead prices should be transmitted to import prices, reversing the uptrend which had occurred in such prices through the first part of this year, and should dampen the rise in the value of imports later in the year.

The increase in imports in April-May over the first quarter level was largely in cars from Europe and Japan as sales of these types in the United States continued at record-breaking levels. There was also some increase in inventories of newly introduced models. Arrivals of foodstuffs (coffee and sugar) were also higher, as were imports of clothing and footwear. A survey by a Washington-based newsletter indicates that domestic retailers were buying abroad heavily in anticipation of the possible imposition of quotas on textiles and other commodities.

Euro-dollar market. Euro-dollar interest rates have declined substantially in the three weeks following the Board's partial suspension of Regulation Q ceilings. The rate on three-month deposits is currently about 60 percentage points below its mid-June levels.

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
Jun. 3	8.58	7.84	0.74	9.25	6.87	2.38
10	8.45	7.98	0.47	9.45	6.78	2.67
17	8.83	7.80	1.03	9.60	6.73	2.87
24	8.63	7.21	1.42	9.46	6.64	2.82
Jul. 1	8.78	7.23	1.55	9.00	6.43	2.57
8	8.60	7.34	1.26	9.18	6.61	2.57
15	7.83	7.55 ^P	0.28 ^P	8.98	6.53 ^P	2.45

U.S. banks' liabilities to their own foreign branches declined by about \$640 million in the two weeks subsequent to the Regulation Q action, to a level of \$12.2 billion (including loan participations). German banks, according to data supplied by the Bundesbank, increased their net foreign liabilities by almost \$500 million in the last three weeks of June, but did not increase their net liabilities substantially in the early part of July. However, there were large inflows to German reserves in early July, presumably reflecting some use of Euro-dollar financing by German non-banks.

The fairly large official reserve losses by the Italians in early July reflected an outflow of funds, part of which may have gone into the Euro-dollar market. In addition, the absence of Euro-dollar borrowings by Italian state-owned corporations in recent weeks, following heavy borrowing earlier, removed some of the upward pressure on rates.

For the four-week reserve computation period ending July 8, there was apparently little change in total reserveable Euro-dollar borrowings of U.S. banks from their foreign branches. (These reserveable borrowings had averaged \$1.6 billion for the computation period ended June 10.) In the last two weeks of the computation period, the two banks which had the largest "excess" borrowings, amounting to nearly one-half of all reserveable borrowings, reduced these borrowings significantly.

Foreign exchange markets. Since June 22 the major activity in foreign exchange markets has centered on the German mark, Italian lira and pound sterling. Demand for the mark has been quite strong -- reflecting very tight monetary conditions in Germany and since July 3 some speculative demand generated by talk of wider margins or a floating D-mark rate. The Italian lira, on the other hand, came under severe selling pressure following the Government's resignation July 6. Sterling has also experienced moderate selling pressure, reflecting the attractiveness of higher interest rates abroad and more recently growing

concern about possible strikes in Britain and the increase in the trade deficit.

The Bundesbank Council raised its minimum reserve requirement for German banks by 15 per cent -- or an estimated \$825 million equivalent -- on July 1, having announced two weeks earlier that this action would be taken. Demand for the mark was already strong because of very favorable interest rate differentials -- both on a covered and an uncovered basis. The mark exchange rate remained at or close to its upper limit until July 8 and the Bundesbank purchased \$700 million between June 30 and that date. Since June 1 the Bundesbank has purchased spot \$1.7 billion and about \$.5 billion on a three-months forward basis.

The slight easing of the mark rate since July 8 may have been partly a reaction to announcement of the government's proposed fiscal measures, including a 10 per cent personal and corporate income surtax (to be refunded at a later date). This fiscal action has led to some easing of the very restrictive monetary policy, principally a decrease of the discount rate on July 15.

Selling pressure on the Italian lira -- which had been rather heavy early in June -- moderated toward the end of the month and the Bank of Italy was able to recoup some of its earlier losses, reducing its total market losses for June to \$200 million. (Italy had a slight balance of payments surplus in June.) Selling pressure on the lira resumed after July 1 and grew heavier following the Government's resignation July 6. So far in July the Bank of Italy has sold \$279

million in exchange markets, \$226 million in one week -- its largest weekly loss since mid-February. However, the Bank of Italy repaid entirely its \$400 million of swap drawings on the System in early July, obtaining dollars by transferring a \$250 million claim on the IMF to Japan, selling \$50 million of SDR's, redeeming in advance a \$68 million lira note purchased from Canada in 1968 and redeeming at maturity an \$85 million medium-term U.S. Treasury note. In addition, it replenished official reserves with proceeds of a \$100 million Euro-dollar borrowing of the Italian public works consortium. The Bank of Italy will acquire further resources this week by selling the remainder of its claim on the IMF under the GAB and drawing its super-gold tranche.

Demand for sterling has weakened moderately since June 22, reflecting the pull of high interest rates outside the U.K., concern over growing labor unrest, and -- more recently -- reactions to a higher trade deficit for June -- £51 million, compared with £32 million in May (seasonally adjusted, balance of payments basis). The Bank of England has let the rate take most of the selling pressure and has intervened only moderately, selling \$75 million so far in July. (It purchased \$200 million net during June.) The sterling rate has fallen to about \$2.39 from \$2.3990 on June 22.

Demand for other major foreign currencies has been firm. The Bank of France completed repayment of its dollar borrowings from French commercial banks during June. (It still has outstanding a

\$987 million drawing on the IMF.) On July 8 it raised the reserve requirements of French commercial banks, citing as the reason its desire to offset the expansionary effects of the "growing inflow of U.S. dollars."

The National Bank of Belgium purchased a small amount of dollars in late June and early July and asked the System to provide cover on \$30 million by drawing on the swap line. The only other drawings the System has outstanding is \$185 million on the Swiss National Bank.

The Canadian dollar exchange rate climbed from 96.06 in late June to a recent high of 96.95 on July 3. The Bank of Canada made small U.S. dollar purchases to moderate the rate climb. More recently the rate eased to 96.65 and the Bank of Canada sold a small amount of dollars.

Economic activity in major industrial countries. Economic

activity in Continental Europe in the first half of 1970 appears to have been virtually unaffected by government efforts to curb inflationary pressures. But the cumulative effects of policy measures taken in 1969 and so far this year are likely to have some impact on the pace of activity in the second half of this year. In France and Germany output increased rapidly during the first half of the year. In both countries export demand and capital investment have been buoyant, and in Germany consumption expenditures have also contributed to the boom. In France there are now indications that growth has begun to slacken, prompting the authorities early this month to ease monetary policy moderately and release funds for public works expenditures during the rest of the year. In Germany, on the other hand, monetary policy remains tight and further deflationary fiscal measures were adopted early this month. This fiscal action was mainly taken with an eye towards moderating the size of wage increases this autumn. Further monetary measures, insofar as they raised interest rates, would be counterproductive by serving only to attract capital flows from abroad. A moderate slowing of the German expansion should develop during the remainder of the year.

Elsewhere in Europe, Italian output recovered sharply in January from the low level of activity at the end of last year, when the economy was hard hit by strikes. Since then, however, industrial

production has been flat, not, apparently, because of deficient demand, but because of further labor troubles and problems associated with the introduction of a shorter work week and with putting back into operation equipment that had been idled by strikes.

The behavior of the British economy has been surprising. The recovery which began in the latter half of 1969 had been expected to continue this year. Instead, gross domestic product fell in the first quarter, and there are no indications that an upturn took place in the second quarter. The economy faltered largely because of a fall in capital investment occasioned by a shortage of credit and high interest rates. Despite the drop in output, wages and prices rose rapidly in Britain. This prevented -- and probably will continue to prevent -- the authorities from significantly easing monetary and fiscal stringency. However, growth is expected to resume in the current half.

Industrial Production
(1969 Q-I = 100)

	1 9 6 9			1 9 7 0			
	Q-II	Q-III	Q-IV	Q-I	March	April	May
OECD-Europe	102.2	102.9	104.4	108.0	108.3		
U. K.	100.8	101.6	101.6	102.5	104.9	104.1	
France	102.2	103.0	104.3	107.2	106.5	107.9	
Germany	103.0	103.0	107.1	110.7	112.1	107.2	112.8 ^P
Italy	101.4	100.0	91.6	105.0	105.6	106.2	
Japan	106.3	110.7	116.1	119.0	120.0	126.8	125.9 ^P
Canada	99.3	97.9	100.0	102.1	101.4	102.3	
United States	101.5	102.2	100.7	100.0	100.7	100.0	99.4

^{P/} Preliminary.

Source: CECD Main Economic Indicators, June 1970.

In Japan, output grew at about the same rate in the first half of 1970 as in 1969. However, delayed impact of the restrictive monetary measures adopted last year may slow the rate of growth during the balance of the year.

In Canada, the very rapid expansion of output which began in the fourth quarter -- following the termination of strikes in major industries -- continued through February. Economic activity subsequently leveled off. Recent steps to ease monetary policy may lead to a revival of growth later in the year.

German productive capacity has been employed at very high levels for over a year now and the labor shortage is again acute, despite the fact that the number of foreign workers in Germany has now risen to an all-time high of over 1.8 million, or 8 per cent of the labor force. Policy measures -- including the revaluation last October which allowed monetary policy to become severely restrictive to aid a moderately restraining fiscal policy -- thus far failed to slow the pace of economic expansion significantly. Though new industrial orders decreased steadily from February through May, the decline was moderate and the backlog of orders remains large.

Fixed capital investment, personal consumption, and exports have all contributed to a sustained high level of demand. Efforts to overcome capacity shortages coupled with the strong profit position of German industry explain the high level of investment activity. The strength in consumption reflects both the continuation

of the boom and the generous wage increases recently awarded in many sectors of the economy. The buoyancy of exports is attributable in part to the inevitable lag between the revaluation of the German mark and the full impact of the change in parity on deliveries of German goods to foreign customers.

Mirroring the overall vigor of the Germany economy is the 8 per cent, annual rate, rise in industrial production from September-December 1969 to January-April 1970, which occurred despite a sharp and probably anomalous drop from March to April. (Preliminary data indicate a rise in May above the March level.) To moderate the expansion of aggregate demand, Federal and local governments have postponed expenditures, thus preventing an appreciable rise in public sector outlays.

The German authorities remain concerned about inflation, particularly since the German boom has moved into the state of cost-push inflation. Unit labor costs in industry, which had been falling steadily from early 1967 to mid-1969, in January-April, 1970, were 12 per cent above the level of the corresponding period in 1969. And upcoming wage negotiations in autumn are likely to involve further large increases as labor seeks to hold its real share of national income.

Retail prices in May were about 4 per cent higher than a year ago and producers' prices for industrial products were up 6 per cent.

The need to give some credibility to the projected lessening of the rate of inflation -- which in Germany will play an important role in the wage negotiations -- may have led those German officials who feel that the boom has already passed its peak to agree to the need, nevertheless, for the new anti-inflationary measures. Early in July, the government attempted to shift private expenditures from this year into next by suspending accelerated depreciation allowances through January 1971, and by imposing a 10 per cent prepayment on personal and corporate income taxes. The cumulative effect of these restrictive measures should slow the advance of both real growth and inflation during the balance of the year. The deceleration is not likely to be great, however, in view of the backlog of orders and the likelihood that wage increases will continue to be substantial.

Now that fiscal policy has been made more restrictive, the German authorities also have more latitude to change the fiscal-monetary policy mix. On July 15, the Bundesbank reduced the discount rate from 7 1/2 to 7 per cent and the "Lombard" rate from 9 1/2 to 9 per cent.

In France, the volume of economic activity in 1970 has exceeded earlier expectations, because of unexpectedly high investment and export demand. Benefiting from the devaluation of the franc, the value of French exports rose at an annual rate of about 40 per cent from September-December to January-April. Fixed investment, despite elimination of special tax benefits last year, has been at so high a level thus far this year that the 1970 over 1969 increase, it has been suggested, could reach 20 per cent in real terms.

Government policies have succeeded in halting growth in consumption, however. Real consumption has been running slightly below the levels of last spring; and during 1970, consumer outlays have been flat, indicating a decline in volume.

Acknowledgment that the Government had underestimated the strength of aggregate demand in France came in May, when Finance Minister Giscard d'Estaing announced that the 1969 to 1970 increase in GNP was now expected to be 6 per cent (real terms), rather than 4 per cent, as forecast in October. Industrial production during the first four months of the year was almost 4 per cent higher than in the last four months of 1969. Inflation has also been higher than anticipated last autumn, with consumer prices, for example, having risen at an annual rate of 6 per cent this year as compared with the 4 per cent annual rate predicted in October.

There are some indications that the economy is cooling off. A mid-June INSEE poll indicates that a majority of businessmen expect a marked slowdown in activity in the second half of the year. This may explain why the authorities eased credit restrictions at the beginning of July and then released the equivalent of \$200 million of the anti-cyclical fund for public works expenditures in the second half of this year. Since last fall, both monetary and fiscal policy have been tight, the only previous instance of relaxation having been a slight easing of stringent installment buying regulations in February.

Recovery in Italy from the sharp drop in economic activity last autumn -- when production was crippled by strikes -- has been below expectations. Industrial production, which in the fourth quarter plunged 11 per cent below the peak level of June-July 1969, rose only 3 per cent above that peak in the first quarter. There was a sharp rebound in January, but this was followed by a leveling off in February and March.

The economy's disappointing performance appears to have been the result of the following factors, none of them related to lagging demand: (a) additional strikes, notably in textiles and electric power; (b) difficulties experienced by some firms in adjusting to a new shorter work week; (c) difficulties, particularly in steel, in putting equipment back into operation; and (d) insufficient capacity in some industries, causing production problems elsewhere.

Underlying demand appears to be strong. Consumer expenditures should receive considerable impetus from the large wage settlements of recent months, most of which were effective January 1 but some of which took effect in March. Minimum contractual wage rates in manufacturing rose by 12 per cent from December to March, to a level 22 per cent above a year earlier. Expenditures for plant and equipment are believed to be rising quite strongly, but so far there does not seem to have been any rebuilding of strike-depleted inventories.

Exports rose sharply in January, but fell below the January level in the following three months. In March-April, they were only 5.7 per cent above a year earlier, a small increase compared with other European countries. Export growth has lagged because of supply shortages, and imports have grown at a healthy pace both because of a shortage of domestic supply and rising aggregate demand.

Gross domestic product in the United Kingdom fell by 1 per cent in real terms from the fourth to the first quarter, reversing a rise of slightly over 1 per cent from the third to the fourth quarter. The decline was attributable to a drop in industrial investment, which was off by about 3 per cent in manufacturing and about 4 per cent in the distributive and service industries. Personal consumption expenditures, exports, government expenditures and inventory accumulation (all in real terms) were virtually flat between the two quarters. Sketchy data for the second quarter suggest little, if any, gain in total output has taken place since the first quarter.

The fall in investment, which surveys of businessmen's intentions early in the year had indicated would rise appreciably this year, is attributable to the lack of bank credit and high interest rates, which have discouraged new securities issues. The failure of real consumption to expand despite an extremely rapid rate of increase in wage and salary earnings is a reflection of how closely price rises have been keeping pace with wage rises. Weekly wage

rates rose by 3.6 per cent from December to May; consumer prices in the same period rose by 3.8 per cent. Economic activity has also been retarded by an unusually large number of strikes.

Economic growth is likely to resume in the second half, though the rate of increase may be below the 3.5 per cent annual rate forecast by the late Labor Government in its April budget presentation. Investment may remain depressed, but, judging by data on orders, exports should increase. And, with prices likely to rise less rapidly in the coming months for seasonal reasons, a pickup in real consumption is to be expected also.

It is unlikely that the government will significantly stimulate demand in the immediate future. The Conservatives owe their election victory in large measure to their attacks against inflation under Labor. They are thus in a position where they must do something about inflationary cost pressures before they can risk any substantial easing of fiscal and monetary policy.

The Japanese economy appears to have grown in the first half at about the 11 per cent rate achieved during 1969. Industrial production in January-May was 10 per cent above the same period in 1969. Both consumption and investment demand have remained strong. Exports have increased this year at a rapid rate, though somewhat more slowly than last year.

There is evidence that the tight money measures instituted in September are at last having some impact. Credit expansion has slowed slightly, bankruptcies have increased, and prices have recently either been advancing at a slower rate or have actually fallen. The rate of growth in total output may be slightly lower during the balance of the year.

Real Canadian GNP increased by almost 7 per cent, annual rate, from the fourth to the first quarter. The main source of growth was exports, which rose in real terms by 36 per cent, annual rate, from the preceding quarter. The surge in exports was attributable mainly to strong demand for raw materials by industrialized countries. The other important contributor to expansion was current government expenditures, which were up, in real terms, by about 16 per cent, annual rate, from October-December.

Real consumer expenditures, on the other hand, declined -- by about 3 1/2 per cent -- as did real gross fixed investment -- off by 16 per cent, both figures at annual rates. In the investment sector both business plant and equipment spending and outlays on residential housing dropped.

Preliminary data for the second quarter indicate that there was little change in total output from the first quarter. Consumption expenditures appear to have remained about the same, while rises in government spending and business capital investment were roughly offset by decreases in housing and exports.

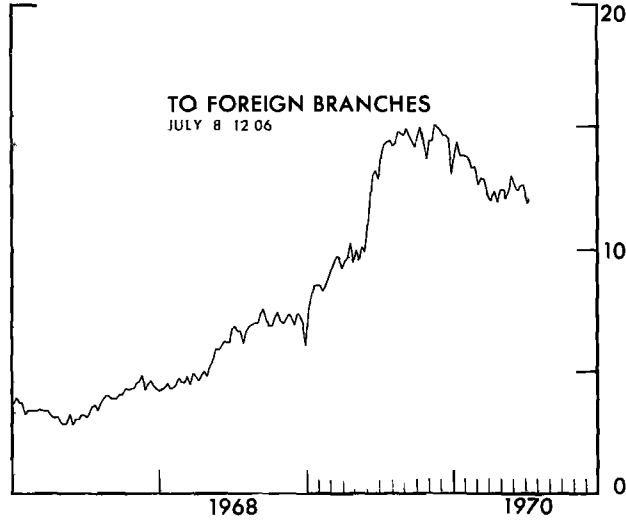
Indicative of flattening out in economic activity was a marked decline in bank loans from February to May, despite a move by the authorities in the direction of monetary ease. A pronounced slowdown in the rate of increase in prices in recent weeks also implies that a slowdown is taking place.

The economy is likely to follow a level course during the third quarter. Assuming no decline in U. S. demand, increased consumer expenditures and a rise in residential construction -- owing to the availability of more mortgage funds because of easier money -- may lead to an upturn in the latter part of the year.

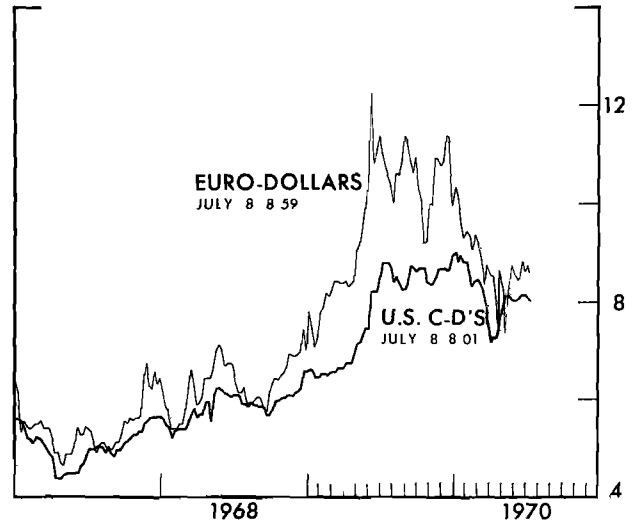
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

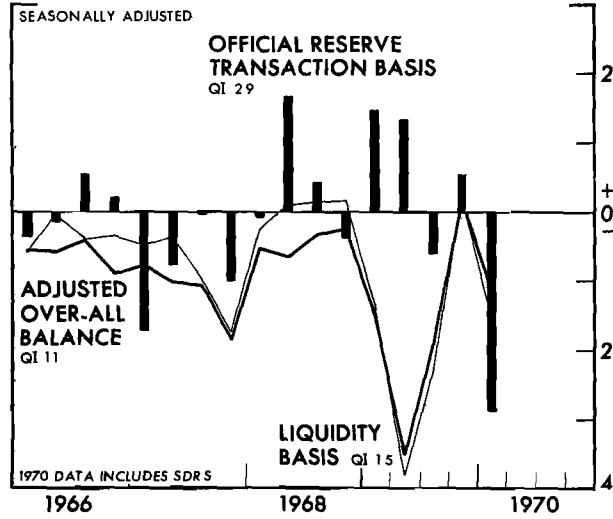
US BANK LIABILITIES



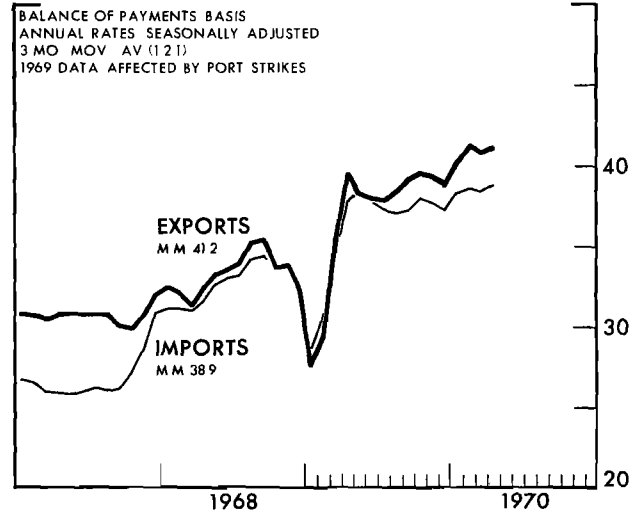
90-DAY RATES



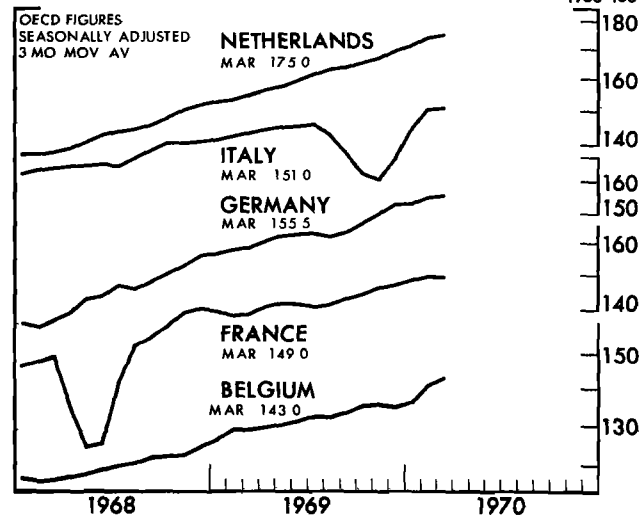
U.S. BALANCE OF PAYMENTS



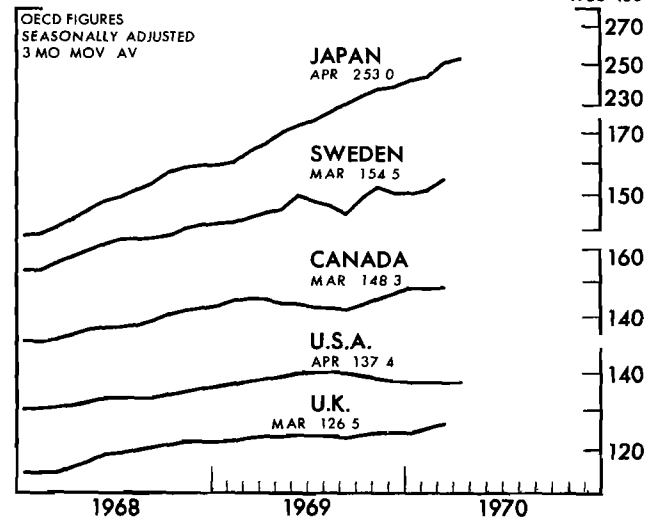
US MERCHANDISE TRADE



INDUSTRIAL PRODUCTION EEC COUNTRIES



INDUSTRIAL PRODUCTION OTHER COUNTRIES



APPENDIX A: SUMMARY AND ANALYSIS OF THE EMERGENCY HOME FINANCE ACT
OF 1970*

On June 25, the House of Representatives passed its version of the Emergency Home Finance Act of 1970 (H.R. 15495). The Senate, almost two months earlier, had passed a somewhat different version of the same Act (S. 3685). With the Senate-House Conference Committee now attempting to resolve the differences between the two measures, the staff felt that a summary of the major provisions of the Acts and a brief analysis of their possible impact on the mortgage and housing markets would be in order.

Taken together, the major provisions of the Emergency Home Finance Act of 1970 appear to promise only marginal additional support to the mortgage market in the short run. Although the ultimate long-run impact of the Act is at this time difficult to predict, its potential may be quite significant. Changes in the institutional framework as well as greater standardization of conventional mortgages and establishment of secondary trading facilities should improve both the primary and secondary market for such loans. However, the final benefit derived from the Act will depend in large measure on the extent to which FMA develops its role in the conventional mortgage market and on the willingness of the Congress to expand and extent the Title V provisions.

The following are considered to be the five most important provisions of the Proposed Emergency Home Finance Act of 1970: 1/

* Prepared by Fred Taylor, Economist, Capital Markets Section, Division of Research and Statistics.

1/ In addition to these five major provisions the acts also provide for (a) an increased appropriation to GNMA, (b) the extension of the flexible rate authority of FHA and VA mortgages, (c) the establishment of a Special Advisory Commission on Housing, (d) prescribed standards to govern the establishment of locally uniform settlement costs, (e) changes in the geographic limitation of S&L business activity, as well as lesser provisions dealing with S&L's, national banks, and a number of technical changes in the National Housing Act.

Title I - (In both the House and Senate versions) Reduction of Interest Charges for Members of the Federal Home Loan Bank System.

Authorizes the appropriation of \$250 million to the Federal Home Loan Bank Board for the purpose of subsidizing the interest rate on either short- or long-term FHLBank advances. The FHLBB is to establish the amount of the subsidy and the maximum rate at which system members may relend these funds. The loans made by savings and loan associations using these subsidized funds would be limited to either new or used residential structures for low and middle-income families. The maximum loan amounts would correspond to the limits applicable to mortgages under the FHA Section 203(b) or 207 (for a single family unit the current level is \$33,000). Each FHLB District would be limited to no more than 20 per cent of the funds appropriated.

According to a Federal Home Loan Bank Board estimate, the implementation of the \$250 million subsidy program could provide financing for an additional 240,000 new and existing dwellings over the balance of this year. However, given the current improved rate of savings inflows to S&Ls, the fact that associations holding only about 20 per cent of the industry's total assets appear likely to expand their borrowing at this time, and with the peak building season passed, this estimate in the staff's views may overstate the actual gross impact of this program on the short period left this year. Moreover, in view of the fact that a number of associations are unable to lend out their current inflows fully due to the low level of housing activity and buyer resistance to high interest rates, the number of associations which may be expected to take advantage of this program are limited. Finally, the net impact of the program will undoubtedly be less than gross, as financing is shifted from non-eligible to eligible loans.

Although we feel that the program's immediate potential is below that forecast by the FHLBB staff, any real analysis is not now possible because the Federal Home Loan Bank Board has not as yet developed a plan to implement this section of the Emergency Home Finance Act.

Title II - (In both the Senate and the House Acts) Authority for the Federal National Mortgage Association to provide a secondary market for conventional mortgages.

This title amends the National Housing Act to permit FNMA to deal in conventional residential mortgages within certain established limits. These limits include (1) the size of the mortgage purchased may not exceed the limits applicable to FHA Section 203(b) or 207 (\$33,000) and (2) no more than 10 per cent of the conventional mortgage portfolio can be comprised of loans originated more than one year prior to the FNMA purchase date. Furthermore, the outstanding principal balance of any mortgage may not be greater than 75 per cent of the assessed value of the property unless (a) the seller retains at least a 10 per cent participation in the loan, (b) the seller agrees to repurchase or replace the mortgage if a default occurs within three years of the purchase date, or (c) any unpaid principal in excess of 75 per cent is underwritten by a qualified private insurer.

It is now anticipated that any short-run impact of the FNMA move into the conventional market will be delayed by the reluctance of HUD and FNMA officials to enter this market at this time. Moreover, FNMA must establish the initial machinery, as well as minimum mortgage purchase requirements, in order to implement their activity in this area. In addition to the delays, FNMA seems likely to be unwilling to purchase conventional mortgages in approximately 20 states because of current usury laws which preclude FNMA from receiving a positive yield spread in relation to their average borrowing costs.

Although this program currently appears limited, it may possess the potential to have an important salutary influence on the level of mortgage activity in the long run. However, much will depend on the emphasis FNMA attaches to this segment of its operations, as well as the corporations' future budget limitations. In any event, FNMA's entrance into the conventional mortgage market should help to standardize the conventional mortgage. Once FNMA establishes minimum purchase requirements for conventional home loans, such standards may well be adopted by a major portion of the nation's lenders. As a result, trading in conventional home loans should be made somewhat easier, to the extent that the heterogeneity of the conventional mortgage resulted from lender actions and not from State laws.

Title III - (Included in both the House and Senate versions)
Federal Home Loan Mortgage Corporation

Established the Federal Home Loan Mortgage Corporation under the control of the Federal Home Loan Bank Board to operate in the secondary market for conventional residential mortgages. The Corporation is to be financed through the sale of capital stock to the FHL Banks (up to \$100 million), through its independent authority to borrow, and through the issuance of GNMA mortgage-backed securities. The limitations on the type of loans eligible for purchase by the Corporation from an insured institution are the same as those prescribed for FNMA under Title II.

In developing the framework of the Federal Home Loan Mortgage Corporation (FHLMC), the Federal Home Loan Bank Board faces short-run problems similar to those confronting FNMA. However, the FHLMC may be somewhat more inclined than FNMA to absorb a lower yield spread, caused by the restrictive state usury ceilings, in order to support the conventional mortgage market.

In the initial stages of its operation the FHLB Board will transfer to the Corporation the FHLBanks' program of buying Government underwritten mortgages from member institutions in order to market GNMA mortgage-backed securities. However, this program, which is designed to attract funds from non-traditional mortgage sources, may be restricted in the future by the limited quantity of qualified loans held by the associations.

Through its participation in the conventional mortgage market, the FHLMC, as with FNMA, is expected to encourage standardization of the conventional mortgage instrument. The Corporation's activity in the conventional market may also stimulate some savings and loans, which in the past have failed to take advantage of the FHLBank advances, to increase their local lending activity through the sale of loans to the Corporation. Thus, by the use of the mechanism of the Corporation, the FHLB Board will in future periods of reduced mortgage credit availability be in a somewhat better position to pump funds directly into the conventional home loan market. Because the FHLMC has no resources to provide funds to support its activity, any massive support by the Corporation would have to be financed through the sale of a large volume of its securities. Although this could increase pressures in the capital markets and may result in raising the interest rates on all housing-oriented Federal agency

issues, perhaps bringing about some disintermediation at the thrift institutions, the offset would not be complete.

Title V - (In the Senate measure only) Funds for financing middle-income housing.

Provides an initial appropriation of \$60 million to subsidize the purchase of mortgages for middle-income by FNMA and the Federal Home Loan Mortgage Corporation. The appropriation is to be increased by an additional \$60 million in each of the two following fiscal years, up to a maximum annual allotment of \$180 million in fiscal 1973. Appropriations in subsequent years would fund subsidy payments on those loans purchased, up to the maximum \$180 million annual level, and could continue for up to 30 years. The interest rate paid by the borrower would be derived by applying 20 per cent of family income toward the payment of principal, interest, taxes, property insurance, and mortgage insurance premiums, but in no case less than 7 per cent, including all discounts. The interest subsidy payments to FNMA and the FHLMC would equal the difference between the amount of interest collected from the mortgages per quarter and the amount of interest the investor (FNMA or the FHLMC) would have received had the yield been equal to the agency's average borrowing costs in the preceding quarter, (plus a fee to cover the administration costs if the Secretary of HUD deems this necessary). The subsidy payments would be adjusted quarterly, over the life of the mortgage, to reflect changes in the institution's average borrowing cost. In order to qualify for a loan under this program, the income of the family could not exceed the median income of the area in which the property is located. Down payments for all loans, whether FHA or conventional, would comply with FHA requirements (3 per cent on the first \$15,000 of property value; 10 per cent of value between \$15,000 and \$25,000; and 20 per cent of value in excess of \$25,000). The program would be limited almost entirely to new one-family or condominium housing units with an appraised value of \$30,000 or less. No new purchases could be made by FNMA or the FHLMC after June 30, 1973.

The "Proxmire" proposal would indeed allow a number of below-the market rate loans to be made to low-to-middle income families, subsequently purchased by either FMA or the FHLMC. This Title does not increase the ability of either institution to raise the volume of their purchases. However, since the borrower's income limits for these loans are relatively liberal (not in excess of the median income of the area in which the property is located) and the funds available modest, the complex problem of rationing will arise.

The subsidy payment formula which is based on the average borrowing cost to the Agency in the preceding quarter increases the cost of the program to these Agencies in periods of rising rates. In basing the formula on the average borrowings costs instead of the marginal cost, the program further understates the cost to the purchasing institution. As a result of the additional costs which the corporation would have to absorb to accommodate this program during periods of rising borrowing rates, the net result could be an actual reduction in the volume of loans purchased during these periods. However, if agency borrowing costs decline over the longer run, the reverse effect would occur, increasing the funds available for mortgage purchases by the two agencies involved. Here again the long-run potential of this Title may exceed its short-run impact, depending upon what the Congress decides to do.

**Title VII - (In the House passed Act only) Investment
of Commercial Bank Reserves.**

Amends the Federal Reserve Act to give the Federal Reserve Board discretionary authority to allow member banks to invest a designated portion of their required reserves in Federal agency obligations issued to finance construction or mortgage loans on residential properties.

As formulated, this provision of the Act is likely to provide little additional support to either the mortgage or housing markets. Because Federal agency issues are good substitutes for Treasury and other securities, as a consequence of even a very small drop in their yield brought on by the expansion of member banks purchases, other investors would shift from housing-oriented securities and into substitute assets. Although banks would be willing to accept any positive yield on these reserve assets, even a minimal decline in their yield, below existing market rates, should cause other

investors to relinquish their participation in this segment of the capital market. Therefore, since the volume of securities offered will depend not only on the yield required but also the agency's desire to support the housing and mortgage markets, the probable end result of this Title would be the creation of a subsidy for commercial banks, with only a minimal reduction in the interest rates paid by Federal agencies which support the housing market. Because of the limited reduction in the rates which are expected, this Title should have only a marginal impact on the inflows of thrift institutions.

If we assume that member banks would acquire agency securities as reserve assets up to the limits specified by the Board, then in subsequent periods of monetary restraint--when reserves rise slowly--the banks would be able to acquire only a small amount of these securities as reserve assets. If the Board authorized a change in the ratio of agency issues to total required reserves this could offset to some extent the slow growth. However, since the System would presumably wish to maintain the same overall growth in total reserves, the increased bank purchases of agency securities would be at the expense of banks acquiring other assets--including mortgages.