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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

January 7, 1972

By the Staff
Board of Governors
of the Federal Reserve System

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THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Moderate expansion in output and sluggishness in the labor market have continued to characterize the economy. The staff is now estimating that GNP increased $19.5 billion in the fourth quarter. This is a somewhat smaller gain than expected a month ago, mainly because of a weaker rise in consumer spending, particularly for nondurable goods. In December, sales of general merchandise stores apparently declined, on the basis of weekly data. Unit sales of both domestic-type and imported autos during the month were down more sharply than expected. The freeze slowed the pace of price advance appreciably in the fourth quarter, so that most of the current dollar increase in GNP represented real gains. Real GNP is now estimated to have increased at an annual rate of 5.7 per cent, well above the third quarter rate.

Industrial production in December is tentatively estimated to have increased by around 0.8 per cent, the same amount as in November, with half of the rise resulting from the return to work of striking coal miners. Output of business equipment apparently continued its recent recovery. Auto assemblies, however, edged down with a further small reduction planned for January. Industrial production apparently increased at an annual rate of about 4 per cent from the third quarter to the fourth. New orders of durable goods rose appreciably in November, with a sizable increase for capital equipment.

In December, the unemployment rate edged up to 6.1 per cent from 6.0 per cent in November, remaining on the plateau prevailing throughout the year. Nonfarm payroll employment showed little net increase after allowing for a reduction of the number on strike. Manufacturing employment declined, but the workweek increased further.

As anticipated, average hourly earnings for the private nonfarm economy increased significantly in December following the freeze. Earnings rose very sharply in manufacturing industries as retroactive and deferred increases became effective. In mining, the new wage contract in the coal industry was also reflected in a sharp jump in hourly earnings.

Gross national product--outlook. The staff continues to project a strong expansion in both nominal and real GNP in 1972. For the year as a whole, nominal GNP is projected to rise by $100 billion, or 9.5 per cent, from 1971. Real GNP is projected to increase 6 per cent, double the 1971 advance. Phase II policies are assumed to be fairly successful, and the rate of price increase is expected to moderate further after an initial transition period. Both the GNP implicit deflator and the private fixed weight index in the second half of the year are projected to be rising at an annual rate under 3 per cent.

The projected pattern of activity is little different from that of four weeks ago. Except for residential construction activity, the major demand sectors are generally expected to be more expansive during 1972 than in 1971. Consumer spending is expected to increase substantially, although less than in our previous projection.

GNP PROJECTIONS

	Change in Nominal GNP $ billion		Per cent increase, annual rate: Real GNP		Private GNP fixed weight price index		Unemployment rate	
	12/8/71	Current	12/8/71	Current	12/8/71	Current	12/8/71	Current
971-IV	22.5	19.5	5.9	5.7	2.0	1.6	5.9	6.0
972-I	29.5	29.9	6.8	5.8	3.6	4.0	5.7	5.9
972-II	27.0	27.0	6.6	6.6	3.1	3.1	5.6	5.8
972-III	28.0	28.0	6,1	6.9	2.9	2.9	5.5	5.6
972-IV	27.0	28.0	6.4	6.8	2.8	2.8	5.3	5.4

Business spending for fixed capital is expected to show increasing strength as the year progresses. The projected 9-1/2 per cent rise for the year as a whole is roughly in line with findings of recent surveys of intentions. Such spending is expected to respond favorably to developing strength in other sectors, an improved climate of expectations, and, to some extent, the stimulus of the investment tax credit. With stock-sales ratios now appreciably improved, and final demands projected to rise appreciably, inventory investment is expected to make a substantial contribution to expansion in 1972.

Federal purchases are now expected to rise sizably in the first quarter, reflecting the recently enacted pay increase. Social security benefits are assumed to be liberalized in the third quarter, a postponement from the first quarter increase anticipated earlier. Residential construction activity is projected to edge down in the second half, as starts recede from current high levels.

A substantial employment increase is projected over the course of the year, but the unemployment rate is expected to decline only gradually to just under 5-1/2 per cent in the fourth quarter. Continued large increases in the civilian labor force, in part reflecting more numerous job opportunities, and a sizable rise in productivity--as is typical of periods of rapid output growth--should work to limit the decline in unemployment.

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GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income figures are billions of dollars, with quarterly figures at annual rates.)

	1971 Proj.	1972 Proj.	1971 III	1971 IV	1972 Projected I	1972 Projected II	1972 Projected III	1972 Projected IV
Gross National Product	1051.3	1151.5	1060.8	1080.3	1110.2	1137.2	1165.2	1193 2
Final purchases	1047.9	1142.0	1059.7	1076.8	1104.4	1129.5	1154.5	1179.5
Private	814.7	887.5	825.5	836.5	856.1	877.2	897.9	918.9
Excluding net exports	814.2	886.2	825.0	839.0	856.6	876.4	895.9	915.8
Personal consumption expenditures	665.2	721.4	672.5	682.8	696.9	712.9	729.1	746.5
Durable goods	102.7	115.1	104.7	107.5	110.5	113.5	116.5	120.0
Nondurable goods	279.8	303.0	282.0	285.3	291.4	299.0	306.7	314.9
Services	282.8	303.2	285.7	290.0	295.0	300.4	305.9	311.6
Gross private domestic investment	152.4	174.3	153.6	159.7	165.5	171.2	177.5	183.0
Residential construction	41.0	46.8	43.3	44.7	46.2	47.5	47.3	46.0
Business fixed investment	108.0	118.1	109.3	111.5	113.5	116.0	119.5	123.3
Change in business inventories	3.4	9.5	1.1	3.5	5.8	7.7	10.7	13.7
Nonfarm	2.8	9.3	0.3	2.5	5.3	7.5	10.7	13.7
Net exports of goods and services	0.4	1.4	0.5	-2.5	-0.5	0.8	2.0	3.1
Exports	65.7	73.8	68.9	61.5	71.4	73.1	74.1	76.5
Imports	65.3	72.4	68.4	64.0	71.9	72.3	72.1	73.4
Gov't. purchases of goods & services	233.2	254.5	234.2	240.3	248.3	252.3	256.6	260.6
Federal	97.5	105.5	97.4	100.0	104.9	105.3	105.9	105.8
Defense	71.8	75.3	70.8	71.5	75.0	75.0	75.7	75.5
Other	25.7	30.2	26.6	28.5	29.9	30.3	30.2	30.3
State & local	135.8	149.0	136.8	140.3	143.4	147.0	150.7	154.8
Gross national product in constant (1958) dollars	742.5	786.7	745.5	756.2	767.2	779.8	793.2	806.7
GNP implicit deflator (1958 = 100)	141.6	146.3	142.3	142.9	144.7	145.8	146.9	147.9
Personal income 1/	858.2	923.3	866.5	876.6	897.3	912.5	932.9	950.5
Wage and salary disbursements	575.2	622.7	579.0	587.0	605.0	616.1	628.2	641.6
Disposable income 1/	742.1	801.8	750.0	755.4	778.7	794.0	809.8	824.6
Personal saving 1/	58.1	60.8	58.5	53.6	62.5	61.6	61.0	58.2
Saving rate (per cent) 1/	7.8	7.6	7.8	7.1	8.0	7.8	7.5	7.1
Corporate profits before tax 1/	80.4	100.1	86.7	84.8	89.5	97.5	105.0	112.5
Corp. cash flow, net of div. (domestic) 1/	79.7	93.8	81.0	82.2	85.9	91.3	96.5	101.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts 1/	202.3	218.1	203.5	209.4	210.4	213.5	221.3	227.1
Expenditures	221.7	242.6	223.9	228.8	236.7	239.1	246.1	248.6
Surplus or deficit (-) 1/	-19.4	-24.5	-20.4	-19.4	-26.3	-25.6	-24.8	-21.5
High employment surplus or deficit (-)	2.6	-3.9	2.5	6.9	-1.2	-2.7	-7.0	-4.8
Total labor force (millions)	87.0	88.6	87.0	87.8	88.1	88.3	88.8	89.3
Armed forces "	2.8	2.5	2.8	2.7	2.6	2.5	2.5	2.5
Civilian labor force "	84.2	86.1	84.2	85.1	85.5	85.8	86.3	86.8
Unemployment rate (per cent)	6.0	5.7	6.0	6.0	5.9	5.8	5.6	5.4
Nonfarm payroll employment (millions)	70.7	72.1	70.7	71.0	71.4	71.8	72.4	73.0
Manufacturing	18.6	19.0	18.5	18.6	18.7	18.9	19.0	19.2
Industrial production (1967 = 100)	106.3	112.0	105.9	107.0	109.1	111.4	114.1	116.8
Capacity utilization, manufacturing (per cent)	74.2	75.8	73.6	73.7	74.4	75.2	76.2	77.2
Housing starts, private (millions, A.R.)	2.03	2.10	2.16	2.20	2.18	2.15	2.10	2.00
Sales new autos (millions, A.R.)	10.09	10.71	10.27	10.46	10.40	10.65	10.80	11.00
Domestic models	8.68	9.28	8.74	9.18	9.00	9.25	9.35	9.50
Foreign models	1.50	1.44	1.53	1.28	1.40	1.40	1.45	1.50

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

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 Proj.	1972 Proj.	1971 III	1971 IV	1972 Projected I	1972 Projected II	1972 Projected III	1972 Projected IV
	----------------------Billions Of Dollars----------------------							
Gross National Product	77.2	100.2	17.7	19.5	29.9	27.0	28.0	28.0
Inventory change	0.6	6.1	-4.6	2.4	2.3	1.9	3.0	3.0
Final purchases	76.6	94.1	22.3	17.1	27.6	25.1	25.0	25.0
Private	62.8	72.8	18.3	11.0	19.6	21.1	20.7	21.0
Excluding net exports	65.9	72.0	17.3	14.0	17.6	19.8	19.5	19.9
Net exports	-3.2	1.0	1.0	-3.0	2.0	1.3	1.2	1.1
Government	13.8	21.3	4.0	6.1	8.0	4.0	4.3	4.0
GNP in constant (1958) dollars	22.5	44.2	7.1	10.7	10.9	12.6	13.4	13.5
Final purchases	21.8	39.4	10.6	9.0	9.3	11.0	11.0	11.0
Private	22.1	33.9	8.2	6.6	7.9	10.1	10.1	10.4
	----------------------In Per Cent Per Year----------------------							
Gross National Product	7.9	9.5	7.0	7.4	11.1	9.7	9.8	9.6
Final purchases	7.9	9.0	8.6	6.5	10.3	9.1	8.9	8.7
Private	8.4	8.9	9.1	5.3	9.4	9.9	9.4	9.4
Personal consumption expenditures	8.0	8.4	7.0	6.1	8.3	9.2	9.1	9.5
Durable goods	15.9	12.1	15.5	10.7	11.2	10.9	10.6	12.0
Nondurable goods	5.7	8.3	3.1	4.7	8.6	10.4	10.3	10.7
Services	7.7	7.2	7.6	6.0	6.9	7.3	7.3	7.5
Gross private domestic investment	12.6	14.4	3.1	15.9	14.5	13.8	14.7	12.4
Residential construction	34.9	14.1	36.3	12.9	13.4	11.3	-1.7	-11.0
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	9.1	7.0	10.4	13.3	6.4	6.8	6.2
Federal	0.3	8.2	7.1	10.7	19.6	1.5	2.3	-0.4
Defense	4.8	4.9	-5.6	4.0	19.6	0.0	3.7	-1.1
Other	17.4	17.5	45.2	28.6	19.6	5.4	-1.3	1.3
State & local	11.1	9.7	6.8	10.2	8.8	10.0	10.1	10.9
GNP in constant (1958) dollars	3.1	6.0	3.9 1/	5.7	5.8	6.6	6.9	6.8
Final purchases	3.0	5.3	5.8	4.8	5.0	5.8	5.7	5.6
Private	3.8	5.6	5.5	4.4	5.2	6.5	6.4	6.5
GNP implicit deflator	4.7	3.4	3.3 1/	1.5 3/	5.2 4/	3.1	2.9	2.8
Private GNP fixed weight price index 2/			4.1 1/	1.6	4.0	3.1	2.9	2.8
Personal income	6.8	7.6	5.5	4.7	9.4	6.8	8.9	7.5
Wage and salary disbursements	6.2	8.3	4.6	5.5	12.3	7.3	7.9	8.5
Disposable income	7.9	8.0	5.0	2.9	12.3	7.9	8.0	7.3
Corporate profits before tax	6.6	24.5	1.4	-8.8	22.2	35.8	30.8	28.6
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	5.6	7.8	8.6	11.6	1.9	5.9	14.6	10.5
Expenditures	8.1	9.4	5.4	8.8	13.8	4.1	11.7	4.1
Nonfarm payroll employment	0.1	2.0	-0.2	1.7	2.3	2.2	3.3	3.3
Manufacturing	-4.1	2.2	-2.4	2.2	2.2	4.3	2.1	4.2
Industrial production	-0.4	5.4	-3.5	4.2	7.8	8.6	9.4	9.4
Housing starts, private	42.0	3.4	36.5	7.4	-3.6	-5.5	-9.3	-19.0
Sales new autos	20.8	6.1	19.0	7.4	-2.3	9.6	5.6	7.4
Domestic models	21.9	6.9	22.7	20.1	-7.8	11.1	4.3	6.4
Foreign models	22.0	-4.0	-1.0	-65.4	37.5	0.0	14.3	13.8

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, 1.1 per cent per year.

4/ Excluding the remaining $1.2 billion, annual rate, of voluntary army pay increase, 4.0 per cent per year.

Industrial production. Industrial production is tentatively estimated to have increased about .8 per cent further in December, the same rise as in November. The index was up 3.0 per cent from a year earlier, but for the year as a whole averaged about .4 per cent below 1970.

Half of the estimated rise in December was attributable to the post-strike recovery in coal production, and there was a further increase in output of steel. Manhour data also suggest a further moderate rise in production of business equipment and some materials, including lumber, textiles and chemicals. Auto assemblies were at an annual rate of 8.6 million units, compared with 8.7 in November. January schedules suggest a drop to an 8.4 million unit rate. Production of most other consumer goods is now estimated to have changed little in December.

Unit auto sales. Sales of new domestic type autos fell 18 per cent from November to December, to an annual rate of 7.8 million units after three consecutive record months when sales averaged 9.7 million units. Sales were strongest in the final 10 days of December, however, at a rate of 8.8 million units. This reversal of the downward trend of 10-day sales which began after October is attributable to a sales incentive program at Chevrolet.

December sales of foreign cars were at an annual rate of 1.1 million units, down 25 per cent from November and 20 per cent from a year ago. The large decline apparently reflected in part shortages stemming from the dock strikes.

For the year 1971, new auto sales totaled a record 10.2 million units--8.7 million domestic type and 1.5 million imports.

Labor market. Both employment and unemployment changed little in December. The unemployment rate edged up 0.1 percentage points to 6.1 per cent, seasonally adjusted, with the rates for most groups also showing little changes. The rate for white workers fell slightly, while the volatile Negro unemployment rate moved up to 10.3 per cent, about the rate in early autumn. The civilian labor force increased 175,000, and was 1.7 million above a year earlier.

Nonfarm payroll employment increased over 120,000 in December, but after adjustment for workers returning from strikes the level was up only slightly. The largest increase was in coal mining, where 80,000 strikers returned to work. Manufacturing employment fell by over 50,000, after increasing 40,000 in November, and was 250,000 below a year earlier. Among nonmanufacturing activities, employment in December increased in trade, services and State and local government.

On the stronger side, average weekly hours of factory workers rose 0.2 hours to 40.3 in December due mainly to increases in the metals industries.

LABOR FORCE, EMPLOYMENT, AND UNEMPLOYMENT
(Seasonally adjusted, in millions)

	1970	1971		
	December	May	November	December
Civilian labor force	83.6	84.2	85.2	85.3
Total employment	78.5	79.0	80.0	80.1
Unemployment rate (per cent)	6.2	6.2	6.0	6.1
Nonfarm payroll employment	70.3	70.8	71.0	71.1
Manufacturing	18.8	18.7	18.6	18.5

Earnings. As was expected, the ending of the freeze led to a sizable jump in hourly earnings as retroactive and deferred increases became effective. Hourly earnings of production workers on private nonfarm payrolls increased 3 cents to $3.51 in December after showing little change during the freeze period. Since a year ago, average hourly earnings in the nonfarm sector have increased 6.1 per cent; this compares to a peak year-over-year increase of 6.9 per cent in May. In manufacturing, average hourly earnings increased 8 cents in December to $3.68, primarily due to the granting of deferred wage increases. Other large earnings increases occurred in mining, largely reflecting the recently signed coal miners contract.and in transportation, where a new railroad contract took effect.

AVERAGE HOURLY EARNINGS OF PRODUCTION
AND NONSUPERVISORY WORKERS

	Oct-Nov.	Nov-Dec.	Dec. 1970-Dec. 1971 (Per cent change)
	Change in cents, seasonally adjusted		
Private nonfarm	0	3	6.1
Manufacturing	0	8	6.3
Mining	-2	40	8.3
Construction	1	3	8.2
Transportation & p.u.	2	6	9.5
Trade	-1	3	5.5
Finance	-1	3	5.7
Services	1	1	4.5

Retail sales. Sales in December are estimated to have declined about 1 per cent from November, on the basis of weekly data through January 1. However, exclusive of automotive and nonconsumer items, sales are estimated to have changed little. Sales were apparently down in the general merchandise as well as in the automotive group. These estimates are more tentative than usual because of the volatility of sales around Christmas. For the fourth quarter total sales are estimated to have increased 1.8 per cent, less than in the second and third quarters. But prices also increased less rapidly in the fourth than in the preceding quarters.

RETAIL SALES
Percentage change from previous quarter

	QI - II	QII - III	QIII - IV
Total sales	2.5	2.6	1.8
Automotive	5.5	7.5	1.9
Furniture & appliances	.1	-.5	5.2
General merchandise	2.6	3.3	1.9
Total, excluding auto and nonconsumer items	1.8	1.3	1.5
Total, real*	1.4	2.0	n.a.

* Deflated by all commodity CPI.

Consumer credit. The increase in consumer instalment credit outstanding during November--$15.2 billion seasonally adjusted annual rate--was the largest on record, exceeding the peak of $12.0 billion reached in September. Autos accounted for $6 billion of the November increase; other consumer goods and personal loans accounted for most of the rest. In the 4-month period since auto sales began to rise and economic controls were introduced, instalment credit has risen at an average rate of more than $12.0 billion compared with a rate of $7.3 billion in the four months preceding August.

During 1970 the rise in instalment credit amounted to only $3.0 billion, in part because the G.M. strike in the fourth quarter led to a contraction in auto credit. The record rise was $9.0 billion in 1968; in the first 11 months of 1971, the rate of expansion was $7.8 billion.

<u>Manufacturers' orders and shipments</u>. New orders for durable goods rose 4.3 per cent in November. Even excluding steel and the volatile defense component, November orders were a substantial 3.6 per cent above October. Capital equipment orders increased, after two quarters of little improvement, and orders for household durables were also higher. The October-November average was 0.7 per cent above the third quarter, despite rather large declines in motor vehicle and defense orders.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
Per cent changes

	November from October (preliminary)	October-November average from Q III average (preliminary)
Durable goods, total	4.3	.7
Excluding steel and defense	3.6	.8
Primary metals	7.7	6.5
Motor vehicles and parts	1.9	-7.2
Household durables	10.8	4.8
Defense products	2.0	-9.2
Capital equipment	4.6	5.8

Shipments of both durable and nondurable goods also rose briskly in November, following several months of stagnation. Unfilled orders for durable goods rose 0.6 per cent.

Inventories. Book value of manufacturers' inventories was unchanged in November, after rising at a $5.7 billion annual rate in October--somewhat more than had been indicated earlier. The October-November average increase of $2.7 billion was larger than in the third quarter, when stocks were being liquidated. Producers in November continued to reduce materials stocks and to build up stocks of end products.

CHANGES IN BOOK VALUE OF MANUFACTURERS' INVENTORIES
(Seasonally adjusted annual rates, $ billions)

	1971		
	Q III	October (Rev.)	November (Prel.)
Manufacturing, total	-1.1	5.7	- .2
Durable	-1.0	- .8	.0
Materials*	-1.7	-1.2	-1.0
End products	.7	.4	1.0
Nondurable	- .0	6.5	- .2

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

Shipments increased fairly sharply in November and the inventory-sales ratio declined from 1.75 in October to 1.70 in November, the lowest ratio since June. The durable goods inventory/backlog ratio also declined, but is still quite high.

Cyclical indicators. The Census preliminary trend adjusted leading composite rose 0.2 per cent in November. While increases in the leading series have slowed since earlier this year, the November levels are above those of three months earlier and are consistent with further economic expansion in coming months. The coincident composite rose 0.6 per cent and the lagging composite--the least reliable measure--was about unchanged.

COMPOSITE CYCLICAL INDICATORS, NOVEMBER 1971

	Per cent change from: Previous month	Per cent change from: Three months earlier
12 Leading (trend adjusted)	.2	1.6
5 Coincident	.6	1.6
6 Lagging	-.1	.3

Construction and real estate. Seasonally adjusted outlays for new construction, revised up slightly to a new high for October and November, were little changed in December at an annual rate of $113.1 billion. Private construction was unchanged but public construction declined slightly. The total was 10 per cent above a year earlier, with most of the rise reflecting higher costs. However, as measured by the Census index, average costs have remained essentially stable since August.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	December 1971 ($billions)1/	Per cent change from	
		November 1971	December 1970
Total	113.1	--	+10
Private	83.2	--	+18
Public	29.9	-2	-6

1/ Seasonally adjusted annual rates, preliminary. Data for December are confidential Census extrapolations. In no case should public reference be made to them.

Seasonally adjusted private housing starts accelerated to a record annual rate of 2.3 million units in November. With commitments and building permits still exceptionally high, starts in December may have held at or even somewhat above the November rate. If so, the fourth quarter average might exceed the unprecedented 2.16 million unit rate of the third quarter and the 1971 total would exceed 2 million for the first time. In October, home sales by merchant builders were at about the advanced third quarter rate with the median price of new homes sold--$25,300--more than $3,000 higher than a year earlier.

PRIVATE HOUSING STARTS AND PERMITS

	November 1971 (Thousands of units)1/	Per cent change from:	
		October 1971	November 1970
Starts2/	2,316	+15	+37
Permits	1,961	-10	+32

1/ Seasonally adjusted annual rates; preliminary.
2/ In addition to starts, mobile home shipments for domestic use were at a seasonally adjusted annual rate of 526,000 units in October, the latest available. This was 6 per cent below the record September rate, but 23 per cent above a year earlier.

Phase I consumer price developments. Consumer prices rose in November at a 2 per cent annual rate, seasonally adjusted, due mainly to a sharp increase in food prices.

From August to November the rate of price rise slowed to an annual rate of under 2 per cent, in spite of lags in the index. Nonfood commodity prices leveled off in this period and service costs rose at substantially reduced rates. The indexes excluding mortgage and home financing costs, respectively, show rates of rise under 2 per cent from August to November in contrast to much higher rates earlier in the year.

According to a BLS rough confidential estimate, items in the index not exempt from the freeze between August and November rose about 0.5 per cent--0.1 per cent more than the total, or at an annual rate of about 2 per cent. The exempt items include raw foods, mortgage rates and taxes, including the auto excise tax. The increase in the CPI was revised down by 0.1 point in both August and September by the retroactive repeal of this tax (and the October level of the index was lowered by 0.2 point from the figure originally published.)

CONSUMER PRICES

(Percentage change, seasonally adjusted annual rates)

	Dec. 1970 to June 1971	June to Aug. 1971	August to Nov. 1971	October to Nov. 1971
All items	4.0	3.3	1.7	2.1
Excl. auto tax refund	--	3.8	2.0	--
Food	6.2	1.0	1.7	8.4
Commodities less food	3.0	2.6	0.0	0.0
excl. auto tax refund	--	3.6	0.3	--
Services 1/	4.2	5.7	3.1	3.8
Addendum:				
All items less mortgage costs 2/	5.0	3.5	1.3	1.0
Services less home finance 1/ 2/	7.4	4.9	1.9	1.9

1/ Not seasonally adjusted

2/ Confidential: Home financing costs excluded from services reflect property taxes and insurance rates as well as the mortgage costs, which in turn move with mortgage interest rates and house prices. The index for property taxes rose nearly 5 per cent between June and November.

Phase II price developments. The Price Commission has received about 3000 applications for price increases from the 1500 large firms required to pre-notify and has approved over 150. According to confidential information, the approvals average below 3 per cent when weighted by appropriate sales categories. Many commodity price increases will not be fully implemented until demand strengthens. A general rent increase of 2.5 per cent has been authorized with larger increases for long-term leases.

Major producers cut prices of large volume steel products by $5 to $8 a ton this past week, effective immediately. The largest volume item cold-rolled sheet, was cut $5; for this item, the cut amounts to a substantial portion of 8 per cent rise scheduled for February 1. Reasons given for the cuts include pressure from auto makers and foreign competition.

As a result of exchange rate re-alignment, prices of domestically produced small cars are now very close to those of major imports--and in some cases lower.

THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Interest rates have declined by as much as another half percentage point since the last meeting of the Committee, particularly in short-term markets where the size and character of System operations have added to reserve availability and led market participants to expect more aggressive policy stimulation. A special factor contributing to the sharp drop in short-term rates was the failure of foreign central bank liquidation of Treasury bills to materialize in the large volume anticipated. In corporate and municipal securities markets the holiday lull in new offerings augmented rate declines, but in the market for longer maturity Treasury issues, above normal market inventories continued to inhibit declines.

With other short-term rates declining and business loan demands still slack, major banks cut the prime rate to 5 per cent. Funds available to banks and other depositary institutions remained ample, as reduced market rates continued to encourage substantial growth of time and savings deposits. These flows provided strong continuing support for the mortgage market. Banks also added significantly further to their holdings of State and local government securities and participated actively in the heavy December volume of Treasury cash financing through additions to tax and loan accounts. While both the bank credit proxy and M_2 grew rather rapidly in December, the narrowly defined money stock showed only a small growth and was close to the average level in August.

Outlook: U. S. Government demands for funds, although expected to remain unseasonally large in the first quarter, are projected to be less than half their fourth quarter volume. The high year-end Treasury balance should permit deferral of further Federal borrowing until the February refinancing. But in that operation the Treasury will need to raise some new money and may decide to include another advance refunding. Debt ceiling constraints are likely to limit the amount of new February cash borrowing and thus to force a sharp run-down in the overall Treasury balance.

Business financing in the public bond market appears to be expanding again in January, as large utility and financial corporations take advantage of reduced interest costs and seasonal reinvestment flows. However, with private placements rising, stock offerings remaining large, and scheduled bond financings of industrial corporations relatively light, the volume of corporate public offerings seems likely to taper off somewhat as the quarter progresses. Similarly, although security offerings of State and local governments can be expected to continue on the high side, fragmentary evidence on the forward calendar suggests that they too may slacken for a time relative to the fourth quarter.

Weakness in business borrowing at banks appears to be persisting, and recent cuts in the prime rate suggest that bankers see little immediate prospect for strengthening of such borrowing. While the economic projection is for more rapid growth in nominal GNP during the current quarter, inventory expansion is expected to continue moderate and corporate generation of internal funds large. Hence the need for expanded business borrowing at banks may be quite modest.

At both bank and nonbank thrift institutions growth of time and savings deposits other than large CD's seems likely to be sustained at a fairly high level during the quarter. Although recently there have been some scattered cuts in rates on deposits at banks, the average spread of such rates over those on market securities has widened further. Expansion of private demand deposits at banks also seems likely to pick up during the quarter, reflecting the expected run-down of Treasury cash balances, lagged affects of the sustained decline in interest rates since mid-August, and the anticipated strengthening of economic activity.

Some further decline in long-term rates seems probable because of the continuing ample availability of funds at financial institutions and the projected dip in capital market financing. If the Treasury should include a sizeable advance refunding in the February refinancing, however, this could tend to brake the extent of such declines. While any massive foreign central bank liquidation of Treasury bills would also tend to generate some offsetting upward rate pressures--particularly in the bill market--the odds now seem to favor a more gradual and smaller foreign liquidation than market participants had anticipated. A modest increase in short-term rates probably could be largely absorbed by a narrowing of rate spreads given the positive influences present in the long-term rate outlook. Any sizeable advance in short-term rates, however, might well lead to a shift in market expectations and force increases in long-term rates as well.

Monetary aggregates. Preliminary estimates indicate that M_1, after remaining essentially unchanged in the previous two months, rose somewhat in December, to about the August level. In contrast, however,

M_2 and M_3 increased at a fairly rapid pace, exceeding the expansion in October and November. The gains in M_2 and M_3 reflected large inflows into thrift accounts at commercial banks and savings institutions as the decline in market interest rates continued to enhance the attractiveness of interest-bearing deposits.[1/]

The adjusted credit proxy continued to rise at a fast pace in December, with growth exceeding the accelerated November rate. A significant component of this increase, in addition to the expansion in consumer time and savings deposits, was a further advance in U. S. Government deposits as the Treasury accumulated balances in anticipation of large redemptions of special issues by foreign central banks following realignment of exchange rates. As U. S. interest rates declined, banks increased their issuance of CD's, repaying a large volume of relatively high cost Eurodollars.

1/ Continued strength in this sector is suggested by partial data for the current dividend-reinvestment period which indicates that deposit attrition at nonbank thrift institutions is only a little above the reduced rate of last year, when the demand for interest bearing deposits was especially strong.

MONETARY AGGREGATES
(Seasonally adjusted changes)

	1971 QI	QII	QIII	QIV	Nov.	Dec.
	Annual percentage rates					
1. M_1 (Currency plus private demand deposits)	9.1	10.6	3.7	1.1	--	2.6
2. M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	18.1	12.4	4.4	7.9	6.5	9.9
3. M_3 (M_2 plus savings deposits at mutual savings banks and S&L's)	19.0	14.7	7.4	9.5	8.7	10.5
4. Adjusted bank credit proxy	10.9	8.4	7.6	9.5	11.2	12.4
5. Time and savings deposits at commercial banks						
a. Total	28.8	14.7	8.2	15.9	9.1	20.8
b. Other than large CD's	27.5	14.0	5.3	14.7	13.0	17.0
6. Savings deposits at mutual savings banks and S&L's	23.3	17.3	12.8	11.5	10.8	11.7
a. Mutual savings banks	17.7	15.0	8.5	9.7	9.7	10.9
b. Savings and loan associations	26.0	18.4	14.9	12.3	11.3	12.0
7. Other commercial bank aggregates						
	Billions of dollars					
a. Negotiable CD's (monthly or monthly average)	.9	.4	.8	.6	- .5	1.3
b. Nondeposit sources (monthly or monthly average, not seasonally adjusted)	-1.5	- .9	- .1	--	.6	-1.4
c. U. S. Government deposits (monthly or monthly average, seasonally adjusted)	- .4	.3	.5	- .3	.7	.4

Bank credit. Total bank credit rose at an annual rate of about 12 per cent from the end of November to the end of December with security acquisitions accounting for most of the increase. Bank holdings of U. S. Treasury securities rose sharply--reflecting participation in the Treasury's three financing operations during the month. Moreover, with ample funds available at reduced cost, banks greatly increased their acquisitions of municipal and other securities. As in November, growth in total loans (adjusted for loan transfers with affiliates) was modest.

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

	1971				
	QII	QIII	QIV 3/	Nov.	Dec. 3/
Total loans & investments 2/	10.3	9.7	8.7	4.5	11.5
U. S. Treasury securities	11.1	-18.5	3.3	-4.1	30.6
Other securities	17.4	12.0	17.7	11.9	22.3
Total loans 2/	8.3	14.7	7.0	3.8	4.5
Business loans 2/	4.2	15.7	-1.3	-6.0	-1.0
Real estate loans	14.0	13.7	13.2	13.6	13.5
Consumer loans	5.5	13.3	13.6	15.8	13.3

1/ Last-Wednesday-of-month series.
2/ Includes outstanding amounts of loans reported as sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
3/ Changes based on incomplete data and may be subject to substantial revision.

The December pattern of loan changes in most major categories was generally similar to that since September: real estate and consumer loans continued to expand sharply, and loans to businesses and nonbank financial institutions remained weak. On the other hand, loans to foreign banks, which had declined since August, rose throughout the month and security loans declined somewhat.

The continued weakness in business loans in December was broadly based by industrial category. However, some strength was shown at large banks in bankers acceptances and foreign business loans. It is not entirely clear why foreign loan demand--including the increase in loans to foreign banks--picked up again in December. However, the increase probably reflected the relative attractiveness of U. S. interest rates, together with the easing of the VFCR guidelines in mid-November, particularly the exemption of direct and indirect export credits from any limitation.

Short-term markets. Short-term interest rates have declined substantially since the last Committee meeting, partly in response to more aggressive System reserve injections. In addition to some outright purchases of Treasury securities, the System made large amounts of re-purchase agreements at rates below the usual level, reinforcing anticipations of even greater ease in money market conditions. Another factor influencing Treasury bill yields was the absence of previously anticipated heavy foreign liquidation of bills. Not only was the reflow of dollars smaller than the market had anticipated, but it was accomplished through foreign central banks' redemption of special issues at the Treasury rather than through sales of bills.

SELECTED SHORT-TERM INTEREST RATES
(Per cent)

	1971 Dec. 14	1972 Jan. 5	Change
Federal funds (wkly. averages)	4.20	3.57	-.63
Treasury bills			
3-month	4.06	3.69	-.37
1-year	4.52	4.05	-.47
Federal agency, 1-year	4.97	4.67	-.30
90-119 day Commercial paper	4.75	4.25	-.50
60-89 day CD's	4.50	3.94	-.56
Predominant bank prime rate	5-1/4	5.00	-.25

In this atmosphere, the auction of an additional $2.5 billion of Treasury tax bills on December 22 did not result in an increase in bill rates. Indeed, bill rates continued to decline through the week ending January 5.

Other short-term rates also have declined recently, ranging from one-quarter to five-eights of a percentage point. In contrast with the increased volume of financing in the bill sector, short-term financing by Federal agencies was light in December. While preliminary figures indicate some increase, after seasonal adjustment, in outstanding non-bank commercial paper in December, final November data show a $933 million seasonally-adjusted decline, a much sharper decrease than the preliminary estimates shown in the last Green Book.

In reflection of the marked decline in short-term yields, together with the continued weakness in loan demand, most large commercial banks reduced their prime rate to 5-1/4 per cent in mid-December and to 5 per cent in early January, the lowest level in over 6 years.

Accompanying this reduction, a large West Coast bank and several smaller banks cut their rates on savings deposits to 4 per cent.

Long-term markets. The interest rate decline since the last Committee meeting, in general, was less pronounced in long-term markets than in short-term markets. Yields on long-term Treasury issues remained about unchanged, while yields on intermediate-term Governments declined somewhat during the past four weeks. The long-term market was influenced during December by the unusually large overhang of inventories from the November refunding. Dealer stocks were reduced early in January by System purchases of about $200 million of coupon issues, but the market was somewhat unsettled by rumors of a Treasury advance refunding in February which could increase the supply of longer-term Government securities.

Yields on high-grade, newly-issued corporate bonds declined about 15 basis points during the first three weeks of December. Although there were no new issues in the public bond market during the holidays, secondary market activity remained relatively brisk. Dealers were able to reduce inventories at declining yields given the light corporate calendar, the sharp decline in short-term rates, and expectations of further cuts in the discount and prime rates. Yields continued to drift downward during the first week of the new year in spite of heavy new issue volume. The staff estimates that public bond offerings, which dropped to $1.3 billion in December, will return to the $2 billion level in January. Private placements, which rose throughout 1971, will be boosted in January by partial takedowns of the debenture portion of the recently announced AT&T financing.

SELECTED LONG-TERM INTEREST RATES
(Per cent)

	New Aaa corporate bonds 1/	Long-term State and local bonds 2/	U.S. Gov't (10-year constant maturity)	Home Mortgages Primary market 3/	Home Mortgages Secondary market 4/
1971					
Low	6.76	4.97	5.42	7.55	7.32
High	8.23	6.23	6.89	7.95	8.07
Month of:					
October	7.29	5.06	5.93	7.80	7.84
November	7.19	5.20	5.81	7.75	7.71
December	7.09	5.21	5.93	n.a.	7.62
Week of:					
December 3	7.18	5.44	5.92	--	7.66
10	7.08	5.23	5.92	--	--
17	7.03	5.21	5.94	--	7.62
24	--	5.13	5.99	--	--
31	--	5.02	5.89	--	7.62
1972					
January 7	7.00	5.03	5.93	--	--

1/ With call protection (includes some issues with 10-year protection).
2/ Bond Buyer (mixed qualities).
3/ FHA series for conventional first mortgages on new homes.
4/ FNMA auction results for 4-month purchase commitments.

New stock issues in December at $1.4 billion, were almost double the total estimated in the last Green Book, as a substantial rise in stock prices over the month stimulated increased offerings, including some issues which had been on the calendar since late summer. January stock volume is expected to be close to the $1 billion level. This total includes about $300 million of AT&T preferred stock which will be placed directly with insurance companies and other institutional investors.

The greatest decline in long-term yields was on State and local government bonds. The Bond Buyer index dropped over 40 basis points during December in spite of an unseasonally high level of new issues. A major factor contributing to this decline apparently was an accelerated rate of acquisitions by commercial banks. The January and February calendars appear to be significantly below 1971 levels at this time. However, if interest rates on municipals decline much further, the pace of new issues could accelerate.

Mortgage yields also continued to decline in late 1971. During November the average interest rate on conventional new-home mortgages in the primary market declined for the second consecutive month and reached 7.75 per cent, according to the FHA series. Secondary market yields on Government-underwritten home mortgages drifted down further during the first half of December and then remained unchanged over the rest of the month, according to FNMA auction results. In anticipation of a further rise in mortgage prices, however, mortgage bankers have reportedly continued to add to their holdings of loans for which no resale commitments have as yet been obtained.

LONG-TERM SECURITY OFFERINGS
(Monthly or monthly averages in millions of dollars)

	1971			1972	
	Annual Average	Nov.e/	Dec.e/	Jan.e/	Feb.e/
Corporate Securities - Total	3,718	3,550	3,375	3,700	3,200
Public bonds	2,063	1,950	1,225	2,000	1,700
Privately placed bonds	577	500	800	700	600
Stocks	1,079	1,100	1,350	1,000	900
State and local government bonds	2,058	2,265	2,021	1,800	1,600

e/ Estimated.

Federal finance. The Treasury cash balance at the end of December was at an unusually high $11.3 billion, reflecting in part a $2.5 billion sale of tax anticipation bills for payment on December 29 (not anticipated in the last Greenbook), undertaken as a precaution in case of large redemptions of nonmarketable foreign issues. In addition, corporate tax payments in December were above projected levels and also about $.5 billion larger than those in September, which are usually approximately equal.

Redemptions of nonmarketable foreign issues just before and after the turn of the year totaled about $900 million. If there were no further such redemptions and no additional Treasury borrowing, the Treasury cash balance would be expected to drop to about $8.billion by the end of January because of seasonal cash drains and large refunds of automobile excise taxes.

Late in January, the Treasury will announce the terms of the February refunding involving $3.7 billion of publicly-held maturing securities. In view of the large cash drain that normally occurs in early February, together with the prospect for additional redemption of special issues, a cash offering in combination with this refunding appears likely. Beginning in February, Treasury debt is expected to approach the statutory ceiling and this will add still another consideration to cash balance management.

While information on the new budget, to be released late this month, is not yet available, several changes in estimates have been made since the last Greenbook due to intervening developments. Receipts are estimated lower for the current fiscal year, but the revisions in expenditure estimates are largely offsetting. The projected deficit for the current fiscal year has been raised from $28.7 billion to $30.5 billion.

On the receipts side, the import surcharge was removed effective December 20, 1971, reducing the receipts estimates by about $1.4 billion for the fiscal year. Also, income assumptions are somewhat lower than in the last Greenbook. Personal income tax relief provided in the Revenue Act of 1971 will start to be reflected in cash flows on January 16, when new withholding schedules become effective. However, the effect of tax relief will be partly offset by structural reform designed to increase the portion of taxes captured by withholdings, with correspondingly lower final payments or higher refunds in subsequent years.

On the outlays side of the budget, the expected timing of liberalization of social security benefits has been shifted from January to July 1972, since legislative action has been delayed. On the other hand, the Federal pay raise, previously projected for July, becomes effective in January.

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

	Fiscal Year		Calendar Years	
	1971*	1972 e/	1971pe/	1972e/
Federal Budget				
Surplus/deficit	-23.0	-30.5	-24.8	-31.7
Receipts	188.4	199.5	194.0	207.1
Outlays	211.4	230.0	218.8	238.8
Means of financing:				
Net borrowing from the public	19.4	26.7	24.5	24.8
Decrease in cash operating balance	- .8	2.8	-3.2*	5.3
Other 1/	4.4	1.0	3.6	1.6
Cash operating balance, end of period	8.8	6.0	11.3*	6.0
National Income Sector				
Surplus/deficit	-18.5	-22.9	-19.5	-24.6
Receipts	194.2	209.2	202.3	218.1
Expenditures	212.7	232.1	221.7	242.6
High employment surplus/deficit (NIA basis) 2/	.6	1.4	2.6	-3.9

* Actual e--estimated by F.R. Board staff. pe -- partially estimated.

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

2/ Estimated by F.R. Board Staff.

INTERNATIONAL DEVELOPMENTS

Summary and Outlook. In the final weeks of 1971 the settlement reached for a major revaluation of foreign currencies against the dollar ended a period of massive outflows of funds from the United States and set the stage for a turnaround in those flows and, over time, in the fundamental disequilibrium in U.S. trade and other international transactions. However, the immediate impact of the settlement on flows of funds was mild, and signs of underlying improvement will not be evident for a considerable time. Thus, a great deal of uncertainty will probably overhang international exchange and money markets for quite a while.

The lack of substantial reflows of capital to the United States since December 18 reflects the fact that there remains a yield advantage on foreign assets as well as a potential for further capital gains since major currencies have not moved much above their lower limits. The yield advantage diminished somewhat in early January, however, as a number of central banks (Germany, Japan, the Netherlands, Belgium and Finland) reduced their discount rates -- pattly in response to the direction of interest rates here, but such moves were also generally consistent with domestic objectives.

At the very end of the year there was not the usual year-end window-dressing inflow to the United States as direct investors appear to be taking advantage of the 60-day grace period for compliance.

In the months ahead the trade balance will probably continue to look precarious, apart from any turbulence created by the possible resumption of dock strikes. The effects of the realignments of exchange rates would at best be only partially felt within the first year. In 1972 the adverse cyclical situation will tend to raise imports and retard the potential rise in exports. The economies of other industrial countries are likely to be reviving in the course of the year but a strong growth of demand -- especially in Germany -- is by no means assured. Under those conditions traders will be more likely to adjust their prices so as to offset some of the change in market exchange rates, which has been considerably less so far than the change from old par values to the new central rates. Thus, the large basic deficit in the U.S. trade and long-term capital accounts is likely to continue and to absorb at least part of any reflow of speculative funds that might be set in motion.

Foreign exchange markets. Exchange markets have been fairly quiet since the establishment of new central rates and wider margins of variation subsequent to the Smithsonian meetings of December 17-18. Major foreign currencies generally moved to near their lower limits, 2-1/4 per cent below the central rates, except for the German mark and the Dutch guilder, which have held about mid-way between their central rates and their lower limits.

The anticipated reflow of funds to the United States has been small and slow to materialize. The central banks of Britain, Japan, France, and Canada (which still maintains a floating exchange rate) sold some $1-1/2 billion dollars in the period December 21-31, but very little after that as foreign currencies tended to strengthen after year-end. The Bank of Japan, in fact, purchased some $450 million on January 6 and 7, after Japanese authorities announced the removal of their remaining exchange control measures imposed after August 13. Other countries have also removed most or all of their exchange controls imposed after August 13, but the interest payment ban on new non-resident deposits remains in effect in several European countries.

The chief consideration tending to limit the reflow of funds into dollars appears to be the continuation of covered interest rate differentials in favor of non-dollar assets. Market interest rates and central bank discount rates in several major foreign countries have declined in recent days, but U.S. interest rates have also fallen further. Also limiting the reflow to the United States is the reported expectation of some market participants that foreign currencies, now near their lower limits, may appreciate further in the near future.

The absence of sales of dollars by foreign central banks does not mean that <u>some</u> reflow of speculative funds is not occurring. The major European countries and Japan continue to be in basic balance of payments surplus. In the absence of outflows of speculative funds, their central banks would probably be accumulating dollars.

The free market gold price has soared since December 20, reaching a new high of $45.75 at the first London fixing on January 7. Factors contributing to this rise are the expectation that the devaluation of the South African rand will reduce that country's need to sell gold, and some European press speculation that the United States may seek a larger devaluation of the dollar in the event that trade negotiations with the EEC, Japan, and Canada do not produce sufficient concessions on the part of those countries.

Euro-dollar market. Euro-dollar rates moved higher in December as compared with November in response to year-end pressures and to renewed speculative activity leading up to the agreement on realignment of exchange rates. Year-end pressures on the market were less than normal partly owing to the 60-day extension of OFDI guidelines. In the first week of January Euro-dollar rates in most maturities moved down sharply to about their mid-November levels; the gap between U.S. and Euro-market rates narrowed, but remained quited large.

However, overnight Euro-dollars became increasingly costly relative to Federal funds, and U.S. banks reduced their gross liabilities to foreign branches by about $1-1/2 billion from December 1 through December 29 to a level of less than $1 billion. Net liabilities to branches plus assets sold subject to Regulation M declined from about $4 billion in the computation period ended November 24 to about $3.1 billion the period ended December 22. We estimate that the outstanding level of such positions midway through the current computation period has declined further to about $2.4 billion.

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

Average for month or week ending Wednesday	(1) Over-Night Euro-$1/	(2) Federal Funds2/	(3) (1)-(2) Differential	(4) 3-month Euro-$ Deposit1/	(5) 60-89 day CD rate (Adj.)3/	(6) (4)-(5) Differential
1971						
December 8	5.06	4.59	0.47	6.60	4.87	1.73
15	5.11	4.20	0.91	6.50	4.74	1.76
22	6.48	3.89	2.59	6.33	4.74	1.59
29	6.60	4.08	2.52	6.28	4.21	2.07
January 5	6.01	3.57	2.44	5.67	4.15	1.52

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 rate are carried forward from the previous Wednesday; CD rates adjusted for the cost of required reserves.

Short-term interest rates in major industrial countries. Declining short-term interest rates in most of the major foreign centers in part reflect efforts to stimulate economic activity. They also reflect a desire to prevent the recent decline in U.S. rates from further widening the differentials in favor of foreign rates. However, except for Canada and Switzerland, short-term rates abroad remain distinctly above comparable yields in the United States, tending to delay returns of short-term funds to the United States.

In Germany, the discount rate reduction from 4-1/2 to 4 percent on December 23 was accompanied by a 10 percent reduction in reserve requirements, against domestic liabilities only, effective January 1.

The 3-month interbank loan rate is currently 6 percent, down 2 percentage points from its early-October level. While the avowed purpose of the latest monetary easing was to encourage capital outflows and forestall any upward pressure on the market exchange rate of the mark, seasonal pressures on bank liquidity and the sluggish pace of the economy were likely contributory factors.

Elsewhere in Europe, discount rate reductions effective January 6 in Belgium (from 5-1/2 to 5 percent) and the Netherlands (from 5 to 4-1/2 percent) were probably speeded by the German action. But the economic slowdown was certainly the major consideration behind the easing in Belgium, where the National Bank acted even though short-term market rates had risen somewhat since the last discount rate slash in September. In Switzerland, the banking system remains extremely liquid, the 3-month deposit rate has fallen to 1-1/2 percent, and banks have cut their rates on discounts of first-class commercial paper. The French call money rate continues at around 5-1/4 percent even though several easing measures were taken in early December, notably including substantial cuts in bank reserve requirements averaging about 20 percent.

By mid-December the 90-day local authority rate in Britain had dropped to 4.7 percent from its March high of 8 percent and a mid-September level of 5.4 percent. Rates declined under the influence of speculative inflows from abroad, expectations of a discount rate cut, and increased competition in rates on bank loans following reforms introduced in September.

The Bank of Japan cut its discount rate again on December 29 from 5-1/4 to 4-3/4 percent, the fourth reduction of the year, in reflection of the sluggish state of the economy. The reduction was preceded by declines in the call money rate totaling 1-1/4 percentage points since last August, and was followed by a 1/2-point drop in commercial bank prime lending rates. Canadian short-term yields, which had begun moving downward in October, declined further through most of December. The Canadian Treasury bill rate on January 5 was about 1/2 percentage point under the U.S. bill rate, a spread smaller than in the past six weeks but about the same as at the end of September. Chartered banks' secondary reserve ratios were lowered on December 31.

Balance of payments. Although there was some movement of funds out of foreign currencies into dollars immediately after the settlement reached on December 18-19, the U.S. official settlements deficit for the month of December as a whole probably approached $3-1/2 billion. This brought the deficit for the fourth quarter to nearly $6-1/2 billion, and the deficit for the year was roughly $31 billion.

During the fourth quarter major elements in the balance of payments remained heavily adverse. As noted below, the trade balance continued to register large import balances -- though data for December are not yet available. Export orders weakened in November. Capital outflows, apart from the more speculative variety, were also contributing substantially to the deficit. Foreign assets reported by banks increased over $600 million in November, and partial weekly data indicate a continuation of banking outflows on a substantial scale through December. Since direct investors were relieved of the need for year-end window-dressing their outflows of funds in the fourth quarter were probably much larger than normal. Finally, foreigners were moderate net sellers of U.S. equity securities in October, and then apparently stepped up their net liquidation to about $400 million in November.

In the early part of this year some of the banks and direct investors who were placing large amounts of funds abroad in 1971 may be under some pressure from the restraint programs, though these are now substantially more liberal. If the U.S. economy moves ahead more strongly than others, however, this, together with the change in exchange rates, should begin to moderate outflows of U.S. private capital and attract investment funds from abroad.

U.S. foreign trade. The November trade balance was a deficit but it was considerably smaller than the record deficit registered in October, largely reflecting the timing of dock strikes. Assuming that there was probably also a deficit in December, the 1971 trade balance is estimated to have been a deficit of about $2-1/2 billion, balance of payments basis, a change of $4-1/2 billion from the $2 billion surplus in 1970.

The 1971 deficit stemmed from a virtual stagnation in exports (about 1 percent higher than the 1970 level) while imports increased by about 15 percent. Increases in exports from 1970 to 1971 in agricultural commodities, commercial aircraft, and automobiles and parts to Canada were just about offset by declines in shipments of industrial materials and machinery as foreign economic activity slowed.

The gain in imports in 1971 was spread over all major categories of goods; the greatest increase was in imports of cars -- especially from Japan.

Trade movements in 1971 were so beset by "special factors" -- domestic strikes, anticipation of controls on U.S. imports, and possible changes in exchange rates -- that a true reading of our underlying rade position is difficult to determine. Advanced buying of foreign goods may have raised imports in the early part of 1971, but this increase was probably more than offset by smaller arrivals in the closing months of the year as a result of dock strikes.

Cyclical conditions here and abroad were favorable, on balance, for U.S. trade in 1971. While exports were limited by the economic slowdown in foreign industrial countries, continued sluggishness in the United States dampened imports to an even greater degree. A rough adjustment of the balance for the effects of domestic strikes and cyclical conditions would suggest that the trade deficit in 1971 might have been about $1 billion larger than actually recorded, i.e., $3-1/2 billion.

The outlook for the immediate future continues to be clouded by the threatened resumption in February of dock strikes at both East and West Coast ports. In the long run, the recently announced realignment of exchange rates will arrest the downtrend in our trade position. Without such a realignment, the trade deficit in 1972 had been projected to be about $5 billion. With the new rates the deficit is now estimated to be about $2-1/2 billion -- about the same as last year.