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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

February 3, 1971

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SUMMARY AND OUTLOOK

Nonfinancial

Recent data support the expectation of a very large rise in GNP this quarter--reflecting a post-strike surge in auto production, a sharp rise in residential construction, and (to a lesser extent) a stockpiling of steel as a hedge against a possible strike. We are now projecting a first-quarter rise in real GNP at an annual rate of about 6 per cent, following the 3.3 per cent decline of the fourth quarter.

Industrial production is tentatively estimated to have increased about 1 point in January, to a level 2 per cent above the November 1970 low. The January rise is attributable to autos and steel. Auto sales have increased appreciably, but less than expected, and production schedules for February have been cut back. Other retail sales are estimated to have remained at about the December level, which was above the fourth-quarter average.

Virtually all of the December rise in manufacturers' new orders for durable goods was also attributable to autos (where orders and shipments are taken as equivalent) and steel. Book value of manufacturers' inventories declined in December following two months of sizable increases. For the fourth quarter as a whole, manufacturing inventories rose as rapidly as in the previous quarter. Ratios of inventories to sales and to unfilled orders declined in December, but generally remained at high levels.

Progress on the price front has been limited and irregular, with occasional reversals. In January, seasonally adjusted wholesale prices of farm products and foods rose sharply after a sustained decline, but the rise in industrial prices was small. The consumer price index rose sharply in December, following a marked slowing of the advance in November. The rate of increase in the GNP deflator for private product appears to have changed little since late 1969, after allowing for fluctuations in the composition of product.

Outlook. The staff's current projections of a first-quarter rise of $26 billion in current dollar GNP and an increase at an annual rate of 6 per cent in real GNP, are both below the preceding projections. Over the fourth and first quarters together, real growth is expected to be at an annual rate of only about 1.5 per cent.

The latest projections for 1971 incorporate an allowance for a sizable build-up of steel stocks--especially in the second quarter--in anticipation of a possible strike; a depletion of steel stocks in the third quarter as a result of a strike, which is assumed to last two months; and a rebuilding of stocks in the fourth quarter. The resulting quarterly pattern of GNP change is uneven. The sharpness of the projected rise in fourth-quarter GNP is largely due to the steel strike assumptions, just as the projected bulge in the first quarter reflects the rebound in autos.

The average rate of expansion in real GNP over the last half of the year is now projected at 3.7 per cent, compared with 3.0 per cent in the last Greenbook. The faster growth is concentrated in the Federal and consumer sectors. In line with the new budget, Federal purchases are shown as rising more in the second half of the year than we had formerly assumed, following a sharper-than-expected decline in the first half. Consumer spending in the second half also is expected to increase somewhat faster than projected earlier.

Despite this slightly stronger outlook, the projected increase in real GNP over the course of the year still falls short of the economy's growth potential, indicating a probable further rise in the unemployment rate and a continued low rate of manufacturing capacity utilization. Costs are expected to rise appreciably further, even with resources in ample supply, and we anticipate that the GNP deflator will still be rising at an annual rate of about 3.5 per cent in the fourth quarter.

Financial

Market expectations of declining interest rates -- which had weakened briefly in late December -- were renewed early in January by the quick succession of cuts in the bank prime and Federal Reserve discount rates and System open market actions to ease money market conditions. As expectations strengthened, financial institutions moved aggressively to put seasonally enlarged supplies of funds to work. In consequence, the heavy continuing volume of new corporate and municipal

security offerings was absorbed at sharply reduced interest rates, and the Treasury received an excellent response to its large February refinancing and pre-refunding. Further rate declines over the month ranged roughly from 1/2 to 1 1/4 percentage points in short-term markets and from 3/8 to 7/8 of a percentage point in long-term markets. But around month-end, investors began to resist additional rate declines, underwriters' inventories of recently offered new issues began to accumulate, and yields in some markets tended to back-up.

Bank efforts to stimulate the demand for business loans appear to have had some success in January. Even so, bank funds continued to be readily available for investment in Treasury and State and local government securities. Although private demand deposits at banks grew significantly less in January than in December, time deposit expansion continued at a rapid pace, particularly in consumer-type accounts which became relatively more attractive as market rates declined sharply. Some banks, in fact, attempted to dampen the pace of savings inflows by reducing rates being paid on various types of consumer accounts. And over the month as a whole markdowns of CD offering rates were generally larger than those on Treasury bills.

Widening rate spreads also stimulated record fund flows to non-bank thrift institutions, thereby contributing to further cuts of mortgage rates in a number of areas of the country. And with the supply of new

mortgages still limited, savings banks continued to be fairly active bidders for new corporate securities. Even life insurance companies reportedly increased their interest in business securities, both in the market and on commitments for private placements. Undoubtedly this reflected a continuation of the slower growth in policy loans and the increased flows of repayments on life company loans and investments evident in December.

Outlook. Over the months immediately ahead borrowing pressures on securities markets may slacken a bit. From now until mid-year the Federally sponsored housing finance agencies are expected to be net debt repayers amounting to possibly $2 billion. With respect to U.S. Treasury borrowing, Board staff projections indicate net cash borrowing of only about $1 billion between now and mid-year, although the Treasury normally repays debt, net, over this period. Even though State and local governments will very likely continue to borrow in record volume--because of their heavy backlog of unsatisfied financing needs--their monthly borrowing totals are likely to average closer to $2 billion over the next month or two than to the $2.6 billion January figure, which was swollen by a bunching of large negotiated offerings.

As for business borrowers, the February volume of capital market financing is likely to be at least as large as in January. But looking beyond February, most forecasters are less sure of borrowing

magnitudes since bank efforts to renew business lending are expected in time to encourage the substitution of bank for capital market financing.

The projected rapid growth of GNP during the current quarter is still expected to add to demands for money and for credit, including consumer credit and business loans at banks. With short-term credit financing substantial--assuming near-term Treasury cash financing in bills--downward pressures on short-term market rates may be moderated. Long-term rates may back up a little over the short-run, but once the current congestion in intermediate and long-term markets is worked out, bond yields are more likely to drop somewhat further, given the historically wide spread of long and short-rates and the possibility of some slackening in demands for long-term credit as the quarter progresses.

International developments and the balance of payments

The hoped-for benefits for the balance of payments from the cooling off of demand in the United States have been considerably eroded by the easing in foreign demands for industrial materials and machinery in the course of the second half of last year. The U.S. trade surplus, which had run at about a $3 billion annual rate during the spring and summer of 1970, was down to below a $1 billion rate in the fourth quarter. With the resumption of output of autos and components, and with increasing aircraft deliveries, exports should rise somewhat more

than imports in the first quarter, but otherwise the export outlook is not bright. Monetary policy in both Germany and Britian is still strongly oriented toward the aim of checking inflation, and measures to stimulate expansion are still being held in reserve. In many other countries reductions in discount rates have been made in recent weeks.

U.S. imports dipped in December when auto arrivals from Canada were belatedly affected by GM's work stoppage at Canadian plants, but this pause is now over. In coming months steel imports will grow in anticipation of a U.S. steel strike.

The over-all balance of payments in the fourth quarter showed a deficit on the liquidity basis of the same order of magnitude ($3 billion annual rate) as in the third quarter, and a record deficit on the official settlements basis ($3-1/2 billion seasonally adjusted for the single quarter). On the liquidity basis the balance was kept from worsening by the substantial repatriations, more or less as expected, of corporate funds at the year-end; these were handled to a considerable extent through U.S. bank branches, reducing the liabilities of U.S. banks to the branches.

In the present quarter, renewed outflows of corporate funds will tend to offset whatever short-run improvement is occurring in trade. Interest rate differences between U.S. and other financial markets will continue to inhibit capital inflows and stimulate outflows, while stock market advances would attract further foreign buying of equities, already large in December. Thus, no marked change in either direction is looked

for in the first-quarter liquidity balance. January data on reserves and liquid liabilities are not inconsistent with this picture, though they are hard to interpret because of the irregularity of seasonal variations in recent years.

The outflow of repayments by U.S. banks to their branches abroad became a flood last November, but since then has slowed markedly as a result of measures taken by the Federal Reserve and the Export-Import Bank. Total liabilities to the branches of the head offices plus those of the Export-Import Bank showed little net change from the end of December to the end of January. In view of international interest rate relationships, some resumption of the runoff is to be expected in coming months.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1970				Per Cent Change* From		
	Sept.	Oct.	Nov.	Dec.	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	83.0	83.4	83.4	83.4	0.1	0.5	2.3
Unemployment rate (%)	5.5	5.6	5.8	6.0	--	--	[3.5] 4/
Insured unempl. rate (%)	4.1	4.4	4.4	4.0	--	--	[2.3] 4/
Nonfarm employment, payroll (mil.)	70.5	70.2	70.1	70.4	0.4	-0.2	-0.7
Manufacturing	19.3	18.7	18.5	18.9	2.0	-1.9	-5.8
Nonmanufacturing	51.2	51.5	51.5	51.4	-0.2	0.4	1.3
Industrial production (57-59=100)	165.8	162.3	161.6	163.9	1.4	-1.1	-4.2
Final products, total	163.1	159.9	159.3	161.8	1.6	-0.8	-4.0
Consumer goods	160.1	157.0	156.8	160.5	2.4	0.2	-0.1
Business equipment	182.3	178.9	178.1	178.6	0.3	-2.0	-7.8
Materials	168.9	165.0	164.0	165.7	1.0	-1.9	-4.7
Capacity util. rate, mfg.	74.6	72.3	71.8	72.7	--	--	[80.9] 4/
Wholesale prices (57-59=100) 1/ 5/	117.8	117.8	117.7	117.8	0.6	0.6	2.2
Industrial commodities (FR)	116.3	117.2	117.2	117.5	0.3	1.0	3.5
Sensitive materials (FR)	114.0	113.0	111.3	110.6	-0.6	-3.0	-3.7
Farm products, foods & feeds 6/	118.5	116.0	115.6	115.0	1.3	0.4	-1.5
Consumer prices (57-59=100) 1/	136.6	137.4	137.8	138.5	0.5	1.4	5.5
Food	133.3	133.0	132.4	132.8	0.3	-0.4	2.2
Commodities except food	123.8	125.0	125.7	126.1	0.3	1.9	4.8
Services	157.7	158.5	159.5	160.4	0.6	1.7	8.2
Hourly earnings, pvt. nonfarm ($)	3.27	3.27	3.28	3.31	0.9	1.2	5.8
Hourly earnings, mfg. ($)	3.42	3.37	3.39	3.44	1.5	0.6	5.2
Weekly earnings, mfg. ($)	133.96	132.92	134.04	136.22	1.6	1.7	2.6
Net spend. weekly earnings, mfg. (3 dependents 57-59 $) 1/	85.83	84.19	84.60	86.37	2.1	0.6	-1.9
Personal income ($ bil.) 2/	812.0	809.9	812.6	817.8	0.6	0.7	5.6
Retail sales, total ($ bil.)	30.9	30.5	30.2	30.6	1.4	-0.9	4.0
Autos (million units) 2/	7.1	6.1	5.0	5.0	0.9	-28.9	-34.7
GAAF ($ bil.) 3/	8.2	8.5	8.6	8.5	-1.5	2.5	4.6
12 leaders, composite (1967=100)	114.9	114.1	114.8	116.4	1.4	1.3	-1.0
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/	1,509	1,583	1,688	1,987	17.7	31.7	41.7
Factory workweek (hours)	39.3	39.4	39.6	39.7	0.3	1.0	-2.5
Unempl. claims, initial (thous.)	342	340	334	292	12.6 7/	14.5 7/	-38.1 7/
New orders, dur. goods, ($ bil.)	29.9	28.5	29.0	30.0	3.6	0.6	-0.5
Producers capital goods indus.	6.8	6.6	6.9	6.1	-11.4	-9.9	-6.9
Common stock prices (41-43=10)	82.58	84.37	84.28	90.05	6.8	9.0	-1.2

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l. merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ January p. 118.5. Per cents indicated are to January.
6/ January p. 116.5. Per cents indicated are to January.
7/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	1970 Averages				1971	1971
	QII	QIII	QIV	Dec.	Jan.	Week ended Jan. 27
Interest rates, per cent						
Federal funds	7.88	6.71	5.57	4.90	4.14	4.23
3-mo. Treasury bills	6.67	6.33	5.35	4.87	4.44	4.19
3-mo. Federal agencies	7.09	6.67	5.50	4.94	4.37	4.14
3-mo. Euro-dollars	8.87	8.34	7.46	7.25	5.92	5.59
3-mo. finance-co. paper	7.41	7.31	6.12	5.48	5.07	4.76
4-6 mo. commercial paper	8.16	7.73	6.28	5.73	5.11	4.55
Bond buyer municipals	6.81	6.33	5.92	5.45	5.36	5.16
Aaa corporate-new issues	8.94	8.51	8.26	7.80	7.24	6.76
20-year Treasury bonds	7.14	6.96	6.57	6.28	6.18	6.05
FHA mortgages, 30-year	9.12	9.06	8.77	8.40	n.a.	n.a.

	1970				1971
	QII	QIII	QIV	Dec.	Jan. p
Change in monetary aggregates (SAAR, per cent)					
Total reserves	2.6	19.1	6.6	18.4	11.5
Nonborrowed reserves	4.1	24.4	9.4	22.8	15.0
Credit proxy	6.0	24.1	15.1	21.4	9.5
Credit proxy + nondep. funds	6.5	17.2	8.3	16.5	11.5
Money supply	5.8	6.1	3.4	6.2	3.0
Time and savings deposits	14.1	32.2	21.8	28.8	26.0
Deposits at S&L's and MSB's	6.9	10.0	11.0	13.0	n.a.
Bank credit, end-of-month 1/	6.6	13.9	6.1	12.0	12.7 e
Treasury securities	30.2	25.9	2.8	4.3	29.0 e
Other securities	11.0	20.3	34.5	35.6	32.2 e
Total loans 1/	1.4	9.8	-1.0	1.2	3.7 e
Business 1/	9.8	1.8	-9.2	-6.5	7.6 e

	1970				
	QI	QII	QIII	QIV	Dec.
Change in commercial paper ($ millions)					
Total (SA)	3,185	2,091	-4,298	- 749	881
Bank-related (NSA)	2,226	1,033	-2,985	-2,269	- 777

	1968		1969		1970	
	QIV	Dec.	QIV	Dec.	QIV	Dec.
New security issues (NSA, $ millions)						
Total corp. issues	5,950	2,054	6,840	2,532	11,601 e	3,700 e
Public offerings	4,029	1,090	5,786	2,018	10,216 e	3,000 e
State and local government bond offerings	4,366	1,115	2,998	831	5,816 e	2,214 e
Fed. sponsored agency debt (change)	568	394	2,889	545	1,985 e	889 e
Fed. govt. debt (change)	3,422	979	5,071	-2,012	8,891	3,024

n.a. - Not available. e - Estimated. p - Preliminary.
SAAR - Seasonally adjusted annual rate. NSA - Not seasonally adjusted.
1/ Adjusted for loans sold to bank affiliates.

I -- T - 3
U.S. Balance of Payments
In millions of dollars; seasonally adjusted

	1970	1 9 7 0 P				
	Year	I	II	III	IV	Dec.*
Goods and services, net 1/	3,598	832	1,104	1,021	641	
Trade balance 2/	2,200	505	829	720	146	120
Exports 2/	42,041	10,228	10,705	10,678	10,430	3,440
Imports 2/	-39,841	-9,723	-9,876	-9,958	-10,284	-3,320
Service balance	1,398	327	275	301	495	
Remittances and pensions		-328	-360	-360		
Govt. grants & capital, net		-855	-725	-759		
U.S. private capital		-1,688	-1,870	-1,339		
Direct investment		-1,411	-1,434	-759		
Foreign securities	-863	-133	66	-576	-220	-20
Banking claims	-810	145	-445	147	-657	-513
Other		-289	-57	-151		
Foreign capital		1,738	1,749	1,065		
Official foreign, liquid	7,615	3,050	466	1,509	2,590	75
Official reserve holders, nonliq.	-268	-421	506	-249	-104	-55
Other official foreign, nonliq.		-32	-198	-1		
Foreign commercial banks, liquid	-6,316	-1,865	-102	-1,414	-2,935	-1,300
New direct investment issues 3/		155	267	170		
U.S. corporate stocks	655	-85	-87	381	446	190
Other		936	897	669		
U.S. monetary reserves (inc.-)	3,344	481	1,022	801	1,040	404
Gold stock	787	-44	14	395	422	406
Special drawing rights	16	-53	-37	-34	140	110
IMF gold tranche	389	-253	227	406	9	-123
Convertible currencies	2,152	831	818	34	469	11
Errors and omissions		-182	-920	-428		
BALANCES (deficit -) 4/						
Official settlements, S.A.		-3,110	-1,994	-2,061	-3,526	
" " , N.S.A.	-10,691	-2,830	-2,061	-2,625	-3,175	-424
Liquidity, S.A.		-1,656	-1,451	-837	-762	
" , N.S.A.	-4,706	-1,548	-1,426	-1,643	-89	844
Adjusted over-all, S.A.		-1,245	-1,892	-647	-591	
" " , N.S.A.	-4,375	-1,145	-1,874	-1,461	105	876
Financed by: 5/						
Liab. to comm. banks	-6,316	-1,685	-187	-1,164	-3,280	-1,300
Official settlements	10,691	2,830	2,061	2,625	3,175	424

* 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. Preliminary Commerce Department GNP estimates show an increase of $5.4 billion for the fourth quarter--just about what we had been projecting. The gain in final sales was somewhat smaller than we had expected, largely because of a disappointing rate of consumer outlays, particularly for autos. But weaker final sales--along with the beginnings of some inventory accumulation in anticipation of a possible steel strike--resulted in a somewhat greater rate of inventory accumulation than we had anticipated.

GNP AND RELATED ITEMS, 1970
(Changes in seasonally adjusted totals at annual rates)

	Fourth quarter	
	Projection of 1/6/71	Commerce Preliminary
	-----Billions of dollars------	
GNP	5.5	5.4
Final sales	8.5	6.8
Inventory change	-3.0	-1.4
	------Per cent per year-------	
Real GNP	-2.6	-3.3
GNP deflator	4.8	5.7

Real GNP declined by 3.3 per cent, annual rate--more than expected. The implicit GNP price deflator rose very sharply, at an annual rate of 5.7 per cent compared with 4.6 per cent the previous quarter. Although there was evidence of further sharp price increases, much of this accelerated rise was the result of compositional shifts in GNP resulting from the decline in auto sales because of the GM strike--which will be reversed in the first quarter. A GNP deflator with fixed weights (which assumes no change in composition) rose at a 5.0 per cent annual rate last quarter, up from a 4.7 per cent rate of increase in the third quarter.

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rates)

	First Quarter		Second Quarter	
	Projection of 1/6/71	Current projection	Projection of 1/6/71	Current projection
	---------------Billions of dollars		----------------	
GNP	29.0	26.4	15.5	19.4
Final sales	28.5	29.7	14.5	14.7
Personal consumption	17.9	18.7	11.0	12.8
Residential construction	2.7	4.4	1.3	1.8
Business fixed investment	2.0	2.1	-1.0	- .5
Net exports	1.4	1.8	.0	-1.0
Federal purchases	1.5	- .1	- .3	-2.1
State & local purchases	3.0	2.7	3.5	3.7
Inventory change	.5	-3.3	1.0	4.7
	---------------Per cent per year		----------------	
Real GNP	7.0 1/	6.1 2/	2.2	3.7
GNP deflator	4.6	4.5	3.9	3.9

1/ Excluding effects of Federal pay increase, 3.8 per cent per year.
2/ Excluding effects of Federal pay increase, 3.6 per cent per year.

We continue to anticipate a substantial post-strike rebound in GNP in the current quarter, although we have scaled the projected increase down somewhat--to about $26-1/2 billion--from the $29 billion projected in the last Greenbook. Major impetus for the upsurge is the anticipated recovery of auto production and sales from the strike-depressed fourth quarter level. The rate of sales of domestic autos projected for the first quarter is not particularly high--in fact, we have revised our estimate down slightly to an annual rate of 8.3 million units. But the gain in sales of domestic makes from the fourth quarter, nevertheless, implies about a $10 billion pickup in consumer expenditures for autos. Thus, even assuming a rather modest rate of growth in other consumption expenditures, total outlays by consumers are expected to rise about $18-1/2 billion.

Of the remaining $11 billion growth in final sales projected for this quarter, a strong gain in residential construction outlays accounts for almost $4-1/2 billion. A post-strike rebound in purchases of motor vehicles by business, some recovery in net exports from the weak fourth quarter rate and a slightly faster rate of growth of State and local purchases than in the fourth quarter account for the remainder of the increase.

Such economic evidence as is currently available appears to support these projections. While the performance of auto sales was not up to expectations, the rate was improving during January, and at mid-month unit domestic sales were at a 7.9 million annual rate. Retail

sales, apart from autos, apparently showed little change in January, but they held at the advanced December level, which was above the fourth quarter average. In residential construction, the surprisingly sharp increases in new housing starts and permits in December suggest an even larger increase in outlays for this quarter than we had previously expected.

In contrast to the large rise in final sales, we now anticipate a decline in inventory investment this quarter to an annual rate of less than $1 billion. Inventory totals are being affected by several opposing forces: on the one hand, dealer auto stocks are being rebuilt by GM to more normal levels, and somewhat disappointing auto sales may be reflected in larger stocks of other makes, although production cuts already in effect or announced should limit any unintended accumulation. In addition, the recent rise of orders suggests a further accumulation of steel inventories as a hedge against a possible strike on August 1. (We had formerly excluded any allowance for hedge-buying of steel from our projections in order to minimize distortions of the underlying economic picture.) On the other hand, already high inventory-sales ratios moved further out of line in some key sectors in the fourth quarter as a result of sluggish final sales; we anticipate some determined efforts to reduce these ratios. The continued decline in defense spending should also be reflected in further reductions in inventories of these products.

In real terms, the expected first quarter increase in GNP would total about 6.0 per cent, annual rate. However, taking the fourth and first quarters together--to neutralize, roughly, the impact of the GM strike--the average quarterly increase in real terms would average about 1-1/2 per cent, at an annual rate, slightly less than we had projected a month ago.

Growth of GNP should drop back sharply in the second quarter. However, we are now projecting a somewhat larger increase than formerly, reflecting expectations of an accelerated pace of inventory accumulation following achievement of a better balance between stocks and sales in the first quarter, along with a step-up in acquisition of steel stocks as the contract expiration date nears. Consumer expenditures are also expected to be bolstered by an assumed 10 per cent increase in Social Security benefits made retroactive to the beginning of the year, and the recent high level of starts indicates larger outlays for residential construction. But these extra gains would be offset in part by the continued decline in Federal defense purchases indicated for this period by the new Budget. In summary, we are now projecting a GNP increase of about $19-1/2 billion for the second quarter--in real terms, a rise of 3.7 per cent, annual rate.

We have assumed that the pattern of activity in the second half of 1971 will be strongly affected by a steel strike, beginning August 1 and lasting approximately 60 days. About 350,000 - 400,000 workers would likely be affected directly by such a walkout. Based

upon past experience it appears that production of autos, appliances and machinery can be maintained; pre-strike inventory accumulation will be augmented by continued production of steel companies not affected by the strike and by some increase in imports. The major impact of the strike would thus be a sharp reduction in the rate of inventory accumulation in the third quarter with a rebound in the fourth.

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rate)

	Third Quarter		Fourth Quarter	
	Projection of 1/6/71	Current Projection	Projection of 1/6/71	Current Projection
	---Billions of dollars---			
GNP	16.5	13.8	17.5	25.0
Final sales	16.0	18.3	17.0	20.0
Personal consumption	9.8	11.9	11.1	12.0
Residential construction	1.1	.7	1.2	.5
Business fixed investment	.5	.7	.5	1.3
Net exports	.0	- .5	.0	.5
Federal purchases	.6	1.3	.2	1.7
State & local purchases	4.0	4.2	4.0	4.0
Inventory change	.5	-4.5	.5	5.0
	---Per cent per year---			
Real GNP	2.7	1.5	3.2	5.9
GNP deflator	3.6	3.8	3.4	3.6

Overall, we are now projecting a somewhat stronger second half than formerly. The new Budget calls for a turn-up in both Federal defense and nondefense purchases after midyear, and some increase in capital outlays appears likely as a result of the recent liberalization of

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1970p	1971 Proj.	1970 III	1970 IVp	1971 Projection I	II	III	IV
	-----------------	Billions	of dollars	-----------------				
Gross National Product	45.4	68.2	14.4	5.4	26.4	19.4	13.8	25.0
Inventory change	-4.9	-0.3	2.4	-1.4	-3.3	4.7	-4.5	5.0
Final purchases	50.3	68.5	11.9	6.8	29.7	14.7	18.3	20.0
Private	42.0	57.8	9.3	4.6	27.1	13.1	12.8	14.3
Excluding net exports	40.3	57.8	9.2	6.1	25.3	14.1	13.3	13.8
Net exports	1.7	0.0	0.1	-1.5	1.8	-1.0	-0.5	0.5
Government	8.3	10.7	2.6	2.2	2.6	1.6	5.5	5.7
GNP in constant (1958) dollars	-2.8	17.1	2.5	-6.1	11.0	6.8	2.7	10.8
Final purchases	1.3	17.5	0.9	-5.0	13.7	3.0	6.4	6.7
Private	7.3	20.1	1.6	-4.9	15.2	3.6	4.4	4.6
	-----------------	In Per Cent	Per Year	-----------------				
Gross National Product	4.9	7.0	6.1	2.2	10.7	7.6	5.5	9.5
Final purchases	5.5	7.0	4.9	2.8	12.0	5.8	7.1	7.6
Private	5.9	7.7	5.0	2.4	14.2	6.6	6.4	7.0
Personal consumption expenditures	6.8	7.8	5.0	3.5	11.9	7.9	7.2	7.2
Durable goods	-0.7	7.7	-3.0	-25.4	40.3	6.4	6.3	6.2
Nondurable goods	7.7	7.1	4.9	8.9	6.8	7.7	6.2	6.3
Services	8.7	8.5	8.0	8.1	8.1	8.7	8.5	8.3
Gross private domestic investment	-2.9	7.0	11.9	-2.3	9.3	17.1	-8.5	18.9
Residential construction	-7.5	29.1	11.3	38.4	55.0	19.8	7.3	5.1
Business fixed investment	3.3	1.2	3.1	-8.5	8.3	-1.9	2.7	5.0
Gov't. purchases of goods & services	3.9	4.9	4.8	4.0	4.7	2.8	9.7	9.8
Federal	-1.6	-1.9	-4.4	-0.8	-0.4	-8.5	5.4	7.0
Defense	-2.8	-5.5	-5.2	-6.3	-2.1	-12.9	-0.6	0.6
Other	2.2	10.0	0.0	15.7	5.0	5.0	22.9	24.8
State & local	9.0	10.4	12.5	7.8	8.7	11.6	12.8	11.8
GNP in constant (1958) dollars	-0.4	2.4	1.4	-3.3	6.1	3.7	1.5	5.9
Final purchases	0.2	2.4	0.5	-2.8	7.7	1.7	3.5	3.6
Private	1.0	3.5	1.1	-3.4	10.5	2.4	3.0	3.1
GNP implicit deflator	5.3	4.5	4.6	5.7	4.5*	3.9	3.8	3.6
Personal income	7.0	6.9	2.9	3.1	7.7	12.3	3.5	8.2
Wages and salaries	6.1	6.4	3.2	1.2	10.7	7.4	5.0	9.0
Disposable income	8.4	7.2	5.5	2.2	8.9	12.5	2.6	6.0
Corporate profits before tax	-9.8	-0.2	14.6	-19.4	-6.5	-15.2	-3.4	23.1
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	-2.6	6.1	-2.4	-1.6	13.4	8.6	4.7	17.4
Expenditures	7.8	9.6	11.5	5.4	13.7	20.1	-3.9	14.7
Nonfarm payroll employment	0.6	0.3	-2.0	-1.7	2.3	1.7	0.0	1.7
Manufacturing	-4.0	-2.6	-6.0	-12.4	4.3	2.1	-4.2	4.3
Industrial production	-2.7	-0.1	-3.3	-12.7	7.4	5.3	0.0	7.2
Housing starts, private	-2.7	30.1	70.0	63.8	11.4	11.1	10.8	0.0
Sales new domestic autos	-15.8	15.9	2.0	-130.5	217.0	0.0	0.0	9.6

* Excluding effects of Federal pay increase, 3.6 per cent.

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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.)

	1970p	1971 Proj.	1970 III	1970 IVp	1971 Projection I	1971 Projection II	1971 Projection III	1971 Projection IV
Gross National Product	976.8	1045.0	985.5	990.9	1017.3	1036.7	1050.5	1075.5
Final purchases	973.2	1041.7	980.0	986.8	1016.5	1031.2	1049.5	1069.5
Private	752.7	810.5	759.0	763.6	790.7	803.8	816.6	830.9
Excluding net exports	749.1	806.9	754.8	760.9	786.2	800.3	813.6	827.4
Personal consumption expenditures	616.8	664.9	622.1	627.6	646.3	659.1	671.0	683.0
Durable goods	89.4	96.3	91.2	85.4	94.0	95.5	97.0	98.5
Nondurable goods	264.7	283.6	265.8	271.7	276.3	281.6	286.0	290.5
Services	262.7	285.0	265.1	270.5	276.0	282.0	288.0	294.0
Gross private domestic investment	135.8	145.3	138.3	137.5	140.7	146.7	143.6	150.4
Residential construction	29.6	38.2	29.2	32.0	36.4	38.2	38.9	39.4
Business fixed investment	102.6	103.8	103.6	101.4	103.5	103.0	103.7	105.0
Change in business inventories	3.6	3.3	5.5	4.1	0.8	5.5	1.0	6.0
Nonfarm	3.0	3.3	5.0	3.6	0.5	5.5	1.0	6.0
Net exports of goods and services	3.6	3.6	4.2	2.7	4.5	3.5	3.0	3.5
Gov't. purchases of goods & services	220.5	231.2	221.0	223.2	225.8	227.4	232.9	238.6
Federal	99.7	97.8	98.6	98.4	98.3	96.2	97.5	99.2
Defense	76.6	72.4	75.8	74.6	74.2	71.8	71.7	71.8
Other	23.1	25.4	22.9	23.8	24.1	24.4	25.8	27.4
State & local	120.8	133.4	122.4	124.8	127.5	131.2	135.4	139.4
Gross national product in constant (1958) dollars	724.3	741.4	727.4	721.3	732.3	739.1	741.8	752.6
GNP implicit deflator (1958 = 100)	134.9	140.9	135.5	137.4	138.9	140.3	141.6	142.9
Personal income	801.0	856.3	807.2	813.4	829.1	854.5	862.0	879.6
Wages and salaries	540.1	574.6	543.8	545.4	560.0	570.4	577.5	590.5
Disposable income	684.7	734.2	693.0	696.9	712.4	734.7	739.4	750.4
Personal saving	50.0	49.8	52.7	50.9	47.1	56.2	48.7	47.3
Saving rate (per cent)	7.3	6.8	7.6	7.3	6.6	7.6	6.6	6.3
Corporate profits before tax	82.3	82.1	84.4	80.3	79.0	82.0	81.3	86.0
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	195.4	207.3	194.9	194.1	200.6	204.9	207.3	216.3
Expenditures	206.2	225.9	206.7	209.5	216.7	227.6	225.4	233.7
Surplus or deficit (-)	-10.8	-18.6	-11.8	-15.4	-16.1	-22.7	-18.1	-17.4
High employment surplus or deficit (-)	-0.7	-0.3	-1.7	1.7	0.7	-4.4	2.2	0.5
Total labor force (millions)	85.9	87.1	86.0	86.4	86.6	86.9	87.2	87.5
Armed forces "	3.2	2.8	3.1	3.0	2.9	2.8	2.7	2.7
Civilian labor force "	82.7	84.3	82.8	83.4	83.7	84.1	84.5	84.8
Unemployment rate (per cent)	4.9	6.4	5.2	5.8	6.1	6.3	6.5	6.5
Nonfarm payroll employment (millions)	70.7	70.9	70.5	70.2	70.6	70.9	70.9	71.2
Manufacturing	19.4	18.9	19.3	18.7	18.9	19.0	18.8	19.0
Industrial production (1957-59=100)	168.2	168.0	167.9	162.6	165.6	167.8	167.8	170.8
Capacity utilization, manufacturing (per cent)	76.6	73.0	76.2	72.3	73.0	73.3	72.5	73.0
Housing starts, private (millions A. R.)	1.43	1.86	1.51	1.75	1.80	1.85	1.90	1.90
Sales new domestic autos (millions, A.R.)	7.12	8.25	7.99	5.38	8.30	8.30	8.30	8.50

NOTE: Projection of related items such as employment and industrial production index are based on projection of deflated GNP. Federal budget high employment surplus or deficit (N.I.A. basis) are staff estimates and projections by method suggested by Okun and Teeters.

depreciation rules for tax purposes. Larger income flows should also be reflected in an improved consumer outlook and we anticipate somewhat stronger gains in consumer outlays than previously projected, with some pick-up in auto sales evident when the new models become available in the fourth quarter. In real terms, GNP is expected to rise at an average rate of over 3-1/2 per cent for the two quarters, as compared with a 3 per cent rate projected in the last Greenbook. This rate of growth would be somewhat below the continuing growth in our long run potential, and thus implies some further increase in unemployment beyond mid-year. Nevertheless, recent price and wage changes suggest that only moderate progress can be anticipated on the price front; the GNP deflator is projected to still be rising at an annual rate of 3.6 per cent in the fourth quarter.

Industrial production. Industrial production is tentatively estimated to have increased by about one point in January to around 165 per cent, 5.5 per cent below the July 1969 peak and up 2 per cent from the November low. The January gain in output is centered in steel and motor vehicles and parts as changes in output in other sectors were apparently offsetting. (A better estimate of the production index may be available in time for the Supplement.)

Auto assemblies in January were at an annual rate of 8.3 million units (preliminary), up 18 per cent from December. Production schedules for February, which earlier had been set at a 9.8 million unit rate, have been cut back to a 9.2 million rate. In early January, production of

television sets and room air conditioners were reduced sharply, a development in line with reported plant shutdowns and layoffs in order to bring inventories into better balance with final takings. Output of furniture and apparel is expected to have changed little and production of consumer staples probably showed its usual rise.

It is estimated that production of industrial, defense, and farm equipment (because of a strike at International Harvester) and commercial aircraft declined. Output of commercial equipment probably showed little change and truck production recovered further from the effects of the GM strike.

Among industrial materials, output of steel and auto and truck parts rose further. Production of most other materials--nonferrous metals, construction and equipment materials, and textiles, paper, and industrial chemicals--are estimated to have changed little.

In the first half of 1968, when there was a threat of a steel strike and when economic activity was advancing rapidly, steel production rose 10.5 per cent from January to June and accounted for .8 of a point of the 4-1/2 points rise in the total index. The build-up of stocks of steel mill products that is anticipated between now and July is likely to have about the same impact on the total index as it did in 1968.

Retail sales. January retail sales are estimated to have increased about 1-1/2 per cent from December, reflecting almost entirely the post-strike rebound in auto sales. Sales of nondurable goods apparently were little changed and were somewhat above the advanced fourth quarter level. General merchandise, gasoline stations, and the

food group showed increases, while sales of apparel and drug stores declined. Total retail sales in January are estimated 3.5 per cent higher than a year earlier, suggesting no growth after allowance for price increases.

RETAIL SALES
(Per cent change from previous period)

	1970					1971
	IIIQ	IVQ	Oct.	Nov.	Dec.	Jan.
Total, all stores	.9	-1.1	-1.1	-1.2	1.4	1.5
Durable	1.7	-8.7	-6.6	-5.6	3.1	5.0
Auto	2.6	-15.8	-12.6	-9.9	4.9	9.0
Furniture & appliance	-3.8	.5	-2.9	.4	- .1	2.5
Nondurable	.6	2.2	1.3	.6	.7	.0
Food	.5	1.5	- .2	- .1	2.7	.2
General merchandise	.7	2.3	1.8	1.5	-2.6	1.0
Total, less auto	.6	2.0	1.4	.5	.8	.0

Consumer credit. The decline last year in new car sales, and the accompanying decrease in the volume of auto credit, has raised the possibility of a lengthening of the typical financing period for new cars to 42 or even 48 months. Any such move would represent a sharp departure from present practice. During 1970 approximately 84 per cent of finance company contracts and 83 per cent of bank purchased paper agreements were for 31-36 months--only 1 per cent of new car contracts had maturities over 36 months.

Auto dealer organizations that have expressed favor for extended-maturity financing cite resistance to increased car prices as a depressant on sales. They indicate a special desire to hold monthly payments for full-size vehicles at a manageable level for consumers. The average monthly payment on new car contracts acquired during 1970 by a large captive finance company (GMAC) is estimated at $108.29, an increase of $21.25 or 24 per cent since 1965. For all lenders--banks, finance companies, credit unions, etc.--average notes for new cars were relatively unchanged at about $3,200 (seasonally adjusted) from the fall of 1969 until the past summer. However, because of a substantially higher proportion of sales of domestic compact units and imported cars, they have recently declined to about $3,130. GMAC notes have slipped to about $3,520 from a peak above $3,600.

Many of the major independent finance companies forsook car financing last year because of competitive factors and the high cost of money. One company (Associates) has indicated that 48-month paper might prompt consideration about re-entering the auto picture; another (CCC) stated it would not favor 48-month financing if it were still in the car financing business and that it would not move back into the field at present. While the three large captive companies have already professed opposition to extended terms, it is admitted that competitive pressures might necessitate acceptance.

At least one bank (the American Bank of Jacksonville), however, after a review of the price structure of 1971 models and an analysis of collateral values, decided to offer 48-month financing on full size domestic models during the first 6 months of the model year.

Most commercial banks are taking a "wait-and-see" posture, with some indication that higher downpayments would be required on longer-term contracts.

Consumer surveys. The latest Conference Board and Census Bureau reports indicate that consumer expectations for the future were on balance little changed from the relatively low levels of the previous surveys, although more respondents expected income increases most recently. The Conference Board also found more favorable expectations for business conditions in the next six months. On the other hand, the Conference Board Survey indicated a more pessimistic evaluation of present business and employment conditions and the Census survey showed a further deterioration in consumer appraisals of recent current income experience.

Actual buying plans, as opposed to general economic expectations, are somewhat inconsistent in the two surveys. The Conference Board survey in November-December 1970 reported fewer plans to buy autos and homes in the next six months compared with plans in September-October and a year earlier. Plans to purchase major appliances were virtually unchanged from September-October and below a year earlier. Census, on the other hand, reported January buying plans for houses little changed from October, but--as they were in the previous survey--higher than a year earlier.

The Census survey also indicated a strong improvement in buying intentions for autos. The seasonally adjusted index of auto buying plans for all households rose from 103.8 (January-April 1967 = 100) in the October survey to 107.9 in January compared with 106.0 a year earlier. This improvement, however, may largely reflect deferred purchases from the GM strike period, since all of the increase in the index is attributable to a sharp rise in plans to purchase within the next six months. Purchase plans for new cars in both the next 12 months and the next 24 months declined.

SELECTED CONSUMER SURVEY RESULTS

	Year ago [1/]	Previous survey [2/]	Latest survey [3/]
		BUYING INTENTIONS (Seasonally adjusted)	
Census			
Index of expected unit car purchases, (Jan.-Apr. 1967=100)			
All households:	106.0	103.8	107.9
Households, above median incomes:	104.3	103.4	110.4
Conference Board			
Per cent of households planning to buy within 6 months:			
All cars	9.1	7.2	7.1
New	4.6	4.4	4.2
Census			
Index of expected house purchases (Jan.-Apr. 1967=100)	93.6	95.6	96.3
Conference Board			
Per cent of households planning to buy home:	2.3	2.8	2.1
		INCOME EXPECTATIONS	
Census			
Probability of substantial:			
Increase	20.1	16.7	17.2
Decrease	6.3	7.3	6.7
Difference	13.8	9.4	10.5
Conference Board			
Per cent of households expecting:			
Increase	29.7	23.5	24.0
Decrease	5.8	7.8	8.1
Difference	23.9	15.7	15.9
		CURRENT EXPERIENCE (per cent of households)	
Census			
Higher current income	35.4	37.3	35.0
Lower current income	11.3	13.6	14.2
Difference	24.1	23.7	20.8
Conference Board			
Business conditions			
Good	34.8	14.5	14.1
Bad	8.8	23.8	34.4
Difference	26.0	-9.3	-20.3

1/ Jan. 1970 for Census and Nov.-Dec. 1969 for NICB.
2/ Oct. 1970 for Census and Sept.-Oct. 1970 for NICB.
3/ Jan. 1971 for Census and Nov.-Dec. 1970 for NICB.

<u>Construction and real estate</u>. Seasonally adjusted value of new construction edged higher in January, following a 2 per cent upward revision for December. The rate in January--at $94.9 billion--was 2 per cent above the earlier peak reached in April of 1969.

Outlays for private nonresidential construction in January were below their level for 1970 as a whole. Outlays for public construction--mainly State and local projects--also continued lethargic in January, and were substantially below a year earlier in terms of constant dollars. By contrast, residential outlays, which have dominated the uptrend in total construction in recent months, were considerably above a year earlier in both real and current dollars. A factor in the rise of residential building has been the greater concentration by builders on smaller and less expensive units, a tendency discussed further in Appendix A.

NEW CONSTRUCTION PUT IN PLACE

	All	Private Total	Private Residential	Private Nonresidential	Public
	Billions of dollars				
Annual					
1969	90.9	62.8	30.6	32.2	28.1
1970	90.8	62.8	29.0	33.8	28.1
Quarterly (SAAR)					
1970					
I	91.2	63.4	28.9	34.5	27.8
II	90.2	62.6	28.9	33.7	27.5
III (r)	90.1	61.6	27.8	33.9	28.4
IV (p)	92.3	64.1	30.8	33.3	28.2
Monthly (SAAR)					
November (r)	91.4	63.4	30.6	32.8	28.1
December (p)	93.7	65.2	32.1	33.1	28.5
1971					
January (p)1/	94.9	66.8	33.7	33.1	28.1
	Per cent change in January from year earlier				
In current dollars	+5	+7	+17	-3	n.c.
In 1957-59 dollars	-4	-1	+12	-12	-11

1/ Data for most recent month (January) are confidential Census Bureau extrapolations. In no case should public reference be made to them.

Private housing starts ended the year on a vigorous note, reaching a seasonally adjusted annual rate of 2 million units in December and carrying total starts for the year to 1.43 million, only a shade below the 1969 total. On a quarterly basis, the fourth quarter

average was two-fifths above its recent low in the first quarter of 1970 and moderately above the recent high reached in the first quarter of 1969. Part of the December rise may reflect seasonal adjustment problems which are difficult to resolve for the winter months when unadjusted housing starts are at their seasonal low. An important part, however, would appear to reflect an extraordinary contra-seasonal upsurge in the Government-assisted sector, especially in the FHA-insured subsidized portion. Subsidized starts, which expanded considerably last year, are discussed in Appendix A. Such starts under all major programs are indicated to have accounted for an unprecedented 60 per cent of total unadjusted private housing starts in December.

PRIVATE HOUSING STARTS
(Thousands of Units)

	Total	Per Cent Multifamily	Per cent Assisted 1/ FHA-VA Underwritten	Per cent Assisted 1/ All Subsidized 2/
Annual				
1966	1,165	33	17	3/
1967	1,292	35	18	3/
1968	1,508	40	19	3/
1969	1,467	45	20	12
1970	1,429	43	34	29
Quarterly (SAAR)				
1970				
I	1,252	46	28	22
II	1,286	42	32	30
III	1,512	44	32	25
IV	1,753	43	40	36
Monthly (SAAR)				
October	1,586	44	33	24
November	1,688	45	31	25
December	1,987	39	59	60

1/ Based on unadjusted totals for all periods.
2/ Partly estimated by FR to exclude Census "public." Includes starts under major program of Farmers Home Administration as well as portions of FHA-insured starts.
3/ Comparable data n.a., but indicated at no more than 4 per cent.

With flows of funds to all financial intermediaries exceptionally strong, mortgage markets easing, commitments for all types of starts at advanced rates, and permits very high, continuance of the uptrend in housing starts over the period ahead seems assured, although the monthly pattern is likely to be uneven. For example, a drop seems likely for

January after four consecutive months of rapid rise and the unusual bulge in subsidized starts in December.

Underscoring the basic underlying strength of shelter requirements, rental vacancy rates in the fourth quarter of last year continued at a reduced average of 4.8 per cent of units available and fit for use, with very little change from the fourth quarter of other recent years. While there was some rise from earlier levels, in the West, where lay-offs in aerospace and defense industries have been large, the latest rate there was still quite low. Vacancy rates for homeowner units in the fourth quarter of last year also remained exceptionally low nationally (1.0 per cent).

RENTAL VACANCY RATES
(Per cent)

	Average for fourth quarter of:			
	1965	1968	1969	1970
All regions	7.7	4.9	4.7	4.8
Northeast	5.1	3.1	2.2	2.3
North Central	6.6	4.7	5.6	5.2
South	8.4	6.2	6.4	6.3
West	11.7	6.1	4.7	5.4

Cyclical indicators. The leading indicator composite rose 1.4 per cent in December, following a smaller increase in November. The increase came both from series directly affected by the end of the GM strike and the beginning of steel stockpiling and from series not so

affected. In the latter group, increases in building permits for private housing and common stock prices outweighed declines in industrial materials prices and contracts and orders for plant and equipment. Upward influences from three strike-affected series--the manufacturing workweek, initial unemployment claims, and new orders for durable goods--were to a considerable extent offset by a sharp decline in the ratio of price to unit labor costs, which apparently reflected extra labor costs in starting up production at GM plants. In January, common stock prices rose further and industrial materials prices declined further.

The coincident composite also rose in December following the end of the GM strike. The lagging composite declined.

COMPOSITE CYCLICAL INDICATORS
(1967 = 100)

	12 Leading Trend Adjusted	5 Coincident	6 Lagging
1970:			
April	114.9	122.0	130.6
May	113.8	121.2	130.7
June	114.4	121.4	130.7
July	116.2	121.4	130.9
August	115.4	121.1	132.0
September	114.9	120.5	132.7 (H)
October	114.1	118.7	132.5
November	114.8	118.1	131.5
December (Prel.)	116.4	119.6	131.1

(H) Current high value. The high for the leading composite was September 1969; for the coincident, December 1969.

Manufacturers' orders and shipments. New orders for durable goods rose 3.6 per cent--$1 billion--in December, according to preliminary data. The principal factor in the increase was a $1.2 billion rise in motor vehicle industry orders, reflecting the sharp rebound as GM production was resumed. A large increase was also reported in iron and steel orders which probably reflected both the end of the GM strike and anticipation of steel price increases and a possible strike in 1971. New orders for durable goods other than steel and autos were down 2.8 per cent.

The December increase followed two months in which new orders for durable goods were depressed by the strike. The average new order level in the fourth quarter declined 4-1/2 per cent, after two quarters of increase, and was back to around the low rate of the first quarter of 1970. Motor vehicles and steel fell 16 per cent while orders to other industries were down 1.5 per cent from the third to the fourth quarter.

Capital equipment orders dropped back sharply in December to around the September rate, reflecting declines in ship and rail equipment, aircraft, and nonelectrical machinery. But on a quarterly average basis, capital equipment orders have increased steadily from the low in the second quarter of 1970--and by slightly more than the rate of price increase for machinery and equipment. In the fourth quarter, however, they were still 2.4 per cent below a year earlier in current dollars--6.6 per cent in real terms.

Orders for nondurable goods rose in December and were back at the October level.

MANUFACTURERS' NEW ORDERS
(Seasonally adjusted monthly rates, billions of dollars)

	1970			
	Q III	Q IV (Prel.)	November	December (Prel.)
Durable goods, total	30.6	29.2	29.0	30.0
Primary metals	4.8	4.6	4.5	4.9
Iron and steel	2.3	2.2	2.1	2.5
Other primary metals	2.5	2.4	2.5	2.4
Motor vehicles and parts	4.1	3.2	2.7	4.0
Household durable goods	2.1	2.1	2.1	2.2
Defense products	2.3	2.1	2.0	2.0
Capital equipment	8.3	8.5	8.9	8.3
All other durable goods	9.0	8.7	8.7	8.7
Nondurable goods, total	25.6	25.6	25.3	25.7

NOTE: Detail may not add to totals because of rounding.

Shipments of durable goods rose 3.1 per cent in December, with autos the principal stimulus. The backlog of unfilled orders rose slightly further--the second month of increase--with increases at iron and steel and communications equipment industries largely offset by declines elsewhere.

Manufacturers' inventories. Book value of manufacturers' inventories declined at a $4 billion annual rate in December, with decreases in both durable and nondurable goods industries. The decline followed two months of substantial increases, and for the quarter as a whole book values were up at a $4.2 billion rate, about the same as the third quarter rate.

The greatest part of the December decline in durable goods stocks occurred in defense products and in construction materials industries, especially fabricated metal products. Inventories also declined somewhat at steel mills with the end of the GM strike and an increased outflow of shipments. Capital equipment inventories, however, increased at a $2.4 billion annual rate. Materials and in-process inventories declined while stocks of durable finished goods continued to rise, especially in machinery industries.

CHANGE IN BOOK VALUE OF MANUFACTURERS' INVENTORIES
(Seasonally adjusted annual rate)
Billions of dollars

	1970			
	QIII	QIV	November	December (Prel.)
Manufacturing, total	3.8	4.2	6.8	-4.0
Durable	3.7	1.6	3.5	-2.5
Nondurable	.1	2.6	3.3	-1.5

Inventory-shipments ratios dropped back from their high, strike-affected levels of November. The durable goods inventory-unfilled—orders ratio declined for the first time since April 1969. For capital equipment, however, inventories were still rising relative to order backlogs.

MANUFACTURERS' INVENTORY RATIOS

	1969		1970	
	November	December	November	December (Prel.)
Inventories to shipments:				
Manufacturing, total	1.71	1.73	1.85	1.80
Durable	2.03	2.08	2.29	2.21
Nondurable	1.30	1.30	1.35	1.32
Inventories to unfilled orders:				
Durable manufacturing	.729	.737	.836	.829

Labor market. Employment and unemployment estimates for January are not yet available, but the employment situation does not appear to have changed appreciably over the month. Insured unemployment (seasonally adjusted) for the first three weeks of January averaged somewhat less than in December. This modest further decline is probably due to the continuing rebound from the General Motors strike, some steel inventory building, and seasonal adjustment problems. Initial claims for jobless benefits have shown signs of another upturn in recent weeks and appear likely to be higher in January than in December.

INSURED UNEMPLOYMENT
(Seasonally adjusted, in thousands)

	Initial claims	Insured unemployment
1970:		
January	235	1,306
August	298	1,994
September	342	2,197
October	340	2,334
November	334	2,350
December	292	2,114
1971:		
January*	310	2,050

* Staff estimates.

<u>Labor force in 1970</u>. Slack demand was reflected in much slower growth of the total labor force in 1970 than in 1969. The total labor force rose only 1.3 million in the year ending in the fourth quarter of 1970 contrasted with 2.3 million in the prior year. The slower growth occurred primarily among teenagers and women, groups whose decisions to seek work are often influenced by demand conditions. Total labor force growth for men was near the 1969 rate.

TOTAL LABOR FORCE
(Not seasonally adjusted, in thousands)

	Change from a year earlier	
	1969 QIV	1970 QIV
Total labor force	2,339	1,331
Men aged 20 years & over	567	478
20-24 years	258	339
25 years and over	309	139
Women aged 20 years & over	1,200	782
Teenagers	572	71
Armed forces	-53	-443
Civilian labor force	2,392	1,774
Men aged 20 years & over	638	836
20-24 years	274	543
25 years and over	364	293
Women aged 20 years & over	1,199	781
Teenagers	555	157

Reflecting a cut of 440,000 in the Armed Forces, growth in the civilian work force was larger than for the total--1.8 million in 1970. The civilian work force of men aged 20 years and over rose by over 800,000, one of the largest increases of the post-war period and doubtlessly an important factor in the doubling of the adult male unemployment rate over the past year.

On the basis of growth of working age population and trends in participation rates the civilian labor force would be expected to rise by over 1.5 million during 1971. However, with the labor market likely to continue slack, labor force increases for women and teenagers may be smaller than normally expected. Among men, however, the normal

rise of about half a million is likely to be realized--reflecting the pressures of family responsibilities and a high propensity to seek work regardless of economic conditions--and is expected to be supplemented by further Armed Forces reductions of perhaps 300,000. This large addition to the civilian work force from the Armed Forces--which would boost the total increase for this age group to about 800,000--will be difficult to absorb quickly in a sluggish economy and unemployment rates for men may rise further in 1971 if our output projections are realized.

Collective bargaining. Wage and benefit increases provided by contracts concluded in the fourth quarter of 1970 were somewhat smaller than in the previous nine-month period. However, the extent of slowing is overstated in the Bureau of Labor Statistics contract cost estimates because the BLS figures exclude wage increases that are clearly identified as cost-of-living increases. (Technically this is done because the BLS cannot foresee the rate of rise of consumer prices.) Normally, wage settlements do not indicate the specific amount considered a "catch-up" for past price increases. However, the auto settlement, which applied to about one-third of all workers covered by wage settlements concluded during the fourth quarter, specifically allowed a 26-cent increase based on past price rises. Thus, while the auto workers actually received a first year wage increase of 12-1/2 per cent, the BLS calculations only included about half of that amount--the portion that was not designated as a cost-of-living increase. This was the major factor in reducing the

rise in first-year wage costs from an average of 8.5 per cent in manufacturing in the first nine months of 1970 to 7.1 per cent for the fourth quarter. Adding the cost-of-living increase back it would raise the first-year figure above 9 per cent.

MAJOR COLLECTIVE BARGAINING SETTLEMENTS, 1970

	Mean Adjustments - Per Cent				
				1970	
	1968	1969	1970	1st. 9 mos.	Q IV
First-year wage adjustments					
Private nonfarm 1/	7.4	9.2	11.9	13.2	9.8
Manufacturing	7.0	7.9	8.1	8.5	7.1
Nonmanufacturing	7.8	10.8	15.4	16.0	13.9
Wages and benefits combined					
Private nonfarm 2/					
First-year	8.7	10.9	13.2	14.7	10.5
Average over life of contract	6.5	8.2	9.1	10.0	7.5

1/ Based on contracts covering 1,000 or more workers.
2/ Based on contracts covering 5,000 or more workers.

In nonmanufacturing, first-year wage increases did ease womewhat, in part reflecting the tapering off in the number of workers covered by negotiations in the construction industry. Wage rates advanced much more rapidly in nonmanufacturing than in manufacturing during 1970; averaged over the life of the contract, wage increases were 11.5 per cent annually for nonmanufacturing compared with 6.0 per cent in manufacturing.

Evidence continues to accumulate that wage pressures are easing somewhat in the nonunion sectors of the economy. In manufacturing establishments only 37 per cent of nonunion workers received wage rate increases in the first nine months of 1970 compared with 67 per cent in the corresponding months of 1969. Average wage increases received by nonunion workers in each of the two periods were the same--5.8 per cent--but because the number of workers receiving increases was almost cut in half, the average wage adjustment (based on all nonunion workers whether or not they received increases) was smaller in 1970 than in 1969. Increases in average hourly earnings in trade and finance have also slowed in recent months compared with over-the-year rises in 1969.

Wholesale prices. Wholesale prices rose at an estimated seasonally adjusted annual rate of 4.7 per cent in January (December 15th to January 12th) largely as a result of sharp increases in prices of farm and food products. Prices for industrial commodities increased at a much lower rate, the smallest monthly change--with the exception of last November when no change was posted--since mid-1969.

WHOLESALE PRICES
(Percentage changes at seasonally adjusted annual rates)

Commodity group	Dec 1969 to June 1970	June 1970 to Dec 1970	Sept 1970 to Dec 1970	Dec 1970 to Jan 1971p
All commodities	2.6	2.1	.4	4.7
Farm products and processed foods and feeds	-1.9	- .5	-9.2	9.7
Farm products	-5.4	-3.2	-16.6	12.9
Processed foods and feeds	1.0	.6	-4.1	7.8
Industrial commodities	3.8	3.4	3.8	1.7

Widespread increases in prices of industrial commodities in January were led by nonmetallic minerals (mainly building materials). Increases for fuels and power and machinery and equipment were substantial, but considerably smaller than in recent months. Prices for motor vehicles and parts were again raised in a "second round" of increases and lumber and wood products prices rose as sizes of lumber were reduced under new voluntary softwood standards adopted by the industry. In the metals index, increases for steel scrap and some other steel and manufactured metal products more than offset further declines in nonferrous metals.

INDUSTRIAL WHOLESALE PRICES, SELECTED COMMODITY GROUPS, 1970
(Percentage changes at annual rates) 1/

Commodity group	Dec 1969 to June 1970	June 1970 to Dec 1970	Dec 1969 to Dec 1970
Industrial commodities	3.7	3.5	3.6
Fuels and related products and power	4.8	15.9	10.2
Transportation equipment	1.2	11.1	6.0
Nonmetallic minerals	6.0	3.6	4.8
Machinery and equipment	3.6	5.1	4.3
Metals and metal products	8.7	-2.6	2.9
Chemicals and allied products	3.5	2.2	2.8
Pulp, paper, and allied products	5.0	.7	2.8
Lumber and wood products	-3.7	-5.1	-4.4
Textile products and apparel	.6	- .9	- .4

1/ Not seasonally adjusted.

The January rise in metal products followed a period of declining prices in the second half of 1970. But the increase in the industrial commodities average from June to December 1970 was maintained at a rate of 3-1/2 per cent--almost as high as in the first half--as the rise in fuel prices and utility accelerated rates and as automobile and other transportation equipment and machinery prices rose strongly. These groups have a heavy weight in the index, and together they accounted for most of the continued uptrend in industrial prices. Prices of crude materials were weak and declining but of major industrial groups only pulp, paper and allied products leveled off in the second half and only lumber and wood products and textiles--in addition to metals--declined.

CONTRIBUTION TO THE INCREASE IN INDUSTRIAL WHOLESALE PRICES,
SELECTED COMMODITY GROUPS, 1970
(In per cent) 1/

Commodity group	Dec 1969 to June 1970	June 1970 to Dec 1970	Dec 1969 to Dec 1970
Industrial commodities	100.0	100.0	100.0
Fuels and related products and power	11.1	44.1	26.5
Chemicals and allied products	7.4	5.5	6.5
Pulp, paper, and allied products	8.7	1.4	5.3
Metals and metal products	41.1	-15.3	14.8
Machinery and equipment	16.1	25.4	20.5
Nonmetallic minerals	6.5	4.6	5.6
Transportation equipment	2.7	32.6	16.7
Lumber and wood products	-3.7	-5.5	-4.6
Textile products and apparel	.6	-2.6	- .9

1/ Not seasonally adjusted.

Although the slackening in the increase in fuel prices in January is encouraging, the long-term outlook is for further increases, especially for natural gas and electric power. Price rises are still being announced for petroleum products and prices of coal are under upward pressure owing to increased costs of mining, partly as a result of new safety standards.

Steel price increases, already announced to be effective March 1, will raise the metals price index by about .2 per cent but will have only a slight effect on the index of all industrial commodities.

Consumer prices. Consumer prices rose at a seasonally adjusted annual rate of about 6-1/2 per cent in December as food and gasoline prices reversed their previous declines and new car and household service prices rose sharply. Although the December advance was among the largest this year, the rise of 5.5 per cent from December 1969 was smaller than that of the preceding year, and there was some slowing in the rate of price increase between the first and second half of the year.

CONSUMER PRICES, 1970
(Per cent change, seasonally adjusted annual rates)

	June to September	September to December	October to November	November to December
All items	4.2	5.7	3.7	6.6
Food	1.4	..9	- .6	2.5
Non-food commodities	3.7	6.4	4.3	7.7
Services 1/	7.2	7.0	7.8	7.0
Addendum				
Services less home finance 1/2/	6.6	7.2	8.3	6.1
New cars	6.9	16.7	10.9	27.8

1/ Not seasonally adjusted.
2/ Not for publication.

The December advance in food prices brought the cost of food to its high point for the year, but only about 2 per cent above a year earlier. Increases for eggs, cereal and bakery and dairy products, fish and poultry outweighed reductions in beef, pork and fresh fruits. Among other nondurables, a notable slowing in the rise of apparel

prices was more than offset by an increase for gasoline as "price wars" ended in several areas.

Additional price increases for new cars and the strike-induced delay in the shift to 1971 models (new car prices usually decline in December) caused a sharp rise in the index for durable goods. Household durables price increases, however, slowed to an annual rate of 1.1 per cent after two months at 4.5 per cent.

The 7 per cent annual rate of increase in service costs was paced by household services, with sharp advances in residential property taxes, insurance, and home maintenance costs. Mortgage interest costs also rose despite unchanged interest rates because of the continued advance in home prices. Utility rates climbed sharply and rents continued to accelerate, reflecting in part the upward adjustment of rents in the New York City area. Medical care costs also continued to rise rapidly.

Six-month changes in the consumer price index show a peak rate in the first half of 1969 and some slowing since, particularly in the second half of 1970. The major contributing factor to the slowing was the leveling off in food prices which started in the second quarter of last year; in December the price of food at home was below the May level. Total food costs rose slightly from May to December, because of the continued advance in restaurant prices; the pace for the latter has moderated since mid-year.

Durable goods price increases accelerated in the second half of 1970 as the 1971 model cars were introduced. (The acceleration

is partly masked by movements in used car and house prices but appears clearly in the series excluding these items.) Over the year new car prices rose about 6-1/2 per cent, more than twice as much as in any year in the previous decade. House prices rose at peak rates of 8-9 per cent from mid-1969 through the third quarter of 1970, but appear to have slowed substantially in the last quarter.

The rise in service costs slowed after the first quarter of 1970, when home finance costs were climbing at near-record rates, but shows no further signs of slowing down. Medical service costs continue their rapid advance and major household service prices, including rents, gas and electricity, accelerated in the last quarter.

Although trends in nondurables excluding food are obscured by fluctuations in gasoline prices, no slowing down is apparent. However, apparel prices, despite four months of substantial increase, are not rising as fast as the peak rates of 1968.

TRENDS IN CONSUMER PRICES
(Percentage increase, seasonally adjusted annual rates)

	6-month increase to:				12-month increase to:	
	1969		1970			
	June	Dec	June	Dec	Dec 1969	Dec 1970
All items	6.4	5.9	6.0	4.9	6.1	5.5
Food	6.2	8.2	3.3	1.1	7.2	2.2
Nondurables less food	5.0	4.0	3.6	4.6	4.5	4.1
Durables	5.6	3.4	5.5	6.1	4.5	5.8
Services 1/	7.7	7.1	9.2	7.1	7.4	8.2
Addendum:						
Durables excluding used cars, home purchase 2/	3.9	2.0	2.3	5.2	3.0	3.7
Services less home finance 1/2/	6.1	5.9	7.2	6.9	6.0	7.0

1/ Not seasonally adjusted.
2/ Confidential.

Price indexes for the GNP. In the fourth quarter of 1970 the increase in the GNP implicit deflator accelerated to annual rate of 5.7 per cent (preliminary estimate) from 4.6 per cent in the third quarter. Much of the acceleration reflected a shift in the composition of output (i.e., changing weights). However, both a fixed-weighted index for GNP components and a chain-weighted index (in which the weights are based on the composition of output in the first of the quarters to be compared) also show a faster rate of rise in the closing period of the year than in the previous quarter.

The fixed-weighted index for gross private product--which excludes the effects of both shifts in weights and government salary increases--reached a peak rate of increase of over 5 per cent around mid-1969. Since then the index has increased at a somewhat slower rate, except for the return to 5 per cent each quarter.

Much of the acceleration in the implicit deflator for GNP last quarter derived from the sharp rise in the deflator for personal consumption expenditures--from an annual rate of 3.9 per cent in the third quarter to 5.7 per cent in the fourth quarter. About half of this acceleration can be attributed to shifts in weights, as the fixed-weighted index for PCE shows a fourth-quarter annual rate of increase of 4.8 per cent compared with 3.9 per cent in the third quarter.

GNP AND PRIVATE GNP DEFLATORS

(Percentage changes from previous period at annual rates, seasonally adjusted)

	Gross National Product			Gross Private Product		
	Implicit Deflator	Fixed-Weighted[1] Index	Chain Index	Implicit Deflator	Fixed-Weighted[1] Index	Chain Index
1967	3.5[3]	3.3[3]	3.3[3]	3.0[3]	2.8[3]	2.8[3]
1968	4.1[3]	4.5[3]	4.5[3]	3.8[3]	4.1[3]	3.9[3]
1969						
I	4.7	4.5	4.5	4.8	4.5	3.9
II	5.0	5.0	4.9	4.9	5.0	4.5
III	5.6	6.1	6.0	4.4	5.1	4.9
IV	4.9	5.0	4.9	4.6	4.8	4.6
1970						
I	6.4	5.9	5.9	5.3	4.8	4.7
II	4.3	5.0	5.0	4.0	4.8	4.8
III	4.6	4.7[2]	4.4[2]	4.7	4.8[2]	4.4[2]
IV[p]	5.7	5.0[2]	5.0[2]	5.7	5.1[2]	5.1[2]

1/ Fourth quarter 1965 weights.

2/ Confidential.

3/ Average rates for 4 quarters.

p/ Preliminary.

The rise in the deflator for fixed investment level off in the fourth quarter of last year at a rate of about 7 per cent annually, but a fixed-weight index indicates some slowing between the third and fourth quarters as a more moderate rise in construction costs more than offset an accelerated increase in prices of producers' equipment. In both the Federal and State and local government sectors, the rise in the deflator slowed in late 1970.

The CPI and the consumer expenditure deflator. The deflator for consumer expenditures has been rising at a lower rate than the consumer price index for some time, reflecting in large part differences in coverage but also different weights. The CPI durables component includes a series for "home purchase"--prices of new and used homes--which has been rising more rapidly in recent years than prices of other durable goods. In addition, prices of used cars are included in the CPI but are excluded from the deflator. Largely because of these differences in composition, new car prices, (which until recently have increased less than most commodities) are more heavily-weighted in the deflator than in the CPI and this accounts in part for its more moderate rate of rise.

The inclusion of home finance costs in the CPI contributed to the rapid rise in the costs of services in 1969 and early 1970. Costs of maintenance and other outlays by homeowners have also been a factor in the relatively fast acceleration of service costs in the CPI. In the deflator, the rent index, which climbs more slowly, is used to measure space-rent services for both owners and renters.

Although the recent downtrend in mortgage interest rates has been a moderating influence on the rise in the CPI, and should continue to be, a continued brisk rise in the price of homes and in costs associated with home ownership will probably cause the CPI service component to continue to increase faster this year than the consumer expenditure deflator.

COMPARISON BETWEEN CPI AND PCE DEFLATOR

	Percent change, QIV to QIV				
	1960-65[1/]	1965-67[1/]	1967-68	1968-69	1969-70
CPI-all items	1.3	3.2	4.7	5.8	5.6
Durables	.4	1.7	2.7	4.2	5.4
Non-durables	1.1	2.9	4.4	5.3	3.4
Services	2.0	4.4	6.0	7.3	8.2
PCE deflator	1.1	2.9	3.9	4.5	4.7p
Durables	- .4	1.5	2.8	2.3	3.5p
Non-durables	1.1	2.8	4.1	4.8	3.3p
Services	1.7	3.4	4.4	5.0	5.8p

p-Preliminary
1/ Annual average of changes from QIV to QIV

Planting intentions. Farmers were sounded out about their crop plans as of January 1 this year, earlier than usual to ascertain their reactions (1) to the corn blight threat, and (2) to the new planting flexibility granted by the feed grain, wheat and cotton programs for 1971 and the reduced diversion of feed grain acreage. The findings

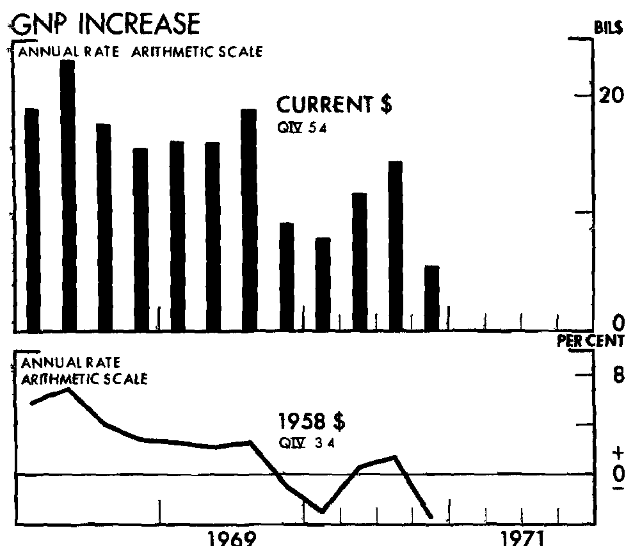
of the special survey revealed national planting plans not greatly different from traditional patterns and remarkably close to Department of Agriculture goals. As a result, final provisions of the 1971 programs, soon to be announced, will probably differ little from those announced in early December.

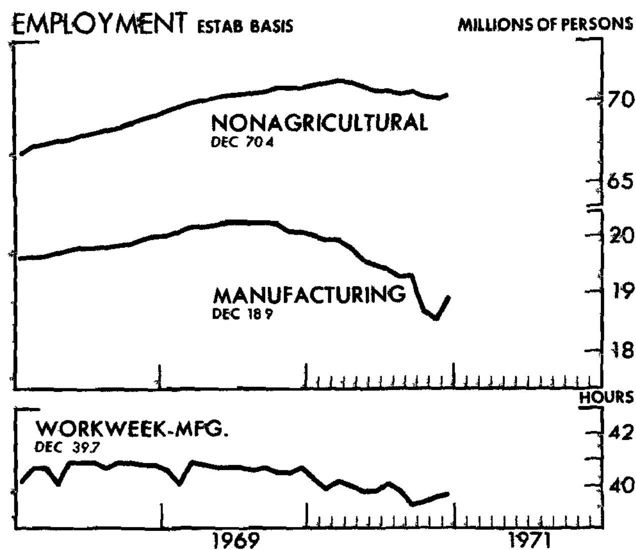
Corn poses the most acute question in 1971 production because of the threat of short supplies to the livestock industry. The survey indicates that a 6 per cent increase in plantings over 1970 is planned. The greatest expansion is planned in the Western Corn Belt and in other areas with little or not blight damage in 1970 and supplies of seed are more than ample for such expansion. In the Eastern Corn Belt and the South where damage was severe last year, smaller increases or actual decreases are planned. Supplies of resistant and blend seed will be a constraint on acreages planted. Larger acreages of soybeans and other feed grains are planned in these areas. Shifts from corn will be limited by the greater relative profitability of corn, assuming normal yields, and by the fact that much land in corn last year contains residual chemicals inimical to soybeans.

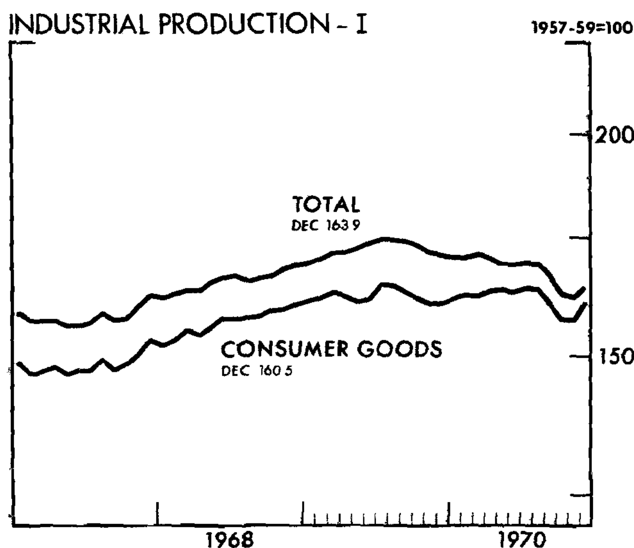
Some analysts feel that farmers were polled in the January survey before they fully understood the new cropping options open to them and before many of them were aware of the shortages of supplies of suitable corn seed in prospect in certain areas. The regular mid-March planting intentions survey may well reveal more marked reactions both to the blight threat and to the new planting rules than those indicated on January 1.

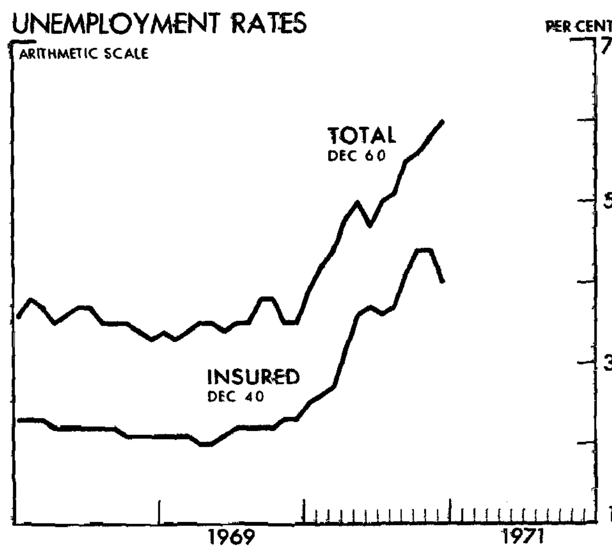
ECONOMIC DEVELOPMENTS - UNITED STATES

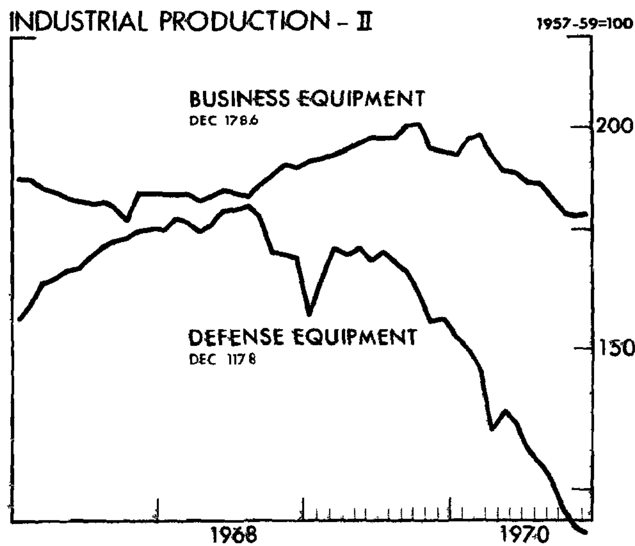
SEASONALLY ADJUSTED, RATIO SCALE

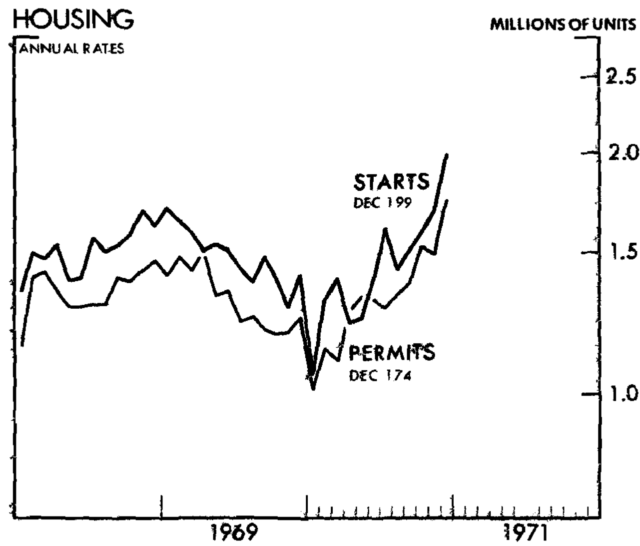






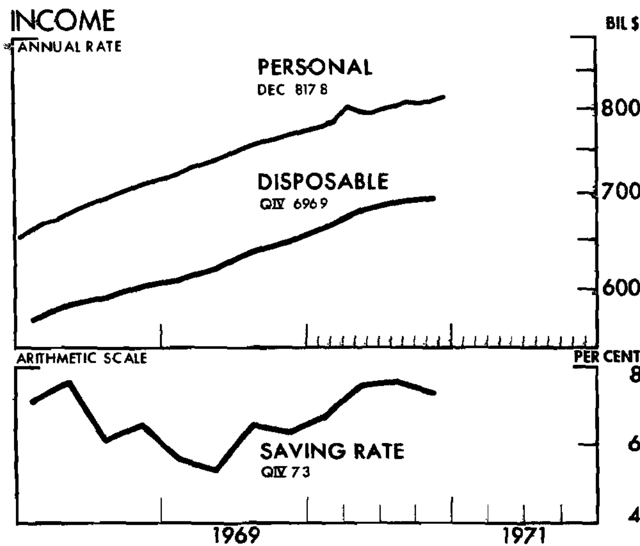


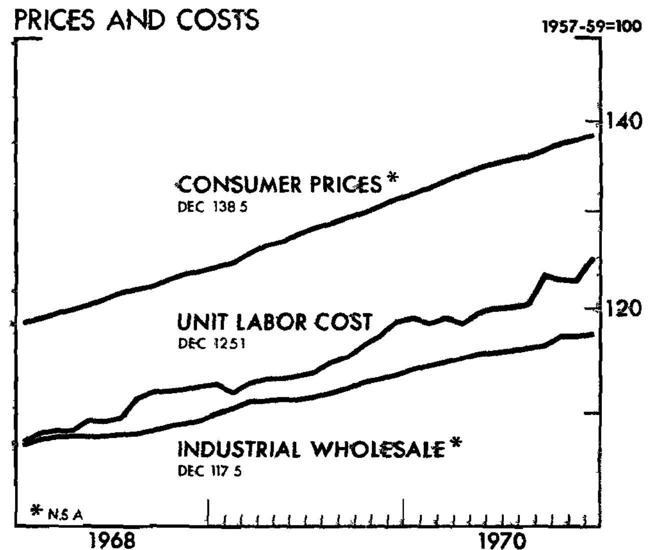


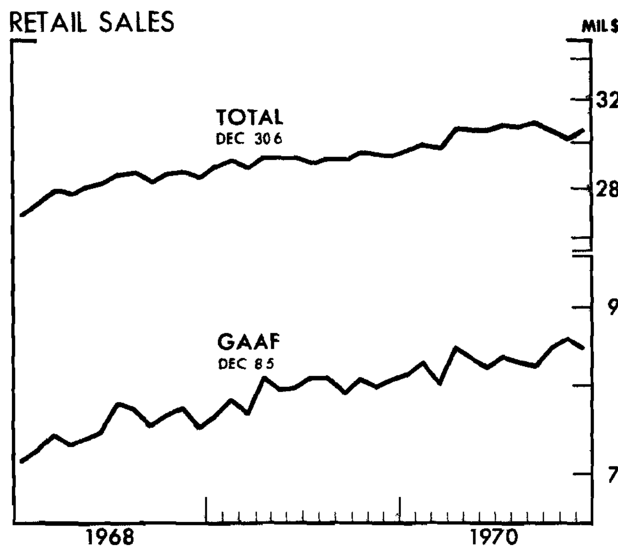


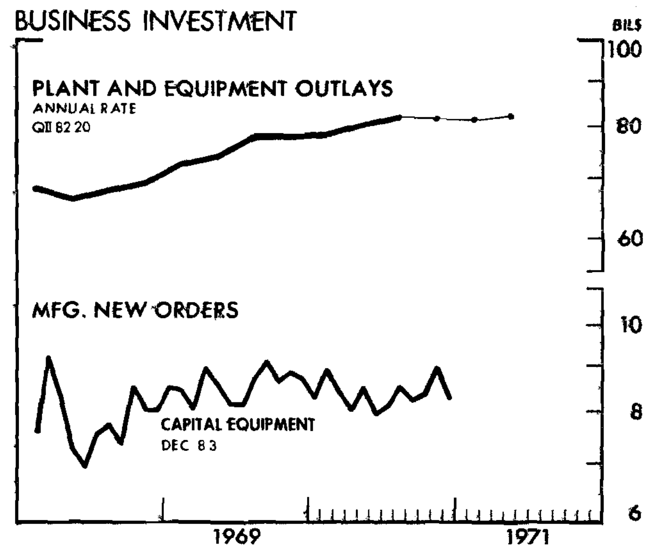
ECONOMIC DEVELOPMENTS - UNITED STATES

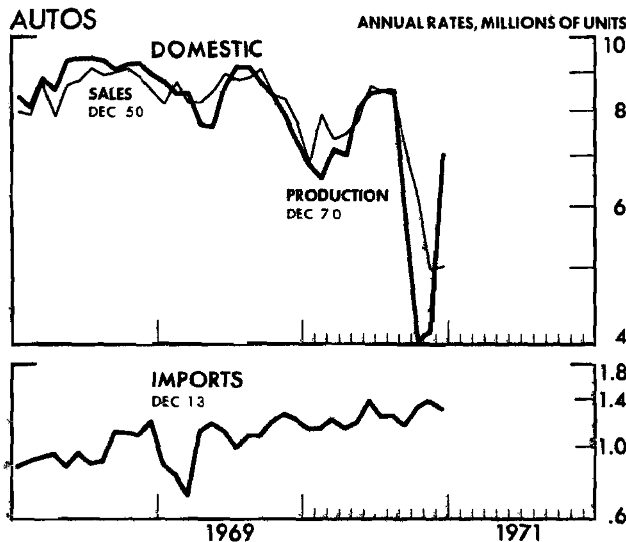
SEASONALLY ADJUSTED, RATIO SCALE

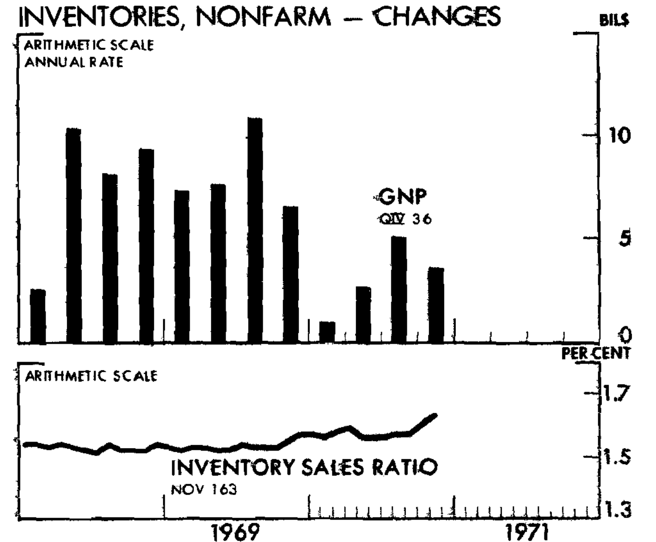












THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Monetary aggregates. The narrowly defined money stock (M_1) appears to have increased at an annual rate of about 3 per cent in January, about half the rate in December. A weakening in private demand deposit expansion was responsible for this slowdown, with public currency holdings continuing to rise at about the strong pace of other recent months. Growth in M_2 (M_1 plus commercial bank time deposits other than large CD's), at an annual rate of 12.5 per cent, was just slightly below the December rate of advance, as a stepup in the expansion of the time and savings deposit component of this measure compensated for slower growth in demand deposits.

An increased rate of growth of consumer-type deposits was primarily responsible for the strengthening in the time deposit component of M_2. In addition, there was a continued large inflow of state and local deposits that took the form of time deposits other than large CD's. In contrast to developments in these deposits, growth in large CD's dropped fairly substantially--although, even at this reduced rate, the inflows were still relatively large by historical standards--and this pulled the rate of growth in total time and savings deposits below that for December.

The slowdown in CD growth may reflect bank decisions to seek these deposits less aggressively, CD offering rates were reduced sharply during the month, from 5.50 per cent to 4.50 per cent for 60 to 89 day

maturities, for example. However, the reductions in bank CD rates were roughly matched by declines in other money market rates--for example, rates on 30 to 89 day finance company paper declined from 5.38 per cent to 4.25 per cent. There have also been numerous reports that banks have been lowering their offering rates on consumer-type time deposits. For the most part, these reductions have been accomplished by eliminating longer-term, higher-rate certificates, but in some cases the minimum required deposit has been raised. In addition, one major bank in the East has lowered its rate on passbook savings accounts to 4 per cent from 4-1/2 per cent.

The adjusted credit proxy also advanced at a somewhat slower rate in January than in December, reflecting a decline in U.S. Treasury deposits as well as the slower growth in private deposits. Bank borrowing from foreign branches declined at a faster pace than in other recent months, the increase in the attrition in part reflecting the reduction in liabilities to foreign branches that took place in conjunction with foreign branch acquisitions of $1 billion in Export-Import Bank certificates. On the other hand, declines in commercial paper liabilities of affiliates diminished to some extent.

MONETARY AGGREGATES
(Per cent, annual rates of change)

	1970 QII	1970 QIII	1970 QIV	1970 Dec.	1971 Jan.
1. Currency plus private demand deposits	5.8	6.1	3.4	6.2	3.0
2. Commercial bank time and savings deposits	14.1	32.2	21.8	28.8	26.0
a. large CD's	59.1	257.6	79.3	105.4	55.5
b. other time and savings	11.3	16.5	15.4	19.7	22.5
3. Savings deposits at mutual savings banks and S&L's	6.9	10.0	11.0	12.9	n.a.
4. Adjusted bank credit proxy	6.5	17.2	8.3	16.5	11.0
Concepts of money					
5. M_1 = (1)	5.8	6.1	3.4	6.2	3.0
6. M_2 = (1) + (2b)	8.4	11.0	9.2	13.0	12.5
7. M_3 = (1) + (2b) + (3)	7.9	10.7	9.7	13.0	n.a.

n.a. - Not available.

Bank credit. Commercial bank credit, adjusted for transfers of loans between banks and their affiliates, is estimated to have increased at an annual rate of 12.7 per cent in January, slightly above December's rate of expansion and more than double that for the fourth quarter. As in other recent months, security acquisitions accounted for the bulk of this increase, but some acceleration in the rate of loan expansion was also recorded.

U.S. Treasury securities were acquired in substantial volume in January, as in December. A major part of the increase in holdings of these issues was in notes and bonds with less than one year to

maturity. This apparently reflected bank acquisition of rights to be exchanged in the Treasury's forthcoming refinancing. Holdings of Treasury bills also were increased, while notes and bonds with over a year to maturity were reduced. Holdings of other securities also expanded sharply in January, almost matching the exceptionally large increases of November and December. Most of this growth was in State and local securities, with a fairly large share of these acquisitions in issues with intermediate and longer-term maturity dates.

Growth in total loans, adjusted for loan transfers, in January was at an annual rate of slightly more than 3.5 per cent. Business loans are estimated to have risen appreciably while moderate increases apparently occurred in loans to nonbank financial institutions and in real estate loans. Other loan categories remained unchanged or declined slightly.

The advance in adjusted business loans in January, at an annual rate of 7.6 per cent, reversed a four month period of reduction in which these loans declined at an average annual rate of 8.9 per cent. Public utilities accounted for a large share of the January advance, but loans to firms in several other industries, particularly chemicals and construction, also appeared fairly strong. The pickup in business loan demand may have been associated in part with the post auto-strike recovery in business activity. In addition, loan repayments out of the proceeds of capital market financing are believed to have fallen off substantially in January. Loan growth may also have been stimulated by the cut in bank prime rates to 6 per cent early in the month. The

improved competitive position that banks gained with this reduction, however, was eroded during the month as commercial paper rates declined further. At month end, the differential between the prime rate and these open market rates was wider than before the prime rate cut.

In part, the January increase may reflect technical window-dressing adjustments affecting both December and January that are difficult to allow for in the seasonal adjustment procedures. For the two months taken together, business loans adjusted show essentially no growth as compared to the sharp declines of the previous three months.

The increase in real estate loans amounted to about $400 million (seasonally adjusted), roughly the same as that in December and somewhat more than in earlier months. These latest increases highlight the gradual increase in flows of bank funds into the mortgage market that has been in progress since about the middle of last year. During the seven month period ending in January of this year it is estimated that banks increased their holdings of mortgages by about $1.5 billion, substantially more than in the first half of 1970 when there was very little growth.

COMMERCIAL BANK CREDIT ADJUSTED TO INCLUDE
OUTSTANDING AMOUNTS OF LOANS SOLD TO AFFILIATES[1/]
(Seasonally adjusted percentage changes, at annual rates)

	1970				1971
	HI	QIII	QIV	Dec.	Jan.[2/]
Total loans & investments[3/]	4.5	13.9	6.1	12.0	12.7
U.S. Government securities	8.5	25.9	2.8	31.9	29.0
Other securities	10.4	20.3	34.5	34.6	32.2
Total loans 3/	2.4	9.8	-1.0	1.2	3.7
Business loans 4/	8.1	1.8	-9.2	-6.5	7.6

1/ Last Wednesday of month series.
2/ All January changes are preliminary estimates based on incomplete data and are subject to revision.
3/ Includes outstanding amounts of loans sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
4/ Includes outstanding amounts of business loans sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

Nonbank depositary intermediaries. Deposit inflows to thrift institutions during the first half of January were exceptionally strong. At S&L's, they not only exceeded by a wide margin the previous record inflow for the entire month but they may well exceed the record growth rate for any month since at least 1955.[1/] The liquidity and safety of thrift institution claims have apparently continued to appeal to consumers in the face of uncertain employment prospects. Moreover, the decline in market interest rates during the past two months has dramatically enhanced the attractiveness of these claims from a yield standpoint,

1/ Data for the full month will be available for the Supplement.

with rates on these deposits now having a yield advantage over market rates on Treasury issues of approximately 150 basis points for one-year accounts and 80 basis points for 90-day accounts.

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

	MSB's	S&L's	Both
1968	7.0	6.0	6.3
1969	4.0	3.1	3.4
1970 p/	6.3	8.2	7.6
1970 - QIII	6.6	11.5	10.0
QIV p/	8.8	12.0	11.0
November*	9.1	9.2	9.2
December*	9.5	14.6	13.0

* Monthly data may not be significant because of difficulties with seasonal adjustment. Data are preliminary.
p/ Preliminary.

Given the recent exceptionally strong deposit growth, it would not be surprising if thrift institutions were to drop their offering rates below deposit ceiling rates now generally prevailing, particularly in light of indications that S&L funds could not quickly be converted into new mortgage loans--apparently even at recently liberalized mortgage terms and rates. As with some recent commercial bank actions, rate cutting might initially take the form of larger minimum deposits required on longer term accounts, or even cessation of offering such accounts.

During the fourth quarter, savings and loan associations acquired an exceptionally large volume of liquid assets. To some extent this undoubtedly constituted an intentional rebuilding of operating liquidity, including liquidity needed to meet forthcoming mortgage commitment takedowns. But in addition, it may partly reflect a lack of sufficiently high-yielding alternative long-term outlets available currently or in the near future. The extraordinary efforts of S&L's to acquire mortgages are indicated by the unusually large volume of loans purchased, apparently from warehousing arrangements of mortgage companies, as shown in the last line of the table below. To the extent that liquidity has been expanded because of a scarcity of mortgages, pressure can be expected to develop not only to stem inflows by reducing offering rates but also to repay outstanding Federal Home Loan Bank advances.

SOURCES AND USES OF FUNDS
AT INSURED SAVINGS AND LOAN ASSOCIATIONS
(Billions of dollars, not seasonally adjusted)

	Year			Fourth Quarter		
	1968	1969	1970	1968	1969	1970
Sources						
Deposit accounts 1/	7.3	3.9	10.8	2.7	.9	4.9
Borrowed funds	1.0	4.0	1.2	.3	1.4	.2
Subtotal	8.3	7.9	12.0	3.0	2.3	5.1
Gross mortgage repayments 2/	14.5	14.1	14.3	3.7	3.3	4.0
Other sources, net 3/	.9	.7	1.1	-.3	-.6	-.1
Total	23.7	22.7	27.4	6.4	5.0	9.0
Uses						
Increase in liquid assets	.1	-.8	3.0	.3	.1	1.1
Gross mortgage acquisitions	23.6	23.5	24.4	6.1	4.9	7.9
Total	23.7	22.7	27.4	6.4	5.0	9.0
Memorandum: Breakdown of gross mortgage acquisitions						
Loans closed	21.2	21.2	20.7	5.4	4.4	6.4
Loans purchased	2.4	2.3	3.7	.7	.5	1.5

1/ Net change in deposits, including interest credited.
2/ Includes, in addition to repayments, proceeds from sales of loans and participations and miscellaneous credits. Excludes interest, taxes, etc.
3/ Includes net changes in loans in process, reserves and surplus, and other liabilities minus the net changes in miscellaneous loans and assets not set out separately in the "uses" statement.

Greater fund inflows were not used to reduce borrowing during the fourth quarter because associations had contractually agreed to keep a large share of their FHLB advances outstanding for a one-year period that began in the spring of 1970. Nearly $3.5 billion of those loans mature in April, and another $3 billion mature in May and June. The current cost of these advances is over 7 per cent which, while a

subsidized rate, now looms exceptionally high in relation to the huge volume of funds associations have attracted from consumers at no more than 6 per cent. Incomplete responses to a FHLBB query on present plans tentatively suggest that S&L's might repay about one third of the outstanding FHLB advances. The prospect of large repayments of such advances suggests that not all of the resurgence in deposit inflows will result in an easing of home mortgage conditions.

Mortgage market. With deposit flows to thrift institutions continuing large into January, and demands for mortgage credit seasonally slack, field reports and trade opinion indicate that the availability of residential mortgage credit improved further and that mortgage rates continued under considerable downward pressure. Following some reduction during November and December in average interest rates on conventional home mortgages, cuts of as much as 1/4 to 1/2 per cent were made in many areas during January, judging from a spot survey of representative lenders conducted late last month by the Federal Reserve Banks. Rate declines were even posted last month in several States where restrictive usury ceilings had formerly kept rates from rising as much as they did in other areas. Meanwhile, respondents indicated that expectations of additional reductions were causing numerous would-be borrowers to hold back. A minority of the lenders interviewed reported limited increases in typical loan-to-value ratios as well, although average dollar downpayments remained quite high on homes purchased with conventional mortgages.

On FHA and VA mortgages, which have accounted for a growing share of all housing finance in recent quarters, contract rates were cut 1/2 of 1 per cent by administrative action announced January 12, following a similar reduction made early in December. This action brought the nominal rate on these Government underwritten loans down to 7-1/2 per cent, the lowest level in a year. Since then, further easing in market conditions has given rise to widespread trade expectations of another rate reduction before long. Based on the small volume of bids involved in FNMA's January 25 auction of forward commitments to purchase Government underwritten mortgages, yields on 6-month commitments declined to 7.97 per cent--39 basis points below the level prevailing in late December and 136 basis points below the peak reached in mid-1970. While results of the FHA conventional home-mortgage rate survey are not yet available for January, they are expected to show an unusually large decline.

RETURNS ON HOME MORTGAGES

Primary Market (Conventional loans)		Secondary Market (FHA and VA loans)	
Month	Rate	FNMA auction date	Yield
1970 - high July, August	8.60	January 12	9.36
September	8.50	September 21	9.01
October	8.50	October 19	8.90
November	8.45	November 16	8.90
December	8.30	December 28	8.36
1971 - January	n.a.	January 25	7.97

Note: For primary market, average contract interest rate on conventional first mortgages for new-home purchased, as reported by Federal Housing Administration. For secondary market, average gross yield before servicing costs implied by results of FNMA auctions of 6-month forward purchase commitments for 30-year Government-underwritten mortgages, after allowance for commitment fee and required purchase and holding of FNMA stock, and assuming prepayment period of 15 years.

Indicative of the improved flow of funds from private lenders into residential mortgages has been the strong market reception accorded 3 auctions held by FNMA last month to sell limited amounts of FHA and VA mortgages out of its portfolio. Taking advantage of the improved tone of the market during January, FNMA agreed to sell off a larger dollar volume of home loans ($104 million) than it committed to purchase ($36 million). In addition, GNMA in recent weeks has received a sharply increased number of applications to insure proposed issues of pass-through participations in pools of Government-backed mortgages. Under this program, which began early last year, a total of $1.6 billion in such applications had been received through late January, and $534 million in pass-through participations had been sold. Although the program was designed to broaden sources of funds for the mortgage market, the principal buyers of these participations to date have been savings and loan associations and savings banks--together accounting for two-thirds of total dollar purchases--which would be in the mortgage market in any case.

Improvement in the availability of mortgage credit during the fourth quarter of 1970 was reflected in a further pick-up in growth of total mortgage debt outstanding. The seasonally adjusted annual rate of net increase in such debt reached $29-1/2 billion, two-fifths above the recent low in the first quarter of last year, with residential mortgage debt expanding at an advanced $22-1/2 billion annual rate. Most net expansion in holdings of outstanding residential mortgage debt continued to be accounted for by savings and loan associations.

Life insurance companies. Demand for policy loans from life insurance companies slackened considerably during the fourth quarter as market interest rates and general credit conditions eased. Maintenance of current easier credit conditions can also be expected to be associated with an increase in loanable funds through larger portfolio return flows and insurance-related sources of funds. It may be indicative of expected increased fund flows that during December new commitments for corporate direct placements increased sharply, amounting to over $300 million for the first time since July 1969.

NET INCREASES IN POLICY LOANS AT 15 LIFE INSURANCE COMPANIES*
(Millions of dollars, not seasonally adjusted)

	Monthly Averages				December
	QI	QII	QIII	QIV	
1965	27	34	30	27	33
1966	42	70	111	104	90
1967	63	54	43	45	55
1968	60	82	73	56	57
1969	90	138	181	140	145
1970	154	138	107	76	66

* These companies account for nearly two-thirds of industry policy loans outstanding.

NEW CORPORATE DIRECT PLACEMENT COMMITMENTS
MADE BY LIFE INSURANCE COMPANIES 1/

STRICTLY CONFIDENTIAL

	Year (monthly average)	High	Low	December
Amounts ($ millions)				
1967	387	565	148	370
1968	387	333 2/	178	283
1969	221	328	138	173
1970	166	332	83	332
Average Interest Rates				
1967	6.63	6.98	6.37	6.98
1968	7.45	7.60	7.15	7.57
1969	8.39	9.32	7.50	9.32
1970	10.08	10.45	9.64	10.35

1/ Sample of companies representing about two-thirds of industry assets.
2/ There was a higher volume, $530 million, committed October 1968, but it represents commitments of nearly $300 million to finance one extraordinarily large project. That amount is included in the monthly average volume for 1968.

Corporate and municipal securities markets. Yields on corporate and municipal securities, on balance, continued their sharp decline in January, despite some initial investor resistance to lower yields early in the month. Further declines in money market rates, the continued weakness in the economy and a stepped-up pace of institutional investment contributed to the January decline. However, extremely aggressive pricing of new issues by investment bankers late in January led to investor resistance and a build-up of dealer positions. A large volume of new offerings in the tax-exempt market also resulted in mounting inventories in that area, as well as some increase in yields later in the month.

BOND YIELDS
(In per cent)

	New Aaa Corporate Bonds 1/	Long-term State and Local Bonds 2/
1970		
Low	7.68 (12/18)	5.33 (12/11)
High	9.30 (6/18)	7.12 (5/28)
Week of:		
December 18	7.68	5.47
25	--	5.50
January 1	--	5.58
8	7.59	5.74
15	7.31	5.39
22	6.98	5.13
29	6.76	5.16

1/ With call protection (includes some issues with 10-year protection).
2/ Bond Buyer (mixed qualities).

Public bond offerings by corporations in January were about $2.1 billion, off slightly from the December pace, as some industrial firms delayed financing plans, apparently in hope of still further declines in new issue yields.1/ Offerings by financial firms picked up significantly in January, however, and utility bond sales remained high. New stock offerings and takedowns of private placements in January appeared to be somewhat below the level of average monthly volume in 1970.

1/ Changes in the composition of public bond offerings in late 1970 and early 1971 are discussed in Appendix B.

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

	Bonds			
	Public Offerings	Private Placements	Stocks	Total
1969 - year	1,061	468	700	2,229
1970 - year	2,092	402e	703e	3,200e
1970 - QIII	1,995	304	553	2,853
QIV	2,516e	466e	816e	3,800e
1971 - QI	2,167e	333e	733e	3,233e
January	2,100e	300e	600e	3,000e
February	2,200e	300e	700e	3,200e
March	2,200e	400e	900e	3,500e

e/ Estimated.

Underwriters report that filings of bond issues by industrial companies will increase in the next 30 days, and the staff estimates that corporate public bond sales will exceed $2 billion a month in February and March. The forward calendar of equity offerings is already beginning to build up, but an increase in private placement takedowns will probably not be evident until later in the year since the increase in new commitments began only recently.

Long-term debt offerings by State and local governments set a postwar record of over $2.6 billion in January. An unusual supply of negotiated issues, including a $250 million New York State Urban Development bond, contributed to the huge total. While the volume of negotiated issues is not expected to be so large in the immediate future, the staff does expect tax-exempt offerings to continue at a monthly average rate in excess of $2 billion.

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

1969 - year	990
1970 - year	1,494e
1970 - QIII	1,473
QIV	1,891e
1971 - QI	2,300e
January	2,600e
February	2,100e
March	2,200e

e/ Estimated.

Bank acquisitions have been particularly heavy in the short-term end of the tax-exempt market--notes and early serial bond maturities--but banks have also been broadening the maturity range of their purchases. This support by the banking system enabled the tax-exempt market to absorb, at declining yields, an unusually heavy volume over the past few months. If business loan demand picks up later in this quarter, however, the pace of commercial bank buying will undoubtedly moderate. Although some increase in acquisitions by casualty insurance companies and mutual savings banks is expected in the quarter, it would be only a partial offset to the potential decline in bank buying.

Stock market. Recent sharp declines in long-term interest rates have made bond investments much less attractive relative to common stocks than has been the case in more than a year, especially when the return from both investments is viewed as the combination of current

yield and potential expected capital gain. To be sure, bond yields remain well in excess of dividend yields on stocks. But investors have apparently adopted a favorable view toward the prospects for sustained price appreciation in equities, with many apparently also concluding that near-term interest rate declines are unlikely to be sufficient to create comparable gains from investment in bonds. The effect of a resulting shift in investor interest from bonds back to stocks, combined with the impact of reentry into the market of institutional and individual investors who have been on the sidelines for the past six months to two years, has been a sharp increase in stock trading volume and a sustained advance in stock prices generally.

Since mid-November, the NYSE Index has risen more than 15 per cent and the AMEX Index approximately 13 per cent. While still well below their all-time high levels of 1968, the NYSE and AMEX indices are respectively about 40 and 25 per cent above their lows of May 1970. Contrary to the speculative appearance of these substantial price increases, the emphasis placed on quality issues in the equity market in recent months appears to be persisting.

Trading volume, which averaged about 11 million shares per day on the NYSE during November--and 11.6 million shares for 1970 as a whole--rose to an average of more than 15 million shares in December and a record 17.4 million shares in January. Reflecting increased trading and the reemergence of some brokerage back-office delays, failures to deliver rose nearly 30 per cent during December to an end-of-month level of $1.4 billion. While a further increase is believed to

have occurred in January (figures not yet available), fails are still well below their critical December 1968 peak of $4.1 billion.

Trading by institutional investors in blocks of 10,000 or more shares has accelerated markedly in the past two months. Relative to total trading on the NYSE, however, the percentage of large block trades has remained very close to the 15.4 per cent average for all of 1970. Thus the recent activity in the stock market appears to be broadly based reflecting the optimism of both institutional and individual investors. Judging by past relationships, investors would appear to be anticipating general recovery in corporate profits in the third or fourth quarter of 1971.

Among institutional investors, mutual funds were especially heavy buyers during December; their net common stock purchases of about $500 million during the month were greater than in any month since December 1968. Bank trust departments continue to provide a rather stable source of demand, as they have throughout the past two years. Insurance companies are reportedly not active in the equity market at the present time.

Government securities market. Interest rates throughout the Treasury market dropped markedly over the month of January, reflecting the same influences at work in corporate and municipal securities markets. In the coupon area, yield declines ranged from 20 to as much as 60 basis points. With the further easing of money market conditions and dealer financing costs, Treasury bill rates also dropped further in

the latter part of January, bringing the declines for the month as a whole to some 50 to 75 basis points.

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

	1970		Weekly average for week ending			
	Daily highs1/	Daily lows1/	Jan. 12	Jan. 19	Jan. 26	Feb. 2
Bills						
1-month	7.84 (1/28)	4.58 (12/28)	4.75	4.38	4.12	4.14
3-month	7.93 (1/16)	4.74 (12/17)	4.74	4.35	4.18	4.15
6-month	7.99 (1/5)	4.78 (12/17)	4.78	4.39	4.20	4.19
1-year	7.62 (1/30)	4.74 (12/31)	4.65	4.34	4.16	4.19
Coupons						
3-year	8.42 (1/7)	5.60 (12/4)	5.89	5.60	5.37	5.35
5-year	8.30 (1/7)	5.85 (12/4)	6.03	5.86	5.78	5.78
7-year	8.12 (4/26)	6.10 (12/4)	6.30	6.13	6.05	6.07
10-year	8.22 (5/26)	6.21 (12/4)	6.42	6.21	6.08	6.09
20-year	7.73 (5/26)	6.15 (12/16)	6.31	6.15	6.06	6.07
Agencies						
6-month	8.65 (12/27)	5.30 (12/31)	5.22	4.72	4.39	4.45
1-year	8.75 (1/2)	5.53 (12/24)	5.52	5.25	4.86	4.70
3-year	8.54 (1/2)	6.16 (12/21)	6.25	6.10	5.89	5.75
5-year	8.43 (1/15)	6.37 (12/21)	6.43	6.27	6.14	6.11

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

The results of the Treasury February financing operation, which involved the first major pre-refunding since the summer of 1966, were generally in line with expectations at the time of the Treasury's announcement. Of the $19.5 billion of publicly-held "rights", a total of $10.8 billion were exchanged, with $5.2 billion going into the new 5-7/8%, 4-1/2 year note and $5.6 billion into the 6-1/4%, 7-year issue. Attrition on the $6 billion of publicly-held maturing February and March

issues totaled about 18 per cent, somewhat higher than the market's expectation, but about as anticipated by Treasury analysts and the Board staff.

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

	January Daily Average	Jan. 11	Jan. 18	Jan. 25	Feb. 1
Treasury securities					
Total	5,629	5,104	4,857	5,317	5,214
Treasury bills (total)	3,861	3,628	3,153	3,200	3,154
Due in 92 days or less	1,254	1,093	928	1,114	962
93 days or over	2,608	2,535	2,225	2,086	2,192
Treasury notes and bonds (total)	1,767	1,476	1,704	2,117	2,060
Due within 1-year	761	673	816	1,421	195
1-5 years	526	368	463	552	904
over 5 years	480	436	425	144	962
Agency securities					
Total	968	862	895	1,060	1,011
Due within 1 year	536	423	450	676	631
over 1 year	432	439	445	384	380

Dealers' positions have increased by $100 million since the time of the last Committee meeting. Dealer awards of the two new issues totaled just under $1.1 billion and were about equally divided between the two notes. Demand for Treasury bills has been quite large, in part reflecting heavy foreign official purchases; and dealers' bill holdings have declined on balance since the last meeting despite awards in each of the last three weekly auctions of around $1.0 billion.

Other short-term credit markets. During December seasonally adjusted commercial and finance company paper outstanding rose $857 million to $33.5 billion. Dealer-placed and direct paper rose $1.6 billion, but this was partially offset by a further decline of $777 million in bank-related paper. Bank-related paper continued to decline through the third week of January, leaving $2.1 billion outstanding.

Despite the turbulence in the commercial paper market in June-July and the General Motors' strike during the fall, nonbank commercial and finance company outstandings rose $2.2 billion during 1970. After a rapid increase early in the year, both dealer and directly-placed paper fell sharply for three months beginning in June of 1970. Dealer paper has rebounded since August and reached a record high by year-end. Directly-placed paper, reflecting the GM strike and the accompanying reduced demand for consumer durables, has regained only $338 million since August. (See table on the following page.)

Short-term interest rates have fallen since December 30, with declines ranging from 50 to 125 basis points. The largest decreases were registered by commercial and finance company paper and certificates of deposit. Bill rates, which earlier showed a sharp decline, have recently tended to decline more slowly while other rates have continued their downward adjustment. The spread between three-month Treasury bills and certificates of deposit recently was about 40 basis points, a narrower spread than has prevailed for several years.

COMMERCIAL AND FINANCE COMPANY PAPER
(End-of-month data, in millions of dollars)

	December 1969	May 1970	August 1970	December 1970	
	Amount Outstanding				
Total commercial and finance paper 1/	33,221	39,503	35,697	33,511	
Bank related 2/	4,209	7,465	7,257	2,349	
Nonbank related 3/					
Placed through dealers	11,461	12,969	10,872	13,256	
Placed directly	17,551	19,069	17,568	17,906	
		Net change from preceding date shown			Net change from Dec. 1969 to Dec. 1970
Total commercial and finance paper 1/		6,282	-3,806	-2,186	290
Bank related 2/		3,256	- 208	-4,908	-1,860
Nonbank related 3/					
Placed through dealers		1,508	-2,097	2,384	1,795
Placed directly		1,518	-1,501	338	355

1/ Combines seasonally adjusted nonbank-related paper and seasonally unadjusted bank-related paper.
2/ Seasonally unadjusted.
3/ Seasonally adjusted.

SELECTED SHORT-TERM INTEREST RATES
(Wednesday Quotation - Discount Basis)
1970

	1970 Highs	1970 Lows	Dec. 30 1970	Jan. 13 1971	Jan. 27 1971	Net change Dec. 30, 1970 Jan. 27, 1971
1-month						
Commercial paper	9.25	5.50	5.75	5.13	4.50	-1.25
Finance paper	9.00	5.00	5.38	4.75	4.25	-1.13
Bankers' acceptances	9.00	5.50	5.50	5.13	4.68	- .82
Certificate of deposit-- new issues 1/	7.75	5.00	5.50	4.75	4.25	-1.25
Treasury bill	7.84	4.58	4.78	4.61	4.17	- .61
3-month						
Commercial paper	9.25	6.00	6.13	5.75	5.13	-1.00
Finance paper	8.25	5.50	5.50	5.38	4.50	-1.00
Bankers' acceptances	9.00	5.50	5.50	5.13	4.68	- .82
Certificate of deposit-- new issue 1/	6.75	5.50	5.63	5.00	4.63	-1.00
Treasury bill	7.93	4.74	4.89	4.56	4.22	- .67
6-month						
Bankers' acceptances	9.00	5.50	5.50	5.13	4.68	- .82
Treasury bill	7.99	4.78	4.91	4.57	4.26	- .65
12-month						
Certificate of deposit-- new issue 1/	7.50	5.50	5.63	5.00	4.63	-1.00
Treasury bill	7.62	4.74	4.78	4.55	4.24	.54
Prime municipals 2/	5.80	2.95	3.10	2.80	2.45	- .65

1/ Investment yield basis. Highs for certificates of deposit are ceilings effective as of January 21, 1970.

Source: Wall Street Journal's Money Rates for commercial and finance paper and bankers' acceptances; all other data from the Federal Reserve Bank of New York.

Federal finance. Staff projections of budgetary flows have been reviewed in light of the new Budget and the staff's revised income assumptions. For fiscal year 1971, the staff is now projecting a budget deficit of $18.8 billion, $0.2 billion more than the new Budget estimate for 1971. The major single difference in the staff assumptions for the current half year relative to the Budget is a projection of a more generous social security bill than the flat 6 per cent increase recommended by the Administration. However, this is mostly offset by lower staff estimates of expenditures in other areas based on shortfalls in recent spending patterns relative to targeted levels (especially in the grants area). On the receipts side, staff estimates for the current fiscal year come out the same as the Budget total on a unified budget basis, with lower income assumptions and slightly higher estimates of marginal tax rates offsetting each other.

With respect to financing requirements, a need for $3 billion of new borrowing is projected for March and a further $3-4 billion in April. According to previous Treasury statements, these financings would take the form of an increase in Treasury bills. The cash borrowing operation that is assumed for April would likely raise the Treasury debt above its current statutory ceiling. Moreover, a further borrowing operation seems required in May.

In view of the sizable maturities of tax anticipation bills during the remainder of the current fiscal year, Treasury net borrowing in the current fiscal year, Treasury net borrowing in the current January-June period would amount to only $1-2 billion. The combined market demands of the Treasury and Government-sponsored agencies are projected to be at about

the same level during this half year as they were in the first half of last year. Agencies are projected to be significant net repayers of debt in this period, in contrast to their large borrowing last year, whereas the Treasury, which made sizable net debt repayments last year, will be a modest net borrower in the current half-year.

An analysis of the budget outlook for fiscal year 1972 is given in Appendix C.

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

	Fiscal 1971e/		Fiscal 1972e/		F.R. Board Staff estimates: Calendar Years		Calendar Quarters				
	Jan. Budget	F.R. Board	Jan. Budget	F.R. Board	1970 Actual	1971e/	1970 IV	1971 I	1971 II	1971 III	1971 IV
Federal Budget											
(Quarterly data, unadjusted)											
Surplus/deficit	-18.6	-18.8	-11.6	-21.6	-11.4	-22.9	-8.9	-4.8	2.7	-9.6	-11.2
Receipts	194.2	194.2	217.6	213.4	190.5	201.4	41.1	47.2	59.5	49.9	44.8
Outlays	212.8	213.0	229.2	235.0	201.9	224.3	49.9	52.0	56.8	59.5	56.0
Means of financing:											
Net borrowing from the public	17.6	17.6	10.6	20.6	11.9	21.7	8.9	.2	1.1	8.4	12.0
Decrease in cash operating balance	n.a.	.1	n.a.	--	-2.8	.2	.7	2.6	-2.4	--	--
Other 1/	n.a.	.9	n.a.	1.0	2.3	1.0	-.7	2.0	-1.4	1.2	-.8
Cash operating balance, end of period	n.a.	7.9	n.a.	7.9	8.1	7.9	8.1	5.5	7.9	7.9	7.9
Memo: Net agency borrowing 2/	n.a.	3.0	n.a.	n.e.	8.8	n.e.	2.2	- .2	-.4	n.e.	n.e.
National Income Sector											
(Seasonally adjusted annual rate)											
Surplus/deficit	-15.0	-16.5	-4.2	n.e.	-10.8	-18.6	-15.4	-16.1	-22.7	-18.1	-17.4
Receipts	200.0	198.6	225.9	n.e.	195.4	207.3	194.1	200.6	204.9	207.3	216.3
Expenditures	215.0	215.1	230.1	n.e.	206.2	225.9	209.5	216.7	227.6	225.4	233.7
High employment surplus deficit (NIA basis) 3/	n.a.	-.9	n.a.	-1.0	-.7	-.3	1.7	.7	-4.4	2.2	.5

* Actual
e--projected
n.e.--not estimated
n.a.--not available

1/ Includes such items as deposit fund accounts and clearing accounts.

2/ Federally-sponsored credit agencies, i.e., Federal Home Loan Banks, Federal National Mortgage Assn., Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives. Projections omit Changes In FNMA discount notes.

3/ Estimated by Federal Reserve Board Staff. The level of the estimated series shown here differs considerably from the estimates by the Council of Economic Advisers.

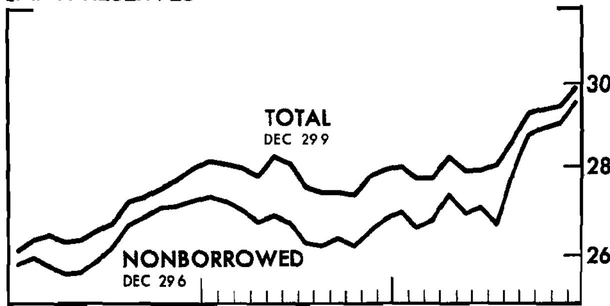
PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

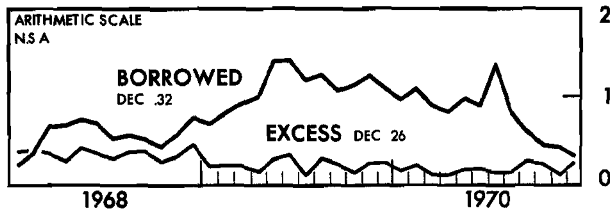
	Jan.	Feb.	March	Apr.
Total net borrowing	.7	-1.2	.7	1.5
Weekly and monthly bills	--	.3	.4	.1
Tax bills	--	--	-2.5	-2.3
Coupon issues	--	--	--	--
As yet unspecified new borrowing	--	--	3.0	3.6
Other (debt repayments, etc.)	.7	-1.5	-.2	.1
Plus: Other net financial sources[a/]	1.0	.3	.7	.6
Plus: Budget surplus or deficit (-)	-.2	- .8	-3.8	1.4
Equals: Change in cash balance	1.5[b/]	-1.7	-2.4	3.5
Memoranda: Level of cash balance, end of period	9.6[b/]	7.9	5.5	9.0
Derivation of budget surplus or deficit:				
Budget receipts	17.0	16.4	13.8	21.3
Budget outlays	17.2	17.2	17.6	19.9
Maturing coupon issues held by public	--	5.0	1.0	--
Net agency borrowing	*	.1	-.2	.1

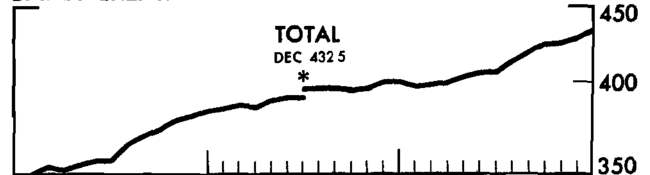
* Less than $50 million
a/ Checks issued less checks paid and other accrual items.
b/ Actual

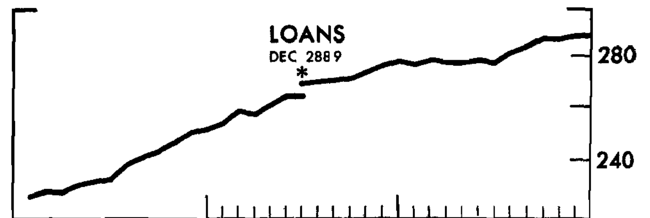
FINANCIAL DEVELOPMENTS - UNITED STATES

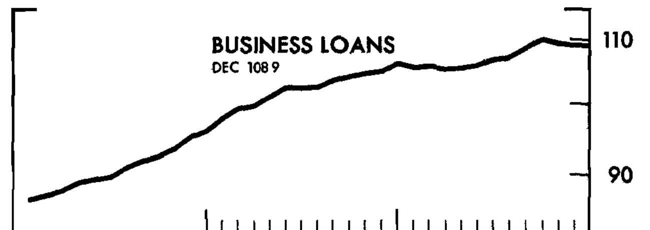
BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

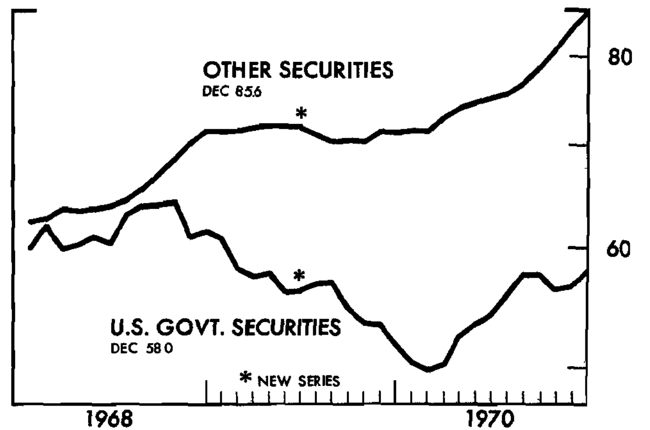


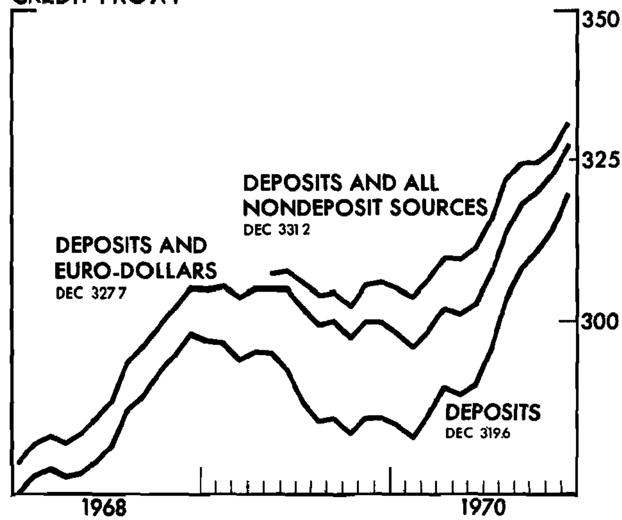


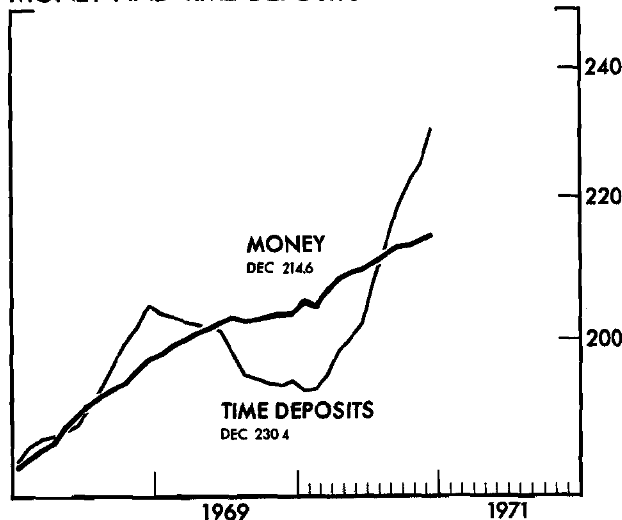


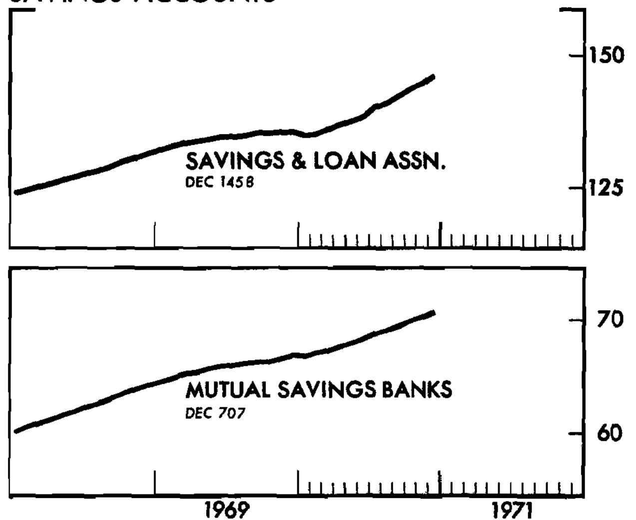






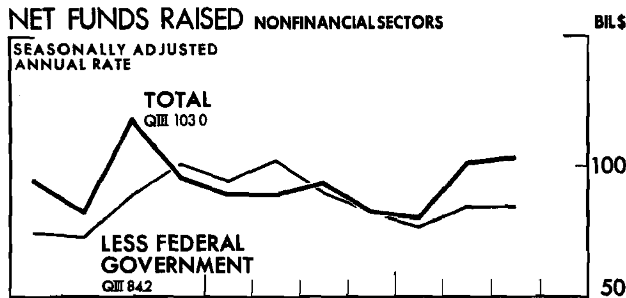


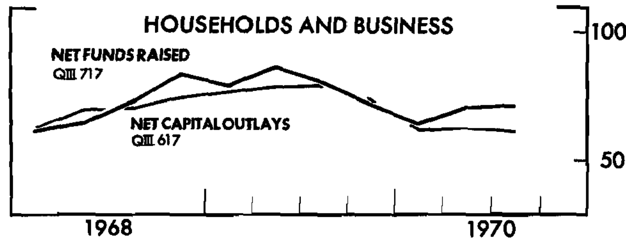




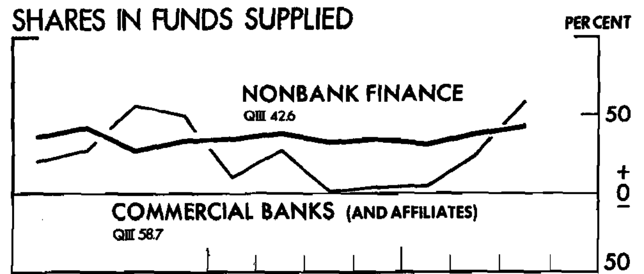
FINANCIAL DEVELOPMENTS - UNITED STATES

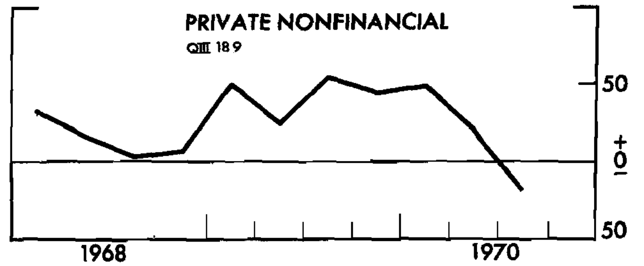
NET FUNDS RAISED NONFINANCIAL SECTORS



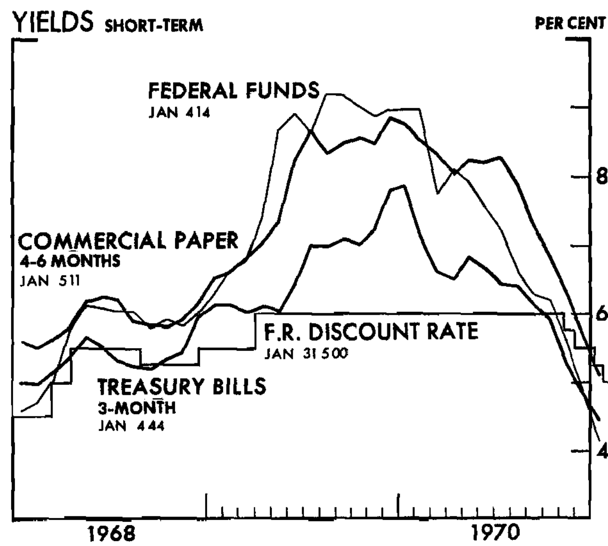


SHARES IN FUNDS SUPPLIED

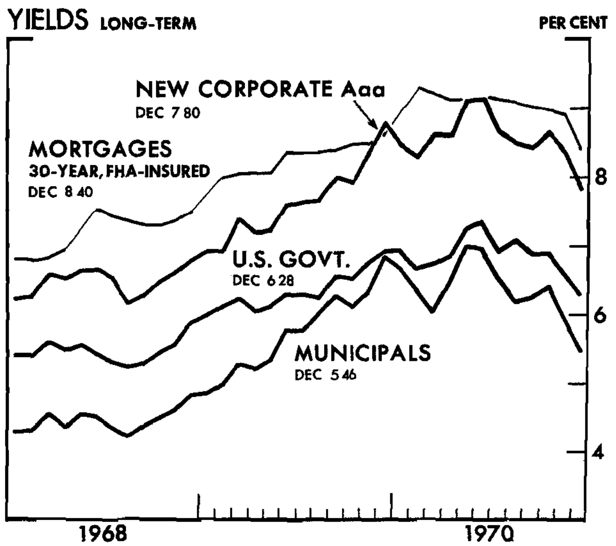




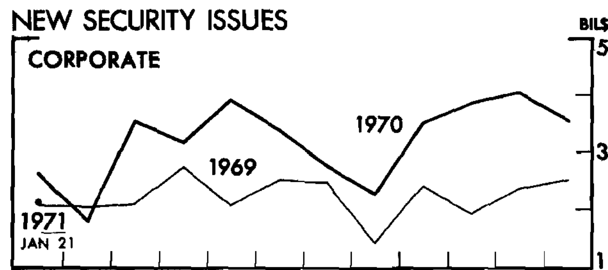
YIELDS SHORT-TERM

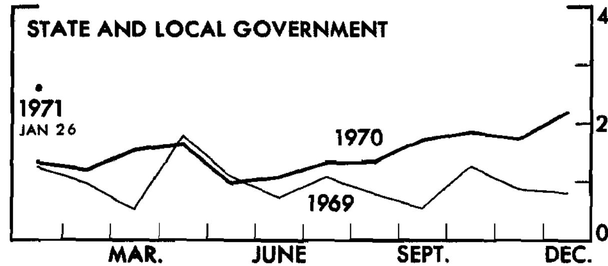


YIELDS LONG-TERM

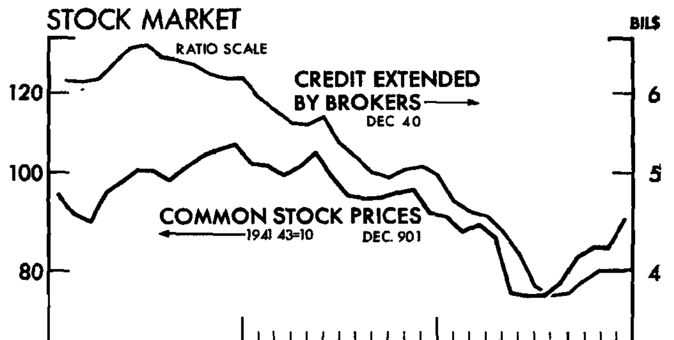


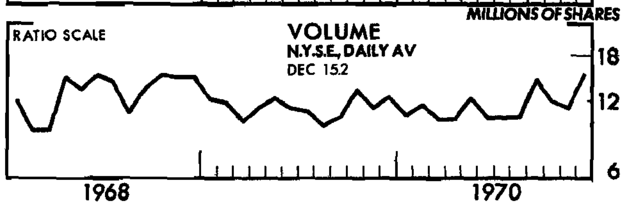
NEW SECURITY ISSUES





STOCK MARKET





THE ECONOMIC PICTURE IN DETAIL

International Developments

U. S. balance of payments. Somewhat more complete data for the overall balances in December comfirm the earlier estimate for the fourth quarter of a $3.0 billion liquidity deficit (annual rate, seasonally adjusted, before special transactions), not significantly different from the third quarter rate. For the year the overall deficit on this basis was $4.9 billion.

U.S. Balance of Payments
(billions of dollars; deficit (-)

	1968	1969	1970[1/]
Liquidity balance before special transactions	-2.3	-6.0	-4.9
Special Transactions	2.5	-1.1	0.2
Liquidity balance as published	0.2	-7.0	-4.7
Official settlements balance before specials	1.4	2.8	-11.0
Special Transactions	0.2	-0.1	0.4
Official settlements balance as published	1.6	2.7	-10.7

1/ Excludes SDR allocation.

Known transactions in the fourth quarter that were adverse included the reduction in the trade surplus (discussed below) and a sharp increase in bank lending in December. Most of the recent outflow of bank credit seems to have represented borrowing by Japanese banks, which turned to their U.S. credit lines for funds as interest rates here declined. The fourth-quarter increase in banking claims was $650 million (seasonally adjusted) following a reduction of $150 million in the third quarter. The net increase for the year in bank reported claims -- $810 million -- was the largest since the VFCR was instituted. However, a sizable part of the reported outflow represented claims not subject to the VFCR, including claims on Canada and credits under the Export-Import Bank exemption.

Transactions in securities in the fourth quarter, however, were more favorable than in the third. Foreign net purchases of U.S. corporate stocks rose to $200 million in December, as the stock market advanced, and for the entire fourth quarter net purchases were over $450 million, somewhat better than the $380 million in the third quarter. These net purchases compare with net sales of $170 million in the first half of the year. Net foreign purchases of U.S. corporate bonds in the fourth quarter were about $250 million -- about the same as the quarterly average for the year. This includes sales of new issues abroad to finance direct investments.

U.S. net purchases of foreign securities in the fourth quarter were about $200 million, much less than the sizable outflow in the preceding quarter. For the year as a whole the outflow to purchase foreign securities were only about $800 million, compared to $1.5 billion in 1969.

Partial data for the January liquidity deficit suggest that it was on the order of $1 billion (before seasonal adjustment or the second allocation of SDRs). Seasonal adjustments have been disrupted by the size and variability of year-end window-dressing, but the unadjusted January deficits have risen steadily since 1967, and last year the January deficit (comparably defined) was about $800 million. This suggests that the January deficit this year still represents a very large underlying deficit. In the last days of the month, a $200 million IBRD medium-term bond issue was sold to U.S. banks, but the proceeds were largely invested in non-liquid assets.

The size of the official settlements deficit for January is not clear at this time; the available weekly data and reported reserve gains of other countries suggest that it was quite large but less than the fourth-quarter rate.

U.S. foreign trade. The export surplus in December 1970 was $1.4 billion at a seasonally adjusted annual rate, balance-of-payments basis, compared with a small deficit ($0.4 billion) in November.

In the fourth quarter, the surplus ran at an annual rate of only $0.6 billion, down sharply from the $2.9 billion third-quarter rate. This sizable reduction in the surplus resulted from a moderate decline in exports and a substantial rise in imports. The GM strike and the continued easing of tight supply conditions among steel producers in Western Europe both affected the balance adversely. The decline in exports of machinery and the rise in imports of petroleum were also contributing factors.

For the year 1970 as a whole, gains in exports outstripped gains in imports, and the surplus rose to about $2.2 billion from the low $0.6 billion levels recorded in both 1968 and 1969. Most of the improvement in 1970 occurred in the first half of the year; the monthly surpluses reached a peak at mid-year and then declined steadily until December.

U.S. MERCHANDISE TRADE[1/]
(billions of dollars, seasonally adjusted annual rates)

		1 9 7 0				
	1969	Year	Q-1	Q-2	Q-3	Q-4
Exports	36.5	42.0	40.9	42.8	42.7	41.7
Agricultural	6.0	7.3	6.7	7.2	7.4	7.8
Nonagricultural	30.5	34.8	34.2	35.7	35.3	33.9
Imports	35.8	39.9	38.9	39.5	39.8	41.1
Balance	+0.6	+2.2	+2.0	+3.3	+2.9	+0.6

1/ Balance-of-payments basis.
Note: Details may not add to totals because of rounding.

For 1971, a somewhat smaller trade surplus than in 1970 is in prospect. Demand for exports may be dempened as a result of less buoyant economic activity abroad, while imports are expected to increase as a result of rising demand in the United States.

The U.S. bilateral trade balances with Canada, Western Europe, and Japan deteriorated in the fourth quarter of 1970. The balance with Canada worsened by $1.7 billion -- partly because of the GM strike -- and accounted for about three-fourths of the total decline in the U.S. export surplus in that quarter. The deterioration in the balance with Western Europe was wholly the result of increases in imports; exports to Western Europe remained unchanged between the third and fourth quarters. For the year 1970, the U.S. bilateral trade balances with all major areas -- except Canada -- improved.

U.S. BILATERAL TRADE BALANCES WITH MAJOR AREAS
(Billions of dollars; seasonally adjusted annual rates)

	1969	1970				
		Year	Q-1	Q-2	Q-3	Q-4P
Total	0.6	2.2	2.0	3.3	2.9	0.6
Canada	-0.8	-1.7	-1.4	-1.4	-1.1	-2.8
Latin America	0.3	0.6	0.4	0.3	0.6	1.1
Western Europe	1.4	3.0	3.0	3.4	2.9	2.7
United Kingdom	-0.1	0.3	(*)	0.6	0.3	0.2
Continental Europe	1.5	2.7	3.0	2.9	2.6	2.5
Japan	-1.4	-1.2	-1.1	-1.0	-1.1	-1.5
All other	1.1	1.5	1.1	2.0	1.6	1.2

Note: Details may not add to totals because of rounding.
(*) = Less than $50 million.
P = Preliminary.

<u>Exports</u> in the fourth quarter of 1970 were $41.7 billion at a seasonally adjusted annual rate, balance-of-payments basis, 2.3 per cent below the third quarter. For 1970 as a whole, exports were $42.0 billion, an increase of over 15 per cent from the strike-depressed $36.5 billion level of a year earlier. Roughly a third of this increase in the value of 1970 exports represented price rises (measured by unit values).

Exports of <u>agricultural</u> commodities -- especially wheat, corn, cotton, rice, and tobacco -- made further substantial gains in the last quarter of 1970. For the entire year, agricultural exports reached a record high of $7.3 billion, up 21 per cent from 1969. This sharp increase resulted from extremely strong demand abroad for most agricultural products, together with a reduction in foreign supplies of some competing commodities. About a third of the rise was accounted for by soybean exports, while the remainder was attributable to exports of wheat, cotton, corn and grain sorghum. Some of the increase in the value of soybean and corn exports reflected higher export prices in 1970. However, high U.S. prices held down exports of unmanufactured tobacco, while shipments of rice were depressed because of greater production abroad. For 1971, the outlook is for another good year for agricultural exports, although the high 1970 levels will probably not be exceeded.

Exports of nonagricultural commodities dropped in the fourth quarter of 1970, more than offsetting the rise in agricultural exports. The declines were concentrated in steel, automotive, and machinery exports. Steel exports, which had been booming from mid-1969 to mid-1970, fell in the third quarter and declined further in the fourth quarter. The sizable reduction in automotive exports -- especially to Canada -- was associated largely with the GM strike. Machinery exports dropped somewhat from the high third-quarter rates, with the greater part of the decline in the months of November and December. This November-December decline occurred in machinery exports to most major areas, but especially to Latin America and Western Europe. In contrast, exports of civilian aircraft, coal, and chemicals rose in the fourth quarter.

Nonagricultural exports for the entire year 1970 increased by about 14 per cent from the 1969 level despite the overall decline in the value of such exports in the third and fourth quarters. A key factor in the increase from 1969 to mid-1970 was the vigorous expansion of industrial activity in major foreign markets into the second quarter of last year. Exports of machinery, civilian aircraft, and industrial supplies -- especially chemicals, steel and coal -- accounted for the greater part of this upsurge in the value of non-farm exports. Automotive exports were the only major comodity group showing a decline in 1970,

mainly because of the GM strike.

Imports in the fourth quarter were at a seasonally adjusted annual rate of $41.1 billion (balance-of-payments basis), 3 per cent above the third-quarter level. For 1970 as a whole, imports were $39.9 billion, 11-1/2 per cent above 1969.

The rise in imports between the third and fourth quarters can be attributed almost entirely to large increases in petroleum imports, resulting from the U.S. fuel shortage, and in steel imports. Imports of coffee, textiles, automobiles from Europe and Japan, and non-durable consumer goods also registered gains. Imports of machinery and automobiles from Canada were the only major categories that were lower in the fourth quarter than the third.

For the year 1970, significant increases occurred in all major categories of imports. Among foods, imports of coffee advanced because of higher prices while domestic supply shortages resulted in higher sugar quotas. Imports of industrial supplies, such as chemicals and metal products, showed great gains in 1970. Steel imports, in particular, increased as foreign producers with enhanced supply capabilities attempted to meet their current U.S. quota levels in the anticipation of possible renegotiation of these quotas. In 1971, imports of steel should rise even further because of hedge buying in anticipation of a mid-year steel strike. Threats of quotas may also have spurred the big increase in textile fabric imports during the final months of 1970.

Imports of fuel oil increased during 1970 to satisfy expanding U.S. demand; however, deliveries of crude oil to the U.S. declined in 1970, reflecting tanker shortages and production cutbacks in Libya.

Imports of machinery, both non-electric and electric, increased significantly in 1970. Automotive imports, particularly from Japan and Europe, also showed great gains. Sales of foreign-types cars in 1970 were 1.2 million units, about 130 thousand more than in 1969.

The strong increase in imports in 1970, despite the slowing of the economy, was largely the result of higher import prices. There was only a 3 per cent increase in the quantity of total imports while import unit values rose by 8 per cent. This large advance in unit values contrasts sharply with the 3 per cent rise in 1969 and year-to-year increases of about 1 per cent in 1967 and 1968. Note, however, that a rise in unit values may reflect compositional changes as well as actual increases in import prices.

Euro-dollar market

Interest rates in the Euro-dollar market fell substantially in the first three weeks of January but firmed -- particularly in the shorter maturities -- in the last few days of the month and the first few days of February.

Call Euro-dollar deposits, which averaged about 6 per cent in late December and early January declined to average about 4.6 per cent in the latter half of January but then firmed to over 5-1/2 per cent in the first few days of February. Three-month deposits fell to about 5.6 per cent late in January, down from nearly 7 per cent in late December. The three-month rate has since firmed to around 5.8 per cent -- a small increase in comparison with the recent advance in the call deposit rate.

As shown in the table below, the excess of the call Euro-dollar rate over the Federal funds rate fell markedly during January -- reaching about 3/8 per cent near the end of the month; but this differential has since widened with the increase in the call Euro-dollar rate. The excess of the one- and three- month Euro-dollar rate over the cost of CD's of comparable maturity changed little on balance during January because reductions in Euro-dollar rates were roughly matched by declines in CD rates. Differentials in these maturities have increased to about 1-1/2 per cent in the first few days of February.

SELECTED EURO-DOLLAR AND U.S. MONEY MARKET RATES

Average for month or week ending Wednesday	(1) Call Euro-$ Deposit 1/	Federal Funds 2/	(3)= (1)-(2) Differ-ential	(4) 3-month Euro-$ Deposit 1/	(5) 60-89 day CD rate (Adj.) 3/	(6)= (4)-(5) Differ-ential
1970						
October	6.65	6.20	0.45	7.94	6.97	0.97
November	5.98	5.60	0.38	7.17	6.26	0.91
December	6.70	4.90	1.80	7.25	5.82	1.43
1971						
Jan. 6	6.10	3.82	2.28	6.44	5.66	0.78
13	5.63	4.27	1.36	6.14	5.26	0.88
20	4.60	4.13	0.47	5.81	4.74	1.07
27	4.60	4.23	0.37	5.59	4.74	0.85
Feb. 3	5.54	4.13 p/	1.41 p/	5.81	4.74 p/	1.07

1/ All Euro-dollar rates are noon bid rates in the London market.
2/ Effective rate.
3/ Offer rate (median, as of Wednesday) on large denomination CD's by prime banks in New York City; C/D rates are adjusted for the cost of required reserves.
p/ Preliminary.

Liabilities of U.S. banks to their foreign branches increased by an estimated $1.1 billion from December 31 to January 20, largely reflecting the unwinding of foreign branch financing of U.S. corporate year-end capital repatriations, rather than a flow of funds from foreign countries to the United States through the Euro-dollar market. From January 20 to 27 liabilities to foreign branches declined by nearly $1.3 billion; $1 billion of this decline reflected foreign branch acquisition of special Export-Import Bank securities on January 25. Thus, for the week ended January 27 liabilities to foreign branches plus foreign branch holdings of special Ex-Im securities declined, net, by about $300 million, to total about

$7.7 billion. The reduction in liabilities to branches associated with the Export-Import Bank security issue reflected the banks' decision to finance the purchase of these securities out of the U.S. money market, rather than with higher cost Euro-dollar funds. Data from January 27 to Monday, February 1 show a further net decline in liabilities to foreign branches of nearly $1/2 billion.

In the Euro-dollar reserve requirement computation period ended January 20, 1971 the banks are estimated to have maintained daily average borrowings about $3/4 billion below the average of the preceding period, which in turn was about $1/2 billion below the average for the computation period ended November 25. There was a very sizeable decline in borrowings around year-end and a subsequent rise; but total liabilities to branches as of January 20 (about $8.0 billion) were little changed from the total outstanding on December 23.

Daily data indicate that the banks' daily average borrowings for January 21-February 1 are about $1.0 billion below their average in the computation period ended January 20. Holdings of the Ex-Im securities, acquired by the branches on January 25, will add back about $860 million (on a daily average basis) to the reserve-free bases of the banks.

Recent advances in Euro-dollar rates may have been associated with a moderate firming of some U.S. money market rates near month-end as well as usual end-of-month tightening of conditions in the Euro-dollar market. Exchange rates for most of the major European currencies,

however, have eased in recent days as Euro-dollar rates have firmed, implying that the advances in Euro-dollar rates have not been a consequence of funds being attracted to European national money markets. One major exception to this pattern was the sterling market where the exchange rate has advanced since the last few days of January, reflecting a substantial tightening of short-term money markets in Britain.

Foreign Exchange Markets

The sharp decline in Euro-dollar interest rates until near the end of January -- see the preceding section -- led to large interest arbitrage flows out of Euro-dollars and into assets denominated in sterling and continental European currencies. Spot exchange rates for most major foreign currencies advanced strongly, reaching or nearly reaching their upper limits. Forward discounts for these currencies widened very sharply, tending to equilibrate covered interest yields in the Euro-dollar market and national money markets. The Bank of England and major European central banks intervened heavily in the exchange markets, purchasing nearly $1-1/2 billion in spot and swap transactions (excluding the reversal of year-end swaps between the Swiss National Bank and Swiss commercial banks). At the end of January and in the first few days of February, as previously cited, Euro-dollar rates rose markedly, and foreign currencies eased.

The Bank of England was the largest reserve gainer in January, purchasing $535 million. Some $235 million of this spot

intake was swapped out to the market, shifting that part of Britain's reserve gains into February. Spot sterling rose by more than two full cents during January, and closely approached the ceiling rate of $2.42. Two main factors behind this strength were interest-arbitrage flows and heavy commercial demand reflecting and anticipating the usual tax period tightness in London financial markets and the accompanying seasonal strength of sterling. Around month-end an acute squeeze on sterling cash balances developed, sending interbank loan rates on over-night sterling to as high as 8-1/2 per cent (compared with Euro-dollar rates of 5-1/2 - 6 per cent). The absence of a discount rate reduct-ion by the Bank of England (widely expected in early January), coupled with a modification of exchange controls to curtail foreign borrowing by British corporations, convinced the market that Britain was deter mined to continue its restrictive monetary policy, and led to some cutting out of short positions in sterling.

Among continental central banks, the Bank of France added $325 million to its reserves through market intervention in January, the German Federal Bank $285 million, the Bank of Italy $240 million, and the National Bank of Belgium $210 million. The currencies of each of those countries strengthened, apparently, mainly on the basis of interest arbitrage demand. The German mark, however, remained well below its upper limit despite the decline in Euro-dollar rates until near the end of January. Following the Bundesbank Credit Council's

decision, on January 20, not to lower the discount rate, the exchange rate jumped up sharply and stayed at or very close to the ceiling through month-end.

The Dutch guilder firmed sharply early in the month as the Netherlands Bank took delivery of guilders swapped against dollars back in October. When the exchange rate reached the ceiling, the central bank again offered guilders to the market on a swap basis, and in effect, rolled over about two-thirds of its maturing swaps. Following this operation, the domestic money market eased, the spot exchange rate slipped below its ceiling and a small premium developed on forward guilders.

The Swiss franc firmed throughout January as Swiss banks delivered almost a billion dollars equivalent of Swiss francs to the central bank, unwinding the over-year-end swaps done during December.

In official transactions, the Treasury during January sold $100 million equivalent of SDRs and $25 million in gold to the Netherlands Bank. In addition, it drew $125 million equivalent of Dutch guilders from the IMF. These transactions enabled the System to reduce its swap indebteness to the Netherlands Bank by $225 million, to an outstanding total of $75 million. (The Netherlands Bank's uncovered dollar position was reduced by $25 million.)

The Treasury also drew $125 million equivalent of Belgian francs on the IMF, enabling the System to repay that amount of its swap drawings on the National Bank of Belgium. In January and early February, however, the System made further drawings, totaling $220 million,on the Belgians, and System indebtedness on that line currently amounts to $305 million.

Reserves and payments balances of major industrial countries. Official reserve gains of major industrial countries other than the United States remained very large in the third quarter of 1970, and increased still further in the fourth quarter. For the Group of Ten countries excluding the United States, and for Switzerland, official net foreign assets rose $3.3 billion in the third quarter -- moderately less than in the second -- and $6.0 billion in the fourth (of which about $2.0 billion reflected year-end repatriations by German and Swiss banks). For all of 1970, these countries' official net foreign assets increased by $15.2 billion, excluding initial allocations of SDR's which provided them with an additional $1.3 billion of reserves. The same group of countries lost $4.1 billion of reserves in 1968 and $2.3 billion in 1969.

In January 1971, known exchange market intervention gains by foreign central banks in the G-10 group (not including Switzerland) totalled around $1.3 billion. The unwinding of Swiss banks' swaps with the Swiss National Bank reduced Swiss reserves by $1.1 billion.

The massive reserve increase of the other G-10 countries in the second half of 1970 reflected the group's collective balance-of-payments surplus as measured by changes in official and commercial bank net foreign assets combined, if allowance is made for year-end window-dressing in Germany. In July-November there was little net change in the net foreign position of commercial banks in the group as a whole.

In December, German commercial banks repatriated about $900 million, and Bundesbank reserves were thereby increased.

Underlying imbalances in payments for international trade and long-term capital movements persisted in 1970. But the extraordinarily large net reserve gains of the other industrial countries last year -- aggregating about $16-1/2 billion if their SDR allocations are counted in and Switzerland is included -- also reflected very large repayments by U.S. banks to the Euro-dollar market in addition to unusually large placements of reserves in the Euro-dollar market by central banks of this group of countries and others, and by the BIS. The funds put

CHANGES IN OFFICIAL NET FOREIGN ASSETS
(in millions of dollars; no sign=increase)

	1970[1/]				1970		
	I	II	III	IV	Oct.	Nov.	Dec.
France	530	514	488	282	55	169	58
Germany	167	1,484	2,232	2,082	543	1,586	-47
Italy	-877	226	171	868	366	127	375
United Kingdom	1,857	494	-449	867	265	477	125
Belgium-Lux.	69	72	189	55	51	54	-50
Netherlands	51	14	305	247	259	-5	-7
Sweden	-77	-8	21	68	-24	55	37
Canada	378	840	260	130	50	48	32
Japan	283	-1	-116	842	219	211	412
Total for G-10 countries excluding United States	2,381	3,635	3,101	5,441	1,519	2,245	935
Switzerland	-432	384	218	519	-440	-30	989

1/ Excluding initial allocations of SDR's.
Source: Confidential BIS data.

into the Euro-dollar market in these two ways helped finance very large private capital inflows into Germany and other countries that contributed heavily to their reserve gains. The $16-1/2 billion net reserve gain of the leading industrial countries outside the United States, together with the gain of about $3-1/2 billion in the net reserves (including SDR allocations) of all other countries (according to early tentative estimates), had their counterpart in the combination of an addition to world reserve holdings of gold and SDR's of more than $3-1/2 billion, a U.S. net reserve loss (after including SDR allocation) and increase in U.S. liabilities to

CHANGES IN OFFICIAL AND COMMERCIAL BANK NET FOREIGN ASSETS
(in millions of dollars; no sign=increase)

	1970 1/				1970		
	I	II	III	IV	Oct.	Nov.	Dec.
France	434	871	313	n.a.	-75	n.a.	n.a.
Germany	-250	1,164	1,883	1,109p	829	1,219	-939p
Italy	-711	180	371	614p	210	53p	351p
United Kingdom	1,304	207	-240	n.a.	5	160	n.a.
Belgium-Lux.	96	41	93	n.a.	65	10	n.a.
Netherlands	4	156	287	n.a.	26	-53	n.a.
Sweden	-77	40	-6	n.a.	13	57	n.a.
Canada	87	630	421	n.a.	143	n.a.	n.a.
Japan	-16	23	650	723	247	76	n.a.
Total for G-10 countries excluding United States	871	3,312	3,772	n.a.	1,463	n.a.	n.a.
Switzerland	421	-131	580	n.a.	n.a.	n.a.	n.a.

1/ Excluding initial allocations of SDR's.
p - Preliminary
n.a. - Not available
Source: Confidential BIS data and FR estimates.

foreign reserve holders totalling nearly $10 billion, and an unidentified discrepancy of more than $6 billion. Indications from various sources suggest that at least half of this discrepancy is to be explained by Euro-dollar placements by central banks and the BIS.

Every one of the G-10 countries other than the United States appears to have run a balance-of-payments surplus in the second half of 1970, with the possible exception of the United Kingdom. Germany, Italy, and Japan had notably stronger payments balances in the second half of the year than in the first, wholly or partly because of shifts in capital flows. Germany's second-half surplus was the largest of any country, notwithstanding a deficit in December, when German business enterprises ceased being net borrowers of large amounts of short-term funds abroad and made net repayments instead. A surplus on current and long-term capital accounts in the latter months of the year indicated underlying strength in Germany's external position.

Italy's balance of payments had already shifted from deficit to surplus in the first half of 1970. The increase in the surplus in the second half in large part reflected a net capital inflow that was heavily concentrated in the month of December. In Japan, the effect on the overall balance of a lower level of net long-term capital outflow was supplemented by a second-half seasonal improvement in the trade balance and by heavy borrowing in the United States in December.

French official reserve gains slowed down, particularly in the fourth quarter. The trade deficit narrowed in the fourth quarter, to about

the second-quarter level, but there was evidently some slackening of nonbank capital inflow. Britain's overall balance shifted into deficit in the third quarter as a result of changes in short-term capital flows but improved in the fourth quarter. Canada's external position has remained very strong. The Canadian dollar exchange rate has risen further, particularly in December and January, and is currently over 99 U.S. cents compared with the 92.5 cent parity prior to last June.

Germany's balance of payments surplus in the second half was about $3.0 billion. The seasonally-adjusted trade surplus increased further in the third quarter and in October, before falling rather sharply in November. In July-November the trade surplus, imports c.i.f., was at a seasonally adjusted annual rate of $4.9 billion, higher than in any preceding quarter except the fourth quarter of 1968 when special factors were involved. Germany's deficit on services and current transfers continued, in the third quarter, to be much larger than the year before, principally because of the effect of the 1969 revaluation on net tourist expenditures and because of larger outward remittances by foreign workers in Germany. In October and November, the year-to-year deterioration on current invisibles was slowed. A services and current transfers deficit of close to $3.5 billion was registered in 1970, compared with $2.4 billion in 1969.

The net outflow of long-term capital from Germany, which diminished rapidly over the course of the first seven months of 1970, gave way to a net inflow in the following four months which totalled $330 million, or $1.4 billion at an annual rate. Short-term net foreign borrowing by German

companies swelled Germany's surplus by increasingly large amounts until December, despite a one-half point reduction in the Bundesbank's discount rate in July. The imposition of marginal reserve requirements on banks' liabilities to domestic and foreign residents effective September 1 (modified and made more severe in November) was an added reason -- along with the high level of business activity and easing credit conditions in the Euro-dollar market -- for German enterprises to go abroad for funds. Their net short-term borrowing abroad rose from $2.3 billion in January-June to $3.3 billion in July-November, but gave way to a reported $500 million of net repayments in December, after the one-point, two-stage reduction of the discount rate in mid-November and early December. Germany's overall balance of payments was in deficit in December by around $900 million. German banks drew down their net foreign assets in most months of the second half, the particularly large reduction in December reflecting window-dressing and other year-end pressures on bank liquidity.

Italy's balance of payments reached a turning point last March, and has been in surplus almost all of the time since. The 10 months March-December yielded a surplus of $1,165 million, of which $985 million was in July-December and $350 million in December alone according to preliminary data for that month. In January, the Bank of Italy had additional large intervention gains totalling $240 million.

There was little change in Italy's seasonally adjusted trade deficit in the second half of the year. The labor unrest which has

continued to plague Italian industry hurt the trade balance by hampering production of exports and import substitutes. For the first 11 months the current account (payments basis) registered a $150 million deficit, in marked contrast to the large current account surpluses of most years of the 1960's, e.g., $2.0 billion (payments basis) in 1968. Both a widened trade deficit and a smaller surplus on current invisibles accounted for this shift. Italian officials generally welcome the elimination of a heavy current surplus as an improvement in resource allocation.

There has been a net inflow of non-bank capital since March, when the earlier outflow was abruptly reversed. This net inflow totalled $570 million through November, and its intensification caused a surprisingly large overall balance of payments surplus in December of around $350 million. Since March there has been a reduced net outflow of Italian capital compared with 1969 and January-February 1970. In particular, the outflow of Italian banknotes (measures by the return flow from banks abroad) dropped to an average of $60 million per month in March-November, from $185 million per month in the preceding 14 months. Administrative measures to discourage the export of banknotes, taken in February, and higher returns on certain types of domestic financial assets -- particularly bonds and bank deposits -- relative to comparable foreign assets contributed to this result.

Very extensive borrowing by Italian companies (almost exclusively state enterprises), through issues of Euro-bonds and in the form of medium-

term Euro-dollar bank loans, added $1,520 million to capital account receipts in 1970, the better part ($930 million) coming before the end of June. Less than one-fourth of these borrowings -- $340 million -- were bond issues.

The French balance of payments surplus of $313 million in the third quarter was much reduced from earlier quarters in 1970, and probably shrank further in the fourth quarter. Official reserves rose $282 million in the fourth quarter and by perhaps as much as $320 million in January. But commercial banks' net foreign assets contracted $75 million in October (latest figure available). Commodity trade with nonfranc area countries showed successively larger deficits in the second and third quarter, but a smaller deficit in the final quarter of nearly the same size as in the second. All of the French surplus in 1970 was caused by a net inflow of non-bank capital, much of which was inspired by a return of confidence in the franc after its August 1969 devaluation.

Shifting capital flows again played the main role in changes in the British balance of payments after mid-1970. The second quarter of last year had already seen the evaporation of most of the very large first-quarter surplus, in which short-term capital flows based on renewed confidence were the main ingredient. The overall balance on current account and nonbank capital flows fell into deficit in the third quarter because of a net capital outflow, partly because of a brief September

crisis of confidence in sterling. In the fourth quarter, October-November saw a payments surplus of $165 million and December a gain in official net foreign assets of $125 million, figures suggestive of renewed capital inflow. In October-November, banks in the United Kingdom reduced their net foreign assets nearly $600 million, most of which constituted shifts from foreign currency to sterling.

Comparing the two halves of 1970, Britain's trade balance (seasonally adjusted) did not deteriorate during the year. A balance in the first half was followed by a nominal $30 million surplus in the second. Because of the July dock strike, monthly figures can be quite misleading. A continuing surplus on current invisibles of $500-600 million in the second half kept the overall current account in substantial surplus.

There was a rush of short-term capital into sterling in January 1971 (and heavy Bank of England intervention gains) which, in conjunction with other capital inflows, was unwelcome to the government because it weakened the effectiveness of domestic monetary restraint. Effective January 12 British nonbank residents are prohibited from borrowing foreign currency for use in the United Kingdom unless the maturity of the loan is at least five years. Such borrowing is thought to have been about $500 million in 1970 but at a much higher rate recently.

Belgium's balance of payments continued in surplus in the second half of 1970 -- about $120 million, assuming that the December decline in official reserves accurately measured a deficit in that month. But this was smaller than the $210 million surplus of the first half. Belgium's trade balance (as measured by shipments through customs) was not as favorable after mid-1970 as in the preceding nine months, but this was a reversion toward a more normal situation following a period of unusual strength. Recorded movements of nonbank capital (i.e., excluding trade credits) resulted in a nominal net outflow in the first eight months of last year, but favorable shifts in leads and lags seem to have persisted. In the period July-November reductions in commercial bank net foreign assets added considerably to the rise in official reserves. The National Bank also had intervention gains of $210 million in January.

The Netherlands ran a surplus of about $250 million in the second half, apparently despite a small deficit in the fourth quarter. Speculative flows into guilders were heavy in the summer and early autumn, their subsequent disappearance perhaps reflecting a reduced likelihood of a guilder revaluation. Contrary to the projections of the Dutch Central Planning Bureau, the balance on current account deteriorated markedly because of a rising trade deficit. For the year 1970 the current account -- with invisibles recording surprisingly high net receipts -- probably showed a deficit of about $275 million. The net inflow of nonbank capital last year was about $700 million, an enormous sum for the Dutch economy.

In Canada, the current account of the balance of payments remained strong in the second half of last year -- although it probably fell below the seasonally adjusted annual rate of $6 billion (in U.S. dollars) registered in the third quarter. An unprecedented trade surplus of $2.8 billion in 1970 was the major factor behind last year's large current account surplus. Exports in the third and fourth quarter of 1970 were at a seasonally adjusted annual rate of more than $16 billion, about 17 per cent greater than a year earlier. Among the main reasons for the surge in exports in 1970 were increased shipments of raw materials following strike distortions in 1969, strong wheat exports -- mainly to China and the Soviet Union -- and import demand in countries outside North America.

Canadian imports declined rather sharply in the fourth quarter, to 6 per cent under the second quarter level (in terms of U.S. dollar values), and -- at a seasonally adjusted annual rate of $12.6 billion -- were the lowest for any quarter since the final three months of 1968. Automobile strikes reduced imports of autos and parts, but weakened import demand in general reflected the continuing softness of domestic demand. Canadian industrial production continued to fall in the second half of last year.

There was some revival of long-term capital inflow into Canada after its virtual disappearance in the second quarter, but this did not bring the rate of inflow to the high levels of 1968-69 and early 1970. Offerings in the United States were about $300 million

in the last nine months of 1970 compared with $1.9 billion in 1968, $1.2 billion in 1969, and $360 million in January-March 1970. This low rate is close to the present rate of retirement of Canadian bonds held in the United States. Short-term capital outflows also resumed in the second half, restoring the pattern that had persisted over the past several years with the exception of the second quarter of 1970 when there was a major net inflow.

The Canadian dollar has shown no sign of weakening in recent months. After appreciating from an average of over 96 U.S. cents in June to 98-1/2 cents in October (New York noon buying rate), the exchange rate oscillated around 98 cents before strengthening further in late December. In the closing days of January the rate was above 99 cents. To moderate movements in the rate -- usually to prevent more appreciation of the rate than it desired -- the Bank of Canada bought $157 million through exchange market intervention in July-August, sold $69 million in September, and bought $33 million in October-December. The remaining $269 million rise in Canadian official net foreign assets in the second half of 1970 appears to have resulted from maturing forward contracts, of which the authorities held $360 million on June 1 according to Finance Minister Benson.

The Japanese balance of payments surplus of $1.37 billion in the second half of 1970 was identical with that of the year-earlier period, and contrasted with the equilibrium of the first half of 1970. The trade surplus increased $1.13 billion from the first half to the

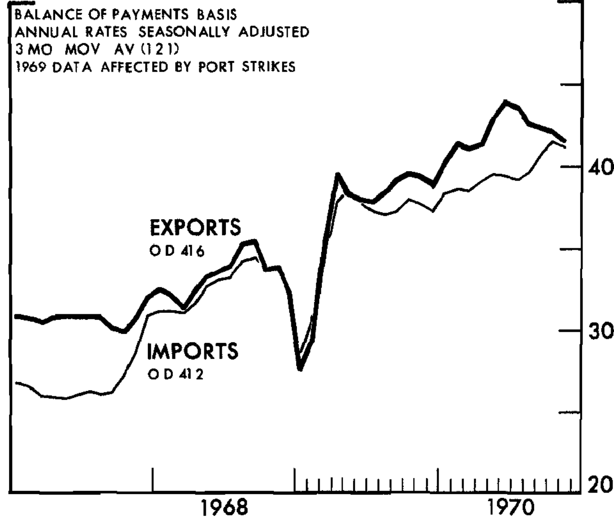
second for seasonal reasons; on a seasonally-adjusted basis the trade surplus was at an annual rate of approximately $4 billion in both halves. Imports rose at an annual rate of 19 per cent from the first half to the second, and exports by 15 per cent. The current account surplus for 1970 was $2.03 billion, a deficit on current invisibles offsetting about one-half of the trade surplus.

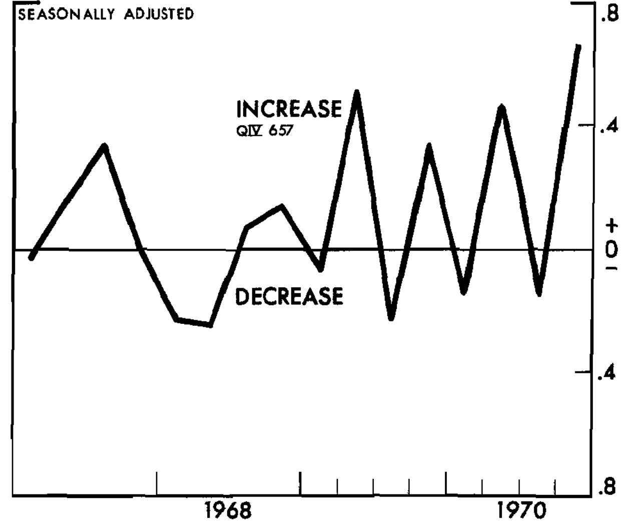
Japan exported $200 million of non-bank capital (including errors and omissions) in the second half, down from about $450 million in the first half but far above the $70 million of a year earlier. Net exports of long-term capital in 1970 were far in excess of 1969, their rise being partly offset by a higher net inflow of short-term funds.

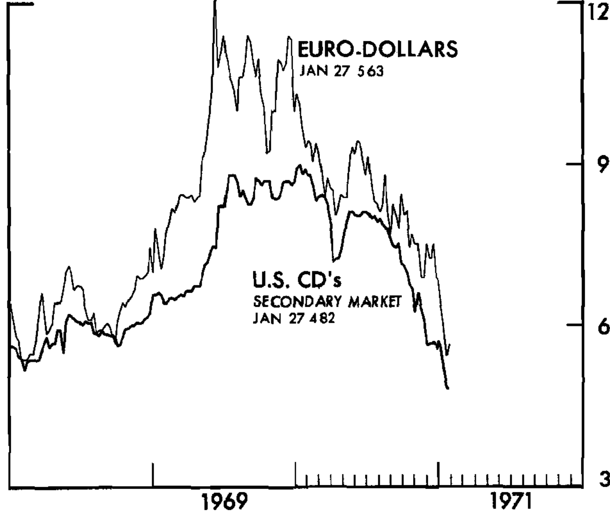
Because of concern over the rapid buildup of its reserves, during the summer and early autumn the Bank of Japan provided about $600 million of special credits to commercial banks to facilitate a shift from dollar to yen financing of imports, operations that were reflected in a very large rise in the banks' net foreign assets in the third quarter and a drop in official reserves. Earlier Bank of Japan moves to reduce reserves in the second quarter were a $200 million loan to the World Bank and purchase of $83 million of U.S. Eximbank participation certificates. Adjusting for these investments, Japan's 1970 balance of payments surplus would be $1,663 million instead of the $1,380 million measured by the monetary movements.

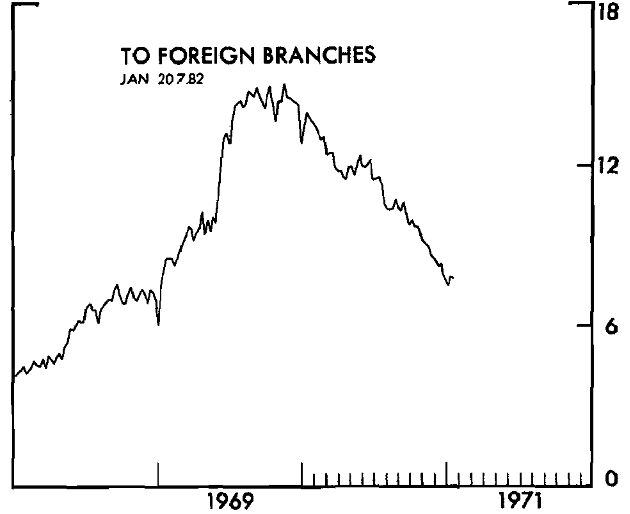
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

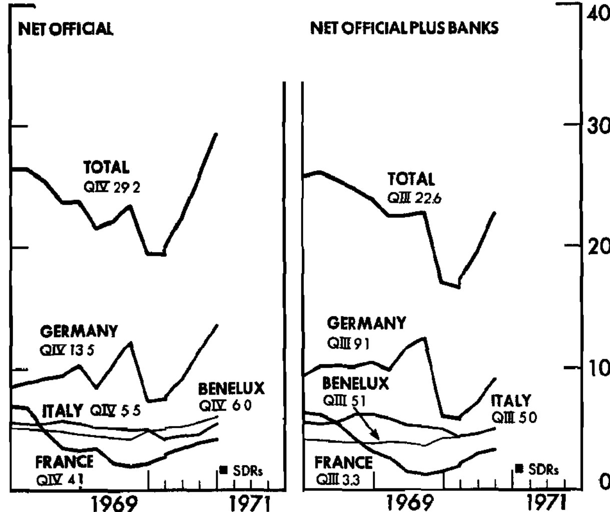
BILLIONS OF DOLLARS

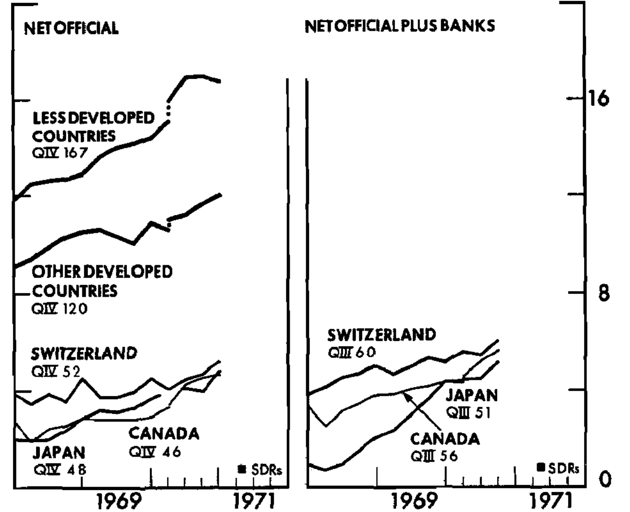












APPENDIX A: SUBSIDIZED HOUSING STARTS IN 1970*

Subsidized housing starts rose sharply in 1970, based on consolidated data from HUD and the Farmers Home Administration on the major subsidy programs for low- and moderate-income families in operation during the year. Altogether, such starts, which include publicly owned dwellings, totaled a remarkable 444,000 units, according to preliminary estimates, and amounted to 30 per cent of all public and private starts. In a year when total starts actually dipped slightly on a year-to-year basis, the subsidized subtotal more than doubled both in number and relative importance, as shown in the table. Moreover, if the preliminary reports are correct, it exceeded the 400,000 annual rate set for such housing as part of the ten-year housing production goal established in the Housing and Urban Development Act of 1968.

SUBSIDIZED HOUSING STARTS FOR LOW- AND MODERATE-INCOME FAMILIES
(Thousands of units, without seasonal adjustment)

	All Units		1-Family		Multifamily	
	Number	Per cent 1/	Number	Per cent 1/	Number	Per cent 1/
1969						
QI	39.2	12	11.5	7	27.8	17
QII	47.2	10	13.3	5	33.9	16
QIII	53.7	14	20.7	10	33.0	19
QIV	67.9	22	23.2	14	44.7	31
Year	208.1	14	68.7	8	139.3	20
1970						
QI	65.6	25	29.7	22	34.0	28
QII	126.2	32	47.4	21	78.8	47
QIII	108.9	27	50.0	22	58.9	33
QIV	143.1	37	57.3	27	85.8	48
Year	443.9	30	184.4	23	259.5	40

1/ Per cent of all subsidized and nonsubsidized starts in the specified category.

* Prepared by Bernard Freedman, Economist, Capital Markets Section, Division of Research and Statistics.

While all subsidized subgroups showed a gain, by far the largest increases were registered by the FHA-insured programs for home-ownership and rent subsidies initiated late in 1968. Such programs, which were only beginning to gain momentum in 1969, are designed to hold monthly cost for eligible home-owners to a level of no more than 20 per cent of income with appropriate reductions in effective interest costs to as low as 1 per cent. For qualified renters, comparable cost maxima in relation to income are fixed at or below 25 per cent. Such terms were obviously very attractive to qualified borrowers last year. Moreover, with market interest rates to non-subsidized borrowers extremely high and demand for the more expensive types of houses eroding, builders turned aggressively toward the subsidized market. While adequate funding by Congress was also important in this development, it may be noted that the Government subsidies apply only to the interest cost and that the principal amounts of mortgages involved must come from the private sector. Consequently, the relative abundance of FNMA commitments for these as well as other Government-underwritten mortgages was also a vital factor in the 1970 advance, especially in the early part of the year.

An interesting facet of 1970 developments was the exceptional rise shown for the fourth quarter, owing mainly to a pronounced upsurge in December. This was related in part to the downward adjustment in ceiling interest rates initiated as the month began, as well as to other special factors, including apparently builders' desires to assure themselves of adequate coverage under the FHA programs over the period ahead and the interest of all the Government agencies involved in assuring that at least the full 400,000 starts figure for all programs be achieved in 1970. Altogether, the December increase in subsidized units contributed dramatically to the rise in the seasonally adjusted annual rate of total starts to nearly 2 million units in December, a twenty-year high as reported by the Census Bureau.

Some slowing in the subsidized starts pace is likely during the early months of this year, owing to the exceptional December surge and the borrowing from the future which that apparently involved. However, assuming full funding for all programs, indicated Government expectations are that the total of such starts for the year as a whole will continue to grow, possibly to or over 500,000 units.1/

1/ While a recent suspension of the FHA-insured subsidized home-owner program for existing units pending elimination of irregularities will impede real estate transactions in general, it will not necessarily have a direct effect on new housing activity, which, under present legislation, benefits from a 70 per cent allocation of total funds for this particular program in any case. Moreover, some additional support may come from (Footnote continues on next page.)

Meanwhile builders themselves have already indicated plans for moving even more strongly into this market, according to a recent survey by the National Association of Home Builders. To meet the more rigorous price requirements involved and to counter increased buyer resistance to higher residential costs, the builders surveyed generally also plan to cut home-sizes further and reduce other amenities. Reflecting this shift, builders expect their median prices for new homes of all types to decline appreciably further this year, possibly to $22,500 compared with $23,500 last year.

(Footnote 1 continued from previous page.)
final implementation of the Federal Home Loan Bank Board's new "Housing Opportunity Allocation Program" (HOAP), which derives from legislation incorporated in the Emergency Home Finance Act of last year and which was recently funded. Under present plans, which are still in a formative stage, about 70,000 additional borrowers on new or existing houses might be accommodated, with income limits ranging up to $12,000 or 150 per cent above those set for HUD's interest- and rent-subsidy programs.

APPENDIX B: COMPOSITION OF CORPORATE BOND OFFERINGS*

Dramatic movements in yields on newly issued corporate bonds in 1970, especially in the latter half of the year, were reflected in changes in the industrial, quality, and maturity composition of total gross offerings. For the year as a whole, the volume of public and private bond offerings increased by almost $11 billion. Most of this growth in bond financing was accounted for by two industrial sectors, communications and manufacturing, which together accounted for almost half of the total offerings in 1970, as compared with one-third of the 1969 total. The increased quality consciousness of investors in the wake of the liquidity problems that became manifest around mid-1970 resulted in a preponderance of investment-grade bonds in the offerings totals and a sharp decline in issues rated Baa or lower. The high level of rates and the uncertainty about future trends which prevailed in the late spring and early summer of 1970 also contributed to the rise in the proportion of intermediate-term issues.

INDUSTRIAL COMPOSITION

The absolute volume of bond offerings increased in each of the major industrial categories in 1970, but not all industries participated equally in this financing growth. As a result of two extremely large individual debt issues by AT&T, and an increased pace of bond offerings by the subsidiary companies of the Bell System, the communications industry's share of new bond issues surged in 1970. However, this increase was concentrated in the second and fourth quarters, when the parent telephone company was in the market, as shown in Chart 1.

The manufacturing sector's share of gross offerings rose from about one-quarter of the 1969 total to almost 30 per cent in 1970, with issues in the $100 million and over size class accounting for an increasing proportion of the new industrial bond volume in the latter half of the year. Indeed, almost 90 per cent of the dollar volume of industrial bonds offered during the year represented borrowing by firms included in the Fortune 500 list of the largest manufacturing companies in the U.S. In the mid-1960's the 500 largest industrial corporations accounted for about 70 per cent of industrial bond financing. In the market environment of 1970, access to the bond market was limited to large, well-known manufacturing corporations.

Public utilities maintained a record level of bond offerings throughout 1970, as indicated in Chart 1, but they were somewhat less important, relatively, in the bond market than in previous years. The

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* Prepared by Eleanor M. Pruitt, Economist, Capital Markets Section, Division of Research and Statistics.

utilities, in an effort to maintain their debt-equity ratios and bond ratings, doubled the volume of their gross equity financing between 1969 and 1970, thus shifting a portion of the industry's long-term financing from the bond to the stock market.

For the year as a whole, the relative growth of the financial and other categories was small, but in the fourth quarter of 1970, when new issue yields declined sharply, there was a resurgence of financing by financial, transportation, and retail firms, which had been effectively barred from the market earlier by prohibitively high interest rates and investor preference for high-grade securities. As a consequence, the share of manufacturing in total bond offerings declined somewhat in late 1970.

QUALITY STRUCTURE

As noted earlier, there was a significant upgrading in the quality structure of bond issues during 1970. Investment-grade bonds, those rated A or higher, accounted for almost 90 per cent of total gross offerings in 1970, as compared to less than three-quarters in 1969. There was a

Table 1

INTERMEDIATE-TERM PUBLIC BOND OFFERINGS
(Millions of dollars and per cent of total)

	Intermediate-Term Debt 1/	As a per cent of total publicly offered debt 2/
1969		
QI	25	1.1
QII	596	18.4
QIII	440	14.5
QIV	335	10.4
Annual Total	1,396	12.0
1970		
QI	668	15.2
QII	1,379	20.4
QIII	1,387	23.9
QIV	1,743	24.1
Annual Total	5,174	21.4

1/ Maturities of 10 years or less.
2/ Serial Maturities excluded.

particularly sharp increase in the volume of A-rated issues, which reflects the dominance of large industrial firms, whose bonds were readily accepted by investors even during periods of rapidly fluctuating rates. The really significant change was the year-to-year decline, in both absolute and relative terms, of bonds rated Ba or lower, shown in Chart 2, which gives the proportion of lower quality bonds, by quarter in 1969 and 1970. Borrowers in the lowest rated categories virtually dropped out of the market in the latter half of 1970, as the spread between Aaa and Baa bonds continued to widen.

MATURITY STRUCTURE

The sensitivity of borrowers to high interest rate levels and shifts in investor expectations is also evident in the apparent substitution of intermediate-term debt for long-term debt in recent years. The volume of bond offerings in the five-to-ten-year maturity range first became significant in 1969, with 12 per cent of the annual public bond volume in such shorter-term instruments. But in the late spring of 1970, as yields on long-term new issues rose rapidly and investors became increasingly concerned about the long-run trend of interest rates, the proportion of intermediate-term debt soared, and during the second half of 1970 almost one-quarter of the new public bond issues had maturities of 10 years or less. As rates fell in the first quarter of 1971, however, fewer firms filed intermediate-term debt issues and, based on the offerings now scheduled for this quarter, the staff estimates that the under-10-year maturity offerings will account for between 15 and 20 per cent of total public bond volume in the first three months of 1971.

SUMMARY AND OUTLOOK

In the stringent market conditions that characterized the spring and summer months of 1970, medium-sized, small, and lower-grade borrowers found it too costly--and often impossible--to raise funds in the capital markets. The bulk of the funds raised in the public bond market went to high-grade borrowers--large manufacturers, communications firms, and public utilities. Favorable net interest cost differentials and a desire for flexibility in financing decisions also led a number of firms to do intermediate-term financing in the bond market. However, as yields dropped in the final months of 1970, the industrial composition of the bond market began to shift back toward a more normal pattern.

In view of the increased availability of funds, the generally easier market conditions now evident, and the potential increase in equity financing, the staff expects the total volume of public bond

offerings to be slightly lower in the first quarter of 1971. There will probably also be some decrease in the proportion of shorter-term issues. There may be a modest increase in the proportion of issues by medium-grade corporations, but this trend could be moderated by the improved ability of corporations to obtain financing through bank term loans, private placements, and new stock issues.

Chart 1
COMPOSITION OF PUBLIC BOND OFFERINGS
(Quarterly, not seasonally adjusted)
1969-70

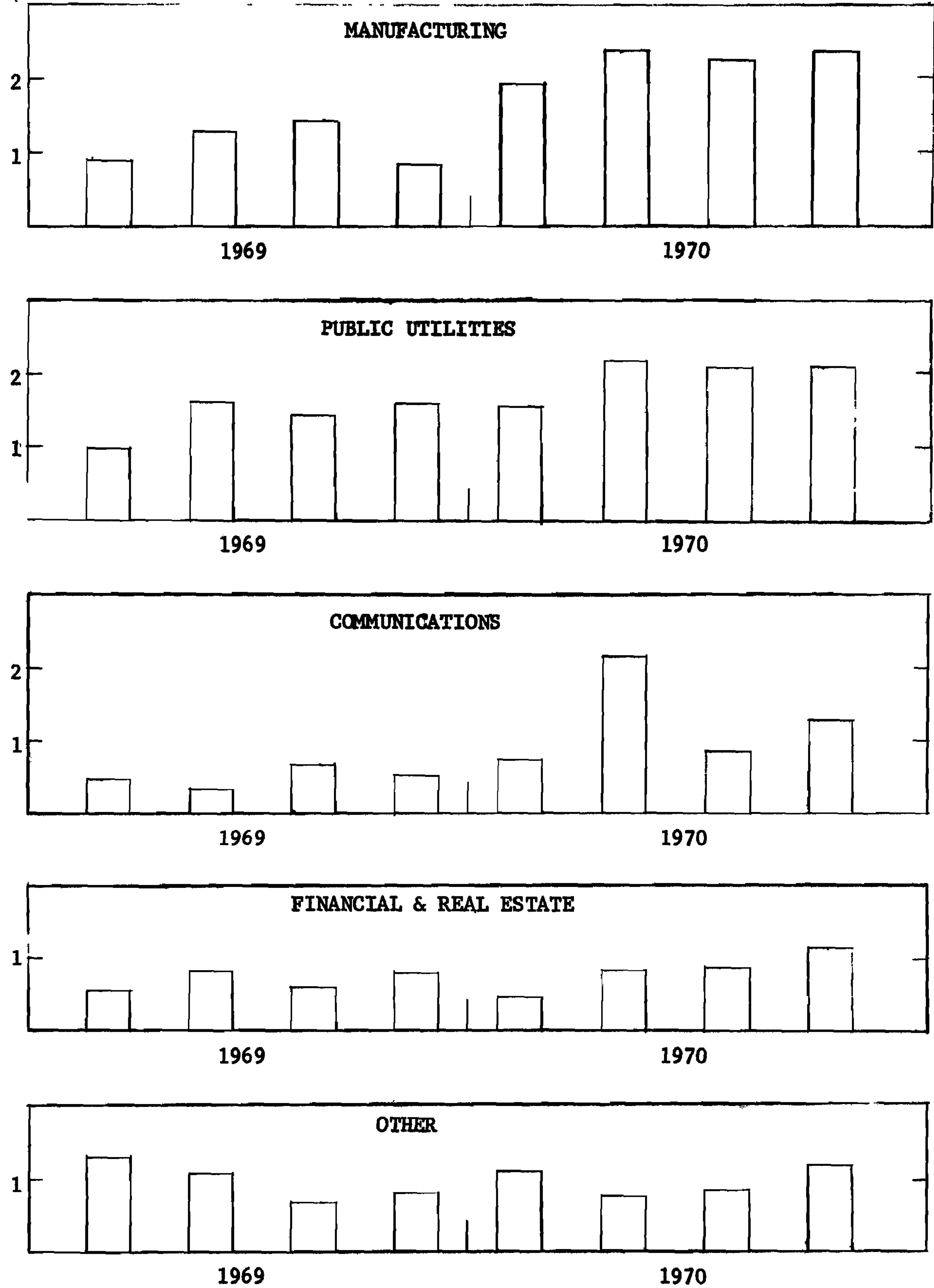


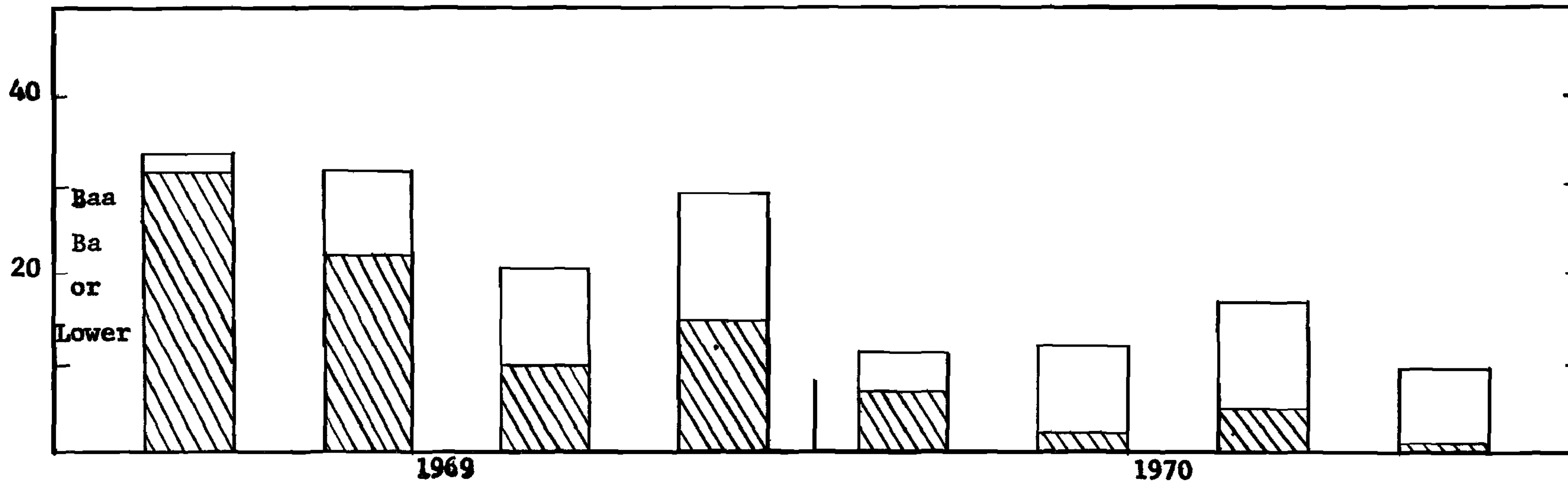
Chart 2

Quality Ratings

Public Bond Issues Rated Baa and Lower by Moody's[1/]

(Per cent Distributions)

Quarterly, 1969-70



1/ Non-rated issues--mostly by finance companies, real estate investment trusts, and very small issuers--are excluded.

Appendix C: Federal Budget Estimates*

I. The Unified Budget

The new Budget projects a unified budget deficit of $18.6 billion in the current fiscal year and $11.6 in fiscal 1972.

UNIFIED BUDGET
(Billions of dollars)

	Fiscal 1970 actual	Fiscal 1971 estimates	Fiscal 1972 estimates
		A. Budget Document	
Receipts	193.7	194.2	217.6
Outlays	196.6	212.8	229.2
Expenditures	194.5	211.1	228.3
Net lending	2.1	1.6	.9
Surplus or deficit (-)	-2.8	-18.6	-11.6
Federal funds deficit	-13.1	-25.5	-23.1
Trust funds surplus	10.3	7.0	11.5
Full-employment surplus	2.6	1.4	.1
		B. Staff Estimates	
Receipts	193.7	194.2	213.4
Outlays	196.6	213.0	235.0
Surplus or deficit (-)	-2.8	-18.8	-21.6

Projected surpluses in the trust funds, amounting to $7.0 and $11.5 billion in fiscal years 1971 and 1972, respectively, partially offset expected deficits of $25.5 and $23.1 billion in the Federal funds component of the unified Budget. A full-employment surplus (unified budget basis) of $1.4 and $.1 billion is expected in fiscal years 1971 and 1972 respectively. The Board staff estimates are a $21.6 billion unified Budget deficit in fiscal 1972 and about a $4 billion high employment deficit (unified budget basis).

*Prepared by W. Beeman, Economist, Government Finance Section

Budget Estimate of Outlays. Federal outlays are estimated to increase $16.4 billion in fiscal 1972, about $.2 billion more than the increase in the current fiscal year. Net lending, included in total outlays, would continue to decline in fiscal 1972. As shown in the table below, the largest planned increases in fiscal 1972 are for general revenue sharing, social insurance, public assistance and natural resource development. General and special revenue sharing is estimated to add $4.0 billion although it is not to be effective until October 1971. But this lump sum addition substitutes to some extent for normal growth in the existing grants program.

In the social insurance category, the major increase is for the Administration's proposed 6 per cent increase in social security benefits, effective retroactively to January 1, 1971, costing $3.0 billion annually. A predicted decline in unemployment insurance benefits is expected to offset most of the normal growth in social insurance benefits. The Administration again porposed adoption of welfare reform (the family assistance program) and although the benefit payments would not begin before fiscal 1973, start up costs of $.5 billion are included in the public assistance category of the Budget for fiscal 1972. In the natural resources category a $.6 billion increase is proposed for the new Environmental Protection Agency (mainly water pollution control). Most of the $1.1 billion indicated increase in outlays for health is for medicare and medicaid, even though legislation proposed by the Administration would save more than $.8 billion in these programs.

After declining for two years, outlays for national defense are expected to increase by $1.1 billion in fiscal 1972. However, the increase in defense includes general pay increases costing $1.5 billion more than this year in addition to $1.2 billion as a step toward an all-volunteer army. The decline in outlays for commerce and transportation reflects an assumed postal rate increase (a negative expenditure) effective May 15, 1971 that would reduce net outlays by $1.6 billion in fiscal 1972.

Staff Estimate of Outlays. The Board staff's estimate of outlays in fiscal 1972 is $5.8 billion higher than the Budget document estimate. This higher estimate is mainly accounted for by out assumption that passage of a social security bill calling for a 10 per cent increase in social security benefits (including an increase in the minimum monthly check to $100) is likely. This compares to the Budget assumption of a flat 6 per cent increase. Also, we project higher outlays for unemployment compensation (consistent with the staff's projection of the unemployment rate) and assume a second pay raise for postal workers in the second half of the fiscal year that is not offset by a further postal rate increase.

CHANGES FROM THE PRECEDING YEAR IN
SELECTED BUDGET FUNCTIONS
(billions of dollars)

Function	Fiscal Years 1971	Fiscal Years 1972
National Defense	-3.9	1.1
Human Resources	15.2	7.2
Health	1.9	1.1
Retirement and social insurance	8.7	3.0
Public assistance and welfare reform	2.3	1.9
Veterans benefits	1.3	.7
Education and manpower	1.0	.5
Physical resources	2.5	2.2
Agriculture and rural development	-.9	.5
Natural resources	.2	1.6
Commerce and transportation	2.1	-.5
Housing and community development	1.1	.6
Interest	1.1	.2
Revenue sharing	--	4.0
Miscellaneous	1.3	1.8
International affairs and finance	*	.4
Space research and technology	-.4	-.2
Other, net	1.7	1.6
Total outlays	16.2	16.4

* Less than $50 million

Budget Estimate of Receipts. The Budget projects total receipts of $217.6 billion in fiscal 1972, a $23.4 billion increase in actual tax receipts. Since the full employment budget receipts increase by $15 billion the economy is assumed to grow rapidly enough to begin reducing the gap between actual and potential output. These estimates include $2.8 billion in receipts arising from proposed legislation to increase the social security tax base from $7,800 to $9,000, effective retroactively to January 1, 1971, and a revenue loss of $2.7 billion because of the recent revision in depreciation guidelines.

The economic assumptions for calendar 1971 underlying the Budget receipts estimates are: (1) an $88 billion increase in GNP to a level of $1,065 billion; (2) a $67 billion increase in personal

income to a level of $868 billion; and (3) an increase in corporate profits before tax to $98 billion. 1/

Staff Estimate of Receipts. The Board staff is currently projecting lower economic magnitudes for calendar 1971--$1,045 billion for GNP, $856.5 billion for personal income, and $81.9 billion for corporate profits before taxes. Because of these lower income assumptions, the staff's estimate of unified budget receipts in fiscal 1972 is considerably lower than receipts in the Budget document,--by $4.2 billion--even though the staff assumes somewhat greater marginal tax rates. For the current fiscal year the staff and the Budget estimates of receipts are in agreement.

Federal Borrowing Estimates. The Budget document indicates that net borrowing from the public will be $17.6 billion in the current fiscal year and $10.6 billion in fiscal 1972. Staff estimates for borrowing in fiscal year 1972 amount to $20.6 billion.

Total debt subject to statutory limitation is projected by the Budget to increase $24.9 and $23.6 billion in fiscal years 1971 and 1972, respectively, necessitating an early increase in the legal debt ceiling.

II. Federal Sector in the National Income Accounts

On a national income accounts basis, the Budget forecasts deficits of $15.0 billion and $4.2 billion in the current fiscal year and in fiscal year 1972, respectively. Federal receipts, NIA basis, are projected to increase from $200.0 billion in fiscal 1971 to $225.9 billion in fiscal 1972. Due to our lower income assumptions, the staff estimate of receipts is $1.3 billion lower in the current fiscal year. 2/ The staff has not projected receipts on a NIA basis for fiscal 1972.

Staff projections of Federal expenditures through fiscal 1972 (NIA basis) are shown in the table below. In these projections, total Federal purchases of goods and services are not expected to increase in calendar 1971 above the level in the second half of 1970. Defense expenditures through calendar 1971 are expected to continue the present downward trend while non-defense moves rapidly upward. In the first half of calendar 1972, the large increase in defense and non-defense purchases reflects a Federal pay increase for civilian and military personel and the initial cost of the proposed move toward the all-volunteer army.

1/ Note: Apparently the corporate profits figure shown in the Budget document should have been $93 billion because a $4.5 billion downward adjustment for increased depreciation expense due to the revision of the depreciation guidelines was overlooked, although the adjustment was made in receipts.

2/ The lower staff estimate of NIA receipts, as compared to the same estimates for unified budget receipts, results from the way corporate profit taxes enter the two budget concepts.

Staff projections of Federal transfer payments call for a sharp increase in the projected period, especially in the first half of calendar 1971. The sharp rise in transfers to persons in the first half of calendar 1971 is due largely to an increase expected in social security benefits. Grants also are expected to grow sharply during the projected period, consistent with the Administration's intentions to accelerate programs that are currently lagging behind schedule and the effects of the proposed revenue sharing program beginning in the fourth quarter of 1971.

According to Staff estimates, the federal deficit (NIA basis) will be about $ 9 billion in calendar 1971, about $6 billion more than in the second half of 1970. To a large extent, the projected deficit in the current calendar year reflects a shortfall in receipts arising from the slowdown in economic activity. As shown in the table below, Staff estimates of the high employment budget (NIA basis) suggest little change in discretionary budget policy in calendar 1971 compared to the second half of 1970. The projected $4.8 billion shift toward deficit in the high employment budget balance in the first half of calendar 1972 suggests that programs proposed in the Budget may result in a more expansive fiscal policy at that time.

STAFF ESTIMATES OF
FEDERAL SECTOR IN THE NATIONAL INCOME ACCOUNTS
AND THE HIGH EMPLOYMENT BUDGET 1/

(Calendar years, billions of dollars, SAAR)

	1970			1972
	2nd half	1st half	2nd half	1st half
Total Receipts	194.5	202.9	210.3	na
Total Expenditures	208.1	222.2	229.6	243.0
Purchases	98.5	97.3	98.4	106.1
Defense	75.2	73.0	71.8	76.3
Nondefense	23.3	24.3	26.6	29.8
Other Expenditures	109.6	124.9	131.2	137.0
Transfers to persons	62.2	72.6	76.9	80.0
Grants	24.8	29.2	32.8	36.0
All other	22.6	23.1	21.5	21.0
Surplus/deficit (-)	-13.6	-19.3	-19.3	na
High Employment surplus/deficit (-)	0	- 1.8	1.3	-3.5

na--not available

1/ The staff estimate of expenditures for the projected period exceeds the budget estimate because (1) the staff assumes a 10 per cent increase in social security benefits in the first half of 1971 rather than the 6 per cent increase included in the budget; (2) the staff estimate includes a postal pay increase in the first half of 1972 that is

(continued)

1/ not financed by an additional rate increase; (3) the staff projects a higher level of unemployment compensation expenditures because of projected higher rate of unemployment than assumed in the budget.