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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

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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)		
Civilian labor force	Jan	2-6-76	93.5	4.6 ^{1/}	1.2 ^{1/}	1.7 ^{1/}
Unemployment rate (per cent)	Jan.	2-6-76	7.8	8.3 ^{1/}	8.6 ^{1/}	7.9 ^{1/}
Insured unemployment, rate (%)	Jan.	2-6-76	4.8	5.2 ^{1/}	5.8 ^{1/}	5.0 ^{1/}
Nonfarm employment, payroll (mil.)	Jan.	2-6-76	78.1	5.5	3.0	1.1
Manufacturing	Jan.	2-6-76	18.7	9.0	4.7	-.5
Nonmanufacturing	Jan.	2-6-76	59.4	4.4	2.5	1.5
Private nonfarm:						
Average weekly hours (hours)	Jan.	2-6-76	36.6	36.4 ^{1/}	36.2 ^{1/}	36.2 ^{1/}
Hourly earnings (\$)	Jan.	2-6-76	4.72	4.68 ^{1/}	4.66 ^{1/}	4.40 ^{1/}
Manufacturing:						
Average weekly hours (hours)	Jan.	2-6-76	40.4	40.3 ^{1/}	39.8 ^{1/}	39.2 ^{1/}
Unit labor cost (1967 = 100)	Dec.	1-30-76	147.1	-1.6	-3.8	5.1
Industrial production (1967 = 100)	Dec.	1-16-76	118.5	12.3	7.9	.9
Consumer goods	Dec.	1-16-76	129.6	12.2	8.8	5.0
Business equipment	Dec.	1-16-76	117.2	10.3	5.5	-7.8
Defense & space equipment	Dec.	1-16-76	80.3	.0	-6.4	-3.7
Material	Dec.	1-16-76	117.9	12.3	9.7	2.7
Consumer prices (1967 = 100)	Dec.	1-21-76	166.4	5.9	7.4	7.0
Food	Dec.	1-21-76	181.4	3.3	8.6	6.5
Commodities except food	Dec.	1-21-76	152.6	3.9	3.7	6.1
Services ^{2/}	Dec.	1-21-76	173.1	7.7	9.5	8.1
Personal income (\$ billion) ^{3/}	Dec.	1-19-76	1301.1	4.8	7.0	8.4
				(Not at Annual Rates)		
Mfrs. new orders dur. goods (\$ bil.)	Dec.	2-2-76	41.9	.7	-.9	9.9
Capital goods industries	Dec.	2-2-76	11.8	-3.5	-3.3	-2.7
Nondefense	Dec.	2-2-76	10.4	-2.6	2.0	-.4
Defense	Dec.	2-2-76	1.4	-10.1	-30.6	-17.1
Inventories to sales ratio:						
Manufacturing and trade, total	Nov.	2-9-76	1.53	1.52 ^{1/}	1.54 ^{1/}	1.59 ^{1/}
Manufacturing	Dec.	2-2-76	1.69	1.69 ^{1/}	1.70 ^{1/}	1.89 ^{1/}
Trade	Nov.	2-9-76	1.37	1.37 ^{1/}	1.36 ^{1/}	1.46 ^{1/}
Ratio: Mfrs.' durable goods inventories to unfilled orders	Dec.	2-2-76	.850	.842 ^{1/}	.831 ^{1/}	.754 ^{1/}
Retail sales, total (\$ bil.)	Jan.	2-10-76	51.5	-.3	2.7	12.0
GAF	Jan.	2-10-76	12.9	-1.6	3.9	13.2
Auto sales, total (mil. units) ^{3/}	Jan.	2-4-76	9.6	-.5	4.0	18.2
Domestic models	Jan.	2-4-76	8.4	1.7	7.9	27.2
Foreign models	Jan.	2-4-76	1.2	-13.8	-16.9	-21.0
Housing starts, private (thous.) ^{3/}	Dec.	1-19-76	1309	-3.3	3.2	48.8
Leading indicators (1967 = 100)	Dec.	1-28-76	102.5	.4	.0	7.9

Actual data. ^{2/} Not seasonally adjusted. ^{3/} At annual rate.

DOMESTIC NONFINANCIAL DEVELOPMENTS

Economic activity strengthened further in January, with further advances in employment and industrial production. With retail sales strong, improved consumer confidence and depleted soft-goods inventories favor continued growth in activity and employment in the weeks ahead. However, current indicators do not as yet suggest more than moderate gains in capital investment. On the inflation front, food and energy prices increased only moderately in December, thereby helping to hold down the rise in over-all consumer prices. However, unit labor costs rose again in the fourth quarter and industrial materials prices continue to increase at an advanced pace.

Industrial production is estimated to have increased by more than half a per cent in January. Gains appear to be widespread, with the largest rise apparently in nondurable materials, where inventory restocking is continuing. Production of durable materials evidently also advanced somewhat, but weak orders and some inventory overhang continues to retard growth in the durable goods sector. Consumer goods output, which was near its prerecession high in December, probably also increased over the month, and output of business equipment, which had turned up in December, is estimated to have extended its gain into January.

Reflecting an increase in raw steel production, major materials capacity utilization apparently rose modestly in January. Most of the earlier recovery from the recession low was in nondurable materials. The major materials utilization rate, now at about 81 per

cent of capacity, is about midway between its first quarter 1975 trough and the 1973 peak. The total manufacturing utilization rate, which is dominated by hard-goods producers who are still reducing stocks, has recovered only about one-fifth of its cyclical decline.

Nonfarm payroll employment has expanded sharply over the past two months. Employers added about 360,000 jobs in January, following a rise of 210,000 in December. Two-thirds of the industry groups showed gains in January, with the largest increases in trade (120,000) and manufacturing (140,000). The factory workweek edged up another .1 hour in January after the large rise in December.

By January, payroll employment had recovered nearly three-fourths of its net cyclical decline. Construction employment, however, remains near its cyclical low and durable manufacturing has recouped only about one-fifth of its cyclical decline.

The unemployment rate fell to 7.3 per cent in January from 8.3 per cent in December, as employment growth outpaced an increase in the civilian labor force. Unemployment rates were lower for most groups (except teenagers) but the largest reduction occurred for adult men whose rate was down from 6.6 to 5.8 per cent, its lowest reading since December 1974. Problems of seasonal adjustment around year-end may have exaggerated the January gain in household employment and the decline in unemployment.

Aggregate unemployment insurance payments and the number of recipients have been on a downward path since mid-year. Between July and January, the number of claimants fell by 1.2 million, with most of the improvement among those claiming regular state benefits (i.e., their first 26 weeks).

NONFARM PAYROLL EMPLOYMENT
(In thousands, seasonally adjusted)

	Sept. 74 to June 75	June 75 to Jan. 76	Nov. 75 to Dec. 75	Dec. 75 to Jan. 75
Nonfarm Total	-2487	1797	208	358
Government Services	392 104	310 416	18 41	8 58
Trade Nondurable Manufacturing	- 266 - 588	330 331	78 19	119 56
Construction Durable Manufacturing	- 510 -1416	8 281	-13 72	4 83

NOTE: September 1974 was the specific peak and June 1975 was the specific low for total nonfarm payroll employment.

SELECTED UNEMPLOYMENT RATES*
(Seasonally adjusted)

	<u>1974</u> Jan.	<u>1975</u>		<u>1976</u> Jan.	
		Jan.	May	Dec.	
Total	5.0	7.9	8.9	8.3	7.8
Men 20 years and over	3.3	5.9	7.2	6.6	5.8
Women 20 years and over	5.0	7.9	8.4	8.0	7.5
Teenagers	14.7	19.8	20.3	19.6	19.9
Household heads	2.9	5.2	6.1	5.7	5.1
State insured**	3.1	5.5	7.0	5.0	4.4
White	4.5	7.3	8.3	7.6	7.1
Negro and other races	9.0	13.0	14.2	13.8	13.2

* Revised labor force series.

** Per cent of covered workers under regular state programs.

The hourly earnings index rose sharply in January after showing little change in December. January increases were large in trade and services, probably reflecting the impact of the January 1 boost in the minimum wage. From October to January hourly earnings increases were at a 7.2 per cent annual rate, slightly under the 8 per cent average rate of rise for 1975.

Judging from the wage and employment figures, growth of wage and salary disbursements in January was well above the rate of increase over recent months and should boost a faltering trend in real personal income. Real personal income had edged off in November and December. Wage and salary disbursements in real terms had expanded only 2.3 per cent over the five months ending in December. This was well below that of the comparable period in the 1953 expansion (4.2 per cent) and followed a more severe contraction--a 7.2 per cent loss in real wages and salaries over 20 months compared to 5.7 per cent over 13 months in 1957-1953.

The book value of manufacturers' inventories rose at a \$1.4 billion rate in December and at an average rate of \$1.5 billion in the fourth quarter. This compares to a decline at a \$6.6 billion rate in the third quarter. Producers in nondurable materials and goods lines, responding to low inventory-sales ratios and improving retail sales, have sharply increased production and employment since summer. Book value of their inventories advanced in December for the fifth

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HOURLY EARNINGS INDEX*
(Seasonally Adjusted)

	Per Cent Change Over Period (compound annual rate)				
	Jan. 75 to Apr. 75	Apr. 75 to July 75	July 75 to Oct. 75	Oct. 75 to Jan. 76	Dec. 75 to Jan. 76
	Private nonfarm	7.8	9.0	8.6	7.2
Construction	7.9	8.8	0.5	9.4	19.8
Manufacturing	9.7	8.7	9.0	5.6	6.7
Trade	5.8	8.6	8.9	6.0	12.7
Services	5.1	7.9	8.3	12.3	15.5

*Excludes the effects of interindustry employment shifts and fluctuations in overtime pay in manufacturing.

CYCLICAL CHANGES IN REAL WAGES AND SALARIES AND PERSONAL INCOME
(Cumulative per cent change based on seasonally adjusted data)

	Duration (Months)	Wage & Salary Disbursements	Personal Income
<u>Contractions</u>			
Mar. 57-Apr. 58	13	-5.7	-1.9
Nov. 73-July 75	20	-7.2	-4.1
<u>Expansions - First 5 Months</u>			
Apr. 58-Sept. 58	5	4.2	3.3
July 75-Dec. 75	5	2.3	2.1
<u>Monthly Changes During Recent Expansion</u>			
August 75		1.26	1.31
September 75		.38	.83
October 75		.38	.03
November 75		.17	-.03
December 75		.12	-.09

NOTE: Seasonally adjusted annual rates deflated by the Consumer Price Index. Reference months are specific highs and lows for deflated wage and salary component.

successive month but restocking may still have fallen short of intentions, triggering further production gains in January. The picture is about the reverse for durables, where inventory-to-sales and inventory-to-unfilled orders ratios remained comparatively high at year-end. Book value of durable stocks declined for the tenth successive month in December and some additional liquidation appears to be in prospect.

Both unit sales of domestic autos and nonautomotive retail sales rose further in January. Excluding autos and largely nonconsumption items, retail sales increased 0.3 per cent in January, with gains for apparel, and furniture and fixture outlets partially offset by a decline from the advanced pre-Christmas pace at general merchandise outlets. The strong advance December estimates were revised down, particularly in nondurable groups.

Unit sales of domestic autos averaged 8.4 million (annual rate) in January, up from 8.2 million in December. These were the highest sales rates since the third quarter of 1974. Sales of imported cars dropped back to a 1.2 million unit annual rate in January--accounting for only a 13 per cent share of the market. This compares with sales of 1.6 million imported cars in 1975, accounting for 13 per cent of sales.

The strengthening of sales has been associated with improving consumer confidence. The Conference Board index of confidence (based on five questions dealing with employment, business and income conditions) moved sharply higher in the early December survey, the

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

	1975						
	I	II	III	IV*	Oct.	Nov.	Dec.
Total, (mfg. and trade)	-10.4	-18.8	5.4	6.5	21.4	- 9.6	n.a.
Manufacturing	3.2	-12.5	-6.6	1.5	1.2	1.9	1.4
Durable	7.6	-4.3	-8.6	-3.7	-5.1	-3.1	-2.8
Nondurable	-4.5	-8.2	2.0	5.2	6.3	5.1	4.2
Trade	-13.6	-6.3	11.9	5.0	20.2	-11.5	n.a.
Wholesale	-4.1	-2.7	3.1	-.2	1.1	-1.9	1.4
Retail	-9.4	-3.6	8.8	4.8	19.1	-9.6	n.a.
Auto	-8.3	-1.7	5.5	.8	4.0	-2.5	n.a.

*October-November averages for retail trade and for the total of trade and manufacturing trade.

INVENTORY RATIOS

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1975</u>		
	IV	IV	IV*	Oct.	Nov.	Dec.
<u>Inventory to sales</u>						
Total, (mfg. and trade)	1.49	1.62	1.52	1.52	1.53	n.a.
Manufacturing	1.61	1.78	1.69	1.67	1.69	1.69
Durable	1.98	2.24	2.22	2.19	2.26	2.22
Nondurable	1.20	1.29	1.16	1.15	1.15	1.17
Trade	1.37	1.46	1.37	1.37	1.37	n.a.
Wholesale	1.16	1.24	1.23	1.22	1.23	1.23
Retail	1.53	1.64	1.47	1.49	1.47	n.a.
<u>Inventory to unfilled orders</u>						
Durable manufacturing	.723	.754	.850	.838	.842	.850

*October-November averages for retail trade and for the total of trade and manufacturing and trade.

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

	1975					1976
	II	III	IV	Nov.	Dec.	Jan.
Total sales	3.4	3.9	2.0	.3	2.8	- .3
Durable	3.9	5.8	4.3	- .1	6.7	- .9
Auto	4.6	7.4	4.5	-2.9	12.2	-4.2
Furniture and appliances	4.9	2.3	5.5	4.8	.4	2.2
Nondurable	3.1	3.0	1.0	.4	1.0	- .1
Apparel	3.3	3.0	.5	1.2	2.9	2.7
Food	1.2	2.8	.7	- .4	- .5	1.0
General merchandise	5.5	2.0	2.5	4.2	1.8	-3.9
Gasoline stations	2.7	6.6	-1.5	-1.3	3.6	1.5
Total, less auto and nonconsumption items	3.1	3.1	1.4	.8	1.0	.3
GAF	5.0	2.3	2.6	3.8	1.7	-1.6
Real*	2.0	1.5	.8	- .2	2.4	n.a.

* Deflated by an unpublished Bureau of Economic Affairs price measure.

AUTO SALES
(Millions of units, seasonally adjusted annual rates)

	I	II	III	IV	Nov.	Dec.	Jan.
Total auto sales	8.3	7.9	9.2	9.2	8.8	9.6	9.6p
Imports	1.7	1.6	1.7	1.3	1.2	1.4	1.2p
Domestic models	6.6	6.3	7.5	7.9	7.6	8.2	8.4
Large	3.6	4.1	4.5	4.4	4.3	4.6	n.a.
Small	3.0	2.2	2.9	3.5	3.3	3.6	n.a.

first substantial gain for this measure since April 1975. Current evaluations as well as expectations for six months ahead were equally improved. There was also a gain in the buying plan index, which relates to autos, homes, and appliances.

Private housing starts declined slightly further in December, but averaged 1.37 million units annual rate in the fourth quarter. This was 9 per cent above the third quarter and 40 per cent above the first quarter trough. Single family and the more depressed multifamily starts were up 30 and 50 per cent, respectively, from their recent quarterly lows. Furthermore, mortgage conditions continue to suggest more improvement as outstanding loan commitments at S&L's moved up to a 2-1/2 year high in December and mortgage interest rates edged off further. Sales of new and existing homes continued strong late in the year and rental markets tightened. In fact, the average rental vacancy rate dropped from 6.2 per cent in the third quarter to 5.4 per cent in the fourth quarter--the largest absolute drop in eight years.

Business fixed investment in real terms is estimated to have increased at a 9 per cent annual rate between the third and fourth quarter. Investment in structures, which had fallen over one-fifth from the late 1973 peak, rose sharply, while real spending for durable equipment advanced at a 6-1/2 per cent annual rate. Much of the increase in structures resulted from work on the Alaska pipeline, which is classified in the utilities category, and the bulk of the rise in producers' durable equipment reflects deliveries of farm equipment.

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

	1975						Per cent change in Dec. from:	
	QI	QII	QIII	QIV	Nov. (r)	Dec. (p)	Month ago	Year ago
Permits	.69	.90	1.04	1.07	1.09	1.06	- 2	+26
Starts	1.00	1.07	1.26	1.37	1.35	1.31	- 3	+49
1-family	.75	.84	.95	1.03	1.03	.97	- 5	+43
2-or more-family	.25	.22	.31	.34	.33	.34	+ 3	+70
Under construction ^{1/}	1.12	1.05	1.04	n.a.	1.06	n.a.	- 1 ^{2/}	-16 ^{2/}
Completions	1.39	1.22	1.28	n.a.	1.42	n.a.	+27 ^{2/}	-15 ^{2/}
MEMO:								
Mobile home shipments	.20	.21	.23	.23	.23	.23	- 2	+17

^{1/} Seasonally adjusted, end of period.

^{2/} Per cent changes based on November.

NOTE--indicates change of less than 1 per cent.

CONSTRUCTION CONTRACTS FOR COMMERCIAL AND INDUSTRIAL BUILDINGS
(Seasonally adjusted rates measured in millions of square feet)

	1975						Percent Change in Dec. from	
	QI	QII	QIII	QIV	Nov.	Dec.	Month Ago	Year Ago
Total ^{1/}	46.9	50.7	48.7	48.9	42.0	50.7	20.8	-6.5
Commercial	34.1	36.5	36.1	34.9	30.3	35.9	18.5	3.1
Industrial	12.9	13.2	11.4	13.6	11.7	14.4	22.8	0.3

^{1/} Census series. Total may not equal the sum of components which are separately seasonally adjusted by F.R.B.

Recent behavior of commitments data suggest that the fourth quarter bulge in investment spending probably will not be followed by equally strong increases in the near term. Nondefense capital goods orders declined 2.6 per cent in December due to weakness in electrical and nonelectrical machinery. In real terms, orders volume was marginally above its first quarter low but over 30 per cent below its peak. Although backlogs continue large for some producers, unfilled orders for capital goods declined for the fourteenth consecutive month. The volatile series on contracts for commercial and industrial buildings (measured in square feet) has traced a sawtooth path in recent months. In December, contract commitments reversed a sharp November decline and returned to a level about equal to the average for the second quarter. On balance, this indicator has not shown added strength since the spring quarter and remains far below its peak readings of 1973.

After showing very large cyclical gains during the middle half of the year, growth of productivity in the private economy slowed to a 1 per cent annual rate in the fourth quarter of 1975. Preliminary data show a minor productivity decline for the nonfarm economy in the fourth quarter. Unit labor costs, reflecting the sharp slowing of productivity gains and continuing large wage and benefit increases, rose at a 6-1/2 per cent rate. While this increase may overstate the upward trend of costs, productivity gains will probably be more moderate henceforth than in the third quarter. Thus, it appears likely that rising wages will be reflected in upward pressure on costs and prices.

BUSINESS FIXED INVESTMENT^{1/}
(Billions of 1972 Dollars)

	1975			
	QI	QII	QIII	QIV
Business Fixed Investment	115.2	110.8	110.6	113.0
Nonresidential Structures	38.9	36.2	36.2	37.3
Public Utilities	12.3	11.3	10.9	12.2
Other	26.6	24.9	25.3	25.1
Producers Durable Equipment	76.3	74.7	74.5	75.7
Farm	5.8	5.7	5.0	5.9
Nonfarm	70.5	69.0	69.5	69.8

^{1/}The detail within Nonresidential Structures and Producers Durable Equipment is available to the Board of Governors on a confidential basis.

NEW ORDERS RECEIVED BY MANUFACTURERS
(Seasonally adjusted annual rates, billions of dollars)

	1975				Nov.	Dec.	Percent Change	
	QI	QII	QIII	QIV			in Dec. from Month Ago	Year Ago
Total Durable Goods								
Nominal	36.5	39.4	42.2	41.9	41.6	41.9	0.7	9.9
Real ^{1/}	22.4	24.0	25.5	24.7	24.5	24.6	0.2	4.0
Nondefense Capital Goods								
Nominal	9.9	10.3	10.4	10.6	10.7	10.4	-2.6	-0.4
Real ^{1/}	6.2	6.4	6.4	6.4	6.5	6.3	-2.8	-7.4

^{1/} Constructed series obtained by deflating new orders by the appropriate wholesale price index, 1967 = 100.0.

The latest comprehensive wholesale and consumer price figures relate to December. Farm prices declined in January, suggesting that the downtrend in farm products and processed foods and feeds at wholesale probably has continued. On the other hand, price increases announced recently, including chemicals and aluminum, indicate a further rise in the industrial commodities group, which increased at an 0.7 per cent rate over the last half of 1975.

Consumer prices rose at a 6 per cent annual rate in December, less than in the previous two months and below the 1975 average of 7 per cent. Advances for both foods and energy were small in December. Exclusive of these categories the rate of increase of consumer prices was 6.8 per cent, about even with earlier 1975 experience.

The increase for foods--0.3 per cent seasonally adjusted, not annual rate--included a large rise for fruits and vegetables and continued increases for dairy products, eggs, and coffee. Pork prices, however, fell sharply, as they began to reflect previous declines in livestock prices. Since the early-December pricing dates, cattle prices have come down substantially.

State and local spending showed more growth than expected in the fourth quarter, with employment up by more than 100,000. Other recent developments indicate that the fiscal pressures on State and local governments may not be as large as thought earlier. Revised data indicate that the "operational budgets" of State and local budgets were in a surplus position in the last two quarters of 1975, following five quarters of deficits. Cost pressures have also

PRODUCTIVITY AND COSTS*

(Per cent change at a compound annual rate, seasonally adjusted)

	QIV 74 to QV 75	1975		
		QI to QII	QII to QIII	QIII to QIV p
<u>Output per hour</u>				
Total Private	1.2	6.0	9.9	1.0
Private Nonfarm	-0.9	8.0	9.4	-0.3
Manufacturing	-9.6	2.8	8.6	5.6
<u>Compensation per hour</u>				
Total Private	10.7	6.4	6.7	7.5
Private Nonfarm	9.1	6.8	8.7	6.1
Manufacturing	11.8	9.2	7.5	6.3
<u>Unit labor costs</u>				
Total Private	9.4	0.4	-2.9	6.5
Private Nonfarm	10.1	-1.1	-0.7	6.5
Manufacturing	23.6	6.2	-1.0	0.7

* Data for total private and private nonfarm based on revised National Income and Product Account measures.

p - Preliminary.

WHOLESALE PRICES

(Per cent changes at annual rates; based on seasonally adjusted data)^{1/}

	Relative impor- tance to Dec. 74	Dec. 73 to Dec. 74	Dec. 74 to Dec. 75	Dec. 74 to June 75	June 75 to Dec. 75	Nov. 75 to Dec. 75
All commodities	100.0	20.9	4.2	.3	8.3	- 5.0
Farm and food products	29.1	11.0	-0.3	-8.0	8.1	-30.1
Industrial commodities	70.1	25.6	6.0	3.4	8.7	7.5
Materials, crude and intermediate ^{2/}	46.0	28.2	5.3	2.1	8.6	9.7
Finished goods						
Consumer nonfoods	17.5	20.5	6.7	3.9	9.6	3.8
Producer goods	8.6	22.6	8.2	8.4	7.9	2.1
Memo:						
Consumer foods	13.4	13.0	5.5	3.8	7.2	-15.3

^{1/} Not compounded for one-month changes.

^{2/} FR estimate.

CONSUMER PRICES

(Per cent changes at annual rates; based on seasonally adjusted data)^{1/}

	Relative impor- tance to Dec. 74	Dec. 73 to Dec. 74	Dec. 74 to Dec. 75	Dec. 74 to June 75	June 75 to Dec. 75	Nov. 75 to Dec. 75
All items	100.0	12.2	7.0	6.6	7.5	5.9
Food	24.8	12.2	6.5	4.7	8.2	3.3
Commodities (nonfood)	39.0	13.2	6.2	6.6	5.6	3.9
Services	36.2	11.3	8.1	7.1	9.1	7.7
Memo:						
All items less food and energy ^{2/3/}	68.3	11.3	6.7	6.8	6.7	6.8
Petroleum products ^{2/}	4.4	22.8	10.1	9.0	11.2	3.8
Gas and electricity	2.5	19.6	14.3	17.6	10.9	7.4

^{1/} Not compounded for one-month changes.

^{2/} Confidential -- not for publication.

^{3/} Energy items excluded: gasoline and motor oil, fuel oil and coal, and gas and electricity.

moderated--the implicit price deflator for purchases rose by only 5 per cent from 1974:IV to 1975:IV, mainly because of very small increases in average compensation rates. Finally, with interest rates on municipal securities having backed down considerably from last fall's high levels, the general outlook for this sector has improved.

Federal purchases--boosted by the \$2.4 billion Federal pay raise and growth in defense procurement--advanced at a 19 per cent annual rate (NIA data) in the fourth quarter. Growth of Federal transfer payments moderated a bit as declines in unemployment benefits and food stamps partially offset continued advances in other benefits.

The staff now expects a deficit for FY '76 of \$74 billion, about \$1-1/2 billion higher than last month. Corporate tax refunds have been larger than previously anticipated and outlays are likely to be somewhat higher as a result of the veto override on the HEW-Labor appropriation bill. Possible outlay effects of a well-supported Congressional bill, the "Local Public Works Act," which authorizes \$6.2 billion of spending over the next few years, have not been allowed for in these estimates because it is uncertain that support can be marshalled to override the expected Presidential veto of the Act.

The Administration's budget for fiscal year 1977 proposes a tight restraint on spending, with outlays targeted at only \$394.2 billion for the fiscal year beginning October 1, 1976. The budget assumes a further conditional \$10 billion mid-year cut in income taxes and expects revenues of \$351 billion. The FY '77 deficit is estimated at about \$43 billion.

Staff analysis of FY '77 spending proposals suggests that unified outlays could easily be \$15 billion higher than recommended by the President. With Congress unlikely to accept in full the President's spending restraints, the President's proposed tax cut may be in jeopardy. Given these uncertainties, the staff projections assume budget outlays of \$410 billion and an indefinite extension of the current Revenue Adjustment Act of 1975. The staff projects revenues at \$356 billion, about \$5 billion higher in FY '77 than those projected by the Administration. This difference reflects the effects of higher tax rates offset somewhat by lower income assumptions in the staff projection (a more detailed discussion of the President's budget for fiscal year 1977 is presented in Appendix A).

In calculations based on staff assumptions, the full employment budget remains fairly level at a deficit of around \$7 to \$10 billion (NIA basis) during the period from mid-1975 to the third quarter of 1976. Thereafter, the full-employment budget turns sharply restrictive and reaches a \$12 billion surplus in the second quarter of 1977. This projected shift in the full employment budget from a sizable deficit in the first half of 1976 to a large surplus in the first half of 1977 would be the largest such swing toward fiscal restraint since 1968-1969.

III-T-1
 SELECTED DOMESTIC FINANCIAL DATA
 (Dollar amounts in billions)

Indicator	Latest data		Net change from			
	Period	Level	Month ago	Three months ago	Year ago	
<u>Monetary and credit aggregates</u>			<u>SAAR (per cent)</u>			
Total reserves	January	35.0	5.6	10.6	-1.0	
Reserves available (RPD's)	January	32.3	-1.0	2.7	-1.3	
Money supply						
M1	January	295.5	2.0	2.9	4.8	
M2	January	669.2	10.7	8.2	8.9	
M3	January	1102.0	11.1	9.8	11.7	
Time and savings deposits (Less CDs)	January	373.6	17.3	12.5	12.3	
CDs (dollar change in billions)	January	79.2	-3.7	-1.7	-13.5	
Savings flows (S&Ls + MSBs + Credit Unions)	January	433.0	11.8	12.2	16.3	
Bank credit (end of month)	January	724.8	5.3	2.8	4.3	
<u>Market yields and stock prices</u>			<u>Percentage or index points</u>			
Federal funds	wk. endg.	2/4/76	4.82	-.30	-.35	-1.64
Treasury bill (90 day)	"	2/4/76	4.82	-.35	-.70	-.80
Commercial paper (90-119 day)	"	2/4/76	5.00	-.44	-.88	-1.60
New utility issue Aaa	"	2/6/76	8.67p	-.21p	-.43p	.54p
Municipal bonds (Bond Buyer)	1 day	2/5/76	6.86	-.27	-.66	.52
FNMA auction yield (FHA/VA)		2/9/76	9.07	-.06	-.25	-.30
Dividends/price ratio (Common stocks)	wk. endg.	2/4/76	3.63	-.28	-.51	-1.05
NYSE index (12/31/65=50)	end of day	2/9/76	53.10	2.81	6.38	15.33
<u>Credit demands</u>			<u>Net change or gross offerings</u>			
			<u>Current month</u>		<u>Year to date</u>	
			1975	1974	1975	1974
Consumer instalment credit outstanding	December		.9	-0.4	3.7	9.8
Mortgage debt outst. (major holders)	November		3.8	2.5	38.3	41.3
Business loans at commercial banks	January		1976	1975	1976	1975
Corporate bonds (public offerings)	January		2.2e	3.7	2.2e	3.7
Municipal long-term bonds (gross offerings)	January		2.4e	2.4	2.4e	2.4
Federally sponsored Agcy. (net borrowing)	January		.4	.5	.4	.5
U.S. Treasury (net cash borrowing)	February		8.8	4.5	16.3	8.2
Total of above credits						

e - Estimated
 p - Preliminary

DOMESTIC FINANCIAL DEVELOPMENTS

New economic information available since the January FOMC meeting appears to have added to investor confidence in the sustainability of the economic recovery. Thus, with Federal funds trading steadily at rates around 4-3/4 per cent, expectations of further easing in money market conditions have dissipated, even though M_1 growth has remained relatively weak. This latter view was reinforced by the Chairman's deemphasis of M_1 as a target in his testimony before Congress in early February.

Against this general background, the uptrend in stock prices recently has lost much of its December-January momentum. Short- and long-term market interest rates have remained about unchanged around the lower levels produced by the December and early January downtrend-- despite heavy financing activity by the Treasury and an unusually large volume of new bond issues by corporations and State and local governments. In lagged adjustment to the preceding decline in market rates, however, mortgage rates and the bank prime rate have moved down further. Also, rates on lower quality market instruments have edged down somewhat, thus narrowing the quality spread on corporate bonds and commercial paper.

Monetary Aggregates

The small increase in M_1 in January only partly offset the December decline in this aggregate. As noted below, shifts from demand to business savings deposits are thought to have played a less important

SELECTED FINANCIAL MARKET QUOTATIONS
(One day quotes--in per cent)

	Jan. '75 FOMC Jan. 21	Nov. '75 FOMC Nov. 18	Dec. '75 FOMC Dec. 16	Jan. '76 FOMC Jan. 20	Jan. 27	Feb. 3	Feb. 10
<u>Short-term</u>							
Federal funds ^{1/}	7.17	5.24	5.17	4.81	4.80	4.82	4.73 ^{4/}
Treasury bills							
3-month	6.24	5.47	5.51	4.83	4.75	4.91	4.87
6-month	6.24	5.80	5.94	5.11	5.03	5.12	5.13
1-year	6.25	6.12	6.28	5.41	5.35	5.38	5.47
Commercial paper							
1-month	7.00	5.38	5.50	4.75	4.50	4.75	4.88
3-month	7.00	5.75	5.88	5.13	5.00	5.00	5.13
Large neg. CD's ^{2/}							
3-months	7.00	6.13	6.10	5.15	4.95	5.10	5.20
6-months	7.15	6.70	6.70	5.50	5.35	5.50	5.65
Federal agencies							
1-year	7.11	6.88	6.95	6.07	5.99	5.95	6.06p
Bank prime rate	9.75	7.50	7.25	7.00	6.75	6.75	6.75
<u>Long-term</u>							
Corporate							
New AAA ^{1/}	9.45	9.11	9.37	8.64	8.62	8.66	8.67p
Recently offered ^{3/}	9.47	9.24	9.25	8.68	8.69	8.68	8.64p
Municipal							
(Bond Buyer) ^{3/}	6.59	7.43	7.34	7.09	7.01	6.85	6.86
U.S. Treasury							
(20-year constant maturity)	7.80	8.36	8.22	8.05	8.03	8.03	8.11p
<u>Stock prices</u>							
Dow-Jones	641.90	855.24	844.30	949.86	957.81	972.61	968.75
N.Y.S.E.	37.71	48.15	46.84	52.33	52.55	53.80	53.56
Keefe Bank Stock	471	494	449	523	521	556	556

^{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 February 11.

n.a.--not available.

p--preliminary.

role in the weakness in M_1 in January than was the case in November and December. Staff studies to date have been able to explain only part of the shortfall in M_1 . Moreover, these studies suggest that continued developments in the payments mechanism, including the increased use of overdraft privileges and the transfer by telephone of funds from savings to demand deposit accounts, could cause some further downward shifts in the public's desired holdings of narrowly defined money in the months ahead.

Despite the slow growth of the narrow money stock, M_2 expanded at a 10 per cent annual rate in January, as banks experienced sizable inflows of savings deposits. The near record 30 per cent rate of growth of these deposits at commercial banks in January clearly reflects the attractive yields on such accounts. With the rates on many money market instruments below the 5 per cent passbook ceiling being maintained by most banks, and with banks in many cases offering such rates on a day of deposit to day of withdrawal basis, savings deposits in January were among the most attractive liquid assets available in the market.

Large savings deposit inflows have occurred in the past when yields on market instruments have declined below passbook ceilings; however, in January these inflows were further stimulated by regulatory changes which have permitted businesses and State and local governments to hold savings deposits at commercial banks.^{1/} At weekly reporting banks--the only banks for which data are available--over one-fourth of the January inflow into savings accounts was from these depositors.

^{1/} Commercial banks were first permitted to issue savings deposits to State and local governments in November, 1974, and to businesses operated for a profit in November, 1975. There is no limitation on the size of state and local savings balances, but business savings accounts are limited to \$150,000.

MONETARY AGGREGATES
(Seasonally adjusted changes)^{1/}

	1975						1976	
	HI	HII	QIII	QIV	Nov.	Dec.	Jan. p	Twelve months ending Jan. 1976
	<u>Per cent at annual rates</u>							
M ₁	4.0	4.8	7.1	2.5	9.4	-2.8	2.0	4.8
M ₂	8.0	8.2	10.1	6.1	10.8	3.1	10.7	8.9
M ₃ ^{2/}	10.2	11.4	13.3	9.2	11.6	6.5	11.1	11.7
Adjusted bank credit proxy	4.3	3.7	1.4	6.0	14.4	.7	-.2	3.3
Time and savings deposits at commercial banks:								
a. Total	8.3	6.9	4.7	9.1	11.9	9.7	4.3	6.4
b. Other than large CD's	11.3	11.0	12.7	9.1	11.9	7.9	17.3	12.3
Deposits at nonbank thrift institutions:								
a. Savings and loan associations ^{3/}	17.6	16.4	18.6	13.4	13.3	12.3	17.3	18.3
b. Mutual savings banks ^{3/}	12.0	9.9	11.6	7.9	8.6	6.8	8.2e	11.5e
c. Credit unions ^{3/}	21.1	17.3	17.1	16.8	16.5	16.0	15.5e	19.9e

Billions of dollars^{4/}

Memoranda:

a. U.S. Government demand deposits	-	-	-	-	0.9	-0.9	-0.4	--
b. Negotiable CD's	-1.0	-0.2	-1.7	1.3	0.9	1.1	-3.7	-1.1
c. Nondeposit sources of funds	-0.2	0.2	-	0.5	0.3	0.2	-0.5	--

1/ Except where otherwise defined, growth rates are based on changes in the average amounts outstanding for the period.

2/ M₃ is defined as M₂ plus credit union shares, mutual savings bank deposits, and shares of savings and loan associations.

3/ Based on month-end series incorporating new (Dec., 1975) seasonal factors.

4/ Changes in average levels month-to-month or average monthly change for the period, measured from last month in period to last month in period, not annualized.

p - Preliminary.

n.a. - Not available.

A significant part of the growth of business savings deposits in November-December represented funds transferred from demand balances, according to a universe survey of member banks taken in early January.^{2/} Business savings deposit flows had been slowing throughout December, but then accelerated in early January. Because the acceleration in these inflows coincided with the sharp decline in market interest rates, most of the estimated \$1 billion increase in business savings deposits in January--after a \$2 billion November-December inflow--probably represented shifts from market securities and time deposits rather than from demand balances. In addition, State and local acquisitions of savings deposits, which perhaps accounted for \$600-\$800 million of the \$5.8 billion total increase in savings deposits at all commercial banks in January, probably also reflect mainly the substitution of savings deposits for market assets.^{3/4/}

M₃ continued its rapid growth in January as combined deposits at S&Ls and MSBs grew at an estimated 14.8 per cent annual rate, up substantially from the 10-3/4 per cent rate of December. In recent

-
- ^{2/} Respondents felt that slightly over 60 per cent of business savings deposits represented funds shifted from demand balances. The size distribution of member banks holding the \$1.6 billion of these deposits on January 7 suggested that an additional \$400 million were outstanding at nonmember banks. Thus, about \$1.2 billion of the estimated total of \$2 billion of business savings deposits at all banks in early January is estimated to have come at the expense of demand deposits.
- ^{3/} At large weekly reporting banks, State and local savings deposits fluctuated around \$25- million in November-December. As market yields declined in January, such deposits more than doubled.
- ^{4/} All data on savings deposit balances noted above are based on changes in last Wednesday of month levels.

months only a small part of nonbank thrift institution inflows--one fourth or less--were in savings accounts with the remainder being in fixed maturity deposit certificates. However, because of the attractiveness of savings deposit yields relative to those of market assets, savings deposits may have accounted for a larger proportion of total thrift inflows in January.

Large commercial banks permitted outstanding CDs to decline by \$7 billion from the end of December to the end of January. While a part of this reduction represented runoffs of CDs sold in December by a few large banks for financial statement window dressing, the near record savings inflows and continued modest loan demand also contributed to the January CD runoff.

Business Borrowing

With retail sales continuing at a high level in January, following the strong gain in December, the need in some sectors for resumption of inventory restocking has become more pressing. The continued strengthening in economic activity associated with the sales growth may have begun to affect demands for short-term financing in January, despite large capital market financing and continued large internal cash generation by the business sector.

Thus, while bank lending to businesses increased only modestly in January, borrowing by nonfinancial businesses in the commercial paper

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

	1975							1976
	QI	QII	QIII ^p	QIV ^p	Nov. ^p	Dec. ^p	Year	Jan. ^p
Total loans and investments ^{2/}	5.7	4.6	3.6	3.1	10.5	-7.2	4.3	5.3
U.S. Treasury securities	79.5	95.0	26.0	4.2	19.2	25.2	59.6	35.4
Other securities	.3	7.1	3.9	1.4	9.9	-19.6	3.2	2.5
Total loans ^{2/}	--	-6.7	.2	3.4	9.4	-8.6	-.8	1.4
Business loans ^{2/}	-3.5	-9.8	--	2.5	6.0	-9.2	-2.7	2.0
Real estate loans	3.1	1.2	.3	4.3	2.7	4.5	2.2	4.5
Consumer loans	-6.9	-6.5	5.7	5.2	1.4	7.0	-.7	n.a.

Memo:

Business loans plus nonfinancial commercial paper ^{3/}	-1.6	-12.1	-.6	-1.0	.6	-5.6	-3.8	5.0
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^{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, non-consolidated nonbank affiliates of the bank holding companies (if not a bank), and non-consolidated nonbank subsidiaries of holding companies.

^{3/} Nonfinancial commercial paper is measured from end-of-month to end-of-month.

^p - Preliminary.

n.a. - Not available.

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

	1975			1976		
	Year ^{e/}	QIV ^{e/}	Dec. ^{e/}	Jan. ^{e/}	Feb. ^{f/}	Mar. ^{f/}
	<u>Gross offerings</u>					
Corporate securities--Total	4,358	1,958	3,550	3,650	3,500	3,500
Publicly offered bonds	2,717	1,946	1,750	2,200	1,800	2,200
By quality						
Aaa and Aa ^{1/}	1,422	776	625	1,275	--	--
Less than Aa ^{1/}	1,295	1,170	1,125	925	--	--
By type of borrower						
Utility	925	783	625	600	--	--
Industrial	1,432	767	675	1,050	--	--
Other	360	396	450	550	--	--
Privately placed bonds	743	946	1,000	750	750	750
Stocks	898	1,066	800	700	950	950
Foreign securities ^{2/}	451	634	975	605	500	500
State and local govern- ment securities						
Long-term	2,544	2,252	2,052	2,360	2,000	1,900
Short-term	2,415	2,197	1,793	1,000	1,500	1,800
	<u>Net Offerings</u>					
U.S. Treasury ^{2/}	7,576	8,097	9,850	6,159	7,898	8,000
Sponsored Federal Agencies	197	374	472	789	-734	388

^{e/} Estimated.

^{f/} Forecast.

^{1/} Bonds categorized according to Moody's bond ratings.

^{2/} Includes only publicly offered issues of marketable securities.

to be below last year's record total, and to be concentrated in less-than-prime rated obligations of businesses whose balance sheets still require considerable restructuring.

Foreign bond offerings were again heavy during January. Publicly offered issues totaled more than \$600 million as foreign private and official institutions, as well as international lending agencies, continued to market relatively large issues in the U. S. capital market. This reflects partly the depth of the U. S. bond market relative to foreign capital markets and also, in the case of Canadian borrowers, rate advantages in the U. S. market. The sizable foreign calendar boosted total bond offerings--both domestic and foreign--to \$2.8 billion during January, the largest monthly total since last June.

Equity offerings were relatively modest in January. However, if price gains made since the first of the year are sustained, more firms can be expected to seek funds through equity issuance in the coming months. The availability of an additional source of long-term capital on favorable terms could, moreover, improve the outlook for real investment spending.

Government Securities Markets

Commercial bank holdings of Treasury securities increased an estimated \$2-1/2 billion in January, near the record monthly average increase in 1975. These purchases largely reflect continued modest

loan demand which has driven large banks, flush with large savings deposit inflows, into the one to five year Treasury market, where rates are somewhat higher than those on bills.

In the February Treasury refunding, \$2.5 billion of new cash was expected to be raised in three issues: \$3 billion of 3-year notes, \$3.5 billion of 7-year notes, and \$400 million of reopened 29-1/4 year bonds. However, the 7-year notes, with an 8 per cent coupon selling at par by subscription attracted \$29 billion in bids, in part because the yield on the issue was 25 basis points above yields on outstanding issues of similar maturity. Subscriptions totaling \$6 billion were accepted for this issue with the average award being \$57,000. The massive size of the issue and its attractiveness to small investors suggests that payment of these issues at mid-month could significantly affect February deposit inflows to both banks and thrift institutions.

The shorter note and bond were sold at auction last Thursday. With the sale of the bond, the Treasury's \$10 billion exemption to issue long-term bonds with coupons above 4-1/4 per cent is exhausted, so that future financings will fall entirely on the bill and note markets.

In addition to the large corporate and Treasury calendar, a relatively large volume of municipal securities was sold since the last FOMC meeting with little change in yields,^{6/} despite the continued

^{6/} The 1/4 point decline in the Bond Buyer index since the January FOMC meeting is largely attributable to a change in the composition of the Index rather than to a movement in market rates. The downgradings by Moody's of the issues of two cities in the Index--Philadelphia and Boston--from A to Baa led the Bond Buyer to drop Detroit (rated Baa) and add St. Louis (rated A) in order to maintain the over all quality mix of the Index.

absence of commercial banks as significant investors. A number of New York State governmental units were successful in selling debt in January, as underwriters reported somewhat greater investor interest for New York paper. The total tax-exempt bond volume of \$2.4 billion for the month of January included a record \$610 million private placement by the New York State Power Authority. Excluding this issue, State and local bond volume was well below the average monthly volume of \$2.5 billion during 1975.

Mortgage and Consumer Credit

In January and early February, S&Ls generally reported home mortgage funds to be in adequate supply relative to demand at going rates of interest. Field reports suggest, moreover, that the availability of funds for construction loans has increased somewhat and the cost of such funds has fallen. However, most lenders apparently are still maintaining stringent quality standards for construction loans, particularly in the case of multi-family housing projects.

With short-term interest rate expectations minimizing the possibility of disintermediation in the near future, and with strong deposit inflows continuing through January, average interest rates on new commitments for conventional home mortgages at S&Ls have declined 15 basis points since the January meeting to 8.86 per cent--40 basis points below the recent high in October. Strong demands for home mortgage funds have tended to limit rate reductions in the primary

INTEREST RATES AND SUPPLY OF FUNDS FOR
CONVENTIONAL HOME MORTGAGES
AT SELECTED S&Ls

End of period	Average rate on new commitments for 80% loans (Per cent)	Basis point change from previous week	Number of Federal Home Loan Bank Districts with funds in short supply
1975--High	9.59	--	10
Low	8.80	--	0
<u>1976</u>			
Jan. 2	9.10	+ 1	1
9	9.07	- 3	0
16	9.01	- 6	0
23	9.00	- 1	0
30	8.90	-10	0
Feb. 6	8.86	-4	0

SECONDARY HOME MORTGAGE MARKET ACTIVITY

	FNMA AUCTIONS OF FORWARD PURCHASE COMMITMENTS						Yields on GNMA guaranteed mortgage- backed securities for immediate delivery <u>2/</u>
	Conventional			Govt.-underwritten			
	Amount (\$ millions)		Yield to FNMA <u>1/</u>	Amount (\$ millions)		Yield to FNMA <u>1/</u>	
	Offered	Accepted		Offered	Accepted		
1975--High	100	51	10.02	643	366	9.95	9.10
Low	10	9	8.96	25	18	8.78	8.01
<u>1976</u>							
Jan. 12	43	32	9.28	58	32	9.13	8.34
26	33	25	9.21	104	58	9.07	8.31
Feb. 9	58	37	9.17	252	178	9.07	8.38

1/ Average gross yields before deducting fee of 38 basis points for mortgage servicing. Data 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.

2/ Average net yields to investors assuming prepayment in 12 years on pools of 30-year FHA/VA mortgages carrying the prevailing ceiling rate on such loans.

market, while non-rate terms at S&Ls have changed little since October. Yields in the secondary mortgage market, which have dropped as much as 90 basis points since October, declined only slightly on balance after mid-January.

Automobile financing paced the expansion in consumer credit in December, with the net change in auto credit outstanding representing about 60 per cent of total consumer credit growth. At commercial banks, auto lending comprised virtually all the increase in bank-held consumer credit. New-car finance rates at banks have declined about 50 basis points from last year's peak first quarter rates, and the proportion of over-36-month new-car financing rose during the year to about 17 per cent from 10 per cent. Credit unions, which hold only 20 per cent of total consumer credit outstanding, continued to account for the largest portion--about 50 per cent--of the growth in such credit.

CONSUMER INSTALMENT CREDIT

	1974	1975	1975			
			QIII	QIV	Nov.	Dec.
<u>Total</u>						
Change in outstandings						
\$ Billion (SAAR)	9.5	3.6	9.1	10.1	9.6	10.7
Per cent	6.5	2.3	5.9	6.4	6.1	6.8
Bank share (%)	39.0	-1.8	35.3	33.7	28.9	34.7
Extended						
\$ Billion	166.1	166.9	173.2	180.0	178.5	183.5
Bank share (%)	43.6	44.0	44.3	44.3	44.4	44.4
<u>Automobile Credit</u>						
Change in outstanding \$bil (SAAR)	0.8	1.5	3.9	5.3	4.8	6.5
Extended, \$ billion (SAAR)	43.3	46.7	49.6	51.3	50.6	52.9
New-car loans over 36 mos. (%)						
Finance companies	8.4	23.6p	24.4	25.6p	25.4	25.7p
Commercial banks ^{1/}	8.8	14.0	15.4	17.0	17.0	...
New-car finance rate (% , APR)						
Finance companies	12.61	13.12	13.12	13.17	13.17	13.19
Banks (36-month loan)	10.97	11.36	11.31	11.24	11.24	11.25

^{1/} Series was begun in May, 1974, with data reported for the mid-month of each quarter. 1974 figure is the average for May, August and November.

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

	1974		1975			
	YEAR	YEAR	H-1	Q-3	Q-4	Dec.*
1. Trade balance	-5,277	9,146	5,165	1,957	2,024	552
2. Merchandise exports	98,309	107,250	52,788	26,644	27,818	9,360
3. Merchandise imports	103,586	98,104	47,623	24,687	25,794	8,808
4. Net service transactions	9,102		2,985	2,521		
5. <u>Balance on goods and services</u> ^{1/}	3,825		8,150	4,478		
6. <u>Remittances and pensions</u>	-1,721		-910	-426		
7. <u>Gov't grants and capital, net</u>	-4,342		-2,276	-1,184		
8. <u>Bank-reported private capital, net change</u>	-2,663	-9,735	-10,026	3,433	-3,142	-2,990
9. Claims on foreigners (inc.-)	(-19,482)	(-12,888)	(-7,509)	(-786)	(-4,593)	(-1,967)
10. Short-term	-18,307	-10,654	-6,750	-190	-3,714	-1,633
11. Long-term	-1,175	-2,234	-759	-596	-879	-334
12. Liabilities to foreigners (inc.+)	(16,819)	(3,153)	(-2,517)	(4,219)	(4,451)	(1,023)
13. Long-term liabilities	9	-430	-327	-114	11	89
14. Short-term liabilities ^{2/}	16,810	3,583	-2,190	4,333	1,440	-1,112
15. to commercial banks abroad	(12,621)	(-586)	(-2,643)	(2,429)	(-372)	(-2,717)
16. (to which liab. to branches) ^{3/}	(2,349)	(158)	(-960)	(-43)	(1,161)	(1,709)
17. to other private foreigners	(2,870)	(1,819)	(248)	(713)	(858)	(528)
18. to int'l regional organizations	(1,319)	(2,350)	(209)	(1,191)	(954)	(1,077)
19. <u>Private transactions in securities, net</u>	-1,318	-2,410	-1,691	35	-754	-367
20. U.S. purchases (-) of foreign securities	(-1,990)	(-6,358)	(-3,022)	(-998)	(-2,338)	(-1,116)
21. of which: New bond issues	(-2,373)	(-7,175)	(-3,324)	(-1,264)	(-2,587)	(-1,273)
22. Foreign purch. (+) of U.S. corp. securities	(672)	(3,948)	(1,331)	(1,033)	(1,584)	(749)
Stocks	544	4,452	1,856	1,288	1,308	639
of which by OPEC	(216)	(1,493)	(643)	(360)	(490)	(238)
Bonds (includes U.S. Govt. agencies)	128	-505	-525	-256	276	110
26. <u>U.S. direct investment abroad, (inc.-)</u>	-7,455		-3,345	-668		
27. <u>Foreign direct investment in U.S., (inc.+)</u>	2,224		1,019	-124		
28. <u>Nonbank-reported: liquid claims, (inc.-)</u>	-133		444	-548		
29. <u>other claims, (inc.-)</u>	-3,004		121	341		
30. <u>liabilities, (inc.+)</u>	1,493		585	-450		
31. <u>Changes in liab. to foreign official agencies</u>	9,831	2,606 ⁴	5,329	-4,577	1,854 ⁴	49 ⁴
32. OPEC countries (inc.+) ^{3/}	10,025	3,758	1,231	1,716	811	419
33. Other countries (inc. +)	-194	-1,152 ⁴	4,098	-6,293	1,043 ⁴	-370 ⁴
34. <u>Changes in U.S. reserve assets (inc.-)</u>	-1,434	-607	-354	-342	89	364
35. Gold	--	--	--	--	--	--
36. Special drawing rights	-172	-66	-20	-25	-21	--
37. Reserve position in the IMF	-1,265	-466	-314	-95	-57	21
38. Convertible currencies	3	-75	-20	-222	167	343
39. <u>Errors and omissions</u>	4,698		2,953	32		
Memo:						
40. Official settlements balance, S.A.			-4,975	4,919	-1,943	
41. N.S.A.	-8,397	-1,999	-3,504	3,051	-1,546	-413
42. O/S bal. excluding OPEC, S.A.			-3,744	6,635	-1,132	
N.S.A.	1,628	1,759	-2,273	4,767	-735	6

*/ Not seasonally adjusted (except for merchandise trade data lines 1-3).

^{1/} Differs from "net exports" in the GNP account. The GNP basis excludes U.S. Government interest payments for foreigners from service imports and special military exports to Israel.^{2/} Includes transactions in U.S. Treasury bonds and notes.^{3/} Not seasonally adjusted. p = preliminary.^{4/} Excludes a \$250 million increase in liabilities resulting from the revaluation of System swap liabilities to Belgium and Switzerland.

INTERNATIONAL DEVELOPMENTS

Foreign exchange market. Exchange markets have been unsettled since the Bank of Italy announced on January 21 that it would no longer provide intervention support for the lira. During the past three weeks, the lira has depreciated sharply, pressures have developed within the snake, particularly against the French and Belgian francs, and the yen and the Canadian dollar have tended to strengthen.

. As a result of all the divergent movements in exchange rates, the weighted average value of the dollar has risen about 1/2 per cent since mid-January. The dollar's rise against the lira exceeded its declines against the yen and Canadian dollar.

Developments in the lira market were the major focus of attention in mid-January. With the fall of the Italian government on January 7, the lira came under renewed selling pressure.

, the Bank of Italy,

partly in a political move to get the Socialists to support a coalition government, announced on January 21 that it would no longer provide intervention support for the lira. Within the next three days, the lira dropped six per cent against the dollar; after that it drifted down another three per cent. In early February, the Bank of Italy made several moves to reduce the excess supply of lire. It raised the discount rate from 6 to 7 per cent, raised minimum reserve requirements on bank deposits, and shortened the time required for converting foreign currency earnings into lira. The lira was also buoyed by news that the Socialist party would not oppose a minority government and that Prime-Minister Designate Moro was proposing several new economic measures.

After the Bank of Italy withdrew from the exchange markets, the French franc came under selling pressure. Some of this pressure developed because France is a major competitor with Italy and because conflicting statements by French officials about the likely size of the French trade deficit in 1976 made market participants unclear what government policy towards the exchange rate would be. Pressures on the franc persisted and the mark strengthened as expectations grew that there would be a general realignment of snake parities. The decision by the Bank of Spain on February 9 to devalue the peseta by 11 per cent heightened the expectations of a realignment of parities.

•
Pressures also developed in the more closely held Benelux rates, as heavy demand for Dutch guilders by foreigners for interest payments on guilder borrowings helped strengthen that currency.

• Pressures
on the Belgian franc persist despite the Netherlands Bank 1/2 per cent cut in its discount rate to 4 per cent

• On February 11 the Belgian National Bank introduced a split rate on the bills that can be rediscounted with the central bank. Henceforth only 50 per cent of a commercial bank's quota can be rediscounted at 6 per cent; for the remainder, an 8 per cent rate will be charged. With the splitting in rates, the Bank hoped to keep basic rates unchanged, but also to minimize "speculative" pressures.

The Canadian dollar has advanced nearly one per cent against the dollar in the past 4 weeks spurred by large scale borrowings by Canadian entities in the U.S. market. The statement by Finance Minister MacDonald that the appreciation of the Canadian dollar was not unwelcome

because it helped reduce the price of imports and thereby helped reduce inflationary pressures also served to reenforce demand for the Canadian currency.

The yen advanced more than one per cent against the dollar during the past 4 weeks

. The yen firmed as foreign investors responded to the favorable yield on a special 2-month Japanese Treasury issue and as prospects for Japanese exports looked more promising as the U.S. economy continued to recover.

The System sold at least \$120 million equivalent of marks during the past month, using all the marks held in balances and drawing on the swap line for more than \$50 million. The System also purchased \$51 million equivalent of Belgian francs, and repaid \$45 million on the outstanding swap debt.

OPEC investment flows. The OPEC investible surplus in 1975 is now being estimated at about \$37 billion, the result of a \$40 billion current account surplus (on a payments basis) and \$3 billion of disbursements of grant aid to developing countries. This represents a substantial decrease from the 1974 investible surplus of \$57 billion, principally because of the rise in OPEC imports. During 1975 the investible surplus is believed to have contracted sharply from \$37 billion in the second half of 1974 to \$21 billion in the first half of 1975, and then to have declined more slowly to \$16 billion in the second half of last year.

Estimated Disposition of OPEC Investible Surpluses
(in billions of dollars)

	<u>1974</u>	<u>1975</u>				<u>Year</u>
	<u>Year</u>	<u>Q1</u>	<u>Q2</u>	<u>Q3</u>	<u>Q4</u>	
I. In United States	11.3	0.7	1.4	2.5	1.3	5.9
A. Short-term assets ^{1/}	9.2	-1.3	0.2	1.3	-0.1	0.1
B. Treasury bonds and notes	0.4	0.8	0.4	0.3	0.4	1.9
C. Other assets ^{2/}	1.7	1.2	0.8	0.9	1.0	3.9
II. In United Kingdom	7.2	0.8	-0.1	-0.5	0.1 ^{4/}	0.3 ^{5/}
A. Banking and money market placements ^{3/}	5.3	0.8	-0.4	-0.6	0.1 ^{4/}	-0.1 ^{5/}
B. Other loans and investments	1.9	0	0.3	0.1	0	0.4 ^{5/}
III. In Euro-currency Market	24.5	4.2	1.8	-0.3	2.9	8.6
A. In United Kingdom	13.8	1.7	0.3	0.2	1.9	4.1 ^{5/}
B. In other countries (est.)	10.7	2.5	1.5	-0.5	1.0 ^{4/}	4.5 ^{5/}
IV. International Institutions	3.3	1.5	0.3	0.2	0.5	2.5
A. Bonds	1.5	0.7	0.1	0.1	0	0.9
B. IMF Oil Facility	1.8	0.8	0.2	1.1	0.5	2.6
V. All Other	10.7	3.8	6.6	6.1	3.2	19.9
Total = investible surplus	57.0	11.0	10.0	8.0	8.0	37.0
Memorandum item: OPEC grant aid	3.0	1.3	0.4	0.4	0.4	2.6
Current account surplus ^{6/}	60.0	12.3	10.4	8.4	8.4	39.6

^{1/} Principally Treasury bills, repurchase agreements, and bank deposits (including CD's).

^{2/} Long-term bank deposits, corporate and Federal Agency bonds, equities, and real estate and other direct investments (estimated).

^{3/} Treasury bills and bonds, and bank and other deposits.

^{4/} October - November only

^{5/} January - November only.

^{6/} With oil receipts on a cash basis.

Sources: Federal Reserve, Bank of England, IBRD, IMF, and estimates by U.S. Treasury.

OPEC receipts from oil (cash basis) in 1975 as a whole are estimated at \$103 billion. This was higher than the 1974 estimate of slightly under \$100 billion; the impact on receipts of a drop of about 10 per cent in the volume of oil shipments was more than offset by the effects of price increases and a reduced shortfall of cash receipts from the value of shipments arising from the lag in settlements. OPEC imports in 1975 probably totalled close to \$60 billion, up about 60 per cent from 1974. However, data for the third quarter, and fragmentary figures for the fourth quarter, concerning exports from OECD countries to OPEC countries show a very marked slowing in the rate of growth of OPEC imports.

Additions to investments of OPEC countries in the United States rose from \$1.4 billion in the second quarter of 1975 to \$2.5 billion in the third, then fell back to \$1.3 billion in the fourth quarter. Nearly all of these fluctuations were in investments in short-term assets, as indicated in the accompanying table. The fluctuations in net acquisitions of short-term instruments may have been in part a consequence of the rise in short-term interest rates in the United States in the third quarter and their subsequent decline in the fourth quarter; they may also have been influenced by the (related) strengthening of the dollar in exchange markets in the third quarter.

Increases in OPEC holdings of longer-term assets in the United States -- Treasury bonds and notes, other securities, and other assets in item IC in the table -- continued at a fairly steady rate in the final two quarters of last year. For 1975 as a whole they totaled \$5.8 billion and accounted for almost the entirety of the increase in OPEC holdings

of assets in the United States. Most of the increase for the year was in Treasury bonds and notes (\$1.9 billion), stocks (\$1.4 billion), and corporate and Federal Agency bonds (\$1.4 billion).

The additions to OPEC assets in the United States absorbed close to one-fourth of the OPEC investible surplus in the second half of 1975, up from one-tenth in the first half. For 1975 as a whole the figure was 16 per cent, compared with 20 per cent in 1974.

OPEC countries continued to draw down their sterling holdings in the United Kingdom in the third quarter, and increased them only minimally in October-November. For the first eleven months of 1975 these assets were increased by only \$0.3 billion, all in the first quarter. Additions to Euro-currency deposits seem likely to have been less than \$3 billion in the second half, down from \$5 billion in the first half; this decrease was somewhat greater, in relative terms, than the decline in the overall surplus.

A larger proportion of the OPEC surplus was invested in longer-term assets in 1975 than in 1974. Known additions to longer-term assets (items IB, IC, IIB, and IV) accounted for 24 per cent of the total investible surplus in 1975, and 51 per cent of that part the disposition of which is known or can be estimated with some confidence (items I through IV); the comparable percentages for 1974 were 13 per cent and 16 per cent, respectively. Uses of the surplus that cannot be identified (item V) were a much larger share of the total in 1975 than in the previous year. However, it is believed that in 1975 this category of uses continued to comprise mostly longer-term assets such as loans to governments, other public sector

borrowers, and international organizations; real estate and other direct investments outside the United States and the United Kingdom; investment trusts; and Euro-bonds. It would appear that in 1975 the OPEC countries may have placed as much as three-fourths of their collective surplus in longer-term assets, compared with less than one-third in 1974.

U.S. International Transactions. Major developments in U.S. international transactions in the fourth quarter of 1975 include 1) an upturn in the volume of both exports and imports and a continuation of the substantial trade surplus, 2) resumption of a large net outflow of bank-reported private capital, 3) substantial increases in U.S. purchases of new issues of foreign bonds and in foreign purchases of U.S. corporate securities, and 4) an increase in U.S. liabilities to foreign official agencies of both non-OPEC countries and OPEC countries. Preliminary weekly data for January indicate a further increase in U.S. liabilities to foreign official agencies (both OPEC and non-OPEC), and a decline in bank-reported liabilities to private foreigners.

Based on actual data for merchandise trade and projections for net service transactions and for transfer payments, it is estimated that the U.S. current account in 1975:IV was in a strong surplus position for the fourth quarter in a row. The net flow of private capital shifted from a net inflow in the third quarter to a large net outflow in the fourth quarter partly in response to a widening of differentials between U.S. and foreign interest rates. There was very little change during the fourth quarter in the average value of the dollar in foreign exchange markets, as intervention activity shifted from very large net sales of U.S. assets by foreign official agencies in the third quarter (\$6.3 billion by non-OPEC countries) to net purchases of about \$1.1 billion in the fourth quarter.

U.S. Merchandise Trade. In the fourth quarter, the United States recorded its fourth consecutive quarterly trade surplus. The surplus was \$8.1 billion at an annual rate (balance of payments basis), about the same as in the third quarter.

U.S. MERCHANDISE TRADE
(Balance of Payments Basis)

	1974	1975	1975			
			I	II	III	IV
(billions of dollars, seasonally adjusted annual rates)						
<u>EXPORTS, total</u>	<u>98.3</u>	<u>107.3</u>	<u>108.5</u>	<u>102.6</u>	<u>106.6</u>	<u>111.3</u>
Agricultural	22.4	22.3	25.1	19.4	22.0	22.9
Nonagricultural	75.9	84.9	83.4	83.3	84.6	88.4
<u>IMPORTS, total</u>	<u>103.6</u>	<u>98.1</u>	<u>101.2</u>	<u>89.3</u>	<u>98.7</u>	<u>103.2</u>
Fuel	27.4	28.4	27.9	24.4	30.1	31.1
Nonfuel	76.2	69.7	73.3	64.9	68.7	72.1
<u>Balance</u>	<u>-5.3</u>	<u>+9.1</u>	<u>+7.3</u>	<u>+13.3</u>	<u>+7.8</u>	<u>+8.1</u>

(per cent change from preceding period)

<u>TOTAL EXPORTS</u>						
Value	+37.7	+9.1	+2.0	-5.4	+3.8	+4.4
Price*	+27.0	+12.5	+3.4	-0.7	-0.6	+0.5
Volume	+8.4	-3.0	-1.3	-4.8	+4.5	+3.9
<u>TOTAL IMPORTS</u>						
Value	+47.1	-5.3	-9.6	-11.7	+10.6	+4.5
Price*	+50.4	+8.3	+1.0	+0.9	-3.5	+0.1
Volume	-2.2	-12.6	-10.5	-12.5	+14.6	+4.4

*Measured by unit value indexes.

U.S. exports and imports increased in both value and volume for the second quarter in a row. The pick-up in the volume of imports was largely related to the upturn in U.S. economic activity while the

increase in the volume of exports (largely of nonagricultural goods) probably reflected some strengthening in economic activity in Germany and Canada and the apparent bottoming out of cyclical contractions in most other major industrial countries. Price movements were affected by the appreciation of the dollar which began in mid-1975 and the general weakness in world-wide demand. On average in the fourth quarter, both export and import prices, as measured by unit value indexes, changed only slightly from the low third quarter levels. But toward the end of the quarter, both export and import prices began to rise. For nonagricultural exports, prices in the fourth quarter rose by about 1 1/2 per cent.

Agricultural exports rose by 4 per cent to \$22.9 billion at an annual rate. The volume of shipments increased by 6 per cent and was more than accounted for by increased shipments of wheat and corn, particularly to the Soviet Union. Of total Soviet orders for delivery in fiscal 1976, 35 per cent of the corn and 72 per cent of the wheat had been exported by the end of December. Increased grain shipments were partly offset by declines in soybean and cotton shipments. Average export prices declined slightly, the fourth consecutive quarterly decline from record highs recorded late in 1974.

Nonagricultural exports rose by 4 1/2 per cent to \$88.4 billion at annual rate. Most of this increase was in volume, but prices, which had been fairly flat during the year, began to pick up

in November and December. Over half of the fourth quarter increase was in machinery exports. New export orders for machinery have held fairly steady since last June, however, suggesting that machinery exports may continue at about the present level in the first half of 1976. Exports of industrial supplies (largely coal, paper, chemicals, and nonferrous metals) and nondurable consumer goods also rose.

Imports of petroleum and products, \$31.1 billion at an annual rate, changed only marginally from the third quarter rate. Average import prices rose by nearly 2 1/2 per cent to \$11.54 per barrel. The full \$1 per barrel OPEC price increase is estimated to bring import prices to about \$12.30 per barrel during the first quarter of 1976; by December the import price reached \$11.89 per barrel. The volume in the fourth quarter declined to 6.8 million barrels per day from nearly 7 million barrels per day in the third quarter. This drop in volume was probably a temporary reaction to stockpiling that apparently took place in late summer and early fall in anticipation of the OPEC price increase announced for October 1.

Other imports rose by 5 per cent to \$72.1 billion (annual rate). The entire increase was in volume as prices of nonfuel imports, as measured by unit value indexes, declined by 1/2 per cent reflecting the appreciation of the dollar in the second and third quarters of 1975, and the continued weakness of commodity prices and world demand. Increased imports of industrial supplies (largely textiles, chemicals

and metals), machinery, and consumer goods other than automotive vehicles and parts accounted for most of the fourth quarter increase in nonfuel imports. Foreign car imports increased by about 9 per cent -- prices increased a bit, but most of the increase was in the number of vehicles imported, mostly from Germany and Japan. U.S. dealer inventories of foreign cars, which had been very low, began to pick up in the fourth quarter placing foreign car dealers in a better position to meet an expected rise in consumer demand for all types of new cars.

Bank-reported private capital transactions. In a return to the pattern in the first half of 1975, bank-reported private capital transactions shifted from a third-quarter net inflow to a fourth-quarter net outflow of \$3.1 billion (quarterly rate). Part of

BANK-REPORTED PRIVATE CAPITAL FLOWS
(in billions of dollars)

	1974	1975	1975			
			I	II	III	IV
Claims on foreigners (incr.-)	-19.5	-12.9	-3.7	-3.8	-.8	-4.6
Liab. to foreigners (incr.+) (of which: foreign branches of U.S. banks)	+16.8 (+2.3)	+3.2 (+.2)	-1.9 (-1.2)	-.6 (+.2)	+4.2 (--)	+1.5 (+1.2)
Net flow (inflow +)	-2.7	-9.7	-5.6	-4.4	+3.4	-3.1

the fourth-quarter outflow can be attributed to a slight widening of interest differentials as short-term interest rates in the United

States declined somewhat more than comparable rates in other major financial centers. Claims on foreigners increased by \$4.6 billion compared with the small (\$800 million) increase in the third quarter when economic activity was sluggish and when U.S. interest rates rose faster than foreign rates. The largest increase in claims was to the United Kingdom, the Bahamas, and Brazil; other large gains were to France and Japan. Bank-reported liabilities to private foreigners rose by \$1.5 billion in the fourth quarter. Declines in December and October were not large enough to offset an unusually large inflow in November. Preliminary weekly data on bank-reported data for January indicate a further net outflow. For the year 1975 as a whole, bank-reported liabilities increased by \$3.2 billion compared with an increase of \$16.8 billion in 1974. At the same time, foreign official accounts at U.S. commercial banks (including OPEC) declined by \$3 billion in 1975 compared to a \$6 billion increase in 1974.

Transactions in securities (other than U.S. Treasury issues) resulted in a net outflow of funds from the United States in the fourth quarter amounting to \$750 million, compared with a negligible net inflow in the third quarter. Foreign purchases of U.S. corporate stocks (which include some foreign official transactions) increased by \$550 million in the fourth quarter to \$1.6 billion -- the highest level since the first quarter of 1973. About half of the increase in net purchases was in direct purchases by OPEC. Indications are that foreigners continued their strong rate of purchases in January and early February.

In the fourth quarter, new issues of foreign bonds being offered in the United States amounted to a record \$2.6 billion (including \$730 million of IBRD issues and \$124 million European Coal and Steel Community issues in December). Canadian new issues reached a record \$1.3 billion in the fourth quarter after dropping off in the third when U.S. interest rates rose faster than rates in other financial centers. Preliminary data indicate that new foreign issues were about

NEW FOREIGN BOND ISSUES IN THE UNITED STATES
(in billions of dollars)

	1974	1975	1975			
			I	II	III	IV
<u>Total</u> (increase,-)	<u>-2.4</u>	<u>-7.2</u>	<u>-2.1</u>	<u>-1.2</u>	<u>-1.3</u>	<u>-2.6</u>
Canada	-1.7	-3.2	-.7	-.7	-.4	-1.3
Int'l Organizations	--	-2.4	-.9	-.1	-.5	-.9
Other	-.6	-1.6	-.5	-.4	-.3	-.4

\$500 million in January, but in February new issues are expected to repeat the very high December level with a \$1 billion Quebec Hydroelectric Commission issue being offered.

U.S. liabilities to foreign official agencies of countries other than OPEC members increased by \$1.0 billion in the fourth quarter after declining sharply in the third quarter. Small declines in November and December were not enough to offset the sharp increase in October. Preliminary weekly data indicate that liabilities increased in January.

Liabilities to OPEC members increased by \$811 million in the fourth quarter and preliminary weekly data showed a further small increase in January. For the year 1975, bank-reported liabilities to OPEC countries increased by \$3.8 billion compared with an increase of \$10.0 billion in 1974. See the separate section on OPEC investment flows for further details.

Economic activity in major foreign industrial countries. The major foreign industrial countries, with the exception of Italy, are experiencing an upturn in economic activity. In several countries, however, the strength and sustainability of the upturn are still in question. In Japan, the upswing that began last March appears to be stalling, with industrial production not having advanced since August. In the United Kingdom, while the recession has reached bottom, the upturn thus far is still relatively weak. French economic activity has been rising at a moderate pace since October, while Canadian industrial production has increased only since November (although real GNP has been rising since the second quarter of 1975). Germany now appears to be the major country most clearly in a recovery stage, and even there industrial production declined slightly in December.

In most of the smaller industrial countries, which generally lag the larger countries in the cycle, recessionary conditions are still prevalent. In recent months, the recession has deepened in Belgium, Switzerland and Denmark. Economic activity remains flat in the Netherlands, Norway, Sweden and Finland, but has started to turn up in Austria.

In most major countries, consumption and government expenditures have been the main factors contributing to the recent rise in output. Capital spending has been the weakest sector, and, because of excess capacity, is expected to remain sluggish much of this year. In only a few countries -- notably Germany and Japan -- has the external sector provided some stimulus and only since the fourth quarter of last year.

All major countries except Japan experienced a decline in real GNP last year of between 1/2 and 4-1/2 per cent from the 1974 level. Japanese real GNP increased by about 1-1/2 per cent in 1975 over 1974, with much of the increase occurring in the second half of the year. Measured in terms of real GNP, pre-recession peak GNP levels of the second half of 1973 were exceeded by Japan in the second quarter of 1975.

As indicated in the following table, which presents data on changes in industrial production, all of the major industrial countries appear to have reached a cyclical low in industrial production by October of last year. The decline from peak to trough varied, with declines exceeding 20 per cent in Italy and Japan, while Canada recorded a relatively moderate decline of less than 3 per cent. The recent gains in industrial output in most countries have been relatively modest compared with the overall declines since the previous peak. Current forecasts indicate that, with the possible exception of Germany, industrial production in the major industrial countries will still be below earlier peaks at the end of this year.

Most foreign countries have not changed policy course in recent months and are counting on the stimulus from the expansionary fiscal policies adopted last fall, accompanied by generally accomodative monetary policies, to sustain their upturns. In the United Kingdom, the authorities are easing monetary policy somewhat, as reflected in the decline since November in the Bank of England's minimum lending rate from 12 to 9.5 per cent, in order to spur investment and economic activity. Several smaller

Industrial Production in Major Countries
(Seasonally adjusted)

	Percentage change from previous month				Latest month from yr. earlier (per cent)	1975/ 1974 (per cent)	Latest peak month	Latest peak to trough (per cent)	Trough month	Trough to latest month (per cent)
	Sept.	Oct.	Nov.	Dec.						
France	-0.9	2.8	0	n.a.	-4.3	-10.4 ^{1/}	Aug. 74	-15.5	Sept. 75	2.8
Germany	2.0	1.0	1.9	-0.9	1.9	-6.9	May 74	-12.3	July 75	6.0
Italy	19.1	-0.3	2.5	n.a.	1.3	-10.7 ^{1/}	Apr. 74	-25.9	Aug. 75	21.7
United Kingdom	1.7	1.2	0.1	n.a.	-3.5	-4.4 ^{1/}	Oct. 73	-11.5	Aug. 75	3.0
Japan	1.6	0.6	-1.7	0.2	0.8	-11.0	Nov. 73	-21.4	Feb. 75	7.3
Canada	-0.7	-0.8	1.6	n.a.	-2.9	-5.1 ^{1/}	Mar. 74	-7.6	Oct. 75	1.6
United States	1.8	0.4	0.5	1.0	0.9	-8.8	Nov. 73	-13.8	Apr. 75	7.8

^{1/} Jan.-Nov. 1975 average compared with Jan.-Nov. 1974.

Sources: National country sources.

countries, such as the Netherlands, Austria and Sweden, lowered their discount rates in the past month, and Switzerland and Austria have adopted stimulative fiscal measures. In Italy, on the other hand, the authorities have tightened monetary policy in recent weeks in order to discourage capital outflows and to restore confidence in the lira.

German industrial production in December was 6 per cent above the July low. The economic recovery since July has been relatively strong, although there was a dip in production in December, partly because of such special factors as holiday schedules. Real GNP, however, increased sharply by about 3 per cent in the fourth quarter of last year over the third quarter.

The main sources of strength in the upturn have been a continuation of the rise in private consumption and some improvement in the external surplus. Consumers now appear to be more confident as inflationary fears have subsided somewhat, and the saving rate declined in the second half of the year to about 14-1/2 per cent, compared with 17 per cent in the first half of 1975.

The outlook for German output in 1976 is relatively favorable, with real private consumption a main spur to the upturn. Real GNP is expected to rise by about 4 per cent. However, the rate of unemployment, which was 5.2 per cent in December, is expected to decline only moderately this year.

The French economy began to recover in the fourth quarter of last year. Industrial production in November was 2.3 per cent above the September low.

The gain in output has mainly reflected a rise in consumer and government expenditures. Foreign orders for non-capital goods have been rising and inventories of finished goods have declined to roughly normal levels. Many corporations, however, are continuing to experience low profits and weak financial positions. Most observers believe that the French economy will grow slowly in 1976, and the year-over-year advance in real GDP is expected to be about 3-1/2 per cent. The unemployment rate remained at a level of over 4 per cent in December, and no substantial reduction in the number of unemployed is now expected until 1977.

In the United Kingdom industrial production in November was 3 per cent above the low reached in August. The major sectors contributing to the rise in output were utilities, mining, chemicals, metal manufactures and petroleum products.

Other indicators of economic activity have been mixed. Preliminary reports indicate that the saving rate fell in the fourth quarter of last year, but retail sales remained virtually flat during both the third and fourth quarters. The unemployment rate rose steadily last year, reaching 5.1 per cent in December, and a further rise throughout most of this year is projected.

The upturn in economic activity in the United Kingdom in 1976 is expected to be quite weak, with a year-over-year rise in real GNP of about 1 per cent. Considerable excess capacity still exists and recent investment surveys indicate that real investment will be down about 6 per cent in 1976,

following an estimated 12 per cent decline last year. The recent decline in interest rates may improve the investment climate somewhat.

Industrial production in Italy declined through last summer, with only some slight recent signs of possible recovery. Through August of last year, industrial output was off 22 per cent from the April 1974 peak. With many employees having been placed on short-time work rather than being laid off, the rate of unemployment has remained relatively stable at about 3-1/2 per cent.

Italian economic prospects have been heavily clouded as a result of the January 7 fall of the center-left government of Premier Moro and the onset of the foreign exchange crisis on January 21. On February 2 the Bank of Italy raised its discount rate from 6 to 7 per cent and subsequently announced additional restrictive monetary measures. Prior to these developments a modest economic upturn was expected in 1976, with real GNP rising about 1 to 2 per cent, but now it is likely that this may not be achieved.

After reaching a low in February 1975, Japanese industrial production rose steadily through July, but since then has remained roughly flat. This pause in the upswing has been strongly influenced by inventory developments. Although inventories of finished goods fell during the first half of 1975, they rose in the second half as aggregate demand proved weaker than anticipated by manufacturers. As a result, the manufacturing industry has been restraining production in order to adjust stocks to present and anticipated demands.

Only a slow rate of growth is now expected in real GNP in the first half of this year, with a more substantial upswing anticipated later in the year. The year-over-year rise in GNP is expected to be 4 per cent. Capacity utilization still remains relatively low at about 33 per cent, and little, or no, growth in real capital investment is expected this year.

GNP data for Canada indicate that an economic upturn began in the second quarter of last year. But industrial production, which has been disrupted by strikes, has not shown the same buoyancy as GNP. Consumer spending and increased expenditures on residential construction have been the main contributors to the rise in GNP. Exports continued as the major source of weakness during most of the year, but strengthened in the fourth quarter. The rate of unemployment leveled off at about 7.2 per cent during most of 1975, and is expected to remain at about that level during 1976.

In recent months Canadian retail sales and new orders in manufacturing industries have been rising, suggesting a further rise in real GNP this year. Current forecasts are that real GNP in 1976 will rise by about 4-1/2 per cent. Business capital spending is not expected to remain as strong in 1976 as last year due to the recent decline in business profits and the high level of excess capacity.

APPENDIX A*
THE FEDERAL BUDGET FOR 1977

This appendix discusses the principal features of the President's budget proposals for fiscal year 1977. Section I outlines the major contours of the President's budget and reviews its implications for economic stabilization. Section II examines the principal tax law changes proposed by the President. Section III reviews the spending actions requested by the Administration.

Overview of the Budget

The Administration is projecting a unified budget deficit of approximately \$43 billion for fiscal 1977, (beginning October 1, 1975). Revenues are estimated at \$351 billion, and a ceiling of \$394 billion is proposed for Federal spending. With outlays for the off-budget agencies estimated at \$11 billion, the enlarged Federal deficit is projected at \$54 billion. Table I summarizes the major fiscal aggregates.

Despite the large size of the unified deficit, the Administration's budget is not expected to provide significant fiscal stimulus in the near-term future. Indeed, the full employment budget would swing from about a \$16 billion deficit in the current fiscal year, to a full employment surplus of around \$3 billion, estimated for 1977. Although the movement toward a full employment surplus is initiated in the current calendar year, the major shift toward fiscal restraint occurs in early CY 1977 when substantial deceleration in the rate of Federal spending contributes importantly to the development of a surplus in the full employment budget.

Revenue Estimates

The Administration's revenue estimate for FY 1977 represents an increase of about 18 per cent, or \$54 billion over the projection for fiscal 1976. This expansion in revenues is primarily generated by a sharp increase in nominal GNP, projected to rise at an annual rate slightly in excess of 12 per cent over the period. The net effect of tax law changes proposed by the Administration is to provide an offset of about \$23 billion to the growth in potential revenues for FY 1977, assuming expiration of the Revenue Adjustment Act on June 30, 1976.

* Prepared by Wayne M. Ayers, Economist, Government Finance Section, Division of Research and Statistics.

Under the Administration program, individual and corporate income taxes are reduced by about \$29 billion--a cut of about \$10 billion more than would be realized if the Revenue Adjustment Act of 1975 were extended for all of CY 1976. 1/ Increases in social security and unemployment compensation taxes have been recommended, however, which would produce about \$7.8 billion of additional revenue, (annual rate, beginning January, 1977).

For individuals, the Administration budget embodies proposals which differ from those contained in the Revenue Adjustment Act. 1) An increase in the personal exemption from \$750 to \$1,000, 2) substitution of a flat \$2,500 standard deduction for the current low income allowance and percentage standard deduction, and 3) a reduction in marginal tax rates for incomes up to \$24,000.

For corporations, it is proposed that 1) the rate changes as well as the increase in the investment tax credit be made permanent, 2) the maximum corporate tax rate be reduced from 48 to 46 per cent, and 3) legislation be enacted to provide tax relief to electric utilities.

The Administration has also proposed a variety of special tax incentives designed to encourage specific economic activity. To encourage financial institutions to hold residential mortgages, the Administration has proposed, as part of the Financial Institutions Act, a new tax credit on interest income from such holdings; this measure would substitute for the current tax provision which permits thrift institutions to maintain excess bad debt reserves. To foster more broad-based ownership of common stock, a proposal to defer taxes on funds placed in a stock purchase plan and held there for at least 7 years is recommended. Finally, to promote job creation in areas of high unemployment, the Administration supports a program of accelerated depreciation of new plant and equipment in areas where the unemployment rate exceeds 7 per cent is proposed. Qualifying firms must undertake projects before January 20, 1977 and complete them within 36 months.

The other major tax proposals contained in the budget are designed to improve the fiscal soundness of the social security and unemployment trust funds. Under the President's program, the combined employer-employee social security tax rate would increase from the current 11.7 to 12.3 per cent. Also proposed is an increase in the

1/ The proposed changes in income tax provisions were originally estimated at \$23 billion. More recently, the cost has been estimated at \$29 billion.

Federal unemployment tax rate from .5 per cent to .65 per cent, and an increase in the taxable wage base from \$4,200 to \$6,000.

Table II compares the Administration proposals with the Revenue Adjustment Act of 1976, and indicates the impact on Federal revenues for fiscal 1977.

Outlay Estimates

In evaluating the implications of the President's spending program, it is useful to compare the President's outlay proposals with those estimated in the current services budget. This alternative budget represents projection of outlays assuming continuation of Federal benefits, services, and purchases as provided under existing law.

In the absence of any Administration proposals, outlays would rise \$41 billion in FY 1977 to an estimated current service level of \$414.5 billion, an increase of 11 per cent. As detailed in Table III, the President has proposed, however, a Federal spending level some \$20 billion below the current service level thereby holding the expansion from FY 1976 to a 5.5 per cent increase. ^{2/} All functional categories of spending would be cut below current service levels, but 90 per cent of the total reduction is concentrated in non-defense spending. Moreover, various cuts in domestic transfers for individuals would account for 80 per cent of the proposed total decline in non-defense spending.

An alternative perspective on the degree of fiscal restraint in the President's budget can be gained by comparing it with past spending patterns. In recent years, spending has been accelerating very rapidly, advancing at annual rates of 20 per cent in fiscal 1975

^{2/} It should be noted that the 5.5 per cent growth rate overstates somewhat the increase in actual spending since the budget for FY'77 includes estimated outlays for the Export-Import Bank. In past years, this agency had off-budget status, and its expenditures were consequently not reflected in fiscal year outlay totals. Moreover, a simple comparison between fiscal years 1976 and 1977 is misleading, since it ignores the transition quarter, and thus essentially compares a 15-month year to a 12-month year. Adjusting for these special factors reduces the growth rate of current dollar spending to 4--4.5 per cent.

and 15 per cent in fiscal 1976. Outlays in these years, of course, were expanded by counter-recessionary programs and inflation, but growth has also been relatively strong in every fiscal year of the present decade. Indeed, the 5.5 per cent rise proposed for FY 1977 would be the slowest rate of expansion since 1969 when expenditure growth was moderated by the deceleration of the Vietnam conflict and the initial adoption of a Congressional spending ceiling. Moreover, if spending is contained at \$394.0 billion and prices rise as projected by the Administration, Federal outlays would decline by about 3 per cent in real terms.

While the Administration's budget represents an attempt to restrain the overall growth in spending, it also proposes a substantial 9 per cent increase in defense outlays. For the entire period between 1969 and 1975, defense spending grew by only 8 per cent. Real defense spending actually fell by 31 per cent in that period. For the second consecutive year, the Administration is proposing an increase however modest, in the level of real defense expenditure.

In other categories, however, spending is to be severely restrained. Income security, for example, which includes social security and a variety of domestic transfer programs grew at an average annual rate of 16 per cent between 1969 and 1975, and an additional 18 per cent in 1976. This category is held to a 6.7 per cent increase for the next fiscal year. The President has suggested actual reductions from 1976 levels for education, training, and social services, veterans benefits, agriculture, commerce and transportation, and community and regional development. The President has proposed a variety of measures to achieve these economies. In addition to a 5 per cent cap on civilian and military pay raises, the Budget assumes a phase out of special and temporary unemployment assistance, and public service jobs, a tightening of eligibility standards for food stamps and for Aid to Families with Dependent Children, and a reduction in veterans educational benefits. Health spending is to be restrained by substituting a single block grant with no matching requirements for 16 separate categorical programs. The block grant approach is also proposed to consolidate 27 education grant programs and 15 child nutrition programs. Increased costs for catastrophic insurance coverage for Medicare recipients are offset by proposals to raise cost sharing by participants and limiting payment increases to physicians and hospitals.

Nearly all of the above proposals will require Congressional approval. Moreover, under the provisions of the Congressional Budget Act, the Congress is expected to formulate an alternative FY 1977 budget by May 15 of this year.

TABLE I
The President's Budget
Fiscal Year 1977

	1975	1976 ^{e/}	TO ^{e/}	1977 ^{e/}
<u>Unified Budget</u>				
Receipts	281.0	297.5	81.9	351.3
Outlays	324.6	373.5	98.0	394.2
Deficit (-)	-43.6	-76.0	-16.1	-43.0
<u>Per cent increase in ^{1/}</u>				
Receipts	6.1	5.9	--	13.1
Outlays	20.9	15.1	--	5.5
<u>Off-budget outlays</u>	9.5	9.3	4.0	11.1
Memo:				
<u>NIA Budget</u>				
Receipts	281.5	307.4	86.5	364.7
Expenditures	328.7	378.7	97.2	404.5
Deficit (-)	-47.2	-71.3	-10.7	-39.8
<u>Per cent increase in ^{1/}</u>				
Receipts	3.6	9.2	--	13.6
Expenditures	17.9	15.2	--	6.3
<u>Full-employment Budget ^{2/}</u>				
Receipts	323	347	--	389
Expenditures	317	363	--	386
Surplus/Deficit (-)	+6.0	-16	--	+3

^{1/} Calculations ignore the time gap created by the Transition Quarter.

^{2/} Unified Budget basis.

TABLE II

Comparison of Administration Tax Cut Proposals
and Revenue Adjustment Act of 1976
(All data shown are at annual rates)

Tax Provisions ^{1/}	Revenue Adjustment	
	Act	Administration
	(\$ billions)	
<u>Individuals:</u>	<u>-14.8</u>	<u>-21.6</u>
1) Standard deduction	-3.9	-4.2
2) Personal exemption	--	-10.6
3) Tax credit	-9.5	--
4) Rate reductions	--	-6.8
5) Earned income credit	-1.4	--
<u>Business:</u>	<u>-4.9</u>	<u>-8.0</u>
1) Investment tax credit	-3.0	-3.0
2) 1975 corporate rate reductions and surtax exemption	-1.9	-1.9
3) Corporate rate reductions: 48 to 46 per cent	--	-2.5
4) Other ^{2/}	--	-6
<u>Grand Total</u>	<u>-19.7</u>	<u>-29.6</u>
Memo:		
<u>Other Income Tax Proposals: ^{3/}</u>	<u>--</u>	<u>-.9</u>
Financial Institutions Act	--	-.3
Stock ownership incentives	--	-.3
Accelerated depreciation on invest- ment in high unemployment areas	--	-.3
<u>Other Tax Proposals ^{4/}</u>	<u>--</u>	<u>+7.8</u>
Social security tax rate increase	--	+4.7
Unemployment tax rate and wage base increase	--	+3.1
<hr/>		
^{1/}	Annual rate; projected 1976 income level.	
^{2/}	Electric utility tax relief.	
^{3/}	Annual rate; projected CY 1977 income level.	

TABLE III
 Budget Outlays for FY 1977 Compared to
 Current Service Outlays for FY 1977
 (\$ billions)

	Outlays, FY 1977		
	President's Budget	Current * Services	Difference
Defense	<u>101.1</u>	<u>103.1</u>	<u>-2.0</u>
Non-Defense	<u>293.1</u>	<u>311.4</u>	<u>-18.3</u>
Human Resources ^{1/}	205.3	220.2	-14.9
Physical Resources ^{2/}	37.5	40.6	-3.1
Interest	32.9	33.2	-.3
All Other ^{3/}	17.3	17.4	-.1
Total	<u>394.2</u>	<u>414.5</u>	<u>-20.3</u>

^{1/} Includes the functional categories of Education, Health, Income Security and Veterans Benefits.

^{2/} Includes functional categories of Natural Resources, Agriculture, Commerce and Community and Regional Development.

^{3/} Includes functional categories of International Affairs, General Science, Space and Technology, Law Enforcement, General Government, Revenue Sharing, Allowances for pay increases, payments to employee retirement funds, and rents for royalties on continental shelf.

* SOURCE: Current Service Estimates for FY 1977, November 10, 1975. Estimates reflect legislation enacted as of September 15, 1975.

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 TABLE IV
 Budget Outlays by Function
 (\$ billions)

Functional Category	Projected for Fiscal 1977	Change from Fiscal 1976
Total	<u>\$394.2</u>	<u>21.2</u>
<u>Categories Increasing</u>		
National Defense	101.1	8.3
Income Security	137.1	3.6
Net Interest	32.9	6.5
Health	34.4	2.3
Natural Resources, Environment and Energy	13.8	2.0
Allowances	2.3	2.1
International Affairs ^{1/}	6.8	1.1
3 Other Categories ^{2/}	<u>11.9</u>	<u>.4</u>
Total	340.3	31.3
<u>Categories Declining</u>		
Education, Training, Employment and Social Services	16.6	-2.3
Veterans Benefits and Services	17.2	-1.8
Agriculture	1.7	-1.2
Commerce and Transportation	16.5	-1.3
2 Other Categories ^{3/}	<u>12.3</u>	<u>-.4</u>
Total	64.3	-7.0
Undistributed Offsetting Receipts ^{4/}	-10.5	3.3

^{1/} Includes outlays of the Export-Import Bank.

^{2/} General Space Science and Technology, Revenue Sharing and Law Enforcement.

^{3/} General Government and Community and Regional Development.

^{4/} This item reflects payments by Federal Agencies to employee retirements and rents and royalties on the outer continental shelf.