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Content last modified 6/05/2009.

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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

January 6, 1971

TABLE OF CONTENTS

SUMMARY AND OUTLOOK

Nonfinancial

Real GNP apparently declined at an annual rate of around 2-1/2 per cent in the fourth quarter of 1970, reflecting the extended GM strike. Even in the absence of a strike, however, any increase in real GNP would have been quite modest.

Industrial production in December is tentatively estimated to have increased about 2 points, or 1.2 per cent, to a level 6.5 per cent below the July 1969 high. The December rise resulted from higher output at GM and related supplying industries, and present schedules suggest a further recovery in auto and truck output in January. Production of defense and business equipment, exclusive of trucks, is estimated to have declined further in December.

Some indicators have been showing strength not related to the ending of the strike, such as housing starts and new orders for capital equipment. Retail sales also are estimated to have risen in December, even apart from autos, mainly reflecting strength late in the month. Book value of manufacturers' inventories, however, rose sharply in both October and November.

In the labor market, manufacturing employment--and presumably total nonfarm employment--increased sharply, reflecting the return to work of some 350,000 strikers plus recalls of workers laid off in supplying industries. Although both initial unemployment claims and insured unemployment apparently declined somewhat in December, they remained far above the levels of a year earlier. Seasonal employment gains in retailing reportedly fell short of usual expectations, however, and it should be noted that most such temporary employees would not have been eligible for unemployment compensation.

The GNP price deflator is now estimated to have increased at an annual rate of 4.8 per cent in the fourth quarter--somewhat faster than in the third--mainly reflecting a compositional shift away from autos. Seasonally adjusted prices of industrial commodities at wholesale increased moderately in December, while wholesale prices of farm products and foods declined further. And the rise in the consumer price index slowed appreciably in November.

Outlook. We are projecting a very large increase in GNP this quarter--$29 billion--mainly because of the post-strike resurgence in output at auto plants and related activities. Real GNP is expected to rise at an annual rate of 7 per cent, faster than indicated in our preceding projection.

For the fourth and first quarters combined, real growth is still expected to average only about 2-1/4 per cent, and to continue at about this rate in the second quarter of 1971. Expansion in real GNP is projected to pick up only moderately thereafter, to around a 3 per cent annual rate. A major factor holding down expansion throughout the year is the relative weakness indicated for business capital outlays. For the year as a whole, business fixed investment is projected to remain about unchanged from 1970 in current dollars and to decline significantly in real terms. Residential building is expected to rise throughout the year, while consumer spending is projected to increase about in line with disposable income.

Projected growth in real GNP thus falls well short of potential in 1971, suggesting a continued rise in the unemployment rate and a manufacturing capacity utilization rate that remains depressed. With further easing in resource use, we still look for a gradual slowing in the price deflator to an annual rate of increase of about 3.5 per cent in the fourth quarter.

Financial

Security yields stopped declining around mid-December and by early January had risen in some key market sectors by about 25 basis points. The halt in the rate decline developed as investors balked at aggressive underwriter pricing of new corporate and municipal bond offerings. To some extent this resistance reflected a larger than anticipated December flow of such issues--particularly in the municipal market. But investors also began to look ahead to a heavy continuing new issue volume early in 1971, and to the possibility that the Treasury might combine a sizeable pre-refunding with its large regular February refinancing. As investors backed off, dealers and underwriters became a bit restive about their large accumulated inventories.

Despite the back up of market rates, weak loan demands over the mid-December corporate tax payment date triggered a further reduction in the bank prime rate. While the ending of the GM strike helped to moderate the degree of business loan contraction for all of December relative to preceding months, the trend of outstanding business loans (adjusted for loan sales) nevertheless continued down. Another prime rate cut--to 6-1/2 per cent--was initiated by a medium-sized bank early in January, but it is not yet clear how other major banks and financial markets will respond to this lead.

Growth of consumer-type time and savings deposits was especially rapid in Decmeber. Banks also elected to increase sales of large CD's, and demand deposits--although falling short of the targeted path--grew much more rapidly than in earlier months of the quarter. A sizeable part of these expanded deposit flows was used to finance the enlarged inventories of dealers and underwriters, a part went for increased consumer and mortgage loans, and bank reliance on non-deposit sources of funds was reduced further. However, the bulk of the large December increase in total bank credit went into new investments--as in earlier months of the quarter--reportedly including an increasing amount of longer-maturity municipal bonds. At non-bank thrift institutions, December deposit inflows apparently also remained relatively strong, contributing further to the recent dramatic improvement of mortgage markets.

Outlook. The new year appears to be starting with a somewhat larger prospective volume of new security offerings than seemed likely a month ago. In addition to the possibility of a large, complicated Treasury pre-refunding and "rights-cash" refinancing (on which terms would be announced January 20, with books open the following week), the January flow of new publicly-offered corporate bonds is now projected to be only slightly smaller than the large average monthly volume of the fourth quarter. While corporate bond volume should taper off somewhat thereafter, underwriters nevertheless expect it to remain relatively large. Municipal bond volume still seems likely to reach a new record in the first quarter, as the backlog of previously post-poned borrowing comes on to the market. But Federally sponsored housing agencies will not be adding to demand pressures in the first quarter, since they are scheduled to repay nearly $1 billion of outstanding debt over the period.

An increase in short-term borrowing demands can be expected in consequence of the projected first quarter spurt in economic activity. Part of these demands will very likely fall on banks, which reportedly have been promoting new loan commitments more aggressively in recent months. However, much of the expanded financing immediately associated with the renewal of General Motors production and sales can be expected to occur through the commercial paper market. Moreover, with commercial paper rates holding about a percentage point below the 6-3/4 per cent prime rate, active bank participation in business financing will probably require an across-the-board reduction of the prime rate from that level.

Unless the money supply grows at a faster rate than in the quarter just ended, the anticipated near-term increase of short-term borrowing may constrain further declines of short-term rates in the period immediately ahead. Short rates will also be affected by downward seasonal influences and by whether or not market expectation of an across-the-board cut in the prime rate and a further drop in the discount are realized. Long-term rates are likely to decline, on balance, given the prevailing wide spreads between short-and long-term rates and continued availability of institutional credit, although heavy new issue volume and large dealer inventories might be temporary inhibiting factors.

Balance of Payments

In November, for the fourth month in succession, U.S. foreign trade results failed to meet expectations. Exports declined in total, and their October-November average was 5 per cent below the June-July high. Imports, on the other hand, were above their projected path, and the two latest months averaged 7 per cent above June-July. Thus, after briefly reaching a high of $5 billion (annual rate) around midyear and averaging about a $3 billion rate in the second and third quarters, the trade surplus fell nearly to zero in October-November.

These developments are difficult to explain simply in terms of changes in total demand abroad or in this country. It is true that total industrial production and new domestic orders in major industrial countries abroad have been pretty flat since last spring and summer, but this alone would hardly explain so marked a decline in U.S. exports. And why have U.S. imports risen so much at a time of slack demand in this country?

Upward price pressures on goods and services have continued strong almost everywhere, and it appears that the prices we have been paying on our imports have risen more than the average prices on our exports. The pressures on prices abroad can be attributed in large part to rising unit labor costs. At the same time signs have not been absent in Europe of continuing pressures from the side of demand. In Britain, for example, where industrial production has risen since May, domestic new orders for machinery and equipment have continued to exceed deliveries. Elsewhere, capital expanditure plans have been sagging, but consumption continues to grow in real terms. In Germany, output of finished durable goods (including machinery and autos) rose in October, recovering a little of the ground lost since the spring. But the most significant development--from the point of view of U.S. exports--seems to have been a marked easing of demand for industrial materials in Europe and Japan.

Analysis of commodity composition suggests that the decline in total U.S. exports must be attributed in great part to the disappearance, since last spring, of the abnormally tight demand-and-supply conditions in foreign markets for many semimanufactured materials, including steel, which had been favoring U.S. exports in the first half of 1970. Greater availability of foreign supplies of such materials, coupled with aggressive selling by foreign producers, also helps to explain the considerable rise in U.S. imports in recent months. In addition, the underlying trend of growth in U.S. imports of finished manufactures was still outweighing cyclical influences on such imports at least through October.

Our estimate of net exports of goods and services in the final quarter of 1970 has now been reduced to $3 billion, annual rate, In the GNP projection for 1971 we are writing down net exports to about $4-1/2 billion ($1 billion less than the projection four weeks ago). Both these figures assume a trade balance in December substantially above the October-November level of $0.2 billion, annual rate, and if this does not materialize further revisions will be in order.

The hoped-for improvement in the over-all balance of payments in the fourth quarter seems not to have occurred. On preliminary indications, the adjusted liquidity deficit was about as large as in the third quarter. Substantial repatriations of corporate funds at the yearend, a seasonal consequence of the OFDI requirements appear to have been settled largely through U.S. bank branches abroad, with little effect on foreign exchange markets. Because of earlier repayments of U.S. bank liabilities to branches, the official settlements deficit for the fourth quarter as a whole was extremely large and brought the total for the year over $10 billion.

Pending a full review of the balance of payments prospects for 1971, it is safe to say that recent developments make the achievement of an adjusted liquidity deficit as low as $3 billion in 1971 less likely than it seemed at the time of the November chart show.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1970				Per cent Change* From		
	Aug.	Sept.	Oct.	Nov.	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	82.7	83.0	83.4	83.4	0.0	0.9	2.5
Unemployment rate (%)	5.1	5.5	5.6	5.8	--	--	[3.5] 4/
Insured unempl. rate (%)	3.7	4.1	4.4	4.4	--	--	[2.3] 4/
Nonfarm employment, payroll (mil.)	70.4	70.5	70.2	70.1	-0.2	-0.5	-1.0
Manufacturing	19.3	19.3	18.7	18.6	-0.7	-3.5	-7.4
Nonmanufacturing	51.1	51.2	51.5	51.5	0.0	0.7	1.5
Industrial production (57-59=100)	168.8	165.8	162.4	161.4	-0.6	-4.4	-5.8
Final products, total	166.5	163.0	159.7	159.1	-0.4	-4.4	-5.5
Consumer goods	163.5	160.1	157.0	156.9	-0.1	-4.0	-2.2
Business equipment	185.9	182.3	178.4	177.2	-0.7	-4.7	-8.8
Materials	171.2	169.0	165.2	163.6	-1.0	-4.4	-6.3
Capacity util. rate, mfg.	76.6	74.5	72.6	71.3	--	--	[81.5] 4/
Wholesale prices (57-59=100) 1/ 5/	117.2	117.8	117.8	117.7	0.1	0.0	2.3
Industrial commodities (FR)	116.1	116.3	117.2	117.2	0.0	0.9	3.6
Sensitive materials (FR)	114.5	114.0	113.0	111.3	-1.5	-2.8	-2.5
Farm products, foods & feeds 6/	117.0	118.5	116.0	115.6	-0.4	-2.9	-1.1
Consumer prices (57-59=100) 1/	136.0	136.6	137.4	137.8	0.3	1.3	5.6
Food	133.5	133.3	133.0	132.4	-0.5	-0.8	3.4
Commodities except food	123.0	123.8	125.0	125.7	0.6	2.2	4.6
Services	156.7	157.7	158.5	159.5	0.6	1.8	8.4
Hourly earnings, pvt. nonfarm ($)	3.26	3.27	3.28	3.28	0.0	0.6	4.8
Hourly earnings, mfg. ($)	3.41	3.42	3.38	3.39	0.3	-0.6	4.0
Weekly earnings, mfg. ($)	135.21	133.96	133.32	133.71	0.3	-1.1	1.4
Net spend. weekly earnings, mfg. (3 dependents 57-59 $) 1/	85.46	85.83	84.43	84.40	0.0	-1.2	-3.1
Personal income ($ bil.) 2/	806.4	812.0	811.0	812.4	0.3	0.7	5.4
Retail sales, total ($ bil.)	30.8	30.9	30.5	30.3	-0.5	-1.5	2.9
Autos (million units) 2/	8.4	7.1	6.1	5.0	-19.0	-40.7	-40.0
GAAF ($ bil.) 3/	8.3	8.2	8.5	8.5	0.6	2.8	6.8
12 leaders, composite (1967=100)	115.1	114.4	114.1	115.2	1.0	0.1	-1.9
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/	1,425	1,509	1,570	1,692	7.8	18.7	32.2
Factory workweek (hours)	39.8	39.3	39.4	39.5	0.3	-0.8	-2.5
Unempl. claims, initial (thous.)	298	342	340	334	1.6 7/	-12.2 7/	-59.2 7/
New orders, dur. goods, ($ bil.)	30.5	29.9	28.5	29.0	1.9	-4.9	-6.5
Producers capital goods indus.	6.3	6.8	6.6	6.9	5.8	10.1	2.8
Common stock prices (41-43=10)	77.92	82.58	84.37	84.28	-0.1	8.2	-12.4

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l. merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ December p. 117.8. Per cents indicated are from December.
6/ December p. 115.1. Per cents indicated are from December.
7/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	1970 Averages					1970 Week ended
	QI	QII	QIII	QIV	Dec.	Dec. 30
Interest rates, per cent						
Federal funds	8.56	7.88	6.71	5.57	4.90	4.82
3-mo. Treasury bills	7.21	6.67	6.33	5.35	4.87	4.87
3-mo. Federal agencies	7.72	7.09	6.67	5.50	4.94	4.97
3-mo. Euro-dollars	9.26	8.87	8.34	7.46	7.25	6.95
3-mo. finance co. paper	7.94	7.41	7.31	6.12	5.48	5.44
4-6 mo. commercial paper	8.55	8.16	7.73	6.28	5.73	5.75
Bond buyer municipals	6.35	6.81	6.33	5.92	5.45	5.58
Aaa corporate-new issues	8.45	8.94	8.51	8.26	7.80	--
20-year Treasury bonds	6.78	7.14	6.96	6.57	6.28	6.42
FHA mortgages, 30-year	9.25	9.12	9.06	n.a.	--	--

	1970				
	QI	QII	QIII	QIVp	Dec.p
Change in monetary aggregates (SAAR, per cent)					
Total reserves	-2.9	2.6	19.2	6.8	18.6
Nonborrowed reserves	-0.4	4.1	24.4	7.5	16.9
Credit proxy	0.6	6.0	24.1	14.7	20.3
Credit proxy + nondep. funds	0.5	6.5	17.2	8.0	15.0
Money supply	5.9	5.8	6.1	3.9	7.9
Time and savings deposits	1.4	14.1	32.2	21.6	28.3
Deposits at S&L's and MSB's	1.7	6.9	10.0	n.a.	n.a.
Bank credit, end-of-month 1/	2.5	6.6	13.9	5.3e	9.7e
Treasury securities	-12.3	30.2	25.9	-2.8e	14.9e
Other securities	9.5	11.0	20.3	32.0e	27.4e
Total loans 1/	3.4	1.4	9.8	-0.3e	3.3e
Business 1/	6.3	9.8	1.8	-9.2e	-5.4e

	1970				
	QI	QII	QIII	Oct.	Nov.
Change in commercial paper ($ millions)					
Total (SA)	3,185	2,091	-4,298	-104	-1,526
Bank-related (NSA)	2,226	1,033	-2,967	-919	- 573

	1968	1969			1970	
	QIV	QIV	Oct.	Nov.	Oct.	Nov.
New security issues (NSA, $ millions)						
Total corp. issues	5,950	6,840	1,933	2,375	3,800e	4,050e
Public offerings	4,029	5,786	1,619	2,148	3,400e	3,750e
State and local government bond offerings	4,366	2,982	1,280	886	1,860	1,600e
Fed. sponsored agency debt (change)	568	2,889	1,311	1,033	616	719e
Fed. govt. debt (change)	3,422	5,071	4,388	2,695	2,561	3,306

n.a. - Not available. e - Estimated. p - Preliminary.
SAAR - Seasonally adjusted annual rate. NSA - Not seasonally adjusted.
1/ Adjusted for loans sold to bank affiliates.

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

	1969 Year	1970 P I	II	III	Oct.*	Nov.*
Goods and services, net 1/	1,949	832	1,104	1,021		
Trade balance 2/	638	505	829	720	78	-43
Exports 2/	36,473	10,228	10,705	10,678	3,592	3,405
Imports 2/	-35,835	-9,723	-9,876	-9,958	-3,514	-3,448
Service balance	1,311	327	275	301		
Remittances and pensions	-1,190	-328	-360	-360		
Govt. grants & capital, net	-3,828	-855	-725	-759		
U.S. private capital	-5,233	-1,688	-1,870	-1,339		
Direct investment	-3,070	-1,411	-1,434	-759		
Foreign securities	-1,494	-133	66	-576	-196	1
Banking claims	-541	145	-445	126	-152	-213
Other	-128	-289	-57	-130		
Foreign capital	12,330	1,738	1,749	1,065		
Official foreign, liquid	-517	3,050	466	1,490	368	1,829
Official reserve holders, nonliquid	-996	-421	506	-244	-2	-62
Other official foreign, nonliquid	259	-32	-198	-1		
Foreign commercial banks, liquid	9,217	-1,865	-102	-1,375	-480	-1,400e/
New direct investment issues 3/	1,029	155	267	170		
U.S. corporate stocks	1,565	-85	-87	381	157	93
Other	1,773	936	897	644		
U.S. monetary reserves (inc.-)	-1,187	481	1,022	801	407	229
Gold stock	-967	-44	14	395	-1	17
Special drawing rights	--	-53	-37	-34	--	30
IMF gold tranche	-1,034	-253	227	406	121	11
Convertible currencies	814	831	818	34	287	171
Errors and omissions	-2,841	-182	-920	-428		
BALANCES (deficit -) 4/						
Official settlements, S.A.		-3,110	-1,994	-2,047		
" " , N.S.A.	2,700	-2,830	-2,061	-2,611	-773	-1,996
Liquidity, S.A.		-1,656	-1,451	-855		
" , N.S.A.	-7,012	-1,548	-1,426	-1,661	-313	-615
Adjusted over-all, S.A.		-1,245	-1,892	-672		
" " , N.S.A.	-6,517	-1,145	-1,874	-1,486	-293	-596
Financed by: 5/						
Liab. to comm. banks	9,217	-1,685	-187	-1,125	-480	-1,400e/
Official settlements	-2,700	2,830	2,061	2,611	773	1,996

* Only exports and imports are seasonally adjusted.
1/ Equals "net exports" in the GNP, except for latest revisions.
2/ Balance of payments basis which differs a little from Census basis.
3/ New issues sold abroad by U.S. direct investors.
4/ Excludes initial allocation of SDRs on January 1, 1970; total $867 million, quarterly S.A., $217 million.
5/ Minus sign indicates decrease in net liabilities. Data not seasonally adjusted.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. It now appears likely that GNP in the fourth quarter will increase by $5-1/2 billion, the same as our Greenbook estimate of last month. However, the implicit GNP deflator appears to have risen substantially more than indicated earlier and real GNP is now estimated to have declined by about 2-1/2 per cent, annual rate. The greater rise in the deflator apparently resulted in significant part from the sharp decline in auto sales which reduced their relative importance in GNP and raised the deflator since auto prices have increased less than the average of goods and services since the base period. The rebound of auto sales expected in the first quarter should have the reverse effect and operate to moderate the rise in the deflator.

GNP AND RELATED ITEMS, 1970
(Changes in seasonally adjusted totals at annual rates)

	Fourth Quarter	
	Projection of 12/9/70	Current Projection
	-----Billions of dollars-----	
GNP	5.4	5.5
Final sales	10.9	8.5
Personal consumption	6.7	7.0
Residential construction	2.8	3.2
Business fixed investment	-1.6	-2.6
Net exports	.7	-1.2
Federal purchases	- .8	- .6
State & local purchases	3.0	2.6
Inventory change	-5.5	-3.0
	-----Per cent per year------	
Real GNP	-2.0	-2.6
GNP deflator	4.2	4.8

Unit auto sales in December remained close to the very low November seasonally adjusted annual rate of 5.0 million. Continued weakness for the most part apparently resulted from the shortage of GM cars with the rate of sales picking up late in the month. However, this does not appear to be the full explanation, since sales of other makes continued unimpressive. Domestic auto sales now appear likely to average about 5-1/2 million annual rate for the fourth quarter as a whole, rather than the 6-1/4 million we had been projecting.

Retail sales, excluding autos, generally picked up in December, with most of the strength evident in the last pre-Christmas week. We have also raised our estimate of residential construction outlays to reflect recent strong increases in housing starts.

On the other hand, net exports weakened further in recent months. Data for November indicate that imports continued much stronger than anticipated, and exports dipped sharply for a wide range of commodities, possibly as a result of a moderating of severe demand pressures in western Europe and Japan. We have also cut our estimate of business fixed investment outlays by an additional $1 billion to reflect a lower rate of auto and truck purchases by business than estimated formerly.

On balance, final sales in the fourth quarter are now estimated to have increased by $8-1/2 billion, about $2-1/2 billion less than we had projected last month. On the other hand, we are now estimating some fourth quarter inventory accumulation, reflecting both the weakness in final demands and substantial increases in the book value of manufacturers' inventories in October and November. The projected decline in the rate of inventory investment between the third and fourth quarter is thus $2-1/2 billion less than we had previously estimated.

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rates)

	First Quarter		Second Quarter	
	Projection of 12/9/70	Current Projection	Projection of 12/9/70	Current Projection
	Billions of dollars			
GNP	26.6	29.0	16.5	15.5
Final sales	24.6	28.5	14.5	14.5
Personal consumption	16.7	17.9	9.9	11.0
Residential construction	2.3	2.7	1.5	1.3
Business fixed investment	.5	2.0	- .5	-1.0
Net exports	.5	1.4	.0	.0
Federal purchases	1.5	1.5	- .1	- .3
State & local purchases	3.1	3.0	3.7	3.5
Inventory change	2.0	.5	2.0	1.0
	Per cent per year			
Real GNP	5.8	7.0	2.7	2.2
GNP deflator	4.9 1/	4.6 2/	3.8	3.9

1/ Excluding effects of Federal pay increase, 4.0 per cent per year.

2/ Excluding effects of Federal pay increase, 3.8 per cent per year.

We are now projecting a larger post-strike rise in first quarter GNP than last time--$29 billion--in part because of the greater-than-expected strike effects in the fourth quarter. In real terms the GNP increase amounts to about 7 per cent (annual rate). In addition, Federal pay raises should add $2.8 billion to personal income somewhat earlier than had been expected and give further impetus to growth of consumer outlays this quarter. Moreover, some recovery is projected in net exports from the depressed fourth quarter level and the recent strong gains in housing starts and permits appear to assure larger increases in residential construction outlays in the first quarter than we had earlier expected.

The projections for the remainder of the year remain essentially unchanged from the preceding Greenbook. The second quarter GNP increase is expected to be much smaller following the catch-up in auto and truck output and sales. We are now projecting an increase of about $15-1/2 billion, excluding any allowance for a build-up of steel inventories as a hedge against a possible strike August 1. In real terms, GNP is expected to increase by about 2-1/4 per cent, annual rate, about the average of the two previous quarters.

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rates)

	Third Quarter		Fourth Quarter	
	Projection of 12/9/70	Current Projection	Projection of 12/9/70	Current Projection
	--------------Billions of dollars---------------			
GNP	16.0	16.5	17.5	17.5
Final sales	15.5	16.0	17.0	17.0
Personal consumption	9.6	9.8	11.0	11.1
Residential construction	1.5	1.1	1.4	1.2
Business fixed investment	.0	.5	.5	.5
Net exports	.0	.0	.0	.0
Federal purchases	.6	.6	.1	.2
State & local purchases	3.8	4.0	4.0	4.0
Inventory change	.5	.5	.5	.5
	------------------Per cent---------------------			
Real GNP	2.6	2.7	3.2	3.2
GNP deflator	3.6	3.6	3.4	3.4

We continue to expect moderately larger gains in real GNP in the second half of 1971. A more favorable financial atmosphere (we are now assuming 6 per cent growth in money supply in 1971) should be reflected in continued expansion of residential construction activity and in a more rapid rate of growth of State and local outlays. Growth of consumer outlays is expected to expand moderately further in line with disposable income, but recent surveys suggest little change in 1971 in fixed investment spending.

Real growth would still fall short of potential, averaging about 3 per cent in the second half, and we are projecting a continued increase in unemployment. As before, this projection is based on a slightly less than "normal" growth in the labor force and relatively small gains in productivity. Factory utilization rates would also remain depressed, as industrial production is expected to rise about in line with expansion of capacity. This further lessening of pressure on resources should contribute to some moderation in average price increases, and we continue to expect the rise in the GNP price deflator to slow gradually to about a 3-1/2 per cent annual rate of increase in the final quarter of the year.

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income figures are billions of dollars, with quarterly figures at annual rates.)

	1970 Proj.	1971 Proj.	1970 III	1970 IV	1971 Projection I	1971 Projection II	1971 Projection III	1971 Projection IV
Gross National Product	976.8	1044.3	985.5	991.0	1020.0	1035.5	1052.0	1069.5
Final purchases	973.6	1040.2	980.0	988.5	1017.0	1031.5	1047.5	1064.5
Private	753.1	806.9	759.0	765.5	789.5	800.8	812.2	825.0
Excluding net exports	749.4	802.5	754.8	762.5	785.1	796.4	807.8	820.6
Personal consumption expenditures	617.2	662.9	622.1	629.1	647.0	658.0	667.8	678.9
Durable goods	89.7	95.5	91.2	86.5	94.6	95.5	95.5	96.5
Nondurable goods	264.8	283.1	265.8	272.1	276.4	280.9	285.3	289.9
Services	262.7	284.3	265.1	270.5	276.0	281.6	287.0	292.5
Gross private domestic investment	135.4	143.7	138.3	135.9	141.1	142.4	144.5	146.7
Residential construction	29.8	36.9	29.2	32.4	35.1	36.4	37.5	38.7
Business fixed investment	102.5	102.6	103.6	101.0	103.0	102.0	102.5	103.0
Change in business inventories	3.2	4.1	5.5	2.5	3.0	4.0	4.5	5.0
Nonfarm	2.8	4.1	5.0	2.5	3.0	4.0	4.5	5.0
Net exports of goods and services	3.7	4.4	4.2	3.0	4.4	4.4	4.4	4.4
Gov't. purchases of goods & services	220.5	233.3	221.0	223.0	227.5	230.7	235.3	239.5
Federal	99.7	99.6	98.6	98.0	99.5	99.2	99.8	100.0
Defense	76.5	73.9	75.8	74.0	74.5	73.5	73.7	73.9
Other	23.2	25.7	22.9	24.0	25.0	25.7	26.1	26.1
State & local	120.9	133.6	122.4	125.0	128.0	131.5	135.5	139.5
Gross national product in constant (1958) dollars	724.7	742.4	727.4	722.7	735.4	739.4	744.4	750.4
GNP implicit deflator (1958 = 100)	134.8	140.7	135.5	137.1	138.7	140.1	141.3	142.5
Personal income	801.0	853.1	807.2	813.1	833.0	846.5	859.5	873.5
Wages and salaries	540.1	572.0	543.8	545.1	560.0	567.5	575.5	585.0
Disposable income	684.9	733.8	693.0	697.8	717.0	728.3	739.0	751.0
Personal saving	49.8	51.4	52.7	50.1	51.0	51.0	51.5	52.1
Saving rate (per cent)	7.3	7.0	7.6	7.2	7.1	7.0	7.0	6.9
Corporate profits before tax	82.6	88.8	84.4	81.5	86.5	88.0	89.0	91.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	195.5	209.0	194.9	194.4	204.3	207.3	210.3	213.9
Expenditures	206.4	224.1	206.7	210.2	219.0	223.1	225.6	228.5
Surplus or deficit (-)	-10.9	-15.1	-11.9	-15.8	-14.7	-15.8	-15.3	-14.6
High employment surplus or deficit (-)	-0.9	3.9	-1.7	1.0	1.0	2.5	4.8	7.3
Total labor force (millions)	86.0	87.2	86.0	86.4	86.7	87.0	87.3	87.6
Armed forces "	3.2	2.9	3.1	3.0	3.0	2.9	2.8	2.8
Civilian labor force "	82.8	84.3	82.8	83.4	83.7	84.1	84.5	84.8
Unemployment rate (per cent)	5.0	6.4	5.2	5.8	6.0	6.3	6.6	6.7
Nonfarm payroll employment (millions)	70.7	70.8	70.5	70.2	70.6	70.7	70.8	71.0
Manufacturing	19.4	19.0	19.3	18.7	19.1	19.0	19.0	19.0
Industrial production (1957-59=100)	167.6	169.1	167.9	162.5	167.2	168.0	169.3	171.7
Capacity utilization, manufacturing (per cent)	76.5	72.0	76.2	72.0	74.0	73.4	73.0	73.1
Housing starts, private (millions A.R.)	1.43	1.78	1.51	1.65	1.71	1.75	1.82	1.85
Sales new domestic autos (millions, A.R.)	7.20	8.38	7.99	5.50	8.50	8.50	8.25	8.25

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1970 Proj.	1971 Proj.	1970 III	1970 IV	1971 Projection I	1971 Projection II	1971 Projection III	1971 Projection IV
	--------Billions of dollars--------							
Gross National Product	45.4	67.5	14.4	5.5	29.0	15.5	16.5	17.5
Inventory change	-5.3	0.9	2.4	-3.0	0.5	1.0	0.5	0.5
Final purchases	50.7	66.6	11.9	8.5	28.5	14.5	16.0	17.0
Private	42.4	53.8	9.3	6.5	24.0	11.3	11.4	12.8
Excluding net exports	40.6	53.1	9.2	7.7	22.6	11.3	11.4	12.8
Net exports	1.8	0.7	0.1	-1.2	1.4	0.0	0.0	0.0
Government	8.3	12.8	2.6	2.0	4.5	3.2	4.6	4.2
GNP in constant (1958) dollars	-2.4	17.7	2.5	-4.7	12.7	4.0	5.0	6.0
Final purchases	2.0	16.9	0.9	-2.3	12.4	3.0	4.6	5.5
Private	7.8	17.8	1.6	-2.7	13.2	2.8	3.4	4.4
	--------In Per Cent Per Year--------							
Gross National Product	4.9	6.9	6.1	2.2	11.7	6.1	6.4	6.7
Final purchases	5.5	6.8	4.9	3.5	11.5	5.7	6.2	6.5
Private	6.0	7.1	5.0	3.4	12.5	5.7	5.7	6.3
Personal consumption expenditures	6.9	7.4	5.0	4.5	11.4	6.8	6.0	6.6
Durable goods	-0.3	6.5	-3.0	-20.6	37.5	3.8	0.0	4.2
Nondurable goods	7.7	6.9	4.9	9.5	6.3	6.5	6.3	6.4
Services	8.7	8.2	8.0	8.1	8.1	8.1	7.7	7.7
Gross private domestic investment	-3.1	6.1	11.9	-6.9	15.3	3.7	5.9	6.1
Residential construction	-6.9	23.8	11.3	43.8	33.3	14.8	12.1	12.8
Business fixed investment	3.2	0.1	3.1	-10.0	7.9	-3.9	2.0	1.9
Gov't. purchases of goods & services	3.9	5.8	4.8	3.6	8.1	5.6	8.0	7.1
Federal	-1.6	-0.1	-4.4	-2.4	6.1	-1.2	2.4	0.8
Defense	-2.9	-3.4	-5.2	-9.5	2.7	-5.4	1.1	1.1
Other	2.7	10.8	0.0	19.2	16.7	11.2	6.2	0.0
State & local	9.1	10.5	12.5	8.5	9.6	10.9	12.2	11.8
GNP in constant (1958) dollars	-0.3	2.4	1.4	-2.6	7.0	2.2	2.7	3.2
Final purchases	0.3	2.3	0.5	-1.3	6.9	1.6	2.5	3.0
Private	1.4	3.1	1.1	-1.9	9.1	1.9	2.3	2.9
GNP implicit deflator	5.2	4.3	4.6	4.8 *	4.6 *	3.9	3.6	3.4
Personal income	7.0	6.5	2.9	2.9	9.8	6.5	6.1	6.5
Wages and salaries	6.1	5.9	3.2	1.0	10.9	5.4	5.6	6.6
Disposable income	8.4	7.1	5.5	2.8	11.0	6.3	5.9	6.5
Corporate profits before tax	-9.4	7.5	14.6	-13.7	24.5	6.9	4.5	11.2
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	-2.5	6.9	-2.4	-1.0	20.4	5.9	5.8	6.8
Expenditures	7.9	8.6	11.5	6.8	16.7	8.0	3.9	5.1
Nonfarm payroll employment	0.6	0.1	-2.0	-1.7	2.3	0.6	0.6	1.1
Manufacturing	-4.0	-2.1	-6.0	-12.4	8.6	-2.1	0.0	0.0
Industrial production	-3.0	0.9	-3.3	-12.9	11.6	1.9	3.1	5.7
Housing starts, private	-2.7	24.5	70.0	37.1	14.5	9.4	16.0	6.6
Sales new domestic autos	-14.9	16.4	2.0	-124.7	218.2	0.0	-11.8	0.0

* Reduction in auto sales in 1970-IV and rise projected for 1971-I are reflected in GNP deflator for these quarters, also reflected in deflator is the Federal pay increase projected for 1971-I; excluding the impact of these, the deflator is projected to rise at an annual rate of 4.4 per cent in 1970-IV and 4.2 per cent in 1971-I.

Industrial production. Industrial production is tentatively estimated to have increased in December by about 2 points to a level around 163.5 per cent. At this level the total index would be 6.4 per cent below the July 1969 high.

With the return of GM to production, the rise in output in December was centered in the automotive and supplying industries. The earlier decline in the index resulting from the strike, will be made up by the end of January with a further possible boost in February, based on schedules published by Ward's Automotive News. There have been, however, reports of production cutbacks scheduled for January at Chrysler and AMC because of high inventories.

OUTPUT OF MOTOR VEHICLES AND PARTS
ESTIMATED EFFECT ON INDUSTRIAL PRODUCTION INDEX

	1970			1971	
	August	Nov.	Dec.[e]	Jan.[p]	Feb.[p]
Auto assemblies* (Millions of units)	8.5	4.1	6.8	8.6	9.7
		Change in points in total index from preceding period			
Motor vehicles & parts	0	-3.1	1.8	1.5	.4
Supplying industries	0	-1.1	.6	.5	.3
Total	0	-4.4	2.4	2.0	.7

* S.A. annual rates
e - estimated; p - projected

Output of consumer durable goods other than autos probably eased off in December. With factory stocks of consumer hard goods at a new high at the end of November, and with retail sales of furniture and appliances showing little change since June, recent production rates do not seem sustainable. (Last week the Frigidaire Division of GM announced the second round of layoffs at its plant. This plus a November 24 cutback in employment amounted to 9 per cent of the Frigidaire work force.) Output of consumer staples, however, may have risen slightly in December. Among other sectors, output of business and defense equipment, excluding trucks, is estimated to have declined further. Production of materials probably rose because of the increase in automotive parts and raw steel. However, further cuts in aluminum production have been announced.

Retail sales. Retail sales are estimated to have increased about 1-1/2 per cent in December, according to estimates based on the four weeks ending December 26. Strength was concentrated largely in the last week, which contained one more pre-Christmas shopping day this year than last. Unit sales of U.S.-made cars strengthened somewhat in the last 10 days but for the month remained close to the depressed November seasonally adjusted annual rate of 5 million. Furniture and appliance sales increased but were no higher than at mid-year. Nondurable sales increased about 1 per cent, as all major types of outlet, except general merchandise, reported higher sales. General merchandising sales declined more than 1 per cent and were only about 5.6 per cent higher than a year earlier.

RETAIL SALES

	Billions $				Per cent change from previous period	
	III Q (ave.)	Oct.	Nov.	Dec.	Dec. e/	QIV e/
All retail	30.80	30.48	30.32	30.82	1.6	- .8
Total durables	9.52	8.89	8.67	8.91	2.9	-7.3
Automotive	5.57	4.91	4.67	4.84	3.8	-13.8
Furniture & appliances	1.38	1.40	1.40	1.44	2.8	2.2
Total nondurables	21.28	21.60	21.66	21.91	1.1	2.1
Apparel	1.69	1.74	1.79	1.83	2.2	5.8
Food	6.81	6.89	6.88	7.02	2.0	1.7
General merchandise	5.23	5.35	5.35	5.28	-1.3	1.9
Total less automotive, building materials, farm equipment	23.54	23.89	23.94	24.25	1.3	2.0
Total real, deflated by SA all commodity CPI	24.33	23.92	23.70	n.a.	n.a.	n.a.

e/ December estimated on basis of four weeks ending 26th.

Cyclical indicators. The Census leading indicator composite rose 1 per cent in November, on a preliminary basis, after declining .3 per cent in October. (The preliminary October index, calculated a month ago, had shown an increase of .8 per cent.) The coincident and lagging composites declined in November. The leading composite has been fluctuating around a reduced level since last March and has not yet broken out of the range established over the last nine months.

COMPOSITE CYCLICAL INDICATORS
(1967 = 100)

	12 Leading Trend Adjusted	5 Coincident	6 Lagging
1970:			
April	114.9	122.0	130.6
May	113.6	121.2	130.7
June	114.2	121.4	130.7
July	115.8	121.4	130.9
August	115.1	121.1	132.0
September	114.4	120.5	132.7 (H)
October	114.1	118.8	132.2
November (Prel.)	115.2	118.2	131.2

(H) Current high value. The high for the leading composite was September 1969; for the coincident, December 1969.

Manufacturers' orders and shipments. New orders for durable goods rose 1.9 per cent in November, according to preliminary data, after declining 4.5 per cent in October. The increase was mainly in capital equipment and primary metals.

Capital equipment orders rose 7 per cent, the second monthly increase in a row. On a three-month moving average basis, these orders are significantly above their second-quarter lows, but have not regained the high levels of late 1969 and early 1970.

Orders for primary metals rose somewhat from October's reduced levels, possibly reflecting both anticipation of the end of the GM strike and the beginning of hedging against possible strikes next year.

MANUFACTURERS' NEW ORDERS
Seasonally adjusted monthly averages, billions of dollars

	1970			
	Q II	Q III	October	November Prel.
Durable goods, total	29.5	30.6	28.5	29.0
Primary metals	4.8	4.8	4.3	4.6
Motor vehicles and parts	3.9	4.1	2.8	2.7
Household durable goods	2.1	2.1	2.0	2.1
Defense products	1.7	2.3	2.1	2.0
Capital equipment	8.2	8.3	8.4	9.0
All other durable goods	8.8	9.0	8.8	8.7
Nondurable goods, total	25.3	25.6	25.7	25.5

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

Unfilled orders for durable goods increased, reflecting increases for capital equipment and primary metals. It was only the second monthly increase in 1970. From November 1969 to October 1970, the backlog dropped 9 per cent--the biggest decline in this series since it dropped 16 per cent from November 1959 to March 1961.

Shipments declined in November, mostly at primary metals and aerospace industries.

Inventories. Book value of manufacturers' inventories rose at a \$6.9 billion annual rate in November. The October rate was revised upward to \$9.7 billion, with all of the revisions at nondurable goods manufacturers.

CHANGE IN BOOK VALUE OF MANUFACTURERS' INVENTORIES
(Seasonally adjusted annual rate)
Billions of dollars

	1970			
	Q II	Q III	October	November (Prel.)
Manufacturing, total	2.9	3.8	9.7	6.9
Durable	.5	3.7	3.7	4.5
Nondurable	2.4	.1	6.0	2.4

In November, durable goods manufacturers continued to accumulate inventories at around the third-quarter rate. Over the past two months, over half of the growth in durable goods stocks has been in materials and in the in-process and finished goods stocks of primary metals plants. In view of the GM strike and of 1971 labor negotiations in steel and other primary metals industries, at least some of the accumulation of materials may have been deliberate. Durable materials stocks do not appear high relative to shipments after allowing for the effect of the GM strike on shipments. However, materials stocks were higher relative to unfilled orders for durable goods except autos and metals than at any time during the 1964-65 and 1967-68 pre-contract-expiration buildups of steel.

Over-all inventory-shipments ratios rose in November at both durable and nondurable goods manufacturers. The durable goods inventory-backlog ratio, already at a record high, rose only slightly further.

MANUFACTURERS' INVENTORY RATIOS

	1969		1970	
	October	November	October	November (Prel.)
Inventories to shipments				
Manufacturing, total	1.68	1.71	1.81	1.84
Durable	1.98	2.03	2.23	2.29
Nondurable	1.29	1.30	1.32	1.34
Inventories to unfilled orders				
Durable manufacturing	.724	.729	.834	.836

Auto production exceeded sales in December and auto dealers may have been able to begin to replenish their stocks; for the fourth quarter as a whole, however, retail auto stocks probably declined substantially.

Construction and real estate. Seasonally adjusted outlays for new construction, which were revised downward by 2 per cent for recent months, rose 1 per cent in December to an annual rate of $92.0 billion, only slightly below the peak reached in April 1969. While the December rate exceeded that of a year earlier by 2 per cent, it reflected an 8 per cent increase in construction costs, as measured by the Census Bureau. Altogether, current dollar outlays for 1970 totaled $90.5 billion, near the 1969 level in current dollar terms, but 7 per cent lower after adjustment for increased costs.

NEW CONSTRUCTION PUT IN PLACE
(Billions of dollars; Confidential FRB)

	December 1/		Year	
	1969	1970 2/	1969	1970 2/
Total	89.8	92.0	90.9	90.5
Private	61.9	64.3	62.8	62.7
Residential	28.9	31.6	30.6	29.0
Nonresidential	33.0	32.7	32.2	33.8
Public	27.9	27.7	28.1	27.8
Federal	3.2	3.3	3.4	3.3
State and local	24.6	24.4	24.7	24.5
Implied cost increase year-to-year (Per cent):	6	8	7	7

1/ Seasonally adjusted annual rates.
2/ Data for December 1969 and 1970 as a whole are preliminary confidential Census Bureau extrapolations. In no case should public reference be made to them.

During December, outlays for residential construction-spurred by the sustained upsurge in housing starts--advanced 3 per cent further on a current dollar basis. Outlays for private nonresidential construction changed little at a level 6 per cent below the peak of last March. Public construction outlays, also were little changed and were about 7 per cent below the high in February of 1969.

Seasonally adjusted private housing starts continued sharply upward in November to the highest annual rate--1.69 million units--in nearly two years. Unlike October, single-family units as well as multifamily units shared in the increase. Also, starts moved higher in all regions except the West, where, however, the rate remained above the relatively advanced level of a year earlier.

PRIVATE HOUSING STARTS AND PERMITS

	November 1970 (Thousands of units) 1/	Per cent change from October 1970	Per cent change from November 1969
Starts 2/	1,692	+8	+32
1-family	933	+6	+22
2-or-more-family	759	+10	+46
Northeast	251	+12	+53
North Central	367	+12	+37
South	731	+13	+41
West	343	-8	+3
Permits	1,508	--	+26
1-family	721	+4	+19
2-or-more-family	787	-3	+33

1/ Seasonally adjusted annual rates; preliminary.
2/ Not included in starts are mobile home shipments for domestic use, which in October--the latest month for which data are available--were at a seasonally adjusted annual rate of 423,000, down 1 per cent from September, and 7 per cent lower than a year earlier.

With building permits in November continuing at the exceptionally high October rate and mortgage markets generally easing further, starts in December may have held near the advanced November rate. If so, the rate in the fourth quarter as a whole would have been almost a third above the low in the first quarter of the year and moderately above the recent quarterly peak of 1.64 million units registered in the first quarter of 1969. Thus, even including the reduced level of starts forced by tight mortgage market conditions in the early part of 1970, starts for the entire year may have totaled 1.42 million, only a little short of the 1969 total of 1.46 million units. Moreover, with mobile home shipments holding at a considerably improved level in recent months, 1970 total shipments also may have approached the record 413,000 units of 1969.

<u>Anticipated plant and equipment expenditures</u>. Businesses report plans to increase spending for new plant and equipment by only 1.4 per cent in 1971, according to the December Commerce-SEC survey. Expenditures of manufacturing industries are projected to decline nearly 3 per cent with only nonferrous metals and petroleum producers showing increases over 1970. In nonmanufacturing, anticipated increases of 19 per cent in electric utilities and 14 per cent in communications more than offset projected declines in all other sectors; overall spending by nonmanufacturing industries is expected to increase by about 4 per cent. The results of this survey are similar to the November McGraw-Hill survey, which showed a 2 per cent increase for 1971.

BUSINESS SPENDING FOR NEW PLANT AND EQUIPMENT

	Billions of dollars			Per cent change from prior year		
	1969 (act.)	1970 (est.)	1971 (ant.)	1969 (act.)	1970 (est.)	1971 (ant.)
Total	75.56	80.58	81.67	11.5	6.6	1.4
Manufacturing	31.68	32.26	31.39	11.7	1.8	-2.7
Durable goods	15.96	15.91	15.42	13.0	- .4	-3.1
Nondurable goods	15.72	16.36	15.97	10.3	4.1	-2.4
Nonmanufacturing	43.88	48.31	50.28	11.4	10.1	4.1

Taken in conjunction with the Commerce-SEC November survey covering the first half of 1971, which indicated no change in total spending from the preceding half year, the current survey implies virtually no change after mid-year also. On this basis, spending tends to level off in the second half for both nonmanufacturing firms, after a rapid increase in 1970, and for manufacturing, following a moderate decline since the first half of 1970.

HALF-YEAR PATTERN OF PLANT AND EQUIPMENT SPENDING

	1970		1970	
	IH (act.)	IIH (est.)	IH (ant.)	IIH (implied)
	(Billions of dollars)			
Total	79.22	81.80	81.80	81.54
Manufacturing	32.44	32.14	31.30	31.48
Durable goods	16.36	15.52	15.28	15.57
Nondurable goods	16.08	16.61	16.12	15.83
Nonmanufacturing	46.79	49.67	50.50	50.06

NOTE: Second half 1971 implied from annual and first half 1971 anticipations.

Labor market. The resumption of production at General Motors likely resulted in an increase in nonfarm payroll employment in December and also appears to have been reflected in a modest decline in insured unemployment. Insured unemployment is now estimated to have averaged 2.25 million weekly in December (seasonally adjusted), a decline of nearly 100,000 from November; the level was still more than a million higher than a year earlier, however.

INSURED UNEMPLOYMENT
(Seasonally adjusted weekly average, in thousands)

	Initial claims	Insured unemployment
1969:		
November	210	1,218
December	212	1,238
1970:		
August	298	1,994
September	342	2,197
October	340	2,332
November	334	2,349
December*	315*	2,250*

* Estimated.

Labor force and unemployment. Labor force growth has slowed somewhat with the sharp rise of unemployment this year. However, the civilian labor force still increased by 1.9 million over the year ending in October-November, including about 450,000 added because of reductions in the Armed Forces. The year-over-year rise in total labor force estimated for the fourth quarter is about in line with the projected "normal" increase in the total labor force of about 1.5 million (based on population increases and long-term trends in labor force participation rates). Total civilian employment at year-end was only slightly higher than a year earlier and nearly all the civilian labor force increase was reflected in a net rise in unemployment.

LABOR FORCE, EMPLOYMENT AND UNEMPLOYMENT
(In thousands, seasonally adjusted)

	(Change from a year earlier)	
	1969 IV	1970 IV*
Total labor force	2,344	1,471
Armed Forces	-53	-451
Civilian labor force	2,397	1,922
Employment	2,161	124
Unemployment	236	1,798

*October-November averages/

TOTAL LABOR FORCE PARTICIPATION RATES

	November			Change from a year earlier	
	1968	1969	1970	1969	1970
All workers	60.6	61.2	61.2	.6	N.C.
Males	80.1	80.2	79.7	.1	-.5
White	80.4	80.5	80.1	.1	-.4
Negro	77.7	77.8	76.2	.1	-1.6
Females	42.5	43.6	44.1	1.1	.5
White	41.6	42.8	43.4	1.2	.6
Negro	49.5	50.6	49.7	1.1	-.9

Some slowing in labor force growth is not unusual in a period in which demand for labor is slack. Some workers become discouraged by the lack of job opportunities and either leave or decide not to enter the work force. Work force participation among women continued to increase, but at a much slower rate than in other recent years, and participation rates for males turned down after rising slightly in 1969. The drop has been especially large among Negroes and probably is a prime factor in the more moderate rise of Negro jobless rates relative to white rates in this period compared with earlier periods of slack activity.

Hourly earnings. Year-to-year increases in average hourly earnings of production and nonsupervisory workers on private payrolls moderated slightly further in the fourth quarter, partly because of the General Motors strike. The sharpest slowing took place in durable goods manufacturing; nondurable goods manufacturing increases were as rapid as earlier. In trade, gains in hourly earnings moderated further, following smaller increases in each of the earlier quarters of 1970. Hourly earnings increases in contract construction, services, and transportation show little indication of slowing, reflecting the impact of large wage settlements in those industries.

AVERAGE HOURLY EARNINGS OF PRODUCTION
AND NONSUPERVISORY WORKERS
(Per cent change from a year earlier)

	1968	1969	1970	1970 Q I	QII	QIII	Q IV*
Total private	6.3	6.7	6.0	6.4	6.0	5.9	5.3
Manufacturing	6.4	6.0	5.3	5.4	5.6	5.5	4.0
Durable	6.3	6.3	5.2	5.4	6.0	5.6	3.5
Nondurables	6.6	6.2	6.0	6.0	6.0	5.9	5.9
Mining	5.0	7.5	6.5	6.9	6.7	6.6	5.7
Construction	7.3	8.4	9.5	10.1	8.9	9.5	9.2
Transportation	7.6	6.1	5.7	5.5	5.3	6.0	6.2
Trade	7.1	6.7	6.2	6.7	6.4	6.2	5.7
Finance	6.6	6.2	5.1	5.1	4.6	5.4	5.4
Services	6.1	8.2	8.3	8.6	7.9	8.3	8.5

* October-November averages.

<u>Collective bargaining</u>. New wage agreements covering nearly 5 million workers under major contracts in private nonfarm industries will be negotiated in 1971, marking the second successive year of peak collective bargaining activity. The largest number of workers covered by contract settlements in the 1960's was 4.6 million in 1968. Another 5.3 million workers already covered by multi-year contracts will receive deferred wage increases. At the beginning of 1971, 3 million workers are covered by cost-of-living clauses providing for adjustments in wage rates tied to increases in the consumer price index.

The 1971 bargaining year will be dominated by negotiations in the basic steel industry, where contracts covering 400,000 workers expire July 31. A preview of the steel workers demands and management's reaction will occur soon as the contract between the metal can companies and the steel workers union expires on February 14. The union has indicated it wants a cost-of-living clause, which is not included in the present contract.

Construction and aluminum contract negotiations will be concentrated in the first half of the year and major contract negotiations during the year also include telephone and telegraph workers, aerospace workers, apparel workers (men's clothing), bituminous coal miners, longshoremen, and rail and airline employees.

Deferred wage increases will average 7.8 per cent this year, substantially more than the 5.6 per cent average deferred increase received in 1970. About 2.6 million nonmanufacturing workers are

Wholesale prices. Seasonally adjusted wholesale prices were virtually unchanged on average between mid-November and mid-December, following a decline in November. The increase over the fourth quarter was at an annual rate of only 0.4 per cent, compared to 3.9 per cent in the third quarter and 2.3 per cent over the past year. The improved performance of recent months is attributable to declining prices of farm products, particularly livestock, and to an unusually large December drop in processed foods, mainly reflecting lower prices for meat and poultry.

WHOLESALE PRICES
(Seasonally adjusted percentage changes at compound annual rates)

	Quarters		Annual	One month
	June 1970 Sept 1970	Sept 1970 Dec 1970 1/	Dec. 1969 Dec 1970 1/	Nov 1970 Dec 1970 1/
All commodities	3.9	.4	2.3	- .2
Farm and food products	8.9	- 8.8	- 1.1	- 7.4
Farm products	12.2	-16.6	- 4.4	- 2.2
Processed foods and feeds	5.6	- 3.5	1.0	-11.7
Industrial commodities	2.9	3.4	3.5	2.7

1/ Preliminary.

The 2.7 per cent rate of rise in industrial commodity prices in December followed no change in November and a large rise in October when 1971 models of new cars were introduced. Over the fourth quarter, industrials rose at an annual rate of 3.4 per cent, higher than in the previous quarter and about the same as over the past year.

scheduled to receive deferred increases averaging 10.8 per cent, with the very large increase mainly reflecting the terms of contracts negotiated in 1970 in the trucking and construction industries. In manufacturing, the average deferred increase is 4.9 per cent for 2.7 million workers, compared with 4.3 per cent in 1970.

The continued substantial increase in industrial prices reflects the obstinacy of inflation in prices of highly fabricated commodities despite growing price weakness in important materials such as metals. Consumer goods rose about 2 per cent (according to a preliminary estimate) in the fourth quarter of 1970, about as much as in the first 3 quarters combined (not at annual rates and not seasonally adjusted). The rise in 1970 was almost 4 per cent compared to 3 per cent in 1969. Producers' goods rose 2.2 per cent in the fourth quarter--almost as much as in the first three quarters--bringing the yearly climb to 4.7 per cent compared to 4.4 per cent in 1969. The fourth quarter acceleration in finished goods prices was in part seasonal but proved larger than had been expected.

PRICES OF MATERIALS AND FINISHED GOODS
(Per cent change from third month of proceeding quarter)

	Dec. 1969	March 1970	June 1970	Sept. 1970	Dec. 1/ 1970
Industrial commodities-total	1.2	1.0	.8	.6	1.0
Materials	.9	1.2	1.1	.4	2/
Fuel and power	1.3	.2	2.2	2.2	5.3
Metals	1.7	2.6	1.7	-.3	-.9
Non-ferrous	4.6	2.2	1.0	-4.3	-4.6
Consumers' finished goods (ex. foods)	1.1	.5	.7	.6	2.0
Producers' equipment	2.0	1.0	.6	.9	2.2

1/ Preliminary estimate. Confidential.
2/ Probably about .3.

The December advance in industrial materials prices exhibited the same general pattern as in most recent months. Fuels and power were the leading upward influence in the last two months, while metals continued weak; in fact, the metals average dropped in both November and December, reflecting lower quotations for non-ferrous metals--including copper and products--and ferrous scrap. Prices of some important building materials increased in December, although lumber and plywood receded to the lowest level since mid-1968.

In late November or early December, automobile prices for major producers were raised slightly further following the GM wage settlement. Since then, Volkswagen has announced increases.

Since mid-December, lead, lead scrap and zinc prices have declined further. Aluminum producers have restricted output to rates well below capacity, and discounts below list are still general. Major foreign copper exporting countries, faced with an apparent world over-supply, have been attempting to work out an agreement for output control. On the other hand, magnesium prices rose this month for the first time since 1956.

<u>Consumer prices.</u> The rise in consumer prices slowed to a seasonally adjusted annual rate of 3.7 per cent in November, from about 6-1/2 per cent in September and October, as food and gasoline prices declined.

CONSUMER PRICES

(Per cent change, seasonally adjusted annual rates)

	Dec 1969 to Mar 1970	Mar 1970 to June 1970	June 1970 to Sept 1970	Sept 1970 to Oct 1970	Oct 1970 to Nov 1970
All items	6.3	5.8	4.2	6.6	3.7
Food	5.4	1.3	1.4	.9	- .6
Non-food commodities	2.9	6.4	3.7	7.1	4.3
Services1/	11.2	7.3	7.2	6.3	7.8
Addendum					
Services, less home finance 1/2/	7.9	6.2	7.0	7.3	8.3

1/ Not seasonally adjusted.

2/ Not for publication.

A more than seasonal drop in meat prices, particularly port, and a contra-seasonal decline for fruits and vegetables, contributed to the seasonally adjusted decline in prices of food at home in November. The increase for non-food commodities was held down by a drop in retail gasoline prices which followed two months of increases. Apparel, household durables and new car prices all continued to rise at rates substantially above those for the first three quarters of the year.

The rate of increase in new car prices, seasonally adjusted, was almost as high as in September and October, and reflected in large part the shift in weights toward the 1971 models. Used car prices also contributed significantly to the November increase, though not so much as in October.

NON-FOOD COMMODITY PRICES

(Per cent change, seasonally adjusted annual rates)

	Dec 1969 to Mar 1970	Mar 1970 to June 1970	June 1970 to Sept 1970	Sept 1970 to Oct 1970	Oct 1970 to Nov 1970
Non-food commodities 1/	2.9	6.4	3.7	7.1	4.3
Apparel	2.4	3.5	4.1	6.2	6.8
Other nondurables	3.0	5.3	3.5	6.8	3.8
New cars	2.5	1.3	6.9	12.2	10.9
Household durables	2.6	3.0	2.3	4.5	4.5
Addendum:					
Used cars 2/	-18.8	58.7	-13.2	31.0	19.0
Non-food commod. adj. 3/	2.6	4.1	3.8	6.2	3.5

1/ Includes items not listed.

2/ Not seasonally adjusted.

3/ Excluding used cars and home purchase. Not for publication.

Among services, medical costs resumed an annual rate of rise of about 8 per cent after the small October increase which reflected an adjustment for previous overestimate of health insurance costs. Rents and gas and electricity rates continued to rise faster than in the first three quarters. Higher house prices raised mortgage interest costs in spite of a slight decline in mortgage rates. (This drop, the largest since June 1967, reflected only conventional mortgage interest rates as the recent cut in VA and FHA rates will not appear in the index until January.) When home finance is excluded, the November rise in service costs is still well above that of earlier months and of 1969.

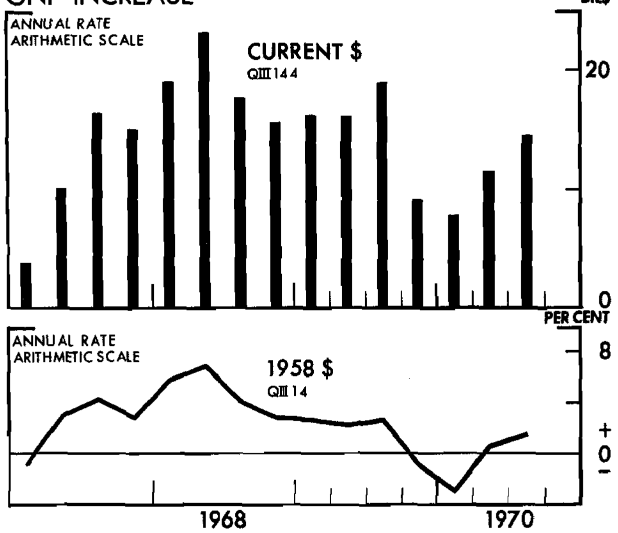
<u>Livestock supply prospects</u>. The moderating influence on food prices exerted by relatively large supplies of livestock products in the past quarter is expected to continue well into 1971, largely because of prospects for continuation of large hog marketings. The recent pig crop survey indicates that hog marketings will stay about a fifth above the low levels of a year earlier throughout the next five or six months. The margin above a year earlier is likely to narrow in the summer and disappear in the fall when marketings may drop below a year earlier. Beef supplies will probably continue to hold close to the record levels of 1970.

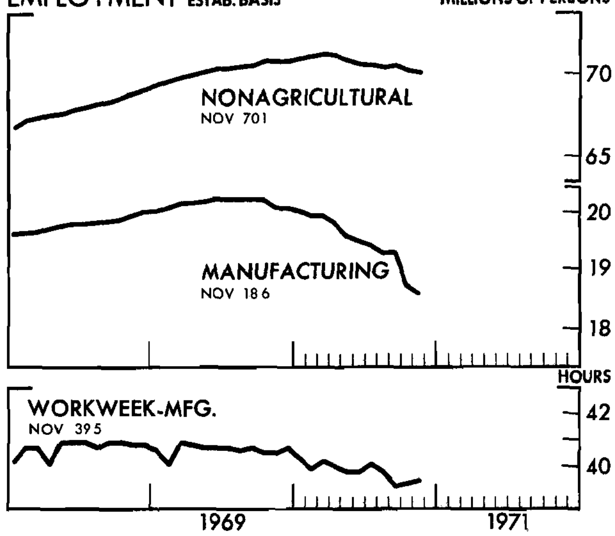
Feed supplies are less ample than last year and more costly, largely because of the 10 per cent cut in the corn crop caused by blight and drought. As the year progresses we can expect livestock producers to scale down production in response to the very unfavorable livestock-feed price ratios. Hog producers in the Corn Belt have reported intentions to produce 6 per cent fewer pigs for next fall's markets.

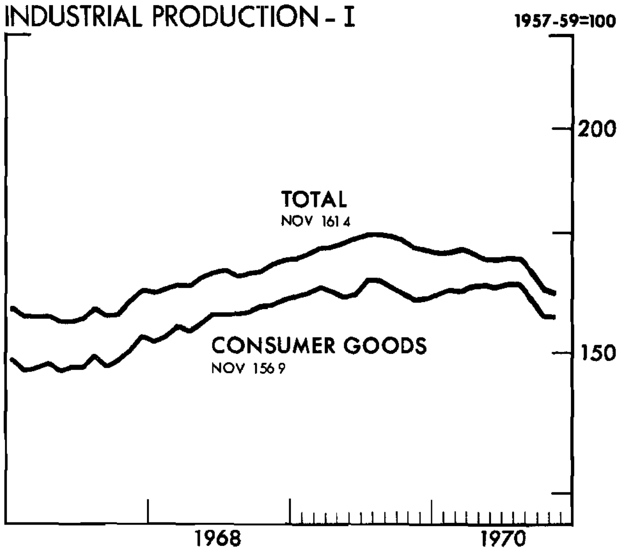
Uncertainties about feed supplies extend beyond the current feeding year. As for the corn blight, it is not known how well spores of the blight can overwinter in the Corn Belt nor is it known how much constraint on 1971 corn acreage may be imposed by the limited supply of resistant seed available. It is not known what impact the blight has had on producers' planting plans in areas heavily infested in 1970. The new farm legislation introduces another uncertainty since it gives producers more leeway than formerly in choosing crops they will plant once they have complied with prescribed "set-asides". Under the preliminary 1971 feed grain "set-aside", less acreage is likely to be idled than in 1970. The released land will probably be used for sharply expanded plantings of soybeans and other crops as well as feed crops.

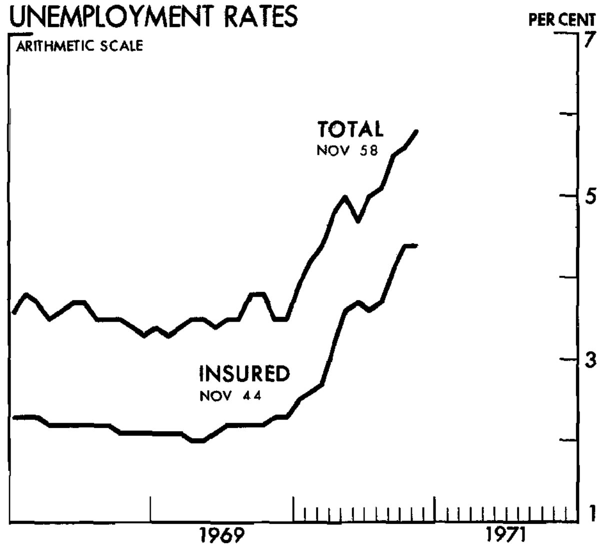
Dr. Don Paarlberg, Director of Agricultural Economics in the USDA, recently stated that corn production possibilities in 1971 range from a low crop of 3.7 billion bushels under conditions of low acreage, bad weather, and severe blight, up to a high of 5.2 billion bushels under conditions of high acreage, good weather, and minimal blight. The USDA hoped-for production is 4.8 billion bushels, an increase of .7 billion bushels over the 1970 crop. If realized, this output would be sufficient to meet livestock feeding and export demands at reasonable prices and permit a small rebuilding of stocks.

ECONOMIC DEVELOPMENTS - UNITED STATES
SEASONALLY ADJUSTED, RATIO SCALE

GNP INCREASE


EMPLOYMENT ESTAB. BASIS


INDUSTRIAL PRODUCTION - I


UNEMPLOYMENT RATES


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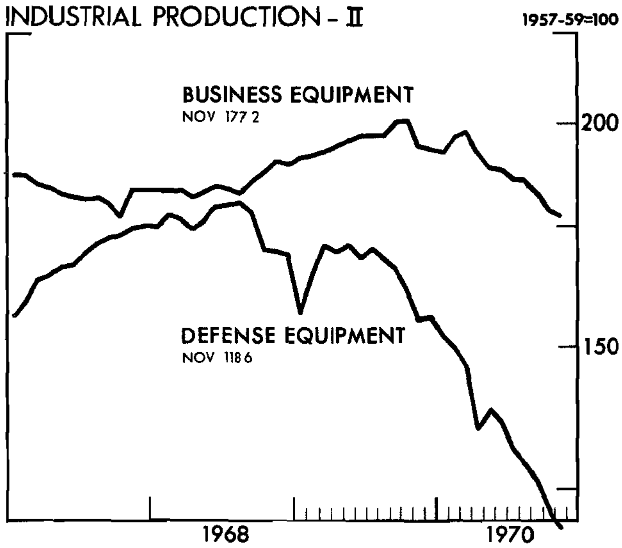
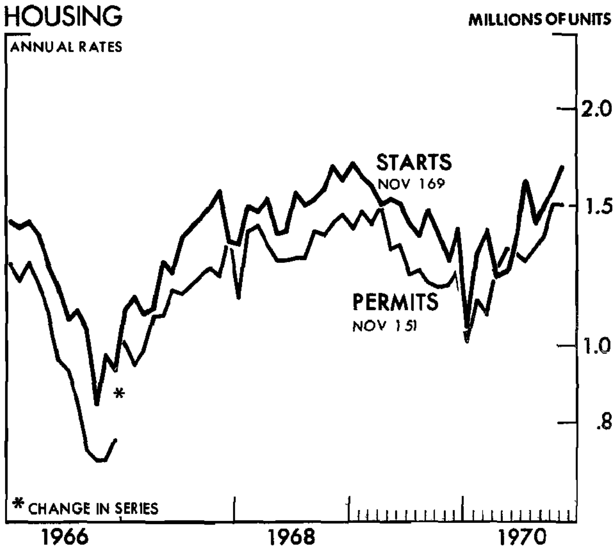
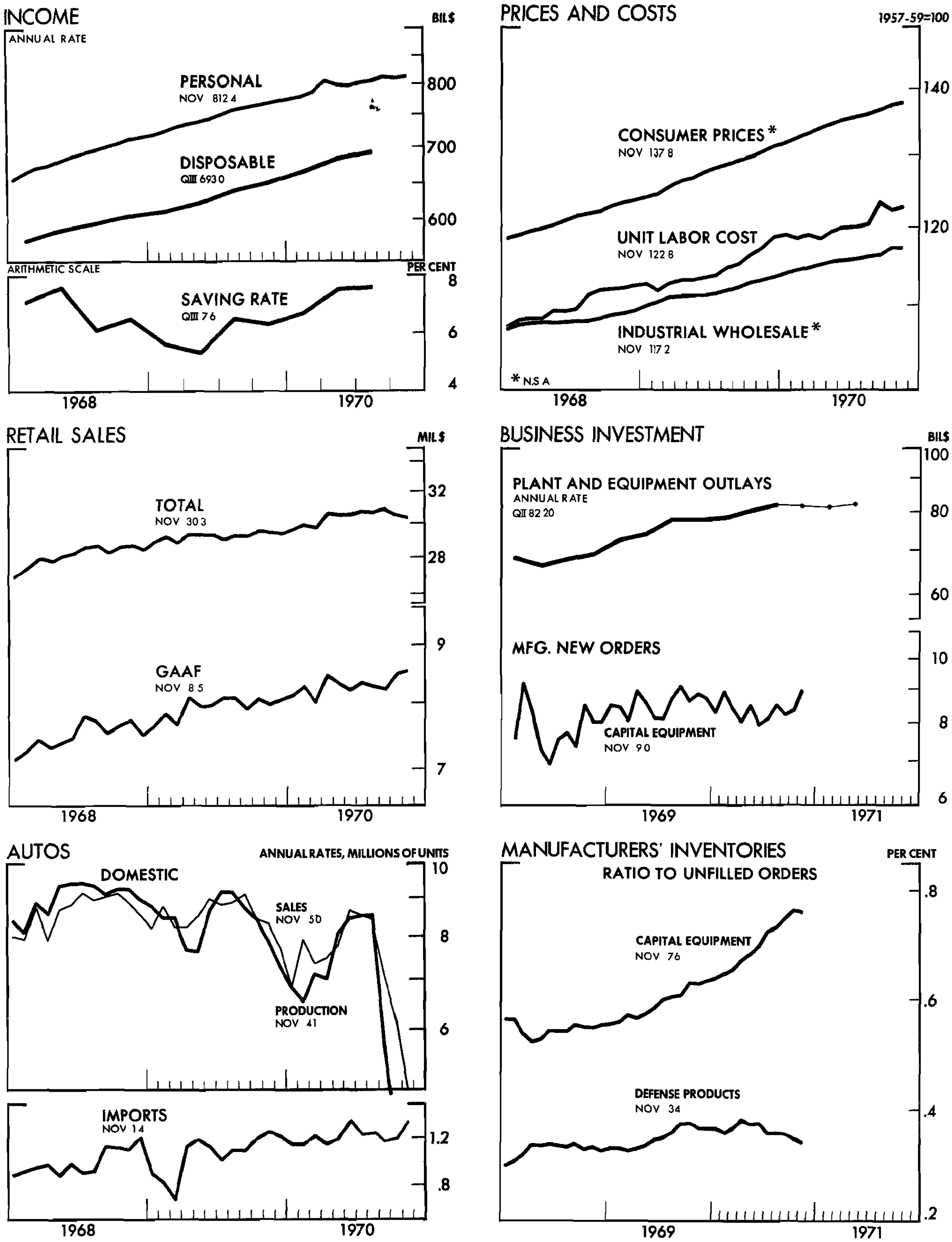


HOUSING


ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Bank credit. Commercial bank credit, adjusted for transfers of loans between banks and their affiliates, increased at an annual rate of nearly 10 per cent in December. This increase followed a somewhat smaller rise in November and a moderate decline in October. For the three months combined, bank credit rose at a 5.3 per cent annual rate, decidedly below the rate for the third quarter and only slightly more than that recorded during the first half of the year.

In December, as in other recent months, banks added substantially to their investment portfolios. Holdings of "other securities" (mainly state and local and Federal Agency issues) increased $1.9 billion, only a little less than the sizable average monthly gains from September through November. Growth in U.S. Treasury securities was larger in December than in November as banks participated actively in the December 2 sale of strip bills and retained a large portion of these securities at month end. The Treasury also increased by $200 million the volume of bills sold in the regular weekly auctions and this also may have tended to promote the growth in bank holdings of these securities. The increase in holdings of Treasury and other securities in December amounted to $2.6 billion, which brought the increase in bank investment holdings of securities for the fourth quarter to $5.9 billion and for the second half of the year to $13.2 billion.

The pace of increase in total loans (adjusted for loan transfers) picked up slightly in December from November's modest rate. The advances during these two months, however, were not enough to offset the fairly sharp decline in October so that in the fourth quarter as a whole total loans (adjusted for transfers) dropped slightly in contrast with the sharp rise recorded in the third quarter.

The improvement in the loan picture in December was primarily due to a sharp advance in loans to security dealers--who used these loan funds to finance a buildup in inventories. Growth in real estate loans also strengthened moderately. The rapid rate of decline in business loans (adjusted for transfers) moderated somewhat, but still remained sizable.

Resumption of auto production at General Motors and some pickup in general business activity may have served to slow the decline in business loans. However, loan demands around the mid-month tax and dividend paying dates and the following week continued to be quite weak, and the prime rate was lowered by another quarter of one per cent. A further one quarter point decline to 6-1/2 per cent was posted by a few banks this week, but the reduction at this writing had not spread to the major city institutions.

COMMERCIAL BANK CREDIT ADJUSTED TO INCLUDE OUTSTANDING AMOUNTS OF LOANS SOLD TO AFFILIATES 1/
(Seasonally adjusted percentage changes, at annual rates)

	1970			1970	
	H1	QIII	QIV p	November	December p
Total loans & investments 2/	4.5	13.9	5.3	7.8	9.7
U.S. Govt. securities	8.5	25.9	-2.8	4.3	14.9
Other securities	10.4	20.3	32.0	35.6	27.4
Total loans 2/	2.4	9.8	- .3	1.2	3.3
Business loans 3/	8.1	1.8	-9.2	-8.6	-5.4

1/ Last Wednesday of month series.
2/ Includes outstanding amounts of loans sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
3/ Includes outstanding amounts of business loans sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

Monetary aggregates. The rate of advance in the narrow money stock (M_1) rose markedly in December, although apparently by somewhat less than expected a month ago. Private demand deposits rose sharply after two months of slow growth and currency holdings continued to increase at the strong pace of the previous two months. The December increase at an annual rate of almost 8 per cent (based on preliminary data) raised the fourth quarter growth rate of M_1 to nearly a 4 per cent annual rate. An alternative monetary measure (M_2), which includes time deposits at commercial banks other than large CD's, increased at a 13.3 per cent annual rate in December. This is also a much faster rate of advance than in preceding months of the fourth quarter and reflects both a pickup in the growth rate of the time deposit component and the faster increase in the M_1 component. Over the fourth quarter, M_2 rose at an annual rate of 9.4 per cent.

The December increase in total time and savings deposits at commercial banks was at an annual rate of 28.3 per cent, nearly double the November rate. A sharp step up in CD sales was partly responsible, with most of the improvement occurring at New York banks. At least some of these sales were reportedly undertaken to bolster year-end balance sheet magnitudes. The gain in other time deposits reflected a marked growth in State and local deposits that more than offset a further decline in deposit balances of foreign official institutions.

Reflecting accelerated growth in demand and time deposits, as well as a sharp rise in Treasury balances, the rate of growth in the adjusted bank credit proxy also increased markedly during December, rising at a 15 per cent annual rate, or almost twice as fast as in November. In addition to financing a substantial growth in assets, banks continued to use a significant portion of their incoming deposit funds to reduce nondeposit liabilities.

MONETARY AGGREGATES
(Per cent, annual rates of change)

	1970				
	QII	QIII	QIV	Nov.	Dec.
1. Currency plus private demand deposits	5.8	6.1	3.9	2.8	7.9
2. Commercial bank time and savings deposits	14.1	32.2	21.6	15.1	28.3
a. large CD's	59.1	257.6	79.3	36.2	105.4
b. other time and savings	11.3	16.5	15.2	12.1	19.1
3. Savings deposits at mutual savings banks and S&L's	6.9	10.0	n.a.	8.8	n.a.
4. Adjusted bank credit proxy	6.5	17.2	8.0	7.0	15.8
Concepts of money					
5. M_1 = (1)	5.8	6.1	3.9	2.8	7.9
6. M_2 = (1) + (2b)	8.4	11.0	9.4	7.3	13.3
7. M_3 = (1) + (2b) + (3)	7.9	10.7	n.a.	7.9	n.a.
8. M_4 = (1) +(2b) + (3) + (2a)	8.9	15.9	n.a.	8.9	n.a.

n.a. - Not available.

Nonbank depositary intermediaries. The relatively strong recent growth in deposits at nonbank thrift institutions apparently continued during December,[1/] when yields on short-term Government securities dropped below comparable-maturity deposit interest rate ceilings for the first time since 1967. This enhanced attractiveness of thrift institution claims was manifest also in the exceptionally stable grace-period deposit pattern at large New York mutual savings banks, where the usual reinvestment period net withdrawals were held to a minimum.[2/]

1/ Based on sample data for the first two-to-three weeks of the month.
2/ Data for the savings and loan grace period experience will be available for the Supplement.

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

	Mutual Savings Banks	Savings and Loan Associations	Both
1970 - QI	2.4	1.4	1.7
QII	6.3	7.1	6.9
QIII	6.6	11.5	10.0
October* p/	8.4	11.8	10.7
November* p/	8.1	9.2	8.8

* Monthly patterns may not be significant because of difficulties with seasonal adjustment.
p/ Preliminary.
NOTE: Preliminary December and fourth quarter data will be available in the Supplement.

Liquid asset holdings of nonbank institutions have increased significantly since early this summer, partly resulting from the inability of the institutions to acquire mortgages as rapidly as funds became available. Liquid asset ratios at mutual savings banks and S&L's show a strong uptrend in liquidity. The growth in liquid assets should moderate, however, as increased mortgage takedowns develop in early 1971. Moreover, S&L's may be accumulating some liquidity now in order to repay part of their one-year subsidized advances maturing in the Spring, despite FHLB efforts to extend such borrowing.

DECEMBER GRACE PERIOD DEPOSIT FLOWS 1/
At the 15 Largest Mutual Savings Banks in New York City

	Net Deposit Flow ($ millions)	Net Adjusted Deposit Flow 2/ ($ millions)	Net Adjusted Deposit Flow 2/ (as % of deposits)
1965	-139	- 58	-.38
1966	-124	- 46	-.29
1967	-186	- 65	-.37
1968	-198	- 83	-.45
1969	-223	-117	-.62
1970	- 82	- 34	-.18

1/ The grace period consists of the last three business days in the month.
2/ Adjusted for repayment of passbook loans made earlier to save interest credited.
NOTE: These fifteen banks account for nearly thirty per cent of total deposits at all mutual savings banks.

SELECTED LIQUIDITY RATIOS AT NONBANK THRIFT INSTITUTIONS

	Savings and Loan Associations 1/		New York Mutual Savings Banks 2/	
	1969	1970	1969	1970
June	10.3	10.5	3.1	3.3
July	9.8	10.1	2.9	3.3
August	9.8	10.1	3.0	3.4
September	9.7	10.0	2.8	3.5
October	9.7	10.5	2.6	3.6
November	10.0	10.7	2.9	3.9

1/ Insured S&L's, which represent about 96 per cent of industry resources. The ratio is of the sum of cash plus all U.S. Government securities plus Federal Agency issues of less than five years, divided by deposit liabilities.
2/ Cash plus all securities due in one year, divided by total assets.

Mortgage market. As a result of the high level of savings inflows to the thrift institutions in recent months, residential mortgage funds now appear to be in relatively ample supply. Seasonally adjusted outstanding mortgage commitments at these institutions were at a 16-month high in November, and recent FNMA field reports and FHA field office surveys confirm the marked improvement in the supply of funds for the mortgage market.[1/]

One indication of the greater availability of funds at private lenders is a recent sharp drop in the demand for FNMA forward purchase commitments. In the auction at the end of December, bids to purchase FNMA commitments totaled only $61 million, the lowest for any auction since this system began in May 1968. Moreover, FNMA has just held its first auction to sell off a small portion of its 8-1/2 per cent Government-underwritten mortgage portfolio. Although the move to sell $25 million of mortgages at this time may in part be an effort to enhance the Corporation's first quarter earnings report,[2/] FNMA would be unable to conduct such an auction if mortgage market conditions had not eased considerably.

The increase in availability of funds has coincided with some reduction in mortgage interest rates and has led to speculation of a further downward movement in these rates in the period immediately ahead. Although the empirical evidence of a sharp downward adjustment

1/ In addition, the enactment of the omnibus Housing and Urban Development Act of 1970, and the Independent Offices and HUD Appropriations Act of 1970, which generally funded programs already in operation, promises further public support for the housing market.

2/ The difference between the price FNMA paid for its mortgages and the price it received from their sale will be reported as ordinary income.

in mortgage interest rates following the recent cuts in the FHA and VA ceiling rate and the prime interest rate is not yet fully available, trade sources and the FNMA auction results suggest that home mortgage interest rates are continuing to decline.

Based on the FHA field market survey for November, conducted just prior to the FHA-VA ceiling rate reduction, yields both in the primary market for conventional home loans and in the FHA secondary market declined modestly. However, in the three FNMA auctions conducted in December, the implicit private market yield for 6-month commitments dropped more than 50 basis points and by the end of the month was nearly 100 basis points below its 1970 high.

FNMA AUCTIONS

	Amount of total offers (Millions of dollars)		6-month commitments	
	Received	Accepted	Discount (Points)	Private market yield (per cent)
Weekly				
1969 - high	$410 (6/16)	152 (9/8)	10.5 (12/29)	8.87 (12/29)
1970 - high	705 (1/5)	151 (1/12)	6.5 (1/12)	9.36 (1/12)
Bi-weekly				
1970 - high	581 (1/26)	298 (1/26)	6.3 (6/28)	9.33 (6/29)
Nov. 2	342	181	3.4	8.93
16	222	170	3.1	8.90
Dec. 7	167	128	4.2	8.54
14	166	125	3.4	8.43
28	61	48	2.1	8.36

NOTE: Average secondary market yield after allowance for commitment fee and required purchase and holding of FNMA stock, assuming prepayment period of 15 years for 30-year Government-underwritten mortgages. Implicit yields shown are gross, before deduction of fee paid by investors to servicers of 50 basis points prior to August 10, 1970, auction, and 38 basis points thereafter. The bi-weekly auction scheduled for November 30 was postponed to December 7.

In contrast to an otherwise improved mortgage market report, the quality of outstanding mortgage credit apparently deteriorated somewhat during the third quarter. Delinquency rates rose in the third quarter to the highest rate since 1967, according to the Mortgage Bankers Association, and the proportion of mortgages in foreclosure was also reported to be at the highest third quarter rate in three years. Regionally, increases in delinquency rates were highest in those areas most affected by layoffs in the defense and aerospace industries. With layoffs in these industries continuing and with economic activity remaining relatively weak, it appears likely that both the delinquency and the foreclosure rates may have risen somewhat further in the fourth quarter.

DELINQUENCY AND FORECLOSURE RATES ON HOUSE MORTGAGES
(Per cent)

	Third quarter averages		Third quarter					
	1953-61	1962-70	1965	1966	1967	1968	1969	1970
Delinquent	2.33	3.05	3.20	3.09	3.15	2.93	2.91	3.11
In foreclosure	n.a.	.32	.36	.33	.31	.26	.25	.31

NOTE: Source Mortgage Bankers Association. Survey based on 4.3 million mortgage loans on 1-to-4 family residential properties held or serviced by approximately 400 member respondents.

Corporate and municipal securities markets. The rally that brought yields on newly issued corporate bonds down over 100 basis points since late October stalled in mid-December. Municipal bond yields, which had also declined a full percentage point over the same period, rose 25 basis points in the last three weeks of the year under the pressure of a new offering total that almost equalled the postwar record set in October of 1968. Equity markets, however, continued to improve through December, with most of the strength, as in previous months, occurring in the higher quality stocks.

BOND YIELDS
(In per cent)

	New Aaa Corporate Bonds 1/	Long-term State and Local Bonds 2/
1970		
Low	7.68 (12/18)	5.33 (12/11)
High	9.30 (6/18)	7.12 (5/28)
Week of:		
November 20	8.39	5.87
27	8.20	5.44
December 4	7.95	5.41
11	7.74	5.33
18	7.68	5.47
25	--	5.50
January 1	--	5.58

1/ With call protection (includes some issues with 10-year protection).
2/ Bond Buyer (mixed qualities).

Lack of new issue activity in the corporate market made it impossible to take interest rate readings on new offerings in the final weeks of the year, but the unusually heavy dealer positions in late December gave evidence of investor resistance to lower rates. The unsold portion of New York Telephone bonds--originally offered on December 14 at a yield ahead of the market--acounted for most of the bonds still in syndicate at year-end. Furthermore, for the first time in two months, several syndicates were terminated with unsold positions in late December, resulting in upward yield adjustments of 12 to 14 basis points, and the New York Telephone syndicate came under heavy pressure in early January when a new Bell System issue was sold at a reoffering yield of 7.85--25 basis points above the yield on the comparable bonds still in syndicate. Although underwriters are looking forward to an upsurge in demand for securities in January, when reinvestment flows are normally heavy, the steadily building forward calendar for early 1971 suggest that any appreciable near-term reduction in the supply of bonds is unlikely.

Corporate bond issues offered publicly in December totalled over $2.2 billion, a record level for this month and a fitting close for a year in which corporations raised $25 billion in the public bond markets. Although the volume of stock offerings in 1970 was little changed from the 1969 level and the annual volume of private placements fell for the fourth year in a row, total corporate security offerings last year amounted to $38 billion, a 44 per cent increase over the 1969 new issue volume.

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

	Bonds		Stocks	Total
	Public Offerings	Private Placements		
1969 - entire year	1,061	468	700	2,229
1970 - entire year	2,092	402e	703e	3,200e
1970 - QIII	1,995	304	553	2,853
QIV	2,516e	466e	816e	3,800e
December	2,200e	700e	650e	3,550e
1971 - January	2,300e	350e	500e	3,150e
February	2,000e	400e	500e	2,900e

e/ Estimated.

The staff now estimates that public bond offerings by corporations in the first quarter of 1971, even though they will probably be 20 per cent below the fourth quarter 1970 pace, may approximate the $2.0 billion monthly average volume of 1970. Underwriters suggest that a number of corporations that have delayed filing new issues in expectation of lower interest rates will probably now schedule issues during the first quarter. Furthermore, prospective issuers with lower ratings and less well-known names than the large industrials that were responsible for much of the 1970 bond total are finding access to the market somewhat easier at the lower rate levels now prevailing. Such issuers are reported to be having difficulty in obtaining accommodation at commercial banks. As in December, the January and February calendar contains a lower-than-normal proportion of utility bonds and a larger number of issues under $100 million and issues by financial firms and transportation companies.

There is as yet no evidence of a pickup in private placements in the next few months, and the staff estimates of takedowns have been reduced accordingly. Announced stock issues by public utilities in the first quarter of 1971 have returned to normal levels; and, despite the recent strength in the stock market, the equity calendar remains below the monthly average levels of 1969 and 1970.

STATE AND LOCAL GOVERNMENT OFFERINGS
(Monthly or monthly averages, in millions of dollars)

1969 - entire year	990
1970 - entire year	1,494e
1970 - QIII	1,473
QIV	1,891e
December	2,200e
1971 - January	2,000e
February	1,800e

e/ Estimated.

Long-term debt issues by State and local governments in 1970 also set a new record, an annual volume of $17.8 billion, which was 45 per cent higher than the 1969 total. Municipal long-term bond offerings in December far exceeded staff estimates made a month earlier as issuers rushed into the market on the heels of sharp declines in the Bond Buyer index. The addition of a number of large revenue issues boosted the December total for tax-exempt offerings to $2.2 billion.

This unseasonally heavy volume and the normal end-of-the-year slowing in trading activity contributed to the buildup of large dealer inventories in mid-December and brought the prolonged late 1970 municipal market rally to a halt. The deterioration in the market occurred despite the continued heavy purchases of tax-exempt securities by banks, which are reported to be making more acquisitions in the 15-year maturity range than they had in previous weeks.

Underwriters expect first-quarter tax-exempt volume to set new records. Based on current schedulings for January, the backlog of authorized but unsold issues, and the needs for funding short-term debt, the staff estimates that January sales of tax-exempts will be about $2 billion. February volume is expected to be little, if any, lower. However, so long as commercial banks continue to add to their holdings of municipals at the recent pace, the market should be able to accommodate this volume without a sharp rise in the level of rates.

Government securities market. Yields on U.S. Government securities rose about 10 to 20 basis points during the latter half of December. This weaker market atmosphere reflected dealer restiveness about their very large inventories, at a time of evident weakening in other securities markets, increased talk of a possible Treasury pre-refunding, and concern about the possible loss of Government security insurance. The rate increases occurred despite the further reduction in the bank prime rate and System purchases of coupon issues totaling about $400 million.

MARKET YIELDS ON U.S. GOVERNMENT AND AGENCY SECURITIES
(Per cent)

	1970		Weekly average for week ending			
	Daily highs 1/	Daily lows 1/	Dec. 15	Dec. 22	Dec. 29	Jan. 5
Bills						
1-month	7.84 (1/28)	4.58 (12/28)	4.76	4.66	4.62	4.77
3-month	7.93 (1/16)	4.74 (12/17)	4.86	4.77	4.87	4.88
6-month	7.99 (1/5)	4.78 (12/17)	4.89	4.81	4.89	4.90
1-year	7.62 (1/30)	4.74 (12/31)	4.86	4.81	4.81	4.75
Coupons						
3-year	8.42 (1/7)	5.60 (12/4)	5.71	5.79	5.83	5.87
5-year	8.30 (1/7)	5.85 (12/4)	5.92	5.97	6.02	6.00
7-year	8.12 (4/26)	6.10 (12/4)	6.17	6.25	6.30	6.28
10-year	8.22 (5/26)	6.21 (12/4)	6.31	6.38	6.55	6.49
20-year	7.73 (5/26)	6.15 (12/16)	6.21	6.23	6.40	6.42
Agencies						
6-month	8.65 (12/27)	5.30 (12/31)	5.40	5.32	5.33	5.30
1-year	8.75 (1/2)	5.53 (12/24)	5.69	5.58	5.56	5.56
3-year	8.54 (1/2)	6.16 (12/21)	6.19	6.18	6.25	6.23
5-year	8.43 (1/15)	6.37 (12/21)	6.46	6.40	6.45	6.42

1/ Latest dates of high or low rates in parentheses.

In the Treasury bill market, rate increases were smaller than in the bond market, although dealers' inventories of bills also remained at high levels. Because of their large positions, dealers generally have bid unaggressively for additional new bills in recent monthly and weekly auctions.

DEALER POSITIONS IN GOVERNMENT AND AGENCY SECURITIES
(In millions of dollars)

	December Daily Average	Dec. 14	Dec. 21	Dec. 28	Jan. 4
Treasury securities					
Total	5,567	4,910	6,315	5,884	5,255
Treasury bills (total)	3,931	3,232	4,668	4,282	3,739
Due in 92 days or less	1,058	737	1,547	991	663
93 days or over	2,873	2,495	3,121	3,291	3,076
Treasury notes and bonds (total)	1,636	1,678	1,647	1,603	1,517
Due within 1-year	462	400	442	547	567
1-5 years	613	689	646	547	463
over 5 years	561	589	558	509	487
Agency securities					
Total	1,047	1,026	994	924	953
Due within 1 year	528	475	500	452	472
over 1 year	519	550	494	472	481

Other short-term credit markets. Final November data on commercial and finance company paper showed a seasonally adjusted decline of $1,526 million, $361 million more than estimated in the November Greenbook on the basis of data up to November 25. Most of the difference was in finance company paper, which declined in the last week of the month.

The seasonally unadjusted weekly data indicate that the downward movement in finance company and dealer paper has continued into December. However, since there is usually a seasonal decline for the month, it is too early to evaluate December as a whole.

Favorable competitive rates on certificates of deposit and a weakening in short-term bank loans have contributed to a further decline in bank-related commercial paper, which fell $655 million during the first three weeks of December as compared with $573 million in November. The cumulative decline in bank-related commercial paper since mid-August is now $5.1 billion.

While bill rates tended to decline until mid-month and then drift back up, other short-term interest rates largely stabilized in the December 2-December 30 period following earlier declines. On net the largest change for the month was a 3/8 of a percentage point increase in one-month finance company paper.

SELECTED SHORT-TERM INTEREST RATES
(Wednesday Quotation - Discount Basis)

	1969 Nov.-Dec. highs 1/	Dec. 2	Dec. 16	Dec. 30	Net change Dec. 2-Dec. 30
1-month					
Commercial paper	9.25 (12/13)	5.50	5.75	5.75	+.25
Finance paper	9.00 (12/31)	5.00	5.13	5.38	+.38
Bankers' acceptances	9.00 (12/31)	5.50	5.50	5.50	--
Certificate of deposit--new issue 2/	6.25	5.38	5.50	5.50	+.12
Treasury bill	7.54 (12/31)	4.85	4.73	4.78	-.07
3-month					
Commercial paper	9.25 (12/31)	6.00	6.25	6.13	+.13
Finance paper	8.13 (12/31)	5.50	5.38	5.50	--
Bankers' acceptances	9.00 (12/31)	5.50	5.50	5.50	--
Certificate of deposit--new issue 2/	6.50	5.63	5.63	5.63	--
Treasury bill	8.00 (12/29)	4.97	4.76	4.89	-.08
6-month					
Bankers' acceptances	9.00 (12/31)	5.50	5.50	5.50	--
Treasury bill	8.09 (12/29)	4.99	4.78	4.91	-.08
12-month					
Certificate of deposit--new issue 2/	7.50	5.63	5.63	5.63	--
Treasury bill	7.86 (11/24)	4.94	4.80	4.78	-.16
Prime municipals 2/	6.25 (11/12)	3.00	2.95	3.10	+.10

1/ Dates of highs in parentheses; latest date used if high occurred on more than one date.
2/ Investment yield basis. Highs for certificates of deposit are ceilings effective as of January 21, 1970.
Source: Wall Street Journal's Money Rates for commercial and finance paper & bankers' acceptances; all other data from the Federal Reserve Bank of New York.

COMMERCIAL AND FINANCE COMPANY PAPER
(End-of-month data, in millions of dollars)

	October	November
	Amounts Outstanding	
Total commercial & finance paper 1/	34,180r	32,654
Bank related 2/	3,699r	3,126
Nonbank related 3/		
Placed through dealers	12,104	12,307
Placed directly	18,377	17,221
	Net Change	
Total commercial & finance paper 1/	-104r	-1,526
Bank related 2/	-887r	- 573
Nonbank related 3/		
Placed through dealers	739	203
Placed directly	44	-1,156

1/ Combines seasonally adjusted nonbank-related paper and seasonally unadjusted bank-related paper.
2/ Seasonally unadjusted.
3/ Seasonally adjusted.

Federal finance. The Board's staff's Federal Budget estimates have not changed significantly since the December Greenbook. On a unified budget basis, the staff projects a Federal deficit in the current fiscal year of about $15.5 billion with outlays of $212 billion.

Expenditure estimates for the current and for the next fiscal year are still rather uncertain. Estimates for both fiscal years depend upon Presidential action with respect to the Federal pay raise recently passed by Congress. The bill gives the President considerable control over the amount and timing of the increase. While it is expected that he will sign the bill, the increase approved may be less than the 6 per cent assumed in the staff estimates. In regard to the next fiscal year, the Administration may propose several new budget programs in the January budget message but it has decided against major new taxes for the time being. In terms of spending projections, a substantial increase in Federal grants and transfer payments is possible depending on the outcome of the revenue sharing program, the House-Senate action on the social security benefit increase, a probable new medical program proposal and other grant-in aid programs. In addition, some observers expect that the January budget message will propose larger appropriations for defense, which might increase the rate of defense spending during the second half of the calendar 1971.

On a NIA basis the staff projects a Federal deficit of about \$14.6 billion in the current fiscal year and \$15.2 billion in calendar 1971. Projected actual receipts for calendar 1971, \$209.0 billion, indicate that the shortfall in receipts, due to the operation of the economy below potential, will be approximately \$18 billion. On a high employment basis, receipts would exceed expenditures in the calendar year by approximately \$4.0 billion.

The short-term outlook for the Treasury cash balance is better than previously estimated partly due to delay in the social security benefit increase and partly due to large receipts from leases of off-shore oil. It now appears that the Treasury might be able to postpone new borrowing until sometime in March, but given the large cash needs in March, the Treasury might still choose to raise some cash in connection with the February refunding.

In the first six months of 1971, net repayment of Federal debt is projected at about $2.3 billion in comparison to a net repayment of $4.4 billion during the same period last year. Agency borrowing in the first and second quarters of 1971 is projected to be negligible on a net basis, compared to the $4.8 billion increase in debt during the first half of 1970.

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

	Fiscal Year 1970*	Fiscal Year 1971e/	Calendar Years F.R. Estimates 1970	Calendar Years F.R. Estimates 1971	Calendar Quarters 1970 I*	1970 II*	1970 III*	1970 IV	1971 I	1971 II
Federal Budget										
(Quarterly data, unadjusted)										
Surplus/deficit	-2.8	-15.4	-11.1	-18.7	-3.5	8.7	-7.8	-8.5	-5.4	6.3
Receipts	193.7	196.6	190.5	203.4	44.4	58.6	46.5	41.0	48.2	60.9
Outlays	196.6	212.0	201.4	222.1	47.8	49.8	54.3	49.5	53.6	54.6
Means of financing:										
Net borrowing from the public 1/	3.8	14.1	12.0	16.6	2.0	-6.4	7.4	9.0	2.4	-4.7
Decrease in cash operating balance	-2.1	.5	-2.8	1.1	-1.6	-1.1	-.8	.7	1.0	- .4
Other 2/	1.1	.7	1.9	1.0	3.1	-1.2	1.2	-1.2	2.0	-1.2
Cash operating balance, end of period	8.0	7.5	8.1	7.0	6.9	8.0	8.8	8.1	7.1	7.5
Memo: Net agency borrowing 3/	10.8	3.8	8.8	n.e.	3.6	1.5	1.4	2.2	.2	5/
National Income Sector										
(Seasonally adjusted annual rate)										
Surplus/deficit	-.4	-14.6	-10.9	-15.2	-1.7	-14.2	-11.9	-15.8	-14.7	-15.8
Receipts	198.9	200.2	195.5	209.0	195.9	196.7	194.9	194.4	204.3	207.3
Expenditures	199.3	214.8	206.4	224.1	197.7	210.9	206.7	210.2	219.0	223.1
High employment surplus deficit 4/	1.1	.7	-.9	3.9	2.7	-5.6	-1.7	1.0	1.0	2.5

* Actual
e--projected   n.e.--not estimated
1/ Excludes effect of reclassification of $1.6 billion of CCC certificates of interest, as of July 1, 1969. This reclassification increased Federal debt, but is not treated as borrowing from the public.
2/ Includes such items as deposit fund accounts and clearing accounts.
3/ Federally-sponsored credit agencies, i.e., Federal Home Loan Banks, Federal National Mortgage Assn., Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives. Projections omit Changes in FNMA (continued)

Footnotes continued

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

3/ discount notes.
4/ Estimated by Federal Reserve Board Staff.
5/ Less than $50 million.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

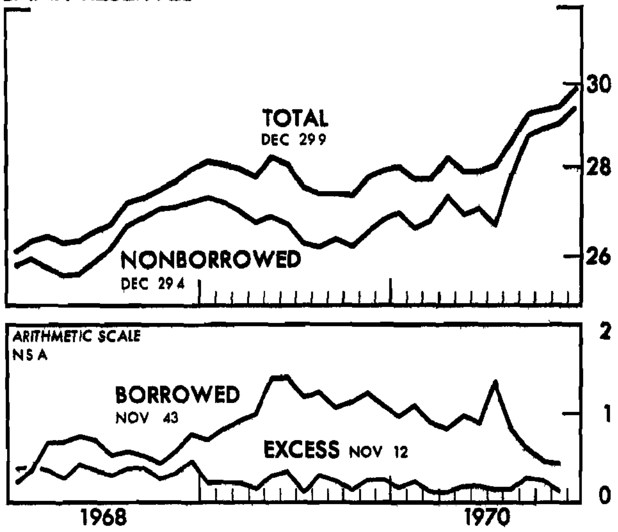
	Dec.	Jan.	Feb.	March
Total net borrowing	3.1	-.3	1.5	1.2
Weekly and monthly bills	3.3	--	.3	.4
Tax bills	--	--	--	--
Coupon issues	--	--	2.0	--
As yet unspecified new borrowing	--	--	--	3.4
Other (debt repayments, etc.)	-.2	-.3	-.8	-2.6
Plus: Other net financial sources a/	-1.1	.9	.4	.7
Plus: Budget surplus or deficit (-)	.2	-.4	-.9	-4.1
Equals: Change in cash balance	2.2 b/	.2	1.0	-2.2
Memoranda: Level of cash balance, end of period	8.1 b/	8.3	9.3	7.1
Derivation of budget surplus or deficit:				
Budget receipts	15.4	17.0	16.8	14.4
Budget outlays	15.2	17.4	17.7	18.5
Maturing coupon issues held by public	--	--	5.0	1.0
Net agency borrowing	.9	*	*	.2

* Less than $50 million
a/ Checks issued less checks paid and other accrual items.
b/ Actual

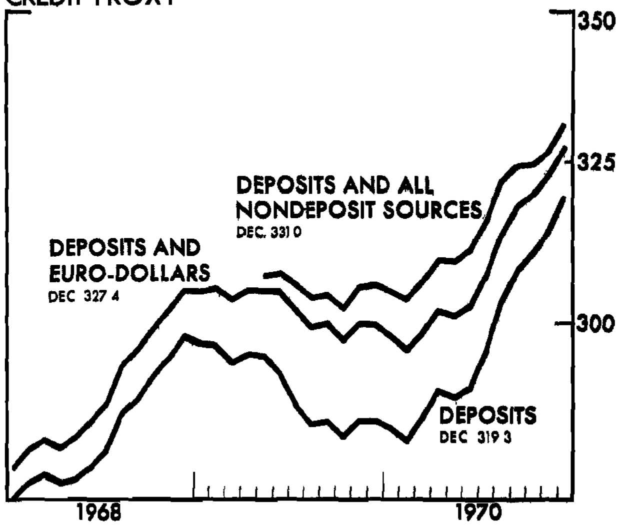
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

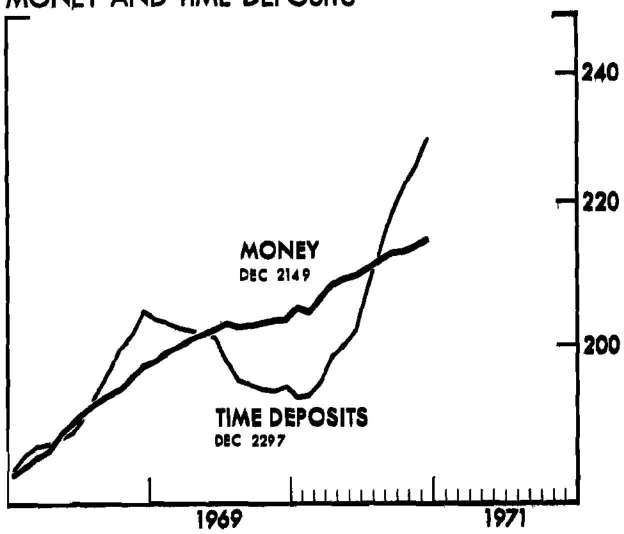
BANK RESERVES



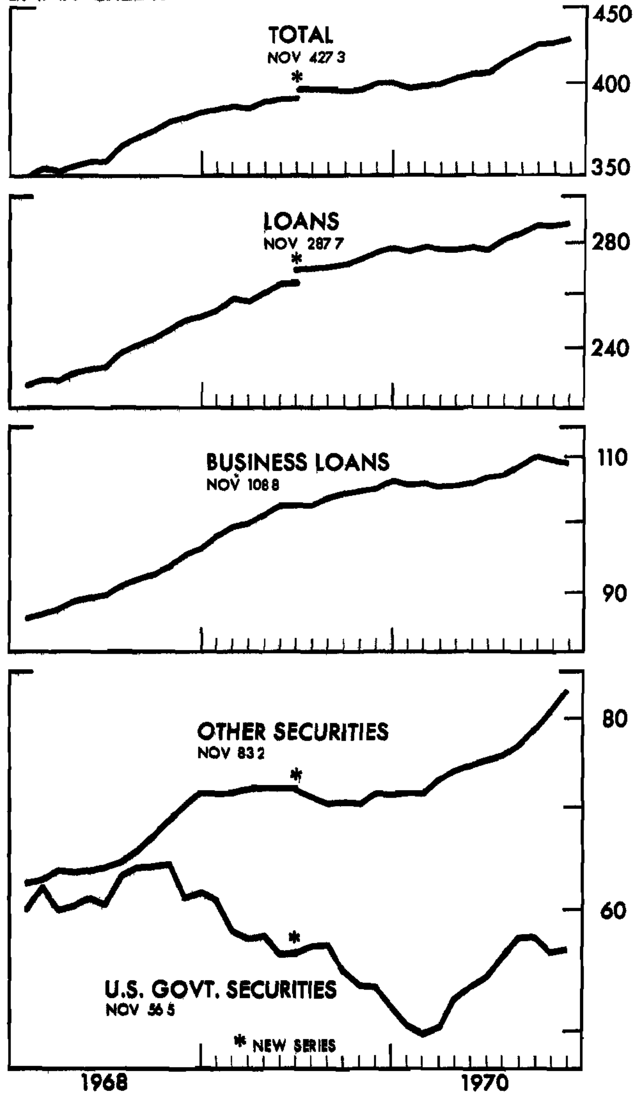
CREDIT PROXY



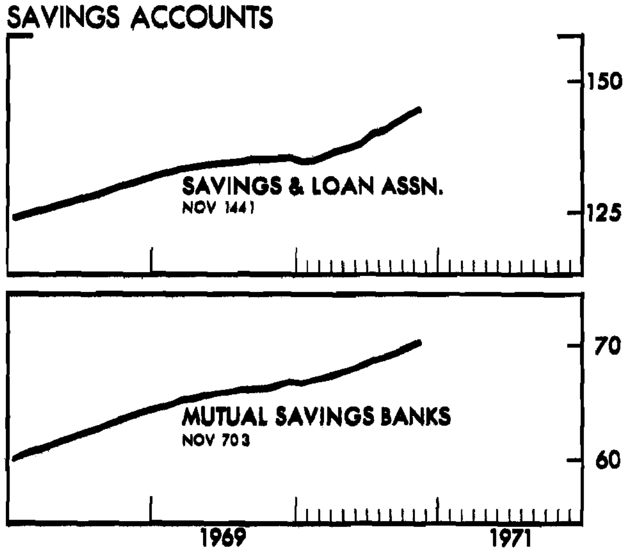
MONEY AND TIME DEPOSITS



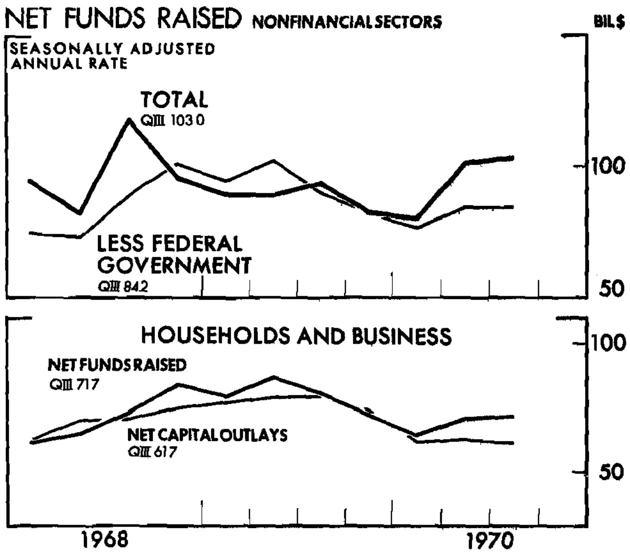
BANK CREDIT

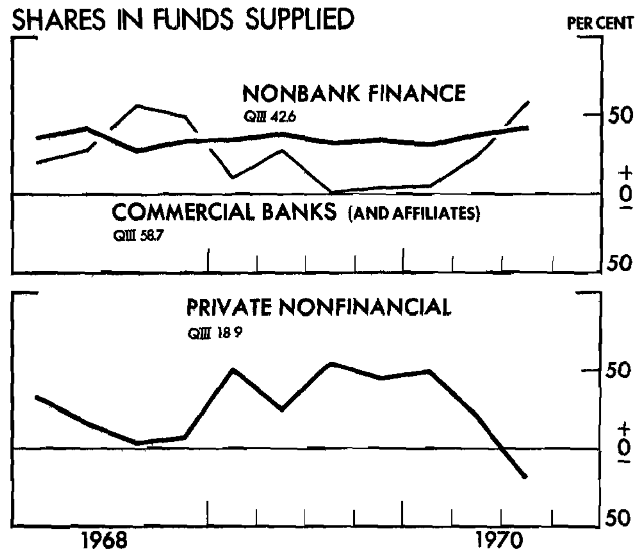


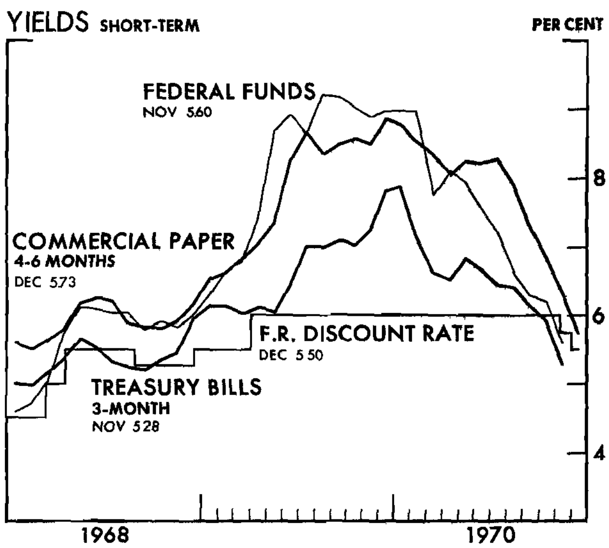
SAVINGS ACCOUNTS

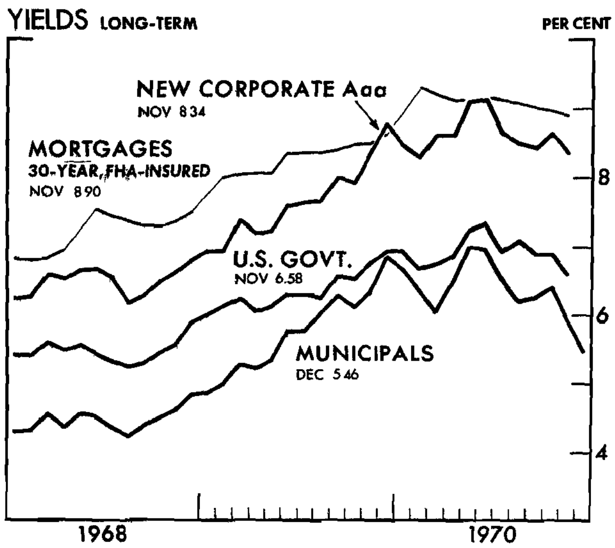


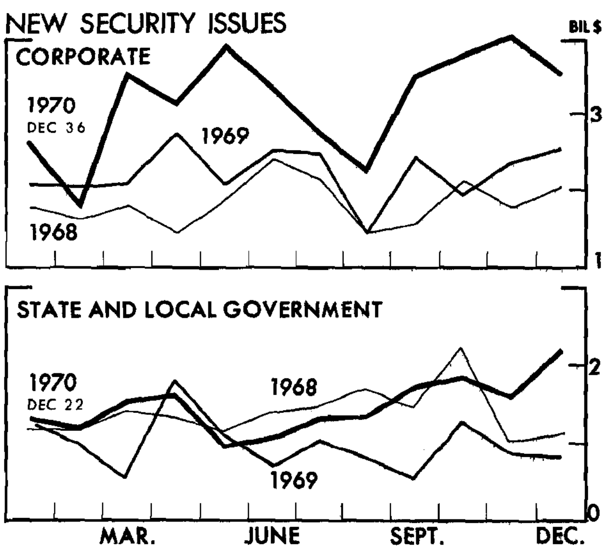
FINANCIAL DEVELOPMENTS - UNITED STATES

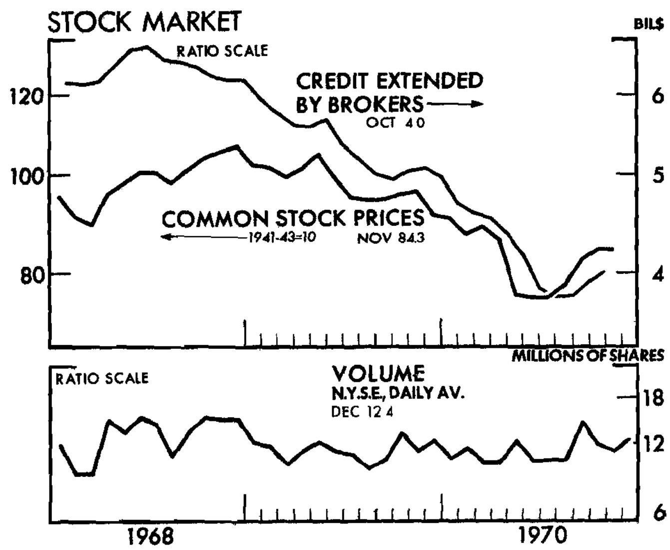












THE ECONOMIC PICTURE IN DETAIL

International Developments

U.S. balance of payments. In the fourth quarter of 1970 the over-all balance-of-payments position did not appear to improve quite as much as had been hoped for, considering the size of the inflow that seemed to be required to satisfy the direct-investment regulations. Moreover, developments in merchandise exports and imports, discussed in some detail below, resulted in a shrinking of the export surplus to an annual rate of only $0.2 billion in October-November. Although some retreat from the strong trade performance of mid-year was expected, the decline occurred earlier and much more sharply than had been anticipated.

In view of the large and variable flows of funds at year end, it is difficult to estimate the over-all balance. Our preliminary guess is that the rate of adjusted liquidity deficit for the fourth quarter was of the magnitude of $3.0 billion, annual rate, not much changed from the third quarter rate. (The combined deficit for October and November, not seasonally adjusted but before special transactions, was about $925 million. For December, the weekly data plus a figure for the change in liabilities to branches on December 31 suggest an unadjusted liquidity surplus of perhaps $1.0 billion. The fourth quarter is seasonally expected to be quite favorable.) The liquidity deficit for the year (before special transactions or SDR allocations) would thus be somewhat below $5.0 billion. For the year 1969 the comparable deficit was $6.0 billion. Special transactions with foreign governments had the effect of worsening the 1969 balance by $1.0 billion, so that the published deficit was $7.0 billion, while in 1970 such transactions reduced the deficit by about $300 million.

Information on capital flows in the fourth quarter is very scant at this time. Bank-reported claims on foreigners rose $213 million in November, following comparable outflows in September and October. This does not seem to be out of line with normal seasonal expectations. U.S. purchases of foreign securities (net) were quite small in November, and though there may have been an increase in December (when a sizable Canadian issue was offered) were probably much lower than in the third quarter. For the year as a whole the outflow was well below the $1.5 billion of 1969. The behavior of the year-end data suggest somewhat less window-dressing of direct investments than in 1969. For the first three quarters of 1970 the net outflow of U.S. corporate funds was $640 million higher than in the same period of 1969; in the fourth quarter of 1969 there was no net outflow, but there may have been a small outflow in the final quarter of 1970.

Foreign net purchases of U.S. corporate stocks were about $100 million in November, off somewhat from the $150 million per month average of August-October. The U.S. stock market has been performing markedly better than other major markets since June. There was also a continuing sizable inflow of foreign funds to purchase U.S. corporate bonds.

On the official settlements basis there was an unadjusted deficit in December of perhaps $650 million -- based on incomplete data. This would be very much lower than the November deficit of $2.0 billion, when repayments of Euro-dollar borrowings were at peak rates. For the fourth quarter, the seasonally adjusted official settlements deficit was roughly $3-1/2 billion, and for the year this deficit was about $10-1/2 billion (before SDR allocation). For the quarter, as for the year as a whole, this record deficit was financed about one-third by a decline in U.S. reserve assets and two-thirds by an increase in U.S. liabilities to foreign official agencies.

The 1970 deficit on the official settlements basis was, of course, swollen by the exceptional $6 billion rundown in U.S. liabilities to commercial banks abroad, just as in 1969 the balance had been distorted in the other direction by huge inflows. The average deficit for the two years taken together was about $4 billion per year, and this figure may be taken as roughly representative of the size of the underlying disequilibrium that persists as a new year begins.

<u>U.S. foreign trade</u>. The trade balance in November 1970 was in deficit by $0.5 billion at a seasonally adjusted annual rate (balance-of-payments basis), down from the already small $0.9 billion surplus in October. This continued the steady deterioration in the trade balance which began in mid-1970, as exports have tended to fall while imports have reached record heights. The export surplus in October-November of $0.2 billion at an annual rate was almost $2.7 billion below the third-quarter level. For the first 11 months of 1970 combined, the surplus stood at an annual rate of $2.3 billion.

<u>Exports</u> in the October-November period were $42.0 billion at a seasonally adjusted annual rate, balance-of-payments basis -- 1.7 per cent lower than in the third quarter and only 5-1/2 per cent higher than in the same period of 1969. Exports of agricultural products increased, but not by enough to offset declines in non-agricultural exports.

U.S. MERCHANDISE TRADE 1/
(Billions of dollars, seasonally adjusted annual rates)

	1969	1970				
		Q-1	Q-2	Q-3	Oct.	Nov.
Exports	36.5	40.9	42.8	42.7	43.1	40.9
Agricultural	6.0	6.7	7.1	7.4	8.0	7.5
Nonagricultural	30.5	34.2	35.7	35.3	35.1	33.4
Imports	35.8	38.9	39.5	39.8	42.2	41.4
Balance	+0.7	+2.0	+3.3	+2.9	+0.9	-0.5

1/ Balance of payments basis.

Among the agricultural exports, wheat, rice, corn, unmanufactured tobacco, and cotton were all up significantly in October-November compared with the third quarter. The increase in wheat and corn exports reflected the continued shortage in foreign supplies and the strong growth in foreign demand for animal feeds, while the rise in cotton and tobacco shipments represented primarily a recovery from relatively low third-quarter levels. Soybean exports, after seasonal adjustment, on the other hand, were off somewhat from the extremely buoyant third-quarter rate despite high October and November prices (unit values). Exports of oils and fats and hides and skins were also lower in October-November, on the average, than in the third quarter.

The fall in exports of nonagricultural commodities between the third quarter and October-November is more than accounted for by sizable declines in steel and automotive exports. The decline in steel exports reflected a return to the pre-boom levels of the first half of 1969 as tight supply conditions in Western Europe and Japan eased. The reduction in exports of cars was associated mainly with the GM strike.

Exports of civilian aircraft, in contrast, were much higher in October-November than in the third quarter. Smaller gains were made in shipments of coal, chemicals, and machinery.

In October-November, exports to Canada, the EEC countries, and Japan -- which together account for about 50 per cent of total U.S. exports -- were below third-quarter levels. These declines exceeded the increases in exports to the rest of the world.

Imports in October-November were at a seasonally adjusted annual rate of $41.8 billion (balance-of-payments basis), 5 per cent above the already high third-quarter level and 9 per cent higher than in the same period of 1969. Sizable increases occurred in imports of petroleum, industrial materials, and automobiles. Gains were registered also in imports of machinery and miscellaneous consumer goods, groups for which there has been a steady upward trend over the years. Imports of food and crude materials were the only categories with a lower average in October-November than in the third quarter.

Imports of petroleum were significantly higher in October-November as the United States continued to face domestic fuel shortages. Further increases are expected in 1971 as the liberalization of import quotas becomes effective.

Despite the slackening in U.S. domestic production, imports of industrial materials in October-November were substantially above third-quarter levels. Imports of textile yarns and fabrics attained record highs for 1970, as foreign suppliers and U.S. importers reacted to the possible imposition of U.S. quotas. Imports of chemicals and metals, particularly steel, also showed great gains. The October-November increase in steel imports can be attributed mainly to semifinished steel mill products from the European Economic Community, where supply conditions have continued to ease. Not only has the volume of steel imports resumed an upward trend during 1970 but import unit values have been significantly above last year's average.

Imports of automobiles were higher in October-November than in the third quarter. This was especially true of imports from Canada despite the fact that the GM strike continued in Canada through mid-December.

In October-November, imports from all major areas, except Australia and Latin America, exceeded third quarter levels. Especially large increases occurred in imports from Canada and Japan.

An important factor in the larger than expected rise in imports in 1970 was the jump in import prices -- as measured by unit values. In the third quarter of 1970 unit values of imports of finished manufactures were 11.2 per cent higher than a year earlier and for total imports the price increase was 9.6 per cent. At the same time the quantity of total imports, and of the finished manufactures category, appears to have been lower in the third quarter of last year than in the third quarter of 1969. This was quite different from the experience in 1968-69, when price increases were small but quantity increases were large. The value of U.S. exports also reflected higher prices in 1970, but less so than imports. In the third quarter export unit values were up about 5-3/4 per cent over the year before.

Euro-dollar market. Liabilities of U.S. banks to their foreign branches continued to decline, on balance, in December, with large day-to-day fluctuations. In the four week computation period for

Euro-dollar reserve requirements ended December 23, gross liabilities to foreign branches are estimated to have averaged about $600 million below their daily average in the preceeding computation period. Weekly Wednesday data show a decline of about $700 million from November 25 to December 23, to a total of $8.1 billion (including domestic loan participations).

From December 23 to 31 liabilities to foreign branches declined further by about $1.2 billion ($400 million by December 30 and the remainder on December 31). There is little doubt that this drop primarily reflects foreign branch financing of American corporate repatriations to be largely reversed in early January. However, in the first half of the December 24-January 20 computation period U.S. banks' gross liabilities to foreign branches appear to have averaged about $700 million below the average for the computation period ended December 23. If the banks are going to rebuild borrowings to the average level of the last computation period they will have to bid heavily for funds in the next two weeks.

Interest rates in the Euro-dollar market reached their December highs around mid-month, and since then have declined substantially. Call and one-month deposit rates have declined from about 8-1/2 per cent in mid-December to around 6-1/4 per cent -- remaining somewhat above their late November levels. Rates for three-month and longer maturities advanced to a high of about 7-7/8 per cent in mid-December; as of early January rates in these maturities are down to a range of about 6-1/2 to 7 per cent -- moderately below their late November levels. With the sharp run-up in rates in early December the excess of Euro-dollar rates over the cost of domestic sources of funds to U.S. banks had widened to very high levels (See table). By the first few days in January the excess of the call Euro-dollar rate over the Federal funds rate declined to about 1 per cent (still well above the November average differential) while the excess of the three-month Euro-dollar rate over the (adjusted) 60-89 day CD rate declined to about 1/2 to 3/4 per cent.

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

Average for month or week ending Wednesday	(1) Call Euro-$ Deposit 1/	(2) Federal Funds 2/	(3)= (1)-(2) Differential	(4) 3-month Euro-$ Deposit 1/	(5) 60-89 day CD rate (Adj.)3/	(6)= (4)-(5) Differential
1970						
September	7.88	6.29	1.39	8.03	7.64	0.39
October	6.65	6.20	0.45	7.94	6.97	0.97
November	5.98	5.60	0.38	7.17	6.26	0.91
Dec. 2	6.91	5.50	1.41	7.31	5.79	1.52
9	6.75	4.91	1.84	7.30	5.92	1.38
16	7.65	5.07	2.58	7.58	5.79	1.79
23	5.85	4.84	1.01	7.19	5.79	1.40
30	6.00	4.82	1.18	6.95	5.79	1.16
1971						
Jan. 6	6.03	n.a.	n.a.	6.44	5.79 p/	0.65 p/

1/ All Euro-dollar rates are noon bid rates in the London market.
2/ Effective rate.
3/ Offer rate (median, as of Wednesday) on large denomination CD's by prime banks in New York City; CD rates are adjusted for the cost of required reserves.
p/ Preliminary.

Foreign exchange markets. During December exchange rates moved mainly in response to changes in interest differentials between the Euro-dollar market and national money markets. Foreign currencies generally eased over the first half of the month as Euro-dollar rates increased, then firmed toward month-end as Euro-dollar rates declined. Outright spot dollar purchases by major European central banks and the Bank of Canada amounted to about $300 million for the month, compared to a massive $1.9 billion in November. The pace of market activity picked up somewhat in the first few days of January, but there was no major intervention by foreign central banks.

The German mark rate dropped dramatically in early December, touching parity briefly, as the Bundesbank's discount rate cut on December 2, the second in two weeks, combined with sharply higher Euro-dollar rates to halt the movement of funds into Germany. Later in the month the mark firmed moderately with the decline in Euro-dollar interest rates. During the month of December, the Bundesbank sold a nominal amount of dollars, in sharp contrast to November when it had purchased $1.3 billion in intervention operations.

The Dutch guilder, Belgian franc, and Italian lira exchange rates also softened in the first half of December but firmed later. The central banks of Belgium and the Netherlands each purchased a small amount of dollars during December, and the Bank of Italy purchased $156 million.

The French franc rate moved only slightly during December. The Bank of France purchased about $50 million during the month, compared with $180 million in November.

Sterling appeared relatively unaffected by the early December firming of Euro-dollar rates, as the exchange rate held in a narrow range around $2.39. The pound advanced in late December as Euro-dollar rates eased relative to British interest rates and moved above $2.3950 in early January.

Strong commercial demand for the Canadian dollar, coupled with some short-covering of Canadian dollar positions by New York banks, led to a strong advance in its rate, from around 98 U.S. cents in early December to about 99 cents at year end.

<u>Prices and wages in major industrialized countries</u>. The economies of the Common Market countries and of the United Kingdom and Japan continued to experience a rapid rate of price inflation in 1970. Increases in the cost of living during the year in these countries -- as measured by consumer prices -- ranged from about 4 per cent in Belgium and Germany to over 7 per cent in Britain. In Canada, by contrast, the rate of inflation substantially slowed last year, as a broad array of restrictive measures helped reduce the increase in the cost of living from 4.5 per cent during 1969 to less than 3 per cent during 1970.

The rate of inflation generally appeared to moderate after the first quarter, but price increases accelerated in Japan and the Netherlands in the latter part of the summer and in Germany during the autumn. In the United Kingdom, a burst of inflationary wage settlements in the fourth quarter portends a spurt in the rate of price inflation in the near future.

Inflation during 1970 was largely a function of steeply rising wages, whose rate of advance was little impeded by demand restraint measures and which overwhelmed the deflationary effects of such developments as a sharp drop in metals prices.

Substantial rises in unit wage costs -- in many instances reflecting not only the inevitably faster increase in wages than in prices but also unusually low advances in productivity -- caused a pervasive squeeze on profits.

Despite continued inflation, consumers were not stampeded into forsaking money for goods. In many countries the rise in real income exceeded the increase in real consumer expenditures. The restraint shown by consumers -- at a time when inflationary expectations were presumably strong -- implied widespread concern over the impact on employment of the efforts of most governments to curb the growth of aggregate demand.

Despite the predominant role of wage increases in the current inflation, none of the large European countries has moved to supplement tight fiscal and monetary policy with direct controls over price and wage increases. Japan, however, recently instituted a modified price freeze, and several smaller European countries --

CONSUMER PRICES FOR SELECTED COUNTRIES a/
(Percentage changes at annual rates)

	1969 Q-4 / 1968 Q-4	Latest 3 mos. / 1969 same 3 mos.	Latest 3 mos. / 1970 Q-1	Latest 3 mos. / Previous 3 mos.
Belgium (Oct.)	4.2	3.8	2.9	2.5
France (Oct.)	5.8	5.7	5.1	4.0
Germany (Nov.) b/	2.8	4.1	3.5	3.2
Italy (Sept.)	4.0	4.7	4.3	3.2
Netherlands (Oct.)	6.9	5.5	6.5	8.0
Canada (Nov.) b/	4.5	2.6	1.9	-0.1
Japan (Oct.)	5.9	7.2	6.8	11.3
United Kingdom (Nov.)	5.1	7.4	7.3	6.5

a/ Latest month for which data are available is indicated in parenthesis after each country.
b/ Seasonally adjusted.

the Netherlands, Finland, Norway, Sweden, and Denmark -- have imposed direct curbs of one sort or another on prices and wages. (Ireland introduced price and wage controls in October but abandoned them in December.) Why the smaller countries are resorting to direct controls while the larger countries are not is not clear. One reason may be that such controls can be more easily and more equitably administered in smaller countries.

It seems unlikely that the rate of price inflation will significantly abate this year, primarily because there is little indication that the current wage inflation will diminish to any marked degree.

WHOLESALE PRICES FOR SELECTED COUNTRIES a/
(Percentage changes at annual rates)

	1969 Q-4 / 1968 Q-4	Latest 3 mos. / 1969 same 3 mos.	Latest 3 mos. / 1970 Q-1	Latest 3 mos. / Previous 3 mos.
Belgium (Oct.) b/	4.7	6.5	4.1	7.0
France (Sept.) c/	11.4	7.5	3.8	-1.3
Germany (Nov.) d/	4.4	5.2	3.3	3.2
Italy (Sept.) e/	5.9	7.4	4.6	4.2
Netherlands (July) f/	6.0	7.7	5.1	6.8
Canada (Nov.) g/	3.6	0.7	-0.4	-0.9
Japan (Nov.) f/	3.6	2.4	0.8	0.2
United Kingdom (Nov.) h/	4.3	7.3	7.0	6.3

a/ Latest month for which data are available is indicated in parenthesis after each country.
b/ Finished industrial products.
c/ Intermediate goods.
d/ Industrial producer prices, seasonally adjusted.
e/ Non-agricultural products.
f/ All commodities.
g/ Manufactures, seasonally adjusted.
h/ Manufactures.

Despite clear signs of a slowdown in economic activity, the rate of price inflation in Germany remains high, at least by German standards. The rate of increase in prices, particularly those for investment goods and consumer durables, advanced sharply in October and November, after several months of more moderate increases. (Production of these goods rose in October after declining in August and September.)

Wages, too, have climbed more rapidly in recent months than earlier in the year -- with settlements generally providing annual hikes of 12 per cent -- and these pay boosts may largely explain the apparent acceleration in the advance of prices lately.

WAGES IN SELECTED COUNTRIES a/
(Percentage changes at annual rates)

	1969 Q-4 / 1968 Q-4	Latest 3 mos. / 1969 same 3 mos.	Latest 3 mos. / 1970 Q-1	Latest 3 mos. / Previous 3 mos.
Belgium (Sept.) b/	9.0	7.6	10.3	11.2
France (Oct.) c/	8.1	10.7	10.5	9.4
Germany (Oct.) d/	13.4	14.0	9.3	6.2
Italy (Aug.) e/	10.7	20.2	9.9	9.9
Netherlands (Sept.) f/	8.5	10.1	10.7	9.7
Canada (Oct.) g/	8.1	7.8	4.8	4.8
Japan (Oct.) h/	16.6	19.3	19.5	15.7
United Kingdom (Nov.) i/	5.4	11.9	10.4	11.9

a/ Latest month for which data are available is indicated in parenthesis after each country.
b/ Hourly earnings in mining, manufacturing, transport.
c/ Hourly wage rates in manufacturing.
d/ Wages and salaries per employed person, seasonally adjusted.
e/ Contractual wage rates in industry.
f/ Hourly wages per male worker.
g/ Average hourly earnings in manufacturing, seasonally adjusted.
h/ Nominal cash earnings in manufacturing.
i/ Weekly wage rates, all industry.

Though faster in 1970 than in 1969, the rate of price inflation in Germany last year was low in comparison to other major countries. Consumer prices, for instance, increased by only about 4 per cent during the year. The previous year the increase was about 3 per cent. The rise in 1970 would have been somewhat greater but for the effect of the 1969 revaluation on food prices, which under Common Market rules are based on dollar values.

German industry was less able to absorb wage increases last year than in 1969 because of a slowing in productivity gains. Unit wage costs rose by a sizable 8 per cent in 1970 over 1969. Consequently, profits were squeezed last year. Wages and salaries per employed person rose by 14 per cent between September-November 1969 and the same three months in 1969. The comparable 1968-69 increase was 11 per cent.

The Council of Economic Experts expects a slight decline in the rate of inflation in 1971, to about 3-1/2 per cent for consumer prices. Its forecast apparently assumes that wage settlements this year will be more moderate, first because the contracts up for negotiation will affect fewer workers and, second, because those affected are thought to be less militant than the workers involved in wage settlements last year. The Council also assumes that the anticipated slackening in real growth will extend to consumer expenditures, which so far have remained buoyant.

Consumer prices in France in October were about 5-1/2 per cent higher than a year earlier. Wages in 1970 increased more rapidly than in any other post-war year except 1968, when the Grenelle agreement in the aftermath of the May civil disturbances had raised wage rates in manufacturing by over 10 per cent in the second quarter alone. Hourly rates rose by 10.5 per cent from the third quarter of 1969 to the third quarter of 1970.

French inflation has been primarily cost-push, reflecting not only wage pressures but also gradual food price increases under the European Common Agricultural Policy as modified by agreement with the Community after the devaluation of the franc in 1969. Under the CAP rules, food prices are measured in dollars and thus had to be raised when the franc was devalued but France was permitted to raise prices in several stages.

Despite the sizable increases in money and real wages, real consumption expenditures have been sluggish, largely because of the prohibitive restrictions on installment buying in effect until October and the public's desire to rebuild savings depleted in the buying spree in the spring and summer of 1969.

Inflation is likely to continue at the current rate in 1971, with wage increases expected to be well in excess of productivity gains, as they were in 1970. The government, early in 1970, urged that wage contracts link wage hikes to productivity increases, but this attempt at incomes policy appears to have been a failure.

In <u>Italy</u>, there has been a deceleration in the rate of increase in prices since March -- moderate with respect to consumer prices, but marked in the case of wholesale prices of non-agricultural goods.

Wholesale prices rose by over 9 per cent from March 1969 to March 1970 but only by about 4-1/2 per cent, annual rate, from March to September. Sharp slowing of the increases in import prices of basic materials and semi-manufactures, and in wage rates were the principal contributors to this development. Import prices, after increasing by about 15 per cent from March 1969 to March 1970, were virtually flat from March to August.

Wage rates in industry rose by a substantial 8.5 per cent annual rate from February to August, but this was far below the more than 20 per cent increase in the year February 1969 to February 1970. The slowing reflected the fact that most of the wage increases won during the strikes of late 1969 became effective immediately in January 1970 rather than being spread out over the three years for which most of the contracts will be valid.

The more moderate slowing of the rise of consumer prices -- exclusive of food,they advanced by 3.7 per cent, annual rate, from March to August, compared to 5 per cent in the year to March -- in part reflects the lag with which retail prices respond to changes in wholesale prices. Moreover, the rise in consumer prices would have slowed more markedly but for the acceleration of wage increase in services, which rose by 18 per cent, annual rate, from February to August after rising by only 10 per cent in the year up to February.

In Italy too the rise in real consumption appears to have been substantially less than the increase in real income of wage earners.

Italian inflation has been mainly cost-push in character. This summer the government, concerned that growing aggregate demand might aggravate the problem, increased sales taxes and raised employers' contributions to social security, the latter effective January 1, 1971.

In the United Kingdom, there was no appreciable change in the rate at which prices of consumer goods advanced during the second half of 1970 compared to the first half. In the five months June to November the retail price index rose by about 7 per cent, annual rate, little changed from the 7.7 per cent annual rate rise in the five months January to June. Wholesale prices of manufactured goods moved up in similar fashion, at annual rates of 7.4 per cent in January-June, and 6.7 per cent in June-November.

Wage inflation, however, accelerated in the latter part of the year, weekly wage rates rising by more than a 14 per cent (annual rate) in June-November, after increasing by about 10 per cent annual rate in the preceding five months. Wages spurted up particularly sharply in November, reflecting recently granted boosts of 10 to 15 per cent a year for about 2 million workers.

Both prices and wages increased much more rapidly in 1970 than in 1969. From September-November 1968 to September-November 1969, retail prices increased by 5.3 per cent, wholesale prices of manufactures by 4.3 per cent, and weekly wage rates by 5.6 per cent. The increases for retail and wholesale prices between the same three-monthly periods in 1969 and 1970 were 7.4 and 7.3 per cent, respectively, while wage rates rose by 11.9 per cent during this interval. Total wage earnings per worker increased even more rapidly, by 13 per cent from third quarter 1969 to third quarter 1970.

British inflation in 1970 was clearly of the cost-push variety, occurring against a background of high unemployment, which has not appreciably diminished in recent months despite a strong and steady rise in industrial production since July. The upward push on prices came primarily from wages, which began to increase at an accelerated pace in the summer and autumn of 1969.

Real consumer expenditures rose only moderately during 1970. The rise in the proportion of income saved that occurred last year -- presumably a period of strong expectations of further inflation -- suggests that concern with inflation was outweighed by other considerations, notably fear of unemployment.

Under the pressure of rising wage costs, company pre-tax profits have steadily fallen at an annual rate of about 10 per cent since the third quarter of 1969.

To bring inflation under control, the government is relying primarily on restrictive monetary policy and encouragement to employers to resist exorbitant wage demands. The present policy of eschewing statutory limits on wage and price increases apparently won a measure of vindication last month when outraged public opinion prompted Britain's electric power workers to terminate a work "slowdown" by which they had hoped to force acceptance of their wage demands. The dispute is now before a court of inquiry.

The public's angry response to the power workers' slowdown -- coupled with the rise in disposable income which the income tax cut in April will produce -- may persuade other unions to put forward wage demands more moderate than those of recent months. Nevertheless, wage settlements are likely to continue to be very high compared to previous years -- in the electric power dispute, for example, management was offering a 10 per cent a year wage boost -- and neither price nor wage inflation can be expected to abate significantly in 1971. With the economy now growing, in real terms, at about its capacity rate of 3 per cent a year, and with growth likely to be sustained at this rate through 1971, inflation might even be intensified by the addition of demand to cost pressures. A more rapid increase in productivity, which is likely to accompany the recovery in the growth of output, might, however, partially offset the inflationary impact of excessive wage increases.

In Belgium, wholesale prices of finished industrial goods increased by about 4.5 per cent, annual rate, from March to October, following a rise of about 6 per cent in the March 1969-March 1970 interval. The 1970 increase took place despite a decline in prices of industrial semi-finished goods and raw materials associated with decreases in import prices of these items.

The increase of consumer prices slowed after April, almost entirely because of a leveling off in food prices. In contrast, the rate of increase in prices of non-food items has not slowed; in October prices of consumer goods other than food were almost 3 per cent higher than a year earlier. The increase from April 1969 to April 1970 had been 2.3 per cent.

Wages during 1970 increased at an accelerated rate. The year-to-year rise in hourly rates in manufacturing increased from 9 per cent in December 1969 to almost 12 per cent in September.

Aggregate demand, by contrast, increased more slowly in 1970 than in 1969, and the cost-push element took on increasing importance in explaining the increase in Belgian prices.

The introduction of a value-added tax in Belgium this month is expected to have a significant inflationary impact.

Inflationary pressures in the Netherlands intensified during the second half of 1970, leading to the reimposition of tight restrictions on price increases. These restrictions are to remain in effect until March. In December, price controls were supplemented by moderate curbs on wages, which will limit wage increases in new contracts to 4 per cent over a six month period.

The suspension of price controls at mid-year was a major factor in the increased rate of price rises, as was a series of strikes last summer which succeeded in winning substantial wage hikes. The surge in strike activity reflected a catch-up effort by Dutch workers, whose real income rose much less rapidly than real GNP in 1969.

Dutch inflation is not only a cost-push phenomenon, however. The economy has been operating essentially at full capacity for two years, with strong demand for Dutch exports in 1969 and vigorous domestic demand in 1970 putting intense pressure on domestic resources. The government, apparently intent on cooling the boom, has proposed several tax increases and expenditure cuts in its draft 1971 budget.

Consumer prices actually rose faster during 1969 than last year. From August-October 1968 to August-October 1969 consumer prices, for example, rose by about 8 per cent, compared to 5.5 per cent between the same periods in 1969 and 1970. The more rapid increase in 1969 resulted from the steep price increases associated with the introduction of a value-added tax early that year. Price increases moderated in late 1969 in response to the imposition of price controls in September. These were removed in June 1970.

Despite a decline in Japanese wholesale prices since mid-1970 -- resulting mainly from a drop in prices of metals -- consumer prices in Japan have risen rapidly in recent months. The government responded in December by imposing a price freeze on goods and services whose prices it is empowered to regulate. The affected items have a total weight of almost 20 per cent in the consumer price index.

A major objective of this action -- which came only two months after monetary policy was eased in October -- is to induce labor unions to exhibit moderation in their wage demands this spring. But the government has indicated that it may be necessary to introduce an incomes policy to restrain wages as well as prices.

For the last two years, cost-push factors have played an increasingly important part in driving up prices in Japan. In particular, wages in 1969 and 1970, in contrast to previous years, increased somewhat faster than productivity. The rate of inflation in Japan was greater in 1970 than in 1969. The year-to-year rise in consumer prices was about 7.5 per cent in 1969-70 compared to only 5.2 per cent in 1968-69. Wages also rose faster last year -- 18 per cent in 1970 over 1969, compared to 15 per cent in 1969 over 1968.

Price performance in Canada has improved considerably since the early months of this year, reflecting the effective restraint of domestic demand, the measure of success achieved by the Prices and Incomes Commission in obtaining restraint in pricing by business, and the appreciation of the Canadian dollar. Over the period April-November, consumer prices rose at an annual rate of only about 1.5 per cent. Although this result was influenced by the downturn in food prices, the rate of increase of the consumer price index excluding food has also decelerated; it rose by only a little more than 3 per cent (seasonally adjusted annual rate) in this period against 4.6 per cent in the previous 12 months. Wholesale prices have tended to decline since the second quarter of this year.

The progress made in bringing down the rate of price inflation occurred even though there has been little evidence of a moderation in the rate of wage increases, notwithstanding the rise in unemployment -- to 6.9 per cent in September, after which it declined to 6.5 per cent in November. Though a wage guideline of 6 per cent had been announced early in 1970 by the Prices and Incomes Commission, the average annual increase in base rates resulting from major wage settlements was around 9 per cent during the first 9 months of 1970. Data on hourly earnings also showed wages rising at close to that rate through the autumn.

Despite the continuation of wage inflation, the Prices and Incomes Commission dropped its wage-price guidelines at the end of the year because of labor's refusal to accept them and business' unwillingness to support them in the absence of cooperation from other groups.

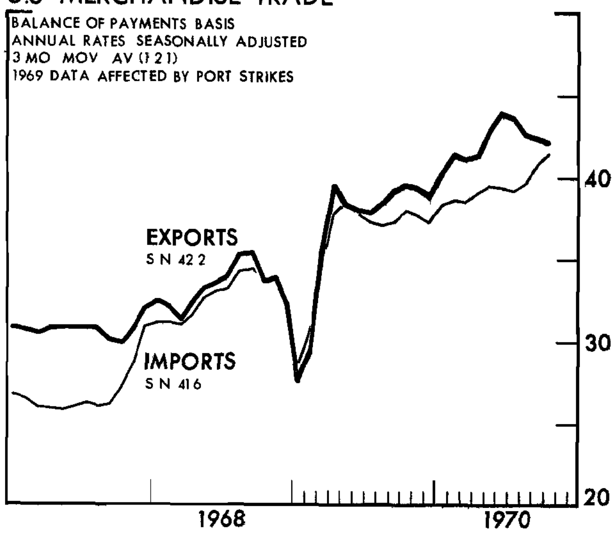
Because of rising unemployment, the government adopted several moderately expansionary fiscal and monetary measures last year. Most recently, in December, a revised budget for the year ending March 13 was presented to Parliament, providing for increased unemployment benefits, more federal government aid to the provinces and an additional allocation of funds to various governmental departments and agencies for capital investment in regions where unemployment is particularly high. Furthermore, a method of calculating capital cost allowances was proposed that is expected to reduce corporate taxes by about $25 million annually.

It is widely thought, however, that the stimulative action taken by the government will not reduce unemployment in 1971 to the point where tight capacity will exert significant inflationary pressure.

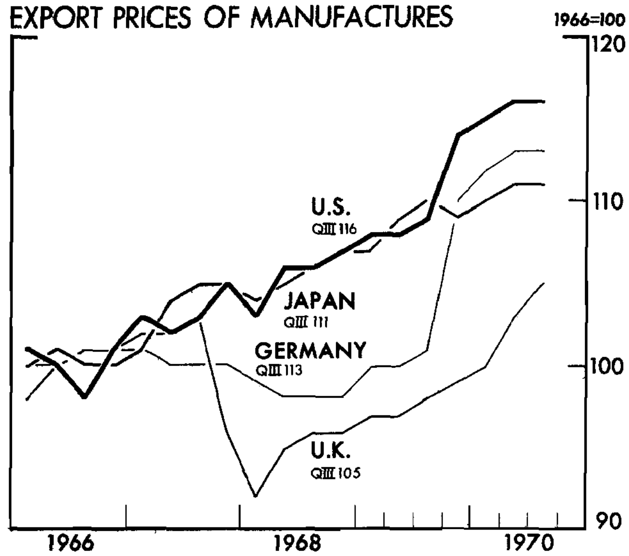
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

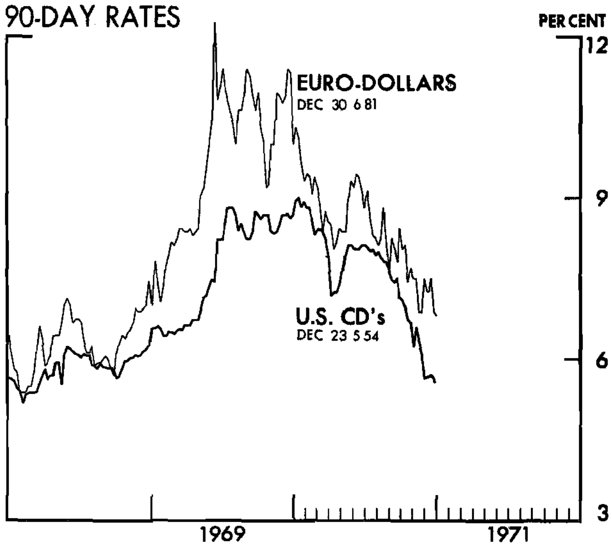
U.S MERCHANDISE TRADE



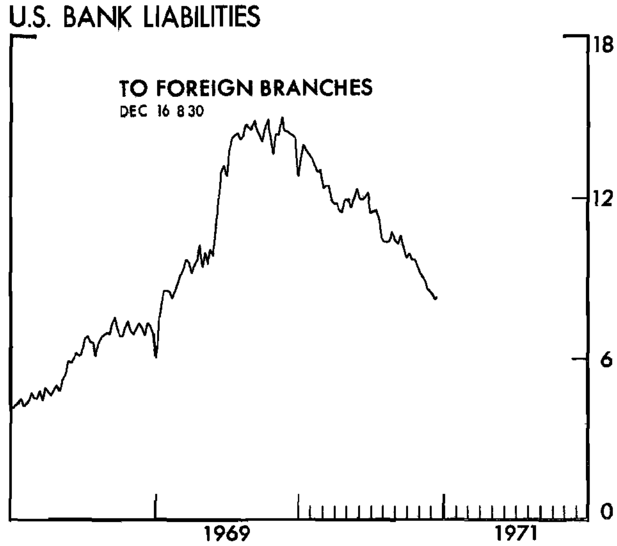
EXPORT PRICES OF MANUFACTURES



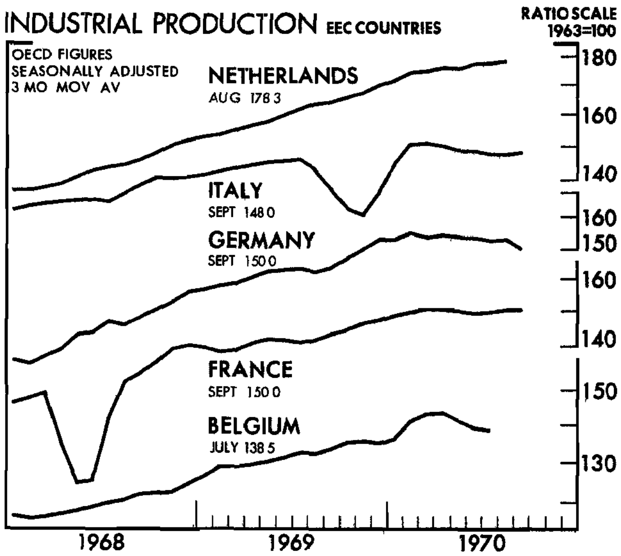
90-DAY RATES



U.S. BANK LIABILITIES



INDUSTRIAL PRODUCTION EEC COUNTRIES



INDUSTRIAL PRODUCTION OTHER COUNTRIES