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Confidential (FR) Class II FOMC

Part 2

May 14, 1975

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the Federal Open Market Committee
By the staff of the Board of Governors of the Federal Reserve System

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DOMESTIC NONFINANCIAL SCENE

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)		
Civilian labor force	Apr.	5-2-75	92.3	5.7	.7	2.1
Unemployment rate (per cent)	Apr.	5-2-75	8.9	8.7 1/	8.2 1/	5.0 1/
Insured unemployment rate (%)	Apr.	5-2-75	6.8	6.4 1/	5.5 1/	3.3 1/
Nonfarm employment, payroll (mil.)	Apr.	5-2-75	76.3	-.8	-4.8	-2.5
Manufacturing	Apr.	5-2-75	18.1	-6.3	-14.1	-10.4
Nonmanufacturing	Apr.	5-2-75	58.2	.9	-1.9	.3
Private nonfarm:						
Average weekly hours (hours)	Apr.	5-2-75	36.0	35.9 1/	36.2 1/	36.6 1/
Hourly earnings ($)	Apr.	5-2-75	44.5	2.7	5.5	8.3
Manufacturing:						
Average weekly hours (hours)	Apr.	5-2-75	39.0	38.8 1/	39.2 1/	39.3 1/
Unit labor cost (1967=100)	Mar.	4-30-75	146.4	13.3	16.8	14.9
Industrial production (1967=100)	Apr.	5-15-75	109.4	-4.4	-15.1	-12.4
Consumer goods	Apr.	5-15-75	119.6	12.2	-1.7	-6.9
Business equipment	Apr.	5-15-75	115.9	-16.3	-20.9	-9.4
Defense & space equipment	Apr.	5-15-75	81.4	-2.9	-11.5	1.0
Materials	Apr.	5-15-75	103.9	-17.1	-23.9	-19.3
Consumer prices (1967=100)	Mar.	4-22-75	157.9	3.7	6.4	10.3
Food	Mar.	4-22-75	171.0	-6.3	1.4	7.7
Commodities except food	Mar.	4-22-75	146.4	7.4	8.1	11.3
Services 2/	Mar.	4-22-75	163.2	4.4	8.0	11.0
Wholesale prices (1967=100)	Apr.	5-8-75	172.3	18.5	.6	12.7
Industrial commodities	Apr.	5-8-75	169.1	1.1	2.4	15.7
Farm products & foods & feeds	Apr.	5-8-75	181.0	57.7	3.3	5.4
Personal income ($ billion) 3/	Mar.	4-17-75	1194.6	1.2	1.2	6.9
				(Not at Annual Rates)		
Mfrs. new orders dur. goods ($ bil.)	Mar.	4-30-75	35.5	-4.0	-6.1	-15.3
Capital goods industries:	Mar.	4-30-75	11.4	-6.3	-6.4	-11.0
Nondefense	Mar.	4-30-75	9.6	-3.2	-7.8	-14.6
Defense	Mar.	4-30-75	1.7	-20.4	-2.4	-16.8
Inventories to sales ratio:						
Manufacturing and trade, total	Mar.	5-9-75	1.69	1.66 1/	1.68 1/	1.46 1/
Manufacturing	Mar.	4-30-75	1.97	1.93 1/	1.89 1/	1.62 1/
Trade	Mar.	5-9-75	1.44	1.42 1/	1.48 1/	1.32 1/
Ratio: Mfrs.' durable goods inventories to unfilled orders	Mar.	4-30-75	.832	.812 1/	.754 1/	.722 1/
Retail sales, total ($ bil.)	Apr.	5-9-75	46.6	1.4	1.4	5.2
GAF	Apr.	5-9-75	12.0	2.0	5.2	3.4
Auto sales, total (mil. units) 3/	Apr.	5-7-75	7.3	-4.9	-9.6	-39.7
Domestic models	Apr.	5-7-75	5.7	-5.5	-13.2	-44.2
Foreign models	Apr.	5-7-75	1.6	-2.5	6.0	-15.6
Housing starts, private (thous.) 3/	Mar.	4-16-75	980	-.6	11.4	-35.1
Leading indicators (1967=100)	Mar.	4-30-75	154.5	-.5	-3.1	-10.3

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

DOMESTIC NONFINANCIAL DEVELOPMENTS

There have been further indications this past month of a slowing in the rate of economic contraction. Total employment rose for the first time since last September and industrial production edged off fractionally in April. An upturn in production and employment in some nondurable goods industries suggests that inventory liquidation is nearing completion in that sector. The outlook for inflation continues to improve as well.

Although there are indications that the recession is bottoming out, there remain disquieting signs of continued weakness in auto sales, in residential construction activity, and in capital spending. The behavior of these key sectors in the months ahead will have a significant effect on the timing and vigor of recovery. The reaction to the tax cut cannot yet be judged.

The industrial production index is estimated to have decreased in April by 0.4 per cent, as compared to the 1.3 per cent drop in March, and much less than the sharp rates of decline recorded in the winter months. Consumer-goods output rose, largely as a result of increases in autos and nondurables. Auto production, at a 6.3 million unit rate in April, had been scheduled to increase further in May and June but schedules are now being cut back in light of weak sales. Ford has announced a 5 per cent curtailment of assembly schedules for May and June and a two-week vacation closedown of most of its plants in July. Other auto makers also are expected to cut back their assembly plans. The April gains in consumer-goods output were more than offset by further declines in equipment, steel and other durable materials.

Already down 12 per cent since last September, business equipment is estimated to have fallen another 1.4 per cent in April. In steel, the inventory liquidation appears to be just beginning, as producers cut raw steel output in April by 7 per cent from March, and weekly data indicate additional sharp reductions in early May. Among non-durable materials, a group that has experienced an exceptionally sharp 20 per cent cutback in output in recent months, production appears to have stabilized.

Capacity utilization in major materials industries declined slightly further in April and remains about one-fourth below its 1973 peak. The operating rate in metals fell sharply last month, more than offsetting a slight rise in capacity utilization for nondurable materials such as textiles and synthetics.

Retail sales, excluding autos and nonconsumer items, increased by about 1 per cent in April, about the same as in the previous two months according to the advance estimate from the Census Bureau. These sales have been increasing in real terms since December. Outlays for apparel and general merchandise were particularly strong in April and spending for furniture and appliances rose somewhat. Only the food group, which had an unusual surge in sales during the first quarter, reported lower April sales. Because durable-goods purchases are more easily postponed and are relatively expensive per unit, consumer spending on these items has declined relative to outlays for nondurable goods--a typical recession phenomenon. Tax rebates that are now being mailed out, are relatively small in size--at least $100, but with a ceiling of $200--which makes it more likely that they will be used for buying a product in the price range of a bicycle rather than a car.

The spring rebound in auto sales anticipated by Detroit has failed to materialize. For the month of April, auto sales were at a 5.7 million unit annual rate, seasonally adjusted, 5.5 per cent below March and 27 per cent below a year ago. An increase in large-car sales from March was more than offset by a sharp drop in small-car purchases. The poor performance of small cars may be partially explained by two related factors. First, since the rebate programs applied to small cars, any borrowing from the future would have a greater impact on this group. Second, producers have increases the base prices of small models relatively more than for large cars since the lifting of price controls in early 1974. By contrast, imported cars for which price increases so far have been more modest (and whose fuel consumption generally is less) have fared better. In April, their sales were at a 1.6 million unit annual rate, seasonally adjusted, down slightly from March but 23 per cent above a year earlier. Imports now account for 22 per cent of the domestic auto market--up sharply from their 14 per cent share a year ago.

Residential construction through March had not yet shown the expected rebound in activity despite a strong flow of savings to major lenders and some further improvement in sales of both new and existing units. Private housing starts were little changed in March at a rate about 35 per cent below a year earlier. Lenders' commitment policies on construction loans to speculative builders have remained quite selective, reflecting the large volume of eligible new units yet to be sold under the 5 per cent tax credit instituted in late March as well as generally cautious attitudes in view of economic uncertainties.

The incoming data on business demand continues weak. Following a small rise in February, total new orders for durable goods fell 4 per cent in March. Declines were widespread, with only some categories of transportation equipment showing increases. The orders data also suggest continued erosion of business fixed investment in the near term. Nondefense capital goods orders declined by 3.2 per cent in March. In real terms, these orders are now 37 per cent below their July peak. Unfilled orders continued to decline in March for both total durable and nondefense capital goods. Since last August, backlogs of nondefense capital goods orders in real terms have fallen by 17.6 per cent. There was also a further decline of 15 per cent in contracts for commercial and industrial buildings in March. Contracted floor space fell 27 per cent from January to March and was about one-half the year earlier rate.

The most recent (April) McGraw-Hill survey, on the other hand, suggests that overall capital spending plans changed little from the prior survey in February. This latest survey indicates that firms are planning a 5 per cent current-dollar increase in capital outlays for 1975. Like the last two Commerce plant and equipment surveys, the McGraw-Hill results suggest that--while the large erosion in investment plans has probably come to a halt--little stimulus is likely to come from real business investment in 1975.

Liquidation of business inventories continues at a rapid pace, preparing the economy for increased activity in the future. The book value of manufacturing and trade inventories decreased at a $23.1 billion annual rate in March following an $11.8 billion decrease in February. The book value of manufacturers' inventories is estimated to have fallen at an annual rate of $8.2 billion in March -- the first decline in this series in nearly four years -- with the liquidation concentrated in nondurable goods. Although it now appears likely that the sizeable inventory liquidations in trade and nondurable manufacturing may be approaching completion, a big run-off of stocks by manufacturers of durable goods has yet to occur.

The improvement in the state of nondurable-goods inventories was also evident in the April payroll employment data. Jobs in nondurable-goods manufacturing industries and in trade rose slightly while durable-goods employment continued to fall sharply -- especially in machinery and basic metals. Total nonfarm employment fell by 53,000, seasonally adjusted. in April. The notion that a number of industries are beginning to adjust production schedules upward is supported by the fact that, of 172 private nonfarm industries surveyed by the Labor Department, 43 per cent increased their employment in April -- compared to only 26 per cent in March and a series low of 17 per cent in February. In addition, the factory workweek rose 0.2 hour in April -- the first increase in 6 months. The gain in hours was widespread among industries, with significant declines confined to primary metals and petroleum producers.

Total employment rose by 240,000 in April, seasonally adjusted -- its first increase since September. But the civilian labor force rose even more rapidly, and the unemployment rate was up 0.2 percentage point to 8.9 per cent. The jobless rate is expected to rise further in the coming months partly because increases in output are expected to be modest and also because business firms typically achieve large gains in productivity during the early stages of recovery.

Wage increases have continued to moderate in response to the slack labor market and the slowing of price increases. The average hourly earnings index for private nonfarm workers, which is a volatile series, was virtually unchanged in April after rising sharply in March. These recent movements are due largely to a bunching of cost-of-living wage adjustments and collective bargaining contract settlements in March. April figures reflected few such adjustments. More indicative of the underlying rate of wage increase, is the 6.7 per cent annual rate rise in the hourly earnings index since December; this compares with an 8.7 per cent increase in the second half of 1974. As is usually the case, the sectors experiencing the greatest wage moderation are the ones that are most competitive in their product markets such as services and trade.

Labor in the more highly organized industries continue to be relatively successful in negotiating wage increases which at least keep up with past increases in prices. In the first quarter of 1975, first-year wage increases averaged 12.5 per cent in major collective bargaining agreements. However the impact of these increases on overall wages has been small because 1975 is a light bargaining year; only about 1 per cent of the total private nonfarm production or nonsupervisory workers were covered by major contracts settled in the first quarter.

Wholesale prices rose sharply -- by 1.5 per cent -- in April, but much of the acceleration reflects an increase in farm and food prices which follows sizeable earlier declines. The index of industrial commodity prices, seasonally adjusted, rose only 0.1 per cent, the same as in March. In the six months since last October, prices of industrial commodities have risen 2.4 per cent (not at an annual rate), as compared to a 13.1 per cent rise in the previous half year. Lower prices were recorded in April for pulp, paper and paper products and metals and metal products, industries that are believed to be in the process of liquidating excess inventories. Additionally, the advance in prices of machinery and equipment was but half the rise in each of the two preceding months. However there were further large increases in the prices of fuel and power, lumber, and hides, skins, leather and related products.

Prices of farm products and processed foods and feeds rose 4.8 per cent. Higher prices for livestock and meats were chiefly responsible for the April increase, and the prices of cattle and hogs have risen further since mid-April as marketings dropped. The total supply of livestock, however, is large, and prices should be down again later this year when marketings are increased.

In March, the consumer price index rose at a seasonally adjusted annual rate of 3.7 per cent -- compared to 6.6 per cent annual rate for the first quarter as a whole and over 14 per cent for the third quarter of last year. Food prices fell, a development that may be reversed in the near term following this month's price movements at wholesale.

In general the staff forecasts of Federal spending are changed only slightly from those reported in the April Greenbook. An expected shortfall in the sale of offshore oil leases will add about 3.0 billion to unified budget spending in fiscal 1976, but will have no effect on an NIA basis. The receipts estimates for FY '75 and FY '76 have both been increased by around $4.0 billion, mainly in response to incoming data and a reappraisal of the effective corporate tax rates used in the projection period. Both corporate and individual tax payments were stronger in April than had been expected, a factor that has been noted by the Treasury and by the securities market. The strength in individual taxes appears to be in final payments on 1974 liabilities rather than in taxes withheld on 1975 liabilities. This suggests that the effective tax rate for 1974 was somewhat higher than previously assumed, probably a result of the impact of inflation in boosting effective tax rates. In contrast, the unexpected strength in corporate tax receipts during April implies higher than projected payments on 1975 liabilities. This could simply mean that many corporations did not fully adjust for the recently enacted tax cuts in their April 15th declarations, or it could mean that in the current period of declining profits, corporate profit estimates are conservative and firms underestimate the likely decline.

Initial disbursements of rebates on 1974 personal taxes -- totaling $1.7 billion -- have been mailed and should be in consumers hands by the May 10/11 weekend.

As a result of the above revisions, the staff currently is projecting unified budget deficits of $41.0 billion in FY '75 and $76.5 billion in FY '76. In comparison, Congressional conference committee has approved a deficit target of $68.8 billion in fiscal year 1976.

Table 1

RETAIL SALES
(Seasonally adjusted, percentage change from previous period)

	1974 QIV	1975 QI	Feb.	Mar.	Apr.
Total sales	-3.2	2.7	1.9	-1.9	1.4
Durable	-10.9	5.2	3.5	-8.5	2.5
Auto	-15.5	7.0	8.2	-12.2	2.5
Furniture and appliance	-7.0	-.7	.5	-.1	.5
Nondurable	.4	1.6	1.2	1.1	.9
Food	1.6	3.3	-.3	2.6	-1.5
General merchandise	-1.5	.4	3.7	1.0	1.8
Gasoline	-1.3	.6	.0	-1.0	2.1
Total, less auto and nonconsumption items	- .1	1.7	1.1	1.0	.9
GAF	-3.1	1.1	3.1	.0	2.0

Table 2

AUTO SALES

(Seasonally adjusted annual rates)

	Total	Domestic		Imports
		Large	Small	
1974:QI	9.0	4.8	2.7	1.6
QII	9.2	5.4	2.5	1.3
QIII	10.1	5.5	3.0	1.6
QIV	7.4	3.9	2.2	1.3
Oct.	8.0	3.9	2.5	1.6
Nov.	7.0	3.7	2.0	1.3
Dec.	7.2	4.0	2.1	1.1
1975:QI	8.3	3.6	3.0	1.7
Jan.	8.1	3.7	2.9	1.5
Feb.	9.2	3.6	3.6	2.0
Mar.	7.7	3.6	2.4	1.6
Apr.	7.3	3.8	1.9	1.6

Table 3

NEW PRIVATE HOUSING UNITS
(Seasonally adjusted annual rates, in millions of units)

	1970 1/	1974	1975			Per cent change in March from:	
	QI	QIV	QI	Feb. (r)	Mar. (p)	Month ago	Year ago
Permits	1.10	.78	.70	.71	.71	- 1	-50
Starts	1.24	1.00	.99	.99	.98	- 1	-35
1-family	.69	.76	.74	.72	.76	+ 5	-22
2- or more-family	.55	.24	.25	.26	.22	-16	-59
Under construction 2/	.89	1.23	n.a.	1.17	n.a.	- 1 3/	-28 3/
Completions	1.39	1.63	n.a.	1.27	n.a.	-18 3/	-32 3/
MEMO: Mobile home shipments	.37	.23	.20	.22	.20	- 9	-58

1/ Previous cyclical trough.
2/ Seasonally adjusted, end of period.
3/ Per cent changes based on February.

Table 4

SALES, STOCKS AND PRICES OF NEW SINGLE-FAMILY HOMES

	Homes sold 1/	Homes for sale 2/	Months' supply	Median price of: Homes sold	Median price of: Homes for Sale
	(thousands of units)			(thousands of dollars)	
1973					
QI	726	425	7.1	30.4	29.4
QII	663	437	7.9	32.7	31.2
QIII	566	453	9.6	33.5	32.1
QIV	503	448	10.7	34.0	32.9
1974					
QI	523	452	10.4	35.2	34.0
QII	550	436	9.5	35.6	35.0
QIII	490	414	10.1	36.2	35.7
QIV(r)	417	400	11.5	37.3	36.2
1975					
QI	419	393	11.3	37.9	36.6
1975					
Jan. (r)	401	403	12.1	37.4	36.5
Feb. (r)	408	407	12.0	37.8	36.7
Mar. (p)	449	393	10.5	38.3	36.6

1/ Seasonally adjusted annual rate.
2/ Seasonally adjusted, end of period.

Table 5

NEW ORDERS
(Per cent change from prior month)

	Total Durable		Nondefense Capital Goods	
	Current	Real	Current	Real
1974: July	1.8	- .7	6.6	4.4
Aug.	3.7	.9	-7.8	-11.1
Sept.	- 6.2	- 8.5	.2	- 2.4
Oct.	- 2.8	- 4.6	-3.8	- 6.8
Nov.	- 4.2	- 4.8	-6.7	- 9.7
Dec.	-12.4	-13.3	-1.5	- 2.9
1975: Jan.	- 4.7	- 5.1	-3.7	- 6.0
Feb.	2.7	2.7	-1.1	- 1.6
Mar.(p)	- 4.0	- 4.0	-3.2	- 3.9

Table 6

SURVEY RESULTS OF ANTICIPATED PLANT
AND EQUIPMENT EXPENDITURES
(Per cent change from prior year)

	1974	1975 Commerce Dec. Survey	1975 Commerce Feb. Survey	1975 McGraw-Hill Oct. Survey	1975 McGraw-Hill Feb. Survey	1975 McGraw-Hill Apr. Survey
All industry	12.7	4.6	3.3	11.8	5.8	5.5
Manufacturing	21.0	9.0	7.1	21.3	15.1	8.5
Durables	17.5	1.8	.0	13.5	7.3	1.9
Nondurables	24.7	16.0	14.1	29.2	22.7	14.9
Nonmanufacturing 1/	7.6	1.6	.6	5.2	- .6	3.4
Railroads	29.5	27.7	13.6	29.1	21.0	31.9
Air & other transportation	1.2	3.0	11.2	3.7	-2.3	12.4
Electric utilities	10.6	1.2	- .7	.0	-4.0	.0
Gas utilities	5.8	21.9	4.1	11.1	12.9	16.1
Communications	8.6	- 1.8 1/	-2.8	4.0	-3.0	-4.0
Commercial & other	3.0	- 4.3 1/	-3.5	-1.0	-5.0	1.0

1/ Contains industries not shown separately.

Table 7

BUSINESS INVENTORIES
(Change at annual rates in seasonally adjusted book values, $ billions)

	1974		1975		
	QIII	QIV	QI (p)	Feb.	March (p)
Manufacturing and trade	59.2	52.9	-11.6	-11.8	-23.1
Manufacturing	37.7	29.7	3.6	4.4	-8.2
Durable	23.3	19.1	8.2	11.5	- .8
Nondurable	14.5	10.6	-4.6	-7.1	-7.4
Trade, total	21.4	23.2	-15.2	-16.2	-14.9
Wholesale	8.6	8.3	-4.8	-3.0	-7.1
Retail	12.8	14.9	-10.4	-13.3	-7.7
Auto	4.0	11.8	-8.5	-18.6	-2.2

INVENTORY RATIOS

	1974		1975	
	Feb.	March	Feb.	March
Inventory to sales:				
Manufacturing and trade	1.47	1.46	1.66	1.69
Manufacturing, total	1.62	1.62	1.93	1.97
Durable	2.04	2.04	2.52	2.59
Nondurable	1.16	1.16	1.32	1.34
Trade, total	1.33	1.32	1.42	1.44
Wholesale	1.10	1.09	1.24	1.26
Retail	1.52	1.51	1.56	1.57
Inventories to unfilled orders				
Durable manufacturing	.721	.722	.812	.832

Table 8

CHANGES IN NONFARM PAYROLL EMPLOYMENT

(In Thousands)

	Employment (Apr. 1975)	Average Monthly Change Apr. 1974-Apr. 1975	Oct. 1974-Apr. 1975	Mar. 1975-Apr. 1975
Total nonfarm 1/	76,293	-161	-429	-53
Good-producing	22,220	-223	-394	-118
Construction	3,462	-52	-75	-16
Manufacturing	18,058	-174	-321	-96
Service-producing	54,073	+62	-35	+65
Trade	16,794	-13	-61	+6
Services	13,773	+34	+11	+21
State & local government	12,109	+55	+54	+40

1/ Totals include industries not shown separately.

Table 9

SELECTED UNEMPLOYMENT RATES
(Seasonally Adjusted)

	1974		1975	
	April	October	March	April
Total	5.0	6.0	8.7	8.9
Men 20 years and over	3.5	4.3	6.8	7.0
Women 20 years and over	5.0	5.6	8.5	8.6
Teenagers	14.0	17.1	20.6	20.4
Household heads	3.0	3.7	5.8	6.0
White	4.5	5.5	8.0	8.1
Negro and other races	8.8	10.9	14.2	14.6
White collar workers	2.9	3.3	4.6	4.7
Blue collar workers	6.3	7.4	12.5	13.0
State insured*	3.3	3.6	6.4	6.8

* per cent of covered workers

Table 10

HOURLY EARNINGS INDEX*
Total and Selected Industries
(Seasonally adjusted; per cent change annual rates)

	Mar.- Apr. 1975	Dec. 1974- Apr. 1975	June- Dec. 1974	Apr. 1974 Apr. 1975
Total private nonfarm	.1	6.7	8.7	9.4
Manufacturing	5.0	8.8	10.3	11.0
Mining	-1.1	10.7	12.2	12.5
Trade	0	6.7	7.6	9.3

* Excludes the effects of fluctuations in overtime premium in manufacturing and shifts of workers between industries.

Table 11

PRICE BEHAVIOR
(Percentage changes, seasonally adjusted annual rates) 1/

	Relative importance Dec. 1974	Dec. 1973 to June 1974	June to Sept. 1974	Sept. to Dec. 1974	Dec. 1974 to Mar. 1975	Mar. to Apr. 1975
			WHOLESALE PRICES			
All commodities	100.0	17.7	34.9	14.2	-6.3	18.5
Farm and food products	29.1	-10.9	60.5	18.8	-27.6	57.7
Industrial commodities 2/	70.9	32.2	28.4	11.1	4.2	1.1
Materials, crude and intermediate	46.0	36.8	32.4	9.0	2.7	3.4
Finished goods:						
Consumer nonfood	17.5	25.6	19.5	11.8	3.8	2.4
Producer	8.6	19.8	29.6	21.2	11.8	7.5
Consumer foods	13.4	.1	33.7	20.7	-12.9	31.7

	Relative importance Dec. 1974	Dec. 1973 to June 1974	June to Sept. 1974	Sept. to Dec. 1974	Dec. 1974 to Mar. 1975	Feb. to Mar. 1975
			CONSUMER PRICES			
All items	100.0	12.3	14.2	10.1	6.6	3.7
Food	24.8	10.9	12.3	14.6	1.4	-6.3
Commodities (nonfood)	39.0	14.9	16.2	7.3	8.3	7.4
Services	36.2	10.1	13.9	10.9	8.2	4.4
Addendum						
All items less food and energy 3/4/	68.3	10.2	15.3	9.6	8.8	7.1
Petroleum products 3/	4.4	58.8	-4.1	-5.9	3.8	- .7
Gas and electricity	2.5	22.0	20.2	14.2	18.3	11.1

1/ Not compounded for one-month changes.
2/ Stage of processing components do not add to the total because they include some items found in farm and food products group.
3/ Confidential--not for publication.
4/ Energy items excluded: gasoline and motor oil, fuel oil and coal, and gas and electricity.

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

	Fiscal 1975e/		Fiscal 1976e/		Calendar Years		F.R.B. Staff Estimates				
							Calendar Quarters				Half-Year
							1975				1976
	Budget Document	F.R. Board	Budget Document	F.R. Board	1974 Actual	1975 F.R.B. e/	I*	II	III	IV	Jan.-June
Federal Budget							Unadjusted data				
Surplus/deficit	-34.7	-41.0	-51.9	-76.5	-10.9	-69.9	-18.0	-9.4	-16.9	-25.5	-34.0
Receipts	278.8	281.0	297.5	289.3	280.5	279.0	65.1	76.1	71.8	66.1	151.5
Outlays	313.4	322.0	349.4	365.8	291.4	348.9	83.1	85.5	88.7	91.6	185.5
Means of financing:											
Net borrowing from the public	43.5 2/	50.8	63.5 2/	84.3	11.8	83.6	19.4	16.6	18.9	28.7	36.
Decrease in cash operating balance	3.1 2/	1.6	-.4 2/	1.6	4.5	-.1	-.7	-1.0	1.6	--	--
Other 1/	-11.9 2/	-11.4	-11.2 2/	-9.5	-5.4	-13.7	-.7	-6.2	-3.6	-3.2	-2.7
Cash operating balance, end of period	6.0 2/	7.6	6.4 2/	6.0	5.9	6.0	6.6	7.6	6.0	6.0	6.0
Memo: Sponsored agency borrowing 3/	14.0	11.6	7.8	n.e.	16.6	2.7	.4 e/	.2	.5	1.6	n.e.
National Income Sector							Seasonally adjusted, annual rates				
Surplus/deficit	-36.1	-50.9 4/	-55.9	78.5 4/	-8.1	-84.9	-61.0 e/	-113.7	-83.0	-82.0	-72.6
Receipts	287.6	278.3 4/	305.1	296.0 4/	291.1	271.3	277.0 e/	241.0	277.7	289.6	310.1
Expenditures	323.7	329.2	361.0	374.4	299.1	356.3	338.0 e/	354.7	360.7	371.6	382.7
High Employment surplus/deficit (NIA basis) 2/5/	n.a.	3.9	n.a.	-7.0	19.1	-10.7	9.7	-36.9	-5.9	-9.8	-6.1

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

1/ Outlays of off-budget Federal agencies, checks issued less checks paid, accrued items, and other transactions.
2/ Estimated by F.R. Board Staff.
3/ Federally-sponsored credit agencies, i.e., Federal Home Loan Banks, Federal National Mortgage Association, Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.
4/ Quarterly average exceeds fiscal year total by $.6 billion for fiscal 1975 and $.9 billion for fiscal 1976 due to spreading of wage base effect over calendar year.
5/ The high-employment budget estimates now fully incorporate taxes on inventory profits beginning in 1973.

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		April	35.1	8.8	-8.0	4.1
Reserves available (RPD's)		April	33.1	3.7	-3.5	4.8
Money supply		April				
M1		April	288.1	5.4	8.4	4.2
M2		April	631.5	7.8	9.9	7.1
M3		April	1017.5	11.5	12.1	7.6
Time and savings deposits (Less CDs)		April	343.4	10.2	11.3	9.8
CDs (dollar change in billions)		April	88.4	-1.4	-4.3	14.5
Savings flows (S&Ls + MSBs)		April	357.3	18.1	15.9	8.0
Bank credit (end of month)		April	700.7	2.2	3.9	4.4
Market yields and stock prices				Percentage or index points		
Federal funds	wk. endg.	5/7/75	5.42	.14	-1.04	-5.87
Treasury bill (90 day)	"	5/7/75	5.41	-.33	-.21	-3.37
Commercial paper (90-119 day)	"	5/7/75	5.98	-.12	-.62	-5.00
New utility issue Aaa	"	5/2/75	9.80	- -	.91	1.02
Municipal bonds (Bond Buyer)	1 day	5/1/75	6.95	.02	.01	1.04
FNMA auction yield	(FHA/VA)	5/5/75	9.29	.31	.31	-.05
Dividends/price ratio (Common stocks)	wk. endg.	4/30/75	4.22	-.20	-.36	.27
NYSE index (12/31/65=50)	end of day	5/16/75	46.91	4.22	5.09	-1.42

Credit demands	Period	Net change or gross offerings: Current month 1975	Current month 1974	Year to date 1975	Year to date 1974
Business loans at commercial banks	April	-.7	4.7	-2.8	14.2
Consumer instalment credit outstanding	March	-.4	.6	5.6	16.3
Mortgage debt outst. (major holders)	February	2.7	4.0	5.3	7.4
Corporate bonds (public offerings)	April	3.0e	1.6	13.4e	7.4
Municipal long-term bonds (gross offerings)	April	2.2e	2.4	8.7e	8.7
Federally sponsored Agcy. (net borrowing)	April	.5e	1.3	.9e	1.3
U.S. Treasury (net cash borrowing)	May	8.3e	- -	34.7e	.9
Total of above credits		15.6	14.6	65.8	56.2

e - Estimated

DOMESTIC FINANCIAL DEVELOPMENTS

Conditions in the money and capital markets have strengthened since the April FOMC meeting. Both short- and long-term market interest rates have declined significantly from recent highs reached around the end of April. Mortgage yields, however, have risen moderately in reaction to the earlier sharp back-up in bond rates and to some pickup in demand for home financing.

Most deposit aggregates increased appreciably in April, although the rates of growth generally were below those in March. Those aggregates which include consumer-type time and savings deposits at banks and nonbank thrift institutions were particularly strong. Depositary institutions generally have continued to use a sizable part of their funds flows to repay debt and/or build liquid assets, although there is some evidence of increased mortgage lending activity. Business and consumer loans remain quite weak.

Short-term securities markets. Private short-term market interest rates registered little over-all change during the last half of April, against the background of general stability of the Federal funds rate in the 5-1/2 per cent area. Most recently, however, the market took note of Federal Reserve operations that suggested a decline in the Desk's intervention point for the funds rate, and commercial paper and CD rates since the beginning of May have moved about 1/4 percentage point lower.

SELECTED SECURITY MARKET QUOTATIONS
(one day quotes-in per cent)

	Aug. FOMC Aug. 20	Feb. FOMC Feb. 19	Mar. FOMC Mar. 18	Apr. FOMC Apr. 15	Apr. 29	May 6	May 13
Short-term							
Federal funds 1/	12.23	6.29	5.38	5.44	5.71	5.42	5.24 4/
Treasury bills							
3-month	9.05	5.30	5.42	5.48	5.60	5.44	5.00
6-month	9.13	5.40	5.53	5.80	6.00	5.82	5.51
1-year	8.86	5.42	5.63	6.28	6.43	6.20	5.81
Commercial paper							
1-month	12.00	6.38	5.88	6.00	5.88	5.75	5.63
3-month	11.88	6.38	6.00	6.13	6.13	6.00	5.88
Large neg. CD's 2/							
3-months	12.35	6.30	6.05	6.15	6.10	5.75	5.75
6-months	12.15	6.30	6.25	6.70	6.80	6.35	6.25
Federal agencies							
1-year	9.65	6.04	6.23	7.05	7.21	6.82p	6.80p
Bank prime rate	12.00	8.75	7.75	7.50	7.50	7.50	7.50
Long-term							
Corporate							
New AAA 1/	10.10	9.02	9.27	9.65	9.66	9.80	9.62p
Recently offered 3/	10.02	9.10	9.31	9.60	9.71	9.69	9.56p
Municipal (Bond Buyer) 3/	6.61	6.27	6.65	7.03	6.97	6.95	6.86
U.S. Treasury (20-year constant maturity)	8.58	7.64	7.97	8.29	8.45	8.27	8.21
Stock prices							
Dow-Jones	726.85	736.39	779.41	815.08	803.04	834.72	850.13
N.Y.S.E.	39.32	43.13	45.10	45.66	45.41	46.91	48.45

1/ Weekly average.
2/ Highest quoted new issues.
3/ One day quotes for preceding Thursday.
4/ Average for first 6 days of statement week ending May 14.

Treasury bill rates also have declined, by 40-50 basis points since the end of April, despite significant additions to supplies in each of the regular bill auctions--$800 million in the weekly auctions and $600 million in the monthly auction. Demand for bills has been strong, especially by thrift institutions and by other investors who are in the process of rebuilding liquidity. This strength in demand along with the drop in the funds rate has pushed the 3-month bill down to 5 per cent, its lowest level since December 1972.

While the spread between commercial paper rates and the bank prime rate (which is still 7-1/2 per cent at most banks) has remained wide by historical standards, outstanding commercial paper of non-financial corporations expanded only slightly in April as their demand for short-term credit remained weak. On the other hand, paper issued by financial corporations (mainly finance companies) picked up sharply, largely substituting for the usual seasonal rise in bank borrowing. As a result, the April increase in total commercial paper outstanding was the largest since September of last year.

Long-term securities markets. Bond rates have declined, on balance, since the last FOMC meeting. Rate fluctuations over the inter-meeting period have stemmed largely from shifts in market expectations concerning the amount, timing, and composition of Treasury borrowing. Most recently, price rallies occurred in the Treasury, corporate, and municipal bond markets following the May 1 Treasury announcement that its overall borrowing needs for the current fiscal year would be $5 billion less than previously stated (owing to larger-than-expected tax receipts). Moreover, the projected share of Treasury financing in long-term bonds was less than generally anticipated by market participants.[1/]

The smaller-than-expected volume of longer-term Treasury borrowing for May and June has contributed to an easing of the pressures in the corporate bond market. Inventories of undistributed corporate bonds have been pared and some of the planned debt issues that were postponed in late March and early April have now been marketed. Thus, while total offerings in April were down somewhat from the record pace of the first quarter, the May calendar of issues is the second largest on record.

Yields in the municipal bond market recently have edged down slightly from the near-record levels prevailing at the time of the last FOMC meeting. Issues of both short-term notes and long-term bonds increased somewhat in April, as State and local governments continued to be faced with revenue shortfalls due to the recession. Investors generally have remained cautious owing to concern over the financial condition of some issuers--particularly New York City. Estimated holdings at commercial banks, which apparently still have only a limited interest in tax-exempt income from municipals, declined slightly on a seasonally adjusted basis in April.

Stock market prices continued to advance during April and into May. Major stock market price indexes have risen close to 7 per cent since the April FOMC meeting, and trading has remained heavy. With the continuing decline in the relative cost of equity financing, new issues of stocks have expanded. April's new-issue volume, $1 billion, was the largest monthly total since November 1973.

1/ A decision by the Federal Home Loan Banks to pay down $1.27 billion of maturing debt during May also encouraged investors.

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

	1974 Year	1975 QIe/	QIIe/	Mar.e/	Apr.e/	May f/	June f/
				Gross offerings			
Corporate securities:							
Total	3,155	5,053	4,760	5,524	4,731	5,150	4,400
Publicly-offered bonds	2,111	4,380	3,150	3,600	2,950	3,500	3,000
Privately-placed bonds	519	878	700	1,000	750	750	600
Stocks	525	695	910	924	1,031	900	800
Foreign securities 1/	94	365	265	175	295	250	250
State and local govt. securities							
Long-term	1,894	2,188	2,224	1,966	2,172	2,300	2,200
Short-term	2,454	2,554	2,913	2,841	2,938	3,000	2,800
				Net offerings			
U.S. Treasury 2/	982	6,484	5,533	11,249	7,100	8,300	1,200
Sponsored Federal agencies	1,394	7	59	461	511	-1,650	1,317

1/ Includes issues of foreign private and official institutions.
2/ Total Treasury issues, including Federal Financing Bank.
3/ Estimated.
4/ Forecasted.

Monetary aggregates. The narrowly-defined money stock (M_1) grew at an annual rate of 5.4 per cent in April, well below the extraordinary pace of March. With transactions requirements for cash balances still limited, and with the rate of disbursement of income tax refunds returning to year-ago levels--after exceptionally large disbursements in February and March--the rate of increase in the money supply slowed markedly during April.

At commercial banks, time and savings deposits other than large CD's have continued to grow rapidly, with the rate of increase for April only slightly less than that for March. Despoit growth at savings and loan associations and mutual savings banks, while well below the record March rates, also remained quite strong last month. Inflows at both banks and thrift institutions in March, and at banks again in April, were heavily concentrated in passbook accounts, presumably reflecting demands for liquidity at a time of uncertain market interest rate expectations. Reflecting the rapid growth in Consumer-type savings, the more broadly defined measures of the money stock--M_2 and M_3--rose during April at annual rates of 7.8 and 11.5 per cent, respectively.

With small-denomination time and savings deposit inflows strong and loan demand still weak, commercial banks allowed large-denomination time deposits to run off appreciably further during the month. As a result, the bank credit proxy advanced at less than a 5 per cent rate.

MONETARY AGGREGATES
(Seasonally adjusted changes)

	1974 QIII	1974 QIV	1975 QI	1975 Feb.	1975 Mar.	1975 Apr. p
	Per cent at annual rates					
M_1	1.6	4.6	3.5	6.8	12.7	5.4
M_2	4.5	7.0	8.5	9.5	12.2	7.8
M_3 1/	4.0	7.0	10.3	10.4	13.9	11.5
Adjusted bank credit proxy	6.7	4.2	3.1	-0.2	5.8	4.8
Time and savings deposits at commercial banks:						
a. Total	9.1	12.6	9.5	7.6	2.5	4.2
b. Other than large CD's	7.1	9.0	12.7	11.9	11.4	10.2
Deposits at nonbank thrift institutions: 2/						
a. Savings and loans	3.3	9.2	17.0	14.9	23.3	16.9
b. Mutual savings banks	.4	5.0	10.5	8.7	18.0	10.2
c. Credit unions 3/	6.1	12.0	14.5	17.2	8.5	8.5
	Billions of dollars 3/					
Memoranda:						
a. U.S. Government demands deposits	.3	-1.5	-0.4	-0.1	0.1	1.4
b. Negotiable CD's	1.2	1.8	-0.2	-0.6	-2.3	-1.4
c. Nondeposit sources of funds	0.1	-0.1	-0.6	-1.1	--	0.2

1/ M_3 is defined as M_2 plus credit union shares, mutual savings bank deposits, and shares of savings and loan associations.
2/ Based on month-end series.
3/ Change in average levels month-to-month or average monthly change for the quarter, measured from last month in quarter to last month in quarter, not annualized.
p - Preliminary.

Loan developments. Total loans outstanding at commercial banks declined substantially further in April and banks continued to channel most of their funds into Treasury securities. All major loan categories remained weak, particularly business and consumer loans.[1/]

Given the sizable contraction in bank loans to business, total short-term business credit outstanding declined for the third consecutive month despite the modest increase in outstanding commercial paper issued by nonfinancial corporations. With inventory liquidation probably continuing, business needs for working capital have been reduced. Moreover, industrial corporations have used part of the proceeds of the recent large volume of capital market financing to repay short-term debt incurred to finance the large buildup of inventories in 1974.

Nonbank thrift institutions continued in April to use a portion of their large deposit inflows to repay outstanding debt and to rebuild liquid assets, although apparently at a somewhat slower pace than in March.[2/] New and outstanding mortgage commitments at S&L's rose further in March, and early FHLBB estimates suggest this uptrend continued in April. Nevertheless, mortgage lenders generally

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1/ An analysis of rural bank credit conditions will appear in an Appendix to the Supplement.

2/ The FHLBB announced on May 1 that the liquidity requirement for member S&L's is being raised from 5½ to 6 per cent, effective June 1. A FHLBB survey indicates that more than 90 per cent of the S&L's already had ratios over 6 per cent at the end of March.

COMMERCIAL BANK CREDIT
(Seasonally adjusted changes at annual percentage rates) 1/

	1974 QIII	1974 QIV	1975 QI	1975 Feb.	1975 Mar.	1975 Apr. e
Total loans and investments 2/	7.3	-1.1	4.4	2.8	6.7	2.2
U.S. Treasury securities	-29.1	-27.5	82.1	110.7	121.6	116.5
Other securities	2.3	9.3	-1.4	2.6	-4.3	-2.6
Total loans 2/	12.8	-1.2	-1.5	-7.6	-2.4	-9.8
Business loans 2/	15.3	3.5	-4.5	-11.6	-10.4	-4.6
Real estate loans	7.3	5.9	3.7	2.7	2.7	4.6
Consumer loans	7.2	-3.3	-6.7	-4.3	-14.4	-14.6
Memo:						
Business loans plus nonfinancial commercial paper (per cent) 3/	19.4	4.3	-2.6	-11.4	-10.3	-3.6

1/ Last Wednesday-of-month series except for June and December, which are adjusted to the last business day of the month.
2/ Includes outstanding amounts of loans reported as sold outright by banks to their own foreign branches, nonconsolidated nonbank affiliates of the bank holding companies (if not a bank), and nonconsolidated nonbank subsidiaries of holding companies.
3/ Nonfinancial commercial paper is measured from end-of-month to end-of-month.
p - Preliminary.

NOTE: Data shown, beginning in the third quarter of 1974, reflect revisions based on the December 31, 1974, Call Report; revisions are discussed in detail in the Supplement to the Greenbook.

have remained cautious in view of the uncertain interest rate outlook. In these circumstances, new mortgage commitments have tended to be concentrated in loans available for near-term delivery--generally on existing homes and other used properties.

Demands for home mortgage credit apparently have picked up in recent weeks, especially on the West Coast. The combination of cautious lending policies and growing borrower demands has exerted some upward pressure on mortgage interest rates. On May 9, the average rate on commitments in the primary market for conventional new-home mortgages at selected S&L's was 8.89 per cent--9 basis points above the recent low in mid-April. Secondary market yields have increased more sharply. In FNMA's May 5 auctions of 4-month commitments to purchase home mortgages, average yields on accepted bids were about 30 basis points higher than a month earlier and the volume of offerings remained quite large. These upward adjustments in mortgage market interest rates prompted an increase in the ceiling rate on FHA/VA mortgages from 8 to 8-1/2 per cent, effective April 28.

Consumer credit outstanding declined sharply in March--the fourth reduction in the last five months--and fragmentary reports suggest that weakness continued through April as well. Auto credit accounted for the major portion of the March decline, following a rise in February associated with the major price rebate programs. Nonautomotive consumer goods credit and home improvement loans also were down, but personal loans outstanding (including consumer borrowing

CONVENTIONAL HOME MORTGAGES AT
SELECTED S&L's

	Average going rate on 80% loans (per cent)	Basis point change from month or week earlier	Rate spread 1/ (basis points)	Federal Home Loan Bank districts with funds in short supply
1974--High	10.03 (9/27, 10/18)	--	97 (11/15)	12 (May, July-Nov.)
Low	8.40 (3/15, 3/22)	--	-106 (7/12)	0 (Feb.-Mar.)
1975--Jan.	9.29	-30	29	3
Feb.	9.02	-27	8	1
Mar. 7	8.99	- 3	8	0
14	8.89	-10	- 38	0
21	8.85	- 4	- 75	0
28	8.85	0	- 75	0
Apr. 4	8.82	- 3	- 98	0
11	8.81	- 1	- 84	0
18	8.80	- 1	- 71	0
25	8.83	+ 3	- 83	0
May 2	8.93	+10	- 87	0
9	8.89	- 4	- 73	0

1/ Average mortgage return, before deducting servicing costs, minus average yield on new issues of Aaa utility bonds paying interest semi-annually and with 5-year call protection.

FNMA AUCTION RESULTS
HOME MORTGAGE COMMITMENTS

Date of auction		Government-underwritten Amount (In $ millions) Offered	Government-underwritten Amount (In $ millions) Accepted	Government-underwritten Average yield	Conventional Amount (In $ millions) Offered	Conventional Amount (In $ millions) Accepted	Conventional Average yield
1974--High		1,155 (3/25)	333 (3/25)	10.59 (9/9)	164 (4/18)	63 (4/8)	10.71 (9/9)
Low		26 (11/18)	18 (11/18)	8.43 (2/25)	14 (10/21)	7 (11/18)	8.47 (3/11)
1975--Jan.	13	25.3	21.2	9.37	17.9	14.9	9.50
	27	41.4	28.6	9.12	11.1	10.6	9.39
Feb.	10	24.6	18.1	8.98	14.8	9.1	9.20
	24	36.2	23.8	8.87	20.0	9.1	9.04
Mar.	10	99.2	60.1	8.78	34.4	22.1	8.96
	24	460.5	321.4	8.85	60.7	35.8	9.00
Apr.	7	551.6	277.2	8.98	99.8	44.6	9.13
	21	470.9	247.3	9.13	79.2	51.3	9.26
May	5	525.5	280.4	9.29	69.8	43.9	9.43

NOTE: Average secondary market yields are gross before deduction of fee of 38 basis points paid for mortgage servicing. They reflect the average accepted bid yield for home mortgages assuming a prepayment period of 12 years for 30-year loans, without special adjustment for FNMA commitment fees and FNMA stock purchase and holding requirements on 4-month commitments. Mortgage amounts offered by bidders relate to total bids received.

under open-end credit arrangements) rose somewhat. Among major lenders, only credit unions increased their net consumer lending in March; the greatest decline in outstanding credit occurred at commercial banks.

INTERNATIONAL DEVELOPMENTS

CONFIDENTIAL (FR)

IV -- T - 1 5/14/75

U.S. International Transactions
(in millions of dollars; seasonally adjusted)

	1974			1975p/		
	Year	Q-3	Q-4	Q-1	Feb.*	Mar.*
Goods and services, net 1/	3,191	-247	826			
Trade balance	-5,881	-2,474	-1,558	1,340	739	1,255
Exports	97,081	24,731	26,217	26,822	8,680	8,652
Imports	102,962	27,205	27,775	25,482	7,941	7,397
Net service transactions	9,072	2,227	2,384			
Remittances and pensions	-1,775	-456	-463			
Gov't grants and capital, net	-4,398	-769	-1,568			
Bank-reported private capital, net change	-3,122	1,994	-255	-5,444	-2,488	-2,448
Claims on foreigners (inc. -)	-18,838	-1,996	-3,990	-3,687	-1,035	-2,250
Liquid	-5,445	-431	-1,385	-4,668	-858	-2,197
Other	-13,393	-1,565	-2,605	981	-177	-53
Liabilities to foreigners (inc. +)	15,716	3,990	3,735	-1,757	-1,453	-198
Liquid liabilities to:	15,732	4,010	3,903	-1,678	-1,377	-209
Commercial banks abroad	12,655	2,896	2,935	-2,160	-1,725	204
(of which liab. to branches) 2/	(1,950)	(-503)	(-182)	(-1,000)	(-1,250)	(-135)
Other private foreigners	2,926	893	805	230	358	-37
Int'l & regional organizations	151	221	163	252	-10	-376
Long-term liabilities	-16	-20	-168	-79	-76	11
Private transactions in securities, net	-752	-138	-761	-1,557	-163	-365
U.S. purchases (-) of foreign securities	-1,951	-306	-686	-2,034	-475	-474
(of which: New bond issues)	(-2,336)	(-416)	(-770)	(-2,129)	(-459)	(-549)
Foreign purchases (+) of U.S. securities	1,199	168	-75	477	312	109
Stocks	447	82	-23	958	533	235
Bonds	752	86	-52	-481	-221	-126
U.S. direct investment abroad, (inc. -)	-6,801	-2,047	-2,600			
Foreign direct investment in U.S., (inc. +)	2,308	-89	-561			
Nonbank-reported: liquid claims, (inc. -)	-19	564	-283		-101	
: other claims, (inc. -)	-2,946	-324	-232			
: liabilities, (inc. +)	1,047	354	28			
Changes in liab. to foreign official agencies	9,507	1,323	4,140	2/ 2,498	2,759	516
OPEC countries (inc. +) 2/ 3/	9,772	3,934	2,481	275	739	-750
Other countries (inc. +)	-265	-2,611	1,659	2,223	2,020	1,266
Changes in U.S. reserve assets (inc. -)	-1,434	-1,003	137	-326	-121	-174
Gold	--	--	--	--	--	--
Special drawing rights	-172	-123	-20	-5	--	-5
Reserve position in the IMF	-1,265	-728	-84	-307	-121	-152
Convertible currencies	3	-152	241	-14	--	-17
Errors and omissions	5,198	838	1,592			
Memo:						
Official settlements balance, S.A.		-320	-4,277			
N.S.A.	-8,070	-1,609	-3,851	-2,172	-2,638	-342
O/S bal. excluding OPEC, S.A.		3,614	-1,796			
N.S.A.	1,702	2,325	-1,370	-1,897	-1,899	-1,092

*/ For monthly data, only exports and imports are seasonally adjusted.
1/ Differs from "net exports" in the GNP account by the amount of special military shipments to Israel (excluded from GNP net exports).
2/ Not seasonally adjusted.
3/ Partly estimated.

Foreign exchange markets. The value of the dollar on a weighted-average basis this week is about 1 per cent lower than the highs reached in mid-April. The dollar appreciated in the first two weeks of April, but then eased back with the declines in interest rates on dollar-denominated assets and most recently with the political uncertainties involved in the Cambodian incident. Compared with a month ago, the dollar has depreciated more than 4 per cent against the French and Swiss francs and nearly 3 per cent against other major Continental currencies, while it has appreciated more than 2 per cent against the pound and Canadian dollar.

The pound has dropped sharply not only against the dollar but also against all other major currencies. Since the end of March, the weighted-average of the pound dropped more than 4-1/2 per cent, hitting new lows. It has been generally assumed that the pound would depreciate at some point because Britain's rate of wage and price inflation is so much higher than inflation rates elsewhere. The suddenness of the decline this past month may reflect the realizations -- heightened by numerous statements and analyses from officials and the press -- that Britain's severe economic problems are likely to persist despite the tax increases announced in the Budget on April 15. In particular, labor's behavior since the Budget does not provide much basis for believing that wage demands will become more moderate. The Bank of England has intervened intermittently in the exchange markets to moderate the pound's declines; it tended to let the rate absorb most of the pressure until the pound's effective depreciation reached 25 per cent on the Bank of England's calculation. The Bank sold nearly $600 million since mid-April.

The Canadian dollar has also depreciated sharply in the past month mainly as a result of a deterioration in the Canadian trade and payments prospects. As a result of the postponement of several new Canadian bond issues combined with only a partial subscription to those that were floated, there has been an insufficient increase in capital inflows to match the growing trade deficit, thereby putting downward pressure on the Canadian dollar. The Bank of Canada has also intervened actively to moderate the drop in the Canadian dollar, selling $400 million in the past few weeks.

The French franc has moved up sharply in the exchanges during the past month, as funds coming out of sterling (some of them from OPEC) have been invested in franc denominated assets. Last week the franc was buoyed further by the announcement that Iran had signed a multi-billion dollar trade and investment package with the French. As a consequence of its large upward movement, the French franc returned to a rate consistent with its old snake parities and on Friday afternoon, May 9, Giscard d'Estaing announced that the French would soon rejoin the snake. The large appreciation has occurred despite heavy intervention sales of francs ($950 million equivalent) by the Bank of France.

During the past month, the System has pursued its policy of purchasing small quantities of foreign exchange on days when the dollar is rising in the exchange markets. Through the first week in May, the System had purchased sufficient marks to repay $82 million on the outstanding drawings with the Bundesbank and to fully repay the Oct-March drawings with the Swiss and Belgian National Banks. As the dollar weakened in the past week, the System sold foreign exchange and initiated new swap drawings in guilders, Belgian francs, and marks.

Euro-currency market. Euro-dollar deposit rates have declined considerably over the past five weeks, both absolutely and relative to U.S. money market rates. The 3-month rate averaged 6-1/2 per cent in the week of May 14, down almost 100 basis points from the week of April 9. The contraction of around 70 basis points in the excess of Euro-dollar rates of 1-month and more compared with U.S. CD rates somewhat reduced U.S. banks' rate incentives to use U.S. source funds to finance foreign branch lending, although the incentives -- calculated to take account of U.S. reserve requirements -- remain substantial. Such advances, funnelled largely to Nassau branches, appear to have increased by around $2.5 billion in the first quarter of this year. The overnight Euro-dollar rate has fallen moderately relative to the Federal funds rate, and this decline, coupled with the reduction in the reserve requirement on Euro-dollar borrowings from 8 per cent to 4 per cent, lowered the cost of overnight borrowings by U.S. banks.

Gross liabilities of banks to their foreign branches increased from an average of $2.1 billion in the week of April 2 to $2.5 billion in the week of May 7. In the four weeks following the lowering of reserve requirements effective April 10, liabilities to branches averaged $0.5 billion higher than in the preceding four weeks.

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

Average for month or week ending Wednesday	(1) Over-night Euro-$	(2) Federal Funds	(3) Differ-ential (1)-(2)(*)	(4) 3-month Euro-$ Deposit	(5) 60-89 day CD rate	(6) Differ-ential (4)-(5)(*)
1975-Jan.	7.16	7.13	0.03 (0.65)	8.49	7.45	1.04 (1.78)
Feb.	6.02	6.24	-0.22 (0.30)	7.26	6.10	1.16 (1.40)
Mar.	5.77	5.54	0.23 (0.73)	6.85	5.86	0.99 (1.22)
Apr.	5.35	5.49	-0.14 (0.17)	7.04	5.85	1.19 (1.22)
Apr. 2	6.29	5.59	0.70 (1.25)	6.98	5.75	1.23 (1.47)
9	5.44	5.28	0.16 (0.63)	7.44	5.88	1.56 (2.21)
16	5.24	5.44	-0.20 (0.02)	7.01	5.88	1.13 (1.04)
23	5.36	5.54	-0.18 (0.04)	6.79	5.88	0.91 (0.81)
30	5.23	5.71	-0.48 (-0.26)	6.93	5.88	1.05 (0.96)
May 7	5.22	5.42	-0.20 (0.02)	6.69	5.63	1.06 (0.98)
14 p/	5.25	5.25	0.00 (0.22)	6.50	5.63	0.87 (0.78)

*/ Differentials in parentheses are adjusted for the cost of required reserves.
p/ Preliminary.

SELECTED EURO-DOLLAR AND U.S. COSTS FOR PRIME BORROWERS
(1975; Friday dates)

	Apr. 4	Apr. 25	May 9	May 13 d/
1) 3-mo. Euro-$ loan a/	8.44	8.13	7.69	7.75
2) 90-119 day com'l. paper b/	6.13	6.25	6.13	6.00
3) U.S. bank loan:				
a) predominant prime rate	7.50	7.50	7.50	7.50
b) with 15% comp. bal's. c/	8.82	8.82	8.82	8.82
c) with 20% comp. bal's. c/	9.38	9.38	9.38	9.38
Differentials:				
(1) - (2)	2.31	1.88	1.56	1.75
(1) - (3a)	0.94	0.63	0.19	0.25
(1) - (3b)	-0.38	-0.69	-1.13	-1.07
(1) - (3c)	-0.94	-1.25	-1.69	-1.63

a/ 1-1/8 per cent over deposit bid rate.
b/ offer rate plus 1/8 per cent.
c/ prime rate adjusted for compensating balances.
d/ Tuesday.

The cost of short-term Euro-dollar loans, geared to the deposit rates of corresponding maturity, has declined since early April relative to short-term borrowing costs in the United States, where the prime rate was unchanged and commercial paper rates held quite steady. From April 2 to May 9 the relative drop in the Euro-dollar loan rate was 75 basis points.

Bank of England compilations show publicized medium-term Euro-currency bank loan announcements declining again in March. This brought the first-quarter total to $3.9 billion, down from $4.1 billion in the fourth quarter and $12.5 billion in the first quarter of 1974. However, announcements of new loans to Latin American borrowers (particularly in Brazil and Mexico) surged in the first quarter to $1.6 billion, nearly double the fourth-quarter and year-earlier rates.

OPEC countries' Euro-currency deposits with banks in the United Kingdom dropped $1.2 billion equivalent between February 19 and March 31, largely because of Iran's lengthening, by about one month, of its credit terms on sales of oil. For the first quarter the rise in deposits was $1.7 billion equivalent, down from $3.5 billion in the fourth quarter of 1974. The quarter-to-quarter decrease also was influenced by a substantial contraction of the OPEC countries' current account surplus.

In February, nonresident holders of Euro-currency deposits in Britain shifted about $800 million from dollar accounts to accounts in other currencies according to BIS data.

U.S. International Transactions. Significant developments in the first quarter of 1975 included a somewhat unexpected shift in the trade balance into a surplus position, sharply higher net outflows of private capital through banks and securities transactions, and a reduction in the net inflow of foreign official funds. The cyclical position of U.S. and foreign economies, movements in interest rate differentials, and the reduction in OPEC placements in the United States contributed in varying degrees to these shifts.

With the merchandise trade balance in surplus in both February and March, the first quarter 1975 trade position showed a surplus of $5.4 billion at an annual rate (balance of payments basis) compared with the $5.9 billion deficit rate registered in the fourth quarter of 1974.

U.S. MERCHANDISE TRADE, BALANCE OF PAYMENTS BASIS
(billions of dollars, seasonally adjusted annual rates)

	1974	1974				1975		
	Year	1Q	2Q	3Q	4Q	1Q	Feb.	Mar.
EXPORTS	97.1	88.8	95.7	98.9	104.9	107.3	104.2	103.8
Agric.	22.3	23.2	22.8	20.9	22.4	25.0	23.3	21.8
Nonagric.	74.7	65.6	72.9	78.0	82.5	82.3	80.9	82.1
IMPORTS	102.9	89.6	102.3	108.8	110.8	101.9	95.3	88.8
Fuels	27.1	19.3	28.4	30.9	31.2	27.6	24.9	18.0
Nonfuels	75.8	70.4	73.9	77.9	79.6	74.3	70.4	70.8
BALANCE	-5.8	-0.8	-6.6	-9.9	-5.9	+5.4	+8.9	+15.1

Note: Details may not add to totals because of rounding.

The swing in the trade balance of more than $11 billion into a surplus position in the first quarter reflected the relatively more severe contraction in U.S. economic activity, which depressed demand for a wide range of imported products. At the same time, the weakness of foreign economic activity has been evident in the decline in the volume of U.S. exports since mid-1974. The contraction in trade volumes has been accompanied by a substantial slowing in the rate of price increases as shortages of some commodities eased and competition intensified in international markets.

The increase in U.S. exports over the preceding quarter resulted from an abrupt jump in the volume of agricultural shipments, which more than offset the effect of lower prices. Nonagricultural deliveries showed no change in value but fell in terms of volume.

Following a declining trend throughout 1974, exports of agricultural commodities increased by 15 percent in volume terms in the first quarter; exports were especially strong in January but fell in both February and March. Export prices declined in March for the third successive month, following the downward trend in domestic spot prices with a lag of about three months. These price developments reflected greater export availabilities stemming from a reduction in U.S. feedgrain use, cancellation of large foreign orders, and, probably, the end in late 1974 of the speculative buying surge which had helped to push farm prices to unusually high levels. However, March export unit values were still considerably higher than spot quotations, suggesting that further declines are to come.

In the first quarter, nonagricultural exports fell by 4-1/2 percent in volume terms as foreign output continued to decline. The trade-weighted industrial production index for six major industrial countries is estimated to have dropped in January-March 1975 for the fourth successive quarter to its lowest level in more than two years. Exports of industrial supplies continued to fall in volume terms even though sharply higher coal exports moderated the downward trend. The generally long lead-time machinery exports were the last to be affected by the downturn in economic activity abroad; these shipments rose throughout last year but, by the final quarter, the rate of advance had decreased sharply before turning negative in the first quarter.

The quarterly trend in U.S. imports has been characterized by decelerating price rises and progressively sharper rates of decline in terms of volume. The drop in nonfuel imports was widespread in the first quarter. Arrivals of industrial materials fell, with particularly sharp decreases for nonferrous metals, chemicals, and textiles. Following strong increases throughout 1974, steel imports showed little further change in January-March as U.S. demand continued to soften and shortages eased. The large drop in sugar imports -- related to the buildup of inventories to rather high levels last year -- was only partially offset by greater imports of other foods. The steepest rate of import decline in the first quarter was registered for autos from both Canada and overseas sources. In fact, imports from overseas fell in the last three quarters despite the continued brisk sales pace for these vehicles, indicating a drawdown of inventories. Sales of imported automobiles appeared to have benefited from the general concern about fuel economy and the focusing of attention on small cars during the rebate programs of U.S. producers.

Imports of fuels dropped steeply in the first quarter in both value and volume while prices (unit values) continued stable at around \$11.50 per barrel for petroleum and products. The daily rate of petroleum imports was 6.2 million barrels (seasonally adjusted), down from an average of 6.9 million in the second half of 1974. The decline was in response to reduced U.S. economic activity, a mild winter, and, probably, to a drawdown of stocks.

Capital transactions

Both an increase in bank lending and a reduction in bank liabilities to foreigners (largely commercial banks and branches located overseas) contributed to the net outflow of \$5.4 billion in bank-reported transactions in the first quarter. Outstanding credits to foreigners rose by \$3.7 billion, only slightly less than in the fourth quarter despite earlier expectations of much more subdued lending activity in view of the reduced needs for external financing by oil-importers. The lending itself can be explained by changes in interest rate differentials, which favored borrowing in the United States during most of the first quarter, and the existence of large loan commitments to foreigners. However, for reasons which are not entirely clear, most of the lending was booked through branches located in the Bahamas in February and, to an even greater extent, March.

SELECTED CAPITAL FLOWS
(in millions of dollars)

	1974		1975P			
	3Q	4Q	1Q	Jan.	Feb.	Mar.
Bank-reported private capital, net	2.0	-0.3	-5.4	-0.6	-2.5	-2.4
Claims (inc.-)	-2.0	-4.0	-3.7	-0.3	-1.0	-2.2
Liabilities	4.0	3.8	-1.8	-0.3	-1.5	-0.2
Private securities transactions, net	-0.1	-0.8	-1.6	-1.0	-0.2	-0.4
U.S. purchases of foreign securities (inc.-)	-0.3	-0.7	-2.0	-1.1	-0.5	-0.5
Foreign purchases of U.S. securities	0.2	-0.1	0.5	0.1	0.3	0.1
Liabilities to foreign official agencies, net	1.3	4.1	2.5	-0.8	2.8	0.5
OPEC	3.9	2.5	0.3	0.3	0.7	-0.8
Non-OPEC	-2.6	1.7	2.2	-1.1	2.0	1.3
Total listed	3.2	3.0	-4.5	-2.4	0.5	-2.3

p = Preliminary. Note: Details may not add to totals because of rounding.

Bank-reported liabilities to private foreigners, including overseas branches of U.S. banks, declined by $1.8 billion in the first quarter in sharp contrast to increases of $4 billion in the third and $3.7 billion in the fourth quarters of 1974. This shift reflected the relative decline in U.S. interest rates, with much of the outflow occurring in January and February. With the firming of U.S. interest rates in early March and the continued decline of foreign rates, the outflow dropped to $0.2 billion in March as transactions by international organizations more than offset a small inflow from commercial banks abroad.

The net outflow on <u>securities</u> transactions increased to $1.6 billion in the first quarter from $0.1 billion in the third and $0.8 billion in the fourth quarter of 1974. This increase was related primarily to sharply higher U.S. purchases of newly-issued foreign bonds which amounted to $2.1 billion in the first quarter, nearly as much as the total for the year 1974. Bond issues by Canadian provincial governments and international organizations were high, and European and Japanese issues picked up as well. The stepped-up volume of foreign bond issues reflected favorable borrowing conditions in the U.S. capital market as the relatively steeper decline in U.S. short-term interest rates stimulated interest on the part of lenders in long-term securities. U.S. purchases of new foreign issues were heaviest in January with $1.1 billion, declining to about $0.5 billion in February and March. By mid-March, borrowing terms had begun to deteriorate and a number of issues were postponed or cancelled; preliminary data indicate that April issues amounted to only about half the March rate.

The increase in sales of foreign bond issues here has more than offset a rise in foreign purchases of U.S. securities. After having been sellers of U.S. securities in the fourth quarter, foreigners became large purchasers of U.S. stocks as the market recovered. About one-third of the nearly $1 billion net foreign stock purchases in the first quarter represented acquisition by the OPEC countries. Foreign interest in the U.S. stock market apparently continued in April.

Large-scale intervention purchases of dollars in the exchange market by foreign monetary authorities in February and March -- mainly for the purpose of limiting the continued appreciation of their currencies against the U.S. dollar -- was the main factor in the $2.2 billion increase in U.S. liabilities to foreign official agencies of non-OPEC countries in the first quarter. This addition to non-OPEC dollar assets held in this country was about $0.5 billion more than in the fourth quarter of 1974. On the other hand, OPEC placements here declined to $0.3 billion from $2.5 billion in the preceding quarter, in part because of a reduction in OPEC surplus revenues and in part because of possible diversification into non-dollar assets. Official liquid OPEC holdings in the United States actually dropped in March, reflecting principally a temporary delay in March tax collections by Iran. Preliminary data for April indicate a renewed inflow of OPEC funds; about $0.7 billion was added to holdings at the Federal Reserve Bank of New York. There was no change in the dollar assets of non-OPEC countries in April as intervention purchases of dollars dropped sharply.

Policy responses to economic downturn in foreign industrial economies. Authorities in most foreign industrial countries have adopted stimulative demand management policies in recent months to counter the slowdown in economic activity. By the end of last year restrictive monetary policies had been eased in most countries, but only the German, Canadian and Dutch authorities had by then adopted substantial expansionary fiscal measures. In recent months, however, as the economic slowdown persisted and turned out to be deeper and more widespread than had been expected earlier, the authorities in an increasing number of both large and small countries have introduced varying degrees of fiscal stimulus, while allowing monetary conditions to ease further. The only exception in the shift to expansionary fiscal policies among major foreign countries has been the United Kingdom.

Despite the depth and duration of the economic slowdown abroad, policymakers have been cautious both with regard to the timing and the scale of actions in their efforts to stimulate demand. In many instances, the authorities waited until the economic slowdown had deepened, and, instead of comprehensive fiscal stimulus, took more limited steps to assist particularly hard-hit sectors or to promote exports. Although price and wage developments have improved in recent months in most countries, policymakers abroad remain concerned about a resurgence of inflation and appear willing to tolerate high levels of under-utilization of resources for a long period. The relatively generous income maintenance programs in most foreign countries are shielding significant portions of the work force from sharp declines in disposable income despite the significant fall in employment, thereby mitigating the extent of political discontent.

The German authorities are waiting to see how effective the tax reform and the December fiscal measures will prove to be in moderating the economic slowdown and in stimulating an upturn before considering the need for additional action. The Bundesbank, however, cut the discount and Lombard rates further in March and reduced the Lombard rate again at the end of April. There are increasing signs, in fact, of a gradual turnaround in German economic activity, including an appreciable rise in industrial production of somewhat more than 2 per cent in March over February.

In Canada, where authorities also moved relatively early to counter the weakening of economic activity, it appears that the measures taken may not have been sufficient to sustain economic activity in light of the more severe than expected U.S. and world recessions. A budget is scheduled to be announced in late May/early June; it is expected to contain additional expansionary measures.

Economic activity in France declined later than in most other major countries. But beginning in December 1974 the Government introduced a series of minor selective credit measures designed to provide assistance to sectors particularly hard hit by the slowdown in activity (e.g., automobile production and construction) and to promote exports. Faced with weakening activity and rising unemployment, the authorities on April 23 introduced a larger expansionary program. This latest package includes temporary tax and credit incentives to stimulate private investment expenditures, increased public expenditures, particularly on public utilities, and credit provisions to promote exports. These latest measures are calculated to add a fiscal stimulus of some FF 15 billion (approximately 1.2 per cent of forecast GNP). Two-thirds of this stimulus is scheduled to be injected into the economy this year and the remainder over the next two years. Most assessments of these measures suggest that they will at best produce only limited results by the end of this year since the existence of excess capacity and the depressed state of demand are likely to delay the response by investors.

Japanese authorities introduced two minor financial assistance programs in February and March, and on April 16 the Bank of Japan reduced its bank rate by one-half percentage point to 8-1/2 per cent. The limited extent of ease introduced thus far is somewhat surprising since there have been significant improvements on both the price and wage fronts in recent months and Japan's external position has also strengthened. (The major part of the 1975 spring wage round was concluded last week, with average wage settlements below 15 per cent. This is a significant improvement over last year's average increase of 33 per cent and even below the wage settlements recorded in the years before the wage-explosion of 1973-74.) Recent statements by Japanese authorities, however, suggest that they intend to maintain a fairly restrictive policy at least for the near term and perhaps only will modify these policies gradually, with the intention of avoiding the rapid output and price increases experienced in recent boom years.

Italian policy remains fairly restrictive. The Government is committed during 1975 to limit credit expansion, government spending, and the size of the government budget deficit, as conditions of its indebtedness to the European Community. The authorities are reluctant to adopt more expansionary policies because of the continuing high rate of inflation and the desire to maintain an improved balance-of-payments position.

Until late last year some of the smaller economies were affected only slightly by the recession in the major countries, in part because the policies adopted by the authorities of these countries during 1973-74 were less restrictive than those instituted by the major countries. In recent months, however, these smaller countries have shown signs of economic weakness, and they too recently have introduced expansionary measures. Discount rates were reduced during the past few months in Austria, Belgium, Denmark, the Netherlands and Switzerland. Belgian and Swiss authorities announced at the end of April the termination of quantitative restrictions on the expansion of bank lending. The Swedish Riksbank increased for the first half of this year the limits on bank lending to 22 per cent above the end-1973 level, compared with a previous 20 per cent credit expansion ceiling. In addition, these countries are increasing government expenditures and reducing taxes to stimulate aggregate demand. The shift towards fiscal and monetary ease has not lessened these countries' desires to restrain inflation, however: Austria has extended until September 1976 its system of price controls that was scheduled to expire this year; effective May 7, Belgium imposed a two-month price freeze, with prices frozen at their April 30 levels; and the Dutch authorities continue to implement partial price and wage controls, but have liberalized pass-through rules relating to wage increases.

In the United Kingdom, interest rates have followed international rates down, and money supply growth has accelerated somewhat this year. However, the persistence of high rates of inflation -- now fueled mostly by continuing high wage increases and low productivity -- and the dependence on private and official foreign borrowing to finance the balance-of-payments deficit leave the British authorities little scope to stimulate economic activity at this time.

The British Budget for Fiscal 1975/76. On April 15, Chancellor of the Exchequer Denis Healey announced the Labour Government's Budget for the fiscal year beginning April 1. The major provisions of this Budget included an increase of two percentage points in the rate of personal income tax, an increase in the value-added tax from 8 per cent to 25 per cent on a range of "luxury" goods (mostly consumer durables), and a steep increase in excise taxes on alcoholic drinks and tobacco. The increase in tax revenue is estimated to be £1.3 billion, equal to about 1-1/2 per cent of GNP (or almost $25 billion in the United States). Public expenditure will not be cut this year, but will be cut by about £1 billion in 1976/77. No changes in the corporate tax rate were proposed, but tax relief on inventory appreciation, introduced last November, will be extended.

The net impact of the Budget measures on demand for British output is expected to be contractionary, but not as contractionary as the tax increase equalling 1-1/2 per cent of GNP might suggest. In fact, the Chancellor estimated that the Budget may increase unemployment by only 20,000. In April the number of unemployed in Great Britain was 760,000, or 3.3 per cent of the labor force (SA).

Several factors might explain the relatively small impact expected from the large increase in personal taxes. First, there is considerable scope for the higher taxes to come out of personal savings, rather than personal consumption. In 1974, savings accounted for 12.1 per cent of personal disposable income (12.4 per cent in the fourth quarter), compared to 11.3 per cent in 1973 and an average of 8.6 per cent in the previous decade.

Second, a substantial portion of the increase in indirect taxes will apply to imported goods (notably wine and tobacco, but also some consumer durables). While there surely will be some income effect tending to reduce total expenditure, there may also be a substitution effect tending to switch expenditure from imports to domestically-produced goods (which will, of course, tend to improve the current account).

Thirdly, the increase in indirect taxes was announced on April 15 but did not become effective until May 1. There is condierable evidence that consumers bought virtually all the "luxury" goods and wines and spirits that thev could find in the final two weeks of April.

Finally, the £1.3 billion of tax increases did reduce the estimated 1975/76 financial deficit of the total public sector (including nationalized industries and local authorities) from £8.9 billion to £7.6 billion (almost 10 per cent of forecast GNP); but the deficit is still expected to be £1.7 billion higher than in 1974/75.

So far as the impact of the Budget on prices is concerned, the Chancellor estimated that the increase in indirect taxes will increase the retail price index by 2-3/4 per cent. To the extent that there are cost-of-living clauses in labor contracts -- and such clauses are prevalent -- this price increase will automatically result in higher wages. Moreover, unions may demand -- and receive -- even higher wage increases than they would have demanded otherwise to offset the increased tax burden.

The Chancellor's explicit objective was to reduce Britain's current account deficit by ensuring that resources would be available to supply an increased volume of exports when world trade recovers later this year or next. But the real problem is ensuring that there will be an increase in foreign demand for British products. The major factor likely to inhibit British exports is the rapidly deteriorating competitiveness of British products, as inflation rates have accelerated in Britain while they have decelerated sharply elsewhere; the depreciation of sterling in recent weeks has reflected that fact. On balance, it is difficult to see how this Budget will contribute to a decline in the rate of wage and price inflation in Britain. It is possible, therefore, that additional measures, perhaps including some tightening of the "social contract" to hold down wage increases, may be forthcoming, especially after the EC referendum on June 5.