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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

October 11, 1972

By the Staff
Board of Governors
of the Federal Reserve System

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DOMESTIC NONFINANCIAL SCENE

October 11, 1972

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SELECTED DOMESTIC NONFINANCIAL DATA
AVAILABLE SINCE PRECEDING GREENBOOK
(Seasonally adjusted)

	Latest Data-1972			Per Cent Change From		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year Earlier
				(At Annual Rates)		
Civilian labor force	Sept.	10/6	87.0	2.6	3.0	3.0
Unemployment rate	Sept.	10/6	5.5	5.6 1/	5.5 1/	6.0 1/
Insured unemployment rate	Sept.	10/6	3.4	3.7 1/	3.7 1/	4.2 1/
Nonfarm employment, payroll (mil.)	Sept.	10/6	73.2	4.0	2.9	3.4
Manufacturing	Sept.	10/6	19.0	5.5	1.9	2.7
Nonmanufacturing	Sept.	10/6	54.2	3.4	3.2	3.6
Private nonfarm:						
Average weekly hours (hours)	Sept.	10/6	37.3	37.1 1/	37.2 1/	36.9 1/
Hourly earnings ($)	Sept.	10/6	3.68	6.6	5.5	5.7
Manufacturing:						
Average weekly hours (hours)	Sept.	10/6	40.7	40.6 1/	40.6 1/	39.6 1/
Unit labor cost (1967=100)	Aug.	9/27	119.8	2.0	1.7	1.5
Industrial production (1967=100)	Aug.	9/18	114.3	6.3	3.9	8.2
Consumer goods	Aug.	9/18	122.3	4.9	0.3	5.5
Business equipment	Aug.	9/18	103.2	11.7	2.7	5.8
Defense & space equipment	Aug.	9/18	80.2	10.6	10.2	5.1
Materials	Aug.	9/18	117.5	10.3	6.6	12.1
Wholesale prices (1967=100)	Sept.	9/6	120.4	3.5	6.5	5.0
Industrial commodities	Sept.	9/6	118.9	2.3	3.2	3.2
Farm products & foods and feeds	Sept.	9/6	124.9	9.7	16.3	10.2
Consumer prices (1967=100)	Aug.	9/22	125.6	3.0	2.9	2.9
Food	Aug.	9/22	123.9	5.8	4.9	3.9
Commodities except food	Aug.	9/22	119.9	4.0	2.3	2.0
Services 2/	Aug.	9/22	133.8	2.7	3.3	3.4
Personal income ($ bil.) 3/	Aug.	9/15	939.8	8.9	6.8	8.1
				(Not at Annual Rates)		
Plant & equipment expen. ($ bil.)	1972	9/5	89.1	--	---	9.7
Mfrs. new orders dur. goods ($ bil.)	Aug.	10/3	35.9	3.6	4.7	14.6
Capital goods industries:	Aug.	10/3	10.6	0.0	0.5	11.6
Nondefense	Aug.	10/3	9.1	0.3	1.0	21.9
Defense	Aug.	10/3	1.5	-1.7	-2.7	-26.2
Inventories to sales ratio:						
Manufacturing and trade, total	Aug.	10/13	1.48	1.50 1/	1.50 1/	1.57 1/
Manufacturing	Aug.	10/3	1.65	1.68 1/	1.67 1/	1.79 1/
Trade	Aug.	10/13	1.30	1.32 1/	1.33 1/	1.36 1/
Ratio: durable goods inventories to unfilled orders	Aug.	10/3	.888	.894 1/	.924 1/	.956 1/
Retail sales, total ($ bil.)	Sept.	10/10	37.3	-1.4	1.3	5.9
GAF	Sept.	10/10	9.9	0.1	2.5	9.4
Auto sales, total (mil. units) 3/	Sept.	10/6	11.77	4.2	16.3	-1.8
Domestic models	Sept.	10/6	10.21	5.8	16.6	-2.8
Foreign models	Sept.	10/6	1.56	-5.5	14.7	5.4
Housing starts, private (thous.) 3/	Aug.	9/20	2,457	12.2	4.6	10.7
Leading indicators (1967=100)	Aug.	9/27	145.5	2.2	2.2	13.8

1/ Actual data. 2/ Not seasonally adjusted. 3/ At annual rate.

DOMESTIC NONFINANCIAL DEVELOPMENTS

GNP is projected to have risen in the third quarter by about $24 billion or 6 per cent in real terms--a substantial gain but short of the exceptional performance in the second quarter. This slowing reflects a smaller rise in inventory investment than in the second quarter as well as a more moderate increase in consumer expenditures and an unexpected decline in defense purchases (apparently amounting to about $2.5 billion annual rate). This drop in defense outlays is probably temporary, due partly to accelerated spending in the second quarter preceding the end of the fiscal year. Price increases have been somewhat more moderate than expected and we are now projecting about a 3 per cent increase in the fixed weight GNP price index for the third quarter.

Industrial production and employment picked up as the third quarter progressed. Industrial output is tentatively estimated to have risen at around a 6 per cent annual rate in September for the second month in a row, following a fairly slow rate of growth from May through July. Nonfarm payroll jobs, including manufacturing, also rose strongly in September for the second month in a row. However, the unemployment rate continued in the 5-1/2 per cent range (5.5 per cent in September versus 5.6 per cent in August) with both employment and the labor force again showing substantial gains.

Retail sales edged off in September following increases in the previous two months. For the quarter as a whole, however, sales averaged 2 per cent above the second quarter. Following introduction of

1973 models at 1972 prices, sales of new domestic-type autos surged in the last 10 days of September, boosting seasonally adjusted sales for the month to a new 1972 high. Other indicators of business activity remain relatively strong. Business inventories were being accumulated on average in July and August at close to the second quarter rate but they continue low relative to sales. Excluding the volatile defense component, new orders for durable goods in those two months rose about as rapidly as in the second quarter, with particular strength in primary metals and motor vehicles. Private housing starts showed unexpected and probably temporary strength in August.

Recent data indicate quite moderate rates of rise in wages and prices. The adjusted index of hourly earnings in nonfarm industries increased at an annual rate of about 4-1/2 per cent in August and September--and about the same increase since January. Consumer prices rose at a 3 per cent annual rate in August, and although food prices again rose rapidly, increases in service prices slowed considerably further. The wholesale price increase in September moderated to a 3-1/2 per cent rate, following advances of about 8 per cent in both July and August, with smaller increases in industrial commodities as well as in farm products; prices of consumer foods declined somewhat.

Outlook. Staff GNP projections continue to show a significant increase in real output in the fourth quarter--about 8 per cent, annual rate. The latest consumer surveys report a marked improvement in optimism, and consumer buying power will be bolstered by the 20 per cent increase in social security benefits which took effect early this month. The fourth quarter should also be strengthened by a projected rebound in defense purchases following the third quarter drop.

The outlook for 1973 is about the same as previously projected. Outlays for capital goods are projected to continue to move up through the end of the year. Among final demand sectors, only residential construction activity is expected to slow. With inventory-sales ratios low, we anticipate a moderate but steady rise in inventory investment, with stocks growing about in line with final sales. Unemployment is expected to decline to slightly under 5 per cent by the fourth quarter of 1973. This outlook is based on the same monetary assumption adopted four weeks ago--a rate of monetary growth indexed by expansion in M_1 at an 8 per cent rate in the second half of 1972 and 6 per cent thereafter.

The staff is now projecting somewhat smaller price increases for the next several quarters than formerly, consistent with the trend toward more moderate rates of wage and price increases. Also, the rise in the minimum wage previously projected for this quarter is now assumed to be deferred until mid-1973. Costs and prices are expected to rise more rapidly next year, particularly if the control program is terminated next April, as we are still assuming. Prices, as measured by the private GNP fixed weight index, are projected to be rising at about a 4-1/4 per cent rate in the second half of next year as compared with slightly less than 3 per cent in the current half year.

STAFF GNP PROJECTIONS

Date	Change in Nominal GNP $ billion		Per cent increase, annual rate: Real GNP		Per cent increase, annual rate: Private GNP fixed weight price index		Unemployment rate	
	9/13/72	Current	9/13/72	Current	9/13/72	Current	9/13/72	Current
1971 1/	74.0	74.0	2.7	2.7	4.5	4.5	5.9	5.9
1972	102.6	101.3	6.4	6.4	3.2	3.2	5.6	5.6
1973	119.4	117.6	6.7	6.7	3.5	3.3	4.9	5.0
1972-I 1/	31.0	31.0	6.5	6.5	4.5	4.5	5.8	5.8
1972-II 1/	30.3	30.3	9.4	9.4	2.5	2.5	5.7	5.7
1972-III	26.5	24.0	6.0	6.0	3.3	2.9	5.5	5.6
1972-IV	31.6	31.5	7.9	8.1	3.0	2.8	5.3	5.4
1973-I	32.5	32.5	7.0	7.1	3.4	3.2	5.1	5.2
1973-II	28.5	28.0	5.9	5.6	3.7	3.6	5.0	5.0
1973-III	28.0	28.0	4.8	4.8	4.2	4.2	4.9	4.9
1973-IV	28.0	27.5	4.3	4.3	4.5	4.3	4.8	4.8

1/ Actual.

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	1972 Proj.	1973 Proj.	1971 IV	1972 I	1972 II	1972 Projected III	1972 Projected IV
Gross National Product	1050.4	1151.7	1269.3	1078.1	1109.1	1139.4	1163.4	1194.9
Final purchases	1046.7	1146.3	1255.5	1076.4	1108.6	1134.4	1156.4	1185.8
Private	813.9	890.3	977.7	835.5	859.2	880.3	900.4	921.2
Excluding net exports	813.2	894.4	980.0	837.6	863.8	885.5	904.2	923.9
Personal consumption expenditures	664.9	720.8	793.3	680.5	696.1	713.4	728.2	745.5
Durable goods	103.5	116.0	130.7	106.1	111.0	113.9	118.0	121.0
Nondurable goods	278.1	299.3	330.4	283.4	288.3	297.2	302.0	309.5
Services	283.3	305.6	332.3	290.9	296.7	302.4	308.2	315.0
Gross private domestic investment	152.0	178.9	200.5	158.8	168.1	177.0	183.0	187.5
Residential construction	42.6	53.0	51.1	47.3	51.6	52.8	54.0	53.4
Business fixed investment	105.8	120.6	135.6	109.8	116.1	119.2	122.0	125.0
Change in business inventories	3.6	5.4	13.8	1.7	0.4	5.0	7.0	9.1
Nonfarm	2.4	5.0	13.8	0.8	0.1	4.3	6.5	8.9
Net exports of goods and services 1/	0.7	-4.1	-2.3	-2.1	-4.6	-5.2	-3.8	-2.7
Exports	66.1	72.9	82.9	63.0	70.7	70.0	74.2	76.7
Imports	65.4	77.0	85.1	65.1	75.3	75.2	78.0	79.4
Gov't. purchases of goods and services	232.8	256.0	277.8	240.9	249.4	254.1	256.0	264.6
Federal	97.8	107.4	109.8	100.7	105.7	108.1	106.0	109.6
Defense	71.4	77.7	78.7	71.9	76.7	78.6	76.0	79.5
Other	26.3	29.7	31.1	28.7	28.9	29.6	30.0	30.1
State & local	135.0	148.7	168.3	140.2	143.7	146.0	150.0	155.0
Gross national product in constant (1958) dollars	741.7	789.4	842.0	754.5	766.5	783.9	795.6	811.7
GNP implicit deflator (1958 = 100)	141.6	145.9	150.7	142.9	144.7	145.3	146.2	147.2
Personal income	861.4	935.2	1024.0	881.5	907.0	922.1	940.8	971.0
Wage and salary disbursements	572.9	626.5	687.9	585.9	608.0	620.5	631.6	645.9
Disposable income	744.4	795.5	881.0	758.5	770.5	782.6	801.2	827.8
Personal saving	60.9	55.6	67.9	59.3	55.7	50.1	53.7	62.9
Saving rate (per cent)	8.2	7.0	7.7	7.8	7.2	6.4	6.7	7.6
Corporate profits before tax	83.3	95.3	112.4	83.2	88.2	91.6	97.5	104.0
Corp. cash flow, net of div. (domestic)	78.2	92.2	105.8	82.7	85.9	90.8	93.9	98.3
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	199.1	227.2	224.1	202.8	221.5	224.9	227.9	234.4
Expenditures	220.8	248.1	274.1	227.5	236.3	246.5	241.3	268.3
Surplus or deficit (-)	-21.7	-20.9	-30.0	-24.7	-14.8	-21.6	-13.4	-33.9
High employment surplus or deficit (-)	3.7	-2.2	-15.1	6.8	8.6	-2.4	4.0	-18.9
Total labor force (millions)	86.9	89.0	90.8	87.7	88.4	88.8	89.2	89.7
Armed forces "	2.8	2.4	2.4	2.7	2.5	2.4	2.4	2.4
Civilian labor force "	84.1	86.6	88.4	85.0	85.9	86.4	86.8	87.3
Unemployment rate (per cent)	5.9	5.6	5.0	5.9	5.8	5.7	5.6	5.4
Nonfarm payroll employment (millions)	70.7	72.7	75.0	71.0	71.8	72.5	73.0	73.6
Manufacturing	18.6	18.9	19.7	18.6	18.7	18.9	18.9	19.2
Industrial production (1967 = 100)	106.8	113.6	122.8	107.4	110.0	113.1	114.3	117.0
Capacity utilization, manufacturing (per cent)	75.0	77.3	80.7	74.6	75.3	77.4	77.7	78.7
Housing starts, private (millions, A.R.)	2.05	2.30	1.98	2.24	2.51	2.26	2.28	2.15
Sales new autos (millions, A R.)	10.13	10.76	11.10	10.55	10.05	10.30	11.43	11.25
Domestic models	8.68	9.31	9.63	9.30	8.65	8.91	9.91	9.75
Foreign models	1.45	1.45	1.47	1.25	1.40	1.39	1.52	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.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1971	1972 Proj.	1973 Proj.	1971 IV	1972 I	1972 II	1972 Projected III	1972 Projected IV
	Billions of Dollars							
Gross National Product	74.0	101.3	117.6	21.2	31.0	30.3	24.0	31.5
Inventory change	-1.3	1.8	8.4	0.4	-1.3	4.6	2.0	2.1
Final purchases	75.2	99.6	109.2	20.8	32.2	25.8	22.0	29.4
Private	61.4	76.4	87.4	13.5	23.7	21.1	20.1	20.8
Excluding net exports	64.3	81.2	85.6	16.0	26.2	21.7	18.7	19.7
Net exports	-2.9	-4.8	1.8	-2.5	-2.5	-0.6	1.4	1.1
Government	13.8	23.2	21.8	7.3	8.5	4.7	1.9	8.6
GNP in constant (1958) dollars	19.6	47.7	52.6	12.0	12.0	17.4	11.7	16.1
Final purchases	21.1	46.3	46.7	12.1	12.5	13.7	10.4	14.5
Private	22.5	40.0	43.0	8.6	11.4	12.0	11.1	11.3
	Per Cent Per Year							
Gross National Product	7.6	9.6	10.2	8.3 1/	12.0 1/	11.4 1/	8.4	10.8
Final purchases	7.7	9.5	9.5	7.9	12.0	9.3	7.8	10.2
Private	8.2	9.4	9.8	6.6	11.3	9.8	9.1	9.2
Personal consumption expenditures	7.8	8.4	10.1	5.8	9.2	9.9	8.3	9.5
Durable goods	14.4	12.1	12.7	0.0	18.5	10.5	14.4	10.2
Nondurable goods	5.2	7.6	10.4	7.0	6.9	12.3	6.5	9.9
Services	8.2	7.9	8.7	6.7	8.0	7.7	7.7	8.8
Gross private domestic investment	10.9	17.7	12.1	17.3	23.4	21.2	13.6	9.8
Residential construction	36.5	24.4	-3.6	25.2	36.4	9.3	9.1	-4.4
Business fixed investment	4.9	14.0	12.4	13.2	23.0	10.7	9.4	9.8
Gov't. purchases of goods & services	6.3	10.0	8.5	12.5	14.1	7.5	3.0	13.4
Federal	1.3	9.8	2.2	11.4	19.9	9.1	-7.8	13.6
Defense	-4.9	8.8	1.3	10.3	26.7	9.9	-13.2	18.4
Other	22.3	12.9	4.7	12.9	2.8	9.7	5.4	1.3
State & local	10.2	10.1	13.2	13.3	10.0	6.4	11.0	13.3
GNP in constant (1958) dollars	2.7	6.4	6.7	6.7 1/	6.5 1/	9.4 1/	6.0	8.1
Final purchases	2.9	6.3	5.9	6.5	6.6	7.2	5.3	7.3
Private	3.9	6.6	6.7	5.7	7.4	7.7	7.0	7.0
GNP implicit deflator	4.7	3.0	3.3	1.5 1/	5.1 1/	1.8 1/	2.5	2.7
Private GNP fixed weight index 2/	4.5	3.2	3.3	1.7 1/	4.5 1/	2.5 1/	2.9	2.8
Personal income	6.8	8.6	9.5	6.3	11.6	6.7	8.1	12.8
Wage and salary disbursements	5.7	9.4	9.8	6.9	15.1	8.2	7.2	9.1
Disposable income	8.0	6.9	10.7	4.3	6.3	6.3	9.5	13.3
Corporate profits before tax	12.1	14.4	17.9	-4.3	24.0	15.4	25.8	26.7
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	3.9	14.1	-1.4	7.4	36.9	6.1	5.3	11.4
Expenditures	8.0	12.4	10.5	9 5	15.5	17.3	-8.4	44.8
Nonfarm payroll employment	0.1	2.8	3.2	2.2	4.5	3.9	2.8	3.3
Manufacturing	3.9	1.6	4.2	0.9	2.2	4.3	0.0	6.3
Industrial production	0.2	6.3	8.1	3.5	9.4	11.5	4.1	9.3
Housing starts, private	43.1	12.2	-13.9	24.2	48.2	-39.8	3.5	-22.8
Sales new autos	21.3	6.2	3.2	-2.4	-18.6	9.9	43.7	-6.3
Domestic models	21.9	7.3	3.4	10.3	-27.9	12.0	44.6	-6.5
Foreign models	17.9	0.0	1.4	-76.8	50.4	-2.9	38.2	-5.3

1/ At compound rates.

2/ Using expenditures in 1967 as weights.

Industrial production. Industrial production is tentatively estimated to have increased at least one-half per cent further or more in September to about 115 per cent (1967=100). This marks the second month of fairly rapid increases following a slow rate of growth from May through July. Gains in output are indicated for equipment and materials with little change in consumer goods. Output in the third quarter is expected to be up at an annual rate of 4 per cent from the second quarter, compared with an 11.6 per cent rise from the first to second quarter. In September the index was 7 per cent above a year earlier.

Available production data for September indicate little change in output of durable consumer goods from levels prevailing since April. Auto assemblies in September were unchanged from the July-August rate of 8.5 million units. Production schedules for October and the fourth quarter, however, indicate an output increase of 9 per cent to about a 9.3 million unit rate. In early September, pro-

liminary data, however, suggest a further rise in production or business and some defense equipment, and a gain in output of aircraft.

Among materials, weekly data indicate that output of raw steel was up one per cent but production of paper board and crude oil was about unchanged. Further increases in output of nonferrous metals, fabricated metal products, and paper and chemical products are also indicated in the preliminary information.

Capacity utilization. Capacity utilization in manufacturing has been rising over the past year although it remains relatively low--an estimated 78 per cent in August, in comparison with 74 per cent in August of 1971.

Productivity and labor costs. Gains in industrial productivity slowed in the third quarter. The third quarter average increase in industrial unit labor cost was, however, somewhat smaller than the increase in the second quarter. The increase in unit labor costs over the past year was 2 per cent, well below the increases in the previous year. (These data are based on FR index of industrial production for output, and Labor Department wage and manhour data adjusted by FR.

OUTPUT PER MANHOUR AND UNIT LABOR COSTS
(1963=100)

	1971	1972		
	QIII	QI	QII	QIII
Output per manhour	130.4	131.9	133.9	135.2p
Unit labor costs	114.3	115.8	116.5	116.8p

Retail sales. In September retail sales were off 1.4 per cent from August, according to the advance estimate, but this decline follows two months of strong increases and the third quarter average is 2.1 per cent above the second quarter. In the third quarter, sales of durable goods were relatively stronger than nondurables with a gain of 3.0 per cent, most attributable to higher sales reported by the automotive group. Sales of nondurable goods were up 1.6 per cent, as the sales of the food group advanced 0.6 per cent and sales of general merchandise 2.6 per cent. Total sales excluding automotive and nonconsumer items were up about 1-1/2 per cent from the second quarter average.

RETAIL SALES
(Seasonally adjusted)
Per cent change from previous period

	1972					
	Months			Quarters		
	July	Aug.	Sept.	Q I	Q II	Q III
Total sales	1.5	1.3	-1.4	1.2	3.3	2.1
Durable	1.8	2.7	-3.7	.3	4.2	3.0
Auto	1.8	4.5	-5.2	-3.1	6.4	3.8
Furniture & appliance	2.7	- .3	.1	9.2	- .5	2.1
Nondurable	1.3	.7	- .3	1.6	2.9	1.6
Food	1.7	- .3	.5	1.7	3.6	.6
General merchandise	2.1	.7	- .2	2.3	2.7	2.6
Total, less auto and nonconsumption items	1.3	.5	- .3	2.1	2.9	1.5
GAAF	2.0	.5	.1	3.0	2.4	1.9

Unit auto sales. September sales of new domestic-type autos were at a 10.2 million unit rate, 6 per cent above a month earlier but 3 per cent below last September's record. Sales were buoyed by an exceptionally strong final 10 days when the 1973 models were introduced, following a weak first 20 days. In all likelihood, the extremely large number of deliveries in the last 10 days reflected orders posted before official introduction but not reported at that time. Dealer inventories were at a 41 day supply at the end of the month, a little below August levels and 15 per cent below a year earlier.

Sales of imported cars in September were at a 1.6 million unit rate, somewhat below August but 5 per cent above a year earlier. The import share was 13 per cent as compared with 12 per cent in September last year.

1972 AUTO SALES
Seasonally adjusted annual rates, in millions of cars

	Domestic-type	Foreign
1st Quarter	8.7	1.4
2nd Quarter	8.9	1.4
3rd Quarter	9.9	1.5
July	9.9	1.4
August	9.7	1.6p
September	10.2	1.6p

Retailers' purchases of durables. Data for the first three weeks of September indicate that retailers' unit purchases of major home appliances were lower than in August but above a year earlier. All appliances in the index either remained equal to or declined from August levels. Retailer purchases of TVs--including domestic label imports--were down 3 per cent from August but well above a year earlier. Radio purchases--almost all imports--were below both a month and a year earlier.

UNIT PURCHASES OF HOME GOODS BY RETAILERS
Seasonally adjusted, 1967=100

	1971	1972			Per cent change	
	Sept.	July	Aug.	Sept.	Month ago	Year ago
TVs 1/	114	142	139	135e	-3	18
Radios	83	98	80	76e	-5	- 8
Home Appliances 2/	123	125	138	129e	-8	4

1/ Includes foreign-made units sold under U. S. brand names. Foreign-made sold under foreign brands not included.
2/ Weighted average of indexes for dishwashers, driers, freezers, electric ranges, gas ranges, room air conditioners, refrigerators, washing machines and vacuum cleaners.

Consumer credit. In August, the net expansion in consumer credit outstanding under instalment and noninstalment contracts rebounded to a seasonally adjusted annual rate of $20.4 billion. This was equal to the previous high earlier this year. The upsurge in growth of instalment credit brought its annual rate of increase for the first eight months of 1972 more than 50 per cent above the rate for the full year 1971. Growth last year was close to the earlier peak in 1968.

NET CHANGE IN CONSUMER CREDIT OUTSTANDING
(In billions of dollars, seasonally adjusted annual rate)

Month	Total	Instalment	Noninstalment
1971 - Aug.	12.3	9.9	2.4
1972 - Jan.	8.4	7.6	.8
Feb.	14.7	11.6	3.1
Mar.	18.7	16.4	2.3
Apr.	14.9	13.2	1.7
May	20.4	17.3	3.1
June	17.4	15.9	1.5
July	14.9	12.3	2.6
Aug.	20.4	17.3	3.1

Extensions and repayments for all major types of instalment credit, except personal loans, were at record high seasonally adjusted rates in August. Credit extensions for nonautomotive consumer goods were elevated by continued strength in the market for conventional housing--reflecting completions and sales of new dwellings and resales of existing units--and in the mobile-home market. Extensions of auto credit, which had declined in July after rising four months in a row, jumped to a new high in August despite a drop in unit sales. The increase in auto credit reflected, to some extent, the usual lag in contract placements after exceptionally strong sales in the final 10-day period of July.

During the first eight months of 1972, total credit extended for new and used automobiles was 15 per cent above the same period of 1971. In the market for new cars, which accounts for about two-thirds of all auto credit, extensions have risen more than sales. The disproportionate growth in credit relative to sales has reflected a moderate increase in contract size, to an average of about $3,480 for new cars, and more important, a rise in the ratio of new cars financed to new cars purchased. This ratio has averaged 68 per cent so far this year, about 5 percentage points above last year's sub-normal rate, and about in line with previous expansion periods. Increased utilization of credit has been stimulated by some easing of non-rate loan terms, mainly less restrictive downpayment requirements.

Although automobile credit has been rising sharply, consumers, benefiting from a strong rise in personal income, have experienced little difficulty in meeting payments. The delinquency rate on bank loans for new and used autos in August was little changed from a year earlier, and delinquency rates at finance companies, while higher than at banks, have declined considerably from a year ago.

At finance companies, average finance rates to consumers on new car contracts have slipped to the lowest level (11.84 per cent) reported since the monthly series originated in mid-1971. Rates on used car contracts have edged up recently, but are still below year-earlier levels. The new bimonthly series for finance companies showed little change in rates on direct personal instalment loans between March and July, and declines of more than 25 basis points on purchased contracts for mobile homes and "other consumer goods." At commercial banks, the most commonly charged rates on various types of direct instalment loans to consumers leveled off in July and August after declining as much as 25 basis points, in some cases, during the first half of 1972.

FINANCE RATES ON CONSUMER INSTALMENT
CREDIT EXTENDED AT FINANCE COMPANIES
(annual percentage rate)

Month	Automobiles		Mobile homes	Other consumer goods	Personal loans
	New	Used			
1971					
July	12.10	16.69	NA	NA	NA
September	12.10	16.77	NA	NA	NA
November	12.06	16.16	NA	NA	NA
1972					
January	12.07	16.17	NA	NA	NA
March	11.92	16.32	12.57	19.73	21.21
May	11.86	16.47	12.29	19.30	21.23
July	11.84	16.57	12.26	19.43	21.24

NOTE: Data, which are customer rates, are for instalment contracts purchased from retail dealers in the case of autos, mobile homes, and other consumer goods, and for direct instalment loans in the case of personal loans.

NA - Not available.

Consumer surveys. The latest surveys by the Michigan Survey Research Center and the Conference Board indicate a marked improvement in consumer optimism. The Michigan index of sentiment for August-September was 4.7 points higher than in May, for the third consecutive quarterly gain; at 94.0 (Feb. 1966 = 100), the index has now about made up the decline of 1969 and 1970. The July-August 1972 survey by the Conference Board indicated very strong improvement from May-June in both appraisals of the present situation and expectations for the next 6 months; previous to this, expectations in this bi-monthly survey have moved unevenly for a year or so.

Most of the increase in the Michigan index was attributable to substantially more optimistic expectations about business conditions in the next 12 months and next 5 years. More households also thought that it was a good time to buy large household durables; the percentage expressing such views were already at a very high level. There was a slight decline in appraisals of present and future financial situations but replies to this question were very favorable in the previous survey.

The percentage of households with favorable responses increased by at least 2 percentage points for all five of the attitudinal questions reported by the Conference Board; although it is not unusual for the individual questions to change by this magnitude, the fact that all of the questions improved together may have important implications for future household expenditures on durable goods. Thus, even though buying plans for autos and homes declined and there was a slight improvement in purchase plans for major appliances, the outlook seems good, because buying intention questions appear less closely related to future durable goods expenditures than attitudinal data.

Construction and real estate. Seasonally adjusted value of new construction put in place rose further in September to a record annual rate of $123 billion. Residential construction continued to account for much of the rise. However, outlays for private non-residential structures approximated the improved rate reached in August despite a persistently low level of industrial plant building so far this year. Public construction outlays also increased in September, although the rise was concentrated entirely in federally owned projects.

Prices of lumber and related materials have risen sharply this year as expanded demands have continued to put additional pressure on capacity. Even so, over-all construction costs have increased only moderately and, in fact, in September they were still holding at last summer's level, according to Census Bureau measures. The average was 4 per cent above a year earlier--about half of the year-to-year rise reported for 1971 as a whole.

Seasonally adjusted private housing starts turned sharply upward in August. The rise, which may be overstated because of working-day adjustment difficulties, followed a two-month decline and was to an annual rate of 2.46 million units, back almost to the record first quarter pace. Although a decline most likely occured in September,

NEW CONSTRUCTION PUT IN PLACE
(Seasonally adjusted annual rates, in billions of dollars)

	1972				
	QII(r)	QIII(p)	July	August	Sept. 1/
Total - current dollars	121.2	121.7	120.1	121.7	123.2
Private	92.1	93.2	91.8	93.5	94.4
Residential	52.6	54.1	53.5	54.0	54.8
Nonresidential	39.4	39.2	38.3	39.5	39.6
Public	29.1	28.4	28.3	28.3	28.8
State and local	24.6	24.2	23.9	24.3	24.3
Federal	4.5	4.2	4.4	4.0	4.4
Total - 1967 dollars	88.8	88.1	87.3	88.1	89.0

1/ Data for September 1972 are confidential Census Bureau extrapolations. In no case should public reference be made to them.

indications are that the average for the third quarter as a whole at least matched the advanced second quarter pace. Meanwhile, with capacity limitations an ongoing problem in some areas, completions of new units remained under a 2 million rate through July, the latest month for which such data are available.

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

	1971	1972				
	QIV	QI	QII	June	July(p)	August(p)
Starts	2.24	2.51	2.26	2.33	2.19	2.46
1-family	1.25	1.35	1.27	1.30	1.27	1.41
2-or-more-family	.99	1.16	.99	1.03	.92	1.05
Permits	2.06	2.09	2.04	2.12	2.11	2.25
Completions	1.84	1.98	1.89	1.90	1.86	n.a.
MEMO:						
Mobile home shipments	.51	.57	.60	.60	.57	.53

p/ Preliminary.
n.a. Not available.

Manufacturers' orders and shipments. New orders for durable goods rose 3.6 per cent (p) in August, more than erasing the July decline and reaching a new high. Excluding the volatile defense component, total new orders appear to be rising about as fast in the third quarter as they did in the second, with particular strength in primary metals and motor vehicles. Orders for capital goods (non-defense) were still below the June high but above the second-quarter average, and unfilled orders for these goods continued to increase.

The backlog of unfilled orders for total durable goods rose a substantial 1.4 per cent in August, increasing for the eleventh consecutive month, following two years of decline from mid-1969 through mid-1971. But, the increase in unfilled orders was less than the increase in shipments, and the order backlog was only 2.55 months' shipments in August, near the lowest point in two decades.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
Per cent changes (prel.)

	August from July	July-August average from Q II average
Durable goods, total	3.6	1.9
Excluding defense	3.8	3.9
Primary metals	9.8	8.2
Motor vehicles and parts	-2.8	11.4
Household durables	8.2	-1.3
Capital goods industries:		
Nondefense	.3	1.1
Defense	-1.7	-29.9
Construction & other durables	6.2	2.2

<u>Inventories</u>. Book value of manufacturing and trade inventories rose at a $12.2 billion annual rate in August (p), following a downward-revised rate of increase of $4.8 billion in July. (All of the downward revision was in manufacturing.) Accumulation was reported to have increased at manufacturing establishments in August, and the rundown of retail auto stocks was less rapid than in July.

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

	1972			
	Q I	Q II	July (Rev.)	Aug. (Prel.)
Manufacturing and trade	5.8	9.6	4.8	12.2
Manufacturing, total	3.1	4.2	4.6	8.2
Durable	2.9	3.3	2.6	5.8
Nondurable	.2	.9	2.0	2.4
Trade, total	2.7	5.3	.2	4.0
Wholesale	1.0	1.9	5.0	2.4
Retail	1.7	3.5	-4.8	1.6
Durable	- .4	.9	-6.8	-2.2
Automotive	-1.1	- .5	-6.3	-2.6
Nonautomotive	.7	1.4	- .4	.4
Nondurable	2.1	2.5	2.0	3.8

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

Sales rose more rapidly than stocks and the over-all inventory-sales ratio declined from 1.50 to 1.48, the lowest since June 1966. In durable manufacturing, unfilled orders rose more than inventories and the ratio of stocks to the order backlog declined further.

INVENTORY RATIOS

	1971		1972	
	July	Aug.	July (Rev.)	Aug. (Prel.)
Inventories to sales:				
Manufacturing & trade	1.60	1.57	1.50	1.48
Manufacturing, total	1.83	1.79	1.68	1.65
Durable	2.22	2.14	1.99	1.96
Nondurable	1.37	1.36	1.30	1.29
Trade, total	1.38	1.36	1.32	1.30
Wholesale	1.23	1.23	1.23	1.20
Retail	1.47	1.45	1.38	1.36
Durable	2.11	2.06	1.82	1.76
Automotive	1.76	1.76	1.44	1.35
Nonautomotive	2.63	2.53	2.37	2.38
Nondurable	1.17	1.16	1.15	1.16
Inventories to unfilled orders:				
Durable manufacturing	.964	.956	.894	.888

Cyclical indicators. The Census trend-adjusted composite index of leading indicators rose a strong 2.2 per cent in August (p). The changes in June and July were revised down somewhat, and for the two months combined the change is now minus 0.1 per cent instead of plus 0.8 per cent.

The coincident composite index continued to rise at a relatively steady rate. The lagging composite index was revised downwards through May but upwards in June and July, reflecting mainly revisions in actual and anticipated plant and equipment spending.

Virtually all leading series increased in August--the manufacturing workweek, (p) initial claims for unemployment insurance (inverted), new orders for durable goods, housing permits, industrial materials prices, common stock prices, and the ratio of price to unit labor cost in manufacturing; contracts and orders for plant and equipment was the only series to decline. The revisions and new data so far available do not suggest major revision of the August change in the leading index.

CHANGES IN COMPOSITE CYCLICAL INDICATORS
(Per cent change from previous month)

	May	June	July	August(p)
12 Leading (trend adjusted)	1.6	- .2	.1	2.2
12 Leading, prior to trend adjustment	1.1	- .5	- .3	1.8
5 Coincident	.8	.4	.7	.8
5 Coincident, deflated	.7	.3	.6	.7
6 Lagging	.3	.9	.7	.8

Of the leading indicator components for September available so far, the monthly average of common stock prices was down but the manufacturing workweek and industrial materials prices rose slightly.

Labor market. The labor market continued to strengthen in September. Both payroll and total employment advanced by about a quarter million and the civilian labor force rose by 200,000. Total unemployment changed little, however, and State insured unemployment also showed no significant change during the month.

Employment expansion slowed considerably during the early summer months following the rapid gains of late 1971 and early 1972. In the past two months, however, there has been a strong resurgence in the growth of nonfarm payroll jobs.[1/] The August increase was revised

1/ These data have been revised to reflect the annual introduction of new seasonal factors and adjustments to new industry benchmarks. As a result, the level of payroll employment has been raised by 110,000.

upward, and the gains in both August and September were well above the monthly average of the preceding year. Manufacturing employment advanced by nearly 90,000 in September as did the number of government jobs. Employment gains in the private service-producing sector, while sizable, were below the average monthly increase recorded earlier in the year.

Average weekly hours of manufacturing workers rose by 0.1 hour in September to 40.7 hours--about the same level as in the prior four months but 1.1 hour longer than in September 1971. Average overtime, at 3.5 hours in September, was up 0.7 hour from a year earlier.

NONFARM PAYROLL EMPLOYMENT
(Seasonally adjusted, in thousands)

	Sept. 1971-May 1972	May 1972-Aug. 1972	Aug. 1972-Sept. 1972
	---------Average Monthly Change--------		
Total	219	141	241
Government	49	8	87
Private	170	132	154
Goods producing	58	80	91
Manufacturing	47	-14	87
Service-producing	112	52	63

<u>Unemployment and labor force</u>. The unemployment rate edged down by 0.1 percentage points in September to 5.5 per cent (seasonally adjusted), returning to the July level. Jobless rates for most groups showed little change, with only marginal declines occurring among adult men and women. The Negro unemployment rate, however, rose to 10.2 per cent, moving the ratio of Negro to white unemployment rates above

the historical 2 to 1 ratio. Overall, recovery in the unemployment rate has been relatively slow; the third quarter jobless rate--at 5.6 per cent--was down 0.1 percentage point from the preceding quarter, and only 0.4 percentage point below a year ago. Much of the decline in unemployment since last year has been among men aged 20 years and over, with smaller improvement for women aged 25 and over. In September, unemployment among teenagers and younger women was not significantly changed from a year earlier.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1971	1972			
	Sept.	April	June	Aug.	Sept.
Total	6.0	5.9	5.5	5.6	5.5
Men 20 years and over	4.5	4.3	4.0	3.9	3.8
Women 20 years and over	5.7	5.4	5.5	5.5	5.4
Teenagers	16.9	17.3	14.5	16.9	16.5
Household heads	3.8	3.4	3.6	3.3	3.3
White workers	5.4	5.4	5.0	5.1	5.0
Negro workers	10.4	9.6	9.4	9.7	10.2

Although the labor force expanded quite rapidly in the last half of 1971 and early 1972, the rate of growth slowed considerably during the spring and early summer. In the past two months, however, rapid labor force growth has resumed. The civilian labor force in the third quarter was up by 2.2 million from a year earlier. Slightly less than half the over-the-year increase occurred among adult women, reflecting largely a rise in their participation rate. All of the recent gains in the labor force and total employment have been among part-time workers.

Earnings. Average hourly earnings of production workers on private nonfarm payrolls (adjusted for overtime in manufacturing and inter-industry shifts) have been rising at a relatively slow pace since January and less than the Pay Board guidelines--4.6 per cent annual rate as compared with a 6.5 per cent rate prior to August 1971. Preliminary estimates indicate about a 4-1/2 per cent rate of increase in September and for the third quarter. The slowing this year has been most apparent in services and finance, and in the construction industry. In manufacturing, wages of production workers have increased at a 5-1/4 per cent rate since January--somewhat less in the latest quarter.

Compared to a year earlier the hourly earnings index in September was up 5.7 per cent, with above average increases in transportation and public utilities, mining and manufacturing reflecting sharp increases immediately following the end of the freeze.

HOURLY EARNINGS INDEX*, PRIVATE NONFARM WORKERS
(Per cent change; seasonally adjusted, annual rates)

	Sept. 1971- Sept. 1972	Jan. 1971- Aug. 1971	Jan. 1972- Sept. 1972	1972 QII- 1972 QIII
Total	5.7	6.5	4.6	4.4
Manufacturing	5.9	6.1	5.2	4.2
Mining	7.1	8.2	5.1	6.8
Construction	5.3	8.8	4.3	3.0
Transportation & p.u.	9.0	8.1	7.7	7.3
Trade	4.9	6.2	3.9	4.5
Finance	4.9	7.0	4.0	2.7
Services	4.3	5.5	2.7	2.0

* Average hourly earnings adjusted for inter-industry shifts and, in manufacturing only, for overtime hours.

Wholesale prices. Wholesale prices rose at a seasonally adjusted annual rate of 3.6 per cent from August to September--only about half as fast as in the preceding three months. The rate of increase slowed in both industrial commodities and farm and food prices.

Favorable developments in September included a less than seasonal rise in prices of consumer foods and a much reduced rise in prices of industrial materials and producer finished goods. However fuel prices continued to advance, accounting for one-third of the rise in industrials, and prices accelerated for consumer goods outside the food category.

WHOLESALE PRICES
(Percentage changes at seasonally adjusted annual rates)

	Sept. 1970 to Sept. 1971	Sept. 1971 to Sept. 1972	June to Sept. 1972	August to Sept. 1972
All commodities	3.2	5.0	6.7	3.6
Farm products 1/	.4	10.2	17.4	10.1
Industrial commodities	4.2	3.2	3.2	2.4
Crude materials 2/	3.6	7.8	10.6	-.9
Intermediate materials 3/	4.7	3.4	2.4	1.0
Finished goods 4/	3.4	2.6	3.3	3.2
Producer	4.1	2.6	2.0	1.0
Consumer	3.1	2.6	3.9	4.3

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

From November through August, materials prices had continued to rise at substantial rates--10.3 per cent annually for crude materials and 4.4 per cent for intermediate materials. But last month crude materials prices declined and intermediate materials prices increased only slightly. Prices of hides and skins advanced little further, although they are at levels twice as high as a year earlier, and plywood prices dropped. Lumber prices continued to advance, however, and non-ferrous metal prices rose, reflecting a rise in nickel.

Although construction materials prices have continued to increase in Phase II, the rise has moderated considerably since last year. The lumber and wood products component of the construction materials index rose about 10 per cent over the year ending in August, compared to 18 per cent in the preceding 12-month period. Other building materials prices, more readily constrained by the stabilization program, have risen only 1.5 per cent in the past year compared to 4.7 per cent in the previous twelve months.

Food prices have been expected to decline about seasonally this fall led by a decline in beef. The situation is uncertain, however, since beef cattle prices have firmed after a sizable decline in August.

As shown below, wholesale food prices have risen considerably faster than retail prices over the past year, and especially in recent months. Correspondingly, retail prices may be slow to move down in response to decreases at wholesale.

ANNUAL RATES
(Seasonally adjusted percentage changes)

	Aug. 1971 to Aug. 1972	May to Aug. 1972	Aug. to Sept. 1972
WPI - Consumer foods	6.0	13.7	-3.8
Meat, poultry and fish	12.4	13.3	5.7
CPI - Food at home	3.9	5.4	NA
Meat, poultry and fish	10.2	13.1	NA

NA - Not available.

Consumer prices. Consumer prices rose in August at a 3 per cent annual rate, seasonally adjusted; rates of increase over the three- and twelve-month periods ending in August were also near 3 per cent. Food prices rose almost as sharply as in July, and prices of other commodities posted substantial advances. Service costs, however, continued to rise relatively slowly.

CONSUMER PRICES
(Percentage changes, seasonally adjusted annual rates)

	Aug. 1970 to Aug. 1971	Aug. 1971 to Aug. 1972	May 1972 to Aug. 1972	July 1972 to August 1972
All items	4.4	2.9	2.9	3.0
Food	3.5	3.8	5.0	6.0
Commodities less food	4.0	2.0	2.4	4.1
Services 1/	5.5	3.4	3.4	2.7
Addendum:				
All items less mortgage costs 2/	4.9	2.9	3.3	3.1
Services less home finance 1/ 2/ 3/	6.8	2.9	2.8	1.9
Commodities less food, used cars, home purchase 3/	3.6	1.7	1.0	3.1

1/ Not seasonally adjusted.
2/ Home financing costs excluded from services reflect property taxes and insurance rates as well as mortgage costs, which in turn move with mortgage interest rates and house prices.
3/ Confidential.

Fresh vegetable prices, which fell much less than seasonally because of short harvests, contributed significantly to the seasonally adjusted advance in food prices in August. Meat prices rose somewhat further. In September, however, beef prices were down more than seasonally at wholesale, and also at retail according to Department of Agriculture estimates based on its chainstore sample (preliminary, not for publication). These estimates indicate a spread between farm and retail prices for beef below the August peak but well above that in November, 1971. Margins for pork, however, still appear low, particularly for packers.

Among other commodities, gasoline and house prices registered substantial advances as in July, again partially offset by more than seasonal declines for apparel. New car prices declined less than seasonally for the third consecutive month.

Agricultural developments. The index of prices received by farmers was unchanged from August 15 to September 15. Higher prices for milk, wheat, eggs, corn and grapefruit were offset by lower prices for cattle, cotton and potatoes. However, cattle prices firmed in late August, moving upward slightly during September and early October. Hog prices were unchanged.

September red meat production, seasonally adjusted, was unchanged from August. Beef production was up seasonally while pork production was down 4 per cent.

Influenced by strong foreign demand, primarily from the U.S.S.R., wheat and corn prices increased 15 per cent and 9 per cent, respectively, during September, falling off somewhat late in the month. Soviet corn purchases totaled 7 million tons by October 4, higher than the expected 4 million tons. The Federal wheat export subsidy to U. S. exporters was eliminated on September 22 since the domestic price was determined to be competitive on the world market.

Agricultural Finance. Total farm debt is expected to increase by $5.3 billion (8.5 per cent) during 1972, according to preliminary USDA estimates. This rise, which approximates that of 1971, lies between the relatively low annual increases of 6 to 7 per cent during 1968-70, when tight credit conditions depressed real estate transfer activity, and the relatively high yearly increases of 9 to 12 per cent that prevailed during the period 1962-67.

In 1971, farm-sector capital flows (real estate transfers, capital expenditures, and inventory change) rose markedly from the level of preceding years, due to a revival in farm land market activity, to increased machinery purchases, and to large additions to crop and livestock inventories. Although indebtedness rose as indicated above, the proportion of capital flows financed by borrowing did not rise appreciably. These trends appear to be continuing in 1972.

The relatively unchanged degree of reliance on internal financing in the face of easier credit conditions may reflect the favorable trend in farm income, as well as the likelihood that loan interest rates, while down from previous peaks, still appear high to many farmers.

AVERAGE INTEREST RATES PAID BY FARMERS
(Per cent)

	1966	1970	1971	1972
Short-term debt (yearly average)				
Banks	6.8	8.1	7.4	7.4p
Production credit associations	6.9	9.0	7.2	7.2p
Farm mortgage debt				
Federal land banks (July 1)	6.0	8.5	7.8	7.4
Insurance companies (first half)	6.4	9.3	8.6	8.3

SOURCE: U. S. Department of Agriculture.

DOMESTIC FINANCIAL SITUATION

SELECTED DOMESTIC FINANCIAL DATA
(Dollar amounts in billions)

Indicator		Latest data: Period	Latest data: Level	Net change from: Month ago	Net change from: Three months ago	Net change from: Year ago
Monetary and credit aggregates				SAAR (per cent)		
Total reserves		September	33.4	-0.6	3.7	7.4
Reserves available (RPD's)		September	30.9	14.1	10.1	8.5
Money supply						
M1		September	241.6	5.5	8.4	6.2
M2		September	501.8	8.4	9.3	10.1
M3		September	788.2	10.1	11.5	12.4
Time and savings deposits (Less CDs)		September	260.2	11.6	10.1	14.1
CDs (dollar change in billions)		September	40.4	1.1	3.3	8.8
Savings flows (S&Ls + MSBs)		September	286.3	12.7	15.4	16.6
Bank credit (end of month)		September	537.5	11.9	13.6	13.1
Market yields and stock prices			Percentage or index points			
Federal funds	wk. endg.	Oct. 4	5.15	.59	.54	-.17
Treasury bill (90 day)	"	Oct. 4	4.60	.78	.54	.06
Commercial paper (90-119 day)	"	Oct. 4	5.13	.13	.31	-.50
New utility issue Aaa	"	Sept. 29	7.42	.01	-.06	-.34
Municipal bonds (Bond Buyer)	1 day	Sept. 28	5.30	-.08	-.13	.06
FNMS auction yield	wk. endg.	Oct. 2	7.69	.06	.07	-.16
Dividends/price ratio (Common stocks)	"	Sept. 27	2.82	.01	-.08	-.31
NYSE index (12/31/65=50)	end of day	Oct. 3	60.46	-.88	.95	5.66
Credit demands			Net Change or gross offerings			
			Current Month: 1972	Current Month: 1971	Year to Date: 1972	Year to Date: 1971
Business loans at commercial banks		September	0.6	1.1	9.9	6.4
Consumer instalment credit outstanding		August	1.4	0.8	9.3	4.0
Mortgage debt outst. (major holders)		August	5.7e	4.6	35.5e	25.7
Corporate bonds (public offerings)		August	2.0e	3.2	23.9e	29.4
Municipal long-term bonds (gross offerings)		August	1.7e	2.1	17.7e	18.9
Federally sponsored Agcy. (net borrowing)		September	0.2e	0.4	1.8e	-0.2
U.S. Treasury (net cash borrowing)		October	3.6e	1.1	7.0e	13.7
Total of above credits			15.2	13.3	105.1	97.9

e - Estimated

DOMESTIC FINANCIAL SITUATION

Market yields have generally fluctuated in a quite narrow range since the last Committee meeting despite some further increase in the Federal funds rate. Market yields had increased considerably from mid-August to mid-September, a factor contributing to a general increase in the prime rate by one-fourth of a percentage point to 5-3/4 per cent in early October.

The uneasiness that characterized financial markets a month ago now seems to have dissipated as the technical position of bond dealers has improved and as peace rumors became widespread. Government, corporate, and municipal security dealers reduced their security holdings, although there are market reports that more recently corporate and municipal bond dealers are increasing their holdings of bonds acquired in the secondary market in anticipation of a rally they expect to follow announcement of a peace settlement in Vietnam.

Primary mortgage interest rates have shown little net change recently, as inflows of consumer interest-bearing deposits to thrift institutions and banks remained large while mortgage commitments continued at record levels. Consumer credit expansion also apparently remained large in September after a record increase in August. However, business loans at banks expanded only moderately, largely in reflection of a surprisingly small volume of borrowing over the tax date as corporations paid an unusually large volume of their September taxes from their liquid assets holdings.

Outlook. The Treasury is expected to make large demands on financial markets over the next six months, with the staff anticipating about $10 billion of net cash borrowing in the current quarter followed by $11 billion in the next quarter. These expanded financing needs are likely to coincide with projected sizable growth in business loan demands, thus exerting upward pressure on rates. Such pressures--which are likely to be greater in short- and intermediate-term market sectors, than in long-term--may be relatively modest in the immediate weeks ahead, but are likely to increase over the quarter as non-bank investors absorb a significant share of the new Treasury issues.

While commercial bank liquidity remains relatively high, rising loan demands will not only limit bank participation in Treasury financings, but could also lead to reduction in bank liquidity and a continued high rate of CD sales. Both high CD sales and reduced holdings of liquid assets would contribute to upward rate pressures in short-term markets--particularly during the forthcoming period of large Treasury financing demands.

In long-term markets, the volume of corporate and municipal bonds coming to market is expected to decline. The cut-back in corporate bond offerings expected this quarter is largely attributable to the sharply reduced volume of industrial bond financing and reduced bond issues by public utilities, which are expected to continue raising a large share of their capital market needs in equity markets. The general dampening of financing needs of State and local governments appears to reflect their anticipation of revenue sharing, as well as their improved financial positions. In the mortgage market, a seasonal slackening in mortgage formation together with a continued large inflow of funds to mortgage lenders should also contribute to relative rate stability of primary mortgages, although rising short-term market rates might lead to some further increase in mortgage rates in the secondary market.

Monetary aggregates. Preliminary data indicate that M_1 during September grew at an annual rate of 5.5 per cent--the same as in August. The pattern of developments within the two months, however, was noticeably different. From late July through early September, M_1 showed almost persistent week-to-week expansion, but after the first week of September, it declined absolutely. In fact, the level of M_1 in the last week of September was no higher than in the last week of August. The reasons for the general weekness of M_1 after early September are not clear, although it may be attributed in part to the larger-than-expected build-up in Government deposits. There is also some indication--noted below--that large corporations relied more heavily than usual on liquid assets, presumably including cash balances, to finance September quarterly tax payments.

Even with the August-September slowdown, M_1 is now estimated to have expanded at an 8.5 per cent rate in the third quarter. For the second and third quarters combined, M_1 growth has been at a 6.9 per cent rate, and over the last year the increase has amounted to 6.2 per cent.

M_2 rose at an 8.5 per cent rate in September, also about the same as in August. Despite the recent rise in yields on market instruments, growth in consumer type time and savings deposits continued strong, though receding from the high rates experienced early this year.

MONETARY AGGREGATES

(Seasonally adjusted changes)

	1972					
	QI	QII	QIII	July	August	Sept.p
	Per cent at annual rates					
M_1 (Currency plus private demand deposits)	9.3	5.3	8.5	14.2	5.5	5.5
M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	13.3	8.6	9.5	11.3	8.0	8.5
M_3 (M_2 plus savings deposits at mutual savings banks and S&L's)	15.5	10.8	n.a.	13.6	10.5	n.a.
Adjusted bank credit proxy	11.3	11.1	11.0	12.2	9.3	11.0
Time and savings deposits at commercial banks						
a. Total	14.8	15.7	13.0	11.6	13.9	13.5
b. Other than large CD's	17.1	11.8	10.0	8.5	9.9	11.5
	Billions of dollars 1/					
Memorandum:						
a. U.S. Government demand deposits	-.1	-.8	.1	--	- .7	.8
b. Negotiable CD's	-.1	3.7	3.3	1.0	1.2	1.1
c. Nondeposit sources of funds	-.3	--	.3	.1	.3	- .1

p - Preliminary and partially estimated.

1/ Month-to-month and last-month-in-quarter to last-month-in-quarter changes in averages, not annualized.

Although there was an unusually large amount of maturing CD's in September, the runoff over the tax period was smaller than had been anticipated. As a result, the seasonally adjusted net increase in outstanding CD's during September was about the same as in the previous three months. Offering rates on large CD's have continued to rise since mid-August in most maturity ranges--albeit more slowly after mid-September--whereas other short-term market rates have leveled off.

The adjusted bank credit proxy grew at an 11 per cent annual rate during September and the third quarter, approximately the same rate as in the first half of the year. The September growth rate was somewhat higher than in August, mainly reflecting the increase in government deposits.

Bank credit. June call report data indicate that commercial bank credit (last Wednesday of the month series) grew somewhat faster during the first half of 1972 than previously estimated. Most of the additional credit expansion was in real estate and business loans. Real estate loans are now estimated to have increased at approximately a 19 per cent annual rate in the first and second quarters, and business loans at an annual rate of 11 per cent in the first quarter and 8 per cent in the second.[1/]

During September, seasonally adjusted bank credit (last Wednesday of the month series) grew more slowly than in August, reflecting almost

1/ Most of the upward revision in business loans in the second quarter reflects a "miss" in staff estimates of window dressing on June 30. For the months of June and December, the all commercial bank credit series is as of June 30 and December 31; for other months it is as of the last Wednesday of the month.

SEASONALLY ADJUSTED BANK CREDIT 1/

COMPARISON OF OLD AND REVISED SERIES

(In billions of dollars)

	Total loans and investments 2/		U.S. Treasury securities		Other securities		Total loans 2/		Business loans 2/		Real estate loans	
	Old	Revised	Old	Revised	Old	Revised	Old	Revised	Old	Revised	Old	Revised
1972--Jan. 26	494.4	494.4	59.7	59.7	106.0	106.0	328.7	328.7	118.1	118.1	82.4	82.6
Feb. 23	499.5	499.5	61.0	61.0	107.1	107.1	331.5	331.5	119.0	119.0	83.3	83.9
March 29	507.0	507.8	62.2	62.3	108.7	108.9	336.1	336.6	119.9	120.2	84.4	85.2
April 26	508.5	510.1	62.4	62.6	108.6	108.9	337.5	338.5	121.1	121.5	85.4	86.5
May 31	516.3	518.6	62.8	63.1	110.7	111.1	342.8	344.4	122.2	122.6	86.6	88.0
June 30	516.3	519.8	62.8	63.2	110.0	110.6	343.5	346.0	120.8 3/	122.2 3/	87.9	89.3
July 26	520.7	524.2	61.8	62.3	110.7	111.2	348.3	350.7	122.2	122.9	89.1	90.6
August 30	528.6	532.2	61.0	61.4	111.7	112.3	355.9	358.6	124.7	125.4	90.5	92.1

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/ Beginning June 30, business loans were reduced by about $400 million as a result of loan reclassifications at one large bank.

Note: Data revised to reflect adjustments to June 30, 1972 Call Report benchmarks. Revisions for major items begin in March; revisions for some loan categories begin in January.

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exclusively a moderation in loan expansion. After allowance is made for a Federal Reserve $800 million matched sale-purchase transaction on the last Wednesday of September--which accounts for a large proportion of the increase in security loans at banks--the growth in total loans in September was at an annual rate of near 10 per cent as compared with 22 per cent over the previous two months.

COMMERCIAL BANK CREDIT ADJUSTED
FOR LOANS SOLD TO AFFILIATES 1/

(Seasonally adjusted changes at annual percentage rates)

	1972 2/							
	QI	QII	QIII		July	August	September	
Total loans and investments 3/	15.7	9.5	13.6	(13.0) 4/	10.2	13.3	11.9	(10.1) 4/
U.S. Treasury securities	10.5	5.0	-7.6		-17.1	-17.3	11.7	
Other securities	16.8	6.2	9.8		6.5	11.9	10.7	
Total loans 3/	16.3	11.2	18.8	(17.9) 4/	16.3	27.0	12.4	(9.7) 4/
Business loans 3/	10.6	7.7 5/	12.4		6.9	24.4	5.7	
Real estate loans	18.7	19.2	17.5		19.9	19.9	14.3	
Consumer loans	11.7	14.2	17.9		14.4	22.2	16.0	

1/ Last Wednesday of month series.
2/ Data revised beginning January 1972 to reflect adjustments to June 30, 1972, call report benchmarks.
3/ Includes outstanding amounts of loans reported as sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
4/ Adjusted to exclude an $800 million matched sale-purchase transaction by the Federal Reserve on the last Wednesday of September.
5/ Second quarter figures have been adjusted to exclude a reclassification of loans by a major New York City bank in June.

The slowdown in loan growth during September was concentrated primarily in business loans and loans to nonbank financial institutions. Consumer loans, which had expanded more rapidly in July and August than in the first and second quarters, continued to show rapid growth through September. All other major loan categories grew at about the same rates in September as in August.

The slowdown in business loan growth in September appears to reflect special factors associated in part with the unusually small amount of tax borrowing by corporations. As can be seen in the table for a tax date with no maturing tax bills, the aggregate of net CD runoffs and business loan expansion during the September 1972 tax period was low relative to total tax payments. As indicated earlier, corporations--with their high liquidity--apparently financed an unusually large proportion of their tax payments out of other financial assets, possibly including cash balances. Since the September slowdown appears to be a temporary aberation, perhaps a better indication of the underlying strength of business loan demands is the 12 per cent annual rate of increase in such loans over the third quarter as a whole.

In September, after two months of decline, bank holdings of short term Government securities increased on a seasonally adjusted basis. Our data do not permit identification of own account acquisitions as opposed to purchases for inventories by dealer banks, but the total increase in bank holdings is no doubt associated with a significant expansion in the market supply of bills in late August and early September. Acquisitions of municipals and other securities at banks continued to rise during September at a rate only slightly below that of August.

CORPORATE TAX PAYMENTS AND SELECTED FINANCING SOURCES

(In millions of dollars)

	September tax period				
	1968	1969	1970	1971	1972
Corporate tax payments	5,133	5,673	4,543	4,505	5,140
Tax bills used for payment of taxes	--	--	749	899	--
Net CD runoff 1/	320	258	-54	521	638
Business loans at weekly reporting banks 2/	1,034	1,007	312	924	552
Other	3,729	4,408	3,536	2,161	3,950

1/ A negative sign indicates an increase in CD's outstanding.
2/ Includes outstanding amounts of loans reported as sold outright by banks to their own holding hompanies, affiliates, subsidiaries, and foreign branches.

Nonbank financial institutions and mortgage market. Deposit flows into nonbank thrift institutions were maintained at a substantial pace during September, according to sample data. For the third quarter as a whole, the rate of deposit growth appears about unchanged from the preceding quarter. Moreover, despite the recent higher level of short-term interest rates, preliminary data indicate that the savings institutions had a favorable experience during the early days of the September-October reinvestment period.

New mortgage commitments at S&L's rose sharply during September and outstanding commitments also rose, according to preliminary data. Even with the further increase in commitments, S&L's continue to maintain a comfortable commitment-cash flow position, given the strong deposit performance, record mortgage repayment flows, and high liquidity positions. Borrowing from the FHLB's did pick up in September, however, reflecting primarily an attractive advanced program in the San Francisco District.

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

	Mutual savings banks	Savings and loan associations	Both
1971 - QI	16.3	24.6	21.9
QII	15.0	13.4	17.3
QIII	9.6	15.7	13.7
QIV	10.6	13.8	12.8
1972 - QI	14.3	23.4	20.5
QII	11.1	16.0	14.5
QIIIe	10.5	16.9	14.9
July	11.1	21.5	18.3
August p/	9.3	13.7	12.4
September e/	10.9	14.9	13.6

p/ Preliminary.
e/ Estimated on the basis of sample data.

COMMITMENTS AND CASH FLOW AT
INSURED SAVINGS AND LOAN ASSOCIATIONS
(Monthly or monthly averages)

	Loan commitments held ($ billions)	Loans in process ($ billions)	Commitments ÷ cash flow1/ (per cent)
1971 - QI	5.4	3.2	.75
QII	8.1	4.2	.94
QIII	8.3	4.9	.96
QIV	7.6	4.9	.99
1972 - QI	8.7	4.8	.98
QII	11.4	5.5	1.05
July	11.9	5.9	.99
August	11.8	6.0	.99

1/ The total of loan commitments held plus loans in process divided by the total sources of funds in the preceding three months (the current month and two previous months).

Due in large measure to the high sustained rate of savings inflows, yields on home mortgages apparently edged up only slightly in September in the secondary market, despite the further increase in the demand for credit on residential properties. In the latest FNMA auction (October 2) for forward purchase commitments on government-underwritten home loans, the average yield edged up 4 basis points to 7.69 per cent. Although this level was higher than at any time since last November, the FNMA commitment yield has risen on 7 basis points since mid-year. The volume of bids received increased sharply in the last auction as an increased number of mortgage bankers attempted to secure FNMA commitments in order to hedge against anticipated further price declines.

FNMA PURCHASE AUCTION

	Amount of total offers: Received (millions of dollars)	Amount of total offers: Accepted (millions of dollars)	Per cent of offers accepted	4-month commitments: Discount (points)	4-month commitments: Private market yield (per cent)
1972 - High	365 (5/1)	336 (5/1)	92 (5/1)	5.6 (10/2)	7.69 (10/2)
Low	69 (2/22)	45 (2/22)	42 (3/20)	4.4 (3/20)	7.54 (3/20)
Aug. 7	106	82	77	5.2	7.63
21	115	87	76	5.1	7.62
Sept. 5	221	151	68	5.2	7.63
18	296	148	50	5.3	7.65
Oct. 2	353	212	60	5.6	7.69

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 7 per cent Government-underwritten mortgages. Implicit yields shown are gross, before deduction of 38 basis point fee paid by investors to servicers.

Despite growing concern about an additional rise in secondary market yields in the period ahead, GNMA's price support program for "nonsubsidized" government-insured residential mortgages should tend to moderate any additional increase in the cost of credit paid by qualified borrowers on FHA and VA loans.[1/] With prices hovering around 95, this program--under which GNMA subsidizes the difference between the secondary market price and its administratively established buying price of 96 for new- and 95 for existing-home loans--should become more active if further price declines occur.

One significant development in the mortgage market this year has been the shift from fixed rate government-underwritten loans, many

1/ Originators are required to certify that they have not charged the borrower more than 4 or 5 points in order to be eligible to sell their loan to GNMA under the price subsidy program.

of which qualify for the GNMA discount subsidy, to high loan-to-value ratio conventional loans which carry going market rates. The market trend to high-ratio conventional financing has been stimulated by loan processing delays at FHA field offices, an abundance of funds for conventional financing, and the regulatory liberalization of the maximum size of conventional home loans at Federal savings and loan associations beyond the limits on FHA loans.[1/] Associated with this development has been a sharp rise in underwriting on private mortgage insurance that is required by FNMA and FHLBB on conventional loans with the highest loan-to-value ratios. In August, Mortgage Guaranty Insurance Corporation, the largest private mortgage insurer, reported receiving a record $371 million in applications for insurance on one- to four-family homes--14 per cent more than in July and over twice the volume received a year earlier. The shift to high-ratio conventional loans may be further accelerated after FNMA begins to issue commitments on 95 per cent conventional loans in mid-November.

1/ Federal savings and loan associations can now lend up to $36,000 on 95 per cent mortgages and to $45,000 on 90 per cent home loans. FHA-insured (Section 203) mortgages, in contrast, run up to $33,000 per unit on 1-family houses on which the loan-to-value ratio is approximately 92 per cent.

<u>Short-term interest rates.</u> Market yields on shorter-term U.S. Treasury bills have increased moderately on balance since the September FOMC meeting. A brief rally had developed in the latter part of September, but this was more than offset by a backing up of rates in recent days. A modest tightening of money market conditions, as reflected in a somewhat higher Federal funds rate and higher dealer borrowing costs, has contributed to the upward pressures on bill rates. Supply factors also were responsible, since the Treasury added $600 million to the volume of 1-year bills in the late September auction. Dealers recently have reduced their bill positions to what appear to be comfortable levels, however, and this together with the Treasury's announcement of a two-year note auction in mid-October--rather than a tax bill--has strengthened the technical position of the market.

As is typically the case, private short-term rates have shown less fluctuation than bill rates since the middle of September. The rate on 90-119 day commercial paper increased from 5 to 5-1/8 per cent on September 18 and moved up further to 5-1/4 per cent in early October. Following the September advance in the commercial paper rate, several banks with a floating prime rate raised their rates to 5-3/4 per cent. Soon thereafter, most other banks also raised their prime rates to the same level.

The Treasury announced on October 5 that it will auction $2 billion of a 2-year 6 per cent note on October 11. Payment is scheduled for October 19, with full tax and loan credit allowance. The Treasury said that it probably will sell similar type issues at quarterly intervals over the rest of the current fiscal year.

SELECTED SHORT-TERM INTEREST RATES

(Per Cent)

	1972			Basis point change
	Sept. 19	Oct. 2	Oct. 10	Sept. 19 - Oct. 10
Treasury bills				
3 month	4.64	4.51	4.74	+10
6 month	5.10	5.13	5.13	+3
1 year	5.43	5.46	5.37	-6
Federal agency				
1 year	5.74	5.78	5.74e	--
Commercial paper				
90-119 day	5.13r	5.13	5.25	+12
Large Negotiable CD's 1/				
90-179 days	5.25	5.25	5.25	--
Bank prime rate	5.50-5.63	5.50-5.75	5.50-5.75	+12

	Statement Week Ended			
	Sept. 20	Oct. 4	Oct. 11 2/	Change week ending Sept. 20 to week ending Oct. 11
Federal funds (daily average)	4.93	5.15	5.12	+19

e - Estimated
r. Because of a reporting error, this rate was revised to 5.13 from 5.00%.
1/ Rate is for closest preceding Wednesday.
2/ Average for first 6 days of the week.

Long-term security markets. Yields on newly issued Aaa utility bonds rose about 10 basis points in mid-September, as underwriters sought to clear their stocks of slow-moving new utility issues. In the last few weeks corporate bond rates have stabilized, however, reflecting underwriters' reduced concern about short-term rate developments, optimism about a possible peace settlement, and the outlook for a light public bond calendar in the fourth quarter.

In contrast, tax-exempt yields declined about 15 basis points since the last Committee meeting, bringing rates back to the mid-August level. Some moderation in the volume of new issues and a pick-up in buying by casualty companies in recent weeks have benefited this market.

Yields on intermediate and long-term Treasury securities have fluctuated within a narrow range since the preceding FOMC meeting. Rates on longer-term securities are up on balance about 5 basis points, but the Treasury bond market has been in a strong technical position over this period. Dealers have reduced their net short positions in intermediate-and longer-term issues. In addition, foreign central banks, Treasury trust accounts, and recently the Federal Reserve System have added to their holdings of Treasury coupon issues by more than $350 million.

Stock prices have shown no sustained trend since mid-August. In early October, most major stock price indices were little changed from the level prevailing two months earlier. Trading volume, on average, has been relatively light, averaging 12.3 million shares daily on the NYSE in September--a drop of one-fifth from August.

SELECTED LONG-TERM INTEREST RATES

(Per Cent)

	New Aaa 1/ utility bonds	Long-term 2/ State and local bonds	U.S. Gov't. (10-year constant maturity)
1971			
Low	7.02 (2/5)	4.97 (11/21)	5.42 (3/26)
High	8.26 (7/30)	6.23 (6/24)	6.89 (7/20)
1972			
Low	7.08 (3/10)	4.99 (1/14)	5.87 (1/14)
High	7.60 (4/21)	5.54 (4/14)	6.61 (9/29)
Week ending:			
Sept. 8	7.38	5.39	6.51
15	7.34	5.38	6.55
22	7.44	5.37	6.57
29	7.42	5.30	6.58
Oct. 6	7.44	5.22	6.54p

1/ This is the FRB new issue, Aaa utility bond index, which was described in the September issue of the Bulletin. It replaces the Aaa corporation bond index previously used in System documents.
2/ Bond Buyer (mixed qualities).
p/ Preliminary.

Corporate public bond offerings dropped to a three-year low in September. The mid-month rise in rates apparently caused some deferral in filings, and total volume for the month was only about $850 million. However, over $1.8 billion is now scheduled for October. Of this total, one-third represents issues by finance companies, which apparently need to raise more long-term capital in view of the large rise in their holdings of consumer loans. But public utilities continue to substitute stock offerings for proposed debt issues and this industry, which usually accounts for one-third to one-half of public bond volume, has scheduled less than $250 million of debt issues for November. Underwriters continue to report that industrial corporations have limited current plans to issue long-term debt. Staff estimates are that November public bond volume will be less than $1 billion.

A decline in the number of prospective borrowers appears to have slowed down the pace of takedowns in the private placement market, but new equity offerings are still being made at a rate of more than $1 billion a month, a trend which is likely to continue over the fourth quarter.

CORPORATE AND MUNICIPAL LONG-TERM SECURITY OFFERINGS
(Monthly or monthly averages, in millions of dollars)

	Year 1971	1st seven months	Aug.e/	Sept.e/	Oct.f/	Nov.f/
Corporate securities Total	3,758	3,493	2,900	2,750	3,750	2,550
Public bonds	2,065	1,685	1,500	850	1,800	800
Privately placed bonds	613	701	600	800	650	650
Stock	1,080	1,107	800	1,100	1,300	1,100
State and local government securities	2,080	2,016	1,918	1,700	1,800	1,700

e/ Estimated.
f/ Forecast.

Municipal long-term debt offerings edged downward in September to $1.7 billion, even with acceleration of a large public power offering originally scheduled for October. The staff estimates that the October total will be about $1.8 billion, which includes a $300 million New York offering and several large revenue issues. Given the strong current revenue picture for most units and the prospective receipt of revenue-sharing funds, many governments apparently have relatively low immediate needs for financing. Further moderation of the volume of general obligation issues is expected in the fourth quarter.

Federal finance. The current staff estimate of the budget deficit for fiscal 1973 is $30.5 billion, $1.5 billion less than that in the preceding Greenbook. This is the net result of a $2 billion downward revision in expenditures and a $.5 billion reduction in projected receipts based on an apparent shortfall of corporate taxes in September.

The new total of $255 billion for outlays allows for a $2 billion reduction in estimated defense spending for the fiscal year, based on lower than anticipated average monthly defense outlays in the third quarter, and the fact that committees in both the House and Senate have passed defense appropriation bills providing for less money than requested by the Administration. While a sizable backlog of orders is expected to result in an increase of defense spending over the balance of the fiscal year, recovery of all of the third quarter's shortfall is unlikely.

Pending legislation in non-defense areas could lead to higher levels of spending than we have projected, but there may be offsetting pressures in the form of a spending ceiling or the impounding of funds by the Administration. The additional spending implied by pending legislation is in the areas of veterans' education, water pollution control, social security-medicare, and social service grants. If the rigid $250 billion spending ceiling, recently passed by the House, is enacted, outlays for fiscal year 1973 would be a good deal lower than now projected without such a ceiling, but this may be accomplished in part by a shifting of expenditures into fiscal 1974 through postponements as well as bookkeeping devices.

The projected pattern of revenue-sharing underlying the current expenditure estimate provides for outlays of $2.65 billion in October and again in January (representing retroactive payments for the January-June and July-December periods), and a quarterly payment of about $1.5 billion in April. This pattern differs from that used in the last Greenbook, which assumed a $4 billion payment in October and monthly payments thereafter. However, it is consistent with the flexibility in the timing of payments permitted by law.

The end-of-September Treasury cash balance was $9.8 billion. This was only $.3 billion above that projected in the September Greenbook, because the shortfalls in receipts and expenditures tended to be partly offsetting. After allowing for the recently announced $2 billion issue of two-year notes as well as the $.6 billion addition to yearly bills scheduled for the end of October, the Treasury's remaining gross cash needs are estimated to be $9 billion for the rest of the calendar year. The next major borrowing is expected to take place in mid-November when $1.3 billion of outstanding coupon issues will mature. In addition to rolling over these maturities the Treasury is expected to raise several billion dollars of new money at that time in a cash refinancing. Prior to the mid-November financing, the Treasury cash balance is expected to decline substantially. Still further cash borrowing will be needed in early December, and may take the form of tax anticipation bills. Borrowing in the first quarter of calendar year 1973 is forecasted to be $11 billion; this unusually large amount reflects the (assumed) second retroactive revenue-sharing payment, and the payment of about 40 per cent of the enlarged personal tax refund in prospect for next year.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	Sept.	Oct.	Nov.	Dec.
Total net borrowing	0.5	2.9	3.6	3.2
Weekly and monthly bills	--	1.2	0.6	0.4
Tax bills	--	--	--	--
Coupon issues	--	2.0	--	--
As yet unspecified new borrowing	--	--	4.3	4.0
Special issues to foreigners	--	-0.5	--	--
Agency transactions, debt repayment, etc.	0.5	.2	-1.3	-1.2
Plus: Other net financial sources a/	1.3	3.0	-2.7	-1.0
Plus: Budget surplus or deficit (-)	3.0	-8.9	-3.0	-0.6
Equals: Change in cash balance	4.8 b/	-3.0	-2.1	1.6
Memoranda: Level of cash balance end of period	9.8 b/	6.8	4.7	6.3
Derivation of budget surplus or deficit:				
Budget receipts	22.7	14.6	17.6	18.9
Budget outlays	19.7	23.5	20.6	19.5
Maturing coupon issues held by public c/	1.8	--	2.1	2.3
Net borrowing by gov't-sponsored agencies	0.2	0.4	0.7	0.1

a/ Checks issued less checks paid and other accrual items.
b/ Actual
c/ In the August prefunding, $1.3 billion was exchanged for the September maturity, leaving $500 million to be redeemed in cash. Of the November and December maturities, $.9 billion and $1.1 billion were exchanged, leaving $1.3 billion and $1.2 billion to be redeemed in cash.

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

	Fiscal Year 1972*	Fiscal 1973 e/ Adm. Estimate 1/	Fiscal 1973 e/ F.R. Board	Calendar Year 1972 2/	Calendar Quarters 1972 I*	1972 II*	F.R.B. Staff Estimates 1972 III	1972 IV	1973 I	1973 II
Federal Budget					Unadjusted data					
Surplus/deficit	-23.0	-25.0	-30.5	-20.0	-10.5	5.8	-2.8	-12.5	-15.1	-0.1
Receipts	208.6	225.0	224.5	222.6	48.1	67.3	56.1	51.1	51.3	66.0
Outlays	231.6	250.0	255.0	242.6	58.6	61.5	58.9	63.6	66.4	66.1
Means of financing:										
Net borrowing from the public	19.4	n.a.	27.0	12.7	3.9	-6.0	5.1	9.7	11.2	1.0
Decrease in cash operating balance	-1.3	n.a.	2.5	5.0	3.6	-2.4	0.3	3.5	0.9	-2.2
Other 3/	4.9	n.a.	1.0	2.3	3.0	2.6	-2.6	-.7	3.0	1.3
Cash operating balance, end of period	10.1	n.a.	7.6	6.3	7.7	10.1	9.8	6.3	5.4	7.6
Memo: Net agency borrowing 4/	4.7	n.a.	n.e.	3.1	.4	1.2	0.1	1.3	n.e.	n.e.
National Income Sector					Seasonally adjusted, annual rates					
Surplus/deficit	-22.1	n.a.	-33.4	-20.9	-14.8	-21.6	-13.4	-33.9	-45.0	-41.2
Receipts	211.0	n.a.	231.0	227.2	221.4	224.9	227.9	234.4	232.6	229.0
Expenditures	233.1	n.a.	264.4	248.1	236.3	246.5	241.3	268.3	277.6	270.2
High employment surplus/deficit (NIA basis) 2/	4.1	n.a.	-16.3	-2.2	8.6	-2.4	4.0	-18.9	-26.4	-23.9

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

1/ Revised Administration estimates were disclosed by Secretary Shultz in testimony before the House Ways and Means Committee on September 18, 1972.

2/ Estimated by F.R. Board Staff.

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

4/ Federally-sponsored credit agencies, i.e., Federal Home Loan Banks, Federal National Mortgage Assn., Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.

INTERNATIONAL DEVELOPMENTS

III -- T - 1
U.S. Balance of Payments
(In millions of dollars; seasonally adjusted)

	1971	1972p/			
	Year	QI	QII	July*	Aug.*
Goods and services, net 1/	726	-1,174	-1,547		
Trade balance 2/	-2,689	-1,673	-1,929	-589	-532
Exports 2/	42,770	11,809	11,463	3,984	4,162
Imports 2/	-45,459	-13,482	-13,392	-4,573	-4,694
Service balance	3,416	499	382		
Remittances and pensions	-1,530	-389	-377		
Govt. grants & capital, net	-4,422	-944	-652		
U.S. private capital (- = outflow)	-9,782	-3,261	-145		
Direct investment abroad	-4,765	-1,266	-200		
Foreign securities	-909	-393	-344	83	93
Bank-reported claims -- liquid	-566	-518	319	-569	-127
" " " other	-2,372	-765	99	-186	22
Nonbank-reported claims -- liquid	-506	-195	60	-177	
" " " other	-664	-124	-79		
Foreign capital (excl. reserve trans.)	-4,551	1,484	2,757		
Direct investment in U.S.	-68	-360	346		
U.S. corporate stocks	849	695	164	-38	242
New U.S. direct investment issues	1,161	296	747		
Other U.S. securities (excl. U.S. Govt.)	272	76	29		
Liquid liabilities to:	-6,691	551	1,162	-1,366	820
Commercial banks abroad	-6,908	476	945	-1,338	794
Of which liab. to branches 3/	(-4,942)	(-200)	(396)	(-559)	(316)
Other private foreigners	-465	53	292	21	-70
Intl. & regional institutions	682	22	-75	-49	96
Other nonliquid liabilities	-74	226	309		
Liab. to foreign official reserve agencies	27,417	2,827	1,094	4,836	1,165
U.S. monetary reserves (increase, -)	3,065	607	-53	249	-34
Gold stock	866	544	--	--	2
Special drawing rights 4/	468	--	7	--	--
IMF gold tranche	1,350	-1	185	-5	-5
Convertible currencies	381	64	-245	254	-31
Errors and omissions	-10,927	850	-1,077		
BALANCES (deficit -) 4/					
Official settlements, S.A.		-3,434	-1,041		
" " , N.S.A.	-30,482	-3,221	-762	-5,085	-1,131
Net liquidity, S.A.		-3,272	-2,582		
" " , N.S.A.	-22,719	-3,041	-3,219	-2,973	
Liquidity, S.A. 5/		-3,985	-2,203		
" , N.S.A.	-23,791	-3,810	-2,924	-3,719	-1,951

* 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/ Not seasonally adjusted.
4/ Excludes allocations of SDRs as follows: $717 million on 1/1/71 and $710 million on 1/1/72.
5/ Measured by changes in U.S. monetary reserves, all liabilities to foreign official reserve agencies and liquid liabilities to commercial banks and other foreigners.

INTERNATIONAL DEVELOPMENTS

Summary and outlook. Improved market sentiment about the dollar since the calming of speculative activity after mid-July has carried through into the early weeks of October, following the generally amicable annual meeting of the IMF. The dollar strengthened in most exchange markets in August and September; only the yen was under upward pressure on the strength of prospects that there may ultimately be another revaluation of the yen. The improvement in market attitudes was no doubt a major factor in a turnaround in the over-all U.S. balance. It appears that there was an official settlements surplus of some $3/4 billion in the four weeks ending October 4, compared to deficits of $5.1 billion in July and $1.1 billion in August (data not seasonally adjusted).

Flows of short-term private capital through banking channels have contributed to this recent strength in the over-all balance. Claims on foreigners reported by U.S. banks, which advanced sharply in July, rose very little in August. Liabilities of the U.S. agencies and branches of foreign banks to bank offices abroad rose considerably in August and September.

The over-all liquidity balance, which does not count the increases in these bank liabilities as inflows "above-the-line," will probably show a moderate deficit in September, after a deficit of nearly $2 billion in August.

There have also been some helpful developments in identifiable elements of the current and long-term capital accounts. The most important factor for the long run was a slight narrowing of the trade deficit in August to an annual rate of $6.4 billion -- about in line with projections of slow improvement in the period ahead. Another significant development has been an upsurge of foreign investment in U.S. corporate securities. In August, net foreign purchases of U.S. corporate stocks rebounded strongly after a period of only minor inflows since March. Also, sales of new issues in foreign markets by U.S. corporations have been rising -- especially in the form of convertible issues -- and were exceptionally large in September; the proceeds of such issues are used mainly for direct investment abroad, enabling corporations to carry through investment plans with less U.S. funds. For their part, American investors were net sellers of foreign corporate stocks in August.

While recent developments are encouraging, the outcome in the period ahead continues to depend to a large extent on favorable capital flows offsetting large current account deficits. In capital markets abroad interest rates have been fairly stable in recent months, generally at levels above the lows of the first quarter, and some further rises may be generated by rising economic activity and inflationary pressures. The recent move to a more restrictive policy in Germany indicates the likely tendency of monetary policy in most European countries. If interest rates abroad should begin to move up relative to those in the United States the support to the U.S. balance of payments that has come from interest-sensitive capital flows during most of the period since mid-March could sooner or later be lost. Renewed weakening of the balance could be accentuated by confidence factors; despite improvement in September, forward quotations for the dollar against some continental European currencies continue to give evidence of market uneasiness about prospects.

Foreign exchange and Euro-dollar markets. The recovery of the dollar in the exchange markets, which had begun around mid-July, accelerated in late September following the release of U.S. trade figures for August and Secretary Shultz's proposals at the IMF meetings for reform of the international monetary system. The trend was interrupted on October 2 when the Swiss National Bank sold $208 million dollars (at a rate for the Swiss franc about one percent above par) and the market interpreted this action as indicating that several other European central banks might take the opportunity to sell dollars. (The National Bank of Belgium, pursuant to an agreement among the EEC central banks, did sell a nominal amount of dollars, and the German Federal Bank has indicated to us -- but not to the market -- that it is also prepared to sell dollars at an "appropriate" time.) When the Bundesbank raised its lending rates on October 6, the dollar eased a bit further, but subsequently has rebounded on the basis of increased speculation on a Vietnam settlement.

While continental currencies eased against the dollar in recent weeks, the Japanese yen has remained hard at its upper limit with the Bank of Japan purchasing large amounts of dollars ($700 million in September, $470 million in the first 11 days of October.) Events at the Fund meetings and developments in Japan seem to have increased expectations of another yen revaluation, and forward yen quotes have strengthened sharply since late September. Yen for delivery in December is currently quoted at nearly a 2 percent (absolute) premium over the spot upper limit; for April delivery, 6 percent.

Sterling, after having held remarkably steady around $2.44 to $2.45 since mid-July, weakened sharply ahead of the IMF meetings on rumors of an imminent return to a fixed parity. Subsequently, the uncertainty over Norway's and Denmark's entry into the EEC and the Trades Unions Conference's rejection of the Heath Government's proposal for a "voluntary" incomes policy combined to push sterling even lower. It is currently quoted at about $2.42.

The Danish krone came under heavy selling pressure in late September after the Norwegian referendum rejected Norway's entrance into the EEC, and, on September 26, the Danish central bank withdrew from the market until after the Danish referendum on October 2.

(The Prime Minister had warned that the Danish currency would have to be devalued if Denmark did not join the EEC.) In the next few days the krone was thinly traded below its lower limit, but, following the Danish "yes' vote in the referendum, the krone firmed sharply to above its central rate and the central bank resumed exchange market operations. On October 3 the Danish discount rate was lowered from 8 to 7 percent, and on October 10 Denmark announced its intention to return to the EEC narrow margins.

In the Euro-dollar market the overnight rate moved higher over the past month along with the Federal funds rate. The differential in favor of borrowing reserve-free overnight Euro-dollars in recent weeks has varied from 1/4 to 1/2 percent. The one-month Euro-dollar rate has remained virtually unchanged and equal to the one-month CD rate at 5 percent since mid-September, while the three-month Euro-dollar rate, after a jump at end-September has been near 6 percent in recent weeks, exceeding the comparable CD rate by about 2/3 percent.

U.S. bank's liabilities to their foreign branches have continued to show little change over the past month, remaining at about the level of their Regulation M reserve-free bases. However, over the four-week period ended October 4, liabilities of U.S. agencies and branches of foreign banks to foreign commercial banks have increased by about $1.4 billion.

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

Average for month or week ending Wednesday	(1) Over-night Euro-$ 1/	(2) Federal Funds 2/	(3) Differ-ential (1)-(2)(*)		(4) 1-month Euro-$ Deposit 1/	30-59 day CD rate (Adj.) 3/	Differ-ential (4)-(5)(*)	
1972 - May	3.79	4.27	-0.48	(0.47)	4.25	4.21	0.04	(1.10)
June	4.07	4.46	-0.37	(0.65)	4.82	4.50	0.32	(1.53)
July	5.20	4.55	0.65	(1.95)	5.34	4.72	0.62	(1.96)
Aug.	4.47	4.80	-0.33	(0.79)	5.18	4.73	0.45	(1.75)
Sept.	4.53	4.86	-0.33	(0.79)	5.15	4.96	0.19	(1.48)
Sept. 6	4.65	4.89	-0.24	(0.92)	5.33	4.93	0.40	(1.73)
13	4.34	4.69	-0.35	(0.74)	5.26	5.00	0.26	(1.68)
20	4.52	4.93	-0.41	(0.72)	5.01	5.00	0.01	(1.26)
27	4.74	4.98	-0.24	(0.95)	5.06	5.00	0.06	(1.33)
Oct. 4	4.62	5.18	-0.56	(0.60)	5.01	5.07	-0.06	(1.19)
11p	4.87	5.13	-0.26	(0.96)	5.16	5.07	0.09	(1.38)

1/ All Euro-dollar rates are noon bid rates in the London market; over-night 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 denomination CD's by prime banks in New York City; CD rates adjusted for the cost of required reserves.

*/ Differentials in parentheses are after adjustment of Euro-dollar rates for the 20 percent marginal reserve requirement (relevant to banks with borrowings in excess of their reserve-free bases).

p/ Preliminary.

Balance of payments. Following the end of the speculative flurry against the dollar in mid-July the official settlements balance improved markedly, probably registering a surplus on the order of $3/4 billion in the four weeks ending October 4. This shift to the better, from deficits of $5.1 billion in July and $1.1 billion in August (not seasonally adjusted) is attributable in large part to the relaxation of anxiety about the dollar generated by the actions taken before and during the annual IMF meeting to indicate support for the Smithsonian rates and initiatives in settling the issues of monetary reform and balance-of-payments adjustments. Also important, however, were the signs of some gains in the U.S. trade account (discussed below) and developments in capital markets that supported a flow of private capital to the United States.

An increased flow of foreign capital to the United States is indicated by the data for liquid liabilities to private foreigners and for transactions in U.S. securities. U.S. banks reported an increase of over $700 million in liabilities to private foreigners (mainly foreign commercial banks) in August, and in the five weeks ended October 4, there was a further increase of over $1 billion. These borrowings, largely by U.S. agencies and branches of foreign banks, reflect the hardening of short-term interest rates in the U.S. relative to those in the Euro-dollar market since July.

The overall liquidity balance, which counts these volatile flows below the line, registered a sizable deficit in August ($2.0 billion) and was probably still in deficit in September as the unfavorable balance on goods and services, remittances, and Government capital flows continued to exceed inflows of nonliquid private capital.

Capital flows connected with transactions in securities have been favorable recently. Foreign net purchases of U.S. corporate stocks moved up sharply to $240 million in August, after averaging about $30 million per month in the April-July period. In addition, as detailed on pp III-13-16, U.S. corporations have been able to sell substantial amounts of convertible bonds in foreign markets, relieving pressure on the U.S. balance of payments to the extent they substitute these funds for U.S.-source funds for direct investment abroad or employ them in the United States. This resurgence of interest in U.S. corporate securities in this period is probably associated with the generally stronger performance of the U.S. economy and the ebbing of speculation on further exchange rate changes. Possibly for similar reasons, American investors sold foreign corporate stocks on balance in August.

Foreign lending by U.S. banks was responsible for only a small outflow in August, and probably also in September, compared to an outflow of $750 million in July. At this date there is no information available on the behavior of direct-investment flows in the third quarter. Some increase in outflows by U.S. corporations for direct investment abroad over the extremely low rate of the second quarter has been expected, but heavy borrowing abroad, coupled with a considerable decline in the rate at which the companies are expanding their foreign plant and equipment expenditures, may be holding down the flow of corporate funds from the United States. Similarly, the actions taken by the Japanese authorities to make dollars available to their banks and business enterprises may be sustaining a further inflow of direct investment capital to the United States, as well as supporting other sectors of the capital account.

U.S. foreign trade. In August, the U.S. trade deficit was at an annual rate of $6-1/4 billion, (balance of payments basis), down moderately from the deficit rates of almost $7 billion in each of the preceding 3 months. Exports in August were nearly 5 percent above July, while imports rose less strongly. The July-August deficit rate of $6-3/4 billion was about in line with our current projections for the third quarter, although the levels of both exports and imports were higher than anticipated.

The August trade movements were distorted by current and earlier foreign work stoppages -- the strike by Japanese seamen during June and July and longshoremen's strikes in the U.K. and at British Columbia ports in August. Possibly both exports and imports in August were inflated. Movements of certain commodity groups were clearly affected by these stoppages. Total imports from Japan in August were about 5 percent higher than during April and May, before the seamen's strike became fully effective. Imports of finished manufactures, particularly automobiles and other consumer goods from Japan, were up sharply in August, recovering from the dip in June and July. The heavy inflow of cars from Japan was probably used to replenish some of the inventories drawn down during the period of the Japanese strike. Imports of industrial materials, which has been rising strongly in the last several months, fell in August. One of the explanations for this is that imports of lumber from Canada were sharply reduced as a result of the dock strike in Vancouver. Another reason for the drop of imports of industrial materials in August was a steep decline in nickel imports from Canada as the refinery there shut down for vacations for the first time in history. Petroleum imports also dipped, but this decline is expected to be short-lived in view of the further relaxation in import quotas which will allow larger imports in the fourth quarter of this year.

On the <u>export</u> side, shipments of industrial materials rose quite strongly in August as deliveries of coal and lumber to Japan picked up significantly with the ending of the Japanese seamen's strike. The major increase in exports in August, however, was in shipments of automotive equipment to Canada, most of which will be returned to United States at a higher value in the form of completed cars. Shipments of agricultural products held at the high July level; greater shipments of grain to the U.S.S.R. were offset by decline in exports of other agricultural commodities. Only a small portion -- less than 5 percent -- of the grain contracted for by the U.S.S.R. was shipped through August. The acceleration of deliveries under the Russian grain agreement, along with additional heavy purchases of grain by other countries, should serve to boost U.S. agricultural exports, (now running at an annual rate of $9.5 billion) to a rate of over $10 billion a year in the last part of this year. This compares with agricultural exports last year of about $8 billion.

The divergent movement of import and export prices (unit values) continues to be a factor in sustaining the trade deficit at a high level. Import prices rose quite sharply in August, while export unit values fell steeply.

Most of the rise in import prices was in foodstuffs (coffee, fish) and in industrial materials (lumber, steel, petroleum). Prices of finished goods rose also, but more moderately. With little improvement expected in food supplies, prices of imported foodstuffs are likely to rise further in the immediate future. In the case of finished goods, there may be a more rapid advance in import prices as economic activity rises here and abroad. It should be noted that even though import unit values of finished goods have been rising much more rapidly than export unit values this year, they have not been rising faster than in the past few years.

The largest drop in export prices in August was in finished manufactures, more than offsetting rises in foods (rice) and industrial supplies (coal). With the elimination of the export subsidy on wheat exports, which was as much as $.47 per bushel at the end of August, there may be a very strong rise in the export prices of wheat once current contractual obligations are fulfilled.

<u>Long-term interest rates abroad</u>. Although long-term bond yields in major industrial countries abroad, and in the Euro-bond market, are down from peak levels attained in 1970, yields in some of these markets have been rising since early this year. Much of the decline from 1970 peaks has been reversed in Germany and Canada, and virtually all of it in the United Kingdom. In these three countries and in France, yields now show smaller drops from the 1970 peaks than do long-term yields in the United States, and this is also true for yields on U.S. companies' dollar Euro-bond issues. In contrast, bond yields in Italy and Japan have declined more since 1970 than U.S. yields.

In all the major bond markets except the Japanese, yields now are above cyclical lows touched in 1967 or 1968, generally by wide margins. The differential is about three percentage points in Britain, two points in Germany and Canada--substantially more than for long-term yields as a whole in the United States--and somewhat under one percentage point in France and Italy. As in the United States, the two principal explanations for today's higher yields are an inflation premium and a high volume of new issues.

It is unlikely that yields in any of the major markets will fall in the foreseeable future, and in Germany and Japan increases appear probable. Factors currently putting upward pressure on yields abroad are the prospects for more vigorous economic growth in Europe and Japan (and further rapid expansion in Canada), continuing high new issue volume in many markets, and the likelihood of little if any reduction in rates of inflation.

The Euro-bond market. New issue volume on the Euro-bond market was at record highs in the second and third quarters, and exceeded year-earlier amounts by very wide margins. For the first nine months of this year new issues totalled about $4.5 billion (September figures being estimated), an amount two-thirds greater than in the comparable period last year.

EURO-BOND ISSUES
(in millions of U.S. dollars)

	Year		Jan.-Sept.	
	1970	1971	1971	1972
Total	2,966	3,642	2,702	4,463
By category of borrower				
U.S. companies	741	1,098	784	1,527
Other companies	1,065	1,119	800	1,323
Other borrowers	1,160	1,425	1,118	1,613
By currency of denomination				
U.S. dollar	1,775	2,221	1,543	2,485
German mark	688	786	580	833
Other currencies	503	635	579	1,145
By type of security				
Long-term straight debt	1,995	2,633	1,949	2,809
Other straight debt	733	714	533	598
Convertible bonds	238	295	220	1,056

Source: Morgan Guaranty Trust Co., World Financial Markets, September 19, 1972.

Both U.S. corporations and non-U.S. borrowers have greatly stepped up their recourse to the Euro-bond market in 1972. Non-U.S. borrowers raised $2.9 billion in the market in the first nine months, 50 per cent more than a year earlier, as private companies, governments, and international organizations increased their takings while state enterprises' offerings were little changed. New flotations by U.S. corporations, at $1.5 billion, were almost double last year's volume, and made up 35 per cent of total new issues. Nearly all of the increase in U.S. companies' issues has been in the form of convertible bonds. U.S. companies issued convertible Euro-bonds on a large scale in 1968-69, but very few in 1970-71. This year, when foreign demand for U.S. equities has strengthened, convertibles have comprised over one-half of total U.S. company Euro-bond issues. The convertibility feature has been sufficiently attractive that, in the second and third quarters, well-known U.S. firms could borrow at 4 to 5 per cent with convertibles compared with yields ranging from 7-1/2 to 8-1/4 per cent on most straight debt dollar issues. There has not been much change this year in the volume of U.S. companies' straight debt issues.

There appear to be several reasons for the surge in U.S. company bond issues. Some of the borrowing that has occurred this year probably would have occurred last year in the absence of the international monetary crisis, which made it harder to float dollar issues. There were also expectations that as part of a monetary settlement, and in accordance with repeated pledges, OFDI regulations would be liberalized. With generally calmer exchange markets this year, and the decision early last spring not to liberalize the OFDI regulations, U.S. companies have entered the Euro-dollar market with a backlog of financing demands. There are indications that some of the Euro-bond proceeds are being used to replace shorter term debt.

Another stimulus to U.S. company Euro-bond issues seems to be an expectation that conditions in the market are likely to be less favorable in the foreseeable future than they are at present, so that some amount of borrowing in advance of needs is taking place. In addition, it is reported that some companies have been issuing Euro-bonds partly to widen the market for their securities, even though they could raise funds more cheaply in the U.S. bond market.

In terms of currency of issue, U.S. dollar issues comprised 56 per cent of total Euro-bond issues in the first nine months of 1972 and German mark issues another 19 per cent, these shares being little changed from last year. The main new feature concerning currency denomination of bonds has been the large volume of French franc bonds, which were not allowed by the French authorities until last autumn. So far this year French franc bonds, which have been issued by both French and non-French borrowers, have accounted for almost 10 per cent of overall new issue volume.

Yields on straight debt issues in 1972 have been lower than at nearly all times in 1971, and are well down from peak levels attained in the spring and summer of 1970. However, yields on straight debt dollar issues have come down much less than yields on German mark issues. Measured from average levels in the second and third quarters of 1970, secondary market yields on dollar issues of U.S. corporations have declined only about 65 basis points, compared with 130 basis points on U.S. corporations' German mark bonds. A yield differential of this type has existed for a long time, but it has widened sharply in 1972 and is greater than at any time since just before the floating of the mark in September 1969. At the end of August the composite yield on 10 U.S. corporation dollar issues in the secondary market was 8.0 per cent compared with 6.5 per cent on 10 mark issues. The present wide differential reflects investors' expectations that the exchange value of the mark is more likely to be maintained, or to appreciate, than is that of the dollar.

Since the peaks attained in middle months of 1970 there has also been a smaller decline in yields on straight debt dollar Euro-bonds of U.S. corporations than on domestic U.S. corporate bonds. Again as measured from the average of the second and third quarters of 1970, the aforementioned decline of 65 basis points in Euro-bond yields compares with a drop of a full percentage point in Moody's Aaa composite corporate bond yield. The recent experience of one U.S. company that floated new dollar issues simultaneously in the U.S. and the Euro-bond markets indicates that borrowing in the Euro-bond market is about one-half per cent more expensive.

Long-term interest rate developments in foreign countries. In several of the major countries, notably the United Kingdom, Canada and Germany, long-term bond yields, which have been rising during most of 1972, are at fairly high levels, although still below (or not above) previous peaks. The current high levels, however, have been attained despite accommodating monetary policy and lagging private investment demand. In France and Italy, long-term rates have been falling during 1972, but remain substantially above the lows of the past five years. In contrast to the experience of the other countries, Japanese rates are low by historical standards, and have declined this year.

Since the mid-1960's, a secular upward trend of long-term rates is observable in most of the countries, excluding Japan. It appears that to some extent a ratchet effect has been operative: increases in yields in periods of higher economic activity exceed reductions in subsequent periods of lower activity. Among the factors accounting for this development are: conversion of short- to long-term debt, inflation, and a general increase in demand for long-term funds. In addition, yields in a particular country are closely linked to those in other countries through interest rate movements, anticipated and actual, in other countries and in the Euro-dollar market.

Long-term interest rates in Germany (as reflected in the average yield on bonds with a 6 per cent coupon) rose through July

1972, but have stabilized since at 7.65 per cent. For the immediate future, the outlook is for a further rise in long-term rates, especially since the authorities seem determined to moderate the expansion of the money supply.

Rates are down a little more than 1/2 of one per cent from the June 1970 peak of 8.3 per cent. And the low earlier this year (February) was nearly two percentage points above the low of four years ago.

The relatively high levels of long-term interest rates over the past year -- at a time when short-term interest rates have fallen sharply in response to the easing of monetary policy and the inflow of foreign funds can be attributed in some measure to the conversion of short- to long-term debt. (The Bardepot law may also have contributed to the increase in rates since last winter.) New issues of fixed-interest securities in Germany were exceptionally heavy during the first quarter of 1972: industrial issuers returned to the market although private investment demand showed no signs of revival and public authorities borrowed heavily. Thus, for the first six months of the year new issues totalled almost as much as they did during all of 1971, leading the authorities to ration access to the market.

The recent acceleration in the rate of inflation in Germany and the probable expectation that it will continue to be worse than in the past may contribute to future increases in long-term rates.

For the future, an increase in the public sector's share in total output -- a program to which the current government is committed -- may exert further upward pressure on long-term rates to the extent that it implies rising borrowing requirements.

Bond yields in France (according to the Bank of France composite yield on public sector bonds) were 7.8 per cent in mid-September, almost one percentage point below the peak level (adjusted to gross yield basis) of March 1970. However, yields are now still well above their previous low of approximately 7 per cent in the summer of 1967.

One important factor accounting for the higher yields now compared with the low point approximately five years ago is the large increase in new issue volume. Total gross new issues of bonds and stocks in 1971, at 30 billion francs, were about double the levels of 1966 and 1967 with both private and public sectors contributing to the increased demand for funds. The higher inflation rate of 5-1/2 per cent per annum in 1967-1971 compared with 3-1/2 per cent in 1959 to 1967, also contributed to the rise in yields.

The drop in yields since early 1970 has not been a steady one but was in fact concentrated in two short periods, February to July 1970 and January to July 1972. The latter was directly related to various steps taken in the first half of this year to ease monetary conditions. The probability of somewhat more rapid economic expansion next year coupled with the government's pessimistic official price projections suggest that the decline in yields may have come to an end.

Long-term interest rates in the United Kingdom (as represented by the yield on 3-1/2 per cent War Loan) have been moving upward almost uninterruptedly during 1972 from 8.32 per cent in January to 9.65 per cent in September. The upward move of long-term yields this year has brought them close to their end of 1970 peak of 9.8 per cent. There was clearly a secular increase in long-term rates from 1966 through the end of 1970, with rates rising by about three percentage points over that period.

Upward price and wage movements, industrial disputes, and external developments -- and the inflationary expectations which these factors have generated -- have played a key role in the behavior of United Kingdom long-term interest rates in recent years. Indeed, the recent behavior of long-term rates can be largely attributed to an intensification of inflationary expectations this year after some moderation last year. Therefore, the future movements of long-term rates as the economic recovery proceeds depend especially on factors such as the success of the government's incomes policy. Greater restraint on the part of the Bank of England in its support of the government bond market, at a time when the government borrowing requirement is expected to be extraordinarily large, has been a further factor pushing up long-term rates.

The demand for funds does not appear to have played a crucial role in the upward movement of long-term rates. Reversing a long period of budgetary deficits, the public sector was in surplus in 1969 and 1970 and net capital issues by United Kingdom companies were unusually low in 1970, yet at that time the trend in long-term rates was upward.

Long-term interest rates in Italy (composite bond yield) have declined steeply since July 1970. At the present (July) level of 7.23 per cent, the yield is 220 basis points under the peak, but still considerably higher (65-90 basis points) than its level in the 3-1/2 year period of stability that ended in mid-1969.

The steep decline in yields from 1970 to the present followed a period of extraordinarily rapid increase during the 1969-70 monetary tightening. Yields have been brought down by the shift to a policy of monetary ease that occurred late in 1970 when it became apparent that aggregate demand was not expanding. Demand has continued to lag since. Consequently monetary policy has continued to be easy in an effort to revive depressed investment spending.

One important factor holding up present yields as compared to pre-1969 yields has been an enormous upsurge in new issues. In 1971 the volume of net new stock and bond issues was 70 per cent greater than in 1968. Bond issues by the Treasury and the special credit institutes, as well as stock issues, account for nearly all of the rise in new issue volume.

The Bank of Italy believes that expectations of inflation affect bond yields. Since 1969, Italian consumer prices have been rising at a 5 per cent annual rate compared with 3.5 per cent in the period 1955-1969, and this experience may well have had the effect of making investors more inflation conscious.

Long-term interest rates in Canada (as reflected by the long-term government of Canada bond average) rose from the beginning of 1972 through July and then leveled off in August and September at about 7.5 per cent -- down three-quarters of one percentage point from the historical high reached in January 1970. In December 1971, the yield reached a low of 6.54 per cent, about 150 basis points higher than the levels in early 1965 and 100 basis points above the 1967 low.

The sharp decline in long-term yields in late 1970 was caused primarily by a large increase in the money supply in the spring of 1970 to bring the economy out of recession. Since late 1971 monetary policy has been cautiously expansionary. The aims of policy have been to encourage economic growth (and thereby reduce unemployment) and to discourage capital inflows in an attempt to keep the exchange rate of the Canadian dollar down.

Inflation and inflationary expectations appear to be significant factors explaining the large rise in yields since seven years ago. For example, from 1961 to 1967 consumer price increases averaged 1.6 per cent per year, but the average from 1966 to 1971 rose to 3.7 per cent, and in 1969 to 4.5 per cent.

The demand for funds also appears to have played an important role in the upward shift of yields. Public sector demand for Canadian long-term funds has been substantial over the past several years. Long-term private borrowing rose sharply in 1970-71, partially reflecting efforts to lengthen the term structure of debt. As the Canadian economy continues through the early stages of cyclical expansion, and in addition, as the government continues to urge provinces to avoid recourse to foreign markets, the demand for Canadian funds should continue to be strong.

Long-term interest rates in Japan (as reflected by the yield on Class A seven-year industrial bonds) are now at what appear to be low levels by historical standards. The latest figure for July 1972 is 6.52 per cent, compared to a high of 8.89 per cent in April 1970. The previous low in August 1968 was 7.99 per cent, but this was at a time when government controls were preventing yields from fluctuating freely. One reason for the low long-term yields is that short-term interest rates are at their lowest postwar level. Even with the fall in long-term yields, the spread between short and long rates has widened. As the demand for funds picks up with the economic recovery, rates are likely to move up once more. In fact, they probably reached their cyclical low this summer.