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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

December 8, 1971

By the Staff
Board of Governors
of the Federal Reserve System

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SUMMARY AND OUTLOOK

Nonfinancial

Recent evidence tends to support the staff expectation of a stepped-up pace of expansion in the fourth quarter. Consumer spending is making a substantial contribution to this expansion, and business fixed investment expenditures now appear to be somewhat stronger than previously anticipated. However, the merchandise trade balance has been in sizable deficit, with port work stoppages having aggravated an already weak situation. The staff continues to project a rise in real GNP at an annual rate of close to 6 per cent in the fourth quarter, compared to about 4 per cent in the third.

Industrial production is estimated to have increased appreciably further in November. A significant development was the apparent further rise in output of business equipment--the sixth consecutive monthly increase--to a level around 5 per cent above the May low. New orders for capital equipment essentially have been on a plateau since January, but they increased a little in October and total new orders to producers of durable goods also rose slightly in October.

Retail sales have advanced at a rapid pace since July, and a further increase is now estimated for November. The most publicized development has been the strength of demand for new domestic-type autos. During November, however, unit sales slowed somewhat to a 9.5 million annual rate, compared with 10.2 million in October, while sales of imported cars strengthened. Less publicized has been the strength in retail sales at nondurable goods stores. These sales apparently rose further in November and were nearly 3 per cent above the third quarter average. Housing starts again exceeded a 2 million annual rate in October, following a September dip below that level.

The labor market, meanwhile, has remained sluggish. In November, the unemployment rate moved back up to 6.0 per cent, as the labor force increased more sharply than employment. The increase in nonfarm payroll employment was quite moderate during the month, but the average work week in manufacturing lengthened. The effectiveness of the wage freeze is evident in the fact that average hourly earnings of production workers rose at an annual rate of only 1.2 per cent from August to November; earlier this year the rate of increase had been nearly 7 per cent.

Recent price developments, too, have been dominated by the freeze. Average wholesale prices of industrial commodities, seasonally adjusted, edged up in November, but remained slightly below their August level. Prices of farm products and foods, partly uncontrolled, were unchanged on balance from August through November. The rise in consumer prices, seasonally adjusted, slowed further in October; from August to October, the CPI rose at an annual rate of only about 2 per cent. In light of initial Pay Board and Price Commission decisions, a faster pace of wage and price increases seems in prospect for the immediate post-freeze period.

Outlook. Current staff projections of GNP for 1972 are marginally stronger than those presented four weeks ago. The somewhat larger increases projected for the first quarter in both current dollar ($29.5 billion) and real GNP (an annual rate of 6.8 per cent) reflect a faster rise in business fixed investment, as suggested by the recent

Commerce-SEC survey, and a rebound in net exports of goods and services following the dock-strike affected fourth quarter.

Over the last three quarters of 1972, current dollar GNP is projected to increase $27-28 billion a quarter, and real GNP is expected to expand at an annual rate ranging from 6 to 6-1/2 per cent. Expansive strength is expected to be fairly widespread; one major exception is residential construction activity which is projected to edge down in the second half of the year. And apart from pay increases, Federal purchases of goods and services are projected to change little over the course of the year.

Consumer spending is expected to rise strongly, reflecting some tax relief and increased social security benefits effective early in 1972, and a continued rise in wages and salaries throughout the year. Business fixed investment is projected to rise about 9-1/2 per cent from the 1971 level, an increase somewhat larger than in the preceding projection, reflecting the greater current strength indicated by the Commerce-SEC survey. With final demands for goods increasing at a significant pace throughout the year, incentives to build stocks are likely to strengthen, and inventory investment is projected to rise fairly steadily.

Although the expansion in real output is projected to be fairly rapid, output per manhour and the civilian labor force are also expected to rise appreciably next year. The unemployment rate is thus projected to decline only gradually, to about 5-1/4 per cent in the fourth quarter. After the initial round of price increases in Phase II, price advances are expected to moderate, with the private GNP fixed weight price index projected to slow to an annual rate of 2.8 per cent late in the year.

Financial

Corporate and U.S. Government security yields, after rising 10 to 20 basis points in late November, have returned to levels similar to those at the time of the last FOMC meeting. Recent declines in yields have been smaller, however, the tax exempt market, where yields, after rising by 25 basis points, remain considerably above earlier levels. Downward yield adjustments in early December occurred against a backdrop of lightened dealer inventories, a reduction in the Federal funds rate, an increase in foreign demand for bills, and large purchases of Treasury coupon issues by Federal Reserve and foreign official accounts. Declines also reflected the abatement of investor uncertainty regarding domestic and international developments.

In the market for Government securities, the late November yield increases in part reflected the size and composition of Treasury financing operations. Thus, even though most other short-term yields were unchanged or lower, bill yields rose in some cases over 20 basis points in late November--despite continued sizeable foreign purchases--as an expansion in the regular weekly and monthly bill offerings was joined by a $2.5 billion issue of special tax bills just before the Thanksgiving holiday. In the longer-term Treasury market, the supply of coupon issues had been increased significantly by the November refunding which expanded the public holdings of longer-term Treasury issues by almost $6 billion. A large portion of the increased supply was taken by dealers, whose over-all coupon positions rose to an extremely high level. Subsequently, dealer inventories were reduced by about a third, reflecting for the most part Federal Reserve purchases totalling about $850 million since mid-November.

At banks, business loans declined in November, while consumer and real estate loans continued to rise rapidly. Reflecting mainly weak business loan demands, banks have remained unaggressive bidders for CD's. However, with rate relationships favorable, inflows of consumer-type time and savings deposits remained large by historical standards at both commercial banks and nonbank thrift institutions.

Outlook. Assuming continuation of the recently easier money market conditions, upward pressures on interest rates generally are unlikely to develop over coming weeks, and in some markets further interest rate declines seem in prospect. The outlook especially in short-term markets, is made uncertain, however, by the state of current international exchange rate negotiations. If these negotiations are prolonged, and market participants continue to expect further appreciation of foreign inventories, private capital outflows are likely to continue, sustaining foreign official demand for dollar assets, particularly Treasury bills. On the other hand, resolution of current international negotiations carries the potential for a sizeable reflow of dollars, accompanied by large sales of bills by foreign official accounts and redemption of Treasury special issues. Such developments might subject the bill market to considerable transitory upward rate pressures.

Even without an international settlement, corporate yields are likely to continue to decline in the weeks ahead in reflection of an expected decline in December offerings of more than seasonal dimensions, the recent reduction of dealer inventories, and seasonal reinvestment demand after year-end. Declines in Treasury coupon and tax-exempt yields may be more modest. Dealer inventories--while reduced--are still large in both markets and the forward calendar of State and local government offerings remains large.

Mortgage rates are also likely to edge off in the weeks ahead. Inflows to the thrift institutions--though diminishing somewhat recently--are expected to remain large, and demands for mortgage credit may subside somewhat as the rate of refinancing slows. The FHLB plans to raise no new funds in the first quarter, although FNMA plans net new long-term financings over the same period of about $1.5 billion, mostly to repay short-term obligations and to acquire mortgages under subsidized programs.

Business loan demands at banks are unlikely to pick up in the near term, given staff projections of conservative inventory policies and growing internal funds generation by the nonfinancial corporate sector. However, demand for consumer and real estate loans should remain sizeable, though subsiding somewhat.

International developments

The available statistics on U.S. foreign trade give no clue as to the influences being exerted by exchange rate changes and the import surcharge or by changes in aggregate demand here and abroad.

The trade surplus of September, generated by the rush of exporters to ship goods before the East Coast dock strike started, was followed by a trade deficit of record magnitude in October.

Foreign official reserves increased further in October, November, and early December, by amounts large enough to indicate continuing buildup of speculative positions in a number of currencies. Market exchange rates for most of the industrial countries' currencies rose further. Since about two weeks ago--i.e., since shortly before the latest G-10 meeting--market expectations about the character of the eventual settlement of exchange rate questions have produced especially large reserve increases and sharp advances in market exchange rates.

Abroad, the business outlook in Germany remains weak, and last summer's pickup in British retail sales has not yet spurred industrial production in Britain. In these two countries the rise in wholesale prices and also the rise in wages have moderated somewhat in recent months. In Japan wholesale prices were virtually level from last spring to August, and since then have declined; Japanese industrial production fell back in October to the level that had been maintained during the summer. Wholesale and retail prices in most European industrial countries have recently been in a range of 3-1/2 to 5-1/2 per cent higher than a year earlier; in Britain, however, the rise had been considerably greater.

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SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1971				Per Cent Change* From		
	Aug.	Sept.	Oct.	Nov.	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	84.3	84.6	84.8	85.2	0.5	1.0	2.0
Unemployment rate (%)	6.1	6.0	5.8	6.0	--	--	5.9 4/
Insured unempl. rate (%) 5/	4.2	4.5	4.5	n.a.	--	--	4.4 4/
Nonfarm employment, payroll (mil.)	70.5	70.9	70.8	70.9	0.1	0.5	1.3
Manufacturing	18.5	18.6	18.6	18.6	0.2	0.7	0.4
Nonmanufacturing	52.1	52.2	52.3	52.3	0.1	0.5	1.7
Industrial production (1967=100) 5/	105.3	106.1	106.3	n.a.	0.2	0.2	2.5
Final products, total	105.1	105.4	105.4	n.a.	0.0	0.5	3.9
Consumer goods	116.1	116.3	116.5	n.a.	0.2	0.4	6.9
Business equipment	96.9	97.6	98.0	n.a.	0.4	1.8	2.2
Materials	103.3	105.1	105.3	n.a.	0.2	0.0	1.2
Capacity util. rate, mfg. 5/	72.9	73.0	73.7	n.a.	--	--	74.2 4/
Wholesale prices (1967=100) 1/	114.9	114.5	114.4	114.5	0.1	-0.3	3.2
Industrial commodities (FR) 5/	114.9	114.8	114.8	n.a.	0.0	0.4	3.3
Sensitive materials (FR)	116.4	116.3	115.4	115.3	-0.1	-0.9	4.8
Farm products, foods & feeds	114.6	113.0	113.0	113.6	0.5	-0.9	3.4
Consumer prices (1967=100) 1/ 5/	122.2	122.4	122.6	n.a.	0.2	0.7	3.8
Food	120.0	119.1	118.9	n.a.	-0.2	-0.8	2.9
Commodities except food	117.3	117.8	118.3	n.a.	0.4	1.1	3.3
Services	129.4	129.9	130.1	n.a.	0.2	1.0	4.8
Hourly earnings, pvt. nonfarm ($)	3.46	3.46	3.48	3.47	-0.3	0.3	5.5
Hourly earnings, mfg. ($)	3.59	3.60	3.60	3.60	0.0	0.3	6.2
Weekly earnings, mfg. ($)	142.40	141.86	143.57	144.72	0.8	1.6	7.6
Net spend. weekly earnings, mfg. (3 dependents 1967 $) 1/ 5/	100.68	101.79	101.36	n.a.	-0.4	0.1	3.5
Personal income ($ bil.) 2/ 5/	867.6	871.5	872.3	n.a.	0.1	1.5	7.2
Retail sales, total ($ bil.)	34.7	35.2	n.a.	n.a.	--	--	--
Autos (million units) 2/ 5/	8.4	9.5	10.2	n.a.	8.0	22.5	67.9
GAAF ($ bil.) 3/	9.0	9.0	n.a.	n.a.	--	--	--
12 leaders, composite (1967=100) 5/	126.8	127.1	128.6	n.a.	1.2	1.4	13.2
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/ 5/	2,258	1,948	2,050	n.a.	5.2	-8.0	29.5
Factory workweek (hours)	39.8	39.5	39.8	40.1	0.8	0.8	1.3
Unempl. claims, initial (thous.) 5/	333	327	313	n.a.	4.2 6/	-13.9 6/	7.9 6/
New orders, dur. goods, ($ bil.) 5/	31.8	31.0	31.2	n.a.	0.6	-2.3	16.5
Capital equipment	8.0	8.0	8.1	n.a.	1.7	8.3	18.6
Common stock prices (41-43=10)	97.24	99.40	97.29	92.78	-4.6	-4.6	10.1

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l. merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ Per cent calculated to October, 1971. 6/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	Averages QI	QII	QIII	Oct.	Nov.	Week ended Dec. 1
Interest rates, per cent						
Federal funds	3.86	4.56	5.47	5.20	4.91	4.68
3-mo. Treasury bills	3.76	4.26	5.01	4.46	4.22	4.35
3-mo. Federal agencies	3.78	4.43	5.29	4.69	4.31	4.37
3-mo. Euro-dollars	5.50	6.72	7.77	6.58	6.27	6.66
3-mo. finance co. paper	4.48	4.74	5.52	5.30	4.81	4.69
4-6 mo. commercial paper	4.57	5.05	5.74	5.54	4.92	4.88
Bond buyer municipals	5.25	5.74	5.75	5.06	5.20	5.36
Aaa corporate-new issues	7.33	7.83	7.68	7.29	7.19	7.17
20-year Treasury bonds	6.00	6.24	6.24	5.92	5.86	5.95
FHA mortgages, 30-year	--	7.67	7.91	7.75	n.a.	--

	QI	QII	QIII	Oct.	Nov.
Change in monetary aggregates (SAAR, per cent)					
Total reserves	11.0	6.6	10.4	-15.9	8.3
Nonborrowed reserves	11.0	5.3	10.8	-13.0	6.3
Credit proxy	16.9	11.8	8.1	2.1	9.3
Credit proxy + nondep. funds	10.9	8.4	7.6	4.8	10.8
Money supply	9.1	10.6	3.4	-1.6	1.1
Time and savings deposits	28.8	14.7	8.2	17.1	9.1
Deposits at S&L's and MSB's	23.3	17.3	12.8	11.8	10.0
Bank credit, end-of-month 1/	12.2	9.1	9.8	9.4	7.0
Treasury securities	19.8	9.8	-14.0	-29.7	6.1
Other securities	27.9	17.0	9.9	24.2	9.5
Total loans 1/	6.3	6.6	14.7	12.3	5.3
Business 1/	2.5	4.6	16.5	3.0	-6.0

	QI	QII	QIII	Oct.	Nov.
Change in commercial paper ($ millions)					
Total (SA)	-2,581	-874	96	791	n.a.
Bank-related (NSA)	-657	41	133	82	50

	1969 2nd Half	1970 2nd Half	1970 QIII	1970 Nov.	1971 QIII	1971 Nov.
New security issues (NSA, $ millions)						
Total corp. issues	13,172	20,499	8,560	4,182	10,447 e	3,450 e
Public offerings	10,770	18,113	7,596	3,899	8,804 e	2,950 e
State and local government bond offerings	5,446	10,327	4,465	1,748	5,917	2,160 e
Fed. sponsored agency debt (change)	5,586	3,057	1,593	480	1,711	202 e
Fed. govt. debt (change)	9,811	16,256	7,087	3,306	9,077	2,500 e

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.

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

	1971 P/ I	1971 P/ II	1971 P/ III 5/	Sept.*	Oct.*
Goods and services, net 1/	1,170	26	-6		
Trade balance 2/	269	-1,040	-537	190	-880
Exports 2/	11,030	10,720	11,481	4,445	2,665
Imports 2/	-10,761	-11,760	-12,018	-4,255	-3,545
Service balance	901	1,066	531		
Remittances and pensions	-342	-355	-388		
Govt. grants & capital, net	-1,026	-1,060	-883		
U.S. private capital (- = outflow)	-2,237	-2,183	-3,575		
Direct investment abroad	-1,370	-1,393	-1,399		
Foreign securities	-353	-388	-224	12	-32
Bank-reported claims -- liquid	-90	35	-405	-11	418
" " " other	-42	-345	-1,203	459	
Nonbank-reported claims -- liquid	-225	55	-115	117	
" " " other	-157	-147	-229		
Foreign capital (excl. reserve trans.)	-2,261	-8	-2,244		
Direct investment in U.S.	92	-16	-319		
U.S. corporate stocks	79	-3	231	155	-44
New U.S. direct investment issues	317	263	181		
Other U.S. securities (excl. U.S. Treas.)	164	-63	153		
Liquid liabilities to:	-2,714	-39	-2,308	-609	356
Commercial banks abroad	-3,065	-92	-2,092	-367	
Of which liab. to branches	(-1,905)	(46)	(-1,630)	(-594)	(-271)
Other private foreign	72	-145	-371	-224	
Intl. & regional institutions	279	198	155	-18	
Nonliquid liab. to banks and others	-200	-150	-182		
Foreign official reserve claims	4,851	5,072	10,927	1,443	1,249
U.S. monetary reserves (increase, -)	862	838	1,373	-3	-15
Gold stock	109	456	300	2	--
Special drawing rights 3/	125	196	150	--	-3
IMF gold tranche	255	252	851	-3	-3
Convertible currencies	373	-66	72	-2	-9
Errors and omissions	-1,017	-2,330	-5,204		
BALANCES (deficit -) 3/					
Official settlements, S.A.	-5,713	-5,910	-12,300		
" " , N.S.A.	-5,435	-6,462	-12,679	-1,440	-1,234
Net Liquidity, S.A.	-2,684	-5,961	-9,472		
" " , N.S.A.	-2,560	-6,596	-10,112	-937	n.a.
Liquidity, S.A. 4/	-2,999	-5,871	-9,992		
" " , N.S.A.	-2,901	-6,586	-10,558	-831	-1,590

* Monthly, 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/ Excludes allocation of $717 million of SDRs on 1/1/71.
4/ Measured by changes in U.S. monetary reserves, all liabilities to foreign official reserve agencies and liquid liabilities to commercial banks and other foreigners.
5/ Third quarter details strictly confidential until December 16.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. The past month has furnished supporting evidence of a strengthening economic upswing, spearheaded by personal consumption expenditures and a stronger outlook for business fixed investment. These developments are reflected in our fourth quarter projection of final sales (exclusive of net exports) which now increase by $23.8 billion or about $3.0 billion more than in the preceding Greenbook. This compares with a revised GNP increase of $17.7 billion in the third quarter. However, because of adverse effects of the port strikes on net exports, and a smaller increase now expected in inventory accumulation, the currently anticipated fourth quarter GNP gain of $22.2 billion is only fractionally higher than that indicated a month ago. In real terms, the fourth quarter GNP increase still amounts to nearly 6 per cent, annual rate.

Retail sales continued to rise at a good pace in October and November, and were well above the third quarter average. Nondurables, in particular, were stronger than expected, while sales of new domestic model cars and other durables remained at the high levels previously expected. These developments have prompted us to add about $1-1/2 billion to the expected increase in consumption during the current quarter. In addition, new figures from the OBE-SEC survey suggest a stronger rise than we had projected earlier for business fixed investment, although this up-scaling partly reflects some catch-up following a shortfall from anticipated expenditures in the third quarter.

We have cut back the anticipated increase in fourth quarter nonfarm inventories by $1 billion. Increases in production have not significantly exceeded expansion in sales in the past few months. Automobile production schedules--at little more than an 8-1/2 million annual rate for the quarter--continue far short of the pace set by sales. Moreover, steel inventories were run down considerably in October, and stocks of coal were depleted as a consequence of the recently settled strike. The port strikes also have resulted in a greater deterioration of the net export position than we had expected. Net exports of goods and services are now expected to register a $2 billion deficit during the quarter--$1 billion more adverse than projected last month.

The tax bill currently on its way to enactment in Congress appears to be in line with our earlier assumptions, and our estimates of Federal Government purchases remain unchanged. However, decisions regarding payment of retroactive wage increases during the freeze and pending legislation could affect both Federal, State and local outlays as well as private wage and salary payments.

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

	Fourth quarter	
	Projections	
	11/10/71	Current
	---Billions of Dollars---	
GNP	22.0	22.2
Final sales	20.1	21.3
Excluding net exports	20.6	23.8
Personal consumption	12.9	14.3
Residential construction	.9	.9
Business fixed investment	.5	2.2
Net exports	- .5	-2.5
Federal purchases	3.6	3.6
State & local purchases	2.7	2.7
Inventory change	1.9	.9
	---Per Cent Per Year---	
Real GNP	5.8	5.9
GNP deflator	2.4 1/	2.4 1/

1/ Excluding the first $1.2 billion, annual rate, of military pay increase, 2.0 per cent per year.

Expected developments in the first quarter appear likely to provide further thrust to the economy. We now anticipate an increase in GNP at an annual rate of $29-1/2 billion as compared with $28 billion projected last month -- with the extra strength reflecting a stronger gain in capital outlays as suggested in the recent business anticipation surveys as well as some rebound in net exports following the return of striking dockworkers. Growth in real GNP would be at about a 6-3/4 per cent rate. Some tax relief and higher social security benefits should help sustain a high rate of increase in consumer outlays.

The large increase in disposable personal income is also reflected in a somewhat higher saving rate for the quarter. Auto sales are expected to recede somewhat from their levels in the fourth quarter, but remain relatively strong, and we project a further rise in residential construction expenditures. Early next year, the housing upswing will enter its sixth quarter and in view of the mounting volume of housing completions, may be expected to provide an increased stimulus for sales of furniture, household furnishings and appliances.

GNP AND RELATED ITEMS, 1972
(Changes in seasonally adjusted totals at annual rates)

	First Quarter		Second Quarter	
	Projections of		Projections of	
	11/10/71	Current	11/10/71	Current
	--------Billions of Dollars--------			
GNP	28.0	29.5	27.0	27.0
Final sales	25.0	27.0	24.7	25.0
Personal consumption	15.1	15.2	16.9	16.8
Residential construction	1.7	1.7	.6	.6
Business fixed investment	1.1	2.0	2.8	2.5
Net exports	2.0	3.0	.5	1.0
Federal purchases	2.0	2.0	.3	.5
State & local purchases	3.1	3.1	3.6	3.6
Inventory change	3.0	2.5	2.3	2.0
	--------Per Cent Per Year--------			
Real GNP	6.3	6.8	6.6	6.6
GNP deflator	4.0 1/	4.0 1/	3.1	3.1

1/ Excluding remaining 1.2 billion, annual rate, of military pay increase, 3.6 per cent per year.

For the rest of 1972, we expect a continuation of the economic expansion, at a pace slightly greater than projected last month, with GNP increases of $27 to 28 billion and gains in real GNP in the 6 to 6-1/2 per cent range. Consumer outlays are expected to be sustained by increases in employment and personal income and improved consumer confidence, with the saving rate dropping to under 7 per cent by year-end. We are projecting automobile sales and housing starts to remain on a historically high plateau for the remainder of 1972. Sizable increases in fixed and inventory investment during the course of the year seem increasingly likely as the economic upturn becomes more firmly established and as profits and the rate of capacity utilization improve. A resolution of some of the issues in international monetary and trade policy and a substantial realignment of exchange rates should react favorably on our trade balance, and we expect a modest surplus in net exports of goods and services in the last half of the year.

Overall, we continue to assume that the rate of price increase will ease to an annual rate of less than 3 per cent after a first quarter spurt reflecting some post-freeze adjustments. Employment gains are expected to exceed labor force growth, resulting in a decline in the unemployment rate to 5.3 per cent by the fourth quarter.

GNP AND RELATED ITEMS, 1972
(Changes in seasonally adjusted totals at annual rates)

	Third Quarter		Fourth Quarter	
	Projections of 11/10/71	Current	Projections of 11/10/71	Current
	--------Billions of Dollars--------			
GNP	27.0	28.0	26.5	27.0
Final sales	25.5	24.8	23.3	24.0
Personal consumption	16.0	16.0	16.5	17.0
Residential construction	- .9	- .9	- .9	- .9
Business fixed investment	3.8	3.5	3.7	3.8
Net exports	1.0	.5	.5	.5
Federal purchases	1.9	2.0	- .6	- .5
State & local purchases	3.7	3.7	4.1	4.1
Inventory change	1.5	3.2	3.2	3.0
	--------Per Cent Per Year--------			
Real GNP	5.8	6.1	6.3	6.4
GNP deflator	3.6 1/	3.6 1/	2.8	2.8

1/ Excluding Federal governmental general pay increase, 2.9 per cent per year.

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December 8, 1971

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.)

	1971 Proj.	1972 Proj.	1971		1972 Projected			
			III	IV	I	II	III	IV
Gross National Product	1051.9	1155.6	1060.8	1083.0	1112.5	1139.5	1167.5	1194.5
Final purchases	1048.9	1145.2	1059.7	1081.0	1108.0	1133.0	1157.8	1181.8
Private	815.7	892.7	825.5	840.5	862.4	883.3	902.4	922.8
Excluding net exports	815.1	890.6	825.0	842.5	861.4	881.3	899.9	919.8
Personal consumption expenditures	666.2	726.9	672.5	686.8	702.0	718.8	734.8	751.8
Durable goods	102.8	115.8	104.7	108.2	111.5	114.5	117.3	119.9
Nondurable goods	280.6	307.7	282.0	288.6	295.4	303.8	311.5	320.2
Services	282.8	303.3	285.7	290.0	295.1	300.5	306.0	311.7
Gross private domestic investment	151.9	172.1	153.6	157.7	163.9	169.0	174.8	180.7
Residential construction	40.9	45.7	43.3	44.2	45.9	46.5	45.6	44.7
Business fixed investment	108.0	118.1	109.3	111.5	113.5	116.0	119.5	123.3
Change in business inventories	3.0	8.4	1.1	2.0	4.5	6.5	9.7	12.7
Nonfarm	2.5	8.3	0.3	1.5	4.3	6.5	9.7	12.7
Net exports of goods and services	0.6	2.1	0.5	-2.0	1.0	2.0	2.5	3.0
Exports	65.0	72.6	68.9	58.5	70.5	72.2	72.8	75.0
Imports	64.4	70.5	68.4	60.5	69.5	70.2	70.3	72.0
Gov't. purchases of goods & services	233.3	252.4	234.2	240.5	245.6	249.7	255.4	259.0
Federal	97.7	104.3	97.4	101.0	103.0	103.5	105.5	105.0
Defense	71.9	74.1	70.8	72.0	73.5	73.5	75.0	74.5
Other	25.8	30.1	26.6	29.0	29.5	30.0	30.5	30.5
State & local	135.6	148.2	136.8	139.5	142.6	146.2	149.9	154.0
Gross national product in constant (1958) dollars	742.5	787.9	745.5	756.4	769.3	781.9	793.9	806.6
GNP implicit deflator (1958 = 100)	141.7	146.4	142.3	143.2	144.6	145.7	147.1	148.1
Personal income 1/	858.8	927.0	866.5	879.2	900.8	916.2	936.7	954.2
Wage and salary disbursements	575.4	621.9	579.0	588.0	603.5	614.5	628.5	641.0
Disposable income 1/	742.9	805.2	750.0	758.2 2/	782.1 2/	797.6 2/	813.2	828.0
Personal saving 1/	57.7	58.1	58.5	52.1 2/	60.3 2/	58.7 2/	58.0	55.5
Saving rate (per cent) 1/	7.8	7.2	7.8	6.9 2/	7.7 2/	7.4 2/	7.1	6.7
Corporate profits before tax 1/	86.2	103.5	86.7	89.5	93.0	101.0	106.5	113.5
Corp. cash flow, net of div. (domestic) 1/	80.4	95.2	81.2	84.3	89.3	92.9	96.9	101.8
Federal government receipts and expenditures (N.I.A. basis)								
Receipts 1/	202.4	219.5	203.5	210.1	212.2	215.2	222.5	228.1
Expenditures	222.0	243.4	223.9	230.1	237.7	240.1	246.8	249.1
Surplus or deficit (-) 1/	-19.6	-23.9	-20.4	-20.0	-25.5	-24.9	-24.3	-21.0
High employment surplus or deficit (-)	2.3	-2.7	2.5	5.6	-0.4	-1.7	-5.6	-3.1
Total labor force (millions)	86.9	88.6	87.0	87.7	88.1	88.4	88.8	89.2
Armed forces "	2.8	2.5	2.8	2.7	2.6	2.5	2.5	2.5
Civilian labor force "	84.1	86.1	84.2	85.0	85.5	85.9	86.3	86.7
Unemployment rate (per cent)	6.0	5.5	6.0	5.9	5.7	5.6	5.5	5.3
Nonfarm payroll employment (millions)	70.7	72.3	70.7	71.0	71.6	72.0	72.5	73.1
Manufacturing	18.6	19.0	18.5	18.6	18.7	18.9	19.0	19.2
Industrial production (1967 = 100)	106.3	113.4	105.8	107.1	109.5	112.0	114.6	117.3
Capacity utilization, manufacturing (per cent)	74.2	76.1	73.4	73.7	74.6	75.6	76.5	77.7
Housing starts, private (millions, A.R.)	2.03	2.10	2.14	2.20	2.18	2.15	2.10	2.00
Sales new autos (millions, A.R.)	10.25	10.88	10.29	11.00	10.80	10.80	10.85	11.05
Domestic models	8.80	9.58	8.76	9.75	9.40	9.50	9.60	9.80
Foreign models	1.45	1.30	1.53	1.25	1.40	1.30	1.25	1.25

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.

1/ Incorporates provisions of Revenue Act of 1971 as passed by House.

2/ Incorporates effects of accelerating payment of estate and gift taxes.

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1971	1972	1971		1972			
					Projected			
	Proj.	Proj.	III	IV	I	II	III	IV
	Billions Of Dollars							
Gross National Product	77.8	101.6	17.7	22.2	29.5	27.0	28.0	27.0
Inventory change	0.2	5.4	-4.6	0.9	2.5	2.0	3.2	3.0
Final purchases	77.6	96.3	22.3	21.3	27.0	25.0	24.8	24.0
Private	63.8	77.0	18.3	15.0	21.9	20.9	19.1	20.4
Excluding net exports	66.8	75.5	17.3	17.5	18.9	19.9	18.6	19.9
Net exports	-3.0	1.5	1.0	-2.5	3.0	1.0	0.5	0.5
Government	13.9	19.1	4.0	6.3	5.1	4.1	5.7	3.6
GNP in constant (1958) dollars	22.5	45.4	7.1	10.9	12.9	12.6	12.0	12.7
Final purchases	22.1	41.2	10.6	10.5	10.8	11.1	9.4	10.3
Private	22.7	37.5	8.2	8.8	10.4	10.3	9.1	9.9
	In Per Cent Per Year							
Gross National Product	8.0	9.7	7.0	8.4	10.9	9.7	9.8	9.3
Final purchases	8.0	9.2	8.6	8.0	10.0	9.0	8.8	8.3
Private	8.5	9.4	9.1	7.3	10.4	9.7	8.6	9.0
Personal consumption expenditures	8.2	9.1	7.0	8.5	8.9	9.6	8.9	9.3
Durable goods	16.0	12.6	15.5	13.4	12.2	10.8	9.8	8.9
Nondurable goods	6.0	9.7	3.1	9.4	9.4	11.4	10.1	11.2
Services	7.7	7.2	7.6	6.0	7.0	7.3	7.3	7.5
Gross private domestic investment	12.3	13.3	3.1	10.7	15.7	12.4	13.7	13.5
Residential construction	34.5	11.7	36.3	8.3	15.4	5.2	-7.7	-7.9
Business fixed investment	5.8	9.4	8.6	8.1	7.2	8.8	12.1	12.7
Gov't. purchases of goods & services	6.3	8.2	7.0	10.8	8.5	6.7	9.1	5.6
Federal	0.5	6.8	7.1	14.8	7.9	1.9	7.7	-1.9
Defense	-4.6	3.1	-5.6	6.8	8.3	0.0	8.2	-2.7
Other	17.8	16.7	45.2	36.1	6.9	6.8	6.7	0.0
State & local	11.0	9.3	6.8	7.9	8.9	10.1	10.1	10.9
GNP in constant (1958) dollars	3.1	6.1	3.9 1/	5.9	6.8	6.6	6.1	6.4
Final purchases	3.1	5.7	5.8	5.7	5.7	5.8	4.8	5.2
Private	3.9	6.2	5.5	5.8	6.8	6.6	5.7	6.1
GNP implicit deflator	4.7	3.3	3.3 1/	2.4 3/	4.0 4/	3.1	3.6 5/	2.8
Private GNP fixed weight price index 2/	4.9	3.3	4.1 1/	2.0	3.6	3.1	2.9	2.8
Personal income	6.9	7.9	5.5	5.9	9.8	6.8	9.0	7.5
Wage and salary disbursements	6.3	8.1	4.6	6.2	10.5	7.3	9.1	8.0
Disposable income	8.0	8.4	5.0	4.4	12.6	7.9	7.8	7.3
Corporate profits before tax	14.4	20.0	1.4	12.9	15.6	34.4	21.8	26.3
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	5.7	8.4	8.6	13.0	4.0	5.7	13.6	10.1
Expenditures	8.2	9.6	5.4	11.1	13.2	4.0	11.2	3.7
Nonfarm payroll employment	0.1	2.3	-0.2	1.7	3.4	2.2	2.8	3.3
Manufacturing	-3.9	1.8	-2.4	2.2	2.1	4.3	2.1	4.2
Industrial production	-0.4	6.6	-3.6	4.8	9.0	10.4	9.1	9.6
Housing starts, private	41.5	3.7	36.5	11.0	-4.5	-4.6	-9.3	-19.0
Sales new autos	22.7	6.1	19.0	27.8	-7.3	0.0	1.9	7.4
Domestic models	23.6	8.9	22.7	45.3	-14.4	4.3	4.2	8.3
Foreign models	18.0	-10.5	-1.0	-72.6	48.0	-28.6	-15.4	0.0

1/ At compound rates.

2/ Using expenditures in 1967 as weights.

3/ Excluding the first $1.2 billion, annual rate, of voluntary army pay increase, 2.0 per cent per year.

4/ Excluding the remaining $1.2 billion, annual rate, of voluntary army pay increase, 3.6 per cent per year.

5/ Excluding Federal government general pay increase, 2.9 per cent per year.

Industrial production. Industrial production in November is estimated to have increased appreciably more than in October, with gains in output widespread and with strength particularly evident in business equipment and materials.

The coal strike was settled in mid-November and, although not all miners have returned to work, the rise in production should amount to .2 or .3 of a point in the total index. Output of textiles and chemicals is estimated to have increased further. Raw steel production has been about unchanged but trade reports indicate further weakening in nonferrous metals, especially aluminum.

Production worker manhour data suggest a further rise in output of industrial and commercial equipment, a leveling off in aircraft production (since August) following a long and deep contraction, but some further reduction in defense equipment. Production of trucks was maintained at record levels.

Output of consumer goods is estimated to have increased somewhat further as production of furniture, some appliances, and consumer staples rose. Auto assemblies were about unchanged from the October annual rate of 8.5 million units and little change is expected in December.

Since the beginning of the year there has been a modest recovery in industrial production. Output of consumer goods rose sharply in the second quarter to a new high and then edged up further through October. Production of business equipment reached its low in the fourth quarter of 1970, showed little change through May 1971, and then rose 4 per cent in the following five months. Output of materials was dominated by the rise and fall in steel production and in October by the coal strike. However, materials production, excluding steel and coal, has also shown some recovery so far in 1971.

INDUSTRIAL PRODUCTION
1967=100, seasonally adjusted

	Per cent change Jan.1971 to Oct.1971
Total index	.9
Consumer goods	3.3
Autos	3.6
Home goods	4.8
Apparel & staples	1.9
Business equipment	4.0
Defense equipment	-4.1
Intermediate products	1.4
Construction products	1.1
Materials, total	-1.1
Durable	-.5
Steel	-16.6
Nondurable	1.0
Fuel & power	-16.0
Memorandum:	
Excluding steel and coal,	
Total index	2.6
Materials	2.3

Retail sales. The stronger rate of growth in retail sales which began in August appears to have continued through November with sales for the month up more than 1 per cent from October, according to estimates based on weekly data. Strength over the past four months--while uneven from month to month--has been widespread among store types. Sales apparently increased at about the same rate in November at both durable and nondurable goods stores.

RETAIL SALES
(Percentage Change from Previous Month)

	1971			
	Aug.	Sept.	Oct.	Nov.1/
All stores	2.9	1.4	.3	1.2
Total, less autos and nonconsumer items	1.8	-.1	1.2	1.2
Total, real*	2.6	1.3	.2	n.a.

* Deflated by all commodities CPI.
1/ Estimated by FRB on basis of weekly data.

Unit auto sales. Sales of new domestic-type autos were at a 9.5 million unit annual rate in November, down 7 per cent from the advanced October pace. The sales rate was progressively lower in each 10-day period of November. Since August 21, domestic-type sales have averaged a 9.6 million unit rate, sharply above the 8.3 million rate of the seven and one-half months before the announcement of the new economic program.

November sales of foreign cars were at an annual rate of 1.5 million units, up 15 per cent from October and the import share of total sales rose slightly to 12 per cent. In the first seven and one-half months of 1971, sales of imported cars were also at a 1.5 million unit rate; since mid-August, when they were slowed by dock strikes, sales have been at a 1.4 million unit average rate.

PERCENTAGE DISTRIBUTION OF AUTO SALES[1/]

	1971		
	September	October	November
Total	100.0	100.0	100.0
Domestic			
Total	85.5	89.0	88.0 e
Large	65.6	70.0	NA
Small[2/]	19.9	19.0	NA
Imports			
Total	14.5	11.1	12.0 e
Low-priced	12.5	9.6	10.0 e

1/ Based on data not seasonally adjusted.
2/ Compacts and subcompacts.
e/ estimated.

Consumer credit. The rate of increase in consumer instalment credit outstanding in October remained close to the record September pace. On a seasonally adjusted basis the increase amounted to $11.1 billion (annual rate) compared with $12.0 billion in September; during the preceding 6-month period--March through August--the annual rate of expansion was $7.5 billion.

Extensions of instalment credit during October were down slightly from September, as were repayments. The contraction in these totals resulted largely from reductions in automobile financing activity. Both extensions and repayments for nonautomotive consumer goods and personal loans were higher in October than in September.

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

	Total	Automobile	Other consumer goods	Personal loans
EXTENSIONS				
1971 - QI	110.1	32.2	38.7	36.9
QII	116.6	33.9	40.6	39.7
QIII	119.5	35.7	41.3	39.9
Oct.	120.4	35.9	41.6	40.1
REPAYMENTS				
1971 - QI	107.4	31.8	38.1	35.2
QII	109.9	31.5	38.8	37.3
QIII	109.2	32.0	38.5	36.3
Oct.	109.3	31.6	38.6	36.7

Consumer surveys. New consumer surveys by the Conference Board and Michigan Survey Research Center present an ambiguous outlook for consumer demand. But it should be noted that the first round of consumer surveys after the August 15 announcement of the New Economic Program failed to anticipate the surge in auto sales and the improved volume of other types of retail sales during the past few months.

The Conference Board October survey found more households reporting jobs hard to get and fewer respondents expecting short-term business conditions to improve. However, there was some pickup in evaluations of present business conditions and a very slight increase in families expecting higher income. Moreover, there was a strong increase in purchase plans for major appliances, and home buying plans remain at a high level--although off fractionally from August. Purchase plans for new cars are about the same as in August and a year earlier.

The Michigan index of consumer sentiment in November was 82.2 (February 1966=100), not significantly changed from 82.4 in September and 81.6 in May. There were conflicting trends in responses to the index questions. On the favorable side, a high number reported that it is a good time to buy household durables and more respondents noted an improvement in their personal financial situation. On the other hand, expectations for improved business conditions during the next 12 months declined rather sharply.

The disparity between previous surveys and the actual strength in auto sales may be attributable to families bunching purchases in advance of expected price increases. (Buying plan questions have a specific time horizon such as "within next 6 months.") The last three Michigan surveys indicated an increase in purchases because of expected inflation, and the latest release suggests that this buying borrows from future demand. However, equally plausible possibilities are that spending by some consumers will increase the confidence of other households and that actual events will show that families are unduly pessimistic about the economic outlook. Consumption of durables and confidence, as measured by the Michigan index, has changed quite rapidly in the past.

Manufacturers' orders and shipments. New orders for durable goods have continued to show relatively little strength; they increased 0.6 per cent in October (preliminary), following a September decline of 2.3 per cent. A major factor in the October increase was a sharp rise in the volatile defense series. Iron and steel orders, which had increased sharply in September, dropped back somewhat in October. Excluding both defense and steel, orders were down 0.9 per cent in October from September and from the third quarter.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
Seasonally adjusted monthly averages

	1971				Change
	Q II	Q III (Rev.)	Sept. (Rev.)	Oct. (Prel.)	Oct. from Sept.
	----Billions of dollars----				Per Cent
Durable goods, total	30.5	31.6	31.0	31.2	.6
Excluding steel & defense	26.8	27.5	27.5	27.3	-.9
Primary metals	4.7	4.4	4.5	4.5	.0
Iron and steel	2.1	1.9	2.0	2.0	-3.1
Other	2.6	2.5	2.5	2.6	2.5
Motor vehicles & parts	4.7	5.2	5.2	4.8	-6.7
Household durables	2.4	2.4	2.4	2.4	.5
Defense products	1.6	2.2	1.5	1.9	32.9
Capital equipment	7.9	7.8	8.0	8.1	1.7
All other durables	9.2	9.6	9.5	9.4	-1.1

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

Orders for capital equipment increased 1.7 per cent and were above the third-quarter average but the October level was no higher than January of this year. The capital equipment orders series, like other related series such as contracts and orders for plant and equipment, fluctuates more than actual spending and has not had a clear, consistent relationship to business spending on plant and equipment. Therefore, the absence of a noticeable increase in orders is not necessarily inconsistent with anticipated increases in fixed capital spending shown by recent surveys. But recent sluggishness in new orders for capital equipment--especially after adjustment for price change--and the continued decline in unfilled orders suggest little likelihood of immediate stimulus to inventory accumulation from this sector.

Motor vehicle shipments and orders declined somewhat, after a high third quarter that may have reflected in part the earlier model changeover this year. Orders for "other durables" (which includes construction materials) declined.

Shipments of durable goods declined 0.6 per cent in October; mainly in the motor vehicles group. Unfilled orders for durables were down very slightly.

Inventories. Book value of manufacturers' inventories rose at a $3.8 billion annual rate in October, according to preliminary data--up from the September rate of $2.4 billion and in contrast to a reduction of $1.1 billion, annual rate, in the third quarter. The turn-around in the last two months reflected accumulation of non-durable goods and of durable goods other than materials; durable materials stocks were run down rapidly in both months, perhaps reflecting use of coal stockpiles as well as of steel stockpiles in October.

The overall rate of inventory growth in manufacturing remains modest--compared for example with the period following the steel settlement in 1968--reflecting such factors as the greater overhang of materials stocks, the absence of stimulus from new orders for defense or capital equipment, and an abundance of productive capacity.

The book value of stocks in wholesale trade increased appreciably in October. Liquidation at metals and nondurables dealers was much smaller than in September.

CHANGE IN BOOK VALUE OF INVENTORIES
(Seasonally adjusted annual rate, $ billions)

	1971			
	Q II	Q III (Rev.)	Sept. (Rev.)	Oct. (Prel.)
Manufacturing, total	.1	-1.1	2.4	3.8
Durable	-1.0	-1.0	.5	-.9
Materials*	1.3	-1.7	-2.5	-4.0
End products	-2.3	.7	3.0	3.1
Nondurable	1.2	.0	2.0	4.6
Wholesale trade	2.2	1.9	.2	2.5

* Including finished and in-process stocks of primary metals manufacturers.

Factory shipments declined in October and the inventory-shipments ratio rose to 1.75 from 1.73 in September. The increase in stocks relative to shipments in October was particularly noticeable at nondurable goods producers where the ratio rose to the highest point since January. There may have been some backup of stocks of goods for export as a result of the East and Gulf Coast dock strikes which began in October, but the increase did not occur in the machinery industry which is a major exporter.

The wholesale inventory-sales ratio rose in October and was at the year-earlier level. The increase in the ratio occurred both for nondurables and for durables other than motor vehicles and metals.

INVENTORY RATIOS

	1970		1971	
	Sept.	Oct.	Sept. (Rev.)	Oct. (Prel.)
Inventories to sales:				
Manufacturing, total	1.81	1.88	1.73	1.75
Durable	2.17	2.32	2.05	2.06
Nondurable	1.37	1.40	1.36	1.39
Wholesale trade	1.24	1.25	1.23	1.25
Inventories to unfilled orders:				
Durable manufacturers	.833	.851	.868	.869

The ratio of manufacturers' durable goods inventories to unfilled orders remained at its highest point in the postwar period, with a decline in the materials ratio offset by an increase in the ratio for end products.

Cyclical indicators. The preliminary Census composite leading indicator rose 1.2 per cent in October to a new high. However, the increase resulted mainly from a large rise in one component, building permits. There were also increases in the manufacturing workweek (preliminary) and new orders for durable goods, and a decline in initial claims for unemployment insurance (treated inversely in the index). The ratio of price to unit labor cost was unchanged, and there were declines in contracts and orders for plant and equipment, materials prices, and common stock prices. Since the preliminary composite was compiled, both the workweek and new orders were revised upward, and the workweek rose further in November.

COMPOSITE CYCLICAL INDICATORS
(1967=100)

		12 Leading trend adjusted	5 Coincident	6 Lagging
1971:	April	124.0	122.6	123.8
	May	125.1	123.5	123.2
	June	125.0	125.6 (H)	124.2
	July	126.8	124.0	124.5
	August	126.8	124.0	126.5
	September	127.1	125.1	127.4
	October (prel.)	128.6 (H)	125.4	127.0

(H) Current high value.

The coincident composite rose 0.2 per cent and remains slightly below its June high. The lagging composite declined.

Construction and real estate. Seasonally adjusted expenditures for new construction put in place, at an annual rate of $112 billion in November, about matched the advanced October pace and continued just below the record level reached last August. Changes in major types of construction were generally small and offsetting.

In November, rising construction costs continued to contribute to the year-to-year increases shown by the current dollar figures. As measured by the Census Bureau, the implied year-to-year advance in over-all costs during the month amounted to 8 per cent, although this was down from nearly 10 per cent in August.

NEW CONSTRUCTION PUT IN PLACE
(Seasonally adjusted annual rate)

	All	Private			Public
		Total	Residential	Nonresidential	
	Billions of dollars				
1970 Annual	94.3	66.1	31.7	34.4	28.1
1971 - IQ	102.0	71.4	36.6	34.8	30.6
IIQ	107.6	78.0	41.1	36.9	29.5
IIQ (r)	111.8	82.5	44.9	37.6	29.3
1971					
August (r)	113.3	83.5	45.2	38.3	29.8
September (r)	111.2	82.6	45.9	36.7	28.6
October (r)	112.3	83.2	46.0	37.2	29.1
November (p) 1/	112.2	82.9	45.6	37.2	29.3
	Per cent change in August from a year earlier				
In current dollars	+14	+20	+34	+6	+1
In 1967 dollars	+6	+11	+27	-5	-7

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

Seasonally adjusted private housing starts turned upward again in October and exceeded a 2 million annual rate for the third month this year. Moreover, with permits at a record pace in October and mortgage commitments for both subsidized and non-subsidized units still exceptionally high, starts in the remaining months of the year may rise sufficiently further to carry the average for the fourth quarter above the 2.14 million unit rate in the third quarter. If attained, this would raise the average for all of 1971 above the 2 million unit mark for the first time in the history of the series, and in a year when mobile home shipments--also experiencing a record pace--may add as much as 500,000 to the total count of "shelter units." In 1970, the "shelter count" was just over 1.8 million, including 400,000 mobiles.

Although vacancy rates in general have remained relatively low, a factor which may operate to limit a further rise in private housing starts beyond this year's indicated second-half pace is the much higher level of completions which is now beginning to develop. In the early stages of the recovery in private housing starts, which began in the second quarter of 1970, the seasonally adjusted rate of

PRIVATE HOUSING STARTS AND PERMITS
(Seasonally adjusted annual rates, in thousands of units)

	Starts			
	Total 1/	Per cent Single-family	Per cent 2/ FHA-insured	Permits
1970 - Annual	1,434	57	29	1,324
1970				
IIQ	1,286	58	28	1,257
IIIQ	1,512	56	28	1,358
IVQ	1,777	58	35	1,593
1971				
IQ	1,813	55	24	1,608
IIQ	1,962	58	22	1,805
IIIQ (r)	2,145	56	24	1,986
1971				
August (r)	2,258	54	23	2,006
September (r)	1,948	60	29	1,900
October (p)	2,050	56	22	2,215

1/ Apart from starts, mobile home shipments for domestic use in September--the latest month for which data are available--were at a record seasonally adjusted annual rate of 557,000, for a third quarter average of 539,000, up more than a tenth from the previous high in the second quarter of the year.

2/ Based on unadjusted totals for all periods. FHA-insured starts include both subsidized and nonsubsidized units.

completions showed comparatively little change, reflecting, in large part, the extended construction period required for multifamily structures. By the third quarter of this year, however, total completions--which, as defined by the Census Bureau, exclude mobile homes--were at a seasonally adjusted annual rate of 1.7 million units. Moreover, the rate, while unprecedented for this series, was some 400,000 units under the annual rate of starts in the third quarter and still not yet as high as the starts rate in the fourth quarter of 1970.

PRIVATE HOUSING COMPLETIONS
(Seasonally adjusted annual rates, in thousands of units)

		Total	Single-Family	Multi-Family
1970 - Annual		1,401	794	607
	IIQ	1,364	758	607
	IIIQ	1,425	817	607
	IVQ	1,420	821	599
1971				
	IQ	1,435	859	579
	IIQ	1,635	977	659
	IIIQ (p)	1,729	1,009	722
		Completions as per cent of starts		
1970	IIIQ	94	96	92
1971	IIIQ (p)	81	85	76

NOTE: Census data, seasonally adjusted by F.R.

Planned expenditures for new plant and equipment. The Commerce-SEC November survey of business plans for expenditures on new plant and equipment indicates larger gains for the next few quarters than had been anticipated earlier. Following a slight decline in the third quarter, spending is expected to increase by about 4 per cent in both the fourth and first quarters. In the second quarter of 1972, however, the rate of gain is expected to slow to about 2 per cent.

If spending in the last half of 1972 were to remain at the anticipated second quarter level, the increases shown for the first half of the year alone would imply a somewhat stronger (8.3 per cent) gain for the year than the 7 per cent indicated for 1972 by the recent McGraw-Hill survey.

Spending in the third quarter of 1971 fell short of earlier expectations, but all of the shortfall is expected to be made up in the fourth quarter so that the expected gain for 1971 as a whole remains at about 2 per cent.

TABLE I

EXPENDITURES FOR NEW PLANT AND EQUIPMENT
(Billions of dollars, seasonally adjusted annual rates)

	1970		1971				1972	
	III	IV	I	II	III	IV	I	II
	Actual					Anticipated		
Total	81.9	78.6	79.3	81.6	80.8	84.0	87.1	88.5
Manufacturing	32.2	31.0	30.5	30.1	29.2	31.1	31.3	31.2
Durable goods	15.7	14.9	14.2	14.1	13.8	15.1	15.9	15.1
Nondurable goods	16.4	16.1	16.3	16.1	15.4	16.0	15.3	16.1
Nonmanufacturing	49.7	47.7	48.9	51.5	51.6	52.9	55.9	57.3

The strength in the new fixed capital plans is concentrated in the nonmanufacturing sector of the economy--especially communications and commercial firms. In manufacturing a decline in spending was reported for the third quarter, but outlays are expected to rise sharply in the fourth quarter as the shortfall is more than made up. The figures show little change thereafter.

This pattern for manufacturing is roughly consistent with the Conference Board new capital appropriations survey which had indicated a depressed level of appropriations until the third quarter of 1971 when a sharp rise was reported. Since changes in expenditures tend to follow appropriations by about two to three quarters little strength seems likely in manufacturing expenditures before mid-1972. After that, the appropriations figures (and the strong rise in manufacturing outlays for 1972 as a whole reported by the McGraw-Hill Survey) suggest a substantial recovery in capital expenditures in this sector.

TABLE II

MANUFACTURERS' NEW CAPITAL APPROPRIATIONS
(Seasonally adjusted, quarterly rates)

	1971	1970				1971		
	IIIp	I	II	III	IV	I	II	IIIp
	Millions of dollars	-----Per Cent Change from Preceeding Quarter-						
Total manufacturing	6,102	-13.4	-1.1	1.6	-9.3	-4.0	-5.7	12.1
Ex petroleum	4,578	-3.5	-0.5	-3.6	-14.0	4.8	-6.7	8.2
Durable goods	3,011	-10.6	-2.2	3.8	-18.9	.2	-7.4	21.5
Nondurable goods	3,091	-15.9	.0	- .5	.5	-7.5	-4.1	4.2

Labor market. Unemployment edged back up in November by 0.2 percentage points to 6.0 per cent, seasonally adjusted, the same as the rate in September. The rise reflected a larger growth in the civilian labor force than in total employment. Over half the rise in unemployment in November occurred among adult women, but unemployment rates rose for most groups. An exception was the rate for Negro workers which fell to 9.3 per cent--the lowest this year.

In general, the unemployment situation has remained essentially unchanged during the past year, with the unemployment rate fluctuating around the 6 per cent mark, and the number of jobless workers about 200,000 higher than a year ago. But there is some indication that layoffs, as reflected in claims for unemployment compensation, have been trending downward in recent weeks.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1970	1971		
	November	May	October	November
Total	5.9	6.2	5.8	6.0
Men aged:				
20 to 24 years	10.4	10.8	10.1	10.7
25 and over	3.4	3.6	3.5	3.5
Women, age 20 and over	5.6	6.0	5.5	5.8
Teenagers	17.6	17.3	17.0	17.0
White-collar workers	3.6	3.7	3.4	3.6
Blue-collar workers	7.4	7.5	7.2	7.5
White workers	5.5	5.7	5.3	5.7
Negroes and other races	9.0	10.5	10.7	9.3

Total employment (household survey) increased by 200,000 in November, but the civilian labor force grew by almost 400,000. Most of the growth this November occurred among women and teenagers. The civilian labor force has increased about 1.7 million over the last year, about in line with trends in population growth and participation rates.

Nonfarm payroll employment showed only a moderate gain in November, rising 84,000 after a decline of 20,000 in October. The 80,000 coal miners who were on strike during October and the first half of November returned to work after the reporting week and are not included in either the October or November job count. Manufacturing employment was up by 40,000. The gains were entirely among production workers, as non-production worker employment continued to show little strength. Outside of manufacturing, employment continued to grow moderately in services and State and local government. Employment in the trade sector was reported down by 50,000.

The number of employees on nonfarm payrolls has increased by 460,000 since the beginning of the year, but the level attained in November was still 230,000 below the peak reached in March 1970. Most of the gain has been in services and State and local government; factory employment is still 1.7 million below the record high reached in July 1969.

On the stronger side, average weekly hours of factory workers rose 0.3 hours to 40.1 in November (seasonally adjusted) due to large increases in the machinery and transportation equipment industries. The increase in the work week, however, may be due in part to seasonal adjustment problems, since this is the first year in which Veterans Day did not fall in November. Generally, the factory workweek has been relatively stable since early this year, at about 40 hours per week.

NONFARM PAYROLL EMPLOYMENT, 1971
(Seasonally adjusted, in thousands)

	Change from Previous Quarter:			Change from
	Q I	Q II	Q III	Oct.-Nov.
Total	315	234	-38	84
Goods producing	-25	-7	-166	47
Manufacturing	20	-31	-114	39
Mining	1	-2	- 14	-4
Contract construction	-46	26	-38	12
Service producing	343	240	129	37
Transportation & p.u.	26	-10	-53	3
Trade	124	73	88	-53
Services and finance	99	86	100	62
Government	94	91	-6	25
Federal	0	-3	-3	-3
State and local	95	94	-3	28

Earnings. The rate of increase in wages slowed dramatically during the wage freeze. Average hourly earnings of production workers on private nonfarm payrolls rose at an annual rate of only 1.2 per cent from August to November, far below the January-August rate. Significant slowdowns in earnings growth were evident in all industries--particularly manufacturing, trade and finance. The peculiar August-November movement in mining is due to the coal strike.

Relatively few actions have been announced so far by the Pay Board. The only recent major wage settlement, involving 80,000 coal miners was treated by the Board as an "existing" contract--signed before the end of the freeze--and therefore not subject to the 5 1/2 per cent guideline for wage and benefit increases. The major action of the Board, so far, has been its restriction on the retroactive payment of most wage increases that had been effective during the freeze period. The Board now has under consideration several major wage settlements, including aerospace and railroadssignalmen, with proposed increases substantially above the guideline.

AVERAGE HOURLY EARNINGS OF PRODUCTION
AND NONSUPERVISORY WORKERS, 1971
(Per cent change, annual rate; seasonally adjusted)

	January-August	August-November
Private nonfarm	6.7	1.2
Manufacturing	5.4	1.1
Mining	7.4	-22.3
Construction	9.1	4.8
Transportation & p.u.	7.6	5.7
Trade	6.1	0.0
Finance	8.1	-3.6
Services	4.1	2.7

Industrial relations. The number of workers on strike in key industries was sharply reduced during November. The bituminous coal miners ratified a new three-year contract just before the 90-day freeze expired at midnight November 13. Most of the 80,000 coal miners returned to work the following week. The first year of the agreement, according to estimates of the coal operators, provides for a 15.8 per cent increase in wage and benefit costs.

East and Gulf Coast longshoremen were ordered back to work November 26 and 27 after the President requested an 80-day injunction under the Taft-Hartley Act. West Coast longshoremen who have been operating under a Taft-Hartley injunction since October 6 will be free to strike again after December 24.

In the aerospace industry, where major contracts covering 200,000 workers expire this year, the first breakthrough in contract negotiations came when a new agreement was reached recently by North American Rockwell Corporation and 20,000 members of the UAW. The settlement was patterned after the 1970 auto contracts with a large first-year "catch-up" wage increase reported at about 12 per cent to be followed by 3 per cent increases in the second and third contract years. The ceiling on cost-of-living adjustments was also removed as in the auto contracts. Since this is a new contract, the increase has to be approved by the Pay Board.

Productivity and labor costs. Productivity and unit labor cost data for the private economy and the private nonfarm economy have been revised by BLS to reflect the new upward revision in third quarter estimates of real GNP. In the private nonfarm economy, output per manhour rose at an annual rate of 3.4 per cent during the third quarter compared to the earlier estimate of 2.1 per cent. Consequently, the estimated increase in unit labor costs was reduced to 2 per cent (annual rate) from the 3.2 per cent reported earlier. Although BLS will not publish revised data for manufacturing output per manhour and unit labor costs to reflect third quarter revisions in the Board's production index, the FRB estimate of output per manhour shows a decline of 0.7 per cent (annual rate) during the third quarter compared with the earlier BLS estimate of a 2.1 per cent decline. As a result, the rise in manufacturing unit labor costs is estimated at a 5.2 per cent annual rate, compared with the 6.7 per cent unrevised BLS estimate.

PRODUCTIVITY AND UNIT LABOR COSTS
Per cent change from previous quarter
at annual rate

	Output Per Manhour		Unit Labor Cost	
	Private nonfarm economy	Manufacturing 1/	Private nonfarm economy	Manufacturing 1/
1971:I	6.7	6.3	2.3	3.5
II	4.3	6.2	3.4	-1.0
III	3.4r	-.7	2.0r	5.2

1/ FRB estimate.
r/ Revised by BLS.

Wholesale prices. Between October and November, the wholesale price index rose 1.3 per cent, seasonally adjusted annual rate, reflecting higher prices of farm and food products. The index of industrial commodities was up only marginally.

Before seasonal adjustment, the WPI advanced 1.1 per cent at an annual rate, with almost all of the increase due to increases for domestically produced raw agricultural commodities. If raw agricultural commodities and imports are excluded, the unadjusted WPI shows no change.

WHOLESALE PRICES
(Percentage changes, seasonally adjusted annual rates

	Dec 1970 to June 1971	June 1971 to Aug 1971	Aug 1971 to Sept 1971	Sept 1971 to Oct 1971	Oct 1971 to Nov 1971	Aug 1971 to Nov 1971
All commodities	5.0	5.7	-4.7	1.3	1.3	- .8
Farm & food 1/	7.2	2.1	-19.0	18.4	4.3	.0
Industrial commodities	4.1	7.7	- .9	-3.3	.4	-1.3
Crude materials 2/	4.7	1.0	2.0	4.0	-2.9	1.0
Inter. materials 3/	5.5	10.4	.0	-2.0	-1.0	-1.0
Finished goods 4/	2.3	4.1	-1.1	-3.8	.0	-1.6
Producer	3.3	4.7	-1.0	-5.0	-2.0	-2.7
Consumer	1.8	3.8	-1.1	-3.2	1.1	-1.1

1/ Farm products and processed foods and feeds.
2/ Excludes foods, plant and animal fibers, oilseeds, and leaf tobacco.
3/ Excludes intermediate materials for food manufacturing and manufactured animal feeds.
4/ Excludes foods.

For industrial commodities, seasonally adjusted increases for lumber and wood products, hides and skins, and metals and metal products about offset declines in prices of chemicals, fuels, and machinery and equipment.

The distribution of the direction of price change for industrial product classes computed monthly by the BLS was similar in November to the pattern of the previous two months but was substantially different from a year earlier and from earlier months of 1972.

WHOLESALE PRICES

Per cent distribution of
Monthly changes in 231 industrial product classes

	1970 1/			1971				
	Sept.	Oct.	Nov.	Jan to June (avg.)	July and Aug. (avg.)	Sept.	Oct.	Nov.
Total changes	100	100	100	100	100	100	100	100
Increases	44	48	43	51	49	22	21	19
Decreases	19	18	18	17	14	23	22	21
No changes	37	34	39	32	37	55	57	60

1/ 228 product classes.

Changes reported for groups classified by state of processing also were small. Prices of consumer nonfood finished goods increased slightly, with consumer nondurables unchanged and consumer durables up, largely because of a seasonally adjusted increase for passenger cars. Producer finished goods declined chiefly as a result of lower prices reported for machinery and equipment. Indexes of both crude and intermediate materials declined.

Thus far, the Price Commission has received requests for price increases from about one-third of the 1300 large firms who are required to obtain prior approval. Some have been granted in full, some in part, and in a few cases firms have been refused price increases and have been asked to submit further data. Automobile producers generally have been allowed increases of between 2-1/2 and 3 per cent (Chrysler was permitted over 4 per cent) in comparison with tentative announcements made prior to the freeze that prices would be raised 4 to 5 per cent. A major steel company has been allowed an average increase of 3.6 per cent on all products with the option of distributing the increase among products as they see fit. The increase granted in this case would permit substantial increases on products, such as sheets, which had not been raised prior to the freeze.

The Price Commission has announced that in the case of coal, and presumably in other cases where wage settlements are substantially in excess of the 5-1/2 per cent guideline it will not allow the full price increase needed to absorb increases in labor costs.

<u>Consumer prices</u>. Consumer prices rose in October at a seasonally adjusted annual rate of 1.6 per cent, less than the 2.4 per cent rise in September and well below the 4.4 per cent average between May and August. Prices of food were unchanged from September, while for nonfood commodities prices actually declined (both seasonally adjusted). The rate of rise in service costs, meanwhile, was reduced sharply. Lags in recording price changes that apparently occurred prior to the freeze account for much of the increae. The net effect on the index of exempted items and imports was minor.

For foods, less than seasonal declines for meats, poultry and fresh fruits were offset by larger than or even contraseasonal-- declines for dairy and cereal and bakery products. In September a sharp drop in the index for fresh fruits and vegetables had resulted in a fall in the index for all food and was a significant factor in holding down the increase in the "All items" index. The cost of restaurant meals rose at an annual rate of only 1 per cent, in contrast to a 5 per cent increase over the previous 12 months.

CONSUMER PRICES
(Percentage changes, seasonally adjusted annual rates)

	Dec.1970 to Mar. 1971	Mar.1971 to June 1971	June 1971 to Sept.1971	Aug.1971 to Sept. 1971	Sept.1971 to Oct.1971
All items	2.8	5.3	3.3	2.4	1.6
Food	6.0	6.3	-[illegible].3	-3.0	[illegible].0
Commodities less food	1.0	4.9	3.1	2.1	-1.0
Services 1/	3.2	5.2	5.4	4.7	1.9
Addendum:					
Services less home finance 1/2/	8.5	6.3	4.9	3.8	.0

1/ Not seasonally adjusted.

2/ Confidential

Among other commodities, apparel prices rose about 5 per cent at a seasonally adjusted annual rate. Apparel prices in October include those for fall and winter items in a sample of cities which had not been priced since July. The increase was much larger than seasonal, and larger than the seasonally adjusted rise in September.

Seasonally adjusted, new car prices fell in October. This decline may be exaggerated, in view of the difficulties of making appropriate seasonal adjustments at a time when suggested dealer prices of the new (1972) models were frozen and when both 1971 and 1972 models were being sold in volume and at various discounts. When finally enacted, the elimination of the excise tax on autos is expected to be phased retroactively into the index for August and September. The price increases recently granted on new autos by the Price Commission will first enter the index in December.

SELECTED COMMODITY AND SERVICE PRICES
(Percentage changes at annual rates)

	Dec. 1970 to Mar. 1971	Mar. 1971 to June 1971	June 1971 to Sept 1971	Aug. 1971 to Sept 1971	Sept. 1971 to Oct 1971
Apparel 1/	1.0	4.4	.7	3.0	5.1
New cars 1/	4.7	3.2	- .3	-4.1	-10.0
Rent	4.7	4.6	3.2	3.2	3.1
Gas & electricity	9.7	4.7	3.9	.0	.0
Home maintenance	8.0	12.0	10.7	11.5	2.5
Medical	9.3	6.5	6.4	4.5	-8.5
Public transport	8.0	9.1	.9	1.7	.0

1/ Seasonally adjusted.

The rise in service costs--at an annual rate of about 2 per cent including home financing costs, and zero excluding them--was held down in October by the annual adjustment for retained earnings in the health insurance component.1/ This adjustment for retained earnings, together with the increase in college tuition charges included in the September index, accounts for most of the difference between the rise in service costs in September and October. However, the increase in home maintenance and repair service costs slowed in October to an annual rate of about 2-1/2 per cent from an average of 11 per cent over the previous quarter.

The rise in rents--about 3 per cent at an annual rate--was similar to that in the previous quarter and well below the rate of over 5 per cent between September 1970 and June 1971. However, recent increases reflect changes over a six-month interval. Just as increases actually made prior to Phase I have entered the index in the last two months, the increases under Phase II will enter the index during the next half-year instead of registering their full effect immediately.

The Chairman of the Price Commission has urged landlords to postpone increases, cautioning about possible rollbacks, until

1/ Changes in retained earnings are estimated monthly from the average change in health services priced. Once a year the index is corrected to conform to the change in retained earnings shown in national financial data reported to the Social Security Administration.

guidelines are spelled out by the recently named Rent Advisory Board. Rent increases averaging about 5 per cent and affecting 10 to 20 per cent of apartments have been reported as planned in the Washington area, for example, with some rent increase notices already mailed out. Units controlled by State and local agencies have been exempted from Phase II guidelines and increases of up to 7.5 per cent, postponed during Phase I, will affect controlled units in New York beginning in January. The increase last December in controlled rents in New York contributed significantly to the acceleration in service costs (excluding home finance) in the last quarter of 1970 and first quarter of 1971.

Announced increases for utility rates suggest a similar reversal of trend for a component which has contributed significantly to the slowing of the rise in service costs over the past four months. Gas and electricity, priced monthly, showed no change in September or October.

<u>Farm situation</u>. Abundant 1971 harvests are helping to ease the price control problems of Phase II but are posing difficult problems for farmers and the Commodity Credit Corporation. Crop output is 13 per cent above last year and 9 per cent above the previous record crop of 1969. The 5.55 billion bushel corn crop overshot the USDA target by 16 per cent and a record wheat crop exceeds prospective demand by a fifth. The soybean crop, also a record, appears to be in close balance with expected needs. These huge crops would have strained transport and storage facilities in any case but prolonged work stoppages at ports and interior elevators have aggravated these problems and intensified downward pressure on prices, corn in particular.

1971 CROPS AND HARVEST PRICES
1967 = 100

	1971 Crop Output	Farm prices Nov. 15, 1971	Per cent change from year earlier	
			Output	Farm prices
<u>All crops</u>	<u>113</u>	<u>108</u>	<u>13.0</u>	<u>5.9</u>
Food grains	106	91	16.5	- 8.1
Feed grains	117	86	30.0	-18.9
Oil crops	122	105	3.4	1.0
Cotton	143	127	3.6	29.6
Tobacco	92	118	- 4.2	8.3
Potatoes 1/	104	99	- 3.1	4.2

1/ Potatoes, sweet potatoes, dry edible beans

The Commodity Credit Corporation has taken many steps since early in the season to facilitate movement of crops under price support loan but storage capacity is still a limiting factor for many farmers eligible for loans. Open market purchases of corn just announced by the USDA is an emergency program designed to bolster corn prices. CCC net expenditures for price support are soaring and expenditures for the year are now expected to exceed the $3.7 billion projected in last January's budget estimate by $1.2 billion.

Nationally, falling grain prices since midyear have been countered by rising prices of livestock and some crops so that it appears that net income realized by farmers in 1971 may be close to the $15.6 billion of last year.

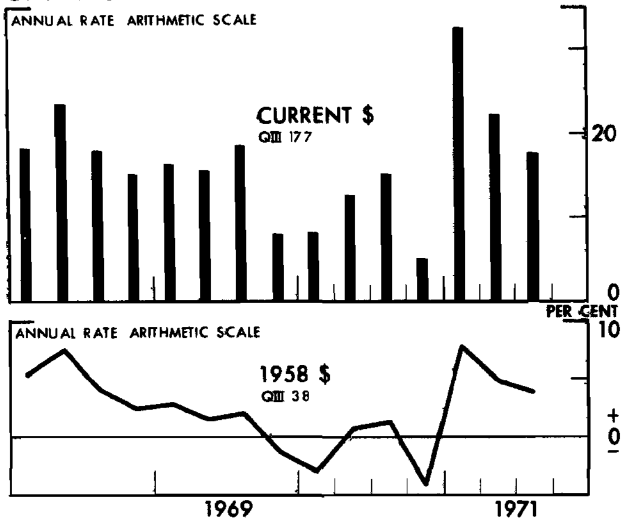
On a quarterly basis, net realized income has zoomed upward from $14.2 billion (seasonally adjusted annual rate) in the fall of 1970 to $16.3 billion in the third quarter of 1971 and it is likely to stay close to this level through mid-1972 at least. Higher hog and cattle prices are boosting cash receipts from sales of livestock and expanded volume of crop marketings is holding up cash receipts from the sales of crops. At the same time, the long-term upward creep of production expenses has leveled out, primarily as a result of declining feed costs but also as a result of the price freeze.

Prospects are less clear for the second half of 1972. Livestock prices are expected to continue strong since hog marketings are likely to remain well below year earlier levels and a cutback in egg production is in prospect. Much will depend on how producers respond to the 1972 programs designed to bring feed grain and wheat supplies into better balance with demands.

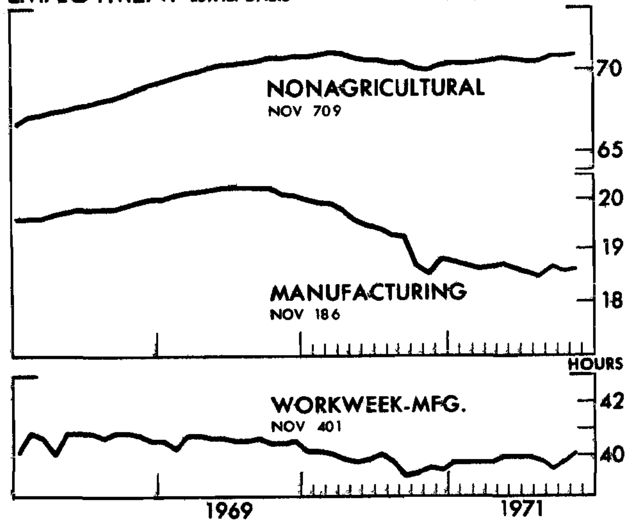
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

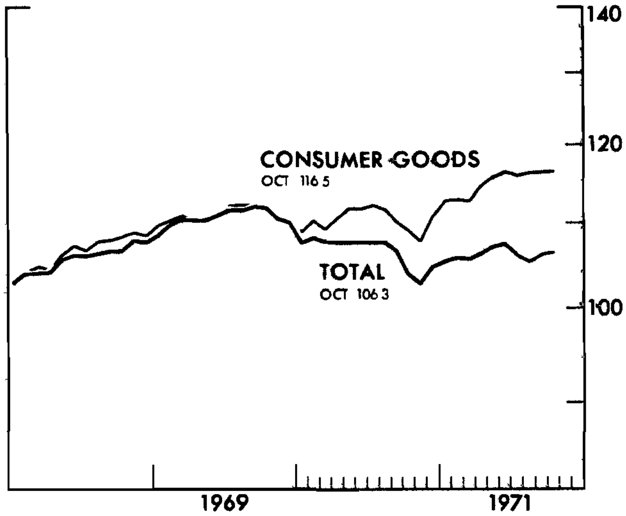
GNP INCREASE



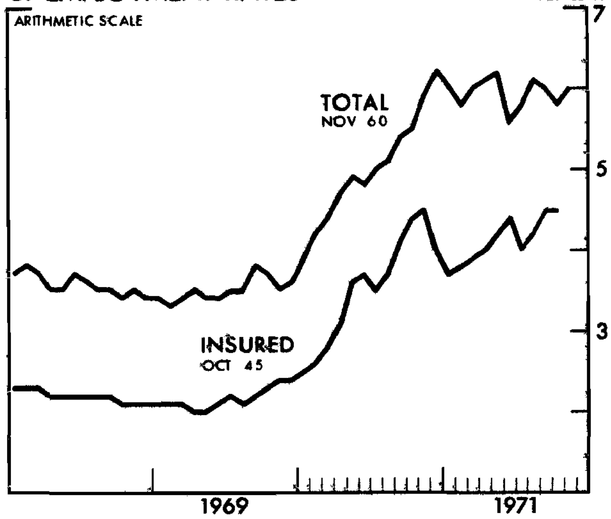
EMPLOYMENT ESTAB. BASIS



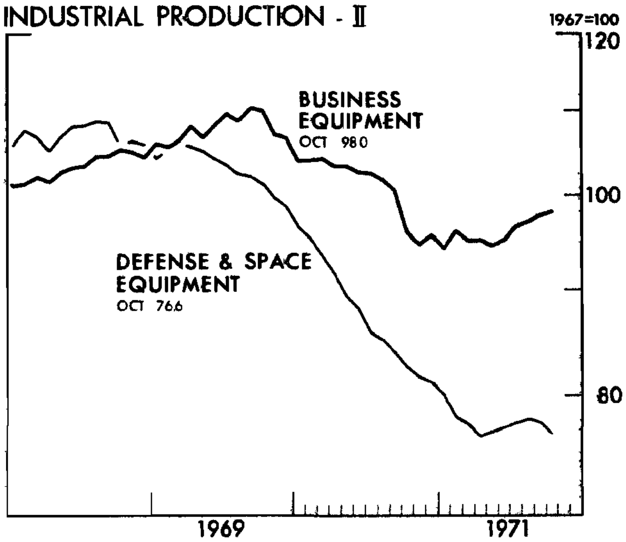
INDUSTRIAL PRODUCTION - I



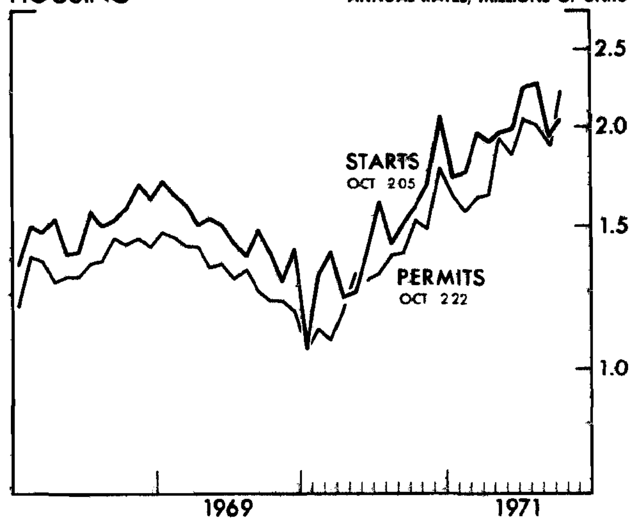
UNEMPLOYMENT RATES



INDUSTRIAL PRODUCTION - II

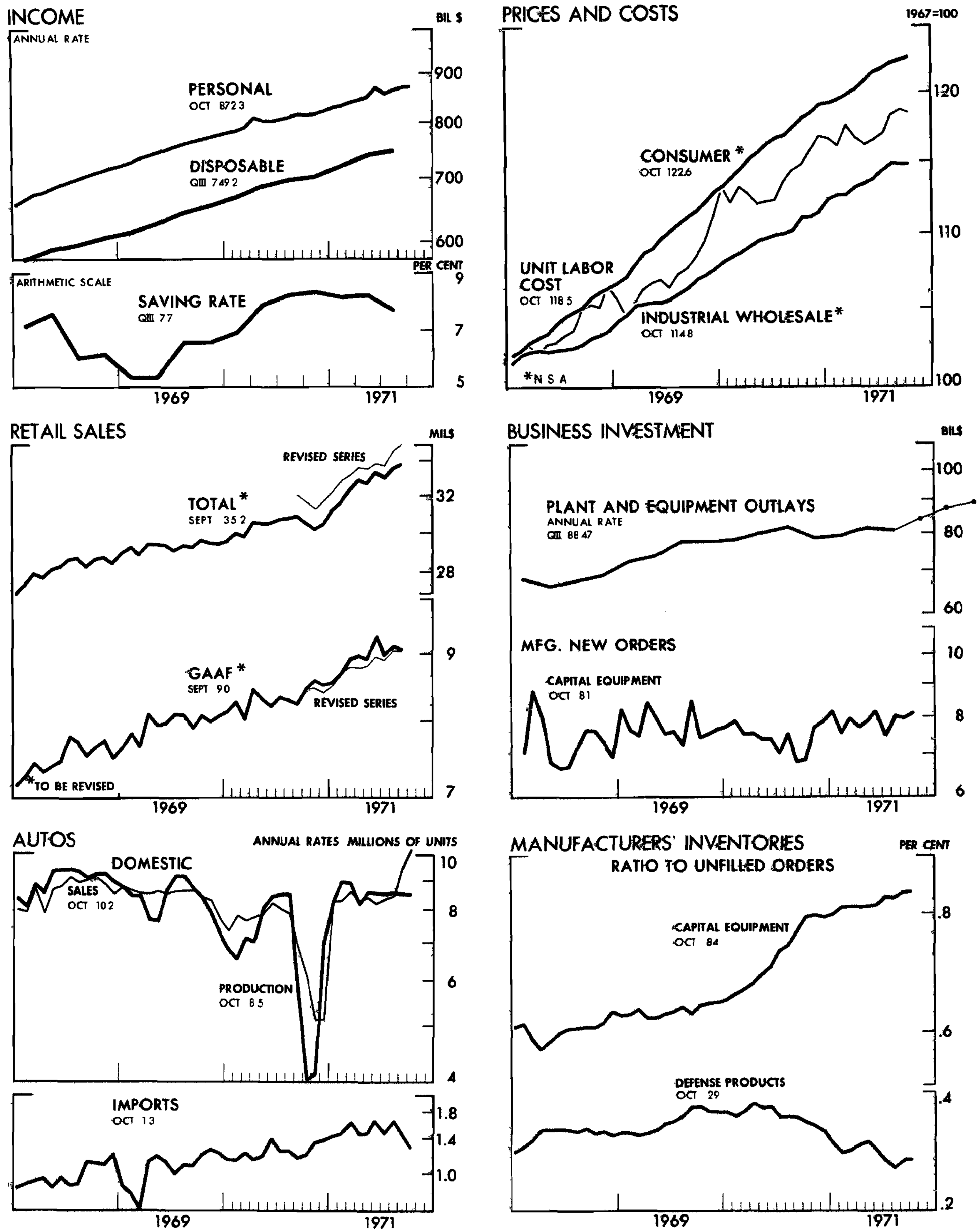


HOUSING



ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Monetary Aggregates. Preliminary data indicate that the narrow money stock (M_1) grew at an annual rate of about 1 per cent during November, bringing the average level for the month back to acout the same point as in July. The November figure, however, as well as that for October and to some extent September, will be revised shortly to correct for the influence of institutional changes in banking structure and of mechanics of clearing procedures that have just come to light.1/ Detailed data are not yet available, but the present small rate of increase for November probably will be adjusted to a small rate of decline, while the small rate of decline for October probably will be converted to a small rate of increase. For the two months together, however, the average rate of change should be little affected. Thus, these adjustments will not alter the fundamental picture of recent weakness in M_1.

1/ These revisions will be presented in the forthcoming Bluebook and will be reflected in the data published Thursday, December 9. One of the structural changes underlying the forthcoming adjustments is the opening of two new branches of foreign banks in New York. The effect of their operations is to create a cash items bias for which a correction will be made. In addition, several large internationally-oriented institutions have been incorporated since early November into the Clearing House Interbank Payments System for clearing foreign transactions in New York (CHIPS) and other similar institutions will be brought into this or the related Paper Exchange Payments System (PEPS) in the near future. Although some adjustments are required since early November, henceforth this should cause no revisions in the published money stock.

MONETARY AGGREGATES
(Seasonally adjusted changes)

	1971				
	QI	QII	QIII	Oct.	Nov.
		Annual percentage rates			
1. M_1 (Currency plus private demand deposits)	9.1r	10.6r	3.4r	-1.6	1.1p
2. M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	18.1r	12.4r	4.3r	5.8	7.6p
3. M_3 (M_2 plus savings deposits at mutual savings banks and S&L's)	19.0	14.5r	7.5r	8.2	8.7p
4. Adjusted bank credit proxy	10.9	8.4r	7.6r	4.8	10.8p
5. Other aggregates					
a) Total time and savings deposits	28.8r	14.7r	8.2r	17.1	9.1p
b) Time and savings deposits other than large CD's	27.5r	14.0r	5.3r	13.7	13.0p
		Billions of dollars			
c) Negotiable CD's (Monthly or monthly average)	.9r	.4r	1.8r	1.1	- .6p
d) Nondeposit sources (Monthly or monthly average)	-1.5	- .9	- .1	.8	.5

r - Revised due to recent benchmark and seasonal factor revisions.

p - Preliminary.

The broad money stock (M_2) increased at about a 7.5 per cent rate during November, as time and savings deposits other than large negotiable CD's continued to expand rapidly. The recent high rates of growth in such deposits are well above those recorded during the third quarter, presumably reflecting the continued favorable yield differential on these instruments in relation to open market securities.

Growth in the adjusted credit proxy increased sharply during November to the highest rate since February. The major factor was the increase in time and savings deposits. In addition the rapid growth in the proxy reflected an increase in Government deposits and a heavier use of nondeposit sources of funds, particularly Euro-dollars, beginning around mid-month. The increased Euro-dollar borrowing occurred despite a progressive widening of the cost differential against such funds as compared with Federal funds or CD's of similar maturity, as banks evidently were attempting to maintain their reserve-free bases for such borrowing. By the last week of November, however, the premium on one-day Euro-dollars over Federal funds reached a full percentage point, and a sizeable portion of the earlier rise in Euro-dollar borrowing was reversed.

Offsetting some of the expansion in net interbank balances and nondeposit sources of funds, the amount of large negotiable CD's outstanding declined on average during November. Much of the reduction had already occurred by the beginning of the month, however, in response to the progressive decline in CD offering rates during October.

Banks continued to be unaggressive bidders for CD's throughout the month in view of the strength of other time deposit flows and the weakness in business loan demand.

<u>Bank credit</u>. Total loans and investments at commercial banks adjusted for loans sold to affiliates (last Wednesday-of-month basis) grew at an annual rate of 7 per cent in November, the slowest expansion since July. Business loans adjusted for sales to affiliates, declining at a 6 per cent annual rate, were the weakest since June, despite late-October and early-November reductions in the prime rate.[7/] The drop in business loans is consistent with the findings of the recent surveys of Bank Lending Practices and Loan Commitments (to be presented in appendices to the Supplement) and was spread over a number of industrial categories. Loans to firms in the metal industry--primary metals producers and manufacturers of machinery, transportation equipment and other fabricated metal products--were the weakest, perhaps reflecting a further rundown of steel inventories accumulated earlier in the year. In addition, loans to chemical and, to some extent, petroleum firms also showed less strength than is usual for November. On the other hand, loans to public utilities were somewhat stronger, and banks increased their holdings of bankers' acceptances, which are not reported on an industry basis, slightly more than is usual for November.

7/ First National City Bank and the Irving Trust Company, both of whom recently adopted "floating" prime rates, further reduced their basic lending rates to 5-1/4 per cent in late November. First National City increased its rate to 5-3/8 per cent early in December, while most other commercial banks continue to quote a prime rate of 5-1/2 per cent.

COMMERCIAL BANK CREDIT ADJUSTED FOR LOANS
SOLD TO AFFILIATES 1/
(Seasonally adjusted percentage changes at annual rates)

	1971				
	QI	QII	QIII	Oct.	Nov.
Total loans & investments 2/	12.2	9.1	9.8	9.4	7.0
U.S. Treasury securities	19.8	9.8	-14.0	-29.7	6.1
Other securities	27.9	17.0	9.9	24.2	11.9
Total loans 2/	6.3	6.6	14.7	12.3	5.3
Business loans 2/	2.5	4.6	16.5	3.0	-6.0
Real estate loans	10.0	13.0	14.2	12.2	12.1
Consumer loans	4.8	6.3	14.1	13.6	13.5

1/ Last-Wednesday-of-month series.
2/ Includes outstanding amounts of loans reported sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

In contrast to the weakness in business loans during November, real estate loans and consumer loans continued to grow rapidly. These were the only identifiable spots of strength in loan demand, however, and the liquidity of large commercial banks--as measured by the ratio of short-term liquid assets to total liabilities less capital and reserves--remained high relative to recent years. Bank holdings of securities other than U.S. Governments increased again on a seasonally adjusted basis, although at a slower rate than in recent months. Holdings of U.S. Government securities were up slightly in November following four months of decline, but this was primarily due to the return of the Treasury to a more "normal" financing pattern after a period of unusually light new offerings in domestic markets.

Nonbank thrift institutions. Deposit inflows to the nonbank thrift institutions as a group declined slightly during November, according to estimates based on limited data. There was some divergence in individual patterns, however, with savings banks showing an increase in the pace of their inflows and savings and loan associations recording a decline.

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

	Mutual Savings Banks	Savings and Loan Associations	Both
1970 - QI	2.7	2.3	2.5
QII	6.4	7.2	7.0
QIII	6.9	10.6	9.3
QIV	10.5	12.1	11.6
1971 - QI	17.7	26.0	23.3
QII	15.0	18.4	17.3
QIII	8.5	14.9	12.8
1971 - September*	9.9	15.6	13.8
October * p/	8.3	13.4	11.8
November* e/	9.8	10.1	10.0
October and November e/	9.1	11.8	10.9

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

p/ Preliminary

e/ Estimate.

During October, S&Ls did not make any significant changes either in their liquidity positions or in the volume of funds borrowed from the FHL Banks. While their new commitments to acquire new mortgages have declined slightly in the last few months, outstanding commitments remained high during October. Part of the high level of outstanding commitments is probably attributable to the sizeable amount of mortgage refinancings.

MORTGAGE COMMITMENTS OUTSTANDING AT THRIFT INSTITUTIONS[1/]
(Billions of dollars, seasonally adjusted)

Date	S&Ls	N. Y. State Savings Banks	Both Thrift Institutions
1970 - High	8.1 (Dec.)	2.6 (Jan.)	10.1 (Dec.)
Low	5.2 (Mar.)	1.8 (Oct., Nov.)	7.7 (Mar., Apr.)
October	7.5	1.9	9.4
1971			
May	12.2	3.1	15.3r
June	13.0	3.1	16.1
July	13.2	3.1	16.4
August	13.3	3.1	16.4
September	13.2r	3.2	16.4r
October	13.1	3.2	16.3

1/ Based on data, including loans in process, from Federal Home Loan Bank Board and Savings Banks Association of New York State. Detail may not add to total because of rounding.

r--revised.

Mortgage market. FNMA auction results suggest that the gradual decline in secondary market yields on FHA and VA home mortgages that had been under way since last summer gathered some additional momentum during November. By the end of the month, average yields on FNMA short-term forward purchase commitments were down to 7.66 per cent--41 basis points below the high of late July and the lowest level since late spring.[1/]

1/ In view of the accompanying decline in discount points on Government underwritten mortgages, discount subsidies for existing-home loans have been suspended since mid-November under GNMA's new Tandem Plan, instituted in August. Although GNMA continues to subsidize discounts on eligible loans on new homes and apartments, the effective amount of the subsidy has dropped to less than 1 point. To date, subsidies paid out by GNMA under the new Tandem Plan have totaled $20 million.

FNMA PURCHASE AUCTIONS

	Amount of total offers		Short-term commitments	
	Received	Accepted	Discount	Private market yield
	(Millions of dollars)		(points)	(Per cent)
1971 - High	1,168 (5/10)	314 (4/26)	8.5 (7/26)	8.07 (7/26)
Aug. 25	635	154	7.8	7.97
Sept. 20	438	193	6.9	7.86
Oct. 18	220	104	6.7	7.83
Nov. 1	126r	56	6.2	7.77
16	145	102	5.7	7.70
29	211	101	5.4	7.66

NOTE: Average secondary market yield after allowance for commitment fee and required purchase and holding of FNMA stock, assuming prepayment period of 15 years for 30-year Government-underwritten mortgages. Implicit yields shown are gross, before deduction of 38 basis point fee paid by investors to servicers. Beginning October 18, short-term commitments are for 4 rather than 3 months.

r--revised

Further declines in secondary market yields are widely expected according to FNMA field reports. To profit from the associated rise in mortgage prices that is anticipated, mortgage companies are apparently continuing to hold a substantial volume of loans without obtaining resale commitments. This speculative practice has been facilitated by the ready availability of credit at costs that are low relative to the yields generated by the mortgages pledged as collateral.

In the sluggish primary market, November data for the FHA series on conventional home mortgages may be available in time for the Greenbook Supplement. During October, this series edged down to 7.80

per cent on new-home loans--the first decline since last spring. On existing-home loans, rates remained unchanged at 7.90 per cent for the third consecutive month. For both types of loans, the FHLBB series for October shows that credit was extended at loan-to-value ratios and maturities that continued to be quite liberal by historical standards.

The seasonally adjusted rate of mortgage credit extensions has apparently slackened from the exceptionally rapid pace reached in late summer and early fall. This slowing is attributable to a great extent to a reduction in the backlog of credit demand, which had mushroomed earlier this year in response to increased availability of funds at costs well below 1970 highs. It may also have reflected the moderation of net savings inflows to nonbank thrift institutions from the all-time high reached in the first quarter.

Corporate and municipal securities markets. Yields on corporate bonds have risen only slightly since the last Committee meeting, even though dealers have worked off heavy inventories in the face of cautious buying by institutional investors. The lightening of the forward calendar and the scarcity of industrial bonds made it possible for corporate underwriters to continue an aggressive pricing policy on new utility issues and at the same time to terminate syndicates on older issues without appreciable upward pressure on yields. As a result, over the last 5 weeks new issue yields on high-grade corporate bonds have risen only about 1/8 of a percentage point, although, sales of new issues have remained relatively slow.

On the other hand, municipal yields increased substantially, with the most widely quoted index rising 45 basis points during the month of November. While municipal dealers are presently in a somewhat better technical position--because the yield advances facilitated a sharp reduction in their inventories of new issues--stocks of seasoned tax-exempt securities remain unusually high. Furthermore, the slower pace of commercial bank acquisitions, which apparently contributed to the recent back-up of yields, appears to be continuing. The forward calendar remains formidable, taking into account the normal holiday slowing of market activity.

BOND YIELDS
(per cent)

		New Aaa Corporate bonds 1/	Long-term State and local bonds 2/
1970			
Low		7.68 (12/18)	5.33 (12/10)
High		9.30 (6/9)	7.12 (5/28)
1971			
Low		6.76 (1/29)	4.97 (10/22)
High		8.23 (5/21)	6.23 (6/24)
Week of:			
November	5	7.05	4.99
	12	7.12	5.19
	19	7.23	5.25
	26	7.17	5.36
December	2	7.18	5.44

1/ With call protection (includes some issues with 10-year protection).

2/ Bond Buyer (mixed qualities).

Stock prices have rallied sharply since the Thanksgiving holiday--after drifting steadily downward during October and most of November--and are now slightly higher than on August 13, immediately preceding the announcement of Phase I. The volume of transactions during this rally has been considerably larger than for the immediately preceding weeks, with NYSE daily trading volume averaging 17.4 million shares since November 26, as compared with 12-13 million for October and November. The market seems to have been encouraged by report of progress towards an international monetary settlement; and, in addition, there is some indication that the small investor's much publicized lack of confidence in the stock market may now be abating somewhat. For example, NYSE data for most of November show that the odd-lot investors, who had been strong net sellers throughout 1971, have greatly narrowed the gap between their sales and purchases in recent weeks. Mutual fund sales have also picked up.

STOCK PRICES

	August 13 1971	Nov. 24 1971	Dec. 7 1971	Per cent change from: August 13 to December 7	November 24 to December 7
NYSE	52.88	49.67	53.49	1.2	7.7
AMEX	24.59	23.40	24.71	.5	5.6
NASDAQ	105.44	100.40	107.26	1.7	6.8
D-J Industrial	856.02	798.63	857.40	.2	7.4

Public bond offerings by corporations in November matched the October total of approximately $2 billion, just below the monthly average for 1971 thus far. At this time, the December calendar includes only about $1.3 billion of public bonds--a larger drop than seasonal considerations alone would suggest--and all of these issues are by utilities or financial firms. There are also almost $500 million of offerings, mainly by corporations in the banking and finance sectors, that have been filed but have no scheduled date of issue. No industrial bonds are scheduled for the month of December. Most underwriters expect an increase in new issue volume in January, however, presumably to take advantage of the seasonal increase in supply of funds to the market.

On the basis of recent revisions in SEC data, it appears that private placement activity has remained relatively stable. New equity financing in November was at about the level previously estimated for that month, but announcements of new issues in December have not built up so rapidly and the staff now expects December volume to be only $650 million. Mainly because of a decline in public long-term issues by industrial firms, therefore, total corporate security offerings for December are estimated at only $2.7 billion, the lowest monthly total since August of 1971. However, present financing plans suggest a return to the $3 billion level early in 1972.

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

	Bonds			
	Public	Private	Stocks	Total
1970 - Year	2,099	403	713	3,245
Through November	2,086	367	725	3,178
1971 - Through November e/	2,140	538	1,030	3,708
1971 - QIII	1,575	547	1,360 1/	3,482
QIV e/	1,733	567	737	3,037
October e/	1,950	500	560	3,010
November e/	1,950	500	1,000	3,450
December e/	1,300	700	650	2,650
1972 - January e/	2,000	500	800	3,300

e/ Estimated

1/ Includes $1.4 billion AT&T stock offering.

Tax-exempt bond issues reached a total of almost $2.2 billion in November, and gross sales of short-term municipal securities were more than $2.7 billion. The staff expects the December volume to decline seasonally, but State and local government borrowing plans suggest a continued large volume of long-term financing early next year.

Revised data show a smaller-than-expected paydown of short-term municipal debt in October, and in November the surge in gross issues resulted in an unusually large addition to short-term debt. The staff now estimates that the total rise in short-term debt outstanding in 1971 will be over $4.0 billion. Although this increase in short-term debt is appreciably below the $4.7 billion total for 1970, it indicates the continued reliance of municipalities on short-term financing. For the period from 1960 through 1968, the average annual volume of net short-term sales was about $900 million; but from 1969 through 1971, the average yearly addition to short-term debt outstanding was $4.0 billion.

State and Local Government Offerings
(Monthly or monthly averages in millions of dollars)

	Long Term	Net Short Term
1970 - Year	1,514	393
Through November	1,452	361
1971 - Through November e/	2,052	410
QIII	1,972	332
QIV e/	1,820	107
October e/	1,700	-20
November e/	2,160	+600
December e/	1,600	-300
1972 - January e/	1,800	n.a.

e/ - Estimated.

Government securities market. Interest rates in the Government securities market have risen only slightly on balance since the last Committee meeting. Rates rose until around Thanksgiving when they stabilized and then moved back toward mid-November levels. Over the whole period, yields on coupon issues are generally unchanged to 12 basis points higher, with most of the increases in the over 7-year maturity area. Bill rates also are generally unchanged to 12 basis higher, with the increase mostly in longer bills perhaps reflecting the increased supply due to the new offerings of tax bills.

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

	1971		Weekly average for week ending				
	Daily highs1/	Daily lows1/	Aug.13	Nov.16	Nov.23	Nov.30	Dec.7
Bills							
1-month	5.33 (7/19)	2.07 (3/12)	5.17	3.95	3.97	4.02	4.14
3-month	5.53 (7/19)	3.22 (3/11)	5.25	4.16	4.20	4.37	4.19
6-month	5.84 (7/27)	3.35 (3/11)	5.67	4.34	4.35	4.51	4.35
1-year	6.01 (7/28)	3.45 (3/11)	5.92	4.44	4.49	4.64	4.56
Coupons							
3-year	6.91 (7/28)	4.27 (3/22)	6.81	5.32	5.35	5.47	5.31
5-year	7.03 (8/10)	4.74 (3/22)	6.94	5.76	5.78	5.87	5.76
7-year	7.11 (8/10)	5.15 (3/23)	7.03	5.90	5.95	6.08	6.00
10-year	6.95 (7/28)	5.38 (3/23)	6.82	5.78	5.80	5.95	5.90
20-year	6.56 (6/15)	5.69 (3/23)	6.41	5.85	5.86	5.96	5.96
Agencies							
6-month	6.20 (7/23)	3.67 (3/16)	6.08	4.60	4.64	4.85	4.74
1-year	6.56 (7/28)	3.93 (3/16)	6.53	4.91	4.90	5.08	5.03
3-year	7.33 (8/12)	4.70 (3/24)	7.33	5.72	5.76	5.97	5.89
5-year	7.45 (8/13)	5.12 (3/23)	7.44	6.10	6.14	6.31	6.24

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

The upward movement in rates on coupon issues immediately following the last Committee meeting can be traced primarily to the general congestion that developed in securities markets at that time, due in large measure to the heavy dealer positions arising out of the November Treasury refunding. Market professionals became a bit restive about the inventory buildup because of deepening uncertainties about the likely results of the President's new domestic and international economic programs. However, as money market conditions evened and progress seemed to be being made on an international settlement market sentiment improved. At the same time, market professionals managed to lighten inventories, primarily through price adjustments, and the Open Market Account became a significant buyer of Treasury coupon issues. Given the need for reserve injections and the available supply of longer-maturities, the Desk had purchased about $850 million of coupon issues since the last meeting.

The bill market had also been subject to supply pressures, especially in the shortened Thanksgiving week when there were three bill auctions--the regular weekly and monthly auctions plus a $2.5 billion auction of April tax bills. The three-month bill, for instance, rose 30 basis points from the data of the last meeting through November 26. However, with the lower recent level of the Federal funds rate and renewed substantial foreign participation in the market, bill rates etabilized and moved lower after November 26, with the 3-month bill now around 4.10 per cent, the same level as at the time of the last meeting. Continued foreign central bank acquisition of dollars in exchange markets has led to their purchasing about $2-1/2 billion of U. S. Government securities (most in bills) since

November 1. This substantial demand for bills, especially in the last week, has enabled dealers to reduce their bill positions to about $3 billion.

About $500 million of new money was raised in the Federal Agency Market in the last half of November. FNMA continued its substantial credit demands by raising $500 million; the October figure was $550 million. Given the large overhang in the Treasury market, the FNMA issues--especially the two long options with eight and thirteen years maturities--received rather cool receptions and moved to discounts after reaching the market. The only operation by the System in this market was a $161 million purchase, including $33 million with maturities over 5 years.

FEDERAL AGENCY OFFERINGS
(In millions of dollars)

Period	New Money	Gross Issues with Maturities over 5 Years
1971		
September	546	600
October	902	900
November	512	900

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

	Aug. 13	November daily average	Nov. 15	Nov. 22	Nov. 29	Dec. 6
Treasury securities						
Total	2,381	5,845	5,551	5,291	5,823	5,009
Treasury bills (total)	1,823	3,383	2,892	2,746	3,858	3,259
Due in 92 days or less	968	1,147	1,081	1,021	832	577
93 days or over	855	2,236	1,811	1,725	3,027	2,682
Treasury notes and bonds (Total)	558	2,462	2,660	2,545	1,964	1,750
Due within 1 year	185	341	248	289	271	285
1-5 years	315	913	1,209	1,130	681	593
over 5 years	59	1,208	1,204	1,126	1,012	871
Agency securities						
Total	599	1,060	902	1,167	1,178	1,140
Due within 1-year	281	440	355	544	513	464
Over 1-year	318	620	547	624	664	675

<u>Other short-term credit markets</u>. Short-term rates, other than those on Treasury securities, have remained unchanged or declined slightly since the last meeting of the Committee, in contrast with the fairly pronounced rise and fall in Treasury bill rates noted in the preceding section. However, there was some small downward and upward adjustments in rates by commercial paper dealers, which led to corresponding changes in the prime rates of the New York City banks that adjust this rate to changes in the 90-day commercial paper rate.

Nonbank commercial and finance company paper data available through the week ending November 24 show a seasonally adjusted decline of $444 million in outstandings to $28.5 billion. Further declines are expected through the end of the month.

The decline has been exclusively in directly-placed finance company paper. Several finance companies borrowed in the long-term market during November, which may have reduced their demands for funds on the commercial paper market. In addition, there are indications that finance companies borrowed fairly heavily in this market in October in anticipation of their November and December need for funds.

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

	1970		1971			Net Change
	Highs	Lows	Nov. 3	Nov. 17	Dec. 1	Nov. 17 - Dec. 1
1-month						
Commercial paper	n.a.	n.a.	5.00	4.63	4.63	--
Finance paper	9.00	5.00	4.75	4.50	4.38	-12
Bankers' acceptances	9.00	5.50	5.00	5.00	5.00	--
Certificates of Deposit--new issue 1/	7.75	5.00	4.63	4.50	4.38	-12
Treasury bill	7.84	4.58	4.04	3.96	4.21	+25
3-month						
Commercial paper	n.a.	n.a.	5.00	4.75	4.75	--
Finance paper	8.25	5.50	4.88	4.75	4.63	-12
Bankers' acceptances	9.00	5.50	5.00	5.00	5.00	--
Certificates of Deposit--new issue 1/	6.75	5.50	4.88	4.75	4.75	--
Treasury bill	7.93	4.74	4.16	4.14	4.31	+17
6-month						
Bankers' acceptances	9.00	5.50	5.00	5.00	5.00	--
Treasury bill	7.99	4.78	4.30	4.27	4.42	+15
12-month						
Certificates of Deposit--new issue 1/	7.50	5.50	5.00	5.13	5.13	--
Treasury bill	7.62	4.74	4.37	4.42	4.60	+18
Prime municipal notes	5.80	2.95	2.55	2.80	2.90	+10

1/ Investment yield basis. Highs for certificates of deposit are ceilings effective as of January 21, 1970.
n.a.-- Not available.

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

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

	September	October	November 1/
Total commercial and finance paper 2/	30,176	30,967	30,573 e/
Bank related 3/	1,900	1,981	2,031 e/
Nonbank related 4/	28,276	28,986	28,542 e/
Placed through dealers	11,396	11,607	11,606 e/
Placed directly	16,880	17,379	16,936 e/
	------Net change-----		
Total commercial and finance paper 2/	+834	+791	-394
Bank related 3/	+108	+ 81	+ 50
Nonbank related 4/	+726	+710	-444
Placed through dealers	+160	+211	- 1
Placed directly	+566	+499	-443

1/ The seasonal adjustment factors have been applied to the weekly data available through the week ending November 24.
2/ Combines seasonally adjusted nonbank-related paper and seasonally unadjusted bank-related paper.
3/ Seasonally unadjusted.
4/ Seasonally adjusted.
e/ Estimated.

Federal finance. The Staff continues to project a unified budget deficit of about $29 billion for fiscal year 1972. There have been no significant revisions in the Staff budget estimates or in the fiscal assumptions listed in the preceding Greenbook. As expected, the House-Senate conference committee adopted most of the provisions of the House version of the tax bill rather than the more costly bill approved by the Senate. The most important tax measure initiated by the Senate that is likely to survive is the child care deduction, estimated to cost about $300 million annually. A highly uncertain staff assumption on the receipts side is the timing of the withdrawal of the import surcharge, now assumed to continue through calendar 1972, with an estimated $2.0 billion annual rate effect on receipts.

Considerable uncertainty remains in the estimate of outlays for the current fiscal year. In the first five months of the fiscal year, cash outlays have been somewhat smaller than expected. In particular, the rate of defense spending (aside from pay raises) in relation to the anticipated fiscal year total figure appears to be 3 per cent ($2.0 billion) or more behind last year's spending rate. The outlook for defense spending is further complicated by the fact that Congress has not completed action on current year defense appropriations. Other developments adding to uncertainty include the recent Senate approval of a Federal pay increase, effective January 1, 1972, (which is not included in Staff estimates and which would increase current fiscal year outlays by about $1.1 billion), and the failure, as yet, of Congress to act on the liberalization of social security benefit provisions, which our projections assume to be effective in January 1972 and which would cost $1.5 billion in the current fiscal year.

The Staff continues to project a $5.0 billion shift toward deficit in the high employment budget from calendar 1971 to calendar 1972. However, in the present circumstance this change in the high employment budget is difficult to interpret. The way price changes enter the calculations may tend to overstate high employment receipts when the rate of price increases is affected by control measures. Also, the high employment budget does not adequately reflect the magnitude and timing of the impact of the import surcharge and the investment tax credit. In particular, the import surcharge increases receipts and thereby makes fiscal policy appear more restrictive even though it may have some positive effect on domestic production.

The end-of-November Treasury balance, $4.3 billion, was less than estimated in the last Greenbook largely because the market borrowing expected in late November was not undertaken until December 1. In that transaction, the Treasury issued $2.5 billion in tax anticipation bills, maturing in April. The Treasury has announced another auction of $2.0 billion of June tax anticipation bills, payable on December 13. With no further borrowing in December, aside from additions to weekly bill auctions through December 16, the end-of-December cash balance is now expected to be about $8.5 billion--a relatively high level for this time of year. This high balance is partly attributable to the recent acquisition of additional special issues by foreign central banks. If this balance is attained, the Treasury probably would not need additional cash financing until February, assuming no significant inflow of dollars from abroad.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	Nov.	Dec.	Jan.
Total net borrowing	2.5	5.7	-.4
Weekly and monthly bills	.8	.6	--
Tax bills	--	4.5	--
Coupon issues	2.7	--	--
As yet unspecified new borrowing	--	--	--
Other (debt repayments, etc.)	-1.0	.6	-.4
Plus: Other net financial sources a/	-1.2	-.7	1.4
Plus: Budget surplus or deficit (-)	-3.7	-.8	-3.7
Equals: Change in cash balance	-2.4 b/	4.2	-2.7
Memoranda: Level of cash balance end of period	4.3 b/	8.5	5.8
Derivation of budget surplus or deficit:			
Budget receipts	14.9	16.8	16.6
Budget outlays	18.6	17.6	20.3
Maturing coupon issues held by public	3.7 c/	--	--
Net agency borrowing	.2	.4	.4

a/ Checks issued less checks paid and other accrual items.
b/ Actual.
c/ The November refunding fell short of its goal by $1.3 billion.

FEDERAL BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS[1/]
(In billions of dollars)

	Fiscal Year		Calendar Years F.R. Estimates		F.R.B. Staff Estimates Calendar Quarters					
					1971		1972			
	1971*	1972 e/	1971	1972	III*	IV	I	II	III	IV
Federal Budget										
(Quarterly data, unadjusted)										
Surplus/deficit	-23.0	-28.7	-25.0	-29.7	-7.8	-10.8	-11.7	1.6	-9.0	-10.6
Receipts	188.4	201.3	193.6	209.4	48.6	44.2	47.3	61.4	52.7	48.0
Outlays	211.4	230.0	218.4	239.1	56.3	55.0	59.0	59.8	61.7	58.6
Means of financing:										
Net borrowing from the public	19.4	27.2	21.9	27.1	9.1	9.6	7.6	.9	8.0	10.6
Decrease in cash operating balance	-.8	.6	-.4	1.0	-1.2	1.5	2.4	-2.1	--	.7
Other 2/	4.4	.9	3.4	1.6	-.1	-.3	1.7	-.4	1.0	-.7
Cash operating balance, end of period	8.8	8.2	8.5	7.6	10.0	8.5	6.1	8.2	8.2	7.5
Memo: Net agency borrowing[3/]	1.1	n.e.	1.4	n.e.	1.7	1.7	2.2	n.e.	n.e.	n.e.
National Income Sector										
(Seasonally adjusted annual rate)										
Surplus/deficit	-18.5	-22.7	-19.6	-23.9	-20.4	-20.0	-25.5	-24.9	-24.3	-21.0
Receipts	194.2	210.3	202.4	219.5	203.5	210.1	212.2	215.2	222.5	228.1
Expenditures	212.7	233.0	222.0	243.4	223.9	230.1	237.7	240.1	246.8	249.1
High employment surplus/deficit (NIA basis) 4/	.6	1.5	2.3	-2.7	2.5	5.6	-.4	-1.7	-5.6	-3.1

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

1/ Estimates reflect effects of House Revenue Bill, which provides $.8 billion less in tax cuts in fiscal year 1972 than the President's program. The Administration budget deficit estimate on the basis of the President's program is $27.0--28.0 billion for FY 1972 with outlays estimated at $232.0 billion. These figures would imply a receipts estimate ranging from $204.0--205.0 billion.

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

3/ Federally-sponsored credit agencies, i.e., Federal Home Loan Banks, Federal National Mortgage Assn., Federal

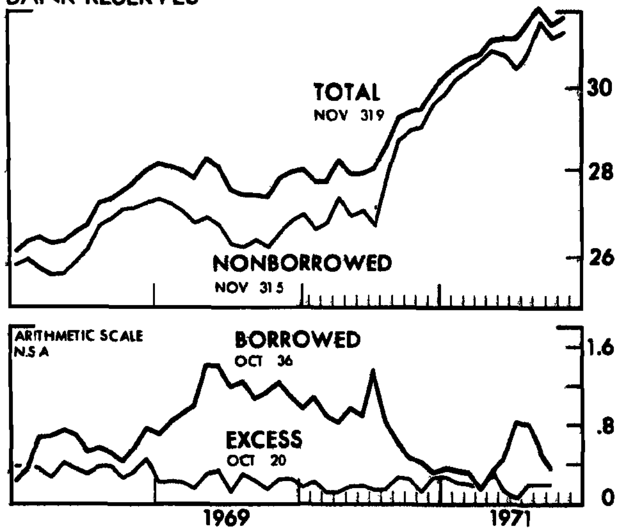
FOOTNOTES CONTINUED FEDERAL BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS 1/
(In billions of dollars)

3/ Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives
4/ Estimated by F.R. Board Staff.

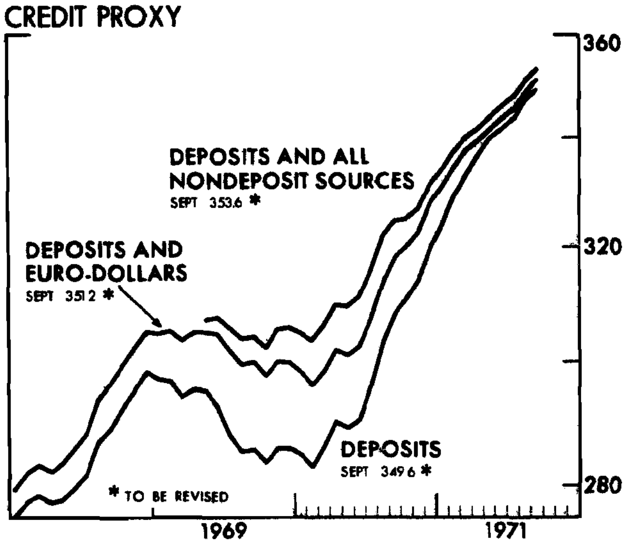
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

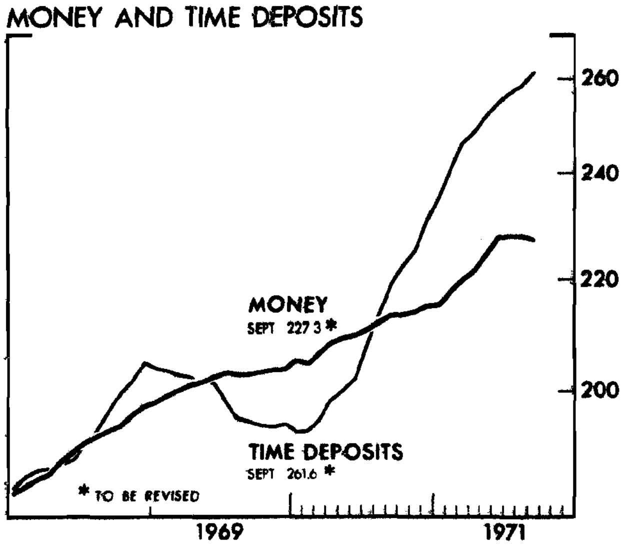
BANK RESERVES



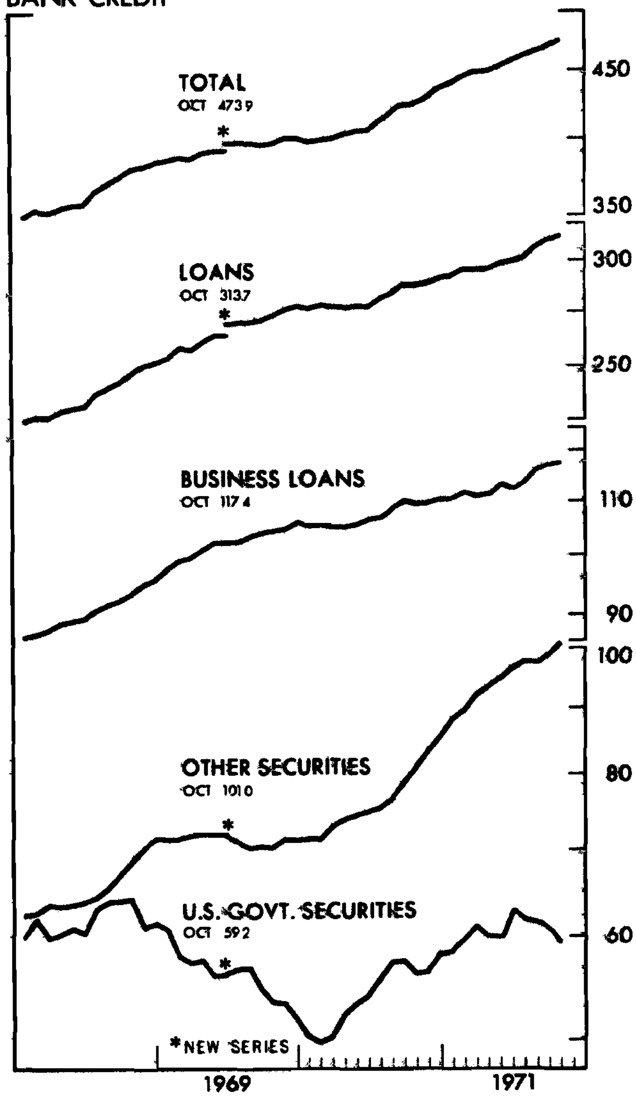
CREDIT PROXY



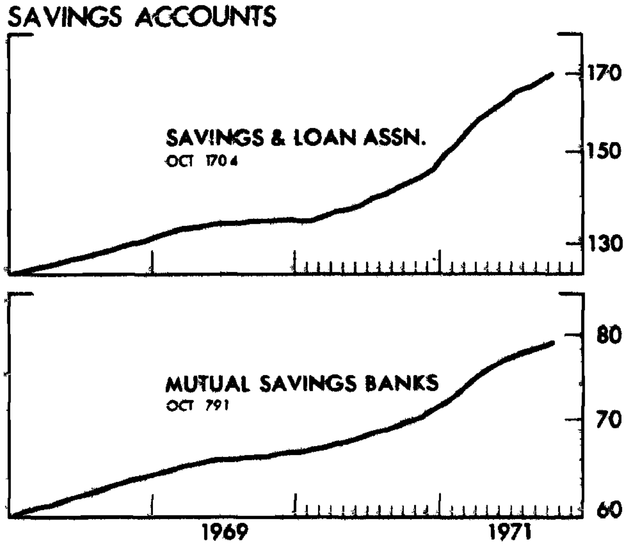
MONEY AND TIME DEPOSITS



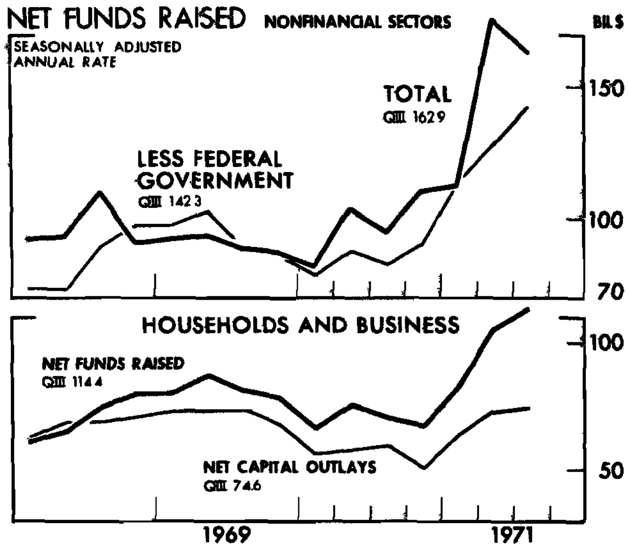
BANK CREDIT

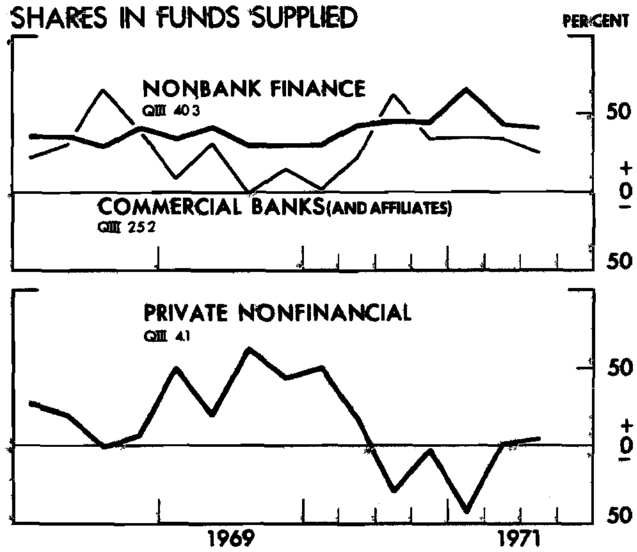


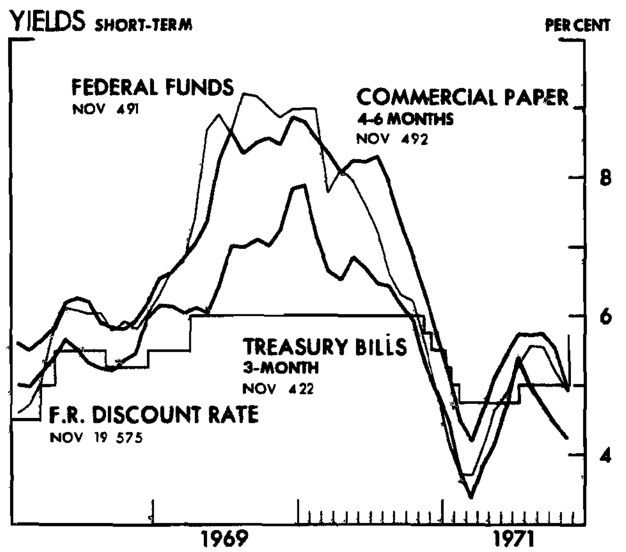
SAVINGS ACCOUNTS

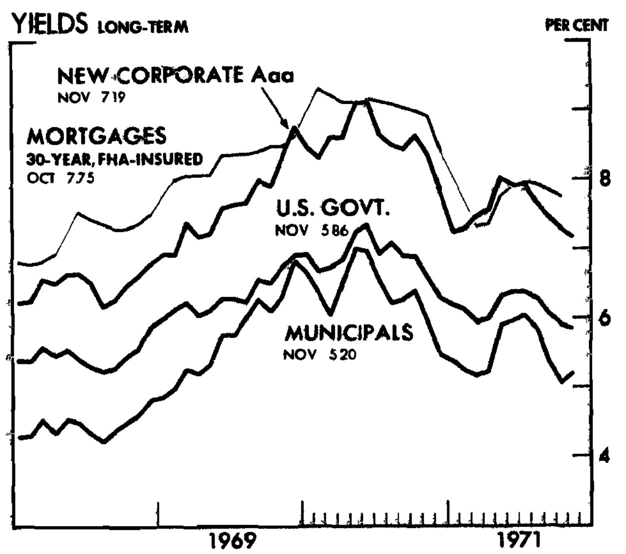


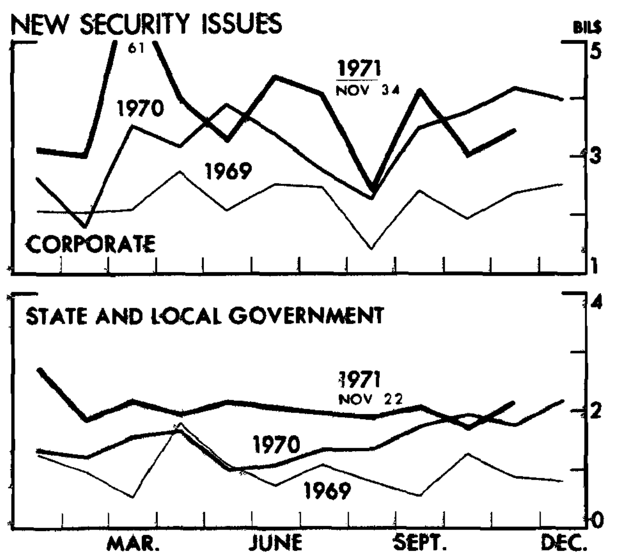
FINANCIAL DEVELOPMENTS - UNITED STATES

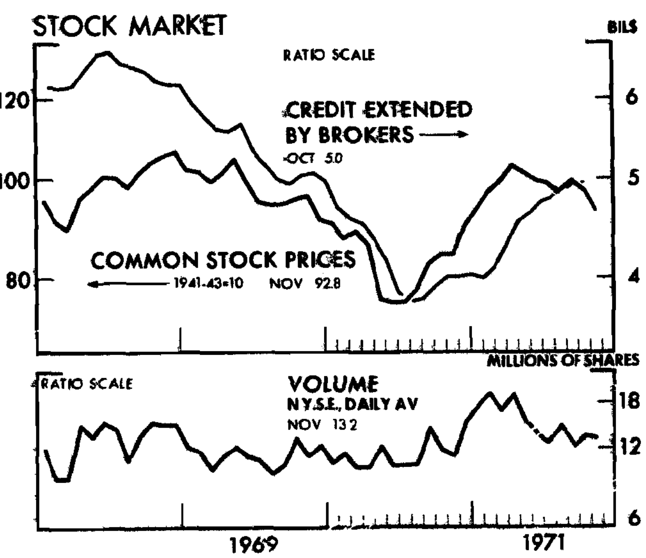












THE ECONOMIC PICTURE IN DETAIL

International Developments

Foreign exchange markets. Major foreign currencies firmed sharply against the dollar following the introduction of the Reuss-Javits bill on November 18, and again following Secretary Connally's reported expression at the G-10 meetings of a U.S. willingness to consider a gold price increase as part of a multilateral settlement of international economic issues. Many exchange market participants, believing that a supposed U.S. intransigence on the gold price question was the major obstacle to an agreement on new parities, interpreted these two developments as greatly enhancing the prospects for a quick parity realignment in which most currencies would appreciate further against the dollar.

As a result of this change in expectations, demand for all major foreign currencies increased, with resulting increases in exchange rates and/or foreign central bank intervention. For one group of countries -- Germany, Switzerland, the Netherlands, Belgium and Italy -- the excess demand for their currencies was reflected in sizable increases in their exchange rates vis-a-vis the dollar, as the respective central banks refrained from market intervention. For other group of currencies, notably those of France, the U.K., Canada and Japan, the excess demands were absorbed by central bank intervention, and exchange rates for the first three of those currencies showed relatively small changes. Reserve gains by major foreign central banks (as measured by the U.S. official settlements balance) amounted to roughly $2 billion in the two weeks ended December 8, virtually all of which was accounted for by the latter group of countries.

(This marked the first period since the Canadian dollar was floated in June 1970 that the Bank of Canada had intervened to hold the rate rather than simply to moderate its fluctuations. On December 6, the day of the meeting of Prime Minister Trudeau and President Nixon, the Bank of Canada reverted to its former policy, and allowed the Canadian dollar to move higher, even to reach U.S. $1.00 at one point.)

PER CENT APPRECIATIONS OR DEPRECIATIONS (-) FROM PAR VALUES
OF MAJOR FOREIGN CURRENCIES

	Aug. 11	Sept. 29	Nov. 10	Nov. 17	Nov. 24	Dec. 1	Dec. 8
Sterling	0.8	3.4	3.9	3.9	3.9	3.9	4.1
Canadian dollar	6.5	7.2	7.6	7.7	7.8	7.8	8.5
DM	7.0	10.5	9.5	9.6	10.0	10.7	11.9
Swiss franc	7.8	10.4	9.5	9.5	10.1	10.6	11.9
Guilder	3.3	7.7	8.3	8.4	8.9	9.4	10.1
French franc	0.8	0.5	0.4	0.4	0.7	0.8	0.7
Belgian franc	0.8	6.3	7.8	7.6	8.3	8.4	9.4
Lira	0.6	2.1	2.0	2.0	2.0	2.4	3.2
Yen	0.7	7.1	9.5	9.6	9.6	10.0	10.7

Note: Parities are those in effect in May 1970, i.e., before the floating of the Canadian dollar on June 1, 1970, the floating of the DM and the guilder on May 10, 1971, and the revaluation of the Swiss franc by 7.1 per cent on May 10, 1971.

In addition to purchasing substantial amounts of dollars, the Bank of France greatly broadened its exchange controls on December 3 in its efforts to prevent an appreciation of the franc. The new regulations were intended to discourage inflows this week by blocking the conversion of non-resident franc balances after December 10, allowing their use thereafter only for payments to French residents. The Bank of Italy announced a little later that it was prohibiting "speculative" purchases or sales of lire by non-residents, and Italian banks were given the authority to determine which transactions were or were not "speculative in character.

Exchange market conditions in the period since December 1 have been characterized as "hectic" by some market sources, with large movements in rates, and widening bid-offer spreads. The new French and Italian regulations, particularly the former, are reportedly causing great confusion and dismay among exchange traders, with the result that some New York banks are refusing to deal in French francs.

In official transactions, the System continued, from time to time, and at the request of the Belgian National Bank, to purchase Belgian francs for the purpose of effecting swap repayments. Such repayments amounted to $25 million equivalent between November 10 and December 9, reducing outstanding System Belgian franc commitments to $535 million equivalent.

Euro-dollar rates. As shown in the table below, Euro-dollar rates, which had dropped off sharply during October from the levels reached in August and September, turned upward during November and early December as uncertainty over the exchange value of the dollar again led market participants to borrow Euro-dollars for conversion into foreign currencies and to substitute foreign currency assets for Euro-dollar deposits. The spread between U.S. money market rates and Euro-dollar rates also widened as it did in previous periods of exchange market uncertainty. In addition, year-end demands for funds by U.S. firms, required to offset capital outflows earlier in the year, may be somewhat larger than usual and may have contributed to the firmness in rates in early December.

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

Average for month or week ending Wednesday		(1) Over-Night Euro-$ 1/	(2) Federal Funds 2/	(3) (1)-(2) Differential	(4) 3-month Euro-$ Deposit 1/	(5) 60-89 day CD rate (Adj.) 3/	(6) (4)-(5) Differential
1971							
November	3	5.25	5.17	0.08	5.02	4.87	0.15
	10	5.05	4.90	0.15	5.09	4.80	0.29
	17	5.15	4.84	0.31	5.26	4.74	0.52
	24	5.85	4.86	0.99	5.65	4.61	1.04
December	1	5.46	4.68	0.78	6.41	4.67	1.74
	8	5.06	4.59p	0.47p	6.86	4.67p	2.19

1/ All Euro-dollar rates are noon bid rates in the London market; overnight rate adjusted for technical factors to reflect the effective cost of funds to U.S. banks.
2/ Effective rate.
3/ Offer rates (median, as of Wednesday) on large denominated CD's by prime banks in New York City; daily rates are carried forward from the previous Wednesday; CD rates adjusted for the cost of required reserves.
p/ Preliminary.

Overnight Euro-dollars were more expensive than Federal funds during November, but partial data indicate that U.S. banks' daily average liabilities to branches showed no great change from October.

U.S. balance of payments. The U.S. balance of payments in November registered large deficits reflecting both the persistent weaknesses in trade and other normal transactions and a new swelling of outflows influenced by expectations that further substantial revaluations of some currencies would occur fairly soon. On the official settlements basis the deficit in November probably approached $2 billion, up from $1.2 billion in October.

The month-to-month worsening appears to have been reflected mainly in a turnaround in liabilities to foreign commercial banks from a small increase in such liabilities in October to a sizable reduction in November. Much of this swing was in liabilities to banks other than American foreign branches. Also, bank-reported claims on foreigners were reduced substantially in October but weekly data suggest they increased somewhat in November. Data for transactions in U.S. and foreign securities in November are not yet available; in October the net balance for such transactions was probably a small plus, but this could have shifted to a negative amount in November.

A preliminary set of third-quarter balance-of-payments accounts is summarized below. More details are given on page I-T-3. Apparently the improvement in the trade balance in the third quarter (though it remained in heavy deficit) was matched by a reduction in the surplus in the services account. This reflected a decline in income receipts from U.S. direct foreign investments -- which had been temporarily inflated in the second quarter -- and larger income payments to foreigners on their assets in the United States.

There was little change in net flows of long-term private capital in the third quarter from the high levels of the first two quarters of the year; for the first nine months the net outflow was $3 billion higher than in the like period of 1970. However, only about $650 million of this change was associated with U.S. direct investments, and since the OFDI controls are somewhat easier than in 1970 there seems to be no need for an extraordinary effort at year-end to windowdress to meet the regulatory limits. Another large year-to-year change was a sharp shift for foreign direct investments in the United States, from a large inflow in 1970 (though this partly involved the use of funds obtained from U.S. sources) to a net withdrawal of funds this year, especially in the third quarter. Long-term claims on foreigners reported by U.S. banks increased by $650 million in the first nine months of this year, a net swing of nearly $800 million from last year.

U.S. Balance of Payments
(billions of dollars, seasonally adjusted)

	1970 Year (1)	1970 Jan.-Sept. (2)	1971 Qtr.1 (3)	1971 Qtr.2 (4)	1971 Qtr.3 (5)	1971 Jan.-Sept. (6)	Change Jan.-Sept. 1970-71 (6)-(2)
1. Merchandise trade balance	2.1	2.0	.2	-1.0	-.5	-1.3	-3.3
2. Services, net	1.5	1.0	.9	1.1	.5	2.5	1.5
3. BALANCE ON GOODS & SERVICES	3.6	2.9	1.2	--	--	1.2	-1.7
4. Remittances and pensions	-1.4	-1.1	-.3	-.4	-.4	-1.1	--
5. U.S. Govt. grants and capital 1/	-3.8	-2.6	-1.1	-1.1	-1.1	-3.3	-.7
6. Long-term private capital	-1.5	-1.5	-1.0	-1.8	-1.6	-4.4	-3.0
7. BALANCE ON CURRENT ACCOUNT AND LONG-TERM CAPITAL	-3.0	-2.2	-1.3	-3.2	-3.1	-7.6	-5.4
8. Nonliquid short-term private capital	-.5	-.4	-.4	-.4	-1.2	-1.9	-1.6
9. Errors and omissions	-1.1	-.9	-1.0	-2.3	-5.2	-8.6	-7.7
10. NET LIQUIDITY BALANCE (excluding SDR allocations)	-4.7	-3.4	-2.7	-6.0	-9.5	-18.1	-14.7
11. Liquid private capital	-6.0	-3.5	-3.0	.1	-2.8	-5.8	-2.3
12. OFFICIAL RESERVE TRANSACTIONS BALANCE (excl. SDR allocations)	-10.7	-7.0	-5.7	-5.9	-12.3	-23.9	-16.9

1/ Includes nonliquid liabilities to otherthan official reserve holders. Details may not add because of rounding. Strictly confidential until published December 16.

As expected, much of the deterioration in the accounts in the third quarter remains unexplained and is reflected in an errors and omissions item of $5.2 billion. For the first nine months of the year these unexplained net payments were nearly $8 billion larger than "normal." Not only these abnormal errors and omissions but also some of the recorded outflow, as well as some of the worsening of the current account, was probably related to reactions to expectations of changes in exchange rates.

U.S. foreign trade. Dock strikes were the dominant factor in the wide fluctuation of U.S. exports, imports and the trade balance in September and October. In September a moderate trade surplus was recorded as exporters accelerated shipments in advance of the longshoremen's strike at East and Gulf Coast ports that began on October 1. The continued shutdown at West Coast ports -- which handle more imports than exports -- also raised exports relative to imports.

In October a huge trade deficit was recorded as exports fell sharply from the strike-inflated September level. The level of exports in October was also adversely affected by the domestic coal strike which began in October and ended in mid-November. The drop in imports in October was much less pronounced, reflecting the end, at least temporarily, of the strike at West Coast ports through a Taft-Hartley injunction.

For the two months of September-October the trade balance was a deficit of $4-1/2 billion at an annual rate (balance-of-payments basis), about the same as the average rate of deficit in the five months of April through August. For January-October the trade balance was a deficit of $2-1/2 billion at an annual rate, compared with a surplus of $2-1/2 billion in the corresponding period of 1970 -- an adverse swing of $5 billion in our trade position within a year.

The distortion of trade movements by the dock strikes in recent months has obscured any quantification of the effect of the import surcharge and changes in parities on our trade position. These distortions are likely to persist through the remaining months of this year and probably into the early part of next year despite the invoking of the Taft-Hartley Act to reopen the East and Gulf Coast ports on November 26.

From data on Bureau of Customs collections, it is evident that the surcharge was still not in full effect in October. Exempt from the surcharge were goods in transit on August 15 (the date on which the surcharge was imposed) which were still entering the United States in the first part of October and goods unloaded from ships caught by the West Coast dock strike which had begun in July. There have been reports that U.S. importers and retailers who did have to pay the surcharge in September and October were not passing it on to consumers. This absorption of the surcharge was attributed to: (1) the possibility or hope that the import surcharge was very temporary and would soon be lifted, and (2) high profit margins on imported goods; whether the profit margins have in fact been exceptionally high is a point on which information is scanty.

The level of foreign orders for U.S. machinery in September and October was moderately higher than the average level in the April-August period and was about back to the higher average value of the first quarter. Such an increase might possibly be a first indication of some reaction to exchange rate changes since August 15.

Prices and wages in major industrial countries. Despite the weakening of aggregate demand in a number of major foreign economies, only limited progress has been achieved thus far in reducing the rates of price and wage advances. The increases in wholesale prices and wages have moderated somewhat in recent months in Germany and the United Kingdom. Japanese wholesale prices were virtually level from April to August and declined in September and October. In Canada -- where economic activity is recovering but unemployment remains high -- price advances since the beginning of the year have been accelerating, partly reflecting the termination of voluntary price guidelines at the end of 1970.

WHOLESALE PRICES IN SELECTED INDUSTRIAL COUNTRIES
(Percentage increase from same period of previous year)

	1970		1971			
	III	IV	I	II	III	Latest 3 months 1/
France 2/	5.6	2.9	2.3	3.3	5.0	5.2p/(October)
Germany 3/	6.2	5.1	4.8	5.1	4.8	4.5p/(October)
Italy 4/	7.4	6.7	4.7	3.8	n.a.	3.8 (August)
United Kingdom 5/	6.9	7.9	7.9	8.4	8.3	7.7 (October)
Japan 6/	4.2	2.5	0.1	-0.9	-0.9	-1.2p/(October)
Canada 6/	0.9	0.9	1.1	2.6	4.8	4.8 (September)
United States 7/	3.8	3.4	3.6	3.6	4.3	3.6 (November)

p/ Includes provisional data for October 1971.
1/ Latest month for which data are available is indicated in parenthesis.
2/ Intermediate products. 3/ Industrial producer prices. 4/ Non-agricultural products. 5/ All manufactured products, home market sales.
6/ Manufactured products. 7/ Industrial commodities.

For most countries, the pace of inflation has remained high in recent months, and prices continue to rise faster than on the average in the late 1960's. Checking inflation, therefore, remains a major objective for most countries. In Germany, this objective has led to a hesitancy to adopt more than mildly stimulative economic policies to counter the emergence of a slowdown in economic activity. In recent months, however, the United Kingdom and Italy -- both facing weaknesses in various sectors of economic activity -- and Canada, experiencing a continuing high rate of unemployment, have adopted active expansionary demand management policies, despite their not having curbed satisfactorily the inflationary pressures.

CONSUMER PRICES IN SELECTED INDUSTRIAL COUNTRIES
(Percentage increase from same period of previous year)

	1970		1971			
	III	IV	I	II	III	August-October
Belgium	3.9	3.3	3.5	4.0	4.6	4.9p/
France	5.9	5.4	4.9	5.2	5.5	5.7p/
Germany	4.0	4.1	4.2	5.0	5.6	5.7p/
Italy	4.7	5.3	5.1	4.8	4.8	4.9p/
Netherlands	5.3	5.6	6.6	7.6	7.5	7.8p/
United Kingdom	6.9	7.7	8.7	9.8	10.0	9.8p/
Japan	6.5	8.5	6.7	6.7	7.4	7.0p/
Canada	3.0	2.1	1.7	2.5	3.3	3.4p/
United States	5.8	5.6	4.9	4.4	4.4	4.2

p/ Includes provisional data for October 1971.

Several temporary conditions are helping to reduce somewhat the rate of price advances in some countries. Direct price restraint programs are currently in effect in the United Kingdom and France. The decline of world commodity prices is acting as a price stabilizer. Finally, the currency appreciations in Germany, Japan, the Netherlands, and Belgium also should help to keep down the rate of advance in prices of imported and exportable goods in these countries.

Two types of developments may be moderating the rapid increases of wages, which until recently have been accelerating and which have been one of the underlying causes of the high rates of inflation. First, although none of the major countries has a formal wage policy in effect, the increase in unemployment in a number of countries now appears to be restraining pay demands. Second, the price restraint policies in operation in some countries and a profit squeeze also may be stiffening employers' resistance to inflationary wage demands. To the extent that these influences do lower the rate of wage increases, the prospects of braking the wage-price spiral, and subsequently price inflation itself, will be improved.

Following a sharp rise in prices in Germany during the first half of 1971, inflationary pressures appear to be receding, partly reflecting the reduced economic buoyancy. In October, industrial producer prices were virtually at the same level as in July. Recent rates of increase of consumer prices, particularly if food is excluded, show much less moderation. Nevertheless, industrial producer prices in August-October were still 4.5 per cent above the same period last year, while on the same year-over-year comparison retail prices had advanced by somewhat less than 6 per cent. The Government is continuing to accord priority to curbing inflation, even if this means extending the duration of the period of slow real growth.

Some deceleration of German earnings increases is noticeable in recent months. This is partly attributable to a reduction in overtime. But wage settlements also are lower than earlier. In June, a leading settlement in the chemical industry involved a 7 per cent wage rate increase, a substantial reduction from the 13 per cent average rise in wage rates in manufacturing recorded in 1970. (The 1970 wage settlements, however, were considered catchups from the relatively more moderate 1968/1969 settlements.) The current metal workers strike, which began November 23 and which is affecting an increasing proportion of German production partly because of lockouts, is becoming a major test of whether the recent slowing of wage increases will be maintained. The workers had demanded an 11 per cent wage increase, which was countered by a 4-1/2 per cent offer by the employers. A state mediation commission recommended 7-1/2 per cent, which the unions accepted but the employers rejected. The unions then reverted to their original 11 per cent demand, and an arbitration council has been established.

In the United Kingdom, the pace of inflation also appears to have been abating. From July to October, wholesale prices for manufactured goods increased by 0.5 per cent (not annual rate), while consumer prices advanced by 0.8 per cent (also not annual rate). Even allowing for favorable seasonal influences on prices during these months, the rate of recent price increases has been substantially reduced from the exceedingly rapid rise in prices experienced earlier in the year.

The break in the rate of price increases since mid-year was aided by a reduction in sales taxes in mid-July and by the announcement of the Confederation of British Industry's (CBI) price restraint agreement. This voluntary arrangement limits price increases by large firms to 5 per cent for 12 months. It appears to be working satisfactorily.

An additional factor helping to slow the pace of British price advance is some relaxation in cost pressures. The rate of increase of weekly wage earnings has declined since early this year. This reflects, in part, the impact of the British economic stagnation -- i.e., fewer hours worked and less wage drift.

Continued moderate deceleration of price and wage inflation over the next several months seems a reasonable prospect. The CBI initiative, the likely further reduction in indirect taxes in the near future, and the sobering effect on union militancy of a 4 per cent unemployment rate -- 1 million workers -- are likely to act as brakes on inflation. Several major wage negotiations are now in progress, and the results soon will reveal whether the recent moderation of wage increases will continue. The likely improvement in productivity as economic recovery gains momentum also will help to relieve cost pressures.

The comprehensive system of price controls in France has not prevented a rapid rise in prices this year. In the three months

August-October wholesale prices of intermediate goods were more than 5 per cent above a year earlier, while retail prices in the same three months showed a year-over-year increase of nearly 6 per cent.

Although economic activity in France has continued to advance this year, aggregate demand is not excessive. Cost-push pressures -- mainly increased wages and, to a lesser extent, rises in import prices of petroleum and manufactured goods and increases in prices of domestic agricultural products -- have been the principal sources fueling inflation.

In September, a new anti-inflationary program was launched. The Government signed a series of agreements with large businesses designed to hold price increases on manufactured goods to 1-1/2 per cent through March 1972. The 0.6 per cent rise in the October retail price index, however, has given this program an inauspicious start.

Most wage contracts now contain some form of escalator clause, and the minimum wage is rigidly tied to changes in the consumer price index. The October price rise will trigger a 2.3 per cent increase in the minimum wage, and this, in turn, will have an effect on the entire pattern of wage rates.

In Italy, the rate of wage increases continues to be high, and the rise in prices, although somewhat slower than in 1970, is fairly rapid. Wholesale prices of nonagricultural products in the three months June-August were nearly 4 per cent above the year-earlier level, and consumer prices in the three months August-October recorded close to a 5 per cent year-over-year increase.

As the Italian economy has been operating far below capacity, the price rises this year (as well as most of last year's) are entirely of a cost-push nature. Labor costs continue to rise rapidly: in both the second and third quarters, hourly wage rates in manufacturing were 13.5 per cent above a year earlier. With productivity gains much lower than the rate of wage increases, it is questionable how much longer part of such wage increases can be absorbed by producers' profit margins.

The pace of inflation has not inhibited the authorities from adopting reflationary measures. In fact, since part of the inflation is caused by increasing unit costs associated with declining or constant output, increasing the rate of economic activity may reduce cost pressures. On November 12, the Government announced its decision to accelerate public spending on housing, hospitals and highways by pumping about 1.2 trillion lire ($2 billion) -- 2 per cent of Italian GNP -- into the economy in the next few months.

In Belgium, consumer price rises have accelerated in recent months, as the pressure of rising wage rates has remained strong. In the August-October period, retail prices were about 5 per cent above the same months a year earlier.

To delay and minimize the immediate impact on consumer prices of the shift from the turnover tax to the TVA last January 1, the Government used its powers to prevent, for up to five months, part or all of any retail price increase. The speeding-up of the rate of increase in consumer prices after mid-year reflects to a major extent the expiration of the five-month maximum delay period. But since the shift to the TVA is estimated to have had the "mechanical" effect of raising consumer prices by about 2 per cent, the Belgian authorities regard the year-to-year rise as satisfactory under the circumstances.

Prices and wages in the Netherlands are continuing to advance at rapid rates. Consumer prices in August-October were nearly 8 per cent above the corresponding months a year earlier. Living costs will have risen by some 20 per cent in the past three years; this compares with a 13 per cent rise recorded in the previous three years.

The recent high rates of price advances, with retail prices jumping nearly 1 per cent in October alone, partly reflected the lifting of the wage moderation policy and the termination of price restrictions in July. Since the Netherlands still has high rates of capacity utilization, the inflation cannot be attributed solely to cost-push factors. However, the high rate of wage increases remains a major cause of the inflation. In 1970, wages advanced at a 12-1/2 per cent clip, and this year, despite statutory limitations for part of the year, the rise is estimated to approach 14 per cent. The outlook for the rate of wage increases for 1972 is hardly any better.

Inflation does not appear to be a serious problem for Japan at present. Wholesale prices, in fact, have declined in recent months, partly reflecting a "bearish" commodity market associated with the continuing slowdown of Japanese economic activity but partly resulting from declining import prices. The rise of consumer prices, on the other hand, has not yet slowed. In the three months August-October, retail prices were 7 per cent above the year earlier level, and the rise was accelerating until October. However, given the lagged effect of movements of wholesale prices on retail prices, the recent decline in wholesale prices suggests an easing of the rise of prices at the retail level in the months ahead.

Average monthly earnings in manufacturing in Japan continued to advance rapidly, but at a slightly lower rate than last year. In view of the intractability of the economic slowdown in Japan, the rate of increase in earnings is likely to be reduced in the near future. Historically, there appear to exist unusually close links between the rate of increase in earnings (especially year-end bonuses) and business conditions in Japanese industry.

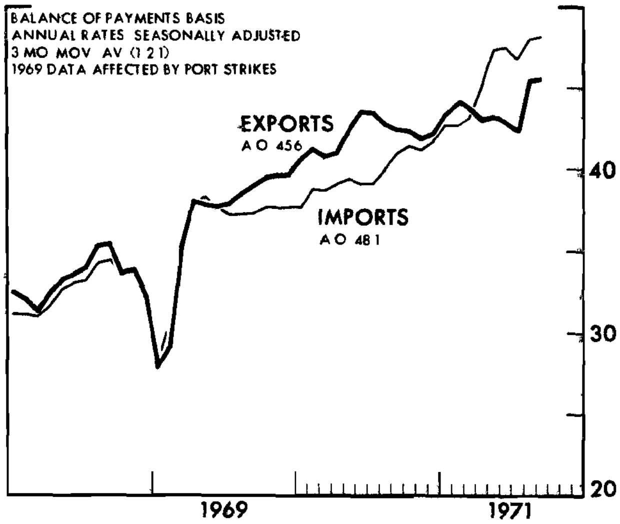
Canada faces the problem of containing prices and wages without sacrificing the expansion of output and employment. Wholesale prices of manufactured goods and consumer prices began to accelerate again at the turn of the year, following the termination of the 1970 voluntary price restraint program. In the third quarter, wholesale prices were nearly 5 per cent above the previous year's level, while consumer prices in the three months August-October had advanced more than 3 per cent over a year earlier. In contrast to the case of Japan, the lag in effects of movements of wholesale prices on retail prices suggests that consumer prices may increase more rapidly in the months ahead.

Such high rates of price rises, at a time when unemployment at 7 per cent is at a ten-year high and when aggregate demand in Canada is far from excessive, indicate that Canada is experiencing cost-push inflation. The average base wage rate negotiated under collective agreements shows an 8.6 per cent year-over-year increase for the third quarter. However, the present phase of above-average productivity growth associated with an early stage of economic recovery (a phase that is expected to continue well into 1972) may help to keep down somewhat the rise of unit labor costs.

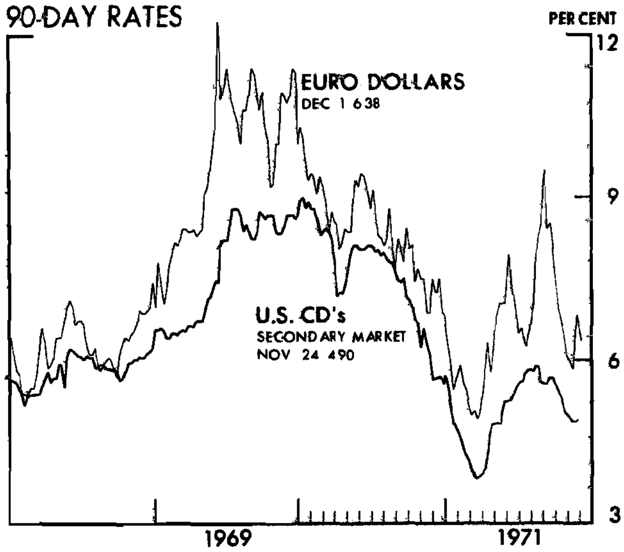
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

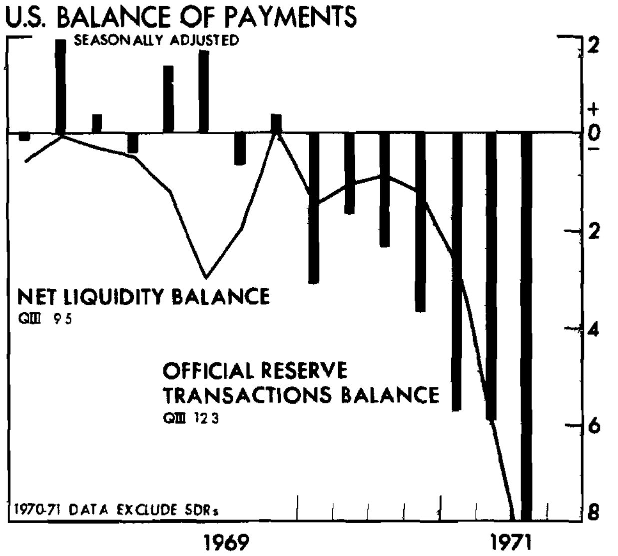
U.S. MERCHANDISE TRADE



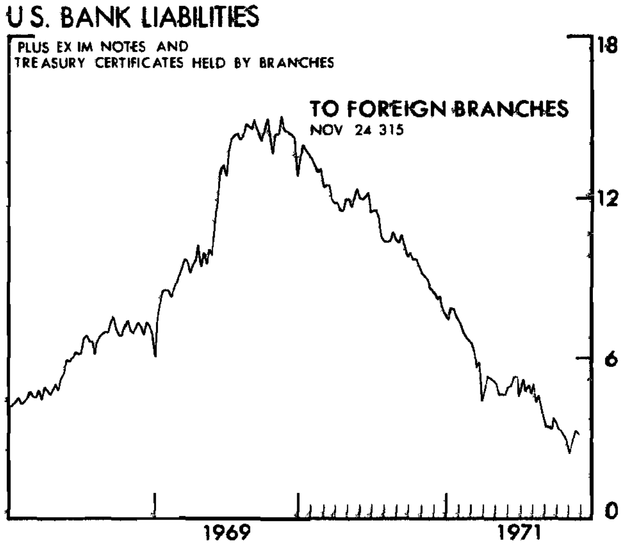
90-DAY RATES



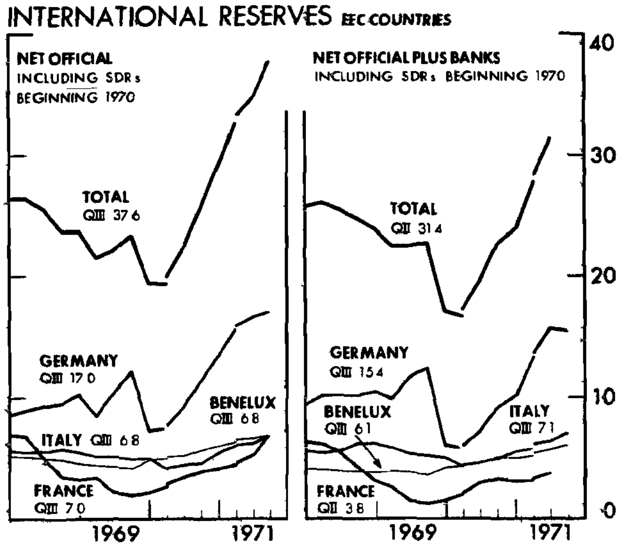
U.S. BALANCE OF PAYMENTS



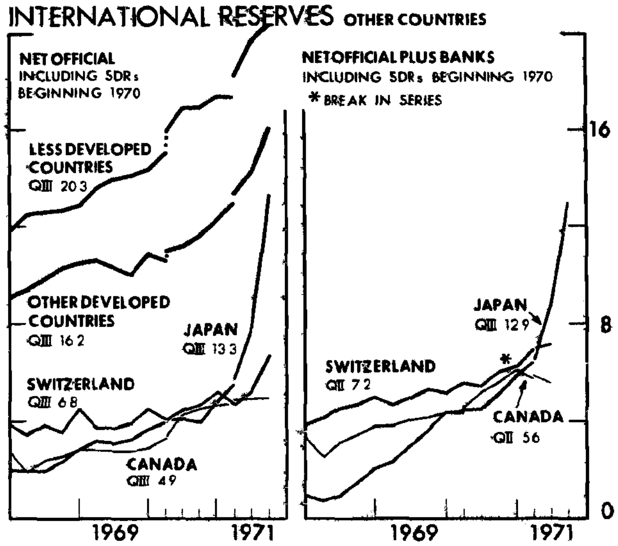
U.S. BANK LIABILITIES



INTERNATIONAL RESERVES EEC COUNTRIES



INTERNATIONAL RESERVES OTHER COUNTRIES



APPENDIX A WILL APPEAR IN THE SUPPLEMENT

APPENDIX B: THE FLOATING PRIME RATE*

In response to an informal survey, the Reserve Banks have indicated that to their knowledge only four commercial banks have thus far publicly adopted a floating prime rate. Two other commercial banks have apparently abandoned the prime rate convention altogether, intending to negotiate rates separately with each customer. Other banks have stated that they are interested in the floating rate concept but do not believe that a suitable rate setting mechanism has been devised as yet.

The rate-setting procedures adopted by banks that have shifted to a floating rate differ to some degree. First National City Bank has tied its prime rate to a level 50 basis points above the rate charged borrowers on 90 day commercial paper and has indicated that, when necessary, it will change the prime rate weekly in one eighth point intervals, using either a weekly average or rates established on the last days of the preceding week as the base rate. Irving Trust Co. has tied its rate 50 basis points above the dealer rate offered buyers of commercial paper, with changes to be made in quarter point intervals on the basis of fluctuations in the weekly average of the base rate. Michigan Bank NA, in Detroit, has adopted an index of the 90 day commercial paper rate and the rate on 360 day negotiable CD's. The prime rate determined in this way will be limited to borrowers in the banks own market area. The final details of the policy of the First National Bank of Boston, have not been worked out yet, but the bank has indicated that it intends to use a broader range of money market variables than those adopted by the other banks, and will also give consideration to its own portfolio position in setting its rate. This bank plans to change its rates on a monthly basis in one eighth point intervals but does not intend to annouce its actions.

The prime rate has progressively become a more flexible rate in recent years, changing more frequently and in smaller intervals to alterations in money market conditions as banks have responded to the competitive challenge offered by the commercial paper market and have placed greater reliance on large CD's and non deposit funds, the cost of which tend to move sensitively with money market conditions. In some respects, therefore, the significance of the new floating rate policy would appear to be more political than economic. That is to say, the newly developed mechanism may bring about a slight speed up in the

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* Prepared by Fred Struble, Economist, Banking Section, Division of Research and Statistics.

reaction of banks to changing market rates and may result in changes in the prime rate of smaller size, but the range of variation in this rate over the cycle will probably not be widened significantly by the mechanism. A device which imparts a more mechanical, non-administered appearance to a prime rate change, however, may reduce public objection to a possible hike in this rate at some future time.

APPENDIX C: A SURVEY OF THE IMPACT OF FLOATING EXCHANGE RATES ON INTERNATIONAL TRADE AND FINANCE*

Summary

As a result of the mid-August suspension of gold convertibility by the United States, since August 23 exchange rates have been allowed to float -- subject to varying degrees of official control -- in all of the European Group of Ten countries, except the French franc rate for trade transactions. The Japanese yen began to float on August 28. The German and Dutch currencies had, of course, been floating since May 10, and the Canadian dollar since June 1, 1970. Moreover, in several countries the authorities have acted with both direct and indirect measures to limit the movement of the exchange rate away from the official parity. Nevertheless, the current situation constitutes a radical departure from the past because floating rates are at present widespread and because great uncertainty prevails, here and abroad, as to the levels of exchange rates in the near future.

A survey of recent exchange market and trade developments was requested by the Department of State from the American Embassies in nine countries[1/] and was carried out in late October. It indicates that, in the limited period of time since mid-August, the new exchange rate situation has so far had no readily apparent effect on the volume of foreign trade, with the important exception of export sales involving credits of relatively long maturity. (The survey did not cover effects on trade of changes in exchange rate levels, i.e., of the resulting changes in relative prices.) The survey results suggest that, on the basis of exchange market activity, capital movements have not been hindered by the floating rates *per se*, except possibly in Japan. On the other hand, despite the great uncertainty about spot exchange rates there has been no general increase in the use of the forward exchange market. The survey also covered reactions of the public to the U.S. measures of August 15; the findings show a general unhappiness but no organized pressure for retaliatory measures in any of the countries surveyed.

1/ Belgium, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, and the United Kingdom.

* Prepared by Rodney H. Mills, Jr., Economist, European Section, Division of International Finance

<u>Effects on trade</u>

The results of the survey suggest that increased uncertainties over exchange rates since August 15 have had no obvious repercussions on most types of trade transactions. But in most of the countries covered by the survey, difficulties have been experienced for exports involving relatively long-term credits, in general those over one year, because the long payment period increases the exchange risk, and forward cover for longer periods is unobtainable or very expensive. One way in which the exporter can avoid an exchange risk is to invoice his shipments in his own currency, thus placing the risk on the buyer. According to the survey, this practice is now widespread, or has recently increased, in Belgium, France, the Netherlands, Sweden, Switzerland and Japan. In Switzerland, exports requiring long-term finance came to a halt after mid-August but now are reviving because buyers have given in and agreed to being billed in Swiss francs.

Importers' resistance to invoicing in the seller's currency obliges some exporters to bill in the importer's currency or some third currency, usually the dollar (although some shifting from the dollar to sterling was noted in Sweden and Switzerland). In these instances, the exporter may still avoid an exchange risk by borrowing the invoice currency from a bank, rather than domestic currency, to finance his sales, and this practice was specifically reported in Belgium. The exporter may also avoid an exchange risk by selling his export proceeds forward. But in most countries, dollars can be sold forward only at substantial discounts from spot rates, and usually markets do not exist for forwards longer than one year. The survey reported that forward cover was a problem, of greater or lesser severity, for exporters in Japan, Germany, the Netherlands, Belgium, and Sweden, especially for relatively small firms.

In Japan, long-term export contract negotiations were suspended after the floating of the yen, but are now being resumed. The exchange risk problem is being resolved in part by increased invoicing of exports in yen, which Japanese shipbuilders were already doing before last August. But activity in the Tokyo forward exchange market has declined drastically, and the cost of forward cover has risen very sharply. This is creating difficulties especially for small- and medium-sized exporters. The Japanese Ministry of Finance is now making dollar deposits with banks to facilitate their purchases of export bills sold by small- and medium-sized firms. In Germany, exporters' problems with exchange risks have apparently been aggravated by the fact that, since the floating of the mark in May, there has been a decline in the proportion of exports invoiced in marks (presumably because of importers' resistance).

Effects on exchange markets

The volume of exchange market trading was reduced drastically in Switzerland, and to a lesser extent in other European countries, in the first few days after the reopening of the European exchanges on August 23. The floating of the yen on August 28 caused trading to fall sharply in Tokyo, where turnover (spot and forward) is still 20-30 per cent below normal. In Europe, trading volume is still generally smaller than in July and early August, when speculative activity was intense. But in all the European countries covered by the survey, trading volume has now returned to the normal levels (reached in Switzerland in late October), or has risen above normal (Sweden). The survey did not specifically seek to inquire about the effects of floating rates on international capital flows. But the resumption of normal levels of exchange market trading in Europe suggests that, if capital flows in European countries were initially hindered by the new exchange rate system, they are no longer hindered. From London it is reported that the international bond market is operating without any difficulties as a result of floating rates, and that activity in that market has been more dominated by dollar issues since the float than it was before. In Switzerland, demand for dollar-denominated Euro-bonds has increased at the expense of issues denominated in marks. The evidence that capital flows are now little if any restricted by floating rates should, of course, be considered in conjunction with the fact that the United Kingdom, France, Switzerland and Japan have imposed controls since mid-August to discourage or prevent inflows of short-term capital of one kind or another, to reduce upward pressure on the exchange rate, and the Netherlands has established a special exchange market for transactions in guilder-denominated bonds between residents and nonresidents.

In Japan, the volume of trading in forward exchange has been reduced by two-thirds or more, which is proportionately a much greater reduction than that in spot exchange trading. In Europe, exchange markets do not show any important shifts in the composition of trading between spot and forward transactions as compared with normal periods in the past. Sweden was the only country for which the survey reported a definite rise in the volume of forward transactions; there, forward sales of dollars and forward purchases of sterling and marks have increased. In Italy there is "some tendency" for more exporters to cover forward, but for Britain the survey found no significant increase in the demand for forward cover. The general situation in European markets remains one in which trading in forwards is a small part of the total (a figure of 10-15 per cent was reported for Belgium) and in which importers and exporters typically do not cover forward. Following the floating of the mark and the guilder in May, and following the reopening of the European exchanges in August, spreads between banks' bid and offer rates for foreign currencies generally widened sharply. Since then, spreads have narrowed again, but they still remain two or three times greater than normal in Switzerland and four times larger in France and the Netherlands.

Reactions to U.S. measures

Apart from the controls on capital inflows imposed by Japan, Switzerland, France, the United Kingdom and the Netherlands, the only significant actions taken specifically in reaction to the U.S. measures of August 15 were several measures by Japan. As reported above, steps have been taken to help exports of small- and medium-sized firms. The Japanese government will pay at least 60 per cent of their normal average wage to workers temporarily laid off because of the U.S. measures and the floating of the yen. In addition, three government-affiliated financing institutions will extend long-term, low-interest loans to export-related firms, and special loans will be made to enable firms to change their line of business. Exporters in Britain, Germany, and France are more concerned about the U.S. investment tax credit than about the import surcharge, while the opposite was reported for Italy and Japan. Exporters' dissatisfaction over appreciation of the exchange rate was noted in Germany and Belgium. Although floating rates have had relatively little injurious effect on trade, there is a general concern that prolonged uncertainty about exchange rates could eventually be harmful. In Switzerland, industrialists and bankers have stated that if progress in eliminating the U.S. surcharge and the uncertainty over exchange rates were not made by early 1972, pressures could begin to influence the Swiss government's economic policies.