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CONFIDENTIAL (FR)

CURRENT ECONOMIC
and
FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

March 1, 1967

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SUMMARY AND OUTLOOK

Outlook for economic activity

Private final demands appear to have weakened further in recent weeks--particularly consumer demands for goods--and we have written down the rise in prospect for GNP during the first half. We are now projecting dollar gains of $5 billion per quarter (compared with $7 billion per quarter projected four weeks ago) and almost no expansion in real terms. The decline in industrial production appears to have continued in February and may be picking up momentum. A slow-down in income gains is expected in the second quarter as production cutbacks limit further increases in employment. Much of the rise in income would come from further gains in wage rates. As indicated in the GNP discussion, consumer outlays are expected to rise about in line with the gains in disposable income and the saving rate should remain at a relatively high level.

The poor showing of retail sales in recent weeks suggest that reduction in the rate of inventory accumulation is not proceeding as fast as was projected earlier. Nevertheless, we still feel that reduced inventory building is likely to materialize in both this quarter and the next, and will continue to serve as a limiting factor on over-all expansion. Given the present uncertainties in the outlook for final demands and in the speed with which producers may cut back on purchasing and output, the actual reduction in the rate of inventory accumulation could prove to be larger than we have estimated. However, in view of the continued high and rising levels of consumer income and increasing availability of credit, we are anticipating some strengthening in consumer expenditures and in residential construction in the second quarter which will serve to enlarge aggregate final demands.

Recent evidence on prospects for business spending on plant and equipment is ambiguous. A further decline in total new orders for machinery and equipment in January--with very sharp cuts reported for such items as machine tools and railroad equipment--and industry pleas for prompt restoration of the 7 per cent investment tax credit suggest growing weakness in this sector. But a recent McGraw-Hill survey reported some slight strengthening in business spending plans for 1967 and corporate expectations for somewhat higher profits in 1967 than in 1966. We are projecting further small gains in business fixed investment through the first half, in line with both the recent McGraw-Hill findings and the earlier Commerce-SEC quarterly survey. But with backlogs now beginning to fall off, a further rise in investment outlays in the second half may be dubious.

Resource use and prices

With new plant and equipment continuing to come on stream at a rapid rate, pressures on industrial capacity have been reduced and are expected to ease further. The utilization rate for manufacturing currently (February) is about 87 per cent, down from 91 per cent in mid-1966. Most nondurable goods industries are operating at rates not much different from their longer-run averages. Utilization rates remain high mainly in the aircraft and machinery industries, in aluminum and in copper; also in rubber products where prospective labor negotiations are influencing inventory policies. Rising stocks of rubber and non-ferrous metal products may lead soon to a reduction in pressure on resources in those areas.

Industrial prices as a whole are estimated to have remained unchanged in February. For foods, retail and wholesale prices have levelled off and domestic food supply prospects have improved recently with marked gains indicated for beef, chickens, eggs, and citrus fruit. A decrease in utilization rates in the equipment industries might lead to reduction of upward pressures in industrial prices, although prices in these industries are probably more responsive to rising labor and other costs than to short-run declines in demand and to moderate reductions in utilization rates. With consumer demands for apparel as well as for durable goods down since last autumn, upward pressures on prices and costs in these markets also have been weakening.

The labor market continues strong, but sighs of some easing are beginning to appear in help wanted indexes, in lower hours of work, and in more than seasonal increases in unemployment claims. We estimate the over-all unemployment rate will be moderately higher in the first quarter than in the fourth and will increase further in the second quarter.

Outlook for bank loans and deposits

Business loans are expected to show an appreciable rise in March following nominal growth in February, but the increase probably will be well below the large $1.4 billion expansion in January. Business needs for financing in March, as in other recent months, will be heavily influenced by the volume of corporate tax payments falling due; such payments are estimated at about $12.5 billion, about the same as in March 1966, but considerably above those in February.

In view of reduced levels of corporate liquidity and the smaller-than-usual volume of tax anticipation bills maturing in March, businesses would be expected to rely heavily on bank borrowing in meeting their tax and dividend payments. However, the extent to which they will need to do so should be moderated by the availability of funds from other sources, particularly from recent capital market financing and expected slackening in the rate of inventory accumulation. Moreover, corporations have acquired a substantial volume of CD's over the past two months, and indications are that the volume of March maturities appreciably exceeds the volume a year ago. Thus, CD run-offs may be used by some corporations to finance a sizable part of March cash needs.

Private demand deposits rose moderately in February on average and we look for further growth in March; Government balances, which rose sharply in January, levelled off in February and are expected to show only a modest increase in March.

In large part, the intensity of business demands for bank loans in March will determine how actively banks compete for CD's and hence will heavily influence the rate of growth in time and savings deposits. The rapid growth in these deposits so far this year has been dominated by the surge in outstanding CD's at large city banks. However, in the last few weeks, the rise in CD's has fallen off sharply, suggesting that major issuers may be approaching or may already have reached desired levels of outstandings. Some support for this conclusion is found in the recent sharp decline in yield spreads of CD's over Treasury bills. Further growth in CD's prior to the mid-month tax period may be relatively small, with outstandings showing the usual decline at mid-month and some late month recovery.

Thus, growth in total time and savings deposits in March is likely to stem mainly from the consumer sector. Consumer-type time deposits, which have been expanding rapidly, are likely to continue to do so, particularly if yields on market instruments ease back from recent advanced levels. However, the rate of growth of these deposits would not be expected to maintain the January-early February pace, which was probably influenced in part by one-time transfers of funds out of market instruments in a period when market rates had been declining rapidly.

Capital markets outlook

The levels to which bond yields had declined by early February, in the face of the large and growing forward calendar of new security offerings, reflected in large part expectations of further easing of monetary conditions. Bond yields backed up sharply when such expectations were called into question, in part by developments in the money market area. This was compounded as the March calendar of scheduled corporate and municipal security offerings grew to even larger proportions than had generally been anticipated, as additional borrowers moved to capture long-term funds before yields rose further, and as expectations grew of an offering in March of Federal participation certificates. Most recently, yield increases appear to have been halted and partly reversed by a succession of factors, including purchases of coupon issues in the market by the Treasury trust accounts, an easing of money market conditions in response to continued System reserve supplying operations in the open market, and by the reduction in reserve requirements.

Scheduled March offerings of publicly-offered corporate bonds reached a record volume in excess of $1.2 billion, and municipal offerings are likely to reach $1 billion or more for the third month in a row, but some of this financing may be rescheduled over a longer period of time if the recent change in market tone creates expectations of more favorable market conditions ahead.

Looking beyond March, business demands for external financing of all types are generally expected to remain large at least through the second quarter. The advance payment of Federal income taxes accounts for a large part of these expected demands, but another large part reflects continuing corporate needs to replenish liquidity and readjust financial structures. Demands of this latter type tend to focus on capital markets. Of course, the post-March calendar of corporate public offerings would be smaller if term loans at banks should become more readily available at lower rates and if funds available for immediate take-down on private-placements from other types of lenders should increase.

In mortgage markets, some observers have expressed concern that the recent congestion in bond markets may slow progress toward mortgage credit expansion. But to the extent that congestion in bond markets is dispelled, the tendencies toward easier credit terms already evident in mortgage markets during January (and probably February) should continue.

International developments

The behavior of U.S. imports now looks less encouraging than it seemed a month ago. This is partly a result of the latest overhauling of foreign trade seasonal adjustment. The new verdict is that the rise in imports has only slowed, and did not come to an end in the fourth quarter, nor in January. Meanwhile, though U.S. exports were sharply higher in January than in December, for the two months together they were down a shade from October-November; and the trade surplus was consequently at a new low, for pairs of months, in December-January.

Despite these results, it still seems reasonable to suppose that the domestic economic outlook implies a weakening of U.S. import demand in coming months. Hopes for early U.S. export gains continue to rest mainly on prospects in Japan and in other countries outside Europe and the Western Hemisphere, and there is no reason to modify these hopes at present. Later in the year the course of world trade, and of U.S. exports, will depend more and more on how soon and how strongly demand picks up in the German, British and other European economies.

The additional decline in interest rates in Germany and Britain during February has been a reassuring development, mainly because it indicates governmental concern in these countries that economic expansion resume. Favorable direct impacts of the rate declines on the U.S. balance of payments are unlikely to be great, but easing of credit conditions in Europe may facilitate overseas financing by U.S. direct investment companies.

Some key rates have fallen no more than U.S. rates. Long-term rates, even after very large declines in some instances, remain generally much higher than U.S. long-term rates. In any case, primary protection against flows of U.S. portfolio capital or bank credit to Europe will still be afforded by the IET and the VFCR program for banks and other financial institutions. Likewise, the Commerce Department is continuing to ask U.S. nonfinancial corporations not to place liquid funds in Canada or elsewhere abroad.

Interest rates in the Euro-dollar market stablized, and moved up slightly, in February after sharp drops in December and January. From mid-December to the end of January, Euro-dollar rates dropped by a full percentage point or more as U.S. banks returned more than $1 billion to the Euro-dollar market. This week, Euro-dollar call money has been at 5-3/8 per cent, and 3-month deposits at a little over 5-1/2 per cent. The very sharp advance in Euro-dollar rates last year when U.S. banks were increasing their liabilities to their branches abroad, the subsequent sharp decline in rates, and then the stabilizing of rates just when U.S. banks ceased reducing their liabilities, all indicate how important a factor in the market the U.S. head offices' demands for funds have become.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per cent change: Year Ago*	Per cent change: 2 Years Ago*
Civilian labor force (mil.)	Jan'67	77.1	76.8	75.4	2.3	4.6
Unemployment (mil.)	"	2.8	2.9	2.9	- 3.8	-20.1
Unemployment (per cent)	"	3.7	3.7	3.9	--	--
Nonfarm employment, payroll (mil.)	"	65.4	65.1	62.5	4.6	9.9
Manufacturing	"	19.5	19.4	18.6	4.9	10.3
Other industrial	"	8.1	8.1	8.0	1.2	5.5
Nonindustrial	"	37.7	37.5	35.9	5.2	10.7
Industrial production (57-59=100)	"	157.9	158.9	150.6	4.8	13.8
Final products	"	157.8	158.9	150.3	5.0	14.1
Materials	"	157.8	158.4	150.9	4.6	13.2
Wholesale prices (57-59=100) 1/	"	106.2	105.9	104.6	1.5	5.1
Industrial commodities	"	105.0	104.7	103.0	1.9	3.4
Sensitive materials	"	101.6	101.4	103.8	- 2.1	0.3
Farm products and foods	"	107.2	106.7	107.7	- 0.5	9.3
Consumer prices (57-59=100) 1/	"	114.7	114.7	111.0	3.3	5.3
Commodities except food	"	107.3	107.7	105.3	1.9	2.3
Food	"	114.7	114.8	111.4	3.0	7.6
Services	"	125.5	125.2	119.5	5.0	7.6
Hourly earnings, mfg. ($)	"	2.77	2.76	2.66	4.1	7.8
Weekly earnings, mfg. ($)	"	113.49	112.93	110.33	2.9	7.0
Personal income ($ bil.) 2/	"	607.2	601.8	560.2	8.4	17.5
Corporate profits before tax ($ bil.) 2/	QIV'66 3/	82.5	81.9	78.7	4.8	21.9
Retail sales, total ($ bil.)	Jan'67	25.3	25.3	25.0	1.2	10.4
Autos (million units) 2/	"	7.8	8.0	9.4	-17.5	-18.8
GAF ($ bil.)	"	6.0	6.0	5.9	2.8	14.4
Selected leading indicators:						
Housing starts, pvt. (thous.) 2/	"	1,243	1,085	1,611	-22.8	-13.8
Factory workweek (hours)	"	40.9	40.9	41.4	- 1.2	- 0.5
New orders, dur. goods ($ bil.)	"	22.7	23.9	23.6	- 3.8	6.6
New orders, nonel. mach. ($ bil.)	"	3.4	3.6	3.4	- 0.2	10.6
Common stock prices (1941-43=10)	"	84.45	81.33	93.32	- 9.5	- 1.9
Inventories, book val. ($ bil.)	Dec'66	135.0	133.9	120.9	11.7	21.6
Gross national product ($ bil.) 2/	QIV'66	759.3	745.3	704.4	7.8	17.9
Real GNP ($ bil., 1958 prices) 2/	"	657.2	649.9	631.2	4.1	11.9

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Feb. 24	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	5.06	4.93	6.25	3.50
U.S. Treas. bills, 3-mo., yield (per cent)	4.61	4.56	5.59	4.46
Net free reserves 2/ (mil. $)	122	48	149	- 583
Member bank borrowings 2/ (mil. $)	477	366	928	176
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.81	4.73	5.64	4.60
20-year U.S. Treas. bonds	4.70	4.59	5.00	4.44
Corporate new bond issues, Aaa	5.20	5.19	5.99	5.11
Corporate seasoned bonds, Aaa	5.05	5.02	5.53	4.99
Municipal seasoned bonds, Aaa	3.53	3.38	4.04	3.25
FHA home mortgages, 30-year 3/	6.62	6.62	6.81	6.58
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	87.41	87.37	86.66	73.20
Dividend yield (per cent)	3.36	3.36	3.89	3.32

	Change in Jan.	Average change Last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	329	104	5.4	2.0
Bank loans and investments:				
Total	3,800	2,100	8.3	6.1
Business loans	1,400	500	8.1	10.0
Other loans	1,700	800	7.5	7.2
U.S. Government securities	- 500	500	10.7	- 7.2
Other securities	1,200	400	9.1	8.0
Money and liquid assets:				
Demand dep. & currency	- 600	0	0.2	1.0
Time and savings dep.	2,400	1,200	9.2	9.3
Nonbank liquid assets	1,000	300	1.3	3.7

N.S.A. -- not seasonally adjusted. S.A. -- seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending February 22.
3/ Latest figure indicated is for month of January. 4/ Data are for weekly closing prices.

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

	1967 Jan.	1966 Dec.	1966 QIV	1966 QIII	1966 QII	1966 QI	1965 QIV	1965 Year (billions)
				Seasonally adjusted				
Current account balance				900	1,252	1,405	1,309	6.0
Trade balance 1/	305	165	742	772	977	1,239	1,248	4.8
Exports 1/	2,595	2,390	7,402	7,333	7,184	7,251	7,011	26.3
Imports 1/	-2,290	-2,225	-6,660	-6,561	-6,207	-6,012	-5,763	-21.5
Services, etc., net				128	275	166	19	1.2
Capital account balance				-1,244	-1,098	-1,587	-1,542	-6.9
Govt. grants & capital 2/				-794	-964	-948	-881	-3.4
U.S. private direct investment				-700	-976	-687	-731	-3.4
U.S. priv. long-term portfolio				-33	-80	-219	-154	-1.1
U.S. priv. short-term				20	-38	-22	-27	0.8
Foreign nonliquid				263	960	289	251	0.2
Errors and omissions				118	-167	-297	-80	-0.4
Balances, with and without seasonal adjustment (- = deficit)								
Liquidity bal., S.A.			-551	-201	-131	-541	-332	-1.3
Seasonal components			30	-502	-21	493	-3	--
Balance, N.S.A.	156	753	-521	-703	-152	-48	-355	-1.3
Official settlements bal.			-249	955	-204	-231	-1,158	-1.3
Seasonal component			71	-528	-176	633	33	--
Balance, N.S.A. 3/	-470	226	-178	427	-380	402	-1,125	-1.3
Memo items:								
Monetary reserves (decrease -)	-686	167	6	-82	-68	-424	-271	-1.2
Gold purchases or sales (-)	-33	-27	-121	-173	-209	-68	-119	-1.7

1/ Balance of payments basis which differs a little from Census basis. Seasonal adjustments for trade revised.
2/ Net of loan repayments.
3/ Differs from liquidity balance by counting as receipts (+) increases in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increase in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. We have revised downward our projection of GNP for the first half of the year--estimating increases of only $5 billion in the current and second quarters, as compared with gains of $14 billion in the fourth quarter and, on average, throughout 1966. Despite a projected slowing in prices from last year's large advance, real growth during the first half would be negligible--at an annual rate of only 0.5 per cent a year.

We still are expecting a sharp fall-off in the rate of inventory accumulation--reversing last year's large run-up--but there is not much evidence that it has begun to any great extent. The projected moderate strengthening in final sales also is not yet evident and, in fact, final sales now appear a little weaker than was estimated four weeks ago, particularly consumer demands for goods.

Retail sales in January and February appear to have shown little change from the reduced December level, with new domestic car sales declining from an annual rate of 8 million units in December to about 7.3 million in February (a fifth below the exceptionally high year-earlier level). Sales of household durable goods also appear to have edged down over the period. In mid-January, consumers' future buying plans for durable goods, as reported by the Census Bureau, remained on the weak side, although the intentions data do not necessarily imply further decreases in consumer takings from recent reduced levels. Altogether, we are now estimating a decline of $2 billion in the annual rate of consumer purchases of durable goods in the current quarter, and with nondurable goods estimated to rise only $1 billion, consumers' total dollar spending for goods--which was virtually unchanged between the third and fourth quarters--is expected to decline slightly in this quarter. In real terms, consumer takings of goods appear to have declined moderately since last fall--after showing only a moderate increase after early 1966. Consumer spending on services, however, apparently continues to expand rapidly--although much of the dollar gain is being accounted for by price increases. Total consumption expenditures are projected to rise $3.3 billion in the current quarter--as compared with a little more than $4 billion in the fourth quarter.

Meanwhile, consumer income showed a surprisingly large rise in January--with wages and salaries, transfer payments and other income up by sizable amounts; despite the boost in social insurance contributions effective January 1, the January rise in personal income was the largest since last August.

Manufacturing employment and wages and salaries rose further in January. However, in February manufacturing employment is expected to decline. With weakness in manufacturing,a distinct slowing of the rise in total employment is projected. The increase in minimum wage rates effective February 1 is presumably adding about $1 billion to wage and salary disbursements and sizable wage rate increases are expected to continue, but, with employment gains slowing markedly, the rise in total wages and salaries is projected at a much slower rate in coming months. Moreover, the rise in transfer payments, which has been very sharp since the institution of Medicare last July, is likely to taper off.

Reflecting mainly the larger than anticipated January rise in wages and salaries, the estimated levels of personal and disposable income have been revised upward appreciably for the first quarter. Disposable income now is estimated to show an increase of $10.5 billion in the first quarter, and with consumer spending projected as rising only about $3.5 billion, the saving rate is projected to rise sharply further to 7.0 per cent--the highest rate since late 1958.

A further increase of only $5.5 billion--about half the first quarter rise--is projected for disposable income in the second quarter, and consumer spending is believed likely to rise about in line with the increase in income. The projected rise in consumer spending--while smaller than was estimated four weeks ago--is somewhat larger than the increase now estimated for the current quarter, owing mainly to the likelihood that durable goods purchases will tend to level off following earlier declines. Nondurable goods purchases are expected to continue upward at a slow rate, while service outlays should show a large further gain. It now seems likely that the saving rate will remain high, probably at about the 7.0 per cent level.

In the second quarter, we are now anticipating some upturn in residential construction activity--in line with gains in seasonally adjusted housing permits and starts reported through January--and we are also projecting a slight further increase in business fixed investment. The latter seems to be implied by the recent McGraw-Hill special survey of business spending plans for 1967, though the increase is only nominal. In dollar terms, business fixed investment is projected as rising at an annual rate of only 3 per cent in the first half--in real terms this probably represents little change. A firmer base for assessing both near-terms trends and the entire year's prospect for business fixed investment outlays will be provided by the next Commerce-SEC quarterly survey, results of which are due in a week or so.

The course of total government purchases of goods and services is about as projected four weeks ago--with expansion at the rate of a little over $5 billion in the first quarter and $4 billion in the second quarter. According to the most recent Treasury statements, defense purchases appear to be running somewhat higher in the current quarter than was projected four weeks ago, although the current expansion (nearly $3 billion) is less than in the fourth quarter ($3.5 billion) and a further slowing to a $2 billion increase is projected in the second quarter.

Total business inventory accumulation in the fourth quarter is now reported at an annual rate of $16.4 billion (up $2 billion from the estimate available four weeks ago), with nonfarm accumulation at a $17.6 billion rate. These figures incorporate preliminary December figures for manufacturing and trade, and the manufacturing figures are now being revised upward. The extraordinary fourth quarter bulge in nonfarm inventory accumulation--which accounted for $7 billion, or half, of the fourth quarter rise in GNP--was heavily concentrated in consumer goods and related lines, both durable and nondurable, at both the factory and distributor level, as sales lagged significantly. Output of major consumer durable goods and such materials as steel began to be reduced in late 1966.

In January, new orders for steel dropped sharply further, the order backlog was down about a fourth from early last fall, and output was cut further; output curtailments were extended for consumer durable goods--particularly autos; and output cuts were initiated in some nondurable goods industries.

With sales of consumer goods continuing to lag in the current quarter and total production down only moderately, it is not yet clear that business is achieving any marked cut in the rate of stock building in this sector--except in the case of autos where unit stocks of new cars have been reduced appreciably. While a major part of the large reduction projected in the rate of nonfarm inventory accumulation over the first half of the year is expected to come from sharply reduced rates of accumulation in consumer goods and materials (with net liquidation in some lines), a considerable slackening in recent high rates of accumulation (much of it in work-in-process stocks) is expected in business and defense equipment industries along with the pronounced slowing of expansion now programmed for final demands in this sector.

CONFIDENTIAL -- FR

March 1, 1967

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

	1965	1966	1966 I	1966 II	1966 III	1966 IV	1967 Projected I	1967 Projected II
Gross National Product	681.2	739.6	721.2	732.3	745.3	759.3	764.3	769.3
Final sales	672.1	727.7	712.3	720.0	735.4	743.1	752.8	764.3
Personal consumption expenditures	431.5	464.9	455.6	460.1	469.9	474.1	477.4	482.6
Durable goods	66.1	69.3	70.3	67.1	70.2	69.6	67.7	67.5
Nondurable goods	190.6	206.2	201.9	205.6	208.1	209.2	210.4	212.0
Services	174.8	189.4	183.4	187.4	191.5	195.3	199.3	203.1
Gross private domestic investment	106.6	117.0	114.5	118.5	115.0	120.0	115.6	110.2
Residential construction	27.8	25.8	28.6	28.0	24.8	21.9	21.9	22.4
Business fixed investment	69.7	79.3	77.0	78.2	80.3	81.6	82.2	82.8
Change in business inventories	9.1	11.9	8.9	12.3	9.9	16.4	11.5	5.0
Nonfarm	8.1	12.2	8.5	12.1	10.4	17.6	12.0	5.0
Net exports	7.0	4.8	6.0	4.7	4.2	4.1	5.0	6.0
Gov't purchases of goods & services	136.2	153.0	145.0	149.0	156.2	161.1	166.3	170.5
Federal	66.8	76.9	71.9	74.0	79.0	81.7	85.1	87.5
Defense	50.1	60.0	54.6	57.1	62.0	65.5	68.3	70.3
Other	16.7	16.9	17.4	16.9	17.0	16.2	16.8	17.2
State & local	69.4	76.2	73.1	75.0	77.2	79.4	81.2	83.0
Gross National Product in constant (1958) dollars	614.4	647.8	640.5	643.5	649.9	657.2	657.7	658.6
GNP Implicit deflator(1958=100)	110.9	114.2	112.6	113.8	114.7	115.5	116.2	116.8
Per cent change, annual rate								
GNP current dollars	7.8	8.6	9.5	6.2	7.1	7.4	2.6	2.6
GNP constant dollars	5.9	5.4	5.9	1.9	4.0	4.4	0.3	0.5
Implicit deflator	1.8	3.0	3.6	4.3	3.2	3.1	2.4	2.1
Personal income	535.1	580.4	564.6	573.5	585.2	598.3	610.0	616.5
Wage and salaries	358.4	392.3	380.0	387.4	396.7	405.0	413.0	418.0
Disposable income	469.1	505.3	495.1	499.9	507.8	518.4	529.0	534.5
Personal saving	25.7	27.0	26.7	26.6	24.5	30.4	37.3	37.3
Saving rate (per cent)	5.5	5.3	5.4	5.3	4.8	5.9	7.0	7.0
Total labor force (millions)	77.2	78.9	78.1	78.4	79.1	79.8	80.4	80.6
Armed forces "	2.7	3.1	2.9	3.1	3.2	3.3	3.4	3.5
Civilian labor force "	74.5	75.8	75.2	75.4	76.0	76.5	77.0	77.1
Unemployment rate (per cent)	4.5	3.8	3.8	3.8	3.8	3.7	3.8	4.0
Nonfarm payroll employment (millions)	60.8	63.8	62.8	63.6	64.1	64.8	65.3	65.5

Note: Labor force revised to exclude persons age 14 and 15. Quarterly data for 1966 also reflect new seasonal factors; projections for 1967 reflect new definitions of unemployment.

Industrial production. Industrial production is estimated to have declined further in February--at least one-half of a point and possibly considerably more. Declines in output are expected in a variety of consumer goods and materials but business and defense equipment may have increased somewhat further.

Auto assemblies, which had earlier been scheduled at the reduced January rate of 7.2 million units, declined 10 to 15 per cent further in February. While February production schedules were reduced as sales continued to decline, snowstorms and a wildcat strike at a General Motors body plant accounted for a part of the February drop.

Production of household appliances and television and radio sets declined further in early February as sales continued soft and inventories held by manufacturers and distributors remained high. A major producer has announced additional cutbacks in output in March for a wide range of appliances.

Steel ingot production was about unchanged in February from a January level for iron and steel, which was down 15 per cent from the mid-1966 highs. The decline in steel production during this period would have been larger but for steel mills building up their own inventories. These stocks rose by almost 10 per cent in the last half of 1966 to a record high of 19 million tons, about 3 months supply at the 1966 consumption rate.

Capacity utilization in manufacturing declined further in January and, at 88 per cent, was the lowest since the first quarter of 1965. A further decline in manufacturing output of one point in February would lower the utilization rate to 87 per cent.

During the 1957-58 period of a major inventory readjustment, industrial production started to decline in September 1957 following a 12-month period of little change. In the first month of the decline--from August to September--the total index declined 1.4 per cent, with almost all the major cyclical industries declining. Output in these industries generally continued to decline through April 1958, with the drop in the total index amounting to 14 per cent from August to April.

In the last half of 1966, the total index changed little, and then declined 0.6 per cent in January. During this seven-month period, the cyclical industries have shown a diversity of movements, as various industries reached the point of excessive inventories at varying times. Output of consumer durable goods peaked in October 1966 and then declined. Production of both business and defense equipment continued to expand to new highs throughout the period. Among materials, lumber production fell 20 per cent from April to October and then bottomed out. Production of iron and steel has been declining since mid-1966, but output of nondurable materials has continued to expand despite some readjustments in textiles, chemicals, and paper.

While available production data for January and February do not, as yet, indicate a downward movement of the breadth and depth of the 1957-58 recession, there are disquieting signs. Inventories are generally high relative to final takings, and there is no upward movement discernible in sales. New orders for durable goods have been declining in recent months, and the preliminary January figure was 4 per cent below both the fourth quarter of 1966 and a year earlier.

Declines in orders are widespread among durable manufacturers, including machinery, and especially orders for metal cutting and forming tools which in January were 40 per cent below a year ago.

Autos. Daily average sales of new domestic automobiles continued to weaken in the first 20 days of February. Assuming this tendency continues through the remainder of the month, the seasonally adjusted annual rate for February will likely be about 7.3 million units, 7 per cent below the 7.8 million unit rate for January and about one-fifth below the 9.2 million unit rate a year earlier.

The automobile industry's planned output curtailments in February, along with severe snowstorms and a wildcat strike at the General Motor's Fisher body plant, seem to have stopped the recent expansion of inventories of new cars at about 1.5 million units. Output for the entire month of February is expected to be at a seasonally adjusted annual rate of about 6.5 million units, down at least 10 per cent from the preceding month and 30 per cent below a year ago. With a sales rate of 7.3 million units, the seasonally adjusted inventory level at the end of February would be slightly less than at the end of January. In relation to this year's lower sales rate, of course, stocks are considerably above a year ago.

Prices of used cars remained virtually unchanged in January at the lowest point in the last four years.

Consumer credit. Consumer instalment credit continued to grow at a slow rate in early 1967. Preliminary January data for commercial banks, however, suggest a little faster rate than in December but slower than in the fourth quarter as a whole. On this basis, and in light of recent auto and other sales information, we project the first quarter expansion at $4.0 billion, annual rate.

INCREASES IN CONSUMER INSTALMENT CREDIT
(Seasonally adjusted annual rate, billions of dollars)

	Extensions	Repayments	Net Change
1965			
Q1	72.5	65.1	7.4
Q2	74.4	66.4	8.0
Q3	76.8	68.5	8.3
Q4	77.8	70.0	7.8
1966			
Q1	78.9	71.7	7.1
Q2	78.6	72.3	6.3
Q3	80.0	73.4	6.6
Q4	78.4	73.9	4.6
1967			
Q1 (est.)	78.0	74.0	4.0

To a large extent, the pattern of credit use last year paralleled developments in consumption expenditures. The second and fourth quarters of 1966, for example, were periods of relative slack in consumer spending, especially for autos and other durable goods, and they were periods of slow growth in consumer credit as well. The low point for the year was reached in December when the increase in outstanding credit was at an annual rate of $3.9 billion, the smallest in more than four years. For 1966 as a whole, the increase in instalment credit amounted to $6.1 billion, sharply less than the record $8 billion for 1965. Expressed in percentage terms, last year's increase was a little less than 9 per cent, compared with a rise of more than 13 per cent in 1965 and increases of 10 per cent or more for all previous years of the current expansion.

Much of the sluggishness in consumer credit has been and continues to be associated with slow sales of autos. But demand for personal loans and repair and modernization loans also has been slow. The only area of strength has been in "other consumer goods", and this probably reflects the inclusion in this category of an ever-widening group of consumer items purchased on revolving credit plans.

The gap between new credit extensions and repayments on old debt has narrowed. Credit extensions were running at a $79 billion annual rate early in 1966, they topped $80 billion briefly in the summer months, and then they backed off again toward the end of the year and apparently are continuing downward in the current quarter. In the meantime, repayments expanded from an annual rate of just under $72 billion in the first quarter to nearly $74 billion in the last and are estimated at about that rate in the current quarter.

<u>Consumer buying plans</u>. Consumer buying intentions have continued to weaken in recent months according to the Census quarterly survey in mid-January. The proportion of households expecting to purchase new automobiles, household durables, and houses were all below a year ago. Declines in intentions to purchase new automobiles and houses

began to show up in the surveys in the third quarter of last year, a quarter later than the initial downturn in actual reported purchases.

Intentions to purchase new automobiles within the next 12 months fell to 9.4 perccent of reporting households from 9.8 per cent a year earlier. Intentions to buy used cars, however, were 8.0 per cent in mid-January as compared with 7.4 per cent a year ago.

Reported intentions to purchase new or previously occupied houses within 12 months decreased to 4.6 per cent in the current survey from 5.3 per cent in January 1966. There was also a decline in intentions to purchase one or more of 7 major household durables: from 23.7 per cent to 22.7 per cent, with plans to buy television sets down the most.

The proportion of households with higher incomes than last year declined for the second successive quarter. Expectations for higher incomes in the next year, however, were up sharply: 27.3 per cent expected their incomes to be higher, as compared with 25.8 per cent a year ago. These optimistic income expectations appear to contradict the restraint indicated in buying plans, since respondents with higher income expectations also typically report higher intentions to purchase new automobiles.

<u>Business inventories</u>. The book value of manufacturers' inventories has been revised up for December, to show a rise for the month of $1 billion as compared with the preliminary showing of a $775 million increase. The upward revision boosted the end-of-month levels--and increases for the month--for both durable and nondurable goods. As a result of the revision, the monthly average rise in manufacturers' inventories during the fourth quarter was at an annual rate of $12 billion--slightly larger than the $11.7 billion rate in the third quarter.

Trade inventories in December (preliminary) increased about $400 million (in terms of book value). Stocks of nondurable goods at retail stores rose sharply, when sales showed a sizable decline. Retail stocks of durable goods (including autos), which had increased sharply in the preceding three months, declined moderately in December; but stocks of durable goods at wholesale distributors rose considerably further. The total book value increase in trade inventories in December was little changed from November but well below the October rise, when durable goods stocks rose sharply at both wholesale and retail.

Altogether, the fourth quarter increase now reported in the book value of trade inventories was at an annual rate of nearly $6 billion, and the increase for manufacturing and trade combined was at an annual rate of close to $18 billion--as compared with $13 billion in the third quarter. With the recent upward revision in data for manufacturing and with the December trade figures subject to possible upward revision, the $17.6 billion rate of accumulation in nonfarm stocks incorporated in the present GNP estimate for the fourth quarter may require upward revision.

Orders for durable goods. New orders for durable goods declined 5 per cent in January, with sizable decreases reported for steel, fabricated metal products, and defense products and a moderate further decline in machinery and equipment. New orders were at the lowest level since November 1965 and were 10 per cent below the peak reached last September when orders for defense products bulged sharply.

Unfilled orders, which rose at a rapid pace through last October, showed little change between October and December and then declined appreciably in January. Declines in order backlogs were widespread in January. Steel showed an especially large decline, to a level about a fourth below last fall's high. Unfilled orders for machinery and equipment--earlier rapid expansion in which had tapered off in late 1966--showed a small decline in January. Expansion in defense order backlogs continued in January but at a sharply reduced rate.

Construction activity. Outlays for new construction--residential and nonresidential--changed little in January, following a moderate downward revision for December. Residential construction turned upward after ten months of decline, reflecting in part, an improved although still low level of starts. While private nonresidential outlays continued at an advanced level, they remained appreciably below the peak reached last March, with public utilities the only component to show a persistent uptrend. Public construction outlays also edged higher in January, after being revised downward by 4 per cent in December.

NEW CONSTRUCTION PUT IN PLACE

	January 1967 ($ billions)1/	Per cent change from	
		December 1966	March 1966
Total	69.7	--	-18
Private	46.5	--	-16
Residential	20.6	+1	-24
Nonresidential	25.9	--	- 7
Public	23.2	+1	- 5

1/ Seasonally adjusted annual rates; preliminary.

Seasonally adjusted private housing starts advanced appreciably further in January, raising the possibility that the near term response of new housing activity to the recent easier mortgage market situation might turn out to be more rapid than had been anticipated. The annual rate of 1,243,000 was the highest since last June, but there is reason to question the sustainability of such a starts level during the next several months when very sharp increases are expected on a seasonal basis. The unadjusted number of starts in January was virtually unchanged from December, but beginning with February, unadjusted starts will have to rise very sharply just to maintain the January seasonally adjusted rate. It should be noted, too, that an unusually large part of the advance was concentrated in one region--the Northeast, where the seasonal allowance for January is particularly large.

Seasonally adjusted building permits, which usually are much less volatile than starts, also expanded sharply in January and were a fourth above the exceptionally low rate reached last October. Unlike developments in other recent months, permits for multifamily structures showed about the same relative month-to-month rise as for single-family structures.

PRIVATE HOUSING STARTS AND PERMITS

	January (thousands of units)1/	Per cent change from	
		December 1966	Year earlier
Starts	1,243	15	-23
Permits	893	18	-29
1-family	560	17	-21
2-or-more family	333	19	-39
Northeast	236	67	-20
North Central	227	18	-30
South	282	- 3	-30
West	148	11	-26

1/ Seasonally adjusted annual rate; preliminary.

In contrast with other postwar periods prior to 1959, the further decline in starts last year was not associated with outright shortages of housing. Nevertheless, with completions below the level of basic demands, there has been an appreciable reduction in vacancy rates nationally from earlier advanced levels. In the fourth quarter of 1966, rental vacancy rates edged upward somewhat, but the average--

7.0 per cent--was one of the lowest since 1959. Among regions, rental vacancy rates during the fourth quarter changed little from those during the third quarter in the Northeast and also in the North Central states, where the decline has been particularly marked. In the South and West, rates turned upward again, but to levels still significantly below earlier highs.

Unlike rental vacancies, vacancy rates for homes for sale dipped further in the fourth quarter, to 1.2 per cent, the lowest for this quarter since 1961. For 1966, as a whole, the average was 1.3 per cent, as against a recent high of 1.45 per cent in 1965--when a downward adjustment in home starts was already under way--and 1.4 per cent in other recent years. Further suggesting the extent to which the groundwork for additional pressure on demands was being laid, this winter, seasonally adjusted new homes for sale by speculative builders continued to drop in December and were at the lowest level on record for the series, (which began in 1963) and more than a fourth below the peak in May 1964.

Business fixed investment. Nonfarm business expenditures for new plant and equipment in 1967 are expected to rise 6.3 per cent from last year, to $64.4 billion, according to a McGraw-Hill special survey of business plans conducted in January. (The McGraw-Hill October survey had indicated a rise of 4.9 per cent.) A 6.3 per cent rise in 1967, while very small compared with the 16.6 per cent rise apparently realized in 1966, would allow outlays to rise in each quarter of the year at an annual rate of about 4 per cent--about the average rate shown for the first two quarters of the year by the November Commerce-SEC survey of business plans. (The Commerce-SEC February survey for the first two quarters and for the year will be available in a week or ten days.)

A special survey conducted last November by the Department of Commerce and the Securities and Exchange Commission indicated that plant and equipment expenditures planned for 1967 would be cut back by $2.3 billion from what they otherwise would have been, as a result of the temporary suspension of the investment tax credit and certain accelerated depreciation allowances for Federal income tax purposes. More than 80 per cent of the indicated 1967 cutback in plans would be about equally divided between manufacturing and the commercial sector with most of the balance in transportation industries.

The relatively small further rise in plant and equipment expenditures this year now indicated by recent surveys seems consistent with the decline in new orders for machinery and equipment since mid-1966 and the apparent peaking at the end of last year in unfilled orders. Machine tool orders, which are particularly sensitive to changes in investment plans, have been trending downward since early last year, except for a bulge in September just before the investment tax credit and the accelerated depreciation allowances were suspended. Moreover, cancellations of machine tool orders have risen sharply since last summer.

The January McGraw-Hill survey indicates that last fall's investment plans have been changed considerably by a number of major industries, even though total fixed investment plans are only moderately higher. Significantly higher outlays are now planned for 1967 by producers of iron and steel, electrical machinery, aerospace products, ships and railroad equipment, paper and pulp, and rubber, and by mining industries and electric and gas utilities. Smaller outlays than were planned last October are now indicated by producers of nonferrous metals, fabricated metal products and instruments, chemicals, foods and beverages, and textiles, and by airlines and commercial enterprises.

The N.I.C. B. capital appropriations data for large manufacturing concerns seem to support the indications that fixed capital spending by manufacturing industries will continue at a high level but not increase substantially further. Closing backlogs of unspent appropriations continued to rise through the fourth quarter of last year, although the increases in the third and fourth quarters were the smallest since early 1963. Newly approved appropriations rose 4.6 per cent in the fourth quarter from the sharply reduced third quarter rate and were about the same as a year earlier. However, for the current quarter, a decline to the reduced third quarter rate is now estimated for this relatively volatile series.

Labor market. The continued over-all strength of the labor market has been impressive, particularly in the face of persistent reports of production cutbacks in selected manufacturing industries. Employers, operating in a tight labor market, apparently have been cutting back on the work-week rather than trimming employment. These efforts to cut costs and yet avoid the loss of scarce manpower suggest that producers so far have been viewing any current slackening in demand as temporary. Although unemployment compensation claims have again started to show significantly more than seasonal increase, after having remained relatively stable in January and early February, employment cutbacks have been selective, and industry-wide reductions have occurred only in construction and the building-related lumber and stone, clay, glass industries--which may now have bottomed out--and in automobiles.

AVERAGE WEEKLY HOURS, PRODUCTION WORKERS,
SELECTED MANUFACTURING INDUSTRIES
Seasonally adjusted

	1966		1967
	IQ	IVQ	January
Total	41.5	41.2	40.9
Durable	42.4	42.0	41.8
Lumber & wood	41.2	40.4	39.9
Furniture & fixtures	41.8	40.9	40.7
Stone, clay & glass	42.6	42.0	42.0
Primary metals	41.9	42.3	41.4
Fabricated metals	42.5	42.3	42.4
Machinery	43.9	43.8	43.8
Electrical equipment	41.4	40.9	40.8
Transportation equip.	43.2	42.0	41.6
Automobiles	43.7	41.7	40.9
Nondurable	40.4	40.1	40.1
Food	41.2	41.0	41.1
Textile-mill	42.3	41.1	41.1
Apparel	36.4	36.6	36.5
Paper	43.4	43.2	43.0
Chemicals	42.0	42.1	42.0
Petroleum	42.5	42.4	42.8
Rubber & plastic	42.3	41.8	41.6

Reductions in the manufacturing workweek from a year earlier, have been general. Average weekly hours in manufacturing--a relatively sensitive lead indicator of economic activity--in January were 0.6 hours below their first quarter 1966 peak of 41.5 hours. The largest reductions in hours in durable goods occurred in autos (down almost 3 hours); and in lumber and furniture and fixtures, which are both down by over an hour since the first quarter 1966. Hours of work are also significantly lower in the electrical equipment and in the primary metals industries. Only in fabricated metals and in the machinery industries has the workweek been maintained at earlier high levels. Hours have not been reduced as sharply in the non-durable goods industries. But in textile mills, last year's unusually long workweek was down by over an hour, and in the rubber and paper industries the workweek also has been curtailed.

Despite the trending-off in the workweek, persistent strength in employment has continued to expand manhour input in manufacturing. In January employee manhours were 4 per cent above a year earlier. Because of the levelling off in output, there has been a virtual cessation of growth in manufacturing productivity since about mid-1966. Meanwhile, hourly earnings have continued to rise and unit labor costs in manufacturing have been moving sharply upward. In the fourth quarter of 1966 they were 2.6 per cent above a year earlier; in January they were almost 4-1/2 per cent higher, according to data currently available.

Although hourly earnings in manufacturing have risen over 4 per cent since January a year ago, the rise in weekly earnings over the year--because of cutbacks in the workweek--was under 3 per cent. Adjusted for cost-of-living increases, the "real" weekly earnings of factory workers actually declined slightly (by 0.5 per cent) in the year ending January 1967; in the year ending January 1966, real earnings had increased by 2.3 per cent.

Changes in labor force data. Beginning in January 1967, some changes were made in the procedures for collecting data on labor force, employment and unemployment which affect the levels and comparability of the statistics somewhat. Briefly, the sample has been enlarged by 50 per cent; the lower age limit for inclusion in the statistics has been raised from 14 to 16; and some changes were made in the definition of unemployment which exclude some groups previously counted. In addition, some questions obtain better information on hours actually worked. These changes were discussed in some detail in the January 5 appendix of the Greenbook.

The effect of the elimination of the 14 and 15 year olds--the only revision actually carried back into the 1966 data--reduced the reported annual average unemployment rate for 1966 from 3.9 to 3.8 per cent, and the December 1966 rate from 3.8 to 3.7 per cent. The new definitions--had they been in effect in 1966--would have lowered the 1966 unemployment rate by another 0.1 to 3.7 per cent. Moreover, they would have resulted in a slightly smaller unemployment rate for adult men (2.2 instead of 2.5 per cent), but a larger rate for adult women (4.2 instead of 3.8 per cent). For the 16-19 year olds the new definitions would have reduced their unemployment rate from 12.7 per cent to 11.7 per cent in 1966. On the other hand, for nonwhite workers the rate would have been raised from 7.3 to 7.6 per cent.

The elimination of 14 and 15 year olds, and the annual recalculation of seasonal adjustment factors changed the monthly pattern of unemployment for 1966 somewhat. The revised data now show the low point of unemployment in the fourth quarter of 1966, at 3.5 per cent in November.

Commodity prices. An advance estimate published by the BLS for their regular monthly total wholesale price index showed an 0.2 per cent decline for February, following a .3 per cent rise in January to 106.2 per cent of 1957-59. The projected February decline anticipates small decreases in prices of farm and food products and no change in industrial commodities. (This advance estimate replaces the weekly indexes which were discontinued because of their inaccuracies--but the sample used for estimating industrial commodities has still not been expanded to include a representation of finished goods).

In January, industrial commodities rose 0.3 per cent, reflecting increases in 11 of the 13 major groupings, but about half of the rise was in metal products and equipment. Prices of equipment and industrial supply items probably have continued to increase since then. Major producers also sought to raise gasoline prices in February but have encountered both competitive and Federal resistence. Prices of some grades of lumber and plywood were reported to have shown a recovery from earlier reduced levels. A major company has raised asphalt floor tile to be effective March 6 but two previous moves last year failed to hold.

In the more sensitive industriál markets, prices have continued to tend downward--mainly metal scrap, brass and copper products, textiles, crude rubber, and waste paper. The most dramatic decline in prices was an array of reductions by the American Motors Company for its lowest priced models ranging up to $234 per unit. This was equivalent to 11 per cent in the retail list price and 7 per cent at the factory level as dealers' margins were reduced. The new prices are aimed to be enough below other domestically-produced compact cars to attract purchases from foreign compacts.

The consumer price index was unchanged in January from its December level of 114.7. Partly seasonal declines in apparel, food, and new and used auto prices, were offset by further increases in charges for consumer services. The total index was 3.3 per cent above a year earlier, with the rise in consumer services amounting to 5 per cent. Influenced partly by rising labor costs, household service charges were up 6 per cent and medical care services up 8-1/2 per cent.

Prospective cattle supplies. New data on cattle inventories indicate that beef slaughter in the second half of 1967 will be at least as large as a year earlier instead of being smaller and, when combined with an anticipated large slaughter in the first half, will provide per capita supplies even larger than the record 103 pounds consumed in 1966. In their price and farm income projections in late 1966, Department of Agriculture analysts had counted heavily on declining beef production to lend strength to pork, poultry, and egg prices in the second half of 1967. Now, with larger beef slaughter in prospect, it appears that prices of fed cattle will average close to year earlier levels rather than above. This assumes that normal pasture conditions will permit orderly marketings.

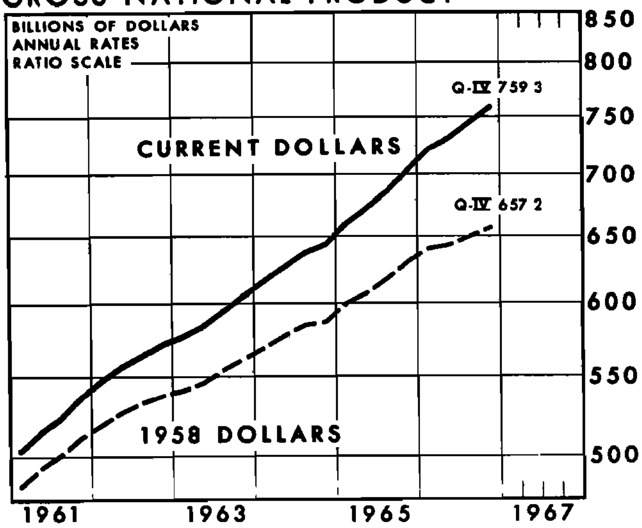
The January 1 inventory data, revised in line with the 1964 Census benchmark and other information, show that, contrary to expectations, the cyclical upswing in cattle numbers that began in 1958 has not stopped but continues to edge upward. Total numbers increased 1 per cent in 1966 and heifers by 3 per cent. Beef cow numbers were unchanged. It appears that slaughther was about in balance with inventory in 1966 and that 1967 slaughter can equal last year's without cutting down on inventory. The long-run price prospects of the cattle industry, from range producers to cattle feeders, are due for considerable realignment in the light of these figures. More or less stable prices over the next two or three years now seem more probable than the strengthening trend forecast on the basis of the old inventory numbers.

Larger supplies of all the high-protein foods except dairy products are likely in the second half of 1967. However, there are some indications of adjustments in production. Broiler producers are reducing the rate of expansion of production and hog farmers indicated in the December survey that pig numbers for fourth quarter marketing would be no larger than a year earlier.

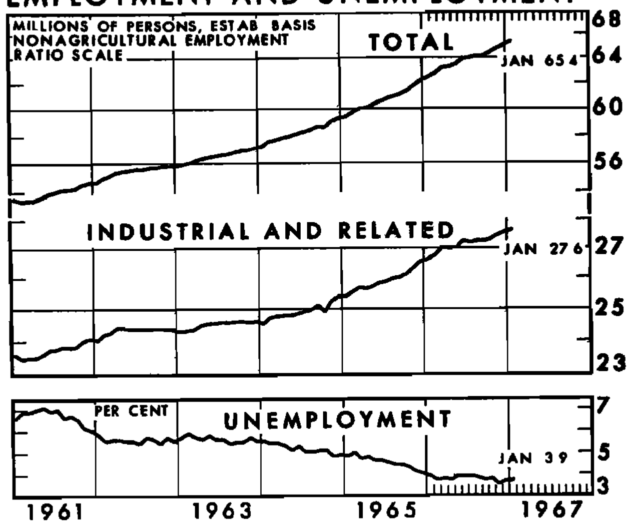
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

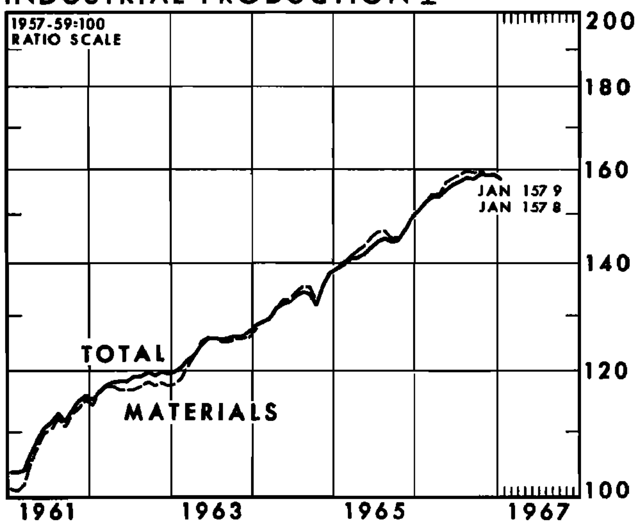
GROSS NATIONAL PRODUCT



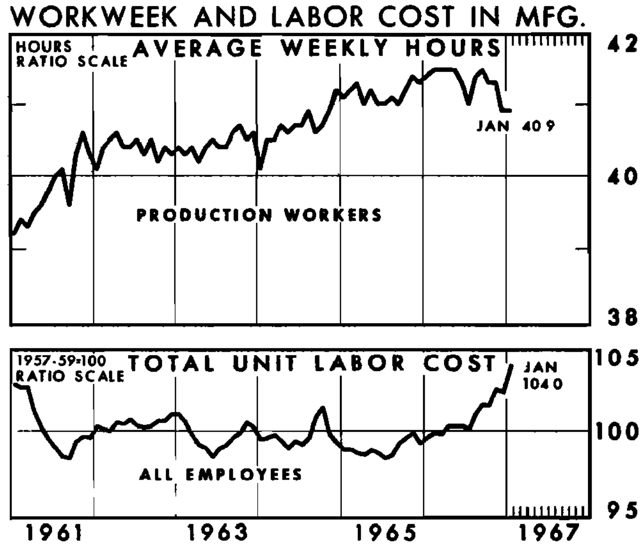
EMPLOYMENT AND UNEMPLOYMENT



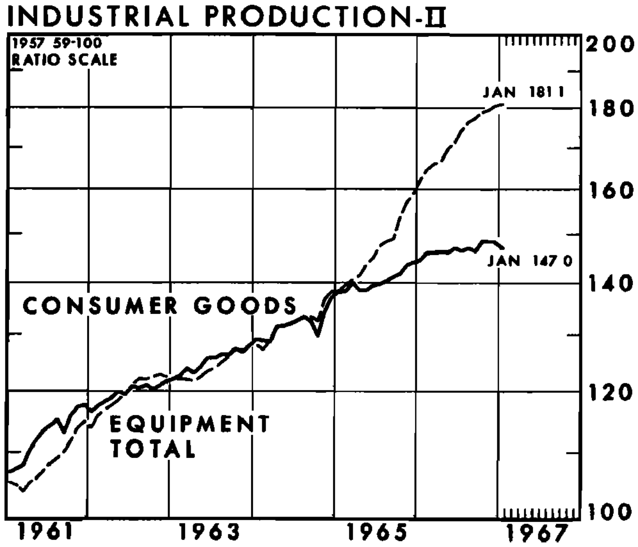
INDUSTRIAL PRODUCTION-I



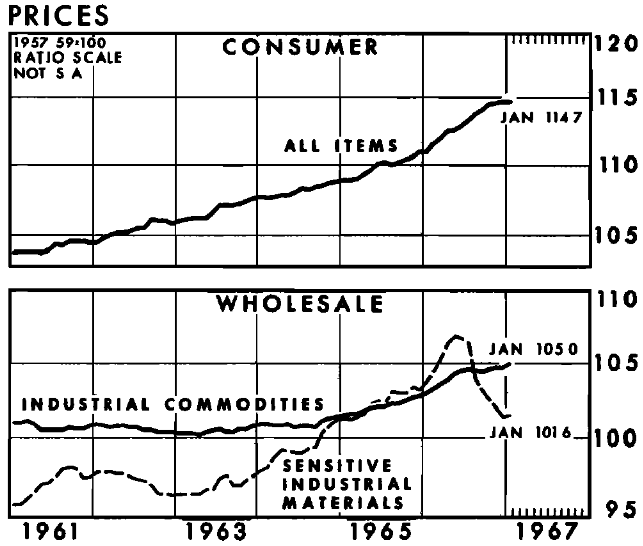
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



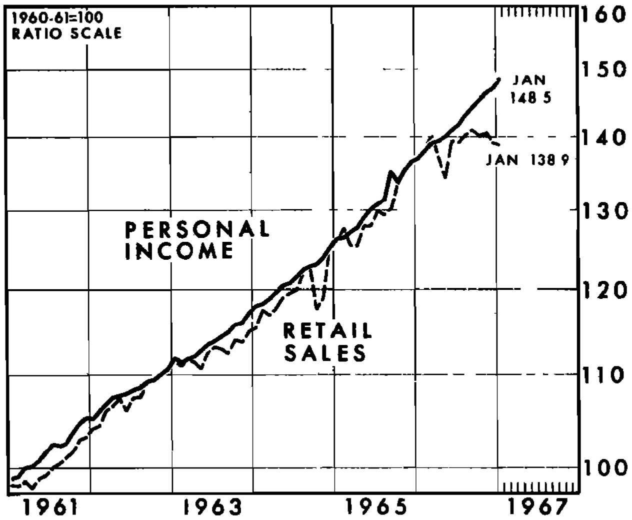
PRICES



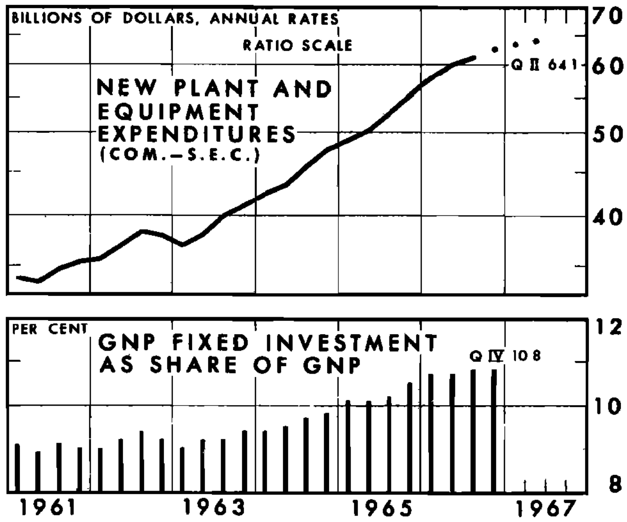
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

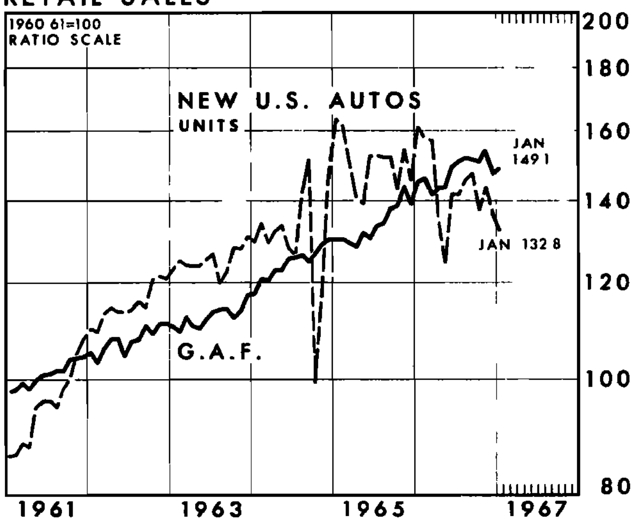
INCOME AND SALES



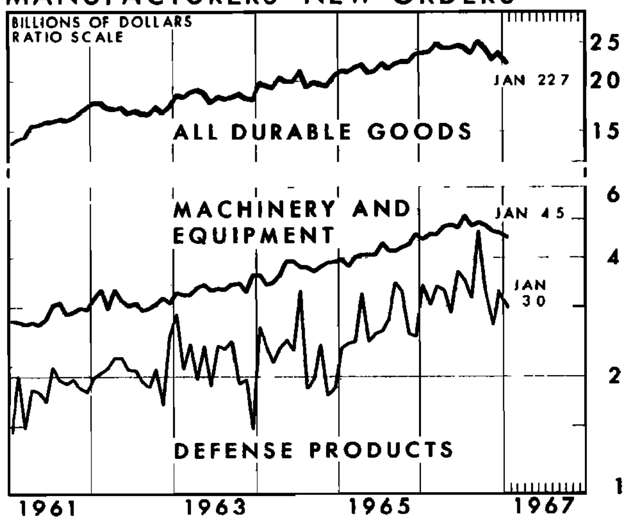
BUSINESS INVESTMENT



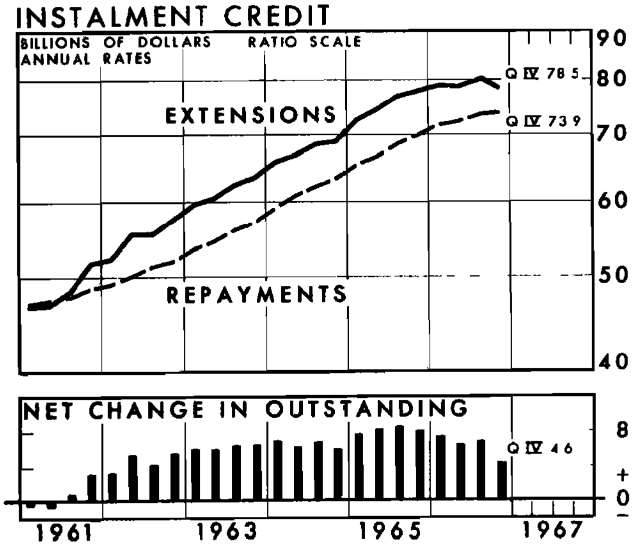
RETAIL SALES



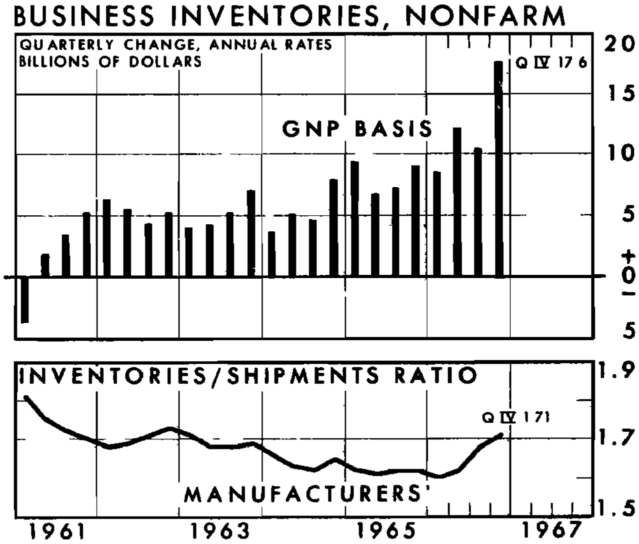
MANUFACTURERS' NEW ORDERS



INSTALMENT CREDIT



BUSINESS INVENTORIES, NONFARM



DOMESTIC FINANCIAL SITUATION

Bank credit. Based on available data, it is tentatively estimated that total loans and investments at all commercial banks may have risen in February by about $2.3 billion--or at a 9 per cent annual rate. This would bring the cumulative increase over the three months since the monetary policy shift in late November to $8.5 billion, or an annual rate of 11 per cent. The February increaee in the end-of-month series appears to be considerably less than that shown on a daily average basis (credit proxy), mainly because the end of January figure was high relative to the average for the month. Also, further reductions in borrowings from foreign branches in Feburary--not reflected yet in the credit proxy--also contributed to this difference.

All of the February credit increase appears to have been accounted for by bank acquisitions of securities. Total loans declined on balance, with small increases in business, real estate, and consumer loans more than offset by declines in loans to security dealers and nonbank financial institutions.

The relatively large inflow of time deposits in February--especially in the first half of the month--further reduced pressure on most banks, though money market banks had an outflow of CD's in the two weeks ending February 22 and a few New York City banks raised their offering rates on CD's late in the month. City banks acquired substantial amounts of new Treasury notes, apparently, in connection with the February 15 refunding. Total holdings of Treasury issues for all banks rose by about $1.2 billion in February--after having declined by $500 million in January. Furthermore, banks continued to acquire municipals and other securities at a rapid pace--adding about $1.2 billion--including significant amounts of tax warrants and other short-term instruments, which added further to their liquidity positions.

Following the substantial January rise, business loans apparently showed only a nominal increase in February--even less than the low rate of growth over the last five months of 1966. As contrasted with January, business payments of accelerated withheld taxes were small in February. Moreover, the near record January-February volume of corporate borrowing in the capital markets, following the large calendar in late 1966, may have reduced the need for some businesses to seek accommodations at banks and enabled some others to repay bank loans. But the reduced level of bank borrowing in the face of widespread indications of increased availability of funds and some easing in bank loan policies suggests that underlying demand for bank loans may be in a weakening phase.

Over the four weeks ending February 15, expansion has been slight or declines have been larger than seasonal in almost all major business loan categories. Weakness has been particularly evident in those industries where borrowing is generally associated with inventory needs. Among these industries, loans to food processors, commodity dealers, and manufacturers of nondurable goods declined sharply.

From mid-August to late November 1966, while the large money market banks were under pressure from CD runoffs and reduced reserve availability, New York City banks increased their business loans relatively more than did weekly reporting banks outside of New York City, as shown in the table. However, from late November 1966 through February 15, 1967, as large banks recovered most of their CD's and monetary policy eased, the expansion of business loans diminished abruptly in New York City while it was better sustained in the outlying banks. This reversal in trends of business lending might be indicative of some over-all weakening in the demand for bank credit by large national corporations.

RECENT CHANGES IN SELECTED ASSETS AND LIABILITIES
Weekly Reporting Banks
(Millions of dollars, not seasonally adjusted)

	Late November 1/ to mid-February			Mid-August 2/ to late November		
	1966-1967	1965-1966	1964-1965	1966	1965	1964
	New York City Banks					
Business loans	26	850	1,276	600	828	657
Time deposits	950	50	1,046	-1,963	611	564
CD's	987	-130	236	-1,903	257	359
Use of Euro-dollars 3/	-542			773		
	Banks Outside of New York City					
Business loans	429	1,207	1,188	409	1,121	976
Time deposits	4,222	1,402	3,291	-1,135	1,708	885
CD's	2,026	- 121	779	-1,154	339	180
Use of Euro-dollars 3/	-379			605		

1/ Twelve weeks ending February 15, 1967, February 16, 1966, and February 17, 1965.
2/ Fourteen weeks ending November 23, 1966, November 24, 1965, and November 25, 1964.
3/ Includes data for 12 banks, 8 in New York City, 2 in Chicago, and 1 each in San Francisco and Boston, and American Express.

Preliminary data from the February 15 lending practices survey show that over the last 3 months, most banks did not change terms on loans other than interest rates to established customers. However, nearly half of the banks reported a greater willingness to lend to new customers, with many banks especially interested in extending real estate and construction loans, particularly on single family homes, as well as consumer loans and term loans to nonfinancial businesses.[1/]

For all commercial banks in February, real estate loans expanded at only a moderate pace, no doubt reflecting the substantial lags in commitment of funds and generation of new mortgages. Loans to security dealers declined in February--following the sharp rise in January--as a change in dealer expectations as to near-term interest rate movements and higher borrowing costs led to reductions in dealer inventories.

Bank Deposits. Time deposit inflows at commercial banks remained strong through most of February. On a seasonally adjusted daily average basis, total time and savings deposits are estimated to have increased at an annual rate close to 20 per cent--above the January rate of 18 per cent and the largest since January 1965. The rate of growth was particularly rapid at large banks outside of New York City where CD's contributed heavily to the expansion, while that at country banks remained about the same as in other recent months.

1/ A more detailed summary of the results of the survey is presented in the Appendix.

In late February, however, the rate of expansion of time deposits at city banks fell off substantially. With time deposit inflows relatively large, banks continued to reduce their Euro-dollar borrowing in February. From the early December 1966, peak of about $4.3 billion through February 22, these borrowings declined by about $1.0 billion.

TIME AND SAVINGS DEPOSITS INFLOWS
Weekly Reporting Banks
(In millions of dollars, not seasonally adjusted)

	All weekly reporting banks		New York City Banks		All other banks	
	1967 1/	1966 1/	1967 1/	1966 1/	1967 1/	1966 1/
Total time and savings deposits	1113	-24	8	-359	1105	335
Negotiable CD's	668	-71	-16	-313	683	242
Other time 2/	459	79	16	- 18	444	97
Savings deposits	-14	-32	8	- 28	-22	- 4

1/ Three weeks ending February 15, 1967, and February 16, 1966.
2/ Other than large negotiable CD's.

The money stock rose at about a 5 per cent annual rate in February--offsetting the decline in January. Currency outstanding increased about $100 million and private demand deposit $600 million. The increase in demand deposits may in part reflect the increased availability of bank credit, though some reductions in Treasury balances late in the second half of the month also contributed to this rise.

Since November, the money stock has increased at about a 3 per cent annual rate, compared with a 1 per cent rate of decline over the preceding three-month period.

The February rise in short-term market rates has generally not induced a similar change in CD rates. While CD rates will remain relatively attractive compared with Treasury bills, their yield advantage declined in February, and other short-term paper continues to yield more than CD's. Accordingly, while most large banks were able to add further to their outstandings, the pace of the expansion has fallen off considerably and New York City banks lost CD's in the last two weeks of February. By February 22, outstandings had almost recovered their mid-August high.

In the three weeks ending February 15, banks outside of New York City accounted for all of the increase in outstanding CD's, whereas earlier in the year, more than half of the growth in CD's occurred at New York City banks. This shift probably reflected mainly a lessening of the desire of New York City banks for CD's, since the sharp expansion earlier in the year may have satisfied temporarily the needs of New York City banks. However, late in February, a few New York City banks raised the offering rates on their CD's as short-term market rates began backing up.

On the basis of data for all but one District on the February 22 CD maturity survey, it appears that the average maturity of outstanding CD's remained about unchanged in February. However, at banks in New York City and Chicago, the average maturities of CD's sold in February were substantially below those sold in January and were heavily concentrated in March maturities. These banks may have preferred to confine their sales of CD's to the short end of the maturity scale in anticipation of lower rates later on. Moreover, corporations may have desired to acquire CD's to finance their March tax payments.

Time deposits other than CD's increased sharply further at weekly reporting banks outside of New York City in February, whereas at New York City banks they only rose slightly after having declined sharply in January. It is possible that the continuing competition from nonbank intermediaries has been primarily responsible for this slowing in consumer-type time deposits at New York City banks.

Corporate and municipal bond markets. Yields on corporate and municipal bonds have turned down in initial response to announcement of the Board's reserve requirement action. An Aaa-rated telephone bond, reoffered to yield 5.55 per cent just prior to the announcement, has sold out quickly; three corporate bonds totaling $150 million and tentatively scheduled for offering this week or early next have been postponed for a week to await market developments; and a fourth has been postponed indefinitely. Prior to the Board's action yields on corporate and municipal bonds had advanced markedly from the 1967 lows reached in early February. On new corporate issues the up-turn amounted to nearly 40 basis points, and on seasoned municipals it ranged to over 25 basis points. In both markets the yield reversal erased more than a third of the previous decline from 1966 peaks.

BOND YIELDS
(Weekly Averages, Per cent per Annum)

	Corporate Aaa New With call protection	Corporate Aaa New Without call protection	Corporate Aaa Seasoned	State and local Gov't. Moody's Aaa	State and local Gov't. Bond Buyer's (mixed qualities)
1965					
End of July 1/	4.58	--	4.48	3.16	3.25
Early December 2/	4.79	--	4.60	3.37	3.50
1966					
Late Summer high	5.98*	--	5.44	4.04	4.24
Weeks ending:					
Dec. 2	5.80	6.10	5.37	3.89	4.02
Feb. 3	--	5.21	5.02	3.25	3.40
Feb. 10	5.09	5.18	5.00	3.25	3.41
Feb. 17	5.16	5.39	5.01	3.50	3.62
Feb. 24	5.20*	--	5.05	3.53	3.66
Feb. 27 3/	5.45				

1/ Week prior to President's announcement of increased U.S. involvement in Vietnam.

2/ Week preceding Federal Reserve discount rate increase.

* The largest issue included in this average carried 10-year call protection.

3/ An adjusted one-day quote calculated from the 5.55 per cent re-offering rate on the Chesapeak and Potomac Telephone Company bond.

Bond yields backed up during February chiefly because the forward calendar of security offerings suddenly became very large at a time when market participants were questioning whether further near-term easing of monetary policy could be expected. Reflecting these pressures, syndicate price restrictions on 8 of 12 sizable new corporate bonds offered in February had to be terminated before distribution was complete, with subsequent upward adjustment in reoffering yields of 8 to 25 basis points. These were the first corporate issues of any size released from syndicate with unsold balances since mid-November. Lack of investor interest in new issues also expanded the security inventories of municipal bond underwriters. As a result, the "blue list" of their advertised inventories grew to more than $650 million in late February, the highest level since November 1965.

Prior to the Board's reserve requirement action, underwriters estimating that gross public offerings of interest bearing securities would total as much as $3.4 billion in March, excluding new issues of U.S. Treasury and Federal agency debt. Corporate bonds accounted for $1.4 billion of the estimated total, municipal bonds for about $1 billion, Federal participation certificates for $800 million, and World Bank bonds for $250 million. Corporate bonds already definitely scheduled for public offering in March total $1.2 billion, including $700 million added to the calendar in the past three weeks. Additional postponements which stretched out corporate demands, the expectation of more favorable market conditions ahead, could, of course, reduce this figure.

It now appears that corporate bond offerings in February totaled $825 million--well ahead of February a year ago and substantially more than had previously been estimated for this month. Most of the increase was accounted for by the $250 million Union Carbide issue, the offering of which was advanced into February in order to escape the congested early March calendar. With the January volume of corporate public offerings also substantially larger this year than last, it now appears that gross public offerings for the first quarter will exceed the first quarter 1966 total by more than 60 per cent.

First quarter corporate security offerings of all types are likely to fall below last year's first quarter volume, however, due chiefly to a greatly reduced volume of private placements. Some year-to-year short-fall is also expected in the volume of stock offerings. While no data are yet available on private placement takedown in 1967, SEC fourth quarter figures indicate that private placements were $350 million smaller than the already reduced volume estimated earlier by the Board staff. While funds available for private placements reportedly have shown some increase recently, it seems unlikely that there will be a substantial expansion as early as the first quarter. Consequently in the accompanying table a year to year short-fall in private placements similar to that evident in the fourth quarter is assumed to persist in early 1967.

CORPORATE SECURITY OFFERINGS 1/
(In millions of dollars)

	Bonds					
	Public Offerings 2/		Private Placements		Total Bonds and Stocks	
	1966	1965	1966	1965	1966	1965
Total	8,018	5,570	7,542	8,151	18,074	15,992
4th Quarter	2,047	1,226	1,247	2,264	3,669	4,030
	1967	1966	1967	1966	1967	1966
January	730e	460	400e	692	1,230e	1,339
February	825e	560	350e	583	1,300e	1,273
March	1,350e	753	600e	1,311	2,075e	2,482
1st Quarter	2,905e	1,774	1,350e	2,586	4,605e	5,094

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

In the municipal bond market, the late February build-up of dealers' advertised inventories reflected both a continuing heavy volume of current offerings and a tendency for investors to hold back in making commitments of funds. While yields were declining generally, dealers were willing accumulaters of municipals, but when bond markets widened, dealers attempted with only limited success to cut back on inventories. This helps to explain the sharpness of the February yield advance in municipal markets.

Municipal debt offerings in February apparently totaled nearly $1.3 billion, even though rising interest rates led to postponement of about $125 million of planned offerings and additional postponements of issues originally scheduled for early March have also been announced recently. Nevertheless, March volume may still aggregate as much as $1.0 billion, increasing volume for the first quarter to a record $3.6 billion, roughly a fifth larger than in the previous record first quarter of 1966.

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

	1966	1965
Total	11,362	11,329
4th Quarter	2,631	2,651
	1967	1966
January	1,325e	1,219
February	1,275e	867
March	1,000e	879
1st Quarter	3,600e	2,965

1/ Data are for principal amounts of new issues.

Stock market. Common stock prices--as measured by Standard and Poor's index of 500 stocks--have recovered most of the losses registered early this week and are now only slightly below the recent high reached February 17. Prior to mid-February, the Standard and Poor's index had risen more than 9 per cent from early January, to a level nearly 20 per cent above its October 1966 low.

Trading activity on the New York Stock Exchange continued to average just under 10 million shares per day in February, about the same as in January. Several low-priced issues have appeared regularly on the most active stocks listed in recent weeks, and Standard's and Poor's price index of 20 low-priced common stocks has advanced more rapidly than the broader 500 stock index this year. From the end of 1966, for example, the low priced index rose 28 per cent to a new high on February 21, slightly above the previous high reached near the peak of the market in April last year. Trading volume on the American Stock Exchange, where low-priced issues are particularly important, has also been relatively high recently, rising to more than 40 per cent of that on the New York Stock Exchange during the final weeks of February. This ratio is substantially above the 20 to 30 per cent relationship that usually prevails.

Despite the rise in stock prices and trading activity during January, stock market credit declined about $100 million. Forty per cent of this decline represented reductions in customer net debit balances at member firms of the New York Stock Exchange and 60 per cent represented a cut-back in purpose loans at banks. The monthly drop in stock market credit was the first since October and tends to support the view that much of the upward pressure on prices during January came from institutional buying.

<u>U.S. Government securities market</u>. Yields on Treasury notes and bonds have risen some 15 to 20 basis points since late January and in the longest maturities this increase has served to erase nearly half of the previous yield decline that started in late November. Intermediate-term issues in recent weeks have retraced 1/5 to 1/4 of their earlier decline. Treasury bill rates moved up sharply in the first three weeks of February, but have declined again in recent trading sessions. The initial impact of the announcement of a cut in bank reserve requirements was to reduce yields moderately throughout the list.

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

Date (Closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1965						
Dec. 3	4.12	4.26	4.54	4.52	4.52	4.44
1966						
Aug. 29	5.02	5.51	6.22	5.89	5.51	5.12
Sep. 21	5.59	5.96	5.90	5.53	5.21	4.97
Nov. 25	5.27	5.47	5.56	5.39	5.23	4.91
Dec. 30	4.81	4.92	4.94	4.80	4.64	4.58
1967						
Jan. 27	4.59	4.56	4.58	4.61	4.47	4.47
Feb. 3	4.46	4.47	4.61	4.66	4.52	4.50
Feb. 7	4.55	4.54	4.65	4.68	4.54	4.53
23	4.64	4.71	4.85	4.83	4.74	4.73
March 1*	4.48	4.48	4.74	4.75	4.69	4.67

* Noon quotations.

Major factors influencing the Treasury bond market in recent weeks have been the large and continuing build-up in the corporate bond calendar and indications of a possible offering of FNMA participation certificates in March. The market has also reacted bearishly to the somewhat tauter atmosphere in the Federal funds and dealer loan markets, and to recent developments in Vietnam. Against this background, a growing conviction developed that the earlier yield declines had been overdone. Dealers accordingly sought to reduce their inventories, and despite some simultaneous investor selling, partly on swaps into new participation certificates, dealers were sizable net sellers of notes and bonds in recent weeks. From their peak on February 3, net dealer holdings of coupon issues due in more than 1-year declined nearly $500 million to a level of just under $600 million on February 28. Of this decline, $223 million was accounted for by Treasury trust fund purchases on February 24.

The rise in bill rates in the first three weeks of February appeared to reflect mainly market reaction to the tighter Federal funds market and the associated rise in dealer financing costs. In this period dealers were willing and at times aggressive sellers of bills and they were able to reduce their inventories somewhat from unusually high levels in January and early February. More recently, dealer bill sales accelerated as the System and the Treasury were large buyers. Partly as a consequence but also as a result of a more comfortable tone in the Federal funds market and the reduction in required reserves, bill rates have fallen sharply in the last few days from their recent highs reached on February 23.

Yields on most other short-term debt instruments rose after the first part of February, as the table shows.

SELECTED SHORT-TERM INTEREST RATES

	1966	1967	
	High	Low	Feb. 24
Commercial paper 4-6 months	6.00 (12/31)	5.38 (2/24)	5.38
Finance company paper 30-89 days	5.88 (12/31)	5.00 (2/14)	5.13
Bankers' Acceptances 1-90 days	5.75 (10/25)	4.75 (2/10)	5.00
Certificates of deposit (prime NYC)			
Typical new issue:			
3-months	5.50 (1/18/67)	5.00 (2/20)	5.13
6-months	5.50 (1/11/67)	5.00 (2/20)	5.13
Secondary market:			
3-months	5.90 (9/21)	5.15 (2/14)	5.25
6-months	6.30 (9/28)	5.20 (2/14)	5.30
Federal Agencies (secondary market):			
3-months	5.76 (9/21)	4.70 (2/10)	4.75
6-months	6.04 (9/21)	4.82 (2/10)	4.99
9-months	6.04 (9/21)	4.92 (2/9)	5.10
Prime Municipals 1-year	4.25 (9/21)	2.75 (2/10)	2.80

N.B. Latest dates on which high or low rates occurred are indicated in parentheses.

Treasury finance. The Treasury is expected to announce a cash offering of around $2.5 billion of June tax bills as soon as final legislation is secured raising the debt ceiling from the present $330 billion to $336 billion. Since payment date for the new bills will not be before mid-March and the Treasury cash operating balance will be drawn down to low levels in the meantime, the Treasury may need to borrow directly from the System at some point during this period.

The next regularly scheduled Treasury financing operation will be the refunding of $9.7 billion of notes maturing in mid-May. Of this total, only $2.9 billion is held by private investors.

Corporate profits. Corporate profits before taxes, according to present staff estimates, were at a seasonally adjusted annual rate of $82.5 billion in the fourth quarter of last year. This is nearly $3 billion larger than advance estimates had assumed and reflects primarily the better than expected earnings reported by manufacturing companies.

Profits of manufacturing corporations, based on data now available for over 600 companies that account for nearly two-thirds of the earnings of all manufacturing corporations, appear to have been 5 to 6 per cent larger than in the fourth quarter of 1965. This is a smaller year-to-year increase than in any quarter since early 1963. But the year-to-year rise is large enough to produce a seasonally adjusted increase from the third to the fourth quarter, since profits were rising sharply in the latter part of 1965. Profits/sales ratios probably held about steady, following declines in the second quarter and again in the third.

It had generally been expected that manufacturing profits would continue to decline in the fourth quarter of last year and such a development would have been consistent with the increase reported in unit labor costs, the decline in price per unit of labor cost and the slight increase in industrial output. Excluding automobiles, profits of manufacturing corporations apparently did in fact decline--but only a little--from the third to the fourth quarter, but auto manufacturers reported a much greater narrowing in the year-to-year decline in their earnings than would have been expected from the moderate narrowing in the year-to-year decline in their output. Presently available data do not indicate whether earnings reported by manufacturers for the fourth quarter were inflated by special factors such as year-end credits or repatriation of foreign earnings in anticipation of increased taxes.

Flows to financial intermediaries. More complete data now available for January document the strength of the improvement in savings flows to financial intermediaries. Net flows to both commercial and savings banks were in record volume. While net flows to savings and loan associations were also dramatically higher than in January 1965, they still fell substantially short of the $600 million average January inflow during the 1960-1964 period.

NET FLOWS TO DEPOSITARY-TYPE FINANCIAL INTERMEDIARIES
(Millions of dollars, unadjusted)

	Total 1/	S&L's	Mutual Savings Banks	Commercial Banks: Without CD's 1/	Commercial Banks: With CD's
January					
1967	2,543	370	400	1,773	3,986
1966	981	-77	227	831	1,164
1965	2,288	254	358	1,676	2,726
1964	2,069	469	382	1,218	1,218
4th Quarter					
1966	5,349	2,210	1,069	2,070	744
1965	8,576	3,032	1,046	4,498	4,678
1964	8,249	3,277	1,202	3,770	4,398

1/ Excludes CD's in excess of $100,000 at weekly reporting banks.

Thus far only fragmentary evidence is available on savings flows in February. During the first half of the month, the 15 largest savings banks in New York City received $50 million in new deposits, more than double the inflow for the same period in February 1965. While similar data are not available for S&L's, the S&L's have continued to make substantial repayments of debt at the Home Loan Banks, suggesting that inflows have remained relatively large. This explains why the Federal Home Loan Bank System was able to repay in full the $543 million issue of its notes which matured in February.

To a considerable extent the large loan repayments by member S&L's in recent weeks have reflected a continuing shortage of immediately available mortgages. For this reason, in January as in December, new mortgage loans by S&L's were smaller than the return flow of payments on outstanding loans.

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

First 3 weeks of February	Change in Advances	Change in Deposits at FHL Banks	Liquidity of the FHL Banks 1/
1967	-511	138	2,309
1966	-142	-44	719
1965	- 89	1	560
1964	-211	-15	857

1/ Represents operating funds in excess of liquidity reserve requirements and reserves for unanticipated advances. This figure is as of the end of January.

Mortgage market developments. With net savings flows to lenders apparently continuing at a high level, mortgage markets eased further during February. Recently, however, some observers have expressed concern that the pace of easing might slow unless congestion is reduced in bond markets.

One indication of further easing in mortgage markets was the FHA Commissioner's recent statement implying that secondary-market yields on certain FHA-insured home loans declined by considerably more in February than they did in January. Also, weekly offerings of FHA and VA mortgages to FNMA for purchase under its secondary-market operations continued at a low level through mid-February, despite some increase in FNMA's prices early in the month along with other steps taken to encourage a larger volume of offerings.

While statistics for February are fragmentary, data available for January show that easing in mortgage markets was greater in certain respects than during any comparable month following shortly after earlier postwar turning points in mortgage yields. Secondary-market offerings to FNMA dropped by nearly half. Applications and requests to FHA and VA to underwrite mortgages on existing homes picked up substantially. And declines were reported both in Federally-underwritten home loan discounts and in conventional home mortgage interest rates.

Secondary-market yields on certain FHA home loans--which had risen so sharply last year--were down by 15 basis points in

January, more than in any comparable month of earlier yield downturns. Average interest rates on conventional first mortgages for home purchase (FHA series) edged down for the second consecutive month, largely reflecting declines in the Southwest and West where rates had risen the most in 1966. Even the lagging FDIC-FHLBB conventional home mortgage series finally turned down in January, as both rate and non-rate terms eased slightly, although not all lenders or areas reported liberalization.

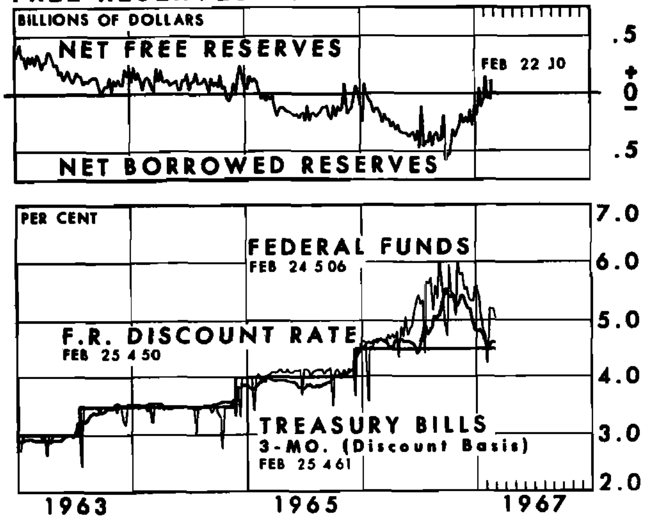
AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES
(Per cent)

	PRIMARY MARKET: Conventional loans		SECONDARY MARKET: FHA-insured loans	
	FHA Series	FHIC-FHLBB Series	Yield	Discount
1966				
January	6.00	5.81	5.70	4.0
November	6.70	6.40	6.81	6.8
December	6.65	6.44	6.77	6.5
1967				
January	6.60	6.43	6.52	5.3

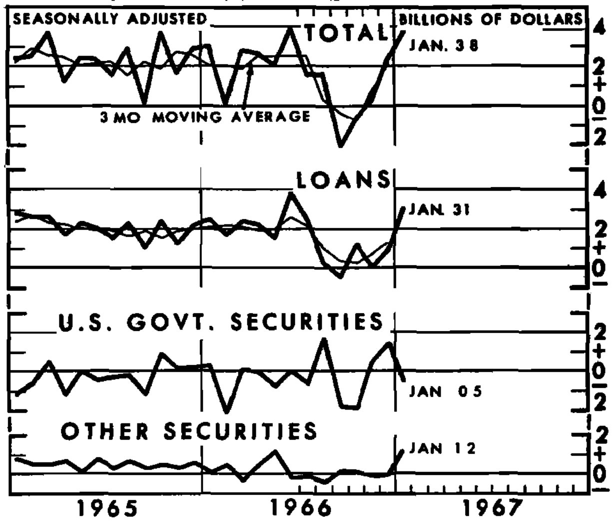
Source: Federal Housing Administration and Federal Home Loan Bank Board. Conventional loan contract interest rate data exclude fees and charges.

FINANCIAL DEVELOPMENTS - UNITED STATES

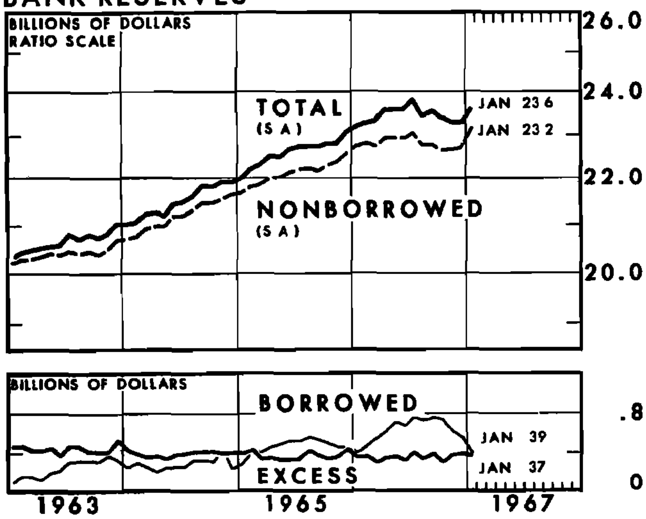
FREE RESERVES AND COSTS



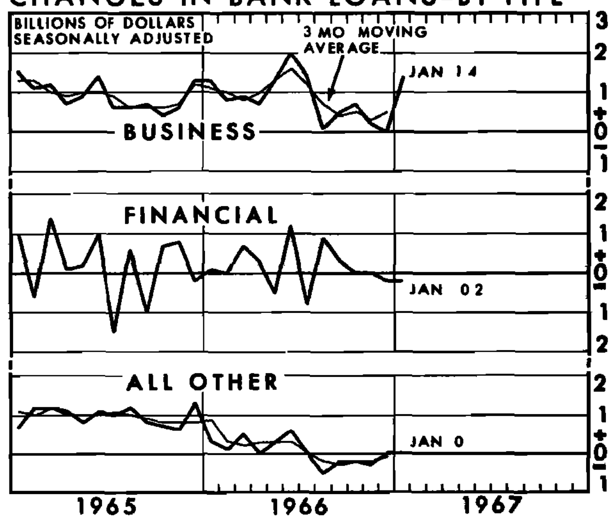
CHANGES IN BANK CREDIT



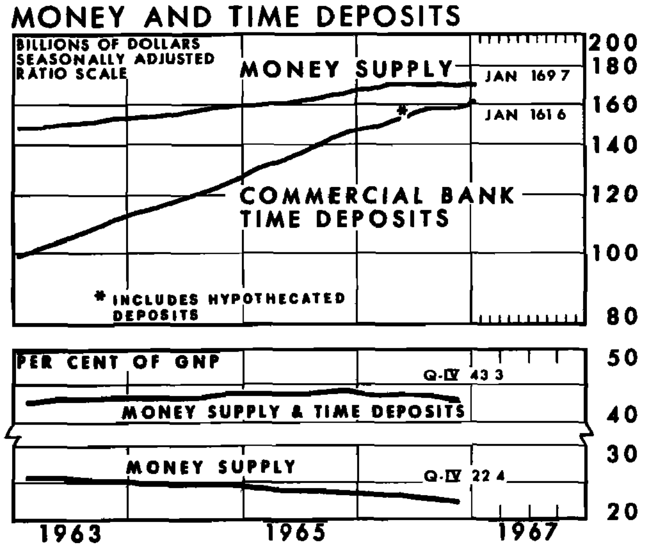
BANK RESERVES



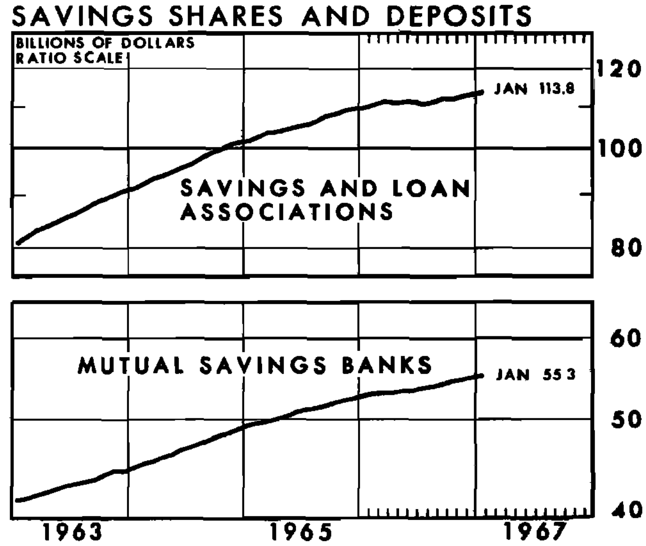
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

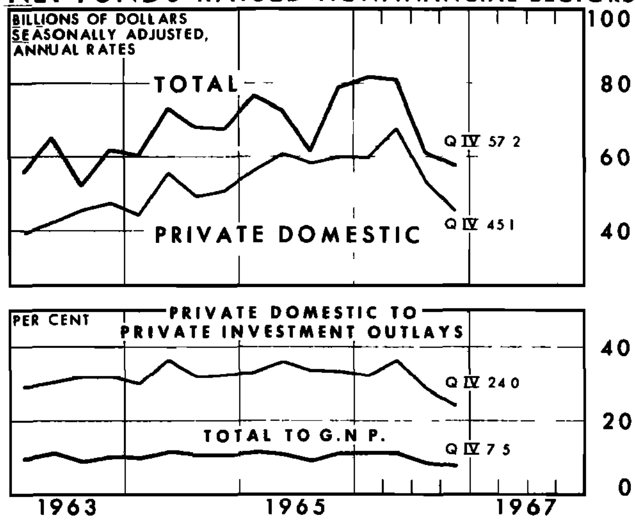


SAVINGS SHARES AND DEPOSITS

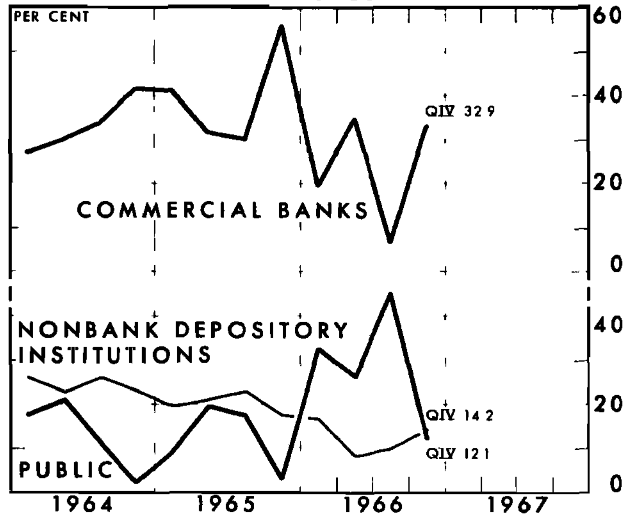


FINANCIAL DEVELOPMENTS - UNITED STATES

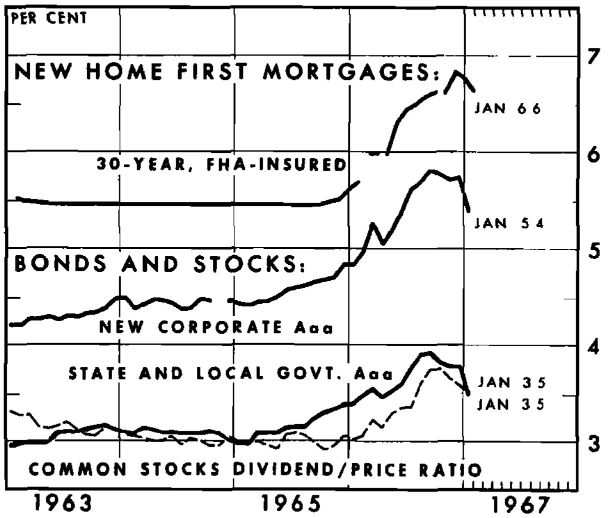
NET FUNDS RAISED-NONFINANCIAL SECTORS



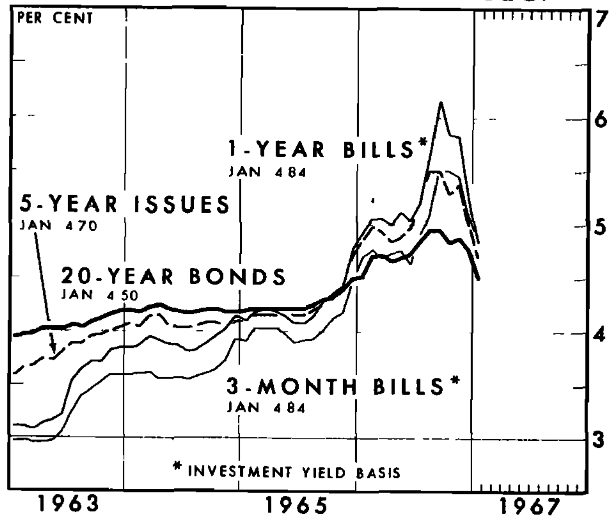
SHARES IN TOTAL CREDIT



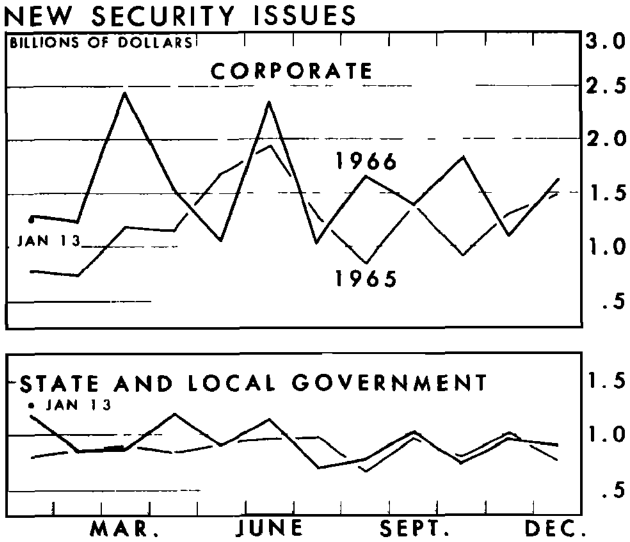
MARKET YIELDS



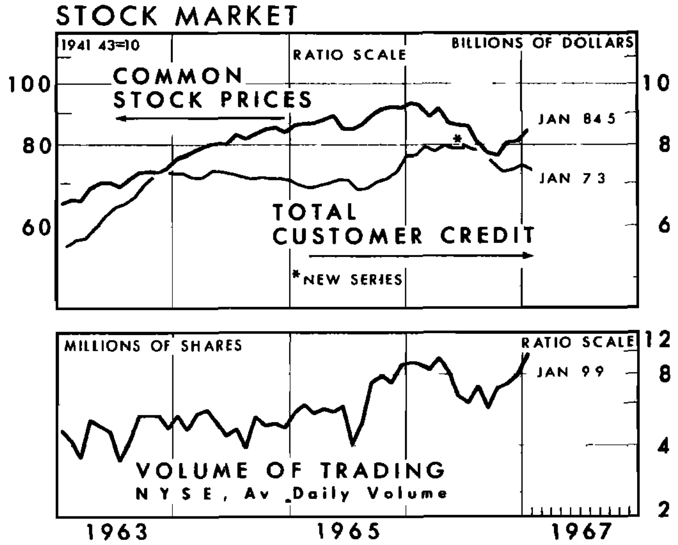
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. The balance of payments measured on the liquidity basis was in moderate deficit in early 1967 -- on the order of $100 million, before seasonal adjustment, for the month of January plus three weeks of February. The first quarter is customarily favorable for the U.S. payments position -- the seasonal adjustment increases the deficit by about $500 million -- but monthly data for recent years suggest that little of this adjustment should be applied to the results for January and February.

In contrast, the balance measured on the basis of official reserve transactions was in deficit in the first seven weeks of 1967 by more than $600 million before seasonal adjustment, and by a larger amount after adjustment. This deficit had a substantial counterpart in the very large dollar accruals by the Bank of England, which used much of its net receipts to repay drawings on Federal Reserve swaps and other official assistance. (In February, there were sizable dollar reserve gains by Germany as well, partly reversing the seasonal decline at the beginning of the year.) Thus, so far the large foreign official reserve gains associated with our deficit on official reserve transactions have not increased foreign demands for monetary gold. The $70 million decline in the total gold stock in the first two months of this year has reflected small purchases by a number of countries and sales to U.S. domestic industry.

The relatively low rate of deficit on the liquidity basis early this year -- relatively low as compared with recent estimates of the underlying payments position -- may be partly explained by a $260 million reduction in outstanding bank credits to foreigners in January. This decline was substantially more than seasonal, and as large as that in January 1966. It showed up in both short-term loans and acceptance credits and long-term loans, and was fairly widely distributed among foreign borrowing countries. Moreover, new long-term loan commitments to foreigners in January were little changed from the low average rate of the last half of 1966. Thus, net flows of U.S. bank credits to foreigners as yet show no evidence of having shifted in response to easier credit conditions in this country.

Moreover, recent scheduling of foreign security issues in the United States appears toreflect changed capital market conditions here only in the case of the prospective $250 million offering by the IBRD (part for delayed delivery); it now appears likely that new bond offerings by Canadian borrowers arranged in the first quarter will be little larger than in the fourth. The IBRD issue can be expected to affect the payments deficit on the liquidity basis only gradually as the IBRD makes disbursements-- initially the Bank will invest the proceeds in long-term instruments in the United States, as it did with its borrowings in the U.S. market last year.

The trade balance improved in January, as exports advanced sharply almost to their October peak. Details on the country and commodity distribution of trade are not available. For December-January together, the surplus was a little below the fourth quarter annual rate of $3 billion.

The fourth quarter trade surplus has been revised downward on the basis of new seasonal adjustment factors, and the trends in both imports and exports have been somewhat changed. Imports now appear not to have leveled off in the fourth quarter, but instead to have increased at an annual rate of 6 per cent from the third quarter. This rise still represents a marked slowing from the annual rate of 20 per cent which occurred between the third quarter of 1965 and the third quarter of 1966.

U.S. EXPORTS, AGRICULTURAL AND NON-AGRICULTURAL: 1965-66
(Billions of dollars)

			1966			
	1965	1966	I	II	III	IV
	(Seasonally adjusted annual rates)					
Non-agricultural exports	20.2	22.4	22.1	22.2	22.4	22.8
Canada	5.0	6.0	5.6	6.0	6.0	6.4
Western Europe	6.2	6.6	6.9	6.7	6.6	6.3
Japan	1.2	1.4	1.3	1.3	1.3	1.6
Latin America	3.3	3.7	3.8	3.6	3.8	3.7
Other countries	4.2	4.3	4.2	4.2	4.5	4.6
Special categories other than military grant aid	.3	.3	.4	.4	.2	.3
Agricultural exports	6.3	7.1	6.8	6.9	7.4	7.1
Total exports	26.5	29.4	28.9	29.0	29.8	29.9

Note: Census basis which differs somewhat from balance of payments basis.

The revised export figures now show a slower growth during 1966, and fourth quarter exports were $29.6 billion at an annual rate (balance of payments basis.) As shown in the table, which presents data on the Census basis, divergent trends in exports continued in the fourth quarter. While total non-agricultural exports were up, there was a further marked decline in these exports to Western Europe, reflecting in part lower sales to the United Kingdom. The expansion in non-agricultural exports to Canada consisted entirely of automobiles and parts, but the growth in sales to Japan is believed to have been broadly based. The decline in agricultural exports in the fourth quarter reflected mainly a dip in sales of wheat and other grains.

Money markets and interest rates abroad. Interest rates in Germany and Britain during February were markedly below last autumn's levels. The decline in three months from mid-November amounted to about 3/4 of a percentage point for typical short-term money market rates in Britain -- about the same as for U.S. 3-month Treasury bills. German 3-month rates were down about 1-1/2 per cent from last September. Long-term bond yields in Britain and in Germany, which were higher in 1963 than ours, and which rose much more than ours in the three years after mid-1963, have also fallen more than ours since last summer and autumn -- but still remain relatively high. After declining by around 0.8 per cent in Britain and over 1 per cent in Germany since early September, long-term government bond yields are still around 6-1/2 per cent in Britain and 7-1/4 per cent in Germany -- compared with about 4-1/2 per cent in the United States, down 30 or 40 basis points from early autumn.

In other European countries, interest rate movements have been less clear-cut; but in most countries the uptrends since 1963 have now topped out.

In Canada, rate movements since December have roughly paralleled those in the United States; earlier in 1966 Canadian short-term rates moved up sharply above ours, but during the summer and autumn they held relatively steady.

Japanese interest rates have moved very differently from those in most other industrial countries. Throughout 1965 and 1966 they tended to decline. In the past two months some Japanese rates have risen a little.

Three major influences are responsible for the striking downturns in British and German interest rates. First, with economic activity no longer expanding, domestic credit demands have been diminishing. Secondly, the easing of money market conditions in the United States has removed upward pressures previously exerted from this country through the Euro-dollar market. Finally, and of special importance, monetary policies have changed in the direction of ease, in recognition of (1) the fading of aggregate demand pressures; (2) the probability of a further decline this year in private investment spending on plant and equipment in Britain and earlier fears of such a development in Germany; and (3) the desirability of concerted efforts to bring interest rates down from last year's extraordinarily high levels.

Highly visible facets of the shifts taking place in policy have included the reductions, since early January, in the discount rates of the central banks in Germany, Britain and Canada, and reductions in bank reserve requirements in Germany. Elsewhere in Europe, the Belgian and Swedish central banks have also reduced their discount rates.

In the Euro-dollar market, rates declined much more than seasonally after mid-December, as U.S. banks reduced their liabilities to their branches abroad. From December 14 to February 1 these liabilities fell by $1.2 billion. In the week ended February 8 they rose by $0.2 billion; changes in the next two weeks were small. The 90-day Euro-dollar deposit rate dropped by 1-1/2 percentage points from mid-December to the end of January; a normal seasonal decline would be about 1/2 per cent.

SHORT-TERM INTEREST RATES
(per cent per annum)

		1963	1965	1966		1967	
		June 28	Dec. 3	Sept. 16	Nov. 18	Jan. 20	Recent
U.S.:	3-mo. Treas. bill 1/	2.99	4.12	5.40	5.38	4.71	4.61 (2/24)
	Federal funds 1/	2.96	4.13	5.80	5.96	5.25	5.18 (2/24)
Euro-dollar:	call money	3.50	4.50	6.25	6.25	5.25	5.25 (2/24)
	3-mo. deposit	3.84	5.25	6.69	6.75	5.75	5.56 (2/24)
U.K.:	3-mo. Treas. bill	3.63	5.24	6.60	6.57	6.10	5.89 (2/21)
	3-mo. local authority	4.25	6.38	7.38	7.25	6.63	6.34 (2/24)
Germany:	3-mo. inter-bk.	3.88	6.25	6.88	7.18	5.31	5.31 (2/24)
Switzerland:	3-mo. deposit	2.86	4.00	4.25	4.38	4.50	4.50 (2/15)
France:	call money	6.25	4.81	3.63	5.38	5.50	4.81 (2/15)
Belgium:	Treas. bill	3.40	5.00	7.75	6.00	6.15	6.00 (2/21)
Netherlands:	Treas. bill	2/1.87	4.29	4.75	5.00	4.88	4.78 (2/17)

1/ Average for week ending at specified date.
2/ Average for June 1963.

Market rates of interest in the United Kingdom began to decline after early September, and by the end of November the yield on War Loan was already almost 40 basis points under the September peak. In the Treasury bill market the Bank of England resisted the declining tendency of short-term rates until the end of November. Renewed declines in December and most of January reflected easing credit conditions in other national and international markets as well as widespread anticipation of an early reduction in Bank Rate.

The cut in Bank Rate on January 26, from 7 to 6-1/2 per cent, was less than many in the market had expected; subsequently, and partly in anticipation of a further cut, market rates declined further. While the British authorities welcome the fall in long-term rates as an encouragement for private fixed investment, they have proceeded cautiously in allowing short-term rates to decline in order to maintain covered interest rate spreads that favor switches from Euro-dollar assets to local authority deposits or other sterling investments. Such switching contributed to large U.K. official reserve gains in January and February.

The rise in seasonally adjusted unemployment in Britain slackened in January and February. Industrial production (preliminary) picked up in December, but for November and December together industrial output averaged 3-1/2 per cent below its level last July and August.

LONG-TERM GOVERNMENT BOND YIELDS
(per cent per annum)

	1963	1965	1966		1967	
	June 28	Dec. 3	Sept. 2	Dec. 2	Jan. 20	Recent
U.S. (10-year and over) 1/	4.00	4.36	4.87	4.74	4.37	4.55 (2/24)
Canada (4-1/2% 1983) 2/	4.95	5.45	5.96	5.97	5.61	5.61 (2/15)
U.K. (War Loan) 3/	5.54	6.49	7.31	6.93	5.75	6.54 (2/23)
Germany (6% publ.author.) 4/	6.1	7.78	8.32	7.79	7.37	7.23 (2/24)
Switzerland (3-1/2% 1967-74)	3.11	3.98	4.08	4.18	4.23	4.24 (2/17)
France (public sector) 5/	5.38	5.86	6.29	6.44	6.45	6.45 (2/10)
Belgium (composite)	5.03	5.66	5.84	5.90	n.a.	n.a.
Netherlands (composite) 6/	4.29	5.97	6.76	6.57	6.06	5.90 (2/10)

1/ Average for week ending at specified date.
2/ Wednesdays.
3/ Thursdays.
4/ Figure for June 28, 1963 is the monthly average for that month on all public authority bonds.
5/ After withholding tax.
6/ Figures for June 28, 1963 and December 3, 1965 are monthly averages for those months.

Sluggish business conditions in Germany in the fourth quarter of 1966 were reflected in a further slowing of the expansion of bank loans to private borrowers. The balance-of-payments surplus has continued to supply additional reserve funds to the banking system, and since the turn of the year the Bundesbank has taken overt action to increase bank liquidity. Consequently, the easing tendency in short-term rates that began last summer has continued -- apart from seasonal tightening near the year-end.

German industrial production in November-December was 4-1/2 per cent below its high of last March and April. In shifting its policy stance to resist the slowdown in domestic economic activity, the Bundesbank has been influenced by the brighter prospects for noninflationary wage settlements this year and by the satisfactory solution the Government has found for its budgetary problem in the current economic situation. The discount rate was reduced by 1/2 per cent on January 6 and by another 1/2 per cent on February 17. Lower bank reserve requirements against domestic deposits, originally announced as a seasonal measure for December only, were extended indefinitely as of January 1. Effective February 1, reserve requirements on foreign liabilities were reduced to the same level as those applying to domestic liabilities, thereby offsetting the restrictive effect of a January 1 change in the basis for calculating foreign liabilities. Then, effective March 1, reserve requirements on all liabilities were reduced further by 10 per cent. The Bundesbank also lowered its buying and selling rates on Treasury bills and other open market paper on five occasions from December 30 to February 17, the reductions generally totalling 1 per cent. The interest rates that banks pay on time and savings deposits were lowered a uniform 1/2 per cent as of February 1.

The bond market has seen a steady rise in prices since November, in response to the improving state of bank liquidity and the near-complete moratorium on new flotations by the German public authorities. This year the German authorities have begun a cautious relaxation of the ban on new bond offerings by the public authorities. In January, one state and one municipal issue were marketed; each was oversubscribed, and the downward trend of bond yields was not interrupted. Further issues were scheduled in February.

The easier tone in Canadian financial markets, induced largely by developments outside the country, has been influenced also by evidence of slackening in the pace of rise in Canadian economic activity. In

December it was learned that real GNP had undergone an absolute decline in the third quarter. On January 30, the Bank of Canada moved to reduce interest rates further and cut its discount rate from 5-1/4 to 5 per cent.

In France, some interest rates have dropped since the beginning of 1967, but it is difficult to determine to what extent the previous upward trend of rates may have been reversed. Short-term rates continued to rise steeply through the end of 1966, so that in December call money averaged nearly 5.7 per cent in contrast to a 4.6 per cent monthly average as recently as September. Principally, this increase reflected a hardening of interest rate policies of the Bank of France, which no longer found it expedient to maintain French money market rates below those in other countries. The call money rate then declined to 4-3/4 per cent by mid-February, influenced partly by seasonal factors and also by structural changes in French monetary regulations. In January, required cash reserves for banks were instituted, while other regulations were eased, and the net effect was to improve the liquidity position of the banking system. (It is not known whether the authorities intended such a net result or not.) In addition, declining rates abroad had an impact on French market conditions.

In the French bond market, some further increases in yields occurred in November and December. In January and February, yields on outstanding corporate bonds declined by about 10 basis points, but yields on public sector bonds have been fairly steady.

In Switzerland, the rate on 3-month deposits had held steady since the end of 1966 at 4-1/2 per cent. Bond yields also seem to have steadied since late December.

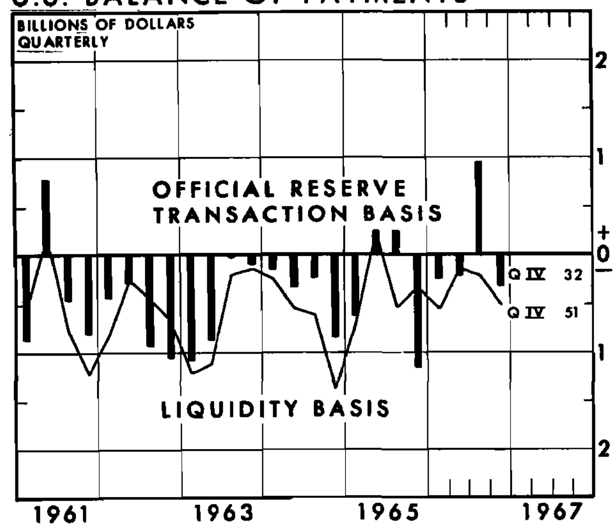
Japanese money market conditions tightened slightly in January and probably also in February, mainly as a result of increased Treasury receipts, marking the first significant change from a two-year trend of easing. Upward pressure on interest rates is considered likely to continue in March. The Bank of Japan on January 25 approved an increase in the maximum call loan rate for over-month-end money, i.e., call money repayable at a day's notice in the following month. The rate rose from 6.57 to 6.75 per cent.

Yields on government and most other bonds generally remained unchanged through December. However, yields on Telephone and Telegraph issues, which are the most freely traded of the Japanese bonds, rose slightly from 7.51 per cent in August to 7.58 per cent in November.

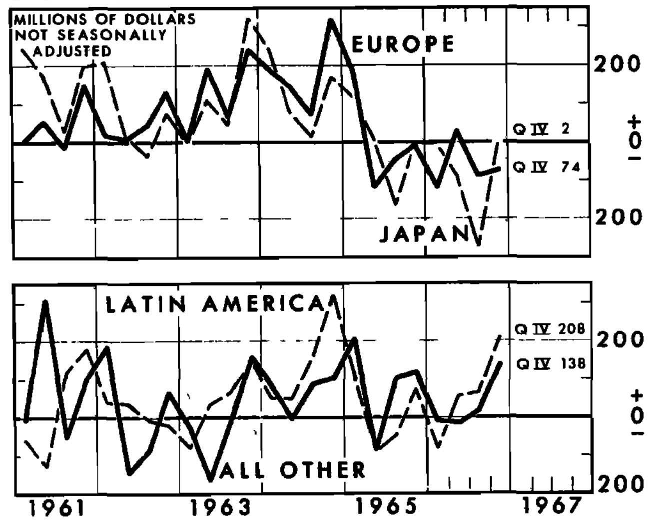
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

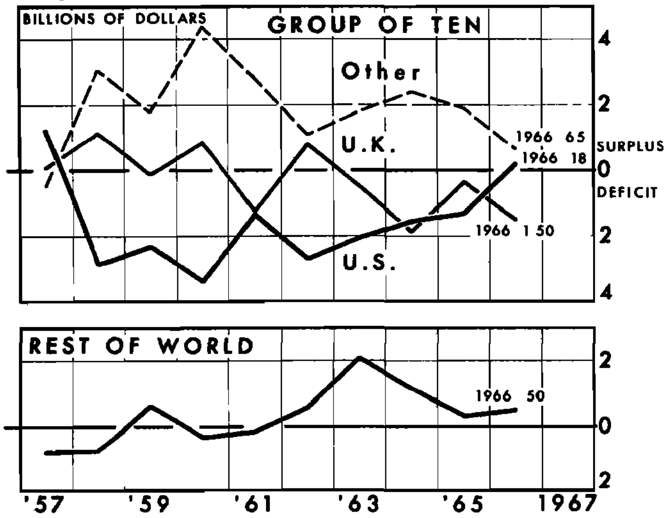
U.S. BALANCE OF PAYMENTS



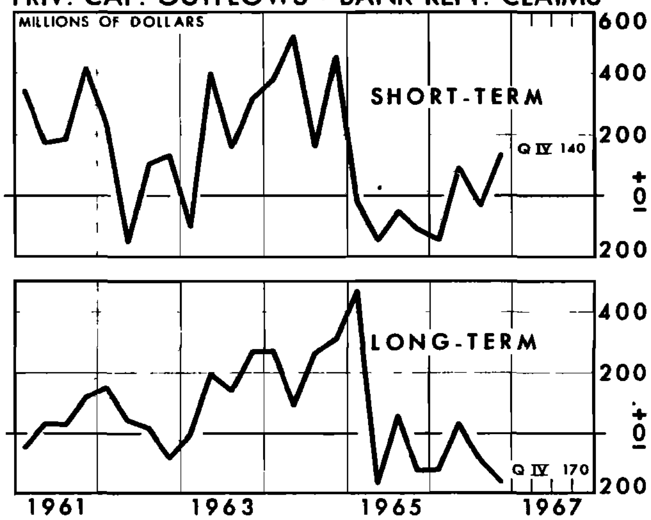
U.S. BANK CREDIT OUTFLOWS



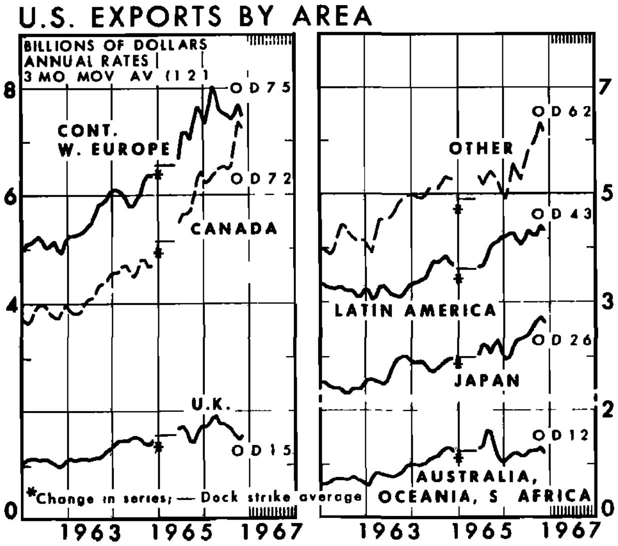
WORLD PAYMENTS PATTERN



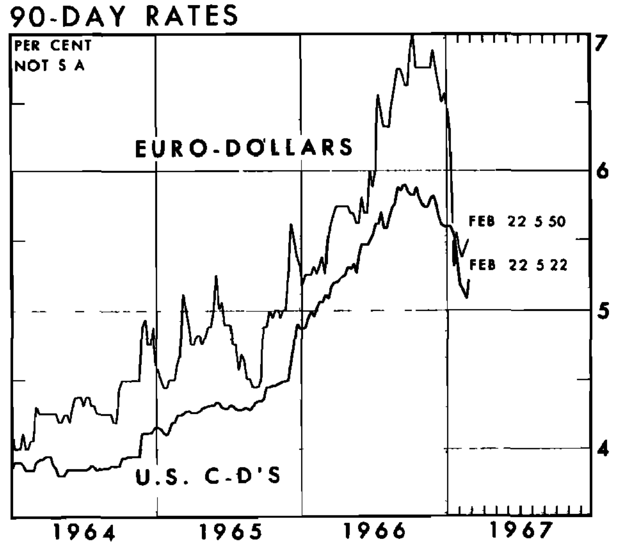
PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



U.S. EXPORTS BY AREA



90-DAY RATES



APPENDIX A: SURVEY OF BANK LENDING PRACTICES, FEBRUARY 1967*

On February 15 the quarterly survey of changes in bank lending practices was conducted for the first time on the new reporting schedule, that is, as of the 15th of February, May, August, and November. The sample also was enlarged to about 130 banks to coincide with the revised reporting panel for the quarterly survey of interest rates charged on business loans. This sample group included 77 banks that had reported in earlier surveys. The results of the February survey are summarized in this appendix and accompanying tables.

Nearly three-fifths of the respondents (77 out of 130 banks) reported loan demand unchanged in the three months ending February 15 and about the same proportion anticipated no change in demand over the next three months, as shown in Table 1. Nevertheless, over one-third of the banks indicated loan demand was moderately weaker in this period--a larger proportion than in any previous survey--while only 8 banks reported that demand had strengthened.

Reflecting the reduction in the prime rate in late January, three-fourths of the banks had lowered interest rates charged business borrowers and about half also had reduced their rates to finance companies. However, at most banks, other lending terms and conditions were essentially unchanged.

Nevertheless, some shift toward easier lending practices was noted in the types of borrowers to which banks were willing to lend and in the intended use of the loan. Almost half of the banks reported moderately easier policies on loans to new customers, and nearly one-fifth indicated easier policies on loans to borrowers outside the bank's service area. Also one-fifth showed reduced concern about the intended use of the loan proceeds. By contrast, few banks reported firmer lending policies in any of these areas.

Easing also was indicated by the greater willingness of banks to make particular types of loans. About half of the banks were more willing than 3 months earlier to make loans on single family residences and nearly one-fourth to make other mortgage loans, except those on multi-family properties. Many banks commented that they were actively seeking single family loans and an even larger number expressed increased interest in construction loans. Several banks stated that they were currently making some real estate construction loans they would not have made three months earlier. This change

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* Prepared by Caroline H. Cagle, Economist, Division of Research and Statistics.

resulted in some cases from a decline in residential loan portfolios, an increase in time deposits or both. Some liberalizing of terms on mortgage loans was being made to meet competition at a number of banks.

A sizable proportion of respondents (over one-fourth) also were more willing to make term loans to business borrowers and consumer instalment loans. One bank stated that with slackening demand for business loans, it was competing more aggressively for consumer loans to maintain earnings. Relatively few banks showed increased willingness to make participation loans, loans to brokers, and multi-family mortgage loans, but even here the proportions ranged from one to two-tenths of the sample.

To indicate the extent of the recent shift in bank lending posture, Table 2 shows the net number of banks reporting easier lending practices in the last three surveys. In other words, this table shows the number of banks reporting easier policies less the number reporting firmer policies, ignoring those reporting policies essentially unchanged. To maintain comparability, the comparison is based on the old survey reporting panel in each period. The table suggests that the numerical shift from restraint toward ease generally was greater from September to December than from December to February. However, the significance of the shift is not adequately measured by the figures alone. The change from September to December represented mainly a reduction in the number of banks reporting firmer policies; that from December to February represented mainly an increase in the number of banks making overt moves to liberalize lending policies.

Comments on the reasons for changes in policies were provided by a larger proportion of respondents than in any previous survey. Many banks stated that their policy changes were not extensive and were applied selectively. Among the more frequently mentioned reasons for easing policy were the decline in loan demand, the greater availability of loanable funds, and the rescinding of the September 1 letter. Some banks emphasized that they had experienced net liquidation of loans as a result of their restrictive policies of last year. The availability of these funds, coupled with their greater ability to compete for time deposits, had given them increased flexibility.

By contrast, some banks pointed out that the demand for loans and for new lines of credit and other commitments had not abated, and that on the basis of loan demand, there was no justification for the reduction in the prime rate. Other banks emphasized that the moderate weakening of interest rates was in response to competitive pressure and improved bank liquidity. Most lending practices, it was stated, were unchanged because respondents anticipated that loan demand pressures would recur later in the year.

Not for quotation of publication

Table 1
QUARTERLY SURVEY OF CHANGES IN BANK LENDING PRACTICES
AT SELECTED LARGE BANKS IN THE U.S. 1/
(STATUS OF POLICY ON FEBRUARY 15, 1967, COMPARED TO THREE MONTHS EARLIER)
(Number of Banks)

	Total	Much Stronger	Moderately Stronger	Essentially Unchanged	Moderately Weaker	Much Weaker
STRENGTH OF DEMAND FOR COMMERCIAL AND INDUSTRIAL LOANS (after allowance for bank's usual seasonal variation) COMPARED TO THREE MONTHS AGO	130	--	8	77	45	--
ANTICIPATION DEMAND IN THE NEXT 3 MONTHS	130	1	39	73	17	--
	Number Answering Question	**Much Firmer Policy**	**Moderately Firmer Policy**	**Essentially Unchanged Policy**	**Moderately Weaker Policy**	**Much Weaker Policy**
LENDING TO NONFINANCIAL BUSINESSES						
Terms and Conditions						
Interest rates charged	130	--	--	32	98	--
Compensating or supporting balances	129	1	6	118	4	--
Standards of credit worthiness	129	--	13	115	1	--
Maturity of term loans	129	1	4	116	8	--
Reviewing Credit Lines or Loan Applications						
Established customers	130	--	4	104	22	--
New customers	130	3	7	60	57	3
Local service area customers	128	--	2	102	23	1
Nonlocal service area customers	127	3	8	92	24	--

(cont'd)

1/ Survey of Lending Practices at 130 Large Banks Reporting in the Federal Reserve Quarterly Interest Rate Survey as of February 15, 1967.

	Number Answering Question	Much Firmer Policy	Moderately Firmer Policy	Essentially Unchanged Policy	Moderately Weaker Policy	Much Weaker Policy
Factors Relating to Applicant 2/						
Value as depositor or source of collateral business	129	4	7	115	3	--
Intended use of the loan	129	3	7	92	25	2

LENDING TO "NONCAPTIVE" FINANCE COMPANIES

	Number Answering Question	Much Firmer Policy	Moderately Firmer Policy	Essentially Unchanged Policy	Moderately Weaker Policy	Much Weaker Policy
Terms and Conditions						
Interest rate charged	130	--	4	58	68	--
Compensating or supporting balances	130	2	5	122	1	--
Enforcement of balance requirements	130	3	10	117	--	--
Establishing new or larger credit lines	130	6	13	90	20	1

WILLINGNESS TO MAKE OTHER TYPES OF LOANS

	Number Answering Question	Considerably less willing	Moderately less willing	Essentially Unchanged	Moderately more willing	Considerably more willing
Term loans to businesses	130	1	1	94	34	--
Consumer instalment loans	129	1	8	82	36	2
Single family mortgage loans	128	4	3	60	52	9
Multi-family mortgage loans	128	6	3	105	14	--
All other mortgage loans	128	3	6	91	28	--
Participation loans with correspondent banks	128	--	1	99	27	1
Loans to brokers	129	1	3	100	23	2

2/ For these factors, firmer means the factors were considered more important in making decisions for approving credit requests, and weaker means they were less important.

Table 2
NET NUMBER OF BANKS REPORTING EASIER LENDING PRACTICES 1/

	Feb. 15, 1967	Dec. 15, 1966	Sept. 15, 1966
LENDING TO NONFINANCIAL BUSINESSES			
Terms and Conditions			
Interest rates charged	61	-18	-79
Compensating or supporting balances	--	-26	-67
Standards of credit worthiness	-3	-14	-40
Maturity of term loans	3	-12	-44
Reviewing Credit Lines or Loan Applications			
Established customers	16	-6	-60
New customers	38	-18	-76
Local service area customers	17	- 7	-56
Nonlocal service area customers	13	-23	-67
Factors Relating to Applicant 2/			
Value as depositor or source of collateral business	-2	-22	-69
Intended use of the loan	12	-15	-66
LENDING TO "NONCAPTIVE" FINANCE COMPANIES			
Terms and Conditions			
Interest rate charged	40	- 9	-64
Compensating or supporting balances	-2	-17	-42
Enforcement of balance requirements	-3	-26	-47
Establishing new or larger credit lines	6	-23	-66
WILLINGNESS TO MAKE OTHER TYPES OF LOANS			
Term loans to businesses	16	-14	-69
Consumer instalment loans	13	4	-18
Single family mortgage loans	36	- 7	-44
Multi-family mortgage loans	5	-19	-55
All other mortgage loans	14	-19	-61
Participation loans with correspondent banks	16	- 1	-55
Loans to brokers	12	-13	-51

1/ Survey of Lending Practices at 81 large banks reporting in the Federal Reserve Quarterly Interest Rate Survey. In the February Survey only 77 of the banks reported due to a revision in the sample.
2/ For these factors, firmer means the factors were considered more important in making decisions for approving credit requests, and weaker means they were less important.