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Part II

CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

September 4, 1974

CONFIDENTIAL

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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of the Federal Reserve System

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DOMESTIC NONFINANCIAL SCENE

September 4, 1974

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

	Latest Data			Per Cent Change From		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year Earlier
				(At Annual Rates)		
Consumer prices (1967=100)	July	8/21/74	148.1	9.0	11.2	11.8
Food	July	8/21/74	159.4	-4.5	3.3	13.9
Commodities except food	July	8/21/74	138.2	15.8	14.9	11.8
Services 2/	July	8/21/74	152.5	12.7	12.4	10.2
				(Not at Annual Rates)		
Mfrs. new orders dur. goods ($ bil.)	July	8/30/74	47.9	2.1	8.5	14.4
Capital goods industries:	July	8/30/74	14.1	2.6	5.0	20.2
Nondefense	July	8/30/74	12.8	6.3	7.1	20.8
Defense	July	8/30/74	1.4	-22.8	-11.4	15.1
Inventories to sales ratio:						
Manufacturing	July	8/30/74	1.62	1.64 1/	1.62 1/	1.58 1/
Ratio: Mfrs.' durable goods inventories to unfilled orders	July	8/30/74	.689	.693 1/	.714 1/	.754 1/
Manufacturing appropriations 4/						
All manufacturing	QII'74	8/30/74	16,289	38.6	--	53.3
Manufacturing excl. petroleum	QII'74	8/30/74	11,505	19.6	--	38.6
Housing starts, private (thous.) 3/	July	8/16/74	1,335	-16.0	-18.1	-38.0
Leading indicators (1967=100)	July	8/30/74	179.2	17.6	3.0	8.2

1/ Actual data. 2/ Not seasonally adjusted. 3/ At annual rates. 4/ Conference Board data.

DOMESTIC NONFINANCIAL DEVELOPMENTS

Judging by incoming but only partial data for August, there has been little basic change in the lackluster performance of the economy. No major category of activity is providing any significant thrust to overall activity. Meanwhile, inflationary pressures continue intense.

Data on industrial production for August are still fragmentary, and it now seems likely that the index will remain little changed for the third consecutive month. Auto assemblies were at about an 8.0 million unit annual rate, an increase of only 2 per cent from July--earlier schedules had called for a 10 per cent increase. Production has been hampered by continuing parts shortages resulting from strikes at some suppliers, but a large overhang of 1974 small cars has probably also contributed to reductions from scheduled output. Production of other consumer goods has been relatively stable in recent months, with no indications of improvement.

Production of materials, meanwhile, is likely to show some decline in August. Strikes at coal and copper mines are partly responsible. Construction materials output probably declined further as a consequence of continued weakness in building activity. Raw steel production in the first three weeks of August was maintained at about the July level.

Some further easing in the labor market in August is suggested by recent data for initial claims for insured unemployment. For the first four weeks in August, claims averaged about 320,000 (seasonally adjusted), up more than 10 per cent from July. This rise appears to be due largely to small, widespread increases in layoffs in manufacturing and a rise in construction unemployment. The recent level of initial claims is the highest since November 1970, except for the period of the energy crisis. The rise in initial claims in August appears to have been among workers with strong attachments to the labor force. Thus, if there has been a continuation of the recent rate of growth in the labor force, the overall unemployment rate in August might well rise from the 5.3 per cent of July.

Retail sales appear to have risen somewhat further in August following the sharp July advance, according to staff estimates based on weekly data. The increase reflects the recent pick-up in auto sales. Total retail sales, excluding autos and nonconsumer items, apparently changed little, and in real terms were probably only a little above the second quarter average.

The auto market has been strong since late July. Sales of new domestic-type autos in the first 20 days of August were at a 9.6 million unit annual rate, compared with 8.2 million in July. The recent strength in sales appears to represent an effort by consumers to beat the large price increases announced for 1975 models. The small car share of domestic-type sales in August, not seasonally adjusted came to about 33 per cent of the total, the same as in other recent months, but less than early this year. However, with sales of smaller cars below expectations, stocks have been rising steadily--reaching a 78 days' supply at the end of July. In some cases, for example Pinto and Valiant, the days' supply exceeded 100, apparently necessitating cutbacks in production schedules.

Total new orders for durable goods rose 2.1 per cent in July. In real terms, however, orders fell slightly, following declines in the first two quarters. (Table 1) The composite index of leading indicators also rose sharply in July. But the Boston FRB index of deflated leading indicators fell .5 per cent--the third decline in the past four months. (Table 2)

Recent indicators of business fixed capital spending reflect divergent trends. New orders for nondefense capital goods rose in July in real as well as nominal terms, and revised data now show a moderate rise in real orders for the second quarter. Order backlogs expanded further. Moreover, capital appropriations of large manufacturing companies rose at a record rate in the second quarter (according to the Conference Board). Strength was concentrated in the capacity-short materials industries. (Table 3) About half of the rise was in the petroleum industry and the balance came mainly from producers of chemicals and nonferrous metals. However, the Conference Board anticipates on the basis of a limited number of returns for the third quarter that appropriations for capital spending may have reached their peak.

Outside of the materials producing sector, there have been increasing reports that tight financial conditions, rising costs, and depressed demand have led to a reexamination of capital spending plans. In manufacturing, the motor vehicles industry has scaled down spending plans; and some other firms also have made cut-backs. In nonmanufacturing, some additional reductions in planned outlays have recently been announced by the electric utilities, and there have also been increasing reports of further weakness in commercial construction in many parts of the country.

Book value of manufacturing inventories jumped sharply in July, exceeding the second quarter average monthly rate of increase, but this probably reflects the extraordinarily rapid rise in prices in recent months. It is not now anticipated that there will be much change in nonfarm inventory accumulation on a GNP basis in the third quarter.

Despite overall sluggishness, there is still a good deal of intended inventory accumulation. Coal is being stockpiled in anticipation of a strike on November 12. Businessmen apparently are also continuing to stock some materials and components, partly in anticipation of further price increases.

However, the ratio of inventories to GNP final sales in constant dollars is very high suggesting a significant amount of involuntary investment. There are persistent reports that many firms are becoming more cautious and are making strong efforts to prevent further accumulation, as delivery times shorten and shortages ease. Newspaper reports over the past few weeks have reported that some companies in the electronics, glass, auto, home appliances, and rubber industries plan to or have already laid off workers in order to reduce current large backlogs of inventories.

Private housing starts were down sharply in July, to a level more than two-fifths below the high in the first quarter of 1973--the largest drop in starts in the post World War II period. Prospects are that the third quarter average will, at best, approximate 1.4 million units--the smallest number for any quarter in over four years. So far, the decline in starts this year has been concentrated in multi-family units. In July these were at the lowest level since mid-1967 and accounted for only 30 per cent of the total, compared with two-fifths in other recent years.

Prospects for halting some further decline in residential construction activity appear to have diminished. There has been further deterioration in net depositary inflows at savings institutions, and interest rates have risen still more for both construction loans and permanent financing. Mortgage lenders have cut back new commitment activity appreciably. In addition, there is still an exceptionally large number of units under construction or in builders' completed inventories.

The rise in consumer prices moderated in July because of a fall in retail food prices and a smaller advance for energy items. The August index, however, is expected to rebound, reflecting a sharp reversal in meat prices--wholesale farm prices climbed in both July and August. Most nonfood commodities in July rose at an accelerated pace following earlier and continued advances at wholesale. Service prices have also been rising at a steadily increasing rate, as mortgage rates, medical costs, and gas and electricity have continued to climb. (See Table 4.)

Prices received by farmers during the month ending August 15 increased 3 per cent. With expected production cut by drought, feed grain prices moved sharply higher. Since mid-August, however, grain prices have declined moderately in response to some slackening in domestic and foreign demand.

The FR price index for industrial materials (not for publication) has declined recently, although it is still nearly 30 per cent above a year ago. Reductions in spot prices since July include copper and steel scrap, cotton, cotton printcloth, lumber, and plywood. Most of these--steel scrap is a notable exception--are below year-ago levels.

Major automobile manufacturers have announced increases on 1975-model automobiles averaging about 8 per cent. Safety and pollution control equipment included in these increases account for less than 3 per cent of the increase. Part of the advance may be reflected in the September consumer price index, as the new models are reaching dealers for sale earlier than usual.

Recent and prospective rises in consumer prices have heightened labor efforts to maintain purchasing power. Wage rates in August are likely to have continued their upward momentum; increases negotiated in the communications industry became effective and workers in the steel, can, aluminum, and clothing industry received large cost-of-living raises. In the previous three months the average hourly earnings index had advanced 10 per cent, with gains somewhat above the average in manufacturing.

Wage negotiations have begun in the soft coal industry, with the contract scheduled to expire November 12. The rank and file will vote on the contract for the first time. This is likely to put additional pressure on the new union president to push for a large settlement. It is generally believed that a strike of considerable duration could take place and, therefore, substantial stockpiling of coal is now under way. Another important challenge to the wage structure is scheduled to take place when railroad contracts covering some 500,000 workers expire at the end of December; announced union demands are extraordinarily large.

The impact of the newly established Council of Wage and Price Stability remains uncertain. Its major function will be to spotlight price and wage increases which are deemed to be excessive. Since it has no enforcement powers, the Council will have to rely mainly on persuasion to limit prospective price increases or wage demands.

Table 1

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

	1973	1974		
	QIV from QIII 1/	QI from QIV 1/	QII from QI 1/	July from June (p)
Durable goods, total	2.3	-1.6	9.5	2.1
Excluding defense	1.5	-1.9	10.2	3.1
Excluding primary metals & motor vehicles and parts	5.1	2.2	4.4	1.1
Primary metals	.3	-3.4	32.3	-6.4
Motor vehicles & parts	-7.2	-17.1	10.7	20.7
Household durables	4.2	1.1	4.8	-1.9
Nondefense capital goods	5.7	2.1	6.0	6.3
Defense capital goods	22.4	5.7	-6.1	-22.8
Construction & other durables	2.8	2.0	4.4	.4
Durable goods total, in 1967 $	.8	-4.9	-3.2	-.3
Nondefense capital goods, in 1967 $	4.1	.0	1.5	4.2

1/ Changes between quarters are based on quarterly average levels.

Table 2

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

	1974						
	Jan.	Feb.	Mar.	Apr.	May	June	July (p)
12 Leading, trend adjusted	1.6	1.4	1.5	.6	1.8	-.6	1.8
5 Coincident	- .3	.6	.7	.7	.7	.1	.3
5 Coincident, deflated	-1.3	-.2	.1	.3	-.1	-.5	.0
6 Lagging	1.2	.7	2.3	2.7	1.9	2.0	1.9
	Leading indexes prior to trend adjustment						
Census undeflated	1.2	1.0	1.2	.2	1.5	-1.0	1.4
Boston FRB deflated	-.2	.4	.6	-.4	.4	-1.6	-.5

Table 3

MANUFACTURERS' NEW CAPITAL APPROPRIATIONS 1/
(Figures are percentage change from prior period
based on seasonally adjusted quarterly totals)

	1972				1973[r]				1974	
	I	II	III	IV	I	II	III	IV	I[r]	II[p]
Manufacturing	10.2	7.5	1.4	16.5	15.0	11.8	6.6	4.4	- .6	38.6
Ex petroleum	8.8	11.5	4.3	11.2	19.4	5.8	14.3	.4	1.1	19.6
Durables	2.4	18.3	5.1	6.2	25.2	7.3	7.0	3.6	1.9	13.2
Nondurables	18.0	-1.6	-2.4	27.7	5.7	16.8	6.2	5.1	-3.0	64.9
BACKLOGS/EXPENDITURES RATIO 1/ (Figures are the ratio of closing backlogs to capital expenditures)										
Manufacturing	3.4	3.5	3.7	3.8	4.0	4.3	4.6	4.7	4.3	4.6
Durables	3.5	3.5	3.9	4.0	4.0	4.2	4.5	4.6	4.3	4.4
Nondurables	3.3	3.5	3.5	3.7	4.0	4.5	4.6	4.8	4.4	4.9

1/ Conference Board data.

Table 4

CONSUMER PRICES

(Percentage changes, seasonally adjusted annual rates)1/

	Relative impor-tance Dec. 1973	Dec. 1972 to Dec. 1973	Dec. 1973 to Mar. 1974	March to June 1974	June to July 1974
All times	100.0	8.8	14.2	10.9	9.1
Food	24.8	20.1	19.4	3.1	-4.5
Commodities less food	38.6	5.0	16.0	15.8	15.8
Services 2/	36.5	6.2	9.2	11.0	12.7
Addendum					
All items less food and energy components 3/4/	68.8	4.7	8.6	12.8	14.4
Petroleum products 3/5/	4.0	23.4	99.3	26.6	6.9
Gas and electricity	2.4	6.9	28.2	16.1	18.3

1/ Not compounded for one-month changes
2/ Not seasonally adjusted.
3/ Confidential--not for publication.
4/ Excludes food, gasoline and motor oil, fuel oil and coal, and gas and electricity.
5/ Includes coal.

DOMESTIC FINANCIAL SITUATION

SELECTED DOMESTIC FINANCIAL DATA
(Dollar amounts in billions)

Indicator		Latest data Period	Level	Net change from Month ago	Three months ago	Year ago
Monetary and credit aggregates				SAAR (per cent)		
Total reserves		July	37.4	22.7	17.0	9.9
Reserves available (RPD's)		July	35.0	8.7	16.5	10.2
Money supply						
M1		July	280.0	1.7	4.8	5.1
M2		July	598.9	5.4	7.1	8.5
M3		July	933.0	4.9	5.7	7.6
Time and savings deposits (Less CDs)		July	319.0	9.5	9.2	11.7
CDs (dollar change in billions)		July	85.4	2.0	10.0	21.5
Savings flows (S&Ls + MSBs)		July	334.0	3.2	3.1	6.0
Bank credit (end of month)		July	686.7	13.1	10.5	11.9
Market yields and stock prices				Percentage or index points		
Federal funds	wk. endg.	8/28/74	11.84	-.41	.30	1.05
Treasury bill (90 day)	"	8/28/74	9.63	2.10	1.79	1.04
Commercial paper (90-119 day)	"	8/28/74	12.00	.55	1.59	1.58
New utility issue Aaa	"	8/30/74	9.99	--	.90	1.70
Municipal bonds (Bond Buyer)	1 day	8/29/74	6.91	.57	.83	1.57
FNMA auction yield (FHA/VA)		8/26/74	10.38	.40	.90	1.43
Dividends/price ratio (Common stocks)	wk. endg.	8/28/74	5.24	.63	1.11	2.07
NYSE index (12/31/65=50)	end of day	9/3/74	36.90	-4.27	-9.91	-18.94

Credit demands		Net change or gross offerings: Current month 1974	Current month 1973	Year to date 1974	Year to date 1973
Business loans at commercial banks	July	2.9	3.3	21.3	22.3
Consumer instalment credit outstanding	June	1.1	1.6	5.7	11.0
Mortgage debt outst. (major holders)	June	4.1	6.0	25.8	33.3
Corporate bonds (public offerings)	June	2.0e	1.3	11.7e	6.2
Municipal long-term bonds (gross offerings)	June	2.0e	2.1	12.5e	11.8
Federally sponsored Agcy. (net borrowing)	August	0.9e	1.6	9.5e	10.8
U.S. Treasury (net cash borrowing)	Sept.	0.9e	0.6	1.7e	1.2
Total of above credits		13.9	16.5	88.2	96.6

e - Estimated

DOMESTIC FINANCIAL SECTORS

Monetary aggregates. Preliminary data suggest that M_1 and M_2 increased more rapidly in August than in July, but the growth rate of M_1 in August is estimated to be considerably below the second quarter pace of 6-1/2 per cent. Time and savings deposits other than negotiable CD's are estimated to have grown at near the 9.5 per cent rate of July, slightly above the second quarter pace. Outflows of savings deposits continue, and there is a presumption that large denomination time deposits other than negotiable CD's at weekly reporters are accounting for most of the sustained strength in other time deposits. Continued weakness in thrift institution deposits in August is expected to have reduced growth in M_3 to about a 4.5 per cent rate.

With loan growth moderating, and the total of private and U.S. Government demand deposits expanding rapidly in August, large banks increased their outstanding CD's less than seasonally, and significantly less than in July; in addition, banks reduced, on daily average, their use of nondeposit sources of funds. As in July, banks outside of New York and Chicago increased their outstanding CD's by a relatively large amount, suggesting that, at least in the aggregate, regional bank ability to issue such instruments is not being constrained.

Bank credit. Preliminary data suggests that growth in bank credit so far in the third quarter, after adjustment for sale-purchase transactions with the Trading Desk,[1] has continued at the slower pace that began late in the second quarter. Before such adjustments, growth in August (on an end-of-month basis) was close to the second quarter pace of 11-1/2 per cent. Despite bank acquisitions of coupon issues in the August refunding, holdings of Treasury securities on a seasonally adjusted basis are expected to show little over-all change in August; other security holdings are also expected to be about unchanged.

Business loan expansion in August is projected to be relatively large, although for the third consecutive month it is likely to be several percentage points below the first half pace of 23 per cent. The slowing of business loan expansion this summer has reflected not only a general tightening of bank loan policies, and possibly reduced inventory acquisitions, but also a prime rate that has remained high in relation to rates on commercial paper, which may have encouraged some prime borrowers to shift to the open market. However, total short-term borrowing of businesses appears to have moderated in August.

Food processors, textiles, and durables manufacturing--particularly machinery and transportation equipment--accounted for most of the business loan growth at large banks. For the first time since early this year, public utilities reduced bank loans in August, possibly with proceeds from market financing.

1/ Sale-purchase transactions inflate security loans as dealers increase their borrowing to finance the securities they purchase from the Desk.

Although growth in dealer-placed commercial paper appears to have slowed from the July pace, and outstanding bank-related paper is expected to decline sharply, finance companies increased their outstanding commercial paper, using the proceeds in part to repay bank loans.

Nonbank financial intermediaries and mortgage markets. Sample data indicate that both savings and loan associations and mutual savings banks experienced large deposit losses on an unadjusted basis in August. On a seasonally adjusted basis, growth of thrift institution deposits is estimated to have been at about a 1 per cent annual rate or slightly worse than the weak July experience. To obtain funds for meeting deposit withdrawals and outstanding commitments, S&L's and MSB's reportedly continued to rely mainly on repayment flows, reductions in liquid assets, and for S&L's borrowing from the FHLBanks. S&L borrowings from FHLBanks is estimated to have been about $1 billion in August, up from the $875 million average monthly pace in June and July.

Seasonally adjusted outstanding mortgage commitments at savings and loan associations and New York mutual savings banks declined further in July to the lowest level since November 1971. New mortgage commitments at these institutions also dropped again in July and were only 45 per cent of the combined volume posted in April of this year, according to Federal Reserve estimates. Furthermore, S&L's continued to report funds in short supply in all 12 of the FHLBank Districts throughout August.

Average interest rates on new commitments for 80 per cent conventional home loans at selected S&L's rose by 27 basis points during August to 9.74 per cent--134 basis points above the recent low in March. These rates are above usury ceilings in 16 states but below the yields on new issues of high-grade utility bonds. Average yields on accepted bids in the August 26 FNMA auction rose to 10.38 per cent on FHA/VA mortgages and to 10.42 per cent on high loan-to-value ratio conventional home mortgages--almost 2 percentage points above the March lows.

Delinquency rates on home mortgages (MBA series) edged up in the second quarter, after seasonal adjustment, to 4.34 per cent of outstanding loans held by reporting institutions--a new high for the series.

The Housing and Community Development Act of 1974, signed into law August 22, contains a number of provisions designed to aid home construction. These include extension of all basic FHA programs to October 1977, increases in the maximum size of FHA-insured home loans, decreases in the downpayment requirements on such loans, and increases in the maximum size of home mortgage loans by Federal S&L's.

Consumer credit. Finance rates on consumer instalment loans have advanced sharply since the Economic Stabilization Act expired at the end of April. At commercial banks, the average rate for direct new car loans in July rose to 10.94 per cent, up 13 basis points from

June, and 43 basis points above the level that prevailed in April. Finance company rates on new-car contracts have shown an upsurge of similar magnitude since April.

The delinquency rate on auto loans at major finance companies (contracts delinquent over 30 days as a percent of total accounts) declined to 2.63 per cent in June from the near-record high of 2.75 per cent in May. Refinancings also declined in June, but both delinquencies and refinancings are well above their year-earlier levels of 2.31 per cent and 1.12 per cent, respectively.

Securities markets. After the August FOMC meeting, most private rates rose by another 1/8 of a percentage point or so, while rates on Treasury bills jumped 60 basis points or more to new highs. Subsequently, however, most rates declined, largely in response to the recent decline in the Federal funds rate below the 12 per cent level and the growing market belief that monetary policy may have eased to come extent. Currently, a number of short-term rates are clcse to their levels at the time of the August FOMC meeting, but bill rates remain 30-40 basis points higher while CD rates are appreciably lower.

The initial sharp rise in Treasury bill rates was prompted mainly by further sizable increases in the supply of bills. The Treasury raised $400 million of new money in the weekly bill auctions on August 26 and August 30 and auctioned $2.0 billion of June 1975 bills on August 28. Also, there were $3.0 billion of Federal Financing Bank bills and September TABs sold in late July and early August, as well as previous increases in the weekly bill auctions. As a result, the spread between bill rates and private rates has narrowed significantly towards more normal levels.

While rates on Government coupon issues, recently offered corporate bonds, and municipal bonds have tended to edge down in the last few days, these rates are up appreciably from the levels prevailing at the time of the August FOMC meeting--by 15 to 30 basis points on most issues. Earlier upward pressures on these rates came from the relatively large size of Government dealer inventories, rising short-term rates, and sizable current and prospective demands in longer-term markets. In the corporate market, underwriters report that pension and trust accounts in general have diverted an increasing portion of their funds to bonds and away from equities. In addition, these investors appear to have sizable short-term investment positions.

The total volume of public and private corporate security offerings in August was slightly less than the monthly average for the first half of the year. Public bond offerings were unseasonally heavy despite $250 million of postponements, cancellations, and reductions in size of previously scheduled issues. This amount includes $95 million of reductions in the size of floating rate note offerings, which have been receiving a mixed reaction in the market. The volume of private placements and stock offerings, however, was relatively small, reflecting in part policy loan drains from life insurance companies and a sharp drop in stock prices.

Total corporate security offerings, bolstered by a seasonal increase in private placements and a higher projected level of stock offerings, are projected to increase in September but then decline seasonally in October. The level of public bond offerings is expected to remain high, and underwriters report a heavy backlog of potential borrowers who will need long-term financing later in the year. Municipal offerings in the coming months are expected to show an appreciable increase from the seasonally low $1.1 billion volume in August, which was held down by high interest rates and postponements or reductions in size of scheduled offerings. Borrowing by Federally sponsored agencies, which currently are expected to require $6.4 billion of new funds over the last four months of this year, will be adding to pressures in securities markets. In 1973 new money needs of the Federal agencies were $1 billion less than projected this year and in earlier years the volume was smaller.

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

	1973 Year	1974 1st half e/	QIII f/	Aug. e/	Sept. f/	Oct. f/
Corporate securities - Total	2,779	3,011	3,067	2,900	3,500	3,200
Public bonds	1,125	1,952	2,200	2,200	2,300	2,300
Privately placed bonds	725	507	467	400	600	400
Stock	929	552	400	300	600	500
State and local government securities	1,942	2,095	1,400	1,100	1,700	1,700

e/ Estimated.
f/ Forecast.

Federal finance. On the basis of the new Administration's budget plans, the staff has cut fiscal year 1975 budget outlays by $5 billion since the last Greenbook to a level of $299.5 billion. The details of the Administration approach are still to be worked out in consultation with Congressional leaders. In our estimates, $2.6 billion of the decline occurs in purchases of goods and services, where the projection is now consistent with recent Senate cuts in defense appropriations and with the Administration's proposal to postpone the Federal pay raise from October this year to January 1975. Spending estimates also were lowered for grants to States and local governments, partly reflecting a later phase-in of the assumed expansion in public service employment program which is now unlikely to start until the spring of 1975. A portion of the remaining spending cut was allocated to asset sales and timing shifts between fiscal year 1975 and 1976.

Staff projections of budget receipts for fiscal year 1975 amount to $293.3 billion, so that a $6.2 billion deficit is now estimated.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	Aug.	Sept.	Oct.	Nov.
Total net borrowing	2.2	.9	.2	4.7
Weekly and monthly bills	1.8	2.4	--	--
Tax bills	1.5	-1.5	--	2.5
Coupon issues, net	4.4	--	--	--
As yet unspecified new borrowing	--	1.8	--	5.0
Special foreign series	-1.2	--	--	--
Budget agency transactions with the public	--	--	.2	--
Net Federal Financing Bank transactions with the public	--	--	--	1.5
Debt repayment	-4.3	-1.8	--	-4.3
Plus: Other net financial sources a/	-1.4	--	.9	-1.7
Plus: Budget surplus or deficit(-)	-1.9	2.9	-5.9	-1.8
Equals: Change in cash balance	-1.1 b/	3.8	-4.8	1.2
Memoranda: Level of cash balance, end of period	5.4 b/	9.2	4.4	5.6
Derivation of budget surplus or deficit:				
Budget receipts	23.5	27.7	19.4	22.3
Budget outlays	25.4	24.8	25.3	24.1
Maturing coupon issues held by public	4.3 c/	1.8	--	4.3
Net borrowing by government-sponsored agencies	0.9	2.3	1.5	0.8

e--Estimated.

a/ Checks outstanding less checks paid and other accrual items.

b/ Actual

c/ In the August refinancing, $4.0 billion of notes and $.4 billion of bonds were sold to provide cash for refunding the $4.3 billion of publicly-held 5-5/8 per cent notes that matured on August 15.

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

	Fiscal Year 1974*	Fiscal 1975 e/ Adm. Est. 5-30-74	Fiscal 1975 e/ F.R. Board	Calendar Years 1973 Actual	Calendar Years 1974 FRB e/	F.R.B. Staff Estimates Calendar Quarters 1974 I*	1974 II*	1974 III	1974 IV	1975 I	1975 II
Federal Budget						Unadjusted data					
Surplus/deficit	-3.5	-11.4	-6.2	-7.9	-7.7	-7.1	9.7	-2.5	-7.9	-6.1	10.3
Receipts	264.8	294.0	293.3	250.4	279.0	60.5	80.1	72.1	66.2	66.7	88.3
Outlays	268.3	305.4	299.5	258.3	286.7	67.6	70.4	74.6	74.1	72.8	78.0
Means of financing:											
Net borrowing from the public	3.0	n.a.	9.9	7.9	7.1	3.4	-6.4	4.7	5.4	2.2	-2.4
Decrease in cash operating balance	3.4	n.a.	.5	.7	4.6	2.0	-.8	--	3.4	3.1	-6.0
Other 1/	-2.9	n.a.	-4.2	-.7	-3.9	1.7	-2.5	-2.2	-.9	.8	-1.9
Cash operating balance, end of period	9.2	n.a.	8.7	10.4	5.8	8.4	9.2	9.2	5.8	2.7	8.7
Memo[2/]: Sales of financial assets to the public 3/	1.3[e/]	n.a.	1.8	3.6	1.4	.4	.2	.3	.5	.4	.5
Borrowing from the public:[4/]											
Budget agency	1.0)	n.a.)	n.e.	-.1)	3.6	0.4	0.1	--)	1.7	n.e.)	n.e.
Federal Financing Bank	--)	)		--)		--	--	1.5)		)	
Treasury borrowing, net	2.0	n.a.	n.e.	8.0	3.5	3.0	-6.5	3.2	3.7	n.e.	n.e.
Sponsored agency borrowing 5/	14.9	n.a.	n.e.	16.3	16.0	--	5.6	6.2	4.1	n.e.	n.e.
National Income Sector						Seasonally adjusted, annual rates					
Surplus/deficit	-4.4[p/]	-12.8	-8.0[6/]	-5.6	-2.5	-1.5	-0.0	-4.4	-4.0	-7.9	-12.0
Receipts	273.8[p/]	304.3	303.4	258.5	292.8	279.4	291.6	298.2	302.1	306.3	309.4
Expenditures	278.2[p/]	317.1	311.4	264.2	295.3	281.0	291.6	302.6	306.1	314.2	321.4
High Employment surplus/deficit (NIA basis) 7/	-3.9	n.a.	9.1	-6.6	-.5	-3.0	-3.5	-3.1	7.6	12.9	19.0

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

Footnotes continued:

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

2/ The sum of sponsored and budget agency debt issues, financial asset sales, and borrowing by the Federal Financing Bank does not necessarily reflect the volume of debt absorbed by the public, since both the sponsored and budget agencies acquire a portion of these issues. Most of the market activities of budget agencies are expected to be handled by the Federal Financing Bank in fiscal year 1975.

3/ Includes net sales of loans held by the Government National Mortgage Assn., Federal Housing Adm., and Veterans Adm. and those Farmers Home Adm. loans still publicly marketed, Receipts from these sales are netted against Federal Budget Outlays shown above.

4/ Budget agencies such as U.S. Postal Service, Export-Import Bank, and Tennessee Valley Authority, borrow directly from the public or from the Federal Financing Bank. The Federal Financing Bank in turn borrows from the public or from the Treasury. To avoid double counting only net borrowing from the public is shown in the table.

5/ 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.

6/ Quarterly average exceeds fiscal year total by $.6 billion for fiscal 1975 due to spreading of wage base effect over calendar year.

7/ Estimated by F.R. Board Staff.

INTERNATIONAL DEVELOPMENTS

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

	1973	1974p/			
	YEAR	1Q	2Q	JUNE*	JULY*
Goods and services, net 1/	4,390	2,727			
Trade balance 2/	470	-74	-1,671	-535	-780
Exports 2/	70,277	22,299	24,049	8,389	8,192
Imports 2/	-69,807	-23,373	-25,720	8,924	8,972
Service balance	3,920	2,801			
Remittances and pensions	-1,943	-396			
Govt. grants & capital, net	-3,472	-1,183			
U.S. private capital (- = outflow)	-14,101	-7,391			
Direct investment abroad	-4,872	-220			
Foreign securities	-807	-647	-350	-101	
Bank-reported claims -- liquid	-1,103	-2,248	-1,197	-180	-1,110
" " " other	-4,773	-2,983	-6,113	-2,524	
Nonbank-reported claims -- liquid	-841	-412	131	61	
" " " other	-1,704	-881			
Foreign capital (excl. reserve trans.)	12,444	6,822			
Direct investment in U.S.	2,537	1,127			
U.S. corporate stocks	2,758	376	5	8	
New U.S. direct investment issues	1,223	25	50		
Other U.S. securities (excl. U.S. Treas.)	70	296	277		
Liquid liabilities to:	4,436	4,573	2,852	961	1,979
Commercial banks abroad	2,978	4,589	1,954	555	5/1,884
Of which liab. to branches 3/	(309)	(3,381)	(-1,165)	(-970)	(-394)
Other private foreigners	1,082	577	606	244	5/
Intl. & regional organizations	376	-593	292	162	95
Other nonliquid liabilities	1,420	426			
Liab. to foreign official reserve agencies	5,095	-836	4,849	2,030	1,072
U.S. monetary reserves (increase, -)	209	-210	-358	-76	25
Gold stock	--	--	--	--	--
Special drawing rights	9	--	-29	-32	-38
IMF gold tranche	-33	-209	-244	-16	-19
Convertible currencies	233	-1	-85	-28	82
Errors and omissions	-2,620	465			
BALANCE (deficit -)					
Official settlements, S.A.		1,044	-4,491		
" " , N.S.A.	-5,304	1,488	-4,104	-1,954	-1,097
Net liquidity, S.A.		-869	-6,277		
" " , N.S.A.	-7,796	-48	-6,695	-2,796	
Liquidity, S.A. 4/		-3,529	-7,343		
" , N.S.A.	-9,740	-2,850	-7,810	-2,915	-3,076
Basic balance, S.A.		2,065			
" " , N.S.A.	-744	2,453			

* 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/ Measures by changes in U.S. monetary reserves, allliabilities to foreign official reserve agencies and liquid liabilities to commercial banks and other foreigners.
5/ "Commercial banks abroad" includes "Other private foreigners."

INTERNATIONAL DEVELOPMENTS

Foreign exchange and Euro-dollar markets. The dollar appreciated by nearly 3 per cent on a weighted average basis against leading foreign currencies during August, with somewhat larger gains against most European currencies and smaller gains against the Canadian dollar and the yen. Central banks of the G-10 countries sold some $3/4 billion in August, moderating the dollar's advance. Principal factors behind the dollar's strength included renewed market expectations that OPEC countries would invest increasing proportions of their revenues in dollars, continued market apprehension over the problems of the German banking system, and the increasingly gloomy outlook for the economy of the United Kingdom.

The German mark showed particular weakness in the exchanges in August, and was supported by central bank purchases of marks against dollars to the extent of $272 million and against other snake currencies to the extent of over $400 million equivalent. The Japanese yen was also under substantial downward pressure. The Bank of Japan sold nearly $460 million to support its currency.

Euro-dollar deposit rates have shown divergent movements in the past three weeks, and a further widening of the gap between very short-term rates and rates on longer maturities. The 3-month rate resumed its upward movement, reaching an average of 13.8 per cent in the week of September 4 (after briefly exceeding 14 per cent in late August), and the excess of the 3-month rate over the 60-89 day CD rate widened to about 2.4 per cent. The overnight rate declined to 11.2 per cent in the latest week.

U.S. banks further increased their gross liabilities to their foreign branches to an average of $4.3 billion in the week of August 28, up from $4.1 billion three weeks before, although there was a sharp intervening decline.

U.S. balance of payments. Preliminary data indicate that U.S. liabilities to foreign official institutions declined by about $3/4 billion in August after increasing in each of the previous five months. Oil-exporting countries continued to add to their official U.S. assets, but other central banks, notably in Japan and Germany, sold dollars in more than offsetting amounts. Also, U.S. reserve assets increased in August by about $600 million, as a result mainly of a drawing by the Bank of Mexico of $180 million on its swap line with the Federal Reserve and an Italian drawing of dollars from the International Monetary Fund which increased the U.S. reserve position in the Fund.

There appears to have been a fairly strong net inflow of private capital during August, particularly through U.S. branches and agencies of foreign banks. These inflows must have more than offset the deficit on current account.

There is still little detailed information available about transactions in July. Nearly all of the official settlements deficit of $1 billion can probably be attributed to inflows of official funds from oil-exporting countries. U.S. liabilities to official Japanese agencies were reduced as the Japanese Ministry of Finance increased their dollar deposits with Japanese commercial banks by $450 million. In July there was a net inflow of short term bank reported capital for the first month since January. Bank lending to foreigners, about $1-1/4 billion, was only half the monthly average rate of the second quarter even though bank acceptance credits (particularly to Japan) which are included in these claims on foreigners, rose to record levels. And there was an increase of $2 billion in liabilities to private foreigners reported by U.S. banks in July. The July trade balance, as described below, was in deficit by $3/4 billion, not annual rate, primarily reflecting increased petroleum imports.

U.S. Merchandise trade. In July the U.S. trade balance showed a large deficit of $9.4 billion (seasonally adjusted annual rate), about equal to the average deficit for May-June -- as compared to a average deficit rate of only $0.6 billion in the first four months of 1974. The marked worsening in the trade deficit in recent months can be attributed to continued large increases in fuel imports and some decline in agricultural exports, with unusually large declines in aircraft exports in May and July also contributing to the large deficits in those months. In contrast to the total trade deficit, the deficit excluding agricultural exports and fuel imports for May-July was unchanged from the $2 billion deficit rate in the preceding four months.

The value of fuel imports in May-July was nearly 30 per cent higher than the January-April average, with about two-thirds of the increase attributable to higher prices. In July, however, there was a sharp rise in import volume -- to nearly 7 million barrels per day, compared with less than 6-1/2 million barrels per day in each of the preceding three months -- reflecting, in part, an increase in stocks of petroleum products. Prices of oil imports in July held fairly steady at then April-June level i.e., slightly over $11.60 per barrel. With stocks now at a very high level and domestic consumption of oil relatively constant, it is unlikely that the high volume of oil imports in July will be sustained.

Agricultural exports have declined in both volume and unit value since April. Agricultural export prices recovered slightly in July; this rise, however, was still too soon to reflect the recent run-up in U.S. agricultural prices, and further large rises in these export prices can be expected. Nonagricultural exports and nonfuel imports have both risen by about 20 per cent over the first seven months of 1974. All of the increased value in nonfuel imports and about two-thirds of the increase in nonagricultural exports were attributable to higher prices.

Petroleum. A substantial world oil surplus developed during the second quarter of 1974, with free world oil supplies exceeding consumption at current prices by around 3 million barrels a day (6 per cent) in June. Storage tanks almost everywhere are full, and sizable quantities of oil are, in effect, in storage at sea in tankers steaming at below-normal speeds or queuing up to unload.

Any hopes for a decisive break in prices, however, have been disappointed as the OPEC countries have reacted since June by cutting back production rather than by offering large amounts of oil in the auction market.. Recent substantial cuts in output have occurred in

Kuwait, Libya, Saudi Arabia, and Venezuela. For the longer run, Iran and Nigeria have asked the producing companies to scale down their expansion plans.

Total OPEC petroleum output in August was at a rate 5 per cent lower than the 1973 average. Percentage cuts in output have been particularly large this year in Libya and Kuwait, where August output was 45 and 31 per cent, respectively, below 1973 average rates. Other OPEC countries producing less in August than in 1973 on average included Algeria and Venezuela (15 per cent) and Iraq and Qatar (9 per cent). While there have been increases from average 1973 levels in the United Arab Emirates, Saudi Arabia, Iran, Nigeria, and Indonesia, the tendency in most of these countries, too, is now to cut back (as in Saudi Arabia) or slow expansion.

Ministers of OPEC countries will meet in September to consider future pricing and perhaps a more systematic sharing of curbs on output.

The economic situation in the United Kingdom. The air of gloom surrounding the British economy is thickening. There are many major problems facing Britain, and there is a lack of confidence in the present Government's -- or any Government's -- ability to solve them. As can be seen in the table below, prices and wages have been rising at high and accelerating rates, and upward pressure on wages is likely to increase further. Output in the second quarter -- though presumably recovered from the electricity cutbacks in the first quarter -- remained below the average level of the second half of last year, and is likely

UNITED KINGDOM: ECONOMIC INDICATORS

	1973				1974			
	Q1	Q2	Q3	Q4	Q1	Q2	July	Aug.
Percentage change from year earlier:								
Retail prices	7.9	9.3	9.2	10.3	12.9	15.9	17.1	n.a.
Wholesale prices1/	6.6	5.8	7.5	9.4	15.7	23.9	24.5	n.a.
Basic weekly wage rates2/	13.2	15.6	14.3	11.8	14.4	14.7	18.1	n.a.
Levels (S.A.):								
Real GDP3/ (1970=100)	110.1	109.3	110.4	110.0	106.8	109.04/	n.a.	n.a.
Unemployment5/ (th)	667	605	562	489	543	552	564	583
(per cent)	3.0	2.7	2.5	2.2	2.4	2.4	2.6	2.7
Current account balance (£ m.)	-147	-189	-291	-663	-993	-1056	-11256/	n.a.
Official reserves ($ m.)7/	6036	7013	6382	6476	6444	6711	6680	6842

1/ Output prices for all manufactured products (home market sales). 2/ For all manual workers in all industries and services. 3/ Based on output data 4/ Preliminary estimate. 5/ Excluding school-leavers and adult students; Great Britain. 6/ At quarterly rate. 7/ End of period, not seasonally adjusted.

to be fairly flat for the next several quarters. Unemployment has been rising. The latest forecast by the National Institute for Economic and Social Research -- published at the end of August -- shows real GNP rising by less than 1 per cent between the second halves of 1974 and 1975, with the number of unemployed rising to 900,000 by the end of next year. Some other forecasts paint an even weaker picture.

On the external side, the current account deficit is likely to be over £4 billion, or about $10 billion, this year -- roughly 6 per cent of British GDP. In the first 7 months of this year, the trade deficit (S.A.) averaged £449 billion, compared to an average monthly deficit of £198 million last year. The bulk of that deterioration has represented the increase in the deficit on petroleum trade. Indeed, one of the few relatively favorable aspects of the British economic situation is that the deficit on non-oil trade has been declining this year, after reaching a peak at the end of last year.

So far Britain has been able to finance its large current account deficit with little change either in the effective exchange rate of sterling since July 1973 or in the level of official reserves. A sizable part of the deficit reflects imports of equipment needed to exploit North Sea oil resources, and these imports have largely been financed by direct investment inflows. In addition, foreign liabilities have increased considerably, largely reflecting foreign currency borrowing by the local authorities and nationalized industries (amounting to $1.9 billion in the first eight months of this year, and $2.5 billion last year), and increased holdings of sterling assets by oil companies and oil exporting countries.