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Content last modified 6/05/2009.

CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

February 1, 1967

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SUMMARY AND OUTLOOK

Outlook for economic activity

Expansion in over-all economic activity continues to moderate in early 1967. Retail sales have been notably weaker, initial unemployment claims have risen more than seasonally, and industrial production appears likely to have declined a bit in January. We now expect increases in GNP of around $7 billion in each of the first two quarters of this year, with the annual rate of growth in real terms reduced to about 1-1/2 per cent.

With industrial activity on the weak side, the rise in private wages and salaries is slowing, but Government transfer payments--mainly for Medicare--are expected to rise substantially further in the current quarter. Moreover, a pronounced tapering off in last year's sharp rise in personal tax payments that resulted from placing such payments on a more current basis is expected in this and the next quarter. Thus, disposable income apparently continues to rise at a respectable pace. But the reduced propensity of consumers to buy goods (and increased propensity to save), in the face of the large inventory over-hang, is resulting in further output cutbacks. Net liquidation of stocks of some consumer products is in prospect for the coming months.

Only a minimal further expansion in business equipment outlays and a reduced rate of increase in defense spending are now expected; considerably slower production gains and a sizable drop-off in the rate of inventory accumulation in the equipment sector of manufacturing seems

probable. On the other hand, owing in part to the effect of sharply reduced business inventory demands on imports, net exports are expected to rise sharply. Also, the decline in residential construction is expected to end and State and local government outlays will likely continue to expand.

Resource use and prices

The outlook for GNP given above would result in further decline in the rate of industrial capacity utilization and some easing in manpower demands, particularly in manufacturing industries. In the labor market, some lay-offs were being reported and unemployment claims were continuing to rise more than seasonally in the first 3 weeks of January. Excessive inventories and the general easing of demands are narrowing the area of price advances for industrial products and prices of some industrial materials are continuing to decline.

Declines are continuing in prices of food and farm products. Supplies of major food items are now running substantially larger than the relatively low volume of a year earlier. Meat production is up one-tenth, for example, and higher domestic output is being supplemented by a large volume of imports. The decline in retail food prices so far has been small but further decreases may be expected. (The expected drop in food prices accounts for much of the reduced rate of rise in the GNP deflator shown in the GNP table.) In both November and December, the total consumer price index rose only 0.1 per cent, and in December the total for nonfood commodities was down slightly. Prices of services

have continued their rapid upward course, and further boosts are expected as the new higher minimum wage increases pervade the wage structure.

In industry, the plant capacity utilization rate has fallen off from last year's peak. Also, there apparently has been some further slowing down in productivity growth, which is falling further behind the rise in average wage rates. Upward pressures on prices from higher unit labor costs have been partly countered in markets for industrial products--except chemicals and metals--by reduced demands for business inventories and decreased consumer buying of autos, home goods, and apparel.

Commercial banks

In the next two or three months, time deposit inflows of commercial banks are likely to continue fairly large, but below the very high January pace. While rate relationships currently make time deposits relatively attractive financial assets, the large money market banks apparently have become somewhat less aggressive in their efforts to attract CD money after the record dollar inflows of CD's in January. Their aggressiveness in the CD market is likely to be influenced in part by the strength of business loan demand; with CD offering rates for all maturities now below the Regulation Q ceiling, the major banks have some flexibility to vary interest rates to attract such funds in order to accommodate business customers.

Business loan expansion at banks in February will probably be below the unusually rapid January pace. A part of the January loan

increase appears temporary, representing funds needed for accelerated tax payments. Repayments of such loans and reduced inventory accumulation will tend to keep business loan growth to moderate proportions in the weeks immediately ahead. Taking a somewhat longer perspective, the apparent sharp fourth quarter erosion of corporate liquidity is likely to be a factor maintaining business demands for credit, including bank loans, especially in the spring when even larger accelerated tax payments have to be made.

It is not yet clear what impact the downward adjustments in the prime loan rate will have on bank lending. The new issue rate on high grade corporates is still low relative to the prevailing prime loan rates, and, on balance, one would not expect any very significant movement away from capital market financing toward banks. The differential in prime loan rates--with only a few banks at the lower rate--may reflect the reportedly large backlogs of loan demands and the still relatively unsatisfactory liquidity position of many banks.

It is likely that banks will continue efforts to improve their positions by using deposit inflows gradually to reduce further their reliance on very short-term borrowed funds and to acquire marketable securities. In this process, and partly in order to anticipate loan demands later in the spring, it would not be surprising to see banks attempt to attract longer-term time deposits, including CD's maturing in beyond three months.

Outlook for the bond and mortgage markets

In capital markets, demands for funds seem likely to be fairly well sustained in the weeks immediately ahead. With the rate on new Aaa corporate bonds now back close to the 5 per cent level, there is some evidence that the volume of new corporate issues is picking up again. Demands from State and local government borrowers have also expanded with the decline in rates, and have been running ahead of the very high level which prevailed in the early months of 1966. Finally, demand pressures on capital markets will continue to be reinforced by the large immediate and prospective volume of Federal participation certificates and also by distribution of the 5-year note component of the current Treasury financing.

Given the demands that appear to have been generated by the recent decline in interest rates and the continuing large external financing requirements of corporations, the short-run sustainability of current long-term bond yields is open to some question during the period immediately ahead. Recent interest rate declines have reflected in part the bullish bond market psychology generated by the President's request for a tax increase and lower interest rates. Without any further overt shifts in monetary policy toward ease, or improved prospects for peace talks on Vietnam, a technical correction from the recent rapid yield declines is a possibility.

In mortgage markets, the marked December-January expansion in savings flows to depositary-type intermediaries has begun to ease

mortgage availability and terms, although to some extent the pressure for ease has reflected a shortage of immediately available mortgages for lenders to buy in the secondary market. Much of the increase in flows to savings and loan associations has apparently been directed toward the rebuilding of liquidity, but a step-up in new mortgage commitments is to be expected shortly. At the mutual savings banks, where the pick-up in savings flows began as early as July and some rebuilding of liquidity was accomplished during the late summer and fall, the pace of mortgage acquisitions was resumed at a nearly normal rate in December of last year.

At life insurance companies, the policy loan upsurge has subsided and there is a more optimistic outlook for cash flows. Like other institutions, insurance companies are making some effort to rebuild liquidity, but some companies are becoming more aggressive in making new loan commitments in both the mortgage and corporate bond markets. The bulk of the new commitments is for delivery many months ahead, extending into 1968.

International developments

New data relating to U.S. international transactions call for no amendment of last month's pessimistic prognostication of a liquidity deficit running above a $2 billion annual rate in the months ahead and an official settlements deficit also that large. The December merchandise trade surplus was smaller than expected, with exports down and imports level. The net inflow of liquid funds through foreign branches of U.S.

banks, which began to taper off at the middle of last November, has ceased; on balance there has been some outflow since then.

For the longer-run trade outlook, no comfort can be found in 1966 price developments here and abroad. Last year, contrary to experience in other recent years, the rise both in consumer prices and in wholesale prices of manufactures was greater in the United States than in Common Market countries other than the Netherlands.

For the near future, however, the easing of domestic inventory demand is expected to hold imports at or below their recent levels. Exports are expected to rise further, bringing an increase in net exports.

Abroad, there are as yet no industrial production data beyond November to show either a cessation of the British recession and an upturn in Germany or--what seems more likely--a continuation of weakness through December and January. However, indications of the development of inventory-and-fixed-investment recessions in Germany and Britain are less disturbing now than they may have appeared two months ago. This is so mainly because further moves have been made, in those two countries as well as the United States, away from the extreme stringency that characterized financial markets in the late summer and early autumn. In Germany, the inclusion of a contingency program of public works in the budget has had a favorable reception in the press, and clearly constitutes insurance against recession. The Bundesbank has taken a series of cautious moves to ease credit. In Britain, last week's long anticipated reduction in Bank rate opens the way to a further decline in long-term interest rates.

In both countries, there are indications that inventories have been cut back considerably by now, so that a general improvement in demand in Germany, at least, might be magnified when it comes, or even triggered, by buying for replenishment of stocks. British policy will no doubt seek to delay and damp any general upturn that might push U.K. imports up, while continuing efforts to encourage productive fixed investment.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per cent change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Years Ago*
Civilian labor force (mil.)	Dec'66	78.2	77.9	76.6	2.1	4.6
Unemployment (mil.)	"	3.0	2.9	3.1	- 5.2	-20.1
Unemployment (per cent)	"	3.8	3.7	4.1	--	--
Nonfarm employment, payroll (mil.)	"	65.1	64.8	62.2	4.5	9.6
Manufacturing	"	19.5	19.4	18.5	5.3	10.6
Other Industrial	"	8.1	8.0	8.1	0.7	4.0
Nonindustrial	"	37.5	37.4	35.7	5.0	10.3
Industrial production (57-59=100)	"	158.7	158.6	149.0	6.5	15.1
Final products	"	159.0	158.4	148.9	6.8	15.7
Materials	"	158.4	158.8	148.8	6.5	14.9
Wholesale prices (57-59=100) 1/	"	105.9	105.9	104.1	1.7	5.2
Industrial commodities	"	104.7	104.7	102.8	1.8	3.3
Sensitive materials	"	101.4	102.0	103.2	- 1.7	0.2
Farm products and foods	"	106.7	107.1	106.5	0.2	9.8
Consumer prices (57-59=100) 1/	"	114.7	114.6	111.0	3.3	5.4
Commodities except food	"	107.7	107.8	105.7	1.9	2.7
Food	"	114.8	114.8	110.6	3.8	7.4
Services	"	125.2	124.7	119.3	4.9	7.7
Hourly earnings, mfg. ($)	"	2.76	2.76	2.65	4.2	7.4
Weekly earnings, mfg. ($)	"	113.21	113.88	109.50	3.4	7.1
Personal income ($ bil.) 2/	"	601.5	598.5	558.2	7.8	17.5
Corporate profits before tax ($ bil.) 2/	QIV'66 3/	79.7	81.9	78.7	1.3	17.7
Retail sales, total ($ bil.)	Dec'66	25.4	25.7	24.8	2.2	11.4
Autos (million units) 2/	"	8.0	8.4	8.5	- 6.2	- 6.7
GAF ($ bil.)	"	5.9	6.2	5.6	5.7	13.0
Selected leading indicators:						
Housing starts, pvt. (thous.) 2/	"	1,102	1,007	1,769	-37.7	-31.6
Factory workweek (hours)	"	41.0	41.3	41.3	- 0.7	- 0.5
New orders, dur. goods ($ bil.)	"	23.9	23.0	23.4	2.1	15.3
New orders, nonel. Mach. ($ bil.)	"	3.6	3.7	3.5	1.3	15.5
Common stock prices (1941-43=10)	"	81.33	80.99	91.73	-11.3	- 3.1
Manufacturers' Inventories, book val. ($ bil.)	"	77.7	76.9	68.0	14.2	23.4
Gross national product ($ bil.) 2/	QIV'66	759.1	745.3	704.4	7.8	17.8
Real GNP ($ bil., 1958 prices) 2/	"	657.0	649.9	631.2	4.1	11.9

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual Rates.
3/ Federal Reserve estimate.

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Jan. 27	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.70	4.98	6.25	3.50
U.S. Treas. bills, 3-mo., yield (percent)	4.66	4.74	5.59	4.59
Net free reserves 2/ (mil. $)	- 47	- 62	73	- 583
Member bank borrowings 2/ (mil. $)	538	476	928	217
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.68	4.72	5.89	4.60
20-year U.S. Treas. bonds	4.51	4.51	5.12	4.44
Corporate new bond issues, Aaa	5.15	5.31	5.98	5.12
Corporate seasoned bonds, Aaa	5.04	5.22	5.53	5.03
Municipal seasoned bonds, Aaa	3.34	3.50	4.04	3.34
FHA home mortgages, 30-year 3/	6.77	6.77	6.81	6.51
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	86.14	84.31	84.00	74.53
Divident yield (per cent)	3.43	3.51	3.89	3.43

	Change in Dec.	Average change Last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $) 5/				
Total reserves	22	- 69	-3.5	1.2
Bank loans and investments:				
Total	2,300	700	2.6	5.9
Business loans	0	300	4.6	14.3
Other loans	900	400	3.8	6.8
U.S. Government securities	1,400	0	0.0	- 5.9
Other securities	0	0	0.0	5.6
Money and liquid assets:				
Demand dep. & currency	1,200	6/	-0.4	1.9
Time and savings dep.	1,200	300	2.5	8.4
Nonbank liquid assets	-1,500	400	1.9	4.2

N.S.A. -- not seasonally adjusted. S.A. -- seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending January 25.
3/ Latest figure indicated is for month of December. 4/ Data are for weekly closing prices. 5/ Where necessary, comparisons shown below have been adjusted for definitional changes in June. 6/ Less than $50 million.

U.S. BALANCE OF PAYMENTS
(In millions of dollars)

	1966					1965		1965
	Dec.	Nov.	QIII	QII	QI	QIV	QIII	Year
								(billions)
			Seasonally adjusted					
Current account balance			908	1,124	1,333	1,290	1,527	6.0
Trade balance 1/	230	295	780	849	1,167	1,271	1,231	4.8
Exports 1/	2,435	2,500	7,439	7,111	7,171	7,027	6,826	26.3
Imports 1/ 2/	-2,205	-2,205	-6,659	-6,262	-6,004	-5,756	-5,595	-21.5
Services, etc., net			128	275	166	19	296	1.2
Capital account balance			-1,244	-1,098	-1,587	-1,542	-1,821	-6.9
Govt. grants & capital 3/			-794	-964	-948	-881	-743	-3.4
U.S. private direct investment			-700	-976	-687	-731	-569	-3.4
U.S. priv. long-term portfolio			-33	-80	-219	-154	-363	-1.1
U.S. priv. short-term			20	-38	-22	-27	105	0.8
Foreign nonliquid			263	960	289	251	-251	0.2
Errors and omissions			118	-167	-297	-80	-240	-0.4
Balances, with and without seasonal adjustment (- = deficit)								
Liquidity bal., S.A.			-218	-141	-551	-332	-534	-1.3
Seasonal component			-493	-11	503	-3	-472	--
Balance, N.S.A.	755	-500	-711	-152	-48	-355	-1,006	-1.3
Official settlements bal.			946	-214	-241	-1,158	232	-1.3
Seasonal component			-519	-166	643	33	-508	--
Balance, N.S.A. 4/	131	-196	427	-380	402	-1,125	-276	-1.3
Memo items:								
Monetary reserves (decrease -)	167	-165	-82	-68	-424	-271	-41	-1.2
Gold purchases or sales (-)	-27	-49	-173	-209	-68	-119	-124	-1.7

1/ Balance of payments basis which differs a little from Census basis.
2/ Monthly figures tentatively adjusted for changes in carry-over of import documents.
3/ Net of loan repayments.
4/ Differs from liquidity balance by counting as receipts (+) increases in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increase in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. The picture for the fourth and first quarters remains, in broad outline, the same as presented in the Greenbook four weeks ago. GNP rose about $14 billion in the fourth quarter--according to the Commerce preliminary estimate--and we are projecting a rise of only half that much in the first quarter. Moreover, we are now projecting a repetition of the slow $7 billion increase in GNP in the second quarter. Despite a slackening anticipated in the rate of price advances, real growth during the first half would be at an annual rate of little more than 1.5 per cent, as compared with about 4 per cent in the last half of 1966 (and over the entire period from late 1965 to late 1966), and it would be accompanied by some decline in the rate of industrial capacity utilization and some rise in unemployment.

The chief contributing factor to the first half slowdown is a projected large decline in the rate of inventory accumulation--the stage for which was set at the end of 1966. Given the poor performance of retail sales in the opening weeks of the year, it may be that inventory reductions will not be as large as expected, or alternatively that output rates will be cut more than now contemplated. But it is too early to judge whether the adjustments needed in production-stocks-sales relationships will take the path of substantial reductions in output with sales sagging, or of output maintained relatively close to earlier levels and stocks reduced by a significant improvement in sales.

Nonfarm inventory accumulation in the fourth quarter is now estimated at a seasonally adjusted annual rate of $15.6 billion--a new postwar high in absolute, though not relative, terms--and this may prove to be on the low side (the estimate for the quarter as a whole was based on only October and preliminary November figures, and implies a marked reduction in stockbuilding in December. A decline has now been reported for manufacturing but complete trade data are not yet in). The fourth quarter bulge in nonfarm inventory accumulation--which accounted for about $5 billion of the $14 billion increase in GNP--accompanied a marked slowing of the rise in final sales--particularly for consumption purposes--and by November, the stock-sales ratio for manufacturing and trade combined reached the highest level since mid-1961.

Consumption expenditures showed a very small rise in the fourth quarter, with real takings of goods now estimated to be declining. Despite production cutbacks instituted in some industries, stocks of major consumer durable goods--already high--increased considerably further. Early indications for January suggest continued slack in retail sales, with new auto sales down further, and additional production cutbacks have been announced. Only a small rise in consumer real takings of goods is now projected for the current and next quarters, and, in view of the large over-hang of stocks of consumer durables at the end of 1966, we anticipate a sharp drop in the rate of inventory accumulation in this sector--with net liquidation possible in some lines.

A major part of last year's large inventory build-up was concentrated in the business and defense equipment sector--much of it

in work-in-process. In the latter part of 1966, when business fixed investment outlays began to taper off and expansion in defense spending was below the extraordinary third quarter increase, the rate of inventory accumulation in this sector appeared to be leveling off. In the first half of this year the prospect is for little, if any, further expansion in business equipment outlays and--according to the new Budget estimates--for further slowing of the rise in defense spending. Given these developments, we are projecting a pronounced slowing of the rate of inventory accumulation in the equipment sector. The inventory "adjustment" envisaged for both the equipment and consumer goods sectors is, of course, expected to have a deterrent effect on production.

Weakness in the goods sector of the economy is expected to virtually halt the rise in industrial employment and payrolls during the first half of the year. However, wages and salaries in the private service sector and in Federal and State and local Government are expected to continue to expand at an appreciable pace, and some pick-up is possible in the construction sector by the second quarter. Moreover, consumers will benefit by a further rise in transfer payments in the first quarter because of additional Medicare benefits and growth in regular social security benefits. In addition, in the first and second quarters, Federal income tax refunds should be large as a result of the introduction of graduated withholding rates last May. This is expected to slow considerably the rise in personal tax payments, which took such

a large bite out of consumers' incomes during 1966. Acting to moderate somewhat the rise in personal--and disposable--income early this year was a moderate boost in social security taxes.

Altogether, disposable income is projected as rising about $9 billion in the first quarter and at a somewhat slower rate in the second quarter. Meanwhile, with no indication yet that consumers are breaking out of the cautious buying pattern evidenced in the late months of 1966, personal outlays are expected to show moderately less increase than income, and the saving rate--which rose sharply in the fourth quarter--may rise slightly further. The estimated saving rate in the first half, at about 6 per cent, is above the average rate prevailing throughout this expansion period, although it was reached temporarily at times of extra large increases in income, as in late 1965 and in mid-1964 when taxes were cut.

Industrial production. Industrial production in January will probably decline from the preliminary December level of 158.7 per cent. Available output data, while insufficient to estimate the January index with precision, show declines for both final products and materials, and the decline in the total index may be possibly about one point.

Auto assemblies in the first four weeks of January were down 10 per cent from December and 17 per cent from a year earlier. Sales declined further in the first 20 days of January and with stocks high, further curtailments in output have been scheduled by all auto producers for February. Sales of trucks eased off in the last quarter of 1966 and declined again in the first 20 days of January partly reflecting curtailed buying because of elimination of the investment tax credit. Inventories of trucks reached a peak in mid-July but were reduced sharply in the August and September model changeover period. Since then they have been rising and on January 20 were near previous highs. Truck production, which was at record levels during much of 1966, was curtailed in December and again in January.

Output of household appliances probably declined further in January. Trade reports indicate that many companies are making selective cuts in output to stop the rise in inventories. Curtailments also have been announced for February, and, for the first time, have included color television sets.

Steel ingot production declined 3 per cent further in January--for the sixth consecutive month--reflecting the lessening in demand for

autos, trucks, and appliances. In December, output of iron and steel mill products was down 10 per cent from the summer peak. Output of paper board--which is sometimes viewed as a general business indicator because of its wide use as an important packaging material--eased off in the fourth quarter of 1966 and declined further in early January. Unfilled orders for paper board since mid-December have posted successively larger declines from year-earlier levels and for the 4-week period ending January 14 were 10 per cent below last year. New orders also declined and on January 14 were 3 per cent below a year ago.

Gains in industrial production in 1966 were substantial as shown in the table. The rate of increase in output slowed considerably

INDUSTRIAL PRODUCTION
Per cent increase

	From IV Qtr. 1965 to IV Qtr. 1966
Total index	7.9
Consumer goods	3.7
Business equipment	12.8
Defense equipment	24.7
Durable materials	9.0
Nondurable materials	7.5

in the fourth quarter, except for autos which rose following the severe cutbacks during the change-over period. Final takings, however, levelled off and the rate of inventory accumulation increased, as a larger proportion of industrial production went into stocks. The slower rate of inventory accumulation projected for the first quarter of 1967, unless

accompanied by a substantial rise in final takings, implies cutbacks in industrial production during this period.

The rate of capacity utilization in manufacturing reached a peak rate of 91 per cent in the first quarter of 1966. With the additions to capacity during 1966 estimated at nearly 7 per cent for the year, the utilization rate remained at 91 per cent in the second and third quarters despite further increases in manufacturing output. It then declined to 90 per cent in the fourth quarter, reflecting reduced output of iron and steel and construction materials.

RATE OF CAPACITY UTILIZATION IN MANUFACTURING
Seasonally adjusted, quarterly averages - per cent

	1966			
	I	II	III	IV
Total	91	91	91	90
Primary industries 1/	91	92	91	89
Advanced industries 2/	91	91	91	91

1/ Mainly materials.
2/ Mainly final products.

In December, the rate of capacity utilization in manufacturing was estimated at 89 per cent, one point below the fourth quarter average. If manufacturing output declines one point in January, the utilization rate would be close to 88 per cent, the lowest rate since the first quarter of 1965.

Autos. Daily average sales of new domestic automobiles during the first 20 days of January were about one-fifth below the very high sales rate a year ago. Assuming sales remain at this rate in the final 10 days, the seasonally adjusted annual rate for January would be about 7.5 million units, compared to 8.0 million for December and 9.4 million a year ago. Trade reports indicate that reduced demands for autos are resulting in output cuts in Canada and European countries as well as in the United States.

Although domestic output was curtailed by about 10 per cent in January, the reduced rate of sales would probably result in a further increase in the number of cars held in dealer inventories to about 1.5 million units by the end of January. January is usually a month of seasonally large increases in stocks, however, and on a seasonally adjusted basis stocks at the end of January would be below the end of December.

Consumer credit. Consumers added to their instalment debt in December at a relatively slow pace. The seasonally adjusted annual rate of increase for October was a very low $4.6 billion. November saw a slight increase to $5.3 billion, but early reports from commercial banks and retailers indicate that in December the rate dropped off again, possibly to about $5.0 billion. For the fourth quarter as a whole, the rate also was about $5.0 billion, the lowest for any quarter in over 4 years.

The slow pace of expansion in December reflected largely the turndown in new car sales, but sales of color television, furniture, and major appliances--all big ticket items frequently bought on credit--were also less buoyant than earlier. Restrictive lenders; standards, as well as reduced demands, also played a role. In recent weeks, however, there have been scattered reports of some easing in credit standards accompanying the general easing of monetary conditions.

A significant feature of the instalment credit expansion in 1966 was the levelling off in new credit extensions. Extensions were at a $79 billion annual rate in the first quarter but increased little further in subsequent quarters. Repayments on instalment debt continued to grow, however, from an annual rate of just under $72 billion in the first quarter to a little over $74 billion in the fourth. Thus, over much of 1966--and particularly since the fall--there has been a narrowing of the excess of extensions over repayments.

Construction activity. New construction outlays--revised upward by 2 per cent for November--dipped slightly in December to a seasonally adjusted annual rate of $70.4 billion. The decline, which continued to be mainly in residential activity, brought the total to $74.6 billion for 1966 as a whole. This was 4 per cent higher than in 1965, but it amounted to a slight year-to-year decline in real terms.

Reflecting in part the sharp further reduction in residential construction toward the year end, both private nonresidential and public construction exceeded residential expenditures in the fourth quarter of

1966, as shown in the table. And, although each of these sectors remained below the highs reached in the first quarter of the year, they maintained their advanced third quarter levels.

NEW CONSTRUCTION PUT IN PLACE

	4th Q 1966 (Billions of dollars) 1/	Per cent change from	
		3rd Q 1966	4th Q 1965
Total	70.6	- 4	- 5
Private	46.8	- 6	- 9
Residential	21.0	-13	-20
Nonresidential	25.8	--	+ 2
Public	23.8	--	+ 4

1/ Seasonally adjusted annual rates; preliminary.

Seasonally adjusted housing starts, which led residential outlays, rose nearly a tenth further in December, but only to an annual rate of 1.1 million units. Starts for the year as a whole totaled only 1.2 million, nearly a fifth below the already declining level in 1965 and the lowest since 1957.

The rise in the seasonally adjusted series in December, as in November, reflected a less than seasonal decline in the unadjusted data. Including the 20-year low of 848,000 reached in October, moreover, the fourth quarter average was appreciably below the reduced third quarter rate; the decline was particularly marked for the Northeast states, as shown in the table. Issuances of building permits increased from November to December, especially for single-family structures, but for the quarter as a whole also were at a sharply reduced rate.

PRIVATE HOUSING STARTS AND PERMITS

	4th Q 1966 (thousands of units)1/	Per cent change from	
		3rd Q 1966	4th Q 1965
Starts	986	-10	-37
Northeast	163	-23	-45
North Central	253	- 7	-43
South	417	- 4	-29
West	154	- 9	-38
Permits	734	-12	-42
1-family	456	- 8	-37
2-or-more family	278	-18	-50

1/ Seasonally adjusted annual rate; preliminary.

Prospects are for an annual rate of starts of a million or better in the first quarter, based on seasonal adjustment considerations, the low level of starts already reached, and also the recent sharp improvement in prospects for mortgage flows. Whether the projected first quarter improvement in starts can be sustained on a seasonally adjusted basis during the second quarter will depend on the extent of the unadjusted rise that can be achieved during the spring months. Under normal conditions, seasonal expectations are for an expansion in actual starts of about 60 per cent from the first to the second quarters, and for a virtual doubling in the number of starts from January to May. In view of this, and given the abruptness of the shift in financial markets, lender needs to replenish liquidity, the interrupted momentum of builder plans during 1966 and the time required by lenders, builders and prospective home buyers alike to review and adjust expectations, it seems

unlikely that more than the usual seasonal rise in starts can be accomodated this spring. Thus, an appreciable rise in the seasonally adjusted starts series probably will be delayed until the third quarter, even if easier credit conditions persist. But the rapidity of change in financial conditions improves prospects for a second quarter rate of starts at least equal to the first quarter rate.

Business inventories. Inventory accumulation by manufacturers declined appreciably in December (the book value increase totaled $775 million as compared with $1.1 billion in November), while shipments increased moderately following some months of little change. As a result, the factory stock-sales ratio declined somewhat but remained well above the low levels prevailing in 1965 and early 1966.

Reduction in the rate of accumulation in December was concentrated in durable goods and it occurred in both the equipment and consumer durables sectors.

For the entire fourth quarter, the inventory book value increase now indicated for manufacturing was at an annual rate of about $11 billion, down moderately from $11.7 billion in the third quarter.

Trade inventory figures are not yet available for December. In October and November, inventory accumulation at wholesale and retail distributors combined was at an (average) annual rate of nearly $6 billion--as compared with less than $1.5 billion in the third quarter. Book value increases in October and November were especially large for wholesale distributors of durable goods and for retail auto dealers.

The prospect for trade inventory accumulation in December is uncertain. While it is expected to show a drop from the high October-November rate (the increase at wholesale was surprisingly large in those months and these inventories fluctuate considerably from month to month; and also, unit auto stocks stopped increasing in December), the sizable decline now reported for retail sales in December may have resulted in a large back-up in stocks outside auto dealers. Altogether, we are now estimating the book value increase in stocks for manufacturing and trade combined in the fourth quarter at an annual rate of around $16 billion, as compared with $13 billion in the third quarter.

Orders for durable goods. New orders for durable goods increased about 3.5 per cent in December, following a decline totaling 9 per cent between September and November. Durable shipments also increased in December and the unfilled order backlog was about unchanged from the October-November level. For durable goods industries with backlogs, the total value of unfilled orders represented 3.60 months' shipments in December, as compared with 3.67 in November and October and 3.15 in mid-1965 before the defense-stimulated boom began.

The recovery in new orders in December--as well as the sharp preceding two month decline--was concentrated mainly in the defense products industries. The December order level for these industries, while sharply below the exceptional September peak, was close to the average for the other months in the year and well above year-earlier levels; unfilled orders rose somewhat to a new high. New orders for

machinery and equipment edged down slightly further in December and were nearly 10 per cent below their midyear high; the order backlog stabilized at a level nearly a fourth above a year earlier.

Labor market. Layoffs and short workweek schedules continued to be reported in January in the automobile and some consumer appliance industries and unemployment claims, on a seasonally adjusted basis, were at slightly higher levels than at the end of the year. Despite weakness in selected activities, the over-all employment picture apparently remained strong in January.

There was a quarter million increase in nonfarm jobs in December following an expansion of 350,000 (revised) in November. One element in December's employment rise was a modest pick-up (seasonally adjusted) in construction employment, following a substantial decline beginning last spring. The expansion in nonfarm payroll employment between the fourth quarters of 1965 and 1966 totaled 2.9 million, an increase of 4.7 per cent over the year. December's unemployment rate of 3.8 per cent--virtually unchanged over the month--remained in the narrow range of 3.7 to 4.0 per cent that characterized unemployment throughout 1966.

Some indications of weakness in the labor market were reflected in the December figures, however. The number of workers employed part-time for economic reasons rose somewhat. The workweek of production workers in manufacturing, usually a fairly sensitive leading indicator of economic activity, declined by three-tenths over the month to 41.0 hours

in December, and was also 0.3 hours shorter than a year earlier. The workweek reached a postwar high of 41.5 hours early last year. Also, the factory hiring rate fell and the layoff rate rose in December, pointing to a slowing in the growth of employment.

Labor force. Manpower needs of the economy in 1966 were met by a substantial expansion of labor supply--mainly from marginal workers. The increase in the total labor force--including the armed forces--between the fourth quarters of 1965 and 1966 totaled 2.1 million; demographic and labor force participation trends would have suggested a "normal" increase of only about 1.4 million.

In part this exceptionally large labor force growth reflected an expansion of the armed forces by about half a million from the end of 1965 to late 1966. But also reflecting exceptionally sharp demands for civilian workers, total nonfarm employment averaged 2.2 million higher in 1966 and agricultural employment and total unemployment each declined by 300,000. Civilian manpower needs were met largely by the addition to the civilian labor force of over a million adult women; teenagers provided 300,000 additional workers, and the adult male labor force increased by less than 200,000.

In contrast to 1966, total labor force is projected to increase only 1.4 million in 1967. The age-sex composition of the increase, moreover, will differ sharply from last year's. Teenagers will contribute relatively little to the projected rise since their population is leveling off. Instead, the 20 to 24 year-olds are expected to account for approximately half the total increase over the next four

quarters as large number of persons born shortly after World War II begin to reach their early twenties. Adult men and women (25 years of age and over) are expected to account in about equal measure for the remainder.

The smaller projected rise in the armed forces in 1967 is expected to be filled largely from the 18 and 19 year-old group, and could result in some reduction in the teenage civilian labor force. The armed forces are expected to total about 3.4 million in mid-1967, and 3.5 million by the fourth quarter--some 200,000 more than in the fourth quarter of 1966.

Productivity and unit labor costs. The average rate of productivity growth for the total private economy in 1966, at 2.8 per cent, was equal to the previous year's gain, but substantially below the 3.6 per cent average for the 1960-1965 period. Moreover, the increase for 1966 as a whole was substantially larger than the rates of increase in the latter quarters of the year. In fact, quarter-to-quarter increases in productivity averaged less than one per cent (annual rate) after the first quarter of 1966 and the year-to-year increases declined progressively throughout the year. By year's end, the rise in productivity over a year earlier was only 1.3 per cent.

PRODUCTIVITY AND UNIT LABOR COSTS
Percentage increases from a year earlier

		Output per manhour		Unit labor costs
		Private Economy 1/	Manufacturing (all employees) 2/	Manufacturing (all employees) 3/
1966	IQ	4.0	3.0	1.0
	IIQ	3.8	2.8	1.6
	IIIQ	2.5	2.7	2.1
	IVQ	1.3	2.6	2.7
		Average annual increases		
	1960-1965	3.6	3.9	-0.3
	1965-1966	2.8	2.8	2.0

1/ Real private GNP per employee manhour, establishment basis, BLS series.
2/ Manufacturing production per employee manhour, FRB series.
3/ Labor costs (wages, salaries and supplements) per unit of output, manufacturing, Bureau of Census series.

Productivity in manufacturing showed only modest gains after mid-1966 and for the year as a whole also averaged 2.8 per cent over 1965. In conjunction with the steady upward pressure on wages, unit labor costs in manufacturing rose appreciably in the latter part of the year. These costs now stand 2.7 per cent above a year ago. With no reduction in pressure for wage increases immediately in sight and some likely easing in output, a continued rise of unit labor costs in manufacturing is in prospect.

Increase in minimum wage. The first-step increase in the minimum wage provided by the 1966 Amendments to the Fair Labor Standards Act went into effect February 1. It is estimated that the direct impact

will raise wages by $1 billion (annual rate) in February, or by about $2/3 billion in the first quarter. There will also be a substantial secondary impact as other wages tend to adjust upward to maintain traditional wage differentials.

The Amendments not only raised the minimum wage from the current $1.25 per hour to $1.40 on February 1 and to $1.60 on February 1, 1968 for workers now covered, but also extended coverage for the first time to an additional 8 million workers mainly in services, trade, construction and on farms. The minimum for newly-covered nonfarm workers started at $1.00 per hour on February 1, and will increase by 15 cents a year until $1.60 is reached on February 1, 1971. For farm workers the $1.00 minimum goes up in two annual steps to $1.20 by February 1969.

Minimum wage protection was extended to 1.5 million service workers in hospitals and educational institutions; to 700,000 workers in restaurants, hotels and motels; to 500,000 laundry workers; and to some 700,000 Federal Government wage board and other workers previously specifically exempted. The largest concentration of newly covered workers with hourly earnings of less than $1.00 is in hospitals, educational institutions, farms and laundries.

Coverage was also extended to additional workers mainly in retail trade, construction, and gasoline service stations by lowering or eliminating the previous annual volume of sales criteria. In retail trade, coverage was extended to 1.5 million additional workers by lowering the annual volume of business criteria from $1 million, set in the 1961 Amendments, to $500,000 on February 1, 1967 and $250,000 on February 1, 1969. In construction, the volume of business criteria was eliminated.

Wholesale prices. Wholesale prices of foods and farm products showed little further decline in December, and with the industrial commodity average unchanged, the total wholesale index showed no change. Since mid-December, prices of livestock and meats have risen somewhat, while eggs, grains, and some other food materials have decreased. It is not certain, however, what the net effect of these price changes have been, because the B.L.S. weekly indexes for these products were discontinued--along with the total weekly index--on December 27.

The industrial commodity price average and the total index probably rose slightly in January, reflecting some important increases in basic chemical and metal prices and continued advances in various machinery and industrial supply items. The price increases for chemicals were generally effective January 1 and were relatively moderate, except for sulphur, which is reported to be in world-wide shortage because of sharply expanded demands for fertilizer.

The special U.S. Arrangement to purchase copper from Chile at the domestic price of 36 cents per pound came to an end in early January and the price of copper supplied by Chile was raised to the world level, which has been around 55 cents. At the same time, major domestic copper producers raised their prices by 2 cents to a level of 38 cents per pound (a previous attempt in November 1965 was withdrawn at Federal request). Prices for aluminum and products were raised one-half to one cent per pound and tubular steel mill products were

generally advanced. Steel scrap, textiles, and other sensitive markets, however, have reflected some mounting concern over a possible business letdown.

Consumer prices. The consumer price index showed a small further rise in December--0.1 per cent, as in November--and ended the year at a level 3.3 per cent higher than in December 1965. In December, prices of food for home consumption declined slightly, but the decrease was less than expected and the food total including restaurant meals was unchanged. Retail prices of meats declined 1 per cent further and were about 3 per cent below the level of last summer, but they still appear high in relation to wholesale prices of meats and livestock.

Prices of nonfood commodities edged off 0.1 per cent in December as a seasonal decrease in new cars and a more-than-seasonal decrease in used cars were nearly offset by a contraseasonal increase in apparel. Services continued on their rapid upward course, with the total excluding rent up another 0.5 per cent.

The 3.3 per cent rise in the index over the 12 months from December 1965 to December 1966 compares with 2.0 per cent during 1965 and an annual average increase of 1.5 per cent in 1962-64--a period generally regarded as one of relative price stability. As the table shows, services made a very large contribution to last year's increase in the total index, with medical care services rising sharply. The increase in mortgage interest rates over the year also was a significant factor in the index, accounting for roughly 1 percentage point of the

5 per cent rise in services and about 0.3 percentage points of the rise in the total CPI.

Retail food prices rose slightly more during 1966 than during 1965. Meats, which accounted for much of the rise in 1965, showed little net change in 1966 but dairy and cereal products increased substantially. Nonfood commodities rose 2 per cent in 1966, with much of the increase resulting from higher apparel prices. For nonfood commodities, a significant portion of the difference in increases between 1965 and 1966 was accounted for by the reduction in 1965 in Federal excise taxes on autos and other consumer durable goods.

CONSUMER PRICE INDEX

	Per cent change		
	Dec. 1965 from Dec. 1964	Dec. 1966 from Dec. 1965	Dec. 1966 from Nov. 1966
All items	2.0	3.3	0.1
Food	3.5	3.8	0
At home, total	3.6	3.4	- .2
Meats, poultry, and fish	11.2	.7	- .8
Dairy products	.5	9.8	- .2
Cereals and bakery products	1.1	5.9	.2
Away from home	3.4	5.3	.5
Commodities less than food	.8	1.9	- .1
Apparel	1.3	3.7	.3
Other nondurables	2.2	2.3	.1
New cars	-2.9	- .1	- .7
Used cars	-4.4	-3.4	-4.3
Household durables	-1.8	1.7	.1
Rent	1.0	1.6	.1
Other services	2.9	5.5	.5
Medical	3.5	8.1	.6
Transportation	3.9	4.3	.3
Household	2.4	5.5	.6
Miscellaneous	2.8	4.6	.3

Food supplies. Supplies of high-protein foods are expected to be substantially larger in the first quarter of 1967 than the relatively low supplies of a year ago. Red meat and poultry slaughter will probably be up about 10 per cent and there is little evidence of slackening in the large red meat imports which were attracted by high U.S. prices during most of 1966.

The number of cattle on feed on January 1 was 7 per cent larger than a year earlier and feeders have reported intentions to market in the first quarter 8 per cent more cattle than a year ago. Slaughter supplies will probably be smaller in the second half of the year.

The large supply of slaughter hogs on farms suggest that pork production may average 10 to 15 per cent above the low first quarter of 1966 with the margin narrowing later in the year. Broiler slaughter since October has been running a tenth above year-earlier levels and shows little sign of slackening; egg production is expanding as the large flocks of layers come into production. Egg output for the year will probably be 3 to 4 per cent larger than in 1966. Milk production also is edging upward after declining in 1966.

Dry edible beans, one of the cheapest sources of protein, are in burdensome supply because of record output. Stocks of winter potatoes are close to the record high of last winter but the movement out of storage is also large. The largest citrus crop of record is being harvested. The orange crop is 28 per cent above 1965-66. Early season movement to fresh market lagged because of slower than usual ripening and packs of processed citrus products will be substantially larger than last year.

Farm earnings. Net realized income of farmers in 1966 was $16.3 billion, $2.1 billion above that of 1965 but below the record $17.1 billion reached in 1947. Net realized income per farm, however, did reach a new record of $5,000, about 19 per cent above 1965, and 72 per cent above 1947. Each year since the mid-1930's total net income has been divided among fewer, but larger, farms.

Gross realized income in 1966 came within 1 per cent of the $50 billion mark, a new dimension in agriculture. Cash receipts totaled $43 billion, 9.4 per cent above the preceding year; and Government payments reached $3.3 billion, about a third higher than the record of the previous year.

The major factor in the rise in cash receipts was the expanding commercial, foreign aid, and military demands for a slightly smaller supply than a year earlier. The quantity of products marketed was 1 per cent larger than in 1965--with stocks run off further--while prices averaged 8 per cent higher. Receipts from the sale of livestock and products were up 13 per cent, reflecting a 2 per cent increase in volume of marketings and a 12 per cent increase in prices. Receipts from crops were up 5 per cent with volume little changed and prices up 2 per cent. The broadening of acreage diversion programs to include cotton and a substantial rise in price support payments on wheat accounted for most of the rise in Government payments.

Production expenses rose 8 per cent to $33 billion, reflecting for the most part, higher prices for purchased livestock, feed, motor vehicles, and farm machinery. Taxes and interest expenses also

increased. Outlays for labor were little changed because, although wage rates averaged 8 per cent higher, the number of hired workers was smaller.

On balance, farmers sold a little more than they produced in 1966. At year-end, farm stocks of some major crops were smaller than a year earlier but stocks of soybeans and flaxseed were larger. Final data on livestock inventories will not be available until mid-February but other sources suggest that cattle numbers are down while hog and poultry numbers are larger.

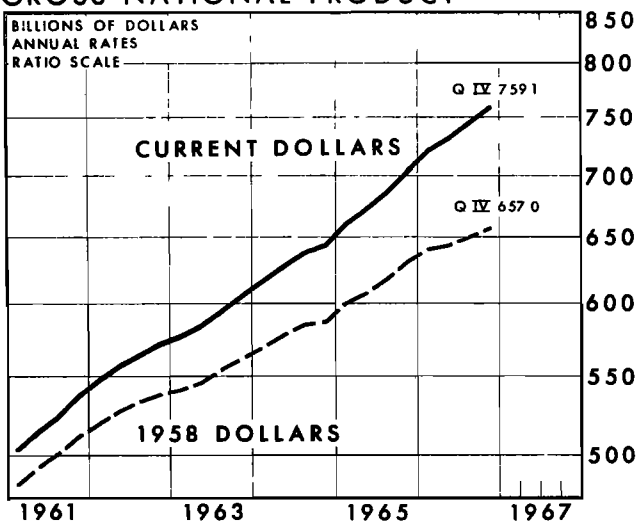
Farmers' asset position--valued at current market prices--improved during the year with the value of farm real estate rising 8 per cent and of other assets rising 6 per cent. Debts rose too but from a smaller base. As a result, the value of farmers' equities increased 7 per cent, or $14 billion. However, the ratio of debts to assets increased to 16.8 per cent from 16.3 per cent in 1965 and 12.2 in 1960.

Farm income in 1967, boosted in 1966 by strong demands to the highest level in two decades, is expected to be down a little, largely because of the continuing rise in production costs. Gross receipts from sales of crops are expected to rise further, reflecting larger marketings from the expanded production indicated in a November survey of farmers' planting plans. Little change is expected in cash receipts from sales of livestock and products. Government payments may be down a fifth because of smaller diversion of feed grain acreage.

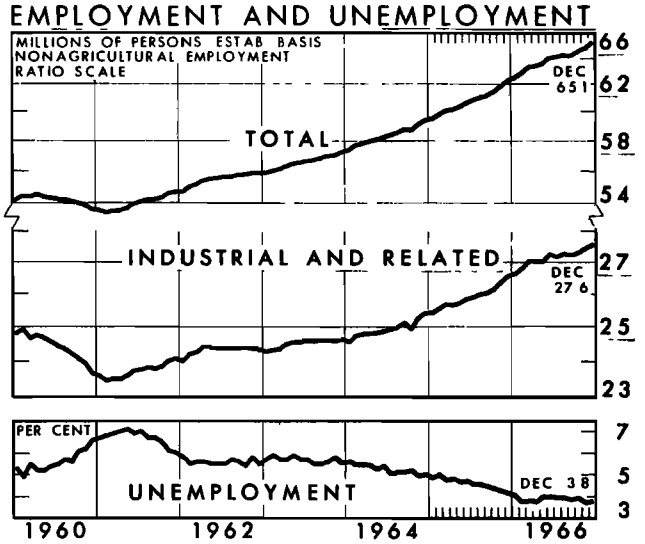
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

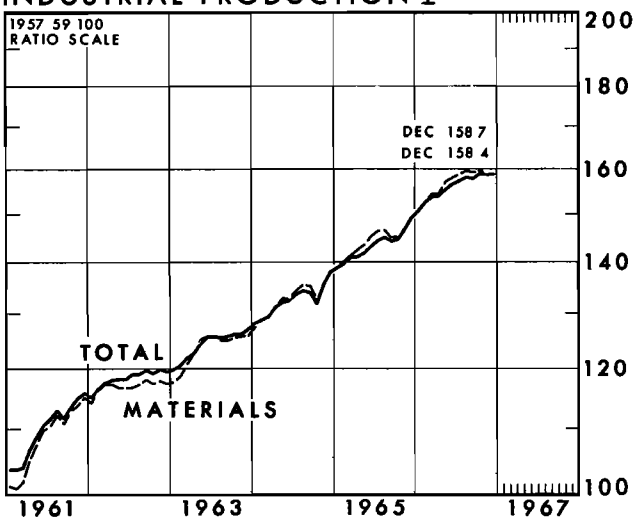
GROSS NATIONAL PRODUCT



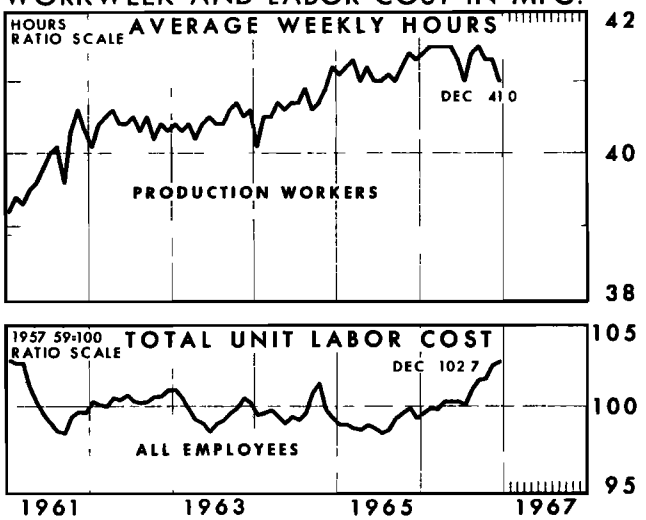
EMPLOYMENT AND UNEMPLOYMENT



INDUSTRIAL PRODUCTION-I



WORKWEEK AND LABOR COST IN MFG.



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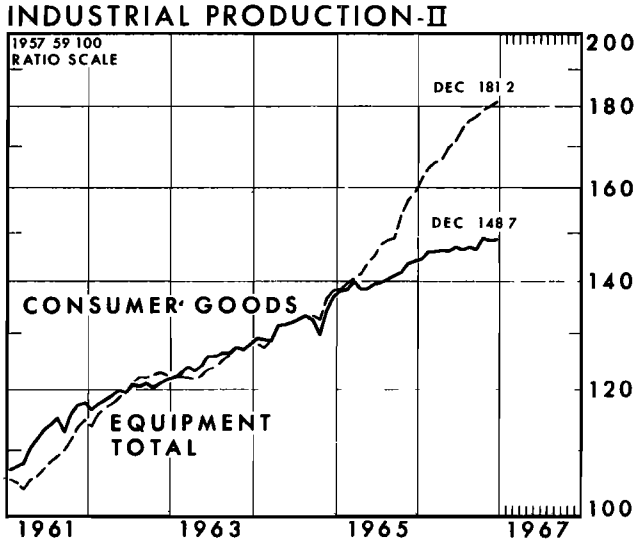
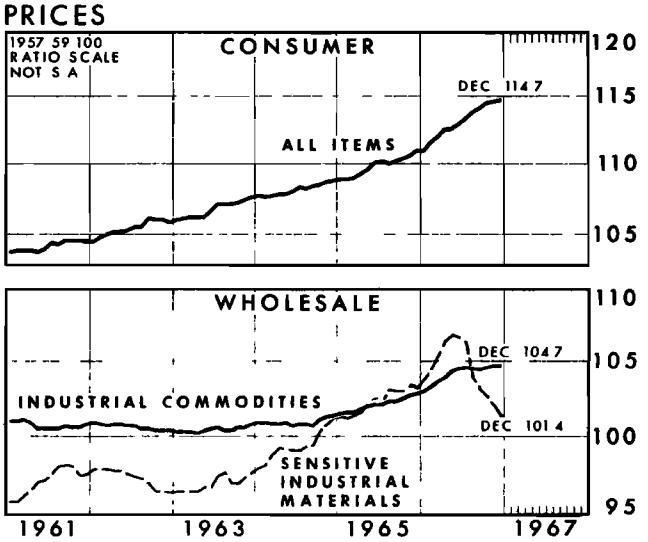


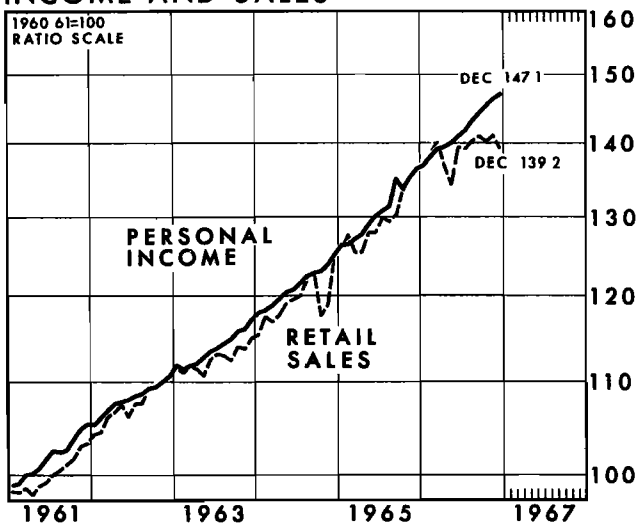
PRICES



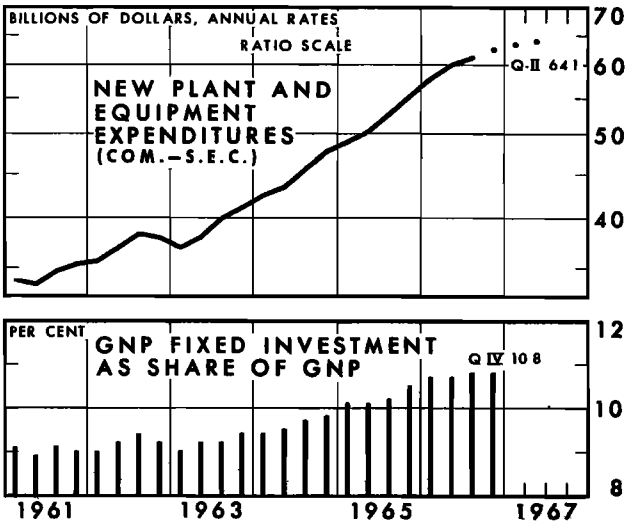
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

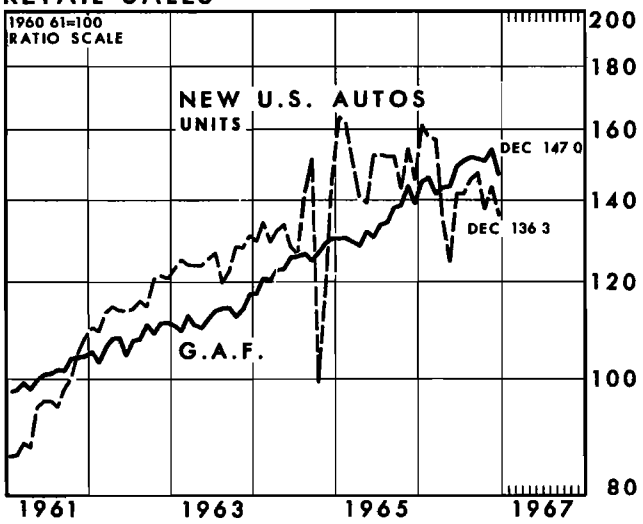
INCOME AND SALES



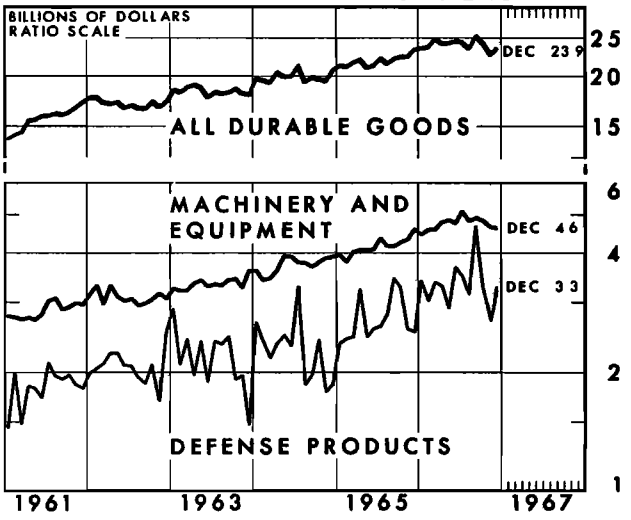
BUSINESS INVESTMENT



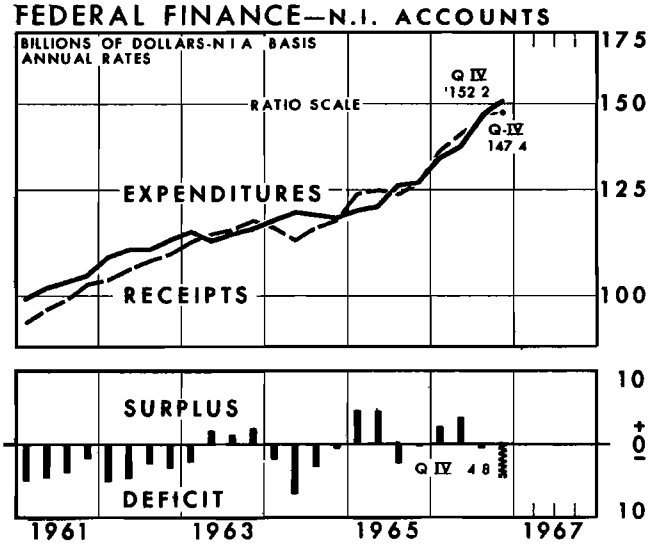
RETAIL SALES



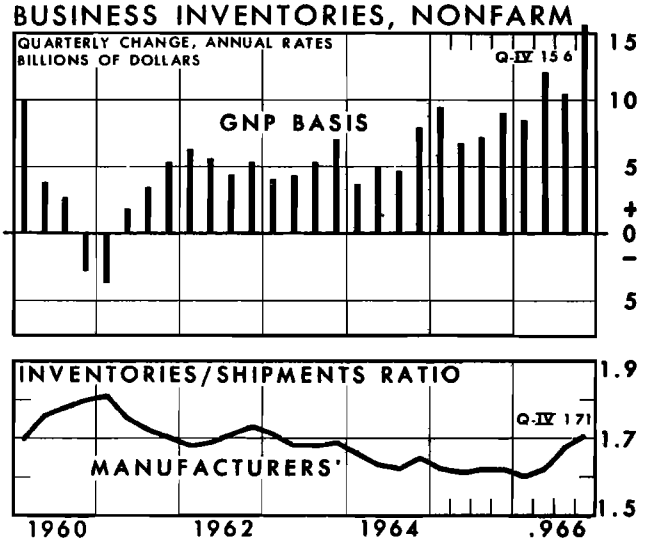
MANUFACTURERS' NEW ORDERS



FEDERAL FINANCE—N.I. ACCOUNTS



BUSINESS INVENTORIES, NONFARM



DOMESTIC FINANCIAL SITUATION

U.S. Government securities market. In recent weeks yields have fallen sharply in all maturity areas of the U.S. Government securities market. The latest declines, following advances in February, have pushed yields on all but the shortest and the longest maturities to levels below those prevailing at the time of the discount rate hike in early December 1965.

YIELDS ON U.S. GOVERNMENT SECURITIES
(Per Cent)

Date (Closing bids)		3-month bills	6-month bills	3 years	5 years	10 years	20 years
1965							
Dec.	3	4.12	4.26	4.54	4.52	4.52	4.44
1966							
Aug.	29	5.04	5.51	6.22	5.89	5.51	5.12
Sept.	21	5.59	5.96	5.90	5.53	5.21	4.97
Nov.	25	5.27	5.47	5.56	5.39	5.23	4.91
Dec.	30	4.81	4.92	4.94	4.80	4.64	4.58
1967							
Jan.	27	4.59	4.56	4.58	4.61	4.47	4.47
Feb.	23	4.64	4.71	4.85	4.83	4.74	4.73
Mar.	7	4.38	4.36	4.63	4.62	4.60	4.59
	28	4.17	4.10	4.35	4.47	4.52	4.57

Major influences on the Treasury bond market in recent weeks have included further weakness in most domestic economic indicators, reductions in the U.K. bank rate and in other central bank rates, and

further indications of easing by the Federal Reserve following announcement of a decrease in certain reserve requirements in late February. Against this background, there has developed increasing speculation about a possible cut in the Federal Reserve discount rate. Restraining influences over the recent period, affecting mainly the longest-term bonds, have included the record calendar of new corporate issues and the $750 million of FNMA PC's offered to the public in March.

Dealers sought aggressively to build up their holdings of Treasury notes and bonds in recent weeks, and a moderate amount of speculative buying was also in evidence from other market professionals such as trading banks. Offsetting this demand, however, was a fair amount of selling by investors switching into new corporate or Federal Agency securities. Since early March dealer holdings of Treasury securities due in more than 1 year have risen over $100 million to $725 million on March 27. This increase occurred in the face of System purchases totaling about $100 million of notes and bonds maturing in more than one year.

In the bill market, rates on the longest bill maturities have fallen most in recent weeks, with the 1-year issue trading just below 4 per cent on some recent days. Declines in bill rates occurred as the market was absorbing $2.7 billion of new June tax bills auctioned on March 7, and despite money market pressures associated with the March dividend and tax dates. The latter pressures appeared to be reflected mainly in the Federal funds market and in closely related dealer lending rates. Some of the pressure on dealers from the latter source was

relieved by sizable System repurchase agreements which totaled over $3.1 billion in the month through March 7 and averaged $315 million in amounts outstanding per day. The System also purchased $1.0 billion of bills from dealers in this period, up sharply from the purchases made in the same period last year.

Despite these large purchases, dealer bill positions have remained relatively high as dealers have been willing buyers of new June tax bills and have bid aggressively for new bills in recent auctions. The continued dealer willingness to hold bills, given still relatively high financing costs over much of the period, has reflected their expectation of further easing of monetary policy.

Yields on short-term debt instruments other than bills have also declined substantially in recent weeks, as the table shows.

SELECTED SHORT-TERM INTEREST RATES

	1966 High	1967 Feb. (high)	1967 Mar. 28
Commercial paper 4-6 months	6.00 (12/31)	5.38 (2/28)	5.13
Finance company paper 30-89 days	5.88 (12/31)	5.25 (2/9)	5.00
Bankers' Acceptances 1-90 days	5.75 (10/25)	5.00 (2/28)	4.50
Certificates of deposit (prime NYC)			
Typical new issue:			
3-months	5.50 (1/18/67)	5.13 (2/28)	4.75
6-months	5.50 (1/11/67)	5.13 (2/28)	4.75
Secondary market:			
3-months	5.90 (9/21)	5.25 (2/23)	4.88
6-months	6.30 (9/28)	5.30 (2/23)	4.88
Federal Agencies (Secondary market):			
3-months	5.76 (9/21)	4.79 (2/3)	4.14*
6-months	6.04 (9/21)	4.99 (2/24)	4.30*
1-year	6.13 (9/23)	4.83 (2/24)	4.31*
Prime Municipals 1-year	4.25 (9/21)	2.80 (2/28)	2.60*

N.B. Latest dates on which high rates occurred are indicated in parentheses.
* Rates on March 23.

Corporate and municipal bond markets. Reflecting the same background influences exerting downward pressure on Treasury bond yields, yields on corporate and municipal bonds have turned down from the levels to which they rose temporarily in late February. While yield declines since late February on new corporate and seasoned municipal bonds amount to as much as 1/8 of a percentage point, current yield levels on both types of issues are still as much as 1/4 of a percentage point above their earlier 1967 lows. Moreover, the most recent efforts of underwriters to mark new issue yields still lower have encountered some investor resistance in both markets.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa			State and local Gov't.	
	New		Seasoned		
	With call protection	Without call protection		Moody's Aaa	Bond Buyer's (mixed qualities)
1965					
End of July 1/	4.58	--	4.48	3.16	3.25
End of December 2/	4.79	--	4.60	3.37	3.50
1966					
Late summer high	5.98*	--	5.44	4.04	4.24
Weeks ending:					
Dec. 2	5.80	6.10	5.37	3.89	4.02
Feb. 3	--	5.21	5.02	3.25	3.40
Feb. 24	5.20*	--	5.05	3.53	3.66
March 3	5.45*	--	5.11	3.53	3.60
March 24	5.33*	--	5.13	3.46	3.53

1/ Week prior to President's announcement of increased U.S. involvement in Vietnam.
2/ Week preceding Federal Reserve Discount rate increase.
* Some issues included carry 10-year call protection.

CONFIDENTIAL -- FR February 1, 1967

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Expenditures and income figures are billions of dollars
seasonally adjusted annual rates)

	1965	1966p	1966				1967 Projected	
			I	II	III	IVp	I	II
Gross National Product	681.2	739.5	721.2	732.3	745.3	759.1	766.1	773.5
Final sales	672.1	728.1	712.3	720.0	735.4	744.7	757.1	769.1
Personal consumption expenditures	431.5	465.0	455.6	460.1	469.9	474.4	480.8	487.8
Durable goods	66.1	69.4	70.3	67.1	70.2	70.1	69.2	69.2
Nondurable goods	190.6	206.1	201.9	205.6	208.1	208.7	212.0	215.0
Services	174.8	189.5	183.4	187.4	191.5	195.6	199.6	203.6
Gross private domestic investment	106.6	116.5	114.5	118.5	115.0	118.0	113.1	108.3
Residential construction	27.8	25.8	28.6	28.0	24.8	21.9	21.8	21.9
Business fixed investment	69.7	79.3	77.0	78.2	80.3	81.7	82.3	82.0
Change in business inventories	9.1	11.4	8.9	12.3	9.9	14.4	9.0	4.4
Nonfarm	8.1	11.7	8.5	12.1	10.4	15.6	9.5	4.5
Net exports	7.0	4.9	6.0	4.7	4.2	4.8	5.9	6.8
Gov't purchases of goods & services	136.2	153.1	145.0	149.0	156.2	161.9	166.3	170.6
Federal	66.8	77.0	71.9	74.0	79.0	82.5	85.1	87.6
Defense	50.1	60.0	54.6	57.1	62.0	65.5	67.8	69.3
Other	16.7	17.0	17.4	16.9	17.0	17.0	17.3	18.3
State & local	69.4	76.2	73.1	75.0	77.2	79.4	81.2	83.0
Gross National Product in constant (1958) dollars	614.4	647.7	640.5	643.5	649.9	657.0	659.1	662.2
GNP Implicit deflator(1958=100)	110.9	114.2	112.6	113.8	114.7	115.6	116.2	116.8
Per cent change, annual rate								
GNP current dollars	7.8	8.6	9.5	6.2	7.1	7.4	3.7	3.9
GNP constant dollars	5.9	5.4	5.9	1.9	4.0	4.4	1.3	1.9
Implicit deflator	1.8	3.0	3.6	4.3	3.2	3.1	2.1	2.1
Personal income	535.1	580.4	564.6	573.5	585.2	598.1	607.4	615.1
Wage and salaries	358.4	392.3	380.0	387.4	396.7	405.0	410.7	416.5
Disposable income	469.1	505.3	495.1	499.9	507.8	518.2	526.9	534.1
Personal saving	25.7	26.9	26.7	26.6	24.5	29.9	31.8	31.7
Saving rate (per cent)	5.5	5.3	5.4	5.3	4.8	5.8	6.0	5.9
Total labor force (millions)	78.4	80.2	79.4	79.7	80.4	81.1	81.5	81.7
Armed forces "	2.7	3.1	2.9	3.1	3.2	3.3	3.4	3.5
Civilian labor force "	75.6	77.0	76.5	76.7	77.2	77.8	78.1	78.2
Unemployment rate (per cent)	4.6	3.9	3.8	3.9	3.9	3.8	3.9	4.0
Nonfarm payroll employment (millions)	60.8	63.9	62.8	63.6	64.1	64.8	65.2	65.5

p -- preliminary figures.

In March, flotations of publicly offered securities aggregated about $4.0 billion, including $2.9 billion of corporate and municipal bonds, $750 million of Federal participation certificates, and $350 million of foreign and World Bank bonds. Corporate bond offerings accounted for nearly $1.7 billion of the total and set a record for any month. Investor response to these latter issues was a bit mixed, with most industrial offerings selling out quickly, whereas several public utility issues have recently moved rather slowly.

Reflecting the very large March calendar, total corporate security offerings in the first quarter now appear to have aggregated $5.8 billion, surpassing by a wide margin the previous record of $5.1 billion in the first quarter of 1966. This total includes stocks and private placements of bonds as well as publicly offered issues. Recently available January data indicate that takedowns of corporate private placements totaled nearly $900 million in January, well above earlier estimates and nearly 30 per cent higher than in January 1966. Reports from the life insurance industry indicate that a part of the unexpectedly large January total represented takedowns that were originally scheduled for December but were postponed because of the tight fourth quarter squeeze on insurance company cash positions. Comment from the industry also suggests that private placements in February and March may have been somewhat above earlier estimates.

Despite the very large volume of first quarter corporate financing, only a moderate immediate respite from heavy public offerings of corporate issues is likely. Bonds already scheduled for April total

nearly $900 million, and the final volume is expected to amount to at least $1 billion. At $1.0 billion, gross public bond offerings would exceed April 1966 by about two-thirds. Looking beyond April, offerings already scheduled for May total about $350 million and those for June $550 million. Since financing in these months typically reaches a seasonal peak, sizeable further additions to the two monthly calendars as the quarter progresses would not be unexpected. But given the heavy volume of financing already accomplished or scheduled far in 1967, some weakening of corporate demands for funds is generally expected later in the year.

CORPORATE SECURITY OFFERINGS 1/
(In millions of dollars)

	Bonds				Total Bonds and Stocks	
	Public Offerings 2/		Private Placements			
	1966	1965	1966	1965	1966	1965
Total	8,018	5,570	7,542	8,151	18,074	15,992
	1967	1966	1967	1966	1967	1966
January	712	460	896	692	1,688	1,339
February	825e	560	600e	583	1,575	1,273
March	1,675e	753	800e	1,311	2,550	2,582
1st Quarter	3,212e	1,774	2,296e	2,586	5,813e	5,094
April	1,000e	628	700e	743	1,825e	1,582

1/ Data are gross proceeds.
2/ Includes refundings.

FLOWS TO NON-BANK FINANCIAL INTERMEDIARIES
(In millions of dollars, seasonally adjusted)

	S&L's	Savings Banks
1966 Monthly		
Oct.	56	293
Nov.	491	255
Dec.	735	348
1966 Quarterly		
1st	1,503	627
2nd	462	313
3rd	364	728
4th	1,282	896

Flows to savings and loan associations expanded nearly $300 million in the first half of January, according to a preliminary staff estimate of the Home Loan Bank Board. When this rate of inflow is extrapolated, it suggests that the seasonally adjusted gain in share capital during all of January may have been as much as $550 million. For mutual savings banks, the 15 largest institutions in New York City experienced an unadjusted net inflow of $111 million during the first two weeks of January, twice that in the like period of 1966 and nearly identical with the figure for the first half of January 1965.

Despite the recent expansion of inflows at depositary-type institutions, only the mutual savings banks resumed a nearly normal pattern of mortgage acquisitions in December. This apparently reflected the earlier pick-up in their deposit growth which had already permitted them to rebuild liquidity during the late summer and fall.

Savings and loan associations used a large part of their new inflows in both November and December to rebuild liquidity -- in particular to repay advances and acquire time deposits at the Home Loan Banks. While some increase in new loan activity has been reported in January, loan repayments and deposit increases at the Home Loan Banks have persisted.

From November to the middle of January, S&L's reduced their outstanding advances with the Home Loan Banks by more than $750 million and expanded deposits by about $220 million. Pressure to reduce outstanding advances apparently stemmed both from the Home Loan Bank policy requiring repayment of the withdrawal advances obtained earlier, and from the cost of these and expansion advances--which remained at 6 per cent until early January when the rate was lowered to 5-3/4 per cent.

CHANGES IN S&L ADVANCES AND DEPOSITS AT HOME LOAN BANKS
(In millions of dollars)

	Change in Advances	Change in Deposits at FHL Banks
From November to mid-January		
1967	-767	+218
1966	+ 63	- 84
1965	+146	+ 42

At life insurance companies the severe pressures on liquidity positions which had developed in the late summer and fall

of 1966 have eased, as the policy loan scare has subsided. Also, there is now a more confident outlook on forward cash flows from mortgage prepayments. As a result, a number of companies--including some of the largest--have become more active in making new loan commitments. On the other hand, other companies, particularly those most seriously affected by earlier policy loan increases, have taken a more cautious approach and have in some cases used their increased lending leeway to add to holdings of readily marketable securities. Where new loan commitments are being made, they are said to be going chiefly into business mortgages and corporate private placements. While some of these allocations are still being made for 1967, the bulk of the funds available are reportedly for commitments in 1968.

Deposits. The turnaround in time deposit inflows at commercial banks, which began in early December, accelerated in January as declines in market yields further increased the relative attractiveness of bank deposits. On a seasonally adjusted daily average basis, time deposits at banks expanded at an estimated annual rate of almost 17 per cent in January--the largest rate of increase since October 1965.

Most of the increase in time deposits was centered in the negotiable CD inflows of the largest banks, and, as a result, reserve city banks--especially those in New York City and Chicago--showed very high rates of time deposit growth. Country banks--most of which do not issue negotiable CD's--increased their time deposits at about their average 1965-66 pace. At weekly reporting banks, negotiable CD's increased by about $2 billion in January, a one month record. Indeed, in the six weeks since mid-December, weekly reporting banks are estimated to have recovered over two-thirds of the $3.2 billion attrition in their CD's over the previous four months.

TIME DEPOSIT GROWTH
Average of Daily Figures
(Seasonally adjusted annual rate--per cent)

	All Commercial Banks	Member Banks		
		Country	Reserve cities outside of New York and Chicago	New York and Chicago
1965-Year	16.0	13.5	15.6	24.9
1966-Year	8.4	11.5	8.7	- 3.9
1966-III	9.6	13.1	12.5	- 5.0
IV	2.5	9.9	4.9	-28.5
1966-Dec.	9.1	13.5	11.7	- 5.9
1967-Jan.	16.6	12.4	16.8	32.4

After mid-January, as short-term rates declined further, many of the larger banks reduced their CD offering rates. By the end of the month, most banks with deposits in excess of $1 billion were posting rates of 5-1/4 per cent across the maturity range, with a few having reduced their CD rates to as low as 5 per cent. Most major banks in New York City were quoting 5 per cent on CD's maturing in less than 90 days, and offering slightly higher rates on longer-term CD's. Even at 5 per cent, yields on 90-day CD's exceeded the investment yield on Treasury bills by about 40 basis points at the end of January, 10 to 15 basis points above the past "normal" spreads, but considerably below the spreads in the spring and summer of 1966 when banks last aggressively sought CD funds.

Over the month of January, banks were able for the first time in 6 months to extend the maturity of their new issues of CD's, considerably reducing the roll-over problem faced since last summer. In New York City, CD's sold in January carried an average maturity of 4.4 months, up from 2.5 months in December and banks outside of New York and Chicago issued new CD's with an average maturity of 5.2 months as compared to 3.0 months in December. Moreover, preliminary estimates indicate that banks sold about $1 billion of CD's with 1968 maturities; most of these were sold by banks outside of New York and Chicago.

While negotiable CD's accounted for the largest proportion of the growth in interest-bearing deposits at banks, other forms of time deposits also accelerated sharply. At all weekly reporting banks during the first three weeks of January, time deposits other than large

negotiable CD's increased by $1.2 billion, almost twice as much as in 1966. A large portion of this growth reflected transfers from passbook savings accounts after the interest-crediting period, but still the growth in total consumer-type interest bearing deposits (passbook savings plus other IPC time) was larger than last January. Transfers from passbook accounts to time deposits appear to have been greater than last January, but were below the very large post interest-crediting outflows from passbook accounts that occurred last April when many banks first introduced higher rate consumer time deposits.

COMPOSITION OF TIME AND SAVINGS DEPOSIT INFLOWS
Weekly Reporting Banks
First three weeks of January

	All Weekly Reporting Banks		New York City Banks		All Other	
	1966	1967	1966	1967	1966	1967
Total	+498	+1,921	+ 58	+565	+440	+1,356
Negotiable CD's	+ 45	+1,361 2/	+ 82	+710 2/	- 37	+ 651 2/
Other time 1/	+670	+1,217	+ 81	- 90	+589	+1,307
Passbook savings	-217	- 657	-105	- 55	-112	- 602

1/ Other than negotiable CD's.
2/ In the fourth week of January, banks in the cities of New York and Chicago increased their outstanding CD's by $444 million.

New York City banks also lost savings deposits, but--despite the introduction of new 5 per cent passbook accounts (in the form of time deposits, open account)--did not offset these outflows by increased issues of time depsoits other than large CD's. This exception to the pattern of other weekly reporters--evidently reflects the attraction of mutual savings bank deposits in New York City. Mutuals in New York

City also offer 5 per cent on passbook accounts, but do not have the notification requirement of the competitive commercial bank open account time deposits.

Treasury deposits at commercial banks were much higher in January, in large part due to accelerated payments of withheld income taxes by corporations. These higher Treasury deposits more than offset declines in private demand balances.

All in all, total bank deposits at member banks on a daily average basis (credit proxy) expanded at a seasonally adjusted annual rate of almost 16 per cent from December to January. However, some repayments of foreign branch bank borrowing reduced the growth of total member bank resources to 13 per cent.

Bank credit. Incomplete data make it possible only to provide very preliminary estimate of month-end bank credit developments for January. With total deposit inflows greatly enlarged however, it appears that bank credit at all commercial banks may have increased at about a 15 per cent annual rate during January--the highest rate since mid-1966. Bank purchases of Treasury issues moderated considerably from the December pace, but other security holdings--tax warrants, other municipals, participation certificates, and agency issues--rose sharply. Total bank acquisitions of securities in December and January rebuilt their holdings to about the early spring level.

Loan expansion to January appears also to have been the largest since mid-1966, with most of the expansion centered in loans to nonfinancial business and to security dealers. The latter loans,

made at rapidly declining interest rates over the month, reflected mainly the continued heavy financing needs of U.S. Government security dealers. Finance companies reduced loans at banks, as open market financing remained relatively cheaper than bank accommodation.

The January spurt in business loans--which may have risen by $1.5 billion, the largest increase since mid-summer--follows five months of very moderate growth. This sharp increase in business loans is probably temporary, however, since it appears to coincide with the impact of large tax payments on liquidity-depleted nonfinancial corporations. Tax payments by businesses in January were enlarged by an estimated $2.5 billion as the result of acceleration of payments otherwise due in February. With business liquidity sharply reduced in the final months of 1966, and with banks in a better position to accommodate customers, a large portion of these tax payments appear to have been financed by bank borrowing, mostly at the large money market banks. In addition, in January expectations of declining market yields might have led some corporations to seek short-term bank accommodation in anticipation of being able to repay the proceeds from later capital market financing.

The reduction in the prime rate from 6 to 5-3/4 per cent (with a few exceptions at 5-1/2 per cent) at the very time that business loans were rising is explained by a number of factors. Not only did these banks have large fund inflows at declining costs, but the reduction in the prime rate may also be indicative of a slower pace of basic loan demands then was indicated by banks in the mid-December lending practices survey. Moreover, at the time of the

reduction, the prime rate was almost 100 basis points above the cost of capital market financing--a record gap--and 50 to 75 basis points above the cost of CD's. Finally, the bank which led the reduction was in a more liquid position than most of its large competitors, and many large non-prime banks evidently also found their position at least as comfortable. Thus, the competitive pressures on other banks--which might have preferred to await later developments before reducing the prime rate--were no doubt intense.

Mortgage market developments. With flows to institutional lenders improving and expected to improve further, and with yields on securities sharply reduced, easing in home mortgage markets, which first appeared in December, has apparently developed further in recent weeks. To some extent the degree of ease has reflected the fact that improved flows of loan funds have come at a time when the supply of mortgages available for immediate delivery to lenders has been particularly low. Because of the temporary paucity of mortgages from private sources, investors recently bought a few mortgages from the FNMA for the first time in many months.

In December, FHA data indicate that home mortgage yields turned down--but only slightly--from their record highs of October or November. On certain FHA-insured home loans, secondary-market yields declined by 4 basis points to 6.77 per cent. On conventional first mortgages, average contract rates were off by 5 basis points (rounded) to 6.65 per cent on new homes and 6.70 per cent on existing homes--both still 65 basis points above a year earlier.

On the other hand, the mixed character of the December mortgage market and the minor nature of yield changes are suggested by the fact that conventional home-mortgage rates, as measured by the FHLBB-FDIC series, actually increased slightly further. This series purports to measure rates on loan contracts actually committed within the month in question, whereas the FHA series is an average of field office judgments of rates lenders are charging in local markets. While the FHLBB-FDIC series also indicates that conventional mortgages approved in December on new as well as existing homes carried slightly

more restrictive average loan-to-value ratios and shorter maturities than they did in November, a breakdown of the series by metropolitan and nonmetropolitan areas suggests that slight tendencies toward ease in the former (on both rates and terms) were more than offset by further tightening in nonmetropolitan areas.

During the fourth quarter, further cut-backs in mortgage closings and mortgage prepayments were reflected in the lowest seasonally adjusted rate of net debt expansion in more than 5 years. Reductions in net takings of mortgages on both nonfarm homes and income properties contributed to the further decline, lowering net debt expansion by a third from the record first quarter high when FNMA net acquisitions were unusually large. For 1966 as a whole, annual net debt expansion of $24.5 billion was nearly a fifth below the record increases of the two previous years.

INCREASES IN MORTGAGE DEBT OUTSTANDING
(Seasonally adjusted annual rates in billions)

		Total	1-4 family	Multifamily Commercial 1/	Farm 1/
1964	IV	30.6	14.9	13.4	2.3
1965	I	29.7	16.0	11.6	2.1
	II	30.3	15.9	12.4	2.1
	III p.	30.3	15.9	12.1	2.3
	IV p.	30.5	16.2	11.5	2.7
1966	I p.	30.9	15.4	13.2	2.3
	II p.	27.4	13.4	11.9	2.1
	III p.	22.2	9.8	10.3	2.2
	IV p.	18.6	7.8	8.4	2.4

1/ Includes estimates for holdings of individuals and others which are excluded in the flow of funds series.

Although savings inflows improved in the closing months of the fourth quarter, net takings of mortgage loans by thrift institutions declined. Savings and loan associations made virtually no change in their portfolios for the first time in the postwar period, and mutual savings bank net takings were less than in the fourth quarters of earlier years. Commercial banks and life insurance companies, which had shown larger increases in holdings than the year before through each of the first three quarters, apparently cut back, too. While net acquisitions by FNMA and other Federal agencies remained relatively high, those by all other types of non-institutional holders were smaller than in 1965.

MORTGAGE DEBT OUTSTANDING BY TYPE OF HOLDER
(Billions of dollars, without seasonal adjustment)

	Amount Dec. 1966p	Increases in fourth quarter of 1966p	1965p	1964	1963
All holders	366.2	4.8	7.9	8.0	7.8
Financial institutions	281.0	3.0	6.0	6.2	6.3
Commercial banks	54.7	.9	1.3	1.0	1.1
Mutual savings banks	47.4	.8	1.1	1.2	1.0
Savings and loan assoc.	114.0	--	1.9	2.3	2.9
Life insurance companies	64.9	1.3	1.6	1.6	1.3
Federal agencies	15.9	.7	.5	.1	.1
FNMA	7.1	.5	.4	--	-.1
Individuals and others	69.3	1.2	1.4	1.7	1.4

Corporate and municipal bond markets. The sharp further roll-back of interest rates in January has carried the average yield on new issues of corporate bonds (adjusted to an Aaa basis) down to the lowest level since April 1966, a full percentage point below the peak reached late last summer. Yields on seasoned municipal bonds have also declined sharply (three-fourths of a percentage point since late summer); and are now at levels below those prevailing just prior to the December 1965 discount rate increase.

Before the prime bank rate cut last week, yields on both corporate and municipal bonds showed signs of leveling off. New issues in both markets attracted a rather lukewarm investor response, and yields on seasoned municipal issues turned up. Following the prime rate action, however, lagging new issues were distributed more rapidly and secondary market yields turned down again.

BOND YIELDS
(Per cent per annum)

	Corporate Aaa			State and local Government	
	New		Seasoned		
	With call protection	Without call protection		Moody's Aaa	Bond Buyer's (mixed qualities)
1965					
End of July 1/	4.58	--	4.48	3.16	3.25
Early December 2/	4.79	--	4.60	3.37	3.50
1966					
Late summer high	5.98*	--	5.44	4.04	4.24
Weeks ending:					
Dec. 2	5.80	6.10	5.37	3.89	4.02
Dec. 30	--	--	5.40	3.74	3.77
Jan. 13	5.45	--	5.32	3.60	3.59
Jan. 20	5.12	--	5.15	3.35	3.40
Jan. 27	5.03	5.26	5.05	3.34	3.43

1/ Week prior to President's announcement of expanded U.S. involvement in Vietnamese War.
2/ Week preceding Federal Reserve discount rate increase.
* The largest of two issues included in this average carried 10-year call protection.

The monthly volume of municipal bond offerings swelled to a new all-time high of more than $1.3 billion in January, in excess of the previous monthly record set in April 1964. This volume was about 8 per cent above January 1966 which had itself been a record for the month. In February, although new offerings are estimated to drop seasonally--to about $1 billion--this volume would still be about 15 per cent in excess of February 1966.

About $125 million of the January supply of municipals represented issues that had been definitely scheduled for 1966 but then were postponed. Looking ahead, the combination of rapid growth in State and local government expenditures and the recent relief from earlier market constraints are generally expected to create a large continuing volume of municipal security offerings this winter.

STATE AND LOCAL GOVERNMENT BOND OFFERINGS
(In millions of dollars)1/

	1966	1965
Total	11,300	11,329
4th Quarter	2,573e	2,651
November	929	1,043
December	900e	764
	1967	1966
January	1,325e	1,219
February	1,000e	867

1/ Data are for principal amounts of new issues.

In corporate bond markets, the January volume of publicly-offered debt aggregated about $730 million--with two large issues accounting for $400 million of the total. While this compares with a similar volume of only $460 million in January 1966, total corporate bond and stock offerings may actually have been slightly smaller this year than last because of a shrinkage in private placements.

CORPORATE SECURITY OFFERINGS[1/]
(In millions of dollars)

	Bonds					
	Public Offerings [2/]		Private Placements		Total Bonds and Stocks	
	1966	1965	1966	1965	1966	1965
Total	8,064	5,570	7,840	8,151	18,449	15,992
4th Quarter	2,098e	1,226	1,601e	2,264	4,048e	4,030
October	499	287	354	574	989	985
November	569	613	447	529	1,129	1,398
December	*1,030e	326	800e	1,161	1,930e	1,646
	1967	1966	1967	1966	1967	1966
January	730e	460	450e	692	1,280e	1,339
February	500e	560	450e	583	1,050e	1,273

1/ Data are gross proceeds.
2/ Includes refundings.
* Includes $135 million of short-maturity Pennzoil notes.

Publicly-offered corporate bonds definitely scheduled for February thus far total only $375 million. But $150 million of this was added last week and if other issues currently rumored to be in the underwriter's pipeline are in fact announced for February, the monthly total may ultimately grow to $500 million or more. Public offerings

already definitely scheduled for March total $485 million. Some underwriters report that there is no diminution in the volume of new capital market financing being discussed with corporations. But they indicate that because of the rapid recent changes in credit market conditions, corporate managements are generally taking another look at both the volume and timing of their prospective requirements.

Estimates just available for fourth quarter flows of funds suggest that nonfinancial corporations in the aggregate began 1967 with a sizable accumulated financing need. Capital expenditures of such corporations (including inventory accumulation as well as plant and equipment outlays) exceeded their flows of internal funds in the fourth quarter by at least as wide a margin as in the second and third quarters. But because of the general tightness of credit, external financing was sharply below that of earlier quarters. New issues of bonds and stocks provided less than half as much funds as in the third quarter, and other forms of credit market borrowing also declined.

Corporations appear to have filled the resulting gap by reducing their holdings of liquid assets by $7.5 billion (seasonally adjusted annual rate) in the fourth quarter. On an unadjusted basis, this means that corporations added much less to their liquid assets than is usual in the fourth quarter and that the conventional liquidity ratio (i.e., cash, deposits, and holdings of U.S. Governments as a per cent of total current liabilities), which usually rises rather sharply in the fourth quarter, may have changed very little.

While a slower rate of inventory accumulation in the early months of this year may result in a narrowing of the gap between internal funds and capital expenditures, corporations are faced with very large income tax payments this spring. In the absence of the usual build-up in liquid assets in the closing months of last year, and with heavy prospective needs for funds to carry out fixed capital spending programs already in progress, the external financial needs of corporations should be large at least over the early months of 1967.

FLOW OF FUNDS, NONFINANCIAL CORPORATE BUSINESS
(Seasonally adjusted annual rates, in billions of dollars)

	Years		1966, by Quarters			
	1965	1966	I	II	III	IV
Internal funds less capital expenditures 1/	-6.6	-15.2	-11.6	-16.2	-16.0	-17.2
Income tax accruals less tax payments	2.0	- .3	3.1	- 7.0	2.7	.2
Funds raised in credit and equity markets	19.2	23.6	23.1	32.4	22.2	16.8
Excess funds available for other uses	14.6	8.1	14.6	9.2	8.9	- .2
Allocated to:						
Liquid assets	.6	- 1.3	8.0	- 2.1	- 3.1	- 7.5
Net trade credit	6.4	5.7	3.6	7.6	5.9	5.7
Other uses (Net)	7.0	1.0	- .6	2.1	1.8	.6
Discrepancy	.7	2.7	3.6	1.6	4.2	1.0

1/ Capital expenditures include inventory accumulation as well as plant and equipment outlays.

Stock market. Common stock prices--as measured by all of the popular indexes--have risen virtually without interruption since New Year's Day on extremely heavy trading. For Standard and Poor's composite index, the advance has amounted to nearly 8 per cent, extending the cumulative rise from the October 1966 low to more than 17 per cent. The rise has now made up about three-fifths of the earlier 1966 decline in the index.

The January rise in stock prices has been widely distributed. All but 1 of the 82 separate indexes which Standard and Poor's constructs for major industrial groupings have advanced, with 32 of these groups chalking up gains in excess of 10 per cent. In general, cyclically "defensive" groups which already had experienced a significant recovery last fall have shown the smallest additional gains. The utilities index, for example, while up more than 20 per cent from the 1966 low, has advanced less than 2-1/2 per cent this year. Low-priced and speculative stocks, on the other hand, have shown larger price increases. The two indexes of low-priced stocks have shown January increases of 12 and 17 per cent. And prices of stocks on the American Exchange--where issues traded are typically of a more speculative character--have advanced about 13 per cent.

Trading statistics also suggest some recent step-up in speculative activity. On the New York Stock Exchange, activity has averaged more than 10 million shares per day in each of the last three weeks, and the daily average for January exceeded the all-time record of 9.3 million shares set in April 1966 when speculative activity was particularly large.

While speculative interest in stocks has clearly been on the rise, its character has been different from that evident early last year. For example, large orders from institutional investors have apparently played a more important role in the recent market than last spring when individuals were particularly active market participants. Also, unlike other recent periods of intense activity, trading has not been unusually concentrated in a small group of issues. During the past three weeks, for example, trading in the 20 most active issues accounted for about 15 per cent of total volume; whereas during the large volume weeks of late 1965 and early 1966, this concentration ratio ranged from 20 to 25 per cent. Finally, while the step-up in speculative interest has been reflected in a January rise of average trading activity on the American Stock Exchange to more than 3 million shares per day (from 1-1/2 million shares per day in November) the recent level of daily activity has still been only about half as large as the Amex record established in mid-April last year.

The importance of credit financed purchases to January stock market activity can not yet be determined, since the latest available credit statistics are for December. The December data show an increase of $112 million in customers' net debit balances with NYSE member firms, but because end of month activity was much larger in December than in November, a large part of the December increase represented an expansion of clearing balances rather than margin credit.

U. S. Government securities market. In January yields continued to decline in all maturity sectors of the U. S. Government securities market. Late in the month, yields on intermediate- and long-term issues touched new 1966-67 lows and were close to their levels just prior to the discount rate increase in early December 1965.

YIELDS ON U. S. GOVERNMENT SECURITIES
(Per Cent)

Date (Closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1965						
Dec. 3	4.12	4.26	4.54	4.52	4.52	4.44
1966						
Aug. 29	5.02	5.51	6.22	5.89	5.51	5.12
Sept. 21	5.59	5.96	5.90	5.53	5.21	4.97
Nov. 25	5.27	5.47	5.56	5.39	5.23	4.91
Dec. 30	4.81	4.92	4.94	4.80	4.64	4.58
1967						
Jan. 10	4.85	4.91	4.89	4.81	4.69	4.56
27	4.59	4.56	4.57	4.61	4.47	4.46
31	4.51	4.51	4.63	4.67	4.52	4.48

The continued decline in Treasury bond yields during January was spurred by a variety of economic and financial developments, including notably the President's tax hike proposal, further easing in money market conditions, and -- late in the month -- the cut in prime loan rates, the reduction in U. K. bank rate, and the favorable reception accorded the Treasury's February refunding (discussed below). Some profit-taking by dealers and other investors resulted in a temporary

pause in the market's improvement around mid-month, but yields subsequently declined to new lows.

Over the course of the month, dealers were net sellers of coupon issues, notably in the intermediate-term area where bank demand was reported. Dealer positions in coupon issues due in more than 1-year declined from around $800 million in late December and early January to $680 million on January 30.

Treasury bill rates continued to move lower in January, with the largest declines occurring in the longest maturities where rates currently are below those in the 3-month area. Dealer bill inventories remained sizable and late in January were at a new record level of $4.3 billion. An improved availability of financing at lower rates in conjunction with the market's outlook for declining yields contributed to dealer willingness to carry these large positions. Dealer holdings of Federal Agency securities, CD's, and bankers' acceptances have also been substantial in recent weeks.

Downward yield adjustments on a variety of short-term debt instruments other than bills have been substantial in January, as the table shows. Some of these rates had previously been sluggish in adjusting lower.

SELECTED SHORT-TERM INTEREST RATES

	1966			1967
	Sept. 23	Nov. 22	Dec. 30	Jan. 31
Commercial paper 4-6 months	5.875	6.00	6.00	5.375
Finance company paper 30-89 days	5.625	5.875	5.875	5.25
Bankers' Acceptances 1-90 days	5.75	5.75	5.50	4.75
Certificates of deposit (prime NYC)				
Typical new issue:				
3-months	5.50	5.50	5.50	5--5.125
6-months	5.50	5.50	5.50	5--5.125
Secondary market:				
3-months	5.90	5.80	5.60	5.20
6-months	6.30	6.00	5.70	5.20
Federal Agencies (secondary market):				
3-months	5.76	5.56	5.07	4.87*
6-months	6.04	5.77	5.22	4.94*
9-months	5.96	6.01	5.49	5.05*
Prime Municipals 1-year	4.25	3.90	3.45	2.85*

* Rates on January 27, 1967.

Treasury finance. On January 25 the Treasury announced a cash refunding to replace $7.5 billion of securities maturing in mid-February. Two new issues were offered, including a 15-month note priced to yield 4.85 per cent and a 5-year note priced to yield 4.84 per cent. Investor response to the refunding was enthusiastic and very low allotment ratios were anticipated. Immediately following the closing of subscription books on January 30, the new 5-year note traded at a premium of about 1/2 point above issue price, while the new 15-month note was quoted at a 1/4 point premium.

The next Treasury financing is expected around the latter part of February or in early March when the Treasury has indicated it would

offer around $2.5 billion of June tax anticipation bills. In addition, the Treasury is expected to raise cash over the balance of fiscal 1967 through the sale of around $2 billion of participation certificates, all tentatively scheduled to be sold to private investors. These sales are in addition to the $600 million of FNMA PC's sold to the public in January and $500 million of Ex-Im PC's scheduled for offering in early February. Finally, the Budget document estimates for Federal Agency spending imply that these Agencies will be raising around $2.5 billion of new money in the first half of calendar 1967.

Despite such financings, net borrowing in the market by the Federal Government in the first half of calendar 1967 would result in some net reduction of debt outstanding, after allowing for maturities of tax bills in March, April, and June. As is shown in the table below, such borrowing increased Federal Government debt slightly in the first half of last year.

In the second half of calendar 1967, the data in the Budget document suggest that gross cash borrowing by the Treasury through marketable issues could exceed the $10 billion raised in the second half of 1966, even on the assumption of a relatively low cash balance at the end of the year. Moreover, this borrowing assumes that the Government will bring to market some $2.5 billion of participation certificates during July-December 1967, or about one half of the total PC sales projected for fiscal 1968. The other Federal Agencies might also raise something on the order of $1 billion in this period.

TREASURY FINANCE
(In billions of dollars)

Jan.-June

Calendar year	Gross Cash Borrowing 1/	Gross debt repayment 1/	Net 1/	New Agency debt 2/	Gross new sales of PC's 3/	End of June cash balance
1965	3.0	- 6.8	-3.8	1.1	--	11.5
1966	4.0	- 9.4	-5.5	3.5	2.2	10.9
1967 proj.	4.0	-10.5	-6.5	2.7	3.1	7.5

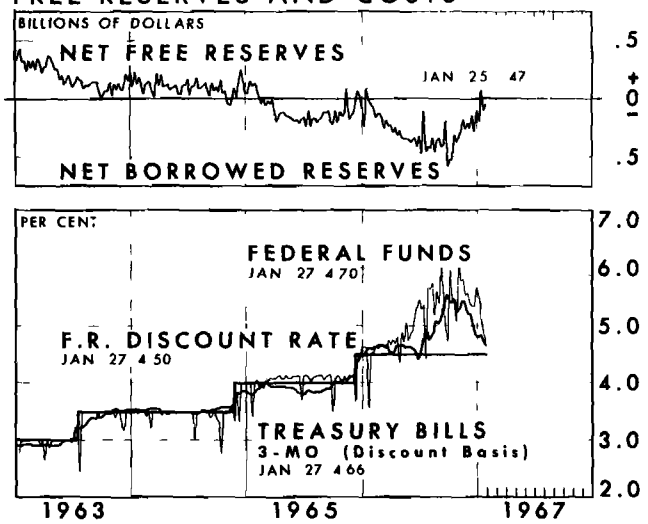
July-Dec.

Calendar year	Gross Cash Borrowing 1/	Gross debt repayment 1/	Net 1/	New Agency debt 2/	Gross new sales of PC's 3/	End of December cash balance
1965	6.5	- 0.6	+5.9	0.6	0.9	5.4
1966	10.0	- 1.0	+8.9	1.6	--	4.6
1967 proj.	10.5	- 1.0	+9.5	1.1	2.5	5.0

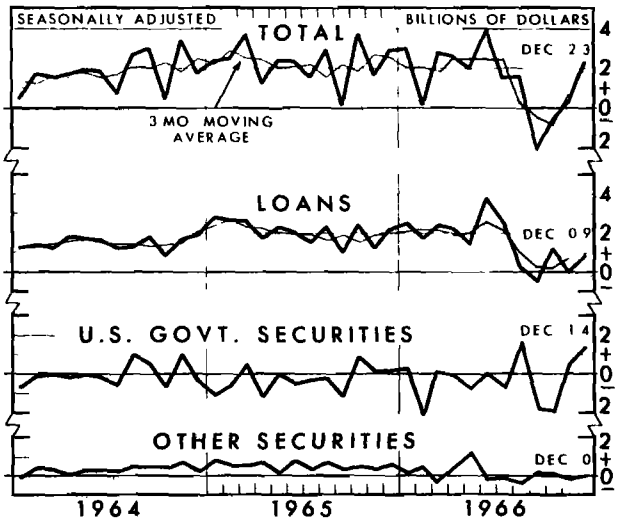
1/ Direct Treasury marketable debt only.
2/ Includes new debt of FICB, FLB, FNMA (debentures), Coops, TVA, and FHLB.
3/ Includes Export-Import Bank Participation Certificates; excludes all maturities and amounts sold directly to Treasury investment funds.

FINANCIAL DEVELOPMENTS - UNITED STATES

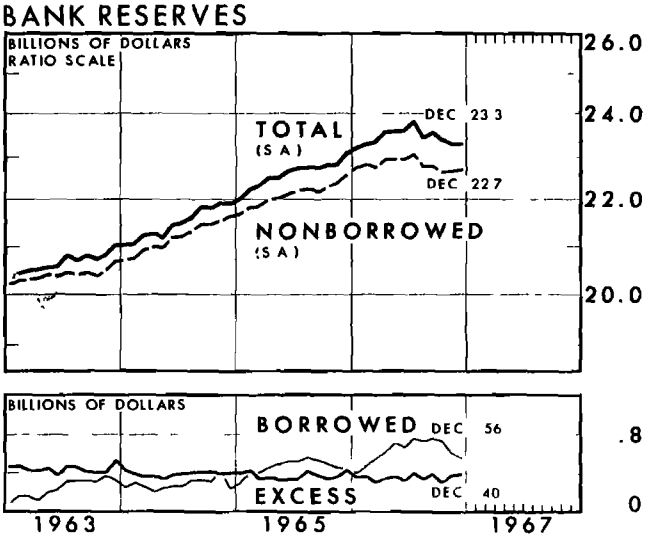
FREE RESERVES AND COSTS



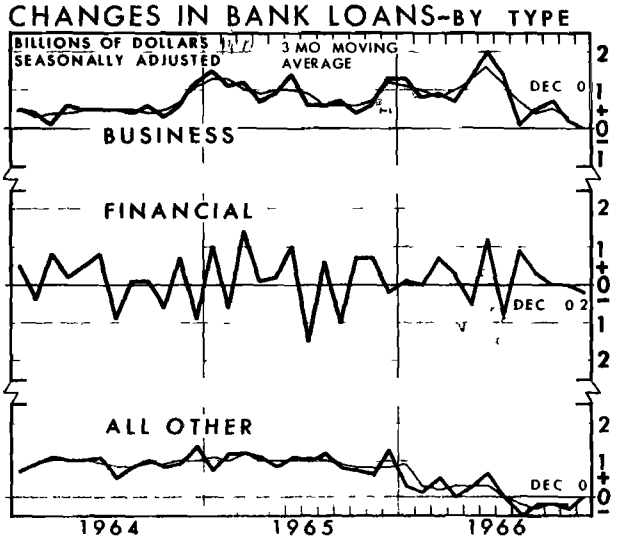
CHANGES IN BANK CREDIT



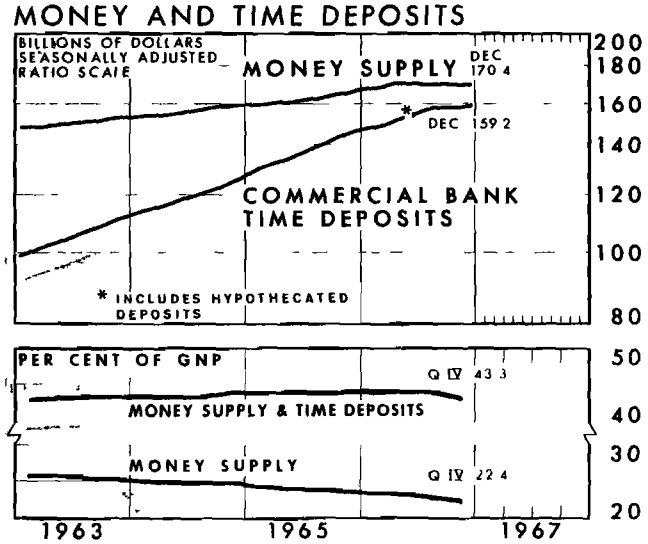
BANK RESERVES



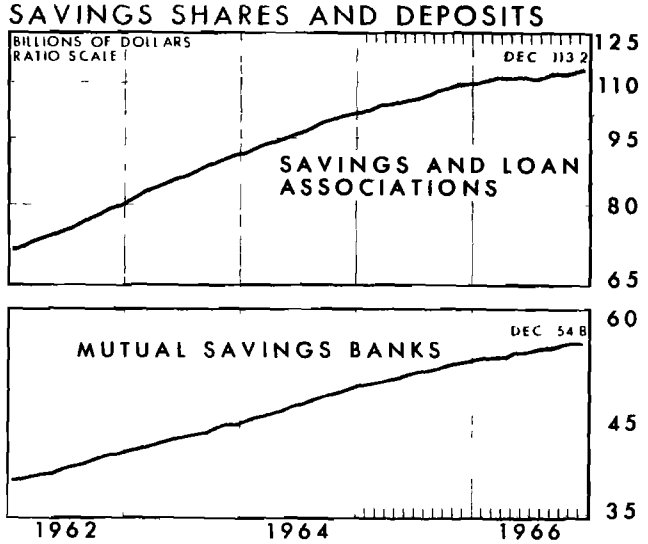
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

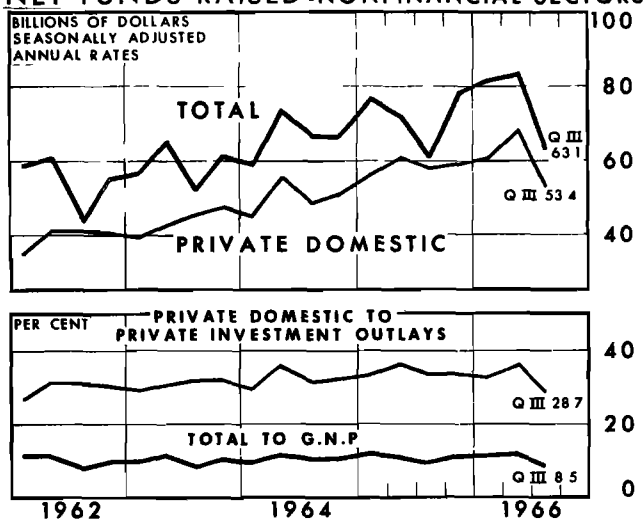


SAVINGS SHARES AND DEPOSITS

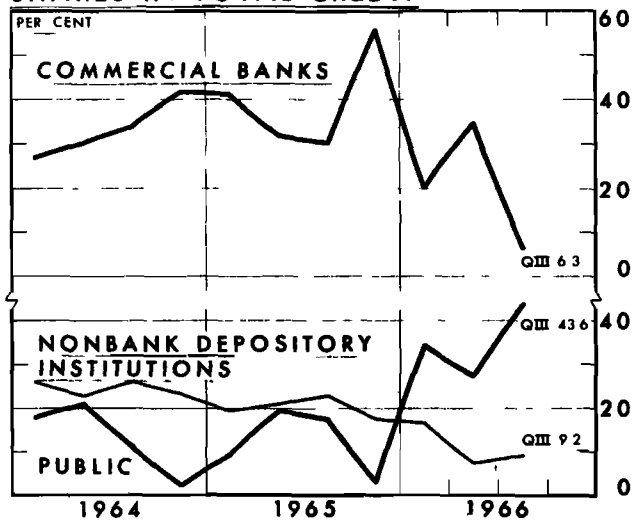


FINANCIAL DEVELOPMENTS - UNITED STATES

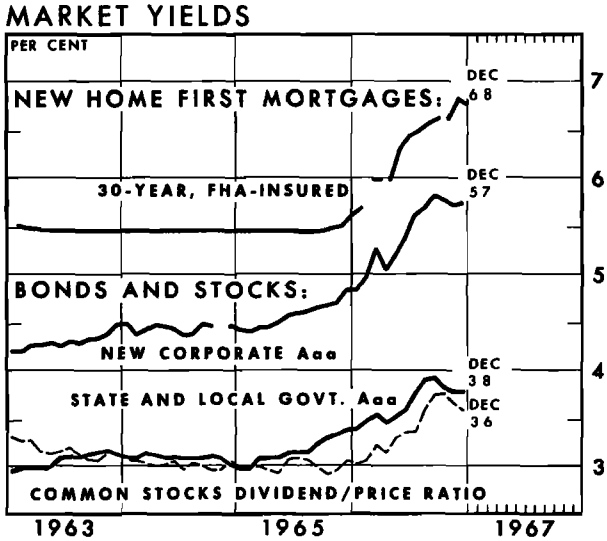
NET FUNDS RAISED-NONFINANCIAL SECTORS



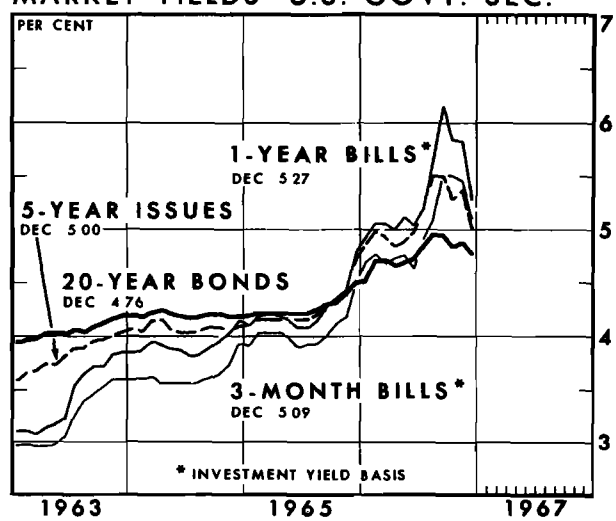
SHARES IN TOTAL CREDIT



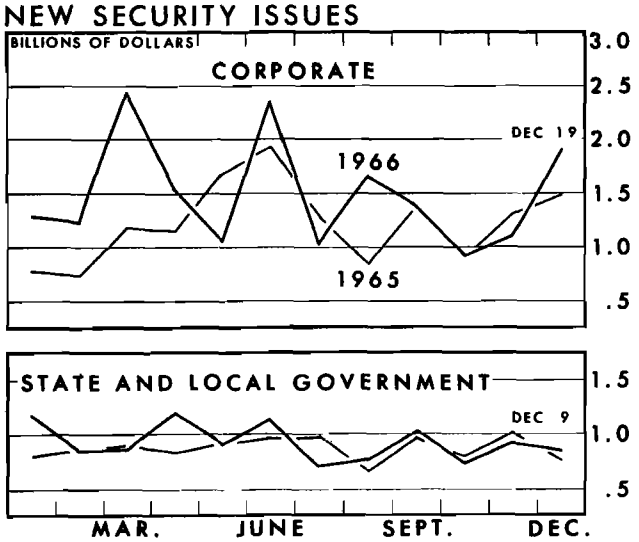
MARKET YIELDS



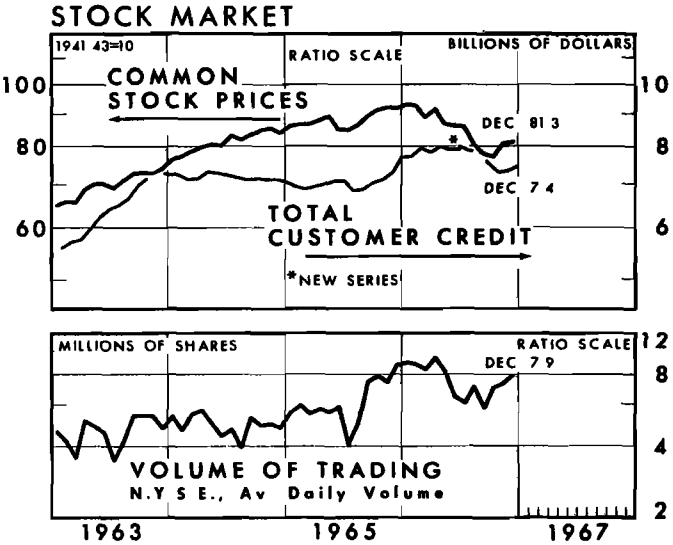
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Large net receipts at the end of December produced a surplus of $750 million for the month on the liquidity basis, not seasonally adjusted, offsetting much of the large October and November deficits. For the fourth quarter the deficit seasonally adjusted was $500 million, and for the year $1.4 billion. In early January, there were apparently large net payments, and weekly indicators point to a deficit for the month.

The December results benefited not only from year-end receipts -- including $600 million of official receipts from the United Kingdom and Germany -- but also from acquisitions by foreign monetary authorities of more than $300 million of non-liquid assets, primarily long-term CD's.

The balance measured by official reserve transactions was not affected by these shifts in holdings of foreign monetary authorities. In December, there was nevertheless a surplus of $130 million on this basis, and for the year a surplus of $175 million -- both results reflecting net inflows of foreign private liquid funds. In January there was apparently a substantial deficit on official reserve transactions, primarily reflecting (1) very large reflows of funds into sterling (which produced dollar accruals for the Bank of England) and probably also (2) the repayment by the BIS of the swap drawing on the System that had been made in late 1966. (Repayment of this drawing reduced U.S. reserve assets, while the accompanying withdrawal of funds

by the BIS from the Euro-dollar market would have tended to reduce U.S. liquid liabilities to commercial banks abroad rather than to central banks.)

The BIS withdrawal of funds from the Euro-dollar market, and the inflows into sterling, largely on a covered basis, have been reflected in a somewhat reduced level of outstanding borrowings of Euro-dollars by U.S. banks through their foreign branches, compared to December. Liabilities of U.S. banks to their foreign branches on balance changed very little since early January -- about $700 million below their December peak -- whereas, in earlier years there has been some seasonal increase in liabilities during January. Nevertheless, liabilities to branches, at more than $3-1/2 billion on January 25, were $1-1/2 billion above the level of last spring, while Euro-dollar interest rates have declined to the levels that obtained at that time.

Recent data on U.S. merchandise trade appear to reflect the slowing of economic activity in this country, and also in some countries abroad. Data on U.S. private capital flows do not extend beyond December, except for information on new issues of foreign securities, and show only fragmentary evidence of changes that might be interpreted as a response to easier credit conditions in the United States.

In the fourth quarter, the trade surplus advanced to an annual rate of $3-1/2 billion from the cyclically low $3.1 billion third quarter rate. After having risen rapidly since early 1964, imports levelled at an annual rate of $26.7 billion in the fourth quarter, while exports -- despite a decline in December[1/] from the

1/ The seasonal adjustments applied to imports and exports for December may understate both figures somewhat, since the adjustments do not take account of last year's changes in Census Bureau procedures for handling documents, which reduce the amount of year-end "clean-up."

high October-November average -- advanced by 2 per cent from the third quarter to an annual rate of $30.2 billion (estimated balance of payments basis).

A further increase in imports of machinery and motor vehicles in the fourth quarter was offset by declines in imports of industrial materials, food and consumer goods other than autos. The decline in imports of industrial materials included a fall-off in imports of steel and petroleum which had bulged high in the third quarter; but imports of other materials (constituting 30 per cent of total imports) also fell in the fourth quarter after having levelled off in the third quarter. The fourth quarter decline in imports of consumer goods other than autos was rather small, but it followed a 25 per cent annual rate of growth in purchases of these goods between early 1965 and mid-1966.

Agricultural exports declined from the third to the fourth quarters, while non-agricultural exports rose. However, strength in

U.S. EXPORTS
(billions of dollars, seasonally adjusted annual rates)

	1965	1966	1966		
			1st Half	3rd Qtr.	4th Qtr.
Agricultural	6.3	7.1	6.8	7.4	7.1
Non-agricultural, excl. military grant aid	20.1	22.4	21.9	22.6	23.2
Total, Census basis	26.4	29.5	28.7	30.0	30.3
Total, Balance of Payments basis	26.3	29.3e/	28.6	29.8	30.2e/

e/ Estimate.

non-agricultural exports was confined to aircraft and motor vehicles and parts; all other non-agricultural exports together declined a little. The sharp rise in shipments of motor vehicles and parts to Canada is a continuation of the growth that resulted from the Canadian auto agreement in 1965. Aircraft exports (civilian and military) increased in the fourth quarter by about $70 million to almost $400 million, about the same rate of sales as in the first two quarters of the year.

Exports averaged larger in October-November than in the third quarter to Japan, Continental Western Europe, Australia and South Africa, and to some less-developed countries outside Latin America. (Inclusion of December data, not yet available, might alter these comparisons.) The sharp rise in exports to Canada shown in the chart at the end of this section represents entirely the October-November expansion of auto shipments; all other exports to Canada were little changed. Exports to the United Kingdom continued to decline.

Net outflows of short-term bank credits in the fourth quarter exceeded by almost $150 million the amount to be expected on seasonal grounds alone. They consisted primarily of credits to Latin America and (in October and November, when the Euro-dollar market was particularly tight) to Europe. Outstanding credits to Japan, which had declined throughout most of last year as Japanese borrowers obtained financing elsewhere, rose less than seasonally in December. For the year as a whole, there was little net change in total outstanding short-term credits to foreigners.

There were further net repayments ($180 million, seasonally adjusted) of long-term bank loans in the fourth quarter, and for the year reflows of such credits totaled $340 million. New commitments on long-term loans to foreigners in 1966, and particularly after mid-year, were down from the $100 million monthly average of the last three quarters of 1965. As shown in the table, the reduction in the total was accounted for entirely by a decline in commitments to developed countries. In both periods, however, new commitments were made to a fairly wide range of developed countries, and in each period commitments to finance U.S. exports accounted for about 40 per cent of the total to developed countries. At least some of the decline in commitments to developed countries may reflect use of alternative sources of financing by borrowers in these countries.

COMMITMENTS ON LONG-TERM LOANS TO FOREIGNERS
(millions of dollars, monthly averages)

		Developed Countries	Less Developed Countries	Total
1964		112	73	185
1965	I	215	120	335
	II	45	54	100
	III	32	40	72
	IV	53	70	122
1966	I	17	54	71
	II	28	58	86
	III	12	48	60
	IV*	10	55	65

*/ still incomplete.

Money markets and interest rates abroad. Developments in the United States, Germany, and Britain in the past two months have brought a decisive decline in interest rates from last autumn's peaks.

90-DAY RATES
(per cent per annum)

	End of January 1966	Middle of September 1966	Near end of January 1967
U.S. Treasury bills	4.6	5.4	4.5
U.S. C.D.'s (secondary market)	5.0	5.9	5.2
U.S. Federal funds	4.6	5.8	5.2
Euro-dollar deposits	5.3	6.8	5.5
German inter-bank loans	5.1	6.9	5.6
U.K. Treasury bills	5.4	6.6	6.0
U.K. local authority deposits	6.2	7.5	6.6

In Germany, the cautious reduction of the Bundesbank's rediscount rate from 5 per cent to 4-1/2 per cent on January 6 was followed on January 19 by a reduction (effective February 1) in reserve requirement ratios on the banks' foreign liabilities -- which, for example, cut requirements against time deposits at the largest banks from 20 per cent to 9 per cent. This partly offset the increase in effective requirements at the beginning of the year that resulted from removal of the privilege of deducting foreign assets from liabilities. Meanwhile, with the balance of payments in surplus, Bundesbank purchases of foreign exchange continue to supply reserve funds to the banking system. Yields on German Government long-term bonds have fallen further to around 7.33 per cent, compared with a peak of about 8-1/2 per cent last July.

In England, the reduction of Bank rate from 7 to 6-1/2 per cent on January 26 ratified the decline that had already occurred in sterling money market rates in expectation of this action. The downward movement of U.K. long-term rates from their peak last September, briefly interrupted in November, has proceeded further in the past two months; War Loan yielded 6.71 per cent this week compared with a peak of 7.31 per cent in early September. Despite the decline in short-term sterling interest rates and a continuing forward discount on sterling in the exchange markets, covered yield differentials have favored switching from Euro-dollars into sterling, and substantial movements occurred during January, to the benefit of the U.K. official reserve position.

The drop in Euro-dollar rates since early December has been much more than the one-half percentage point or so that would be expected seasonally. The extra decline no doubt reflects the change in U.S. money market conditions, and may have included an expectational element as well. Liabilities of U.S. banks to their foreign branches have been reduced considerably from their December peak, releasing Euro-dollar funds for other uses. Probably the flow of funds into sterling assets has been fed also by movements, partly seasonal, out of continental European money markets, either directly or via the Euro-dollar market.

Both the Bank of Canada and the National Bank of Belgium have reduced their Bank rates from 5-1/4 per cent to 5 per cent, effective January 30 and February 2, respectively.

Business conditions in Germany and Britain. The last several month's rise in seasonally adjusted unemployment in both these countries appeared to be tapering off in December and January, but this may have been

a result of unusually good weather rather than changes in demand trends. For both countries the industrial production declines to November (latest available) were especially sharp in automobiles, and also in steel and in textiles and apparel -- probably a sign that in these cycle-sensitive industries users' inventories were being cut back. So far no clear indications have appeared of an upturn in new orders or production in either country. However, in Germany changes in financial markets and budgetary developments appear to be generating some optimism about the business future. The budget-balancing actions submitted to Parliament last week are largely nominal, a contingency program of public works has been proposed, and depreciation allowances are to be accelerated.

The evidence from France now shows a decided slowing of expansion last fall, no doubt partly in reaction to the easing of demand in Germany and Britain. Output declines are evident for autos -- following a very good 1965-66 year -- and for textiles. There was also a dip in total French imports in November; up to October they had been rising rapidly.

Basic commodity prices abroad. The easing of demand last year in Britain and Germany may have been a significant factor behind the decline in primary commodity prices on world markets. Indexes that include the London Metals Exchange price of copper -- which fell 40 per cent from an extraordinary peak caused by supply uncertainties -- show declines of well over 10 per cent from last spring to late summer. Prices were of course affected by varying supply conditions and by the workings of governmental stabilization arrangements, but declines in prices of materials such as metals, fibers, and natural rubber were sufficiently general to indicate the influence of an easing in industrial demand for use or for inventory.

Since September, movements in raw material and foodstuff prices have been diverse, and indexes of such prices have fluctuated with no clear tendency to advance or fall further.

Prices in industrial countries. In almost all European countries and in Canada and Japan -- as well as in the United States -- consumer price averages showed larger increases than prices of manufactures at the wholesale level in the twelve months through November 1966. However, after the spring of last year, the pace of consumer price advances tended to moderate, reflecting generally slower increases in demand. The United States and Canada were notable exceptions to this pattern of moderating rise in consumer prices and so, to a lesser extent, was France.

CHANGES IN CONSUMER PRICES, SELECTED INDUSTRIAL COUNTRIES
(per cent)

	Change from 12 months earlier				
	Nov. 1965	Feb. 1966	May 1966	Aug. 1966	Nov. 1966
Belgium	+ 4.1	+ 4.7	+ 5.0	+ 3.6	+ 3.5
France	+ 2.5	+ 2.7	+ 2.9	+ 2.7	+ 2.9
Germany	+ 3.8	+ 4.3	+ 4.5	+ 2.9	+ 2.9
Italy	+ 3.2	+ 2.9	+ 2.7	+ 2.0	+ 2.1
Netherlands	+ 5.2	+ 7.7	+ 6.6	+ 5.8	+ 4.9
Sweden	+ 5.4	+ 8.1	+ 8.0	+ 5.2	+ 5.7
United Kingdom	+ 4.4	+ 4.5	+ 3.9	+ 3.9	+ 4.0
Japan	+ 6.1	+ 6.2	+ 4.9	+ 4.8	+ 4.1
Canada	+ 3.1	+ 3.5	+ 3.9	+ 3.9	+ 3.8
United States	+ 1.8	+ 2.5	+ 2.7	+ 3.5	+ 3.6

Wholesale prices of manufactures also tended to advance more slowly after the spring of 1966 than before. Some of the indexes given in the following table (especially the French one) were affected in some degree

by the sharp run-up in raw material prices (e.g., copper and hides) in the early months of 1966 and their subsequent decline. In no countries but the United States did the indexes selected for use in this table show accelerating rises in wholesale prices of manufactures in the latter part of 1966.

CHANGES IN WHOLESALE PRICES OF MANUFACTURES, SELECTED INDUSTRIAL COUNTRIES
(per cent)

	Change from 12 months earlier				
	Nov. 1965	Feb. 1966	May 1966	Aug. 1966	Nov. 1966
Belgium	+ 1.1	+ 2.9	+ 2.6	+ 1.8	+ 2.2
France a/	- 0.1	+ 2.3	+ 3.8	+ 3.0	+ 1.9
Germany b/	+ 1.9	+ 1.9	+ 2.9	+ 3.1	+ 2.0
Italy b/	- 0.8	+ 0.6	+ 1.3	+ 1.5	+ 0.9
Netherlands	+ 2.7	+ 5.4	+ 4.5	+ 5.4	+ 5.4 c/
Sweden	+ 2.6	+ 3.6	+ 3.4	+ 3.5	+ 2.6
United Kingdom d/	+ 2.9	+ 2.2	+ 2.6	+ 2.9	+ 2.5
Japan e/	+ 3.1	+ 2.7	+ 2.4	+ 2.4	+ 2.5
Canada	+ 3.2	+ 4.0	+ 2.4	+ 3.0	+ 2.4
United States f/	+ 1.1	+ 1.3	+ 1.8	+ 2.0	+ 2.5

a/ Intermediate products. No index for prices of finished manufactures is available.
b/ Investment goods.
c/ September 1966.
d/ Excluding food.
e/ Finished goods.
f/ Industrial products (not including industrial materials).

In comparison with average prices advances over the six years from 1960 to 1966, last year's increases at both retail and wholesale were below average in Germany, France and Italy, and above average in the United States, Canada, and (for wholesale prices of manufactures) in Japan. In each of the latter three cases, however, the 1960-66 rises had been relatively small.

Consumer prices have risen most rapidly over the past six years in Japan, Italy and the Scandinavian countries (including Denmark and Norway, not shown in the following table).

PRICE INCREASES IN SELECTED INDUSTRIAL COUNTRIES, 1960-1966[1/]
(per cent)

Country [a/]	Consumer Prices		Wholesale Prices of Manufactures
	Total	Food	
Japan	+ 44	+ 47	+ 9 [b/]
Italy	+ 31	+ 29	+ 10
Sweden	+ 29	+ 39	+ 19
Netherlands	+ 26	+ 29	+ 18 [c/]
United Kingdom	+ 25	+ 25	+ 15 [d/]
France	+ 25	+ 27	+ 13 [e/]
Germany	+ 20	+ 17	+ 17 [f/]
Canada	+ 14	+ 17	+ 12
United States	+ 11	+ 13	+ 4 [g/]

1/ Increases from 1960 average to November 1966.
a/ Listed in order of increase in total consumer prices in 1960-66.
b/ Finished goods.
c/ Through September.
d/ Excluding food.
e/ Intermediate goods.
f/ Investment goods.
g/ Industrial products, excluding industrial materials.

Export unit values continued to rise through the third quarter of 1966 in a majority of the industrialized countries, with 12-month advances in the range of 1 to 3 per cent. However, export unit values again declined in Italy and Japan, as in the previous year. For the United States, data are not available beyond the second quarter of 1966; the index for that period was unchanged from a year earlier.

CHANGES IN EXPORT UNIT VALUES IN SELECTED INDUSTRIAL COUNTRIES
(per cent)

	1964 Q-3 to 1965 Q-3	1965 Q-3 to 1966 Q-3
Increasing in 1966:		
Canada	+ 0.9	+ 3.4
France	+ 1.9	+ 2.7
Germany	+ 2.0	+ 1.3
Netherlands	+ 2.9	+ 3.4
Sweden	+ 2.9	+ 1.8
United Kingdom	+ 1.9	+ 3.1
Declining in 1966:		
Italy	- 2.0	- 1.8
Japan	- 2.1	- 1.3
United States	+ 2.9	0. a/

a/ 1965 Q-2 to 1966 Q-2.

The Japanese consumer price rise last year, though larger than those in many other industrialized countries, was below average for Japan; this is partly explained by absence of the usual annual governmental action to raise the retail price of rice.

In Italy, the continuation of relatively slow price advances despite rapid growth in output has reflected both the absence of inflationary wage increases and the availability of less-than-fully-utilized manufacturing capacity. Productivity gains undoubtedly much exceeded the 4 per cent increase in contractual wage rates in Italian industry in the twelve months through October.

In the Netherlands, after rapid price increases at the beginning of 1966, a freeze was imposed in May. Meat prices declined following the end of an epidemic of hoof-and-mouth disease, and the easing of over-all demand in the Netherlands has helped to keep prices under control. However,

wholesale prices of manufactured goods have continued to rise; under the terms of Dutch price control measures, increases in raw material prices may be passed on in higher prices.

In Britain, increases in both retail prices and wholesale prices of manufactures slowed in the second half of 1966, after imposition in July of a freeze on all prices with exceptions only for increases necessitated by unavoidable cost rises, including indirect taxes. The price freeze ended on January 1, but the authorities have made clear that during the current period of "severe restraint" they will continue to use their powers to prevent price increases not justified by unavoidable cost rises. The absence of any fast expansion in demand is tending to minimize upward pressures on prices.

In France, productivity gains and labor force increases have kept labor markets sufficiently free of tensions so that the rise in wage rates has held steady, at 6 per cent, for the past year. The steady but moderate rise in prices reflects cost-push as well as demand forces, but neither have intensified over the past year.

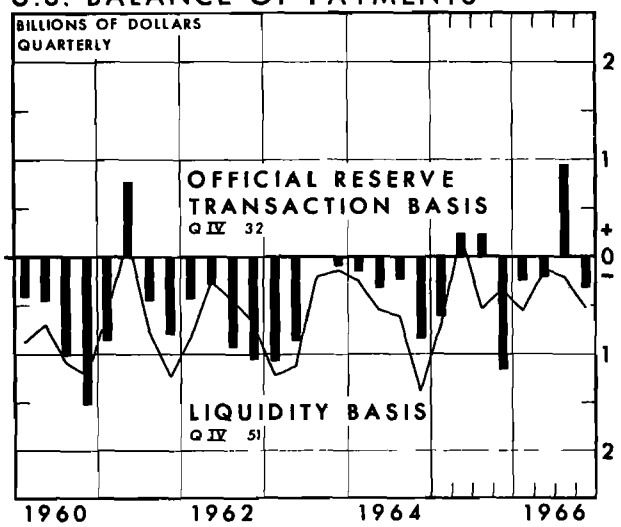
Prices in Germany appear to be rising more slowly now than in the first few months of 1966. Important elements in the consumer price rise at that time had been sharp advances in rents and in the cost of services and transportation, stemming largely from governmental action to relax rent control and to increase transportation charges. In the light of the general easing in over-all economic activity in Germany, one official forecast has predicted that the total consumer price index will rise by only 2 per cent in 1967, compared to an increase of about 3 per cent in 1966.

The Canadian consumer price index rose somewhat more rapidly last year than in 1965, with increases concentrated in services and food; prices of durables rose only fractionally.

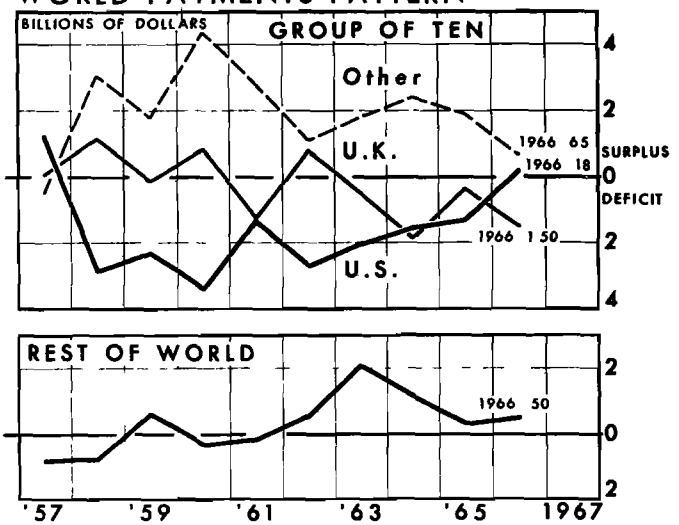
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

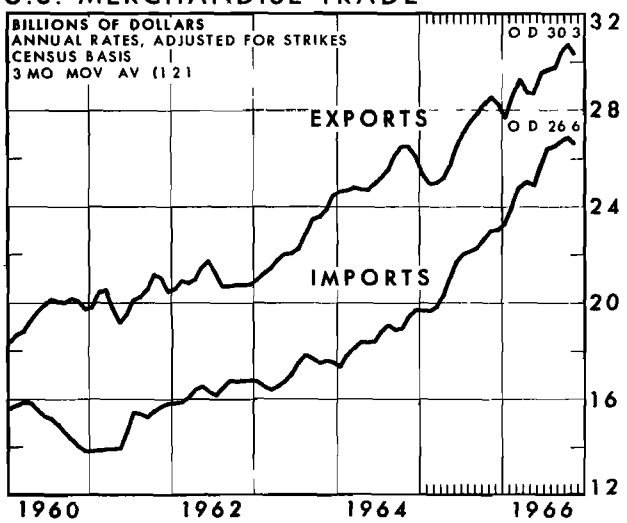
U.S. BALANCE OF PAYMENTS



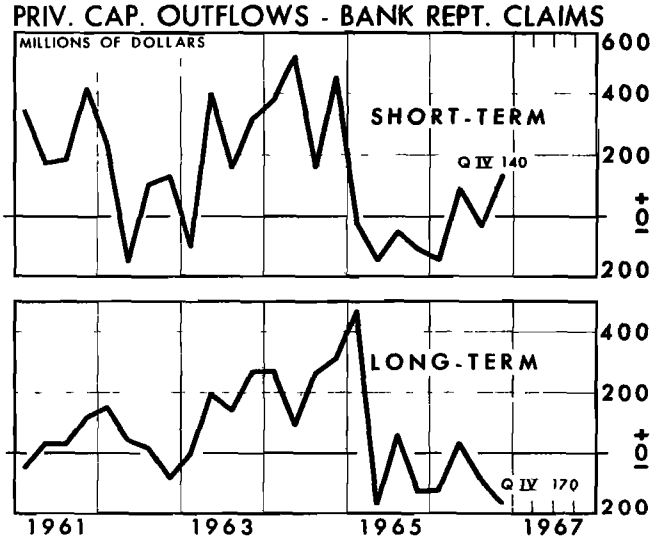
WORLD PAYMENTS PATTERN



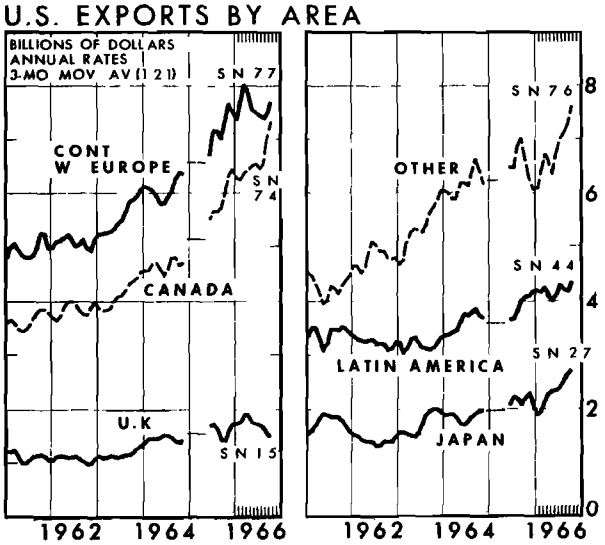
U.S. MERCHANDISE TRADE



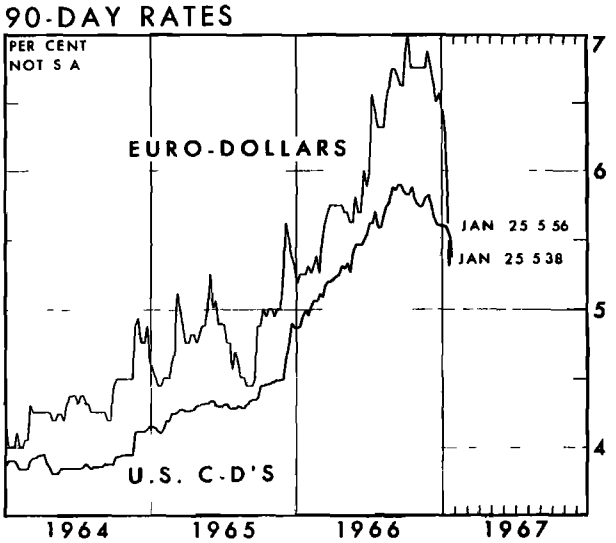
PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



U.S. EXPORTS BY AREA



90-DAY RATES



APPENDIX A: THE FEDERAL BUDGET*

The President's Budget Document predicts Federal deficits on all three bases in fiscal 1967 and 1968. All of the deficits would be even larger if the proposed $5 billion tax increase is not enacted. The NIA budget, stressed by the Document because of its greater usefulness for economic analysis, shows the smallest deficit of the three types; the cash deficit is larger because it includes a sizeable amount of net lending (which is a cash expenditure but not a NIA expenditure), and the administrative deficit is even larger because it excludes the surplus-prone trust funds.

The first table gives the three budgets for fiscal 1966, 1967, and 1968. Both receipts and expenditures are expected to grow rapidly in all budgets, with expenditures generally growing somewhat more rapidly to create the increasing deficits.

TABLE I

FEDERAL BUDGETS BY FISCAL YEARS
(In billions of dollars)

	1966 actual	1967 projected	1968 projected
NIA Budget:			
Receipts	132.6	149.8	167.1
Expenditures	132.3	153.6	169.2
Surplus or deficit	.3	- 3.8	- 2.1
Cash Budget:			
Receipts	134.5	154.7	168.1
Expenditures	137.8	160.9	172.4
Surplus or deficit	- 3.3	- 6.2	- 4.3
Administrative Budget:			
Receipts	104.7	117.0	126.9
Expenditures	107.0	126.7	135.0
Surplus or deficit	- 2.3	- 9.7	- 8.1

* Prepared by Government Finance Section

The major increases in expenditures are for National Defense and Social Security. Other civilian expenditures are projected to show a rather small increase. Table II gives this information on an NIA basis (thus eliminating the effect sales of participation certificates).

TABLE II

PROJECTED GROWTH IN FEDERAL EXPENDITURES, FISCAL YEARS
(Billions of dollars)

	1966 actual	1967 proj.	1968 proj.	Change	
				1966-67	1967-68
National Defense	56.5	68.3	74.1	11.8	5.8
Health & Welfare	33.0	39.2	46.4	6.2*	7.8*
Space	5.9	5.6	5.3	- .3	- .3
Great Society Sector**	12.0	14.0	14.9	2.0	.9
All other***	24.9	26.5	28.5	1.6	2.0
Total	132.3	153.6	169.2	21.3	16.2

* Includes increased Social Security payments and Medicare payments.
** Education, Housing, Communication, and Transportation, National Resources.
*** Int. Affairs, Agriculture, Veterans, Interest, General Government.

The projected growth in revenues has two explanations. First, a succession of discretionary tax rate changes are expected to result in revenue increases of $8.0 in fiscal '67 and $5.1 billion in fiscal '68. The important changes are the 1966 increase in Social Security tax rates and the proposed surtax on corporate and personal incomes. Over and above these discretionary changes, revenues are expected to grow with the growth in projected income. Table III breaks down the growth in revenue into these two components for each type of tax. The table suggests that the Budget Document has projected quite an optimistic automatic revenue increase between fiscal 1967 and 1968, but it is not clear whether this optimism pertains to the level of income in January-June 1968 or to the relationship between revenues and income.

TABLE III

PROJECTED GROWTH IN REVENUES
(Billions of dollars)

	1966 actual	1967 proj.	1968 proj.	Change 1966-67	Change 1967-68
Personal taxes	57.9	65.5	76.8	7.6	11.3
Discretionary	--	--	--	1.2	3.4*
Automatic	--	--	--	6.4	7.9
Corp. taxes	30.7	32.3	35.3	1.6	3.0
Discretionary	--	--	--	.6*	.7*
Automatic	--	--	--	1.0	2.3
Social Insurance	28.1	35.5	38.1	7.4	2.6
Discretionary	--	--	--	5.8	1.0
Automatic	--	--	--	1.6	1.6
Indirect taxes**	15.9	16.5	16.9	.6	.4
Total revenue	132.6	149.8	167.1	17.2	17.3
Discretionary	--	--	--	8.0	5.1
Automatic	--	--	--	9.2	12.2

* Proposed surtax.
** Discretionary changes are small and mutually offsetting.

Another highlight pertains to the credit programs embodied in the budget. These credit programs involve a simple transfer of assets between the Government and the private sector, and for this reason are not included in the NIA budget. Yet they do affect the liquidity of the private sector, and are important from a monetary and economic stabilization standpoint.

The table IV gives information on net new lending by the Government. According to the Document projections, the large amount of net lending the Government has been doing for the past few years will begin to tail off in fiscal 1968. New loans are expected to run at about the same rate, but more of the loans will be sold to the private sector in the form of participation certificates. There also is projected to be a shift in the timing of new loans. In fiscal years 1966 and 1967 most of the new loans came and are expected to come in the January-June period, primarily because of the large spring outflows from the Federal Home Loan Banks. But in fiscal 1968 the FHLB is expected to stop its January-June net lending, and with it the seasonal pattern of total Federal lending will change markedly.

TABLE IV

FEDERAL CREDIT PROGRAMS

	1965	1966		1967		1968	Fiscal years		
	II	I	II	I	II	I	1966	1967	1968
Total new loans	1.6	4.7	2.4	4.5	3.6	3.2	6.3	6.9	6.8
Less: Sales of participation certificates to public	.9	2.2	-.5	3.1	2.5	2.5	3.1	2.6	5.0
Net Govt. lending	.7	2.5	2.9	1.4	1.1	.7	3.2	4.3	1.8