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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

March 27, 1968

SUMMARY AND OUTLOOK

Outlook for economic activity

Recent economic data confirm the acceleration of inflationary pressures. Prices have been rising faster and final sales, particularly for consumer outlays and defense expenditures, are advancing rapidly. Over-all prices (GNP deflator) are now expected to rise at an annual rate of 4 per cent this quarter, up from the 3 per cent (ex Federal pay raise) in the fourth quarter. Real GNP seems likely to grow by over 6 per cent, the largest rise since the first quarter of 1966. Assuming tax increases, if any, do not significantly affect activity in the second quarter, the gain in real GNP should be only moderately smaller than in the current quarter. Pressures on manpower resources, wages and prices are expected to continue very strong.

The recent rise in consumer expenditures is likely to be maintained. Preliminary retail sales data for the first half of March (adjusted for the changing date of Easter) suggest that the sharp upward trend in sales evident since the end of last year is continuing. Incomes are likely to rise substantially further in the second quarter because of higher employment and accelerating wage increases. This should be reflected in a rise in consumer expenditures almost as large as in this quarter, aided somewhat by a slight further drift-off in the savings rate which, nevertheless, is expected to remain at a relatively high level.

Defense spending is rising at a more rapid pace than estimated in the January Budget. It now seems probable that such expenditures will increase by at least \$1.5 billion this quarter (about \$1 billion more than the Budget estimate) and the rise may be equally as large next quarter. As yet, however, there has been no announcement of the magnitude of an upward adjustment in defense costs. Any new spending cuts are not expected to have much effect until after mid-year.

In contrast to the stepped-up momentum in consumption and defense expenditures, changes in other sectors of the economy are likely to be relatively moderate in the first half of the year. Business fixed investment should level off in the second quarter according to the latest Commerce-SEC survey. Housing starts, high in February, should begin to slide somewhat, in reflection of the further tightening in mortgage markets. And inventory investment in the first quarter is likely to be below the high fourth quarter rate, in part because of more limited stockpiling of steel and autos than had been anticipated. A small rise in the rate of inventory accumulation may occur in the second quarter in response to the recent heightened levels of final sales and the approach of the deadline in steel negotiations.

Outlook for resource use and prices

Following the period of relative stability during the winter, industrial production is expected to start moving up again in March and April. Strike disruptions have ended in the auto industry; the

glass strike is settled; and production is in process of being restored in the copper industry following an 8-month work stoppage. Moreover, the momentum of the sharp step-up in consumer demands since the beginning of the year is expected to provide an expansionary impetus to output. With capacity continuing to grow, however, production gains through the second quarter are likely to result in only a small increase in the rate of manufacturing capacity utilization from the fourth quarter average of 84.3 per cent.

The lag in industrial production growth in the first two months of the year was accompanied by a slackening in productivity gains, and, with hourly compensation moving up sharply further, unit labor costs spurted again. Strong upward pressures on wages continue. The glass and copper settlements incorporate package boosts of 7 per cent or more--larger than the December GM settlement and setting a new target for upcoming negotiations in aluminum, shipbuilding, and apparel. Deferred wage increases in the 4 to 5 per cent range will be received in the second quarter by 400,000 trucking workers and by 1.5 million workers in a wide range of other industries, both manufacturing and nonmanufacturing.

Further strong gains in employment, particularly in non-manufacturing sectors, are expected to be large enough (assuming no major disruption in connection with wage negotiations) to keep the labor market tight and the unemployment rate close to the current level of about 3.6 per cent.

Since last autumn, wholesale prices of industrial commodities have increased at an annual rate of about 4-1/2 per cent compared with a rate of less than 3 per cent last summer, and less than 1 per cent from mid-1966 to mid-1967. Prices of foods and foodstuffs have also moved up sharply; and price increases have accelerated for services. The pace of advance in the consumer price index is continuing at about 4 per cent, as compared with less than 3 per cent from early 1967 to last autumn.

Demands for credit

Between now and mid-year the largest foreseeable source of rising credit demand pressures is from the Federal Government. But because of the stalemate on the fiscal program, the market remains uncertain about the dimensions of Treasury cash needs, not only in late spring but also in the second half of calendar 1968. Sizable cash borrowing operations are not likely to be undertaken by the Treasury until May in connection with the mid-month refunding, which may be the first occasion for market participants to focus on the precise size of forthcoming cash needs.

Demands for credit from State and local governments are likely to remain fairly substantial, although not picking up beyond their recent pace. Recent maneuverings with respect to the tax status of industrial revenue bonds appear to have diminished the potential for an upsurge in such issues.

Business needs for external financing are likely to remain on the moderate side, although an acceleration in financing demands could develop if fears of further monetary restraint as direct credit controls become widespread. Insofar as can be judged from the April calendar, corporate demands in security markets are as yet below the average of recent months, but there are indications that some further offerings may be in the wing. Business loan demands at banks in the last few months have been lower than bankers had expected, or hoped. However, the odds do favor a pick-up in such demands during the spring, given the large corporate income tax payments to be made and a continued high rate of inventory accumulation. Borrowing at banks may also rise if any appreciable further increase in short-term rates induces commercial paper issuers to shift more of their financing to commercial banks.

Supply of funds

With no substantial build-up in credit demand pressures immediately in the offing, upward interest rate movements are likely to depend on further constraints on the supply of funds or on expectations that such constraints will develop. The March-April reinvestment period (which unfortunately will be upon us before the ink is dry on this text) is likely to see some movement of funds away from nonbank savings institutions to the market, since market interest rates have generally moved back to levels close to their late 1967 highs. The spring re-investment period experience is unlikely to be as severe as in 1966, but should contribute to a further stiffening in mortgage terms.

Deposits inflows are also likely to diminish at banks following the March quarterly interest crediting, and contribute to continued reduced bank interest in acquisitions of State and local and U.S. Government securities. At present market yields, a noticeable slackening in inflows of consumer-type time and savings deposits appears likely. A large increase in California state income tax payments may accentuate pressures on savings institutions there in coming weeks.

Given recent Treasury bill rates, leading banks may be able to roll-over maturing negotiable CD's if they are willing to offer the maximum rate on 30-60 day maturities, as many seem to be doing now. Even so, the sheer magnitude of April tax period maturities suggests some further attrition in CD's over the next few weeks for banks as a whole.

There are great uncertainties as to how liquid financial institutions will feel after they come out of the spring interest-crediting period and in light of business loan demands and CD run-offs that develop around the mid-April tax period. Nevertheless, it seems most likely that institutions in the second quarter will have an even smaller net inflow of funds available for loans and investments. Thus, barring a tax increase, market interest rates could come under further upward pressure. Such pressures, however, might not develop to any significant extent until later in the spring,

after seasonal downward pressures on short-term rates have dissipated and when the Treasury begins to test the market's--and particularly the banks'--ability or willingness to acquire new Federal debt. A tendency for interest rates to rise sooner and cumulatively could develop, however, if failure to take effective fiscal action, combined with speculation against the dollar in exchange and gold markets, led to expectations of a further market and overt tightening of monetary policy.

Balance of payments

The payments deficit has remained very large during the first quarter of 1968. On the basis of preliminary and incomplete figures, the liquidity deficit before special transactions appears to have been at a seasonally adjusted annual rate of about \$5 billion during the quarter. The comparable figure for the previous quarter was over \$6 billion. The deficit on the official reserve transactions basis before special transactions may have been at a rate of about \$4 billion in the first quarter.

The large size of the deficit has not been widely recognized recently because seasonal influences are strongly favorable to the United States at this time of year. But publication in mid-May of deficit figures of this magnitude could well set off a new round of private speculation in foreign exchange and gold markets, and also of official gold purchases, unless U.S. economic policies have been considerably altered in the meantime.

The main reason that the deficit has been larger in recent quarters than before is that the trade surplus has been much smaller-- the smallest since 1959. Merchandise exports and imports both remained in February at the very high levels reached in January. Each was up about 10 per cent from its fourth quarter rate; but compared with a year earlier, imports were up 17 per cent and exports only 6 per cent. The trade surplus in January-February was only slightly above the low fourth quarter annual rate of \$1 billion, and was down \$3 billion from that of early 1967. In March, the trade balance is expected to be adversely affected by a longshoremen's strike that has been underway in New York since March 18.

Some non-trade elements in the balance of payments have shown improvements in the first quarter. Net foreign purchases of U.S. corporate stocks reached a record volume in January. Outstanding bank claims on foreigners that are subject to FCRP guidelines were reduced further by \$90 million in February, after a \$190 million reduction in January; in both months, the reflow was more than seasonal. The imposition of mandatory controls on direct investments from January 1 may also have had a restraining effect on outflows in the first quarter; a large volume of Euro-bond issues to finance direct investments has been recorded. In March, a rights issue by the Shell Oil Company attracted direct investment receipts of about \$200 million from its foreign parent company.

But these favorable developments--some of them clearly temporary--appear to have been partly offset by adverse movements in other transactions, possibly including shifts of funds to Canada with the lifting of restrictions on such transfers, and some flight of U.S.-owned capital to Europe during the weeks in March when the foreign exchange markets were most disturbed and when the weekly U.S. deficit figures were unusually large.

SELECTED DOMESTIC NONFINANCIAL DATA

March 26, 1968

(Seasonally adjusted)

	Latest Period	Amount			Per Cent Char	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Yrs. Ago*
Civilian labor force (mil.)	Feb'68	78.7	77.9	76.9	2.3	4.7
Unemployment (mil.)	"	2.9	2.8	2.9	2.9	4.5
Unemployment (per cent)	"	3.7	3.5	3.7	--	--
Nonfarm employment, payroll (mil.)	"	67.7	67.1	65.7	3.0	7.6
Manufacturing	"	19.6	19.5	19.5	0.3	3.9
Other industrial	"	8.4	8.1	8.2	2.0	4.1
Nonindustrial	"	39.7	39.5	38.0	4.7	10.4
Industrial production (57-59=100)	"	161.3	161.2	156.6	3.0	5.8
Final products	"	161.6	161.0	157.0	2.9	6.5
Materials	"	161.0	161.6	155.8	3.3	5.6
Wholesale prices (57-59=100) ^{1/}	"	108.0	107.2	106.0	1.9	2.5
Industrial commodities (FR)	"	107.6	107.1	105.1	2.4	4.2
Sensitive materials (FR)	"	106.4	104.8	101.9	4.4	1.8
Farm products, foods & feeds	"	106.8	105.3	105.7	1.0	-2.7
Consumer prices (57-59=100) ^{1/}	Jan'68	118.6	118.2	114.7	3.4	6.8
Commodities except food	"	111.2	111.1	107.3	3.6	5.6
Food	"	117.0	116.2	114.7	2.0	5.0
Services	"	130.8	130.1	125.5	4.2	9.5
Hourly earnings, mfg. (\$)	Feb'68	2.94	2.93	2.78	5.8	10.1
Weekly earnings, mfg. (\$)	"	119.60	118.36	111.99	6.8	7.7
Personal income (\$ bil.) ^{2/}	"	658.4	650.9	612.6	7.5	16.0
Corporate profits before tax (\$ bil.) ^{2/}	QIV'67	85.4	80.0	83.9	1.8	5.7
Retail sales, total (\$ bil.)	Feb'68	27.4	27.0	25.5	7.7	9.5
Autos (million units) ^{2/}	"	7.9	8.0	6.7	17.5	-10.7
GAF (\$ bil.)	"	6.6	6.5	6.1	7.8	12.3
Selected leading indicators:						
Housing starts, pvt. (thous.) ^{2/}	"	1,566	1,453	1,149	36.3	11.2
Factory workweek (hours)	"	40.7	40.2	40.3	1.0	-2.2
New orders, dur. goods (\$ bil.)	"	25.0	24.6	22.3	12.0	5.3
New orders, nonel. mach. (\$ bil.)	"	3.4	3.8	3.3	5.2	3.6
Common stock prices (1941-43=10)	"	90.75	95.04	87.36	3.9	-2.1
Inventories, book val. (\$ bil.)	Jan'68	141.6	140.7	136.3	3.9	16.7
Gross national product. (\$ bil.) ^{2/}	QIV'67	807.3	791.2	762.1	5.9	14.0
Real GNP (\$ bil., 1958 prices) ^{2/}	"	679.6	672.0	661.1	2.8	7.1

* Based on unrounded data. ^{1/} Not seasonally adjusted. ^{2/} Annual rates.

SELECTED DOMESTIC FINANCIAL DATA

	Week ended	4-week	Last 6 months	
	March 22, 1968	average	High	Low
Money Market <u>1/</u> (N.S.A.)				
Federal funds rate (per cent)	5.20	4.87	5.20	3.40
U.S. Treas. bills, 3-mo., yield (per cent)	5.25	5.14	5.25	4.47
U.S. Treas. bills, 1-yr., yield (per cent)	5.39	5.37	5.64	5.14
Net free reserves <u>2/</u> (\$ millions)	-322	-236	384	-322
Member bank borrowings <u>2/</u> (\$ millions)	733	614	779	58
Capital Market (N.S.A.)				
Market yields (per cent)				
5-year U.S. Treas. bonds <u>1/</u>	5.75	5.72	5.84	5.45
20-year U.S. Treas. bonds <u>1/</u>	5.62	5.55	5.73	5.18
Corporate new bond issues, Aaa adj. <u>8/</u>	6.58	6.50	6.58	6.18
Corporate seasoned bonds, Aaa <u>1/</u>	6.14	6.10	6.24	5.64
Municipal seasoned bonds, Aaa <u>1/</u>	4.20	4.23	4.28	3.82
FHA home mortgages, 30-year <u>3/</u>	--	6.78	6.81	6.53
Common stocks, S&P composite series <u>4/</u>				
Prices, closing (1941-43=10)	88.42	88.92	97.00	88.42
Dividend yield (per cent)	3.38	3.35	3.38	3.01

	Latest month	Amount	3-month average	Change from year earlier	
				Latest 3-month month	average
New Security Issues (N.S.A., \$ millions)					
Corporate public offerings <u>5/</u>	Mar. '68 ^{e/}	2,100	1,796	-217	8
State & local govt. public offerings	"	1,150	1,152	289	-220
Comm. & fin. co. paper (net change in outstandings)	Feb. '68	- 557	+ 222	-1,038	-121

	Latest month	Out-standings Latest month	Change		Annual rate of change from				
			Latest month	3-month average	Pre-ceding month	3 months ago	12 months ago		
Ranking (S.A.)									
		(\$ billions)						(per cent)	
Total reserves <u>1/</u>	Feb. 1968	25.25	0.24	0.16	11.5	7.8	9.8		
Credit proxy <u>1/</u>	"	277.0	2.3	1.4	10.0	6.0	10.4		
Bank credit, total <u>6/</u>	"	352.4	4.0	2.7	13.8	9.4	10.8		
Business loans	"	87.0	0.5	0.8	6.9	11.3	8.6		
Other loans	"	141.3	0.6	1.2	5.1	10.5	7.5		
U.S. Govt. sec.	"	61.8	2.7	--	54.8	--	10.6		
Other securities	"	62.3	0.2	0.7	3.9	14.0	21.9		
Total liquid assets <u>1/</u> <u>6/</u>	"	658.2	2.3	3.4	4.2	6.4	8.2		
Demand dep. & currency <u>1/</u>	"	182.6	0.2	0.5	1.3	3.1	6.5		
Time & sav. dep., comm. banks <u>1/</u>	"	185.0	1.3	0.8	8.4	5.5	13.1		
Savings, other thrift instit. <u>6/</u>	"	185.6	1.3	0.7	8.5	4.4	8.7		
Other <u>6/</u> <u>7/</u>	"	105.0	-0.5	1.5	-5.7	17.5	2.3		

N.S.A.--not seasonally adjusted.

S.A.--seasonally adjusted.

e. Estimated by F.R.B. 1/ Average of daily figures. 2/ Average for statement week ending March 20. 3/ Latest figure is for Feb. 4/ End of week closing prices; yields are for Friday. 5/ Corporate security offerings include both bonds and stocks.

6/ Month-end data. 7/ U.S. savings bonds and U.S. Government securities maturing within 1 year. 8/ Adjusted to Aaa basis.

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

	1967	1 9 6 7				1 9 6 8	
	Year	QI	QII	QIII	QIV	Jan.	Feb.
		Seasonally adjusted					
Goods and services, net <u>1/</u>	4,800	1,353	1,320	1,408r	719		
Trade balance <u>2/</u>	3,483	1,009	1,154	1,077r	243r	99	141
Exports <u>2/</u>	30,463	7,671	7,712	7,626r	7,454r	2,720	2,748
Imports <u>2/</u>	-26,980	-6,662	-6,558	-6,549r	-7,211r	-2,620	-2,607
Services balance	1,317	344	166	331r	476		
Remittances and pensions	-1,284	-264	-395	-356r	-269		
Govt. grants & capital <u>3/</u>	-4,127	-1,201	-1,013	-966r	-947		
U.S. private capital	-5,446	-984r	-1,113r	-1,741r	-1,608		
Direct investments	-3,027	-622	-648	-939r	-818		
Foreign securities	-1,252	-263	-170	-446r	-373r		
Banking claims	-455	69r	-228r	-392r	96r		
Other	-712	-168r	-67r	36r	-513		
Foreign capital, nonliquid	3,077	858r	1,194r	808r	217		
Official foreign accts.	1,272	392	736	25	119		
Long-term deposits	820	304	584	-215r	147		
U.S. Govt. liab.	452	88	152	240r	-28		
Int'l. institutions <u>4/</u>	299	70	97	117	15		
Other <u>5/</u>	1,506	396r	361r	666r	83		
Errors and omissions	-595	-295r	-546r	209r	37		
		Balances, with and without seasonal adjustment (- deficit)					
Liquidity balance, S.A.	-3,575r	-533r	-553r	-638r	-1,851r		
Seasonal component		295r	330r	-573r	-52r		
Balance, N.S.A.		-238	-223r	-1,211	-1,903r	-169	-57
Off'l settlements bal., S.A.	-3,398	-1,817r	-832r	456r	-1,205r		
Seasonal component		537r	143r	-495r	-185r		
Balance, N.S.A. <u>6/</u>		-1,280r	-689r	-39r	-1,390r	291	38
		Reserve changes, N.S.A. (decrease -)					
Total monetary reserves	-52	-1,027	419	375	181	-210	170
Gold stock	-1,170	-51	-15	-92	-1,012	-62	-103
Convertible currencies	1,024	-1,007	424	462	1,145	-169	59
IMF gold tranche	94	31	10	5	48	21	214

1/ Equals "net exports" in the GNP.

2/ Balance of payments basis which differs a little from Census basis.

3/ Net of scheduled and non-scheduled repayments.

4/ Long-term deposits and Agency securities.

5/ Includes some foreign official transactions in securities.

6/ 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 (+) increases in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. In the first quarter, economic activity rose briskly and price increases accelerated at both wholesale and retail. Final sales rose considerably faster than anticipated, pushing up GNP at a rate we now estimate at \$21 billion for the quarter. Much of this increase reflects rising prices, with the GNP deflator rising at an annual rate of 4 per cent. But the rate of economic expansion in real terms apparently also increased substantially--from an annual rate of 4.5 per cent in the fourth quarter to 6.5 per cent. In the absence of fiscal restraint we expect the second quarter rise in real GNP to be only moderately smaller. Even if a tax increase were to be enacted, the impact would probably not be felt until after mid-year; consequently, consumer expenditures are expected to maintain a sharply rising course in the second quarter. Also, Federal expenditures will probably continue to rise, since any new spending cuts initiated now would not be effective until fiscal 1969. On the other hand, the most recent survey of business intentions indicates that after a substantial rise in the first quarter, fixed capital outlays will level off.

The GNP deflator is now increasing at the rate of about 4 per cent annually, compared to 3.6 per cent in the final quarter of last year. However, prices have risen more rapidly in the private sector of the economy than this suggests, since the Federal pay raise directly accounted for .6 percentage points of the increase in the GNP deflator in the fourth quarter.

The sharply rising rate of consumer spending has been fueled by substantial gains in personal income. Wages and salaries appear to have increased at a rate of over 10 per cent annually in the first quarter, reflecting rising employment, a higher minimum wage, and widespread gains in wage rates and salaries. In addition, the quarter included one month of increased social security benefits which contributed materially to a rise of \$2 billion in transfer payments. The rise in spending by consumers about matched the upward thrust of income and the rate of saving appears to have continued above 7 per cent.

Consumer expenditures, including services, are thus likely to have increased by \$14 billion or at an annual rate of over 10 per cent from the weak fourth quarter. The upsurge in sales was well-distributed over all major categories of durable and nondurable purchases. Unit sales of domestically produced cars have been maintained at a rate of about 8 million annually in the last 2-1/2 months, a marked improvement over the 7.5 million rate in the second half of 1967. Furniture and appliance sales, which turned up in the fourth quarter, are showing further strength, apparel sales have jumped sharply after a disappointing Christmas season, and food sales are surprisingly strong. (However, caution should be observed in interpreting the changes in retail sales too literally, since the preliminary data for two months now available are subject to revisions which in the past have often been sizable).

Nonfarm inventory accumulation continues high: auto stocks have been replenished, steel inventory accumulation has continued in anticipation of a possible steel strike, and defense product inventories are still rising. Nevertheless, on the basis of the available January book value inventory statistics and in the context of the high retail sales figures, our previous projection of the dollar value of inventory accumulation for the first quarter appears too high; and the estimated first quarter rate of accumulation has been reduced to that of the fourth quarter of 1967. (In evaluating current changes in book values, it should be noted that industrial price increases have been more rapid than earlier. Consequently, a smaller proportion of the rise in the book value of inventories represents real accumulation.)

Business investment in new plant and equipment has also added to demand in the first quarter. The recently completed Commerce-SEC survey showed spending for fixed capital was higher in the fourth quarter than had been previously indicated, and a further rise of \$2.1 billion, annual rate, was indicated for the first quarter. In the second quarter, fixed investment is expected to level off. A decline in capital outlays indicated in the Commerce-SEC survey is likely to be offset by higher purchases of autos for business use and by construction by institutions, which are not covered by the survey

Expansion in real GNP is expected to decline from an annual rate of 6.5 per cent in the first quarter to 4.9 per cent in the second. The increase in personal income is also expected to be smaller than in the quarter just ending, when wages and salaries were recovering from the strike-affected fourth quarter and the minimum wage was increased. Consumer expenditures however, should continue to rise at a fast pace. Sales of domestic new cars may rise to a rate of 8.5 million annually, but unless consumers change their plans considerably from those indicated in the Michigan Survey released this month, they are unlikely to exceed this figure. Nondurable goods sales are likely to increase at a rate approaching that of the first quarter, and outlays for services may rise even faster. The rate of saving may dip slightly, but should remain high.

The rate of inventory accumulation may be larger in the second quarter than in the first. Growth in auto stocks should slacken, but the accumulation of steel inventories will continue and other industries may show larger increases in the rate of inventory investment in response to rapid growth in final sales.

Residential construction activity is expected to show little change in the second quarter, after a slight rise in the quarter just ending. Despite a jump in February, starts in the quarter now ending will probably average 1.49 million--moderately above the fourth quarter rate which, in turn, was higher than in the

third quarter. In the second quarter, starts are projected to drop about 100,000 units, as a result of tightening in mortgage fund availability. This reverses the upward trend in starts which began in late 1966, but the effects on the dollar volume of residential construction will be slight until the second half of this year.

Federal expenditures for goods and services are continuing to rise substantially both for defense and other purposes. Preliminary evidence for the first quarter suggests that the increase for defense over the fourth quarter will be about \$500 million higher than shown in the last Greenbook, or about \$1.5 billion. A similar increase is shown for the second quarter. These increases are much larger than in the fourth quarter, aside from the Federal pay-raise. The present estimates of defense exceed those implied in the Budget by \$700 million, at an annual rate, in the first quarter and \$1.8 billion in the second. Crops are also being put under loan at a faster rate than anticipated, boosting Federal non-defense outlays. For the fiscal year as a whole our estimates of goods and service expenditures are about \$1 billion above the Budget.

The rise in Federal expenditures is being accompanied by a fast growth in receipts, owing both to the accelerated gains in personal income and the surge in corporate profits. In the fourth quarter profits before tax rose to \$85.4 billion, annual rate, which was even above Federal Reserve estimates and much higher than generally anticipated. In the second quarter, profits are likely to be at a rate of \$93.0 billion.

As a result, of the increase in both expenditures and in receipts, the NIA deficit is projected to expand by only \$2 billion, annual rate, between the fourth quarter of 1967 and the second quarter of 1968.

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

	1966	1967	1967				1968	
			I	II	III	IV	Proj.	
			I	II	III	IV	I	II
Gross National Product	743.3	785.0	766.3	775.1	791.2	807.3	828.5	847.0
Final sales	729.9	779.8	759.2	774.6	787.4	798.1	820.4	838.0
Private purchases	575.6	603.5	588.8	599.6	609.2	616.4	634.0	647.2
Personal consumption expenditures	465.9	491.7	480.2	489.7	495.3	501.8	516.0	528.5
Durable goods	70.3	72.1	69.4	72.5	72.7	73.8	77.5	80.0
Nondurable goods	207.5	217.5	214.2	217.2	218.5	220.3	227.0	233.0
Services	188.1	202.1	196.6	200.0	204.1	207.7	211.5	215.5
Gross private domestic investment	118.0	112.1	110.4	105.1	112.2	120.8	122.8	123.5
Residential construction	24.4	24.4	21.4	23.1	25.6	27.6	28.2	28.0
Business fixed investment	80.2	82.6	81.9	81.5	82.8	84.0	86.5	86.5
Change in business inventories	13.4	5.2	7.1	.5	3.8	9.2	8.1	9.0
Nonfarm	13.7	4.8	7.3	.6	3.4	7.7	7.5	9.0
Net Exports	5.1	4.8	5.3	5.3	5.4	3.0	3.3	4.2
Gov't purchases of goods & services	154.3	176.3	170.4	175.0	178.2	181.7	186.4	190.8
Federal	77.0	89.9	87.1	89.5	90.9	92.2	94.7	97.0
Defense	60.5	72.5	70.2	72.5	73.3	74.2	75.7	77.2
Other	16.5	17.4	16.8	17.0	17.6	18.0	19.0	19.8
State and local	77.2	86.4	83.3	85.4	87.4	89.5	91.7	93.8
Gross National Product in constant (1958) dollars	652.6	669.3	660.7	664.7	672.0	679.6	690.6	699.0
GNP Implicit deflator (1958=100)	113.9	117.3	116.0	116.6	117.7	118.8	120.0	121.2
Personal income	584.0	626.4	612.9	619.1	631.0	642.5	659.0	673.2
Wages and salaries	394.6	423.8	414.7	418.3	426.2	435.9	448.5	457.2
Disposable income	508.8	544.7	532.7	540.0	548.2	557.9	571.9	584.5
Personal saving	29.8	38.7	38.8	36.0	38.5	41.6	41.1	40.9
Saving rate (per cent)	5.9	7.1	7.3	6.7	7.0	7.5	7.2	7.0
Corporate profits before tax	83.8	80.8	79.0	78.9	80.0	85.4	89.5	93.0
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	143.2	151.8	149.1	148.1	152.7	157.4	164.2	167.6
Expenditures	142.9	164.3	160.9	162.8	165.9	167.9	173.0	180.4
Surplus or deficit (-)	.3	- 12.5	- 11.9	- 14.7	- 13.2	10.5	- 8.8	- 12.8
Total labor force (millions)	78.9	80.8	80.3	80.3	81.1	81.6	82.0	82.5
Armed forces "	3.1	3.4	3.4	3.5	3.5	3.5	3.5	3.5
Civilian labor force "	75.8	77.3	76.8	76.8	77.6	78.2	78.5	79.0
Unemployment rate (per cent)	3.8	3.8	3.7	3.8	3.9	3.9	3.6	3.6
Nonfarm payroll employment (millions)	64.0	66.1	65.7	65.7	66.1	66.8	67.6	68.2
Manufacturing	19.2	19.3	19.5	19.3	19.2	19.4	19.6	19.7
Industrial production (1957-59=100)	156.3	157.8	157.1	155.9	157.2	159.5	162.0	164.5
Capacity utilization, manufacturing (per cent)	90.5	85.1	87.1	84.9	84.0	84.3	84.5	84.6
Housing starts, private (millions A. R.)	1.17	1.29	1.12	1.21	1.41	1.44	1.49	1.38
Sales new U.S.-made autos (millions, A. R.)	8.38	7.57	7.16	8.11	7.57	7.44	8.00	8.50

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1966	1967	1967				1968	
			I	II	III	IV	Proj.	
			I	II	III	IV	I	II
-----In Billions of Dollars-----								
Gross National Product	59.4	41.7	4.2	8.8	16.1	16.1	21.2	18.5
Final sales	55.4	49.9	15.6	15.4	12.8	10.7	22.3	17.6
Private purchases	37.5	27.9	6.9	10.8	9.6	7.2	17.6	13.2
GNP in constant (1958) dollars	35.9	16.7	-.4	4.0	7.3	7.6	11.0	8.4
Final sales	32.1	24.6	10.1	10.3	4.2	2.5	12.0	7.7
Private purchases	21.9	10.4	3.7	7.1	3.0	1.7	9.5	5.7
---In Per Cent; Quarterly Changes are at Annual Rates---								
Gross National Product	8.7	5.6	2.2	4.6	8.3	8.1	10.5	8.9
Final sales	8.2	6.8	8.4	8.1	6.6	5.4	11.2	8.6
Private purchases	7.0	4.8	4.7	7.3	6.4	4.7	11.4	8.3
Personal consumption expenditures	7.6	5.5	5.4	7.9	4.6	5.2	11.3	9.7
Durable goods	6.5	2.6	-6.8	17.9	1.1	6.1	20.1	12.9
Nondurable goods	8.5	4.8	7.4	5.6	2.4	3.3	12.2	10.6
Services	6.9	7.4	7.7	6.9	8.2	7.1	7.3	7.6
Gross private domestic investment	9.9	-5.0	-38.6	-19.2	27.0	30.7	6.6	2.3
Residential construction	-9.6	0.0	9.6	31.8	43.3	31.2	8.7	-2.8
Business fixed investment	12.8	3.0	-4.3	-2.0	6.4	5.8	11.9	0.0
Gov't purchases of goods & services	13.1	14.3	21.5	10.8	7.3	7.9	10.3	9.4
Federal	15.3	16.8	27.5	11.0	6.3	5.7	10.8	9.7
Defense	20.8	19.8	28.0	13.1	4.4	4.9	8.1	7.9
Other	-1.2	5.5	22.6	4.8	14.1	9.1	22.2	16.8
State & local	10.9	11.9	15.5	10.1	9.4	9.6	9.8	9.2
GNP in constant (1958) dollars	5.8	2.6	-.2	2.4	4.4	4.5	6.5	4.9
Final sales	5.3	3.8	6.3	6.3	2.5	1.5	7.2	4.5
Private purchases	4.4	2.0	2.9	5.5	2.3	1.3	7.2	4.2
GNP Implicit deflator	2.7	3.0	2.4	2.1	3.9	3.6	4.0	4.0
Personal income	8.6	7.3	7.5	4.0	7.7	7.3	10.3	8.6
Wages and salaries	9.9	7.4	7.2	3.5	7.6	9.1	11.6	7.8
Disposable income	7.8	7.1	8.2	5.5	6.1	7.1	10.0	8.8
Corporate profits before tax	9.5	-3.6	-23.4	-0.5	5.6	27.0	19.2	15.6
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.7	6.0	1.3	-2.7	12.4	12.3	17.3	8.3
Expenditures	15.8	15.0	23.7	4.7	7.6	4.8	12.1	17.1
Nonfarm payroll employment	5.3	3.3	4.3	0.0	2.4	4.2	4.8	3.6
Manufacturing	6.1	0.5	0.0	-4.1	-2.1	4.2	4.1	2.0
Industrial production	9.0	1.0	-5.5	-3.1	3.3	5.9	6.3	6.2
Housing starts, private	-20.4	10.3	87.0	32.1	66.1	8.5	13.9	-29.5
Sales new U.S.-made autos	-4.4	-9.7	-50.3	53.1	-26.6	-6.9	30.1	25.0

Industrial production. Industrial production in March is tentatively estimated to have increased about one-half point from the preliminary February level of 161.3. The sketchy available data for March do not indicate any weakness, but also do not indicate any marked upward movement. Production of raw steel (through March 23) has increased only fractionally, but was at an annual rate of 149 million tons as compared with 127 million tons for the year 1967. With rolling mill operations near capacity, the expected steel inventory accumulation by consuming industries may be accomplished in part by pulling down near-record steel mill stocks rather than by much further expansion of production.

Auto assemblies have recovered from the strike reduced February level and, at an annual rate of 9.0 million units, are up about 10 per cent (.3 of one point in the total index). Production of trucks also rose in March and is well above a year ago. Output of television sets and home radios in early March remained at the February level but was below previous highs of last year. Other available weekly production data indicate that in early March output of crude petroleum and refined petroleum products rose, while paperboard production declined.

While the tentatively estimated level of the production index in the first quarter of 1968 is below the December record high, it is 1.2 per cent above the fourth quarter of 1967, or an annual rate of increase of 4.8 per cent. With business stocks generally

ample, further gains in industrial production in the months ahead probably will come mainly from increased demands by final users rather than from large further increases in inventory accumulation.

INDUSTRIAL PRODUCTION
(Seasonally adjusted)

	1966	1967				1968
	IVQ	IQ	IIQ	IIIQ	IVQ	IQ Est.
Total index	159.3	157.1	155.9	157.2	159.5	161.4
Percent change from:						
Previous quarter		-1.4	-.8	.8	1.5	1.2
1967 low (June) to March (est.) 1968						3.9
IQ 1967 to IQ 1968, est.						2.7

Capacity utilization. Utilization of capacity by manufacturers was estimated to be 84.0 per cent in February, down from 84.5 per cent the previous month. The decline was due to the continuing increase in estimated capacity. At the February level the operating rate was about the same as in midsummer.

Operating rates continue to be high in the aircraft, electric power generating equipment and petroleum refining industries and only moderate amounts of unused capacity are available for production of most textile and rubber steel products. Production of some steel products has reached near-capacity levels.

UTILIZATION RATES
(per cent)

Industry	1 9 6 7					1 9 6 8	
	QI	QII	QIII	QIV	Dec	Jan.	Feb.
Manufacturing	87.1	84.9	84.1	84.4	85.5	84.5	84.0
Primary processing	86.0	83.1	82.5	84.5	85.8	84.5	83.7
Advanced processing	87.8	86.2	85.2	84.3	85.2	84.5	84.2

Retail sales. Retail sales in February rose 1.5 per cent further to a level sharply above the depressed level a year earlier. The February increase followed a 2 per cent rise in January. Figures for the 2 weeks ending March 16 suggest a further rise for the month, after allowance for the date of Easter. It should be noted, however, that higher sales recently reflect more rapid price increases than earlier.

Increases in sales in the past two months were widespread. The advance from the fourth quarter was largest at durable stores, at which automobiles, lumber, furniture, and appliances were all up substantially. Sales at nondurable stores also rose considerably, with increases for apparel and food especially large.

INCREASES IN DOLLAR VOLUME OF RETAIL SALES
(In per cent)

	Jan-Feb. 1968 from a year earlier	Jan-Feb. 1968 from Q4, 1967
Total, all stores	6.5	3.5
Excluding automotive group	5.7	3.0
Durable goods stores	6.5	4.1
Automotive group	10.0	5.6
Lumber	5.0	6.0
Furniture and appliances	3.5	2.0
Nondurable good stores	6.5	3.2
Food, eating and drinking	6.0	2.9
Apparel	5.0	5.0
General merchandise	7.0	1.2

Unit sales and stocks of autos. Dealer deliveries of new domestic autos in the first 20 days of March rose about 5 per cent from the January-February 8 million unit annual rate.

Domestic New Car Sales
(Seasonally adjusted annual rates, millions of units)

Year	January	February	March 1-20(Est.)
1967	7.4	6.7	7.2
1968	8.0	7.9	8.4

Sales have not reached the post-strike levels anticipated, and industry estimates for the 1968 model year have been scaled down from about 8.5 million units to around 8.2 (excluding an estimated 800,000 imports). Since sales so far in the model year have averaged 7.8 million units, an average annual rate of 8.6 million will have to be maintained from now on to reach industry predictions.

New car stocks, seasonally adjusted, have increased only slightly since the end of January. On March 10 they totaled about 1.5 million units, or slightly below the high level a year earlier. Relative to sales, the current 52-days supply is also lower than a year earlier but about average for other recent years. Both stocks and sales of used cars in February were 3 per cent above a year ago.

Consumer credit. Expansion in instalment credit has shown renewed strength in recent months, as compared with the slow pace of most of last year. Net increases in instalment credit outstanding have been running close to \$5 billion, annual rate, nearly \$2 billion larger than the increase for all of 1967.

The pick-up reflects both a somewhat faster pace of borrowing and a tapering off of the exceptionally rapid rate of debt repayments in 1967. Repayments in the first quarter, from the evidence now available, are not likely to be much larger than in the fourth. The leveling-off tendency has been most noticeable in other consumer goods and personal loans, the same categories experiencing the sharp rise in repayments in the second and third quarters of last year.

Much of the recent pick-up in use of credit has been in the auto area and has been associated with the improvement in auto sales. Extensions of credit for nonauto consumer goods loans have also continued to grow, and personal loans have held up well. Instalment credit extended for home repair and modernization continues weak, but the overall impact on the total has been negligible since this type of credit is small in amount.

The average size of new-car contracts has shown little further change in early 1968, following the sharp run up last fall when the new higher-priced models were introduced. Indeed, contracts written by some lenders have called for smaller amounts than a month or two ago. This has been particularly true for bank purchased paper and credit union loans. However, for direct auto loans made by the banks and paper purchased by sales finance companies, the average note has continued to creep up.

For all lender groups, the average new car note is now running a little over \$100 above a year earlier. Last fall the differential was closer to \$150. The narrowing of this differential probably reflects mainly an increase in dealer discounts as inventories of the new models reach more normal proportions. There is, of course, the possibility that customers are being asked for larger downpayments, but we have no evidence that this is so.

Orders and shipments: durable goods. New orders received by manufacturers of durable goods edged up 1.6 per cent in February according to Census advance figures. Iron and steel orders were up 15 per cent, however, accounting for almost all the rise in the total. Changes in other industries were mixed, with increases in orders for aircraft and electrical machinery offset by declines for autos and non-electrical machinery.

Partly as a result of past or anticipated future strikes, the recent movements of the new orders series have been difficult to interpret. While the trend remains upward, it does not appear quite so strong now as it did toward the end of last year when orders rose very sharply. The February volume of new orders was about 5 per cent above last summer's average, but if iron and steel are excluded the increase over this period was only 2 per cent. Shipments are now at about the same level as orders and order backlogs are no longer rising rapidly. Although unfilled orders did increase 0.6 per cent in February, they remained slightly below their December levels despite a rapid buildup in order backlogs for steel.

New orders for machinery and equipment were down sharply in February after rising in each of the three previous months. Despite large fluctuations, machinery orders have shown no consistent trend since last summer. Unfilled orders for machinery have recently been declining.

Shipments of durable goods declined 2.8 per cent in February. Declines were widespread with only iron and steel producers recording an increase. The February decline was the second in succession and the upward trend which began last summer does not look as strong now as it did earlier. Nevertheless, February shipments were still about 6 per cent above the level of last July.

ORDERS AND SHIPMENTS: DURABLE GOODS
(Billions of dollars)

		New Orders (monthly)	Shipments (monthly)	Unfilled Orders (end of month)	Ratio of Unfilled Orders to Shipments
1966	III	24.4	23.0	73.8	3.22
	IV	23.7	23.5	76.3	3.25
1967	I	22.2	22.9	74.9	3.26
	II	23.5	22.7	75.1	3.30
	III	23.6	23.3	76.9	3.31
	IV	24.5	23.7	78.8	3.32
	December	25.5	25.3	79.6	3.15
1968	January	24.6	25.2	79.0	3.13
	February	25.0	24.5	79.5	3.24

Construction and real estate. Total new construction activity, which had risen 3 per cent to a new high in January, changed little in February, according to the preliminary projection of the Census Bureau. Residential construction, which may be understated,

continued not far from the record high reached in November of 1963. While private nonresidential activity also changed little, this followed a substantial and widespread recovery in January back almost to the peak of January 1967. Public construction edged higher, but was below the record rate a year earlier,

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	February 1968 (\$ billions) <u>1/</u>	Per cent change from	
		January 1968	February 1967
Total	80.4	--	+ 7
Private	54.6	--	+14
Residential	26.9	--	+33
Nonresidential	27.7	--	--
Public	25.8	+1	- 5

1/ Seasonally adjusted annual rates; preliminary. Data for the most recent month (February) are available under a confidential arrangement with the Census Bureau. Under no circumstances should public reference be made to them.

Housing starts expanded further in February, nearly to the advanced rate reached last November. The increase, which was somewhat above staff expectations, reflected in part the more than usual number of operating days this February because of leap year. (Census makes no direct allowance for this type of variation in the case of starts.) But improved builder confidence about mortgage market prospects--aroused at the time by the less than anticipated disintermediation experienced by lenders in the December-January reinvestment period--may also have been a factor.

A feature of the February increase in starts was its concentration in single-family structures. These exceeded the million-unit mark for the first month since December of 1965. While the South accounted for most of the expansion, only the Northeast states--which had led the upturn in January--showed a drop.

Building permits (which are adjusted for working days) also rose in February and exceeded the advanced rate reached last December. Moreover, all regions and all types of structures shared in the rise. Even so, some decline in the seasonally adjusted rate of starts seems likely for March because the normal seasonal allowance from February to March calls for a rise of more than 50 per cent in the unadjusted level and March this year has two fewer working days (9 per cent) than in other recent years. Altogether, however, starts in the first quarter may approach a 1.50 million annual rate and average moderately more than in the advanced fourth quarter of 1967.

PRIVATE HOUSING STARTS AND PERMITS

	February 1968 (Thousands of units)1/	Per cent change from	
		January 1968	February 1968
Starts	1,566	+ 8	+36
1 - family	1,085	+19	+35
2 - or-more-family	481	-12	+39
Northeast	195	-21	-24
North Central	435	+ 6	+57
South	654	+24	+48
West	282	+ 5	+64
Permits	1,373	+25	+54
1 - family	701	+11	+27
2 - or-more-family	672	+42	+96

1/ Seasonally adjusted annual rates; preliminary.

Seasonally adjusted sales of single family houses by speculative builders continued little changed in January at a level a fifth above a year earlier. Builders' stocks of such houses (including those under construction) also changed little. The extremely low level of available stocks, which has persisted without essential change since early 1967, has been a limiting factor on sales, particularly at a time when resistance by buyers to either higher prices or higher interest rates has apparently lessened further as prospects for any decline in such costs over the near term have dwindled.

Vacancy rates for home-owner units now available for the fourth quarter of last year remained about the same--1.2 per cent-- as in most other recent periods. But vacancy rates for the sensitive rental series dropped from a reduced third quarter average of 6.4 per cent to 5.6 per cent of all units available and fit for use. The fourth quarter decline brought the rate to the lowest in a decade and was sharpest in the South.

RENTAL VACANCY RATES
(Per Cent)

	Average for fourth quarter of				
	1957	1964	1965	1966	1967
<u>All regions</u>	5.3	7.5	7.7	7.0	5.6
Northeast	3.2	5.0	5.1	4.9	3.9
North Central	5.6	6.8	6.6	5.8	5.1
South	6.4	7.9	8.4	7.6	6.4
West	6.8	11.2	11.7	10.9	7.4

Business plans for plant and equipment expenditures. Business spending on new plant and equipment in 1968 will total \$65.25 billion, \$3.6 billion or 5.8 per cent more than last year, according to the Commerce-SEC February survey of business plans. This gain is a little larger than the 4.9 per cent indicated by the McGraw-Hill survey of business plans taken last October. The 5.8 per cent increase now anticipated compares with an actual rise in 1967 of only 1.7 per cent--the smallest since 1961 when there was a decline--and with increases of about 15 to 17 per cent in the three years 1964 through 1966.

Business fixed capital outlays in the final quarter of 1967 exceeded earlier plans for the first time since the spring quarter of 1966. Spending increased 3.0 per cent in the fourth quarter rather than the 1.9 per cent indicated by business plans mid-way through the quarter. As plant and equipment expenditures fell short of earlier anticipations in each successive quarter last year, plans for 1967 outlays were scaled down--from a 3.9 per cent increase as indicated in the February survey to a 1.4 per cent as shown in the November one. The actual gain for the year, as noted above, was 1.7 per cent.

The increase in 1967 outlays was less than the 2.6 per cent estimated rise in prices of nonresidential fixed investment; consequently, the physical volume represented by these outlays was smaller than in 1966. Moreover, the 1968 physical volume equivalent may be no larger than, or perhaps even smaller than that in 1967 since prices of machinery and equipment have recently risen at a faster rate than the anticipated increase in outlays.

According to February plans, outlays will rise substantially in the current quarter, edge off in the second quarter, and then increase moderately in the last half of the year to a rate 6.9 per cent above that of a year earlier.

Plant and equipment expenditures now planned by manufacturers for 1968 are 4.6 per cent above 1967. Manufacturers' spending accounts for the bulk of the first quarter rise in the total; but their spending will increase only a trifle further in the second quarter and then edge down in the last half of the year.

Nonmanufacturing industries plan to increase their outlays by 6.7 per cent in 1968. Relatively large increases are indicated by nonrail transportation, public utilities, communication, and mining industries; the commercial and other industry grouping indicates only a small increase from last year and railroads plan a further substantial decline.

In the first half of this year total nonmanufacturing spending will decline a little from the final quarter of 1967, despite a large increase by public utilities. In the second half of the year, however, nonmanufacturing outlays will rise because of increases in nonrail transportation and the communication, commercial, and other industry grouping. Public utilities now report a 10 per cent increase in 1968, but most of this gain reflects a very large rise in the first quarter as declines are now indicated for the second quarter and for the second half of the year.

BUSINESS SPENDING FOR NEW PLANT AND EQUIPMENT

	1967	1968 Planned	1967		1968 Planned		2nd Half
			III	IV	I	II	
(Billions of dollars; quarterly and half-year figures are seasonally adjusted at annual rates)							
All business	61.7	65.2	60.9	62.7	64.8	64.3	66.1
Manufacturing	26.7	27.9	26.2	26.0	28.0	28.1	27.9
Nonmanufacturing	35.0	37.3	34.8	36.7	36.8	36.2	38.2
Railroad	1.5	1.3	1.4	1.4	1.5	1.2	1.3
Nonrail transportation	3.9	4.5	4.1	4.5	4.0	3.9	5.1
Public utilities	9.9	10.9	9.8	10.7	11.3	11.0	10.7
Other	19.7	20.6	19.5	20.2	20.1	20.2	21.1
Per cent change from preceding same-length period; quarterly and half-year figures are at annual rates							
All business	1.7	5.8	- 3.9	11.8	13.4	3.1	4.6
Manufacturing	- 1.1	4.6	-12.6	- 2.3	30.8	1.4	-1.4
Nonmanufacturing	4.0	6.7	2.9	22.4	1.1	-6.5	9.3
Railroad	-22.7	-17.0	-38.7	0.0	14.3	-82.8	-7.7
Nonrail transportation	12.8	16.2	20.5	34.1	-40.5	-10.0	58.2
Public utilities	17.5	10.1	4.1	34.7	22.5	-10.7	-7.2
Other	- .8	4.9	2.1	15.4	- 2.0	2.0	9.4

Labor market. Employment rose sharply in February, rebounding from the weather-induced slowdown the previous month. Along with a substantial recovery in the workweek and further gains in wages, this produced in February the largest increase in personal income in over two years. The labor force also expanded strongly (after declining the previous month) and the unemployment rate returned to the December level of 3.7 per cent from 3.5 per cent in January.

Nonfarm payroll employment increased by 550,000; nearly half, or 250,000, of the rise was in the volatile construction industry and probably reflected improved weather conditions. But even apart from the employment gain in construction and the net effect of strikes, the increase in nonfarm employment was still very large (330,000) and widely based. Since August (prior to the auto strike), nonfarm employment has increased at an annual rate of 3.0 million.

Manufacturing employment rose by 66,000 in February to a level somewhat above the January 1967 high. If it had not been for the 36,000 net increase in workers on strike (mainly glass workers), the rise in factory employment would have been in the neighborhood of 100,000, the strongest since the summer of 1966. Particularly large gains occurred in the transportation equipment and electrical machinery industries as well as in textile products and apparel. Fairly large employment gains also were reported in the construction-related lumber and furniture industries, and in the auto-related rubber and fabricated metal industries.

As compared with a year ago, however, employment gains in manufacturing were small--about 100,000--and concentrated in the non-durable goods sector. Increases in ordnance (where employment has expanded since mid-1965 in response to defense needs) and in transportation equipment were offset by a dip in primary metals, partly reflecting the prolonged copper strike, and in the machinery and electrical equipment industries.

The average workweek of manufacturing production workers in February regained the previous month's loss, returning to the December level of 40.7 hours. Gains in hours of work over the month were widespread. Significant increases since December have occurred in transportation equipment, stone-clay-glass and leather. The workweek was nearly half an hour longer in February than a year earlier, when hours of work had declined to the lowest point reached in 1967, but it remained almost an hour below the 1966 peak levels.

In nonmanufacturing activities, employment gains have been widespread. Employment in transportation and public utilities has been advancing in recent months. In the nonindustrial sector, the February gain in trade employment was particularly large--almost 100,000--and could help to explain the very large rise in part-time employment of teenagers which occurred that month. The finance and service sectors continued to advance strongly as did State and local government. Federal government employment rose slightly and has increased 26,000 since November, reversing the downtrend of the preceding 4 months. In February, total nonfarm employment was 2.0 million larger than a year earlier with the trade-service-State and local government complex accounting for 90 per cent of the increase.

The January dip in unemployment had occurred among teenagers and women; in February the teenage unemployment rate rose somewhat but was unchanged from December and from a year earlier. The over-all strength of the labor market during the past few months is indicated by the continued low rate of unemployment for men 25 years and over. Their unemployment rate was 1.9 per cent in February for the third month in a row, about equal to the low rate reached in the Korean War period.

Earnings in manufacturing. Hourly earnings of production workers in manufacturing averaged \$2.95 in February, 5.7 per cent higher than a year earlier. This was much larger than the average year-over-year rise during 1967, and reflected the large first-year wage increases negotiated in the high-wage durable goods industries since last fall. The settlements in copper and glass in the past few weeks provided packages that were even higher than the recent run of settlements, 7 per cent or more a year. Acceleration in wage increases in the nondurable goods sector has been less pronounced, although hourly earnings in low-wage nondurable goods industries increased faster in February than for nondurable goods as a whole, as a result of the increase in the Federal minimum wage effective February 1.

Average weekly earnings in February were 6.8 per cent higher than a year earlier. The sharp over-the-year rise in February reflected both increasing wage rates and the 0.4 hour rise in the average workweek from the low level of a year earlier. After more than a year of little

or no increase, the purchasing power of workers' weekly earnings should now begin to show substantial gains over the year, providing continued expansive impetus to personal consumption expenditures.

Unit labor costs. Unit labor costs in manufacturing rose sharply further in February as compensation per manhour surged up and productivity dipped. Unit labor costs were 4.7 per cent above a year earlier, the largest increase since last October, although still below the 5.5 per cent increases of the first three quarters of 1967.

UNIT LABOR COSTS IN MANUFACTURING, ALL EMPLOYEES

	Level (1957-59 = 100)	Per cent change from a year earlier
1967 - 1Q	105.2	5.5
2Q	106.1	5.4
3Q	107.2	5.5
4Q	107.5	4.6
1968 - January	108.3	3.3
February	110.3	4.7

While earnings have continued to rise sharply, output per manhour dropped below the December-January levels because of the sluggish performance of manufacturing output. Output per manhour showed a larger increase in February from the year-earlier level than it did in most months last year--when average increases were one per cent or less. But this still slow pace fell far short of the rapid rate of growth in wages, so that the increase in average hourly earnings has been reflected in sharply rising unit labor costs.

Increasing wage rates will continue to exert substantial pressure on labor costs in the immediate future; any significant easing of the pressure is dependent upon a rebound in productivity, which usually accompanies a pickup in manufacturing output.

Wholesale prices. The BLS industrial commodity index increased 0.5 per cent in February and, according to their preliminary estimate, 0.3 per cent further in March to 108.6 per cent of the 1957-59 average. Prices of foods and foodstuffs also rose substantially further in February and March, with gains recorded for livestock, meats, eggs, fresh fruits, and fats and oils. At 107.0 the BLS March estimate for farm products and processed foods and feeds was up 3-1/2 per cent from last November's low. With both industrial and agricultural commodities up, the total wholesale price index reached a new high in March estimated at 108.3 per cent of the 1957-59 average.

The rise in industrial commodity prices, which began last summer, accelerated in the autumn and winter months. The February increase was the largest since the upturn began and also the largest since November 1956. While the March estimate indicates a slowing of the advance, the preliminary estimates have been revised upward consistently in other recent months.

The acceleration of the rise beginning last autumn has been reflected in an upward movement in the number of industrial commodities showing month-to-month increases--particularly between September and October and again in January and February, as shown in the table below.

DIFFUSION OF CHANGES IN 225 INDUSTRIAL PRODUCT
COMPONENTS OF BLS WPI

	1967					1968	
	Aug.	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.
Number of:							
Increases	86	87	109	103	110	127	131
Decreases	49	38	34	30	25	36	25
No change	90	100	82	92	90	62	69

In terms of a product breakdown--and in terms of the special FR groupings of industrial commodities as materials and products--the February step-up in the pace of advance reflected in large part unusually sharp further increases for raw and semi-fabricated copper and lumber and plywood and a turn-around in prices of petroleum products which had been declining since last August following the brief run-up during the Mid-East crisis. The FR grouping of industrial materials showed an especially large rise in February.

Reflecting mainly sharp increases for copper, lumber, and cotton, average prices of sensitive industrial materials increased 6-1/2 per cent from last July through February, almost back to the high reached in the spring of 1966. Over the 7-month period ending in February, sensitive materials (with a weight of 12-1/2 per cent) accounted for over a third of the rise in the industrial commodity total. Prices of cotton goods have already eased off somewhat since the turn of the year. With the copper strike now in process of being

settled, the sharp price run-up--which has reflected mainly the shift to high-priced imported copper with domestic supplies cut off--may soon be over. Lumber prices have been under upward pressure from short supplies and strong demands, and by February, were at a new high for the post-World War II period.

RECENT CHANGES IN WHOLESALE PRICES OF INDUSTRIAL COMMODITIES
(Special FR Groupings)

	Per cent change at annual rates		
	July 1967 to Oct. 1967	Oct. 1967 to Feb. 1968	July 1967 to Feb. 1968
Industrial commodity, total	2.7	4.8	3.9
Materials	<u>1.8</u>	<u>5.7</u>	<u>4.1</u>
Sensitive	4.7	15.6	10.9
Other	1.0	2.9	2.1
Products	<u>3.9</u>	<u>2.7</u>	<u>3.3</u>
Consumer nonfoods	<u>3.4</u>	<u>2.0</u>	<u>2.6</u>
Producers' equipment	5.0	4.2	4.6

Prices of other (sluggish) materials also showed a sizable rise in February. Reflecting earlier gains in copper prices, prices of plumbing fixtures and brass fittings increased substantially. Price increases were larger than in other recent months for millwork, metal containers, refractories, and glass containers; and prices of motor vehicle parts were boosted again. Also contributing in February was the turn-up in prices of petroleum products.

Prices of consumer nonfoods rose 0.3 per cent in February--more than in any of the preceding three months but less than last August and last October when the large rubber tire and auto price increases became effective. Price increases for appliances showed some acceleration in February, and apparel and textile house furnishings continued to rise at a sizable pace.

The rise in producers' equipment prices slowed rather abruptly in February--the increase for the month was 0.2 per cent as compared with an average of over 0.5 per cent a month between September and January. For the entire period since last July these prices have increased at the high annual rate of 4.6 per cent.

Consumer prices. The consumer price index increased another 0.3 per cent in February, to 119.0 per cent of the 1957-59 average. Consumer services--particularly medical care, mortgage interest, home maintenance, housekeeping services, and auto repairs--led the advance. Food prices showed a somewhat smaller increase (0.3 per cent; or 0.2 per cent seasonally adjusted) than in other recent months. With apparel and furniture prices continuing to climb, the average for all non-food commodities increased 0.3 per cent, about in line with recent trends.

The CPI has increased 0.3 per cent (on a rounded basis) for five consecutive months. However, for 4 of the 5 months the unrounded increase was 0.34 per cent, and from September to February the index rose at an annual rate of 3.9 per cent--with the January-February rate slightly higher.

Farm production plans. Farmers surveyed on March 1 about their spring planting plans reported cuts of only 2 per cent (3.5 per cent with winter wheat included) from last year's acreage which had been boosted 6.3 per cent to meet the world food crisis. With good weather, this acreage could easily produce a crop close to the 1967 record and somewhat in excess of expected use.

In an effort to get 1968 acreages back in line with what they had been prior to the 1967 expansion, the USDA offered a feed grain diversion program essentially the same as the attractive 1966 program; cut back acreage allotments a very moderate 13 per cent, considering that they had been raised 32 per cent for the 1967 crop; and, lowered the mandatory cotton program minimum diversion from 12.5 per cent of allotments to 5.0 per cent in an effort to get land back into cotton. These program changes have apparently encouraged shifts in the right direction. Rice allotments for 1968 were raised 20 per cent because of expected heavy export requirements.

With normal weather, the Crop Reporting Board estimates that the prospective corn acreage could produce a 4.4 billion bushel crop compared with last year's 4.7 billion bushel record and a wheat crop equaling the 1.5 billion bushels of last year--both in excess of prospective use for the second year. Unless growing conditions are unusually favorable, the planned 11.1 million acres of cotton is unlikely to produce the record yield which would be required to meet the 13.0 to 13.5 million bales needed in the 1968-69 marketing year.

Prospective soybean acreage could produce the nation's first billion bushel crop and rice may exceed last year's record output by 22 per cent.

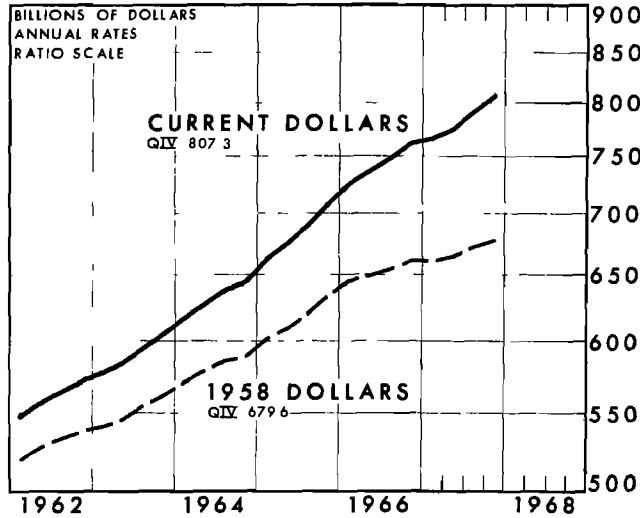
Hog production prospects. The March 21 pig crop report indicates that producers are sticking to their December plans to hold the pig crop to year-earlier levels in December-February and then to cut it 2 or 3 per cent below in March-May. Corn Belt producers accounting for three-fourths of production on March 1 confirmed the December projection and indicated plans to keep the June-August crop 3 per cent below a year earlier. The report suggest producer dissatisfaction with hog price prospects which is hard to explain in terms of farm-oriented factors because feed supplies are large and hog-corn price ratios have ranged from 16.9 to 18.8 during the past 10 months, ordinarily considered favorable ratios.

Producer plans will still permit a relatively high level of pork consumption in 1968 because hog numbers have been increasing cyclically over the past two years. Per capita consumption in 1967 amounted to 64 pounds, 9 per cent above the short supplies of the two preceding years, and a little above the 1957-59 average. The projected pig crop cuts will affect slaughter in the seasonally high fall and winter months and may moderate the usual seasonal price declines then.

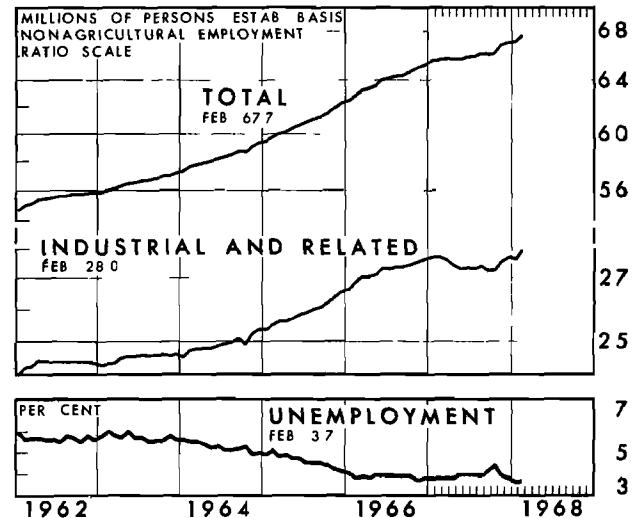
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

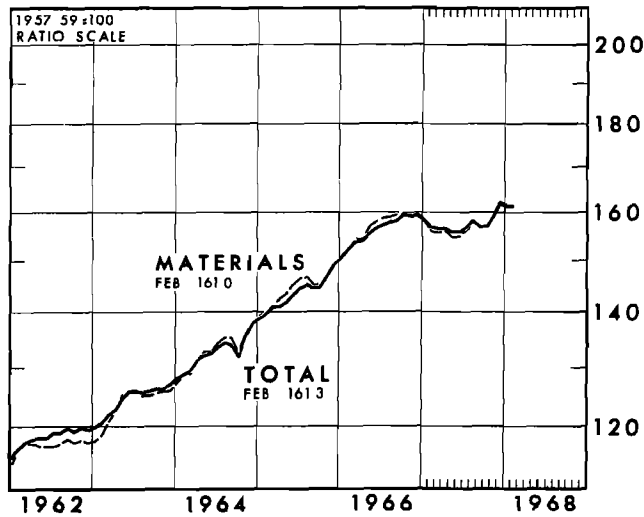
GROSS NATIONAL PRODUCT



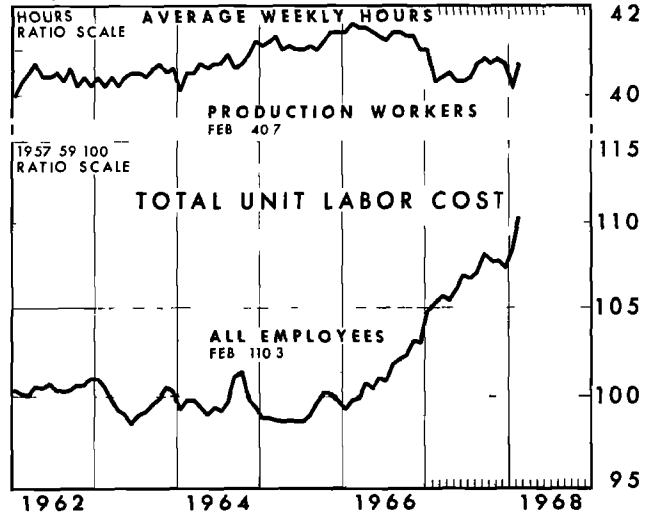
EMPLOYMENT AND UNEMPLOYMENT



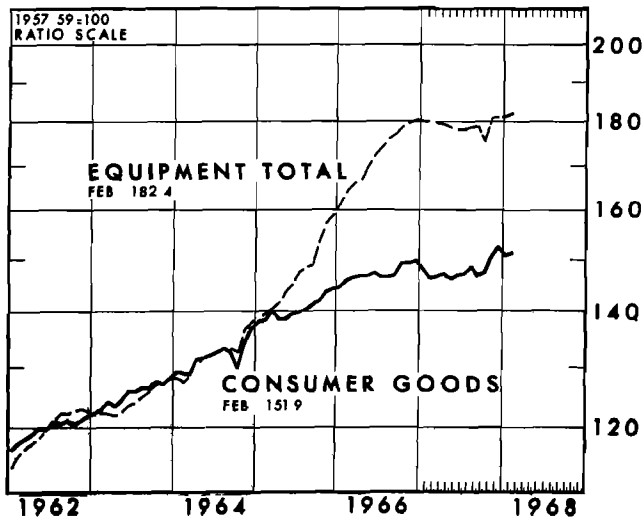
INDUSTRIAL PRODUCTION-I



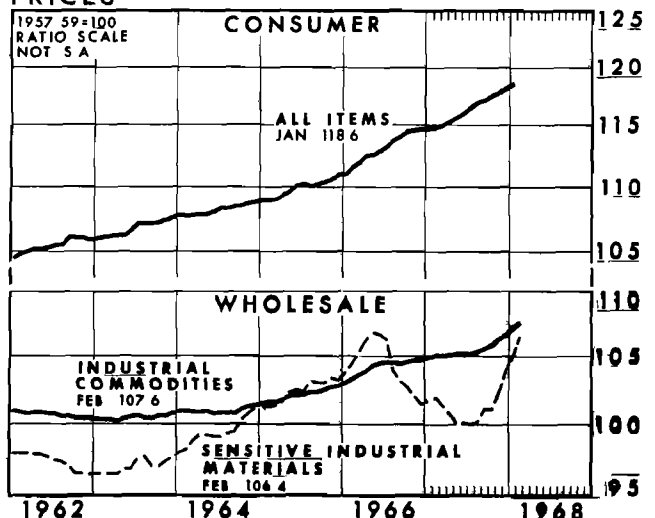
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



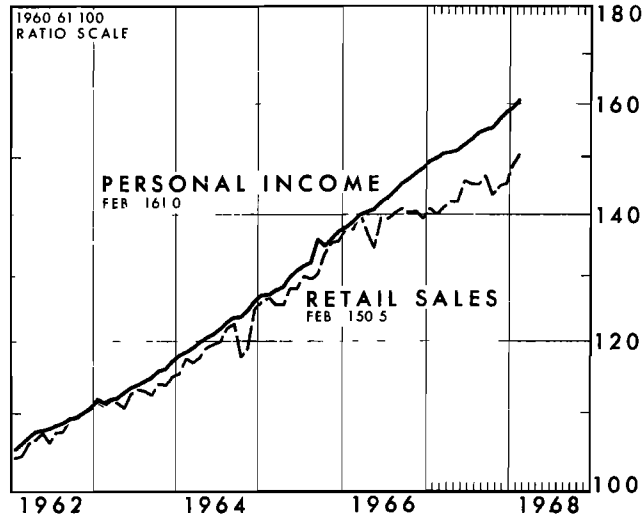
PRICES



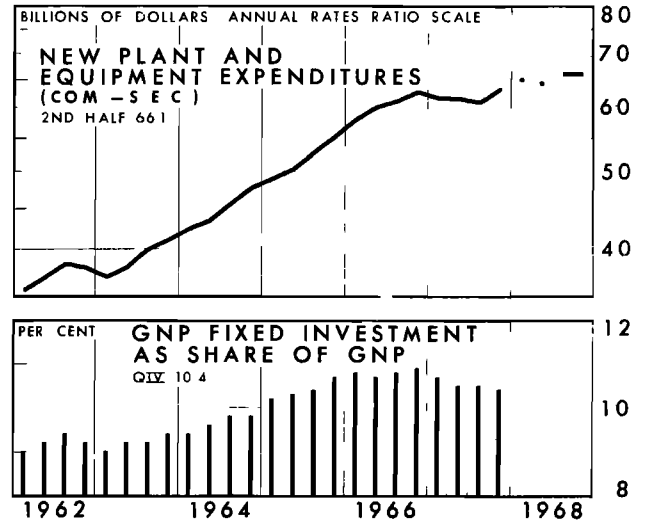
ECONOMIC DEVELOPMENTS - UNITED STATES

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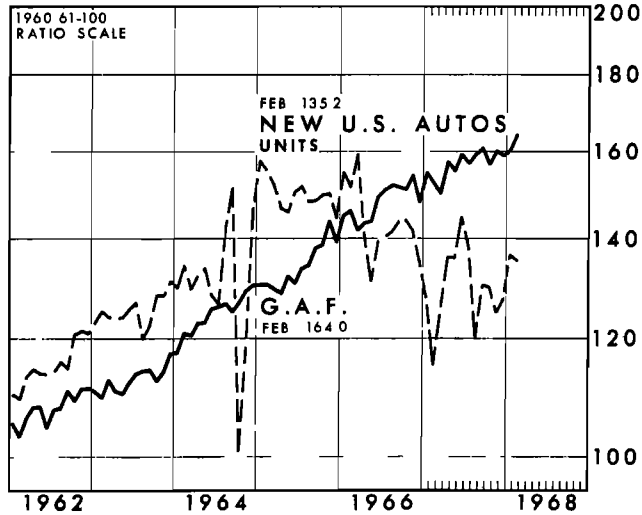
INCOME AND SALES



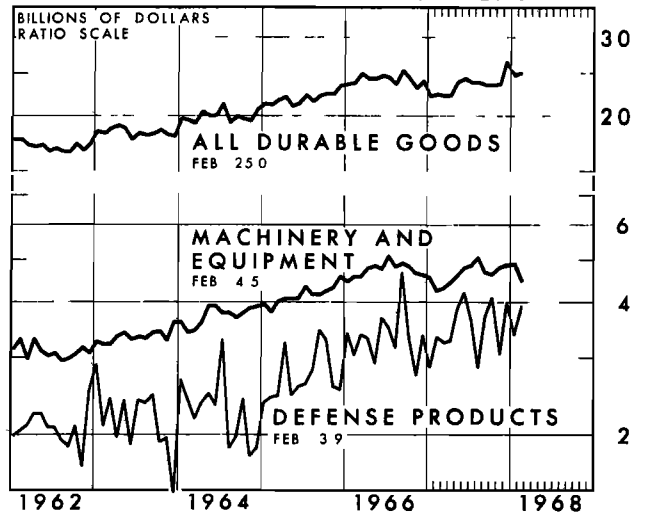
BUSINESS INVESTMENT



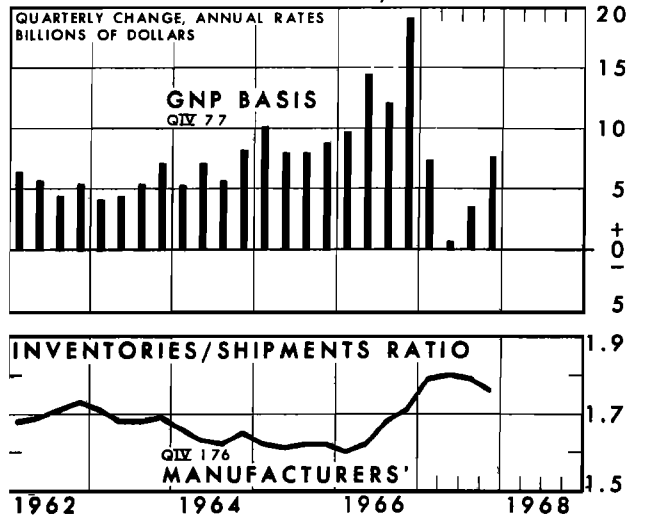
RETAIL SALES



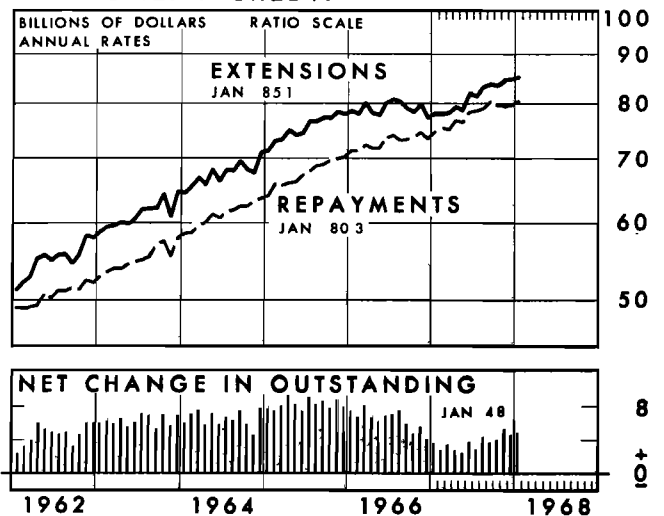
MANUFACTURERS' NEW ORDERS



BUSINESS INVENTORIES, NONFARM



INSTALMENT CREDIT



DOMESTIC FINANCIAL SITUATION

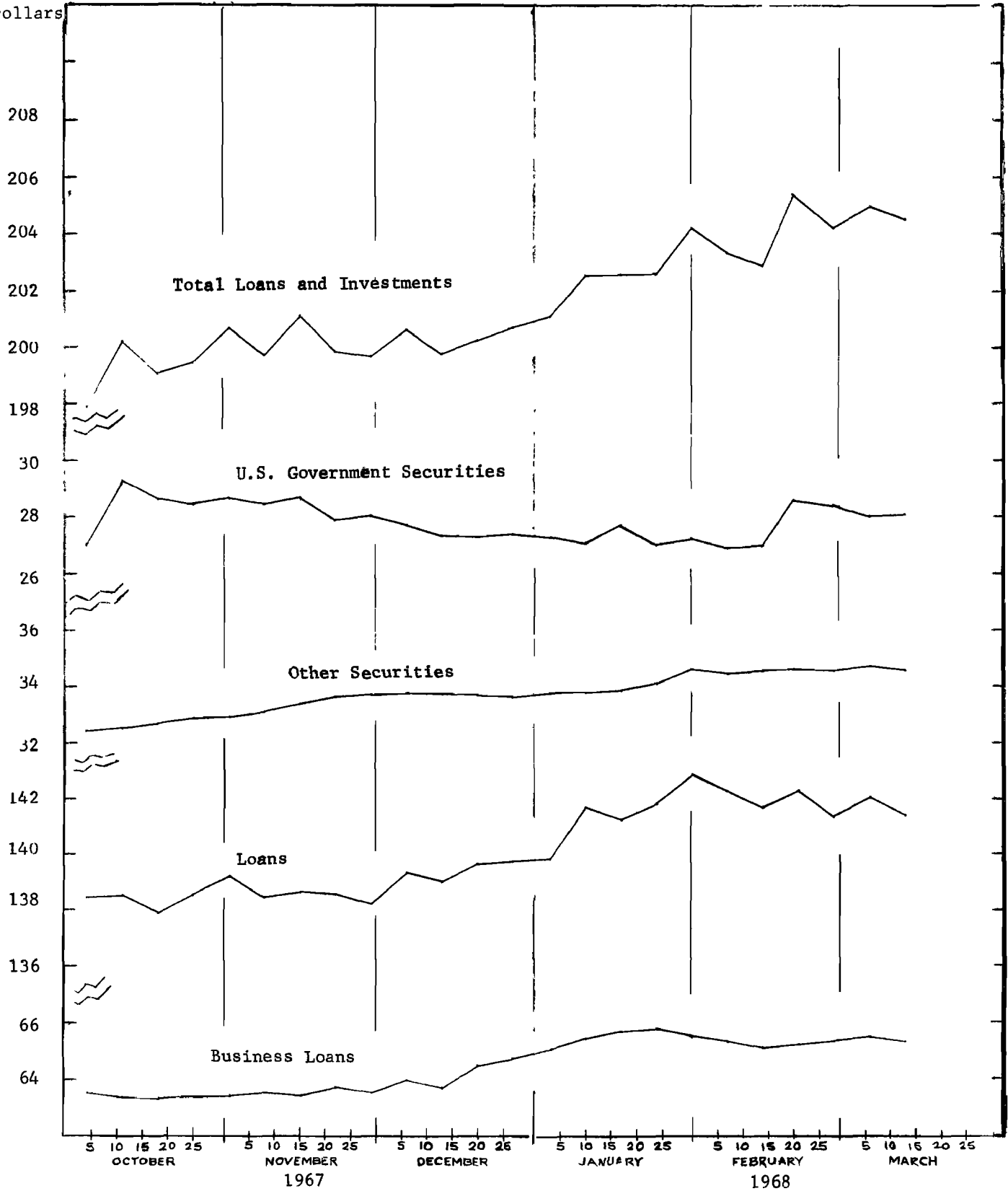
Bank credit. Commercial bank credit in March, as measured by the bank credit proxy on a daily average basis, is expected to increase at a considerably slower pace than the 9.2 per cent average annual rate of January and February. Data thus far in March indicate that growth in the bank credit proxy may be only about 4-1/2 per cent for the month as a whole.

After expanding in the latter part of February in connection with bank underwriting of the Treasury financing, total loans and investments at large banks displayed relatively little growth through the first two weeks of March, as indicated by the chart on the following page showing seasonally adjusted weekly reporting bank data. The reduced rate of expansion in early March reflects both a reduction of Government security holdings by banks and relatively weak loan demand, particularly for business and security loans.

Bank liquidation of Government securities following the February Treasury financing contributed substantially to the slower rate of bank credit expansion in early March. Bank sales of such securities probably reflect the strong investor demand for short-term securities, as well as the desire by dealer banks to lighten their portfolios in view of the uncertainties about the course of monetary policy. In addition, given the rising cost of issuing CD's, banks probably found the sale of bills a less expensive means to acquire funds.

LOANS AND INVESTMENTS AT WEEKLY REPORTING BANKS 1/

Millions of Dollars



1/ Seasonally adjusted levels; experimental series based on preliminary seasonal factors.

Acquisitions of other securities by banks remained moderate, although banks in New York added substantially to their holdings of municipals, probably reflecting the relatively weak loan demand at these banks and possibly some switching out of Treasury issues into these higher yielding securities.

The reduction in total loans outstanding in early March was associated in large part with the decline in security loans. Government security dealers lightened their inventories, including some longer-term maturities.

Business loans, after showing some moderate growth in late February, remained almost unchanged on balance during early March. As has been the case since the first of the year, however, banks in New York City have generally experienced weaker business loan demand than banks outside New York. Although the February lending practices survey indicated that most large banks were expecting business loan demand to pick up, no significant increase is yet visible. Corporations still seem to have adequate cash flows, and commercial paper continued to offer an attractive alternative to bank financing through early March, but during the current week the rate advantage has largely disappeared, particularly for dealer placed loans.

Corporate borrowings from banks for March tax payments were small in comparison to previous years. Estimated tax payments for that month are about 40 per cent below the average of those in the same period for the preceding three years. However, even taking into account the reduced level of tax payments, data for New York City banks suggest

that demands for bank financing over the March tax and dividend period were mild. As a per cent of total tax payments, bank financing was significantly lower this year than in previous years, as shown in the table.

CHANGES IN SELECTED BALANCE SHEET ITEMS AT NEW YORK CITY BANKS
OVER THE MARCH TAX AND DIVIDEND PERIOD 1/
(Millions of dollars)

Item	1965	1966	1967	1968
Business loans	483	609	461	433
Government security dealer loans	-11	28	187	-92
Finance company loans	220	512	142	133
Treasury bill holdings of banks	-57	241	550	-225
Negotiable CD's outstanding	-103	-156	58	-140
Total bank financing	738	1,546	1,282	389
Corporate income tax payments (1968 estimated)	6,759	7,244	6,728	4,300
Total bank financing as a percentage of tax payments	11	21	19	9
MEMO:				
Tax bills outstanding	2,504	3,009	2,006	2,003
Tax bills turned in for taxes (1968 preliminary)	2,020	2,157	1,124	822p
Bills turned in for taxes as a percentage of tax payments	30	30	17	20

1/ Reporting week or weeks including March 10 and 15.

While the expansion of business loans since the turn of the year has been moderate, the volume of business loans with maturities greater than one year (term loans) has increased substantially. This

is reflected in a rise in the ratio of term to total loans from 43.7 per cent at the end of December to 45.5 per cent at the end of February for weekly reporting banks. This ratio always jumps in late December and in January, reflecting primarily "carve-out" loans of extractive industries. However, the increase this year was more than seasonal in January and contraseasonal in February. This increase was associated, in most part, not only with the unusually large volume of carve-out loans this year but also with expanded term loan borrowing by the primary metals industry, which includes iron and steel producers. Several major steel companies are reported to be borrowing under longer-term revolving credits arranged in recent months, mainly to finance plant and equipment outlays, but some of these funds presumably are also being used to finance inventory expansion of borrowers and their customers.

Bank deposits. Through the third week in March, total time and savings deposits have generally maintained the more rapid rate of expansion begun after mid-February. However, this recent growth was the result of a more than seasonal increase in time and savings deposits other than CD's, since outstanding CD's declined substantially in early March and are not expected to recover much by month-end. But, with the exceptional strength in other time deposit flows, for the month as a whole, the increase in total time and savings deposits, on a daily average basis, is currently projected at an annual rate of 11.0 per cent as compared with an 8.4 per cent rate in February.

As has been the case since the end of the year, the recent decline in outstanding CD's took place primarily at banks in New York City. Weaker business loan demand at these banks relative to banks outside New York probably made New York banks less interested in issuing new CD's. In addition, rising short-term market rates had forced CD offering rates to the Regulation Q ceiling on all maturities by mid-March. Earlier in the year, banks had been able to attract funds maturing in 6 months and often longer at the ceiling rate.

Growth in consumer-type time deposits is estimated to have accelerated somewhat in March from the approximate 10 per cent annual rate of increase in February. Regular savings deposits continued to expand in spite of rising short-term market rates and higher yielding alternative instruments at banks and other savings institutions. The bulk of this increase appears to have taken place at country banks, where depositors are probably somewhat less interest-sensitive than at large city banks.

After a temporary surge early in March, bank liabilities to foreign branches for the week ending March 20 fell \$100 million below the level outstanding at the end of February, reflecting in most part the sharp 145 basis point jump in Euro-dollar rates during that gold crisis week.

The money stock in late February and early March continued to fluctuate around a moderate upward trend. Most of these fluctuations, particularly the decline in the money stock around the time of the Treasury financing in late February and the subsequent increase in

early March, reflect the movement of funds in and out of Government deposits. However, the decline in the money stock after the first week in March--at the same time that Government deposits were falling--may indicated that some private demand balances were used to meet tax and dividend payments, particularly in view of the relatively light bank borrowing for these payments. On a daily average basis, however, the money stock is projected to increase at a 4.5 per cent annual rate for the month as a whole, with increases in currency holdings of the public accounting for over half the projected expansion.

Nonbank depository intermediaries. Suggesting a continuation of the improved February performance at all mutual savings banks, inflows for the fifteen largest mutuals in New York City during the first half of March were about equal to the previous record inflows a year earlier. Inflows to savings and loan associations in February remained below their 1967 pace, but after rough allowance for seasonal factors, they were above the reduced inflows experienced from late fall through January.

NET NEW MONEY INFLOWS^{1/} TO NONBANK DEPOSITORY INTERMEDIARIES
(Millions of dollars; not seasonally adjusted)

	Insured savings and loan associations ^{2/}			Mutual savings banks		
	1965 ^{e/}	1966	1967	1965	1966	1967
Monthly average:						
January-October	348	-141	543	119	-9	212
November-December	490	428	355	168	160	128
	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>
January	-65	290	-270	144	331	162
February	505	741	560 ^{p/}	179	286	290 ^{p/}

^{1/} Deposits less withdrawals less interest credited.

^{2/} Insured savings and loan associations represent 96 per cent of the resources of all operating savings and loan associations.

^{e/} Estimated.

^{p/} Preliminary.

The general improvement in depositary inflows in February-- and possibly in March--may be associated with a smaller volume of total security issues and declining short-term market yields, as well as with a continued high rate of personal saving. However, the sharp increase in market yields in mid-March, despite some abatement late in the month, seem likely to be associated with more than seasonal outflows during the March-April reinvestment period.^{1/}

The increase in passbook loans at the New York savings banks in both February and early March has approximated the pace in 1966 and-- as then--this development will probably lead to increased withdrawals during the end of March grace period. Moreover, savings and loan associations appear to be adjusting their balance sheets in anticipation of an unfavorable reinvestment period experience. S&L liquidity ratios returned to recent highs and in February their mortgage commitments rose no more than seasonally.

Mortgage market developments. During the first half of March, the availability of mortgage credit apparently changed little following a slight easing in February. With rising yields on competitive market instruments since mid-March, however, there has probably been a resumption of the tightening which had been in progress in the mortgage market during the second half of last year.

^{1/} The effect of rising market yields on inflows to nonbank depositary institutions is discussed more fully in Appendix A.

During February--when savings inflows improved and mortgage portfolio repayments remained high--contract interest rates on conventional home mortgages remained unchanged at the postwar peak reached in January, according to the FHA series. In the more sensitive secondary market, yields on certain FHA home mortgages, which had reattained their 1966 high in December-January, edged down for the first time in 10 months. Since returns on new issues of high-grade corporate bonds rose, the already depressed gross yield spread of home mortgages over such bonds narrowed somewhat, as the table shows. The yield spread continued to offer little net incentive for mortgage investment by institutional investors after allowance for customary mortgage servicing fees.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary Market: Conventional loans		Secondary Market: FHA-insured loans		
	Level (per cent)	Yield spread (basis points)	Level (per cent)	Yield spread (basis points)	Discount (points)
<u>1967</u>					
April	6.40	101	6.29	90	2.5
May	6.45	79	6.44	78	3.8
June	6.50	71	6.51	72	4.4
July	6.50	72	6.53	75	4.6
August	6.55	66	6.60	71	5.2
September	6.55	67	6.63	75	5.4
October	6.55	43	6.65	53	5.6
November	6.65	12	6.77	24	6.5
December	6.70	19	6.81	30	6.8
<u>1968</u>					
January	6.75	51	6.81	57	6.8
February	6.75	46	6.78	49	6.6

NOTE: FHA series; interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points; secondary market yields and discounts are for certain 6 per cent, FHA-insured Sec. 203 loans. Gross yield spread is average mortgage return minus average yield on new issues of high grade corporate bonds.

New mortgage loans (chiefly on residential properties) were disbursed by savings and loan associations and New York State savings banks in February at a seasonally adjusted rate which changed little, and remained somewhat below the advanced pace reached last fall. Outstanding mortgage commitments were taken down by these thrift institutions at approximately the same over-all rate as new commitments were approved. As a result, the seasonally adjusted backlog of residential mortgage commitments on their books, which had risen through November of last year, continued essentially unchanged. The lack of further recent growth in S&L mortgage commitments has partly reflected the already advanced level of such commitments in relation to recent cash inflows from new savings and mortgage repayments; for the more diversified New York State savings banks, it has apparently evidenced the continued preference for corporate bonds in view of the still comparatively unfavorable mortgage yield spreads.

Corporate and municipal bond markets. Yields on new corporate and municipal bonds have advanced significantly since the end of February, with the rise in yields in both markets quickened by the gold crisis and related monetary developments. Over the four weeks since the end of February, corporate new issue yields rose about 25 basis points to a level only slightly below the peak yields of December 1967. While municipal yields have dropped back from the level registered at midmonth, these yields on balance have advanced about 10 to 12 basis points since the end of February to levels exceeding their 1967 highs.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa		State and local Government	
	New	Seasoned	S&P High Grade	Bond Buyer's (mixed qualities)
	With call protection			
<u>1966</u>				
Late summer high	5.98*	5.44	4.26	4.24
<u>1967</u>				
Low -				
late January- early February	5.03	5.00	3.43	3.40
High - December	6.55*	6.24	4.51	4.45
<u>1968</u>				
Low -	6.16(2/2)	6.07(3/8)	4.23(2/2)	4.16(2/2)
Weeks ending:				
February 23	6.27	6.09	4.43	4.38
March 1	--	6.09	4.48	4.44
8	--	6.07	4.53	4.49
15	6.43*	6.08	4.61	4.62
22	6.50*	6.13	4.53	4.50

* - Some issues included carry 10-year call protection.

Municipal yields were influenced not only by a sharply reduced pace of bank purchases but also by a continuing large volume of offerings and a surge of industrial revenue bond issues. In the corporate market, while domestic new issues continued relatively light, the market was put under pressure by announcements of a large Canadian corporate offering and by issues of PC's and World Bank Bonds--instruments directly competitive with corporate bonds.

Available evidence continues to point to moderation in the volume of publicly-offered corporate bonds, even though the estimate of the March volume has been raised--mainly because of the addition to the calendar of a large Canadian issue. Total bond and stock offerings in March will likely aggregate about \$2.1 billion, which is about a normal seasonal rise from the \$1.7 billion volume during February.

CORPORATE SECURITY OFFERINGS^{1/}
(Millions of dollars)

	Bonds				Total bonds and stocks	
	Public Offerings ^{2/}		Private Placements			
	<u>1966</u>	<u>1967</u>	<u>1966</u>	<u>1967</u>	<u>1966</u>	<u>1967</u>
Annual total	8,018	14,991	7,543	6,965	18,075	24,799
	<u>1967</u>	<u>1968</u>	<u>1967</u>	<u>1968</u>	<u>1967</u>	<u>1968</u>
Quarter I	3,263	2,358e	1,811	2,118e	5,464	5,537e
February	900	755e	362	700e	1,418	1,655e
March	1,618	900e	601	900e	2,362	2,125e
April	1,368	750e	410	700e	2,016	1,650e

^{1/} Data are gross proceeds.

^{2/} Includes refundings.

In April, total corporate security offerings are expected to decline to less than \$1.7 billion, a larger than seasonal drop-off from March. Public offerings of corporate bonds in April are now estimated at \$750 million, below the first quarter monthly average rate. However, in light of the late March announcement of two large industrial

bond issues, as well as several smaller offerings, this estimate may be subject to considerable revision. The recently announced issues all have indefinite offering dates and could come to market anytime this spring. Moreover, one of the large proposed issues is highly tentative.

In contrast to corporate markets, State and local government bond volume remains large with offerings in April estimated at \$1.15 billion, the same as in March. Included in the March volume are industrial revenue bonds of more than \$200 million which were rushed to market in the first half of the month in anticipation of the loss of tax-exemption privileges. As a partial offset, there was about \$100 million of other issues which were postponed because of high interest costs.

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

	1966	1967
Annual total	11,405	14,652
	<u>1967</u>	<u>1968</u>
Quarter I	4,173	3,497
February	1,231	1,200e
March	1,455	1,150e
April	1,130	1,150e

1/ Data are for principal amounts of new issues.

It is possible that more municipal borrowers will defer a significant portion of issues scheduled for April. And if this occurs, it is not expected that industrial revenue issues will fill the gap. The number of such issues brought to market in order to meet the Treasury's initial deadline of March 15--after which interest on these bonds would supposedly not be tax-exempt--apparently exhausted all financing reasonably far along in the planning stage. Appendix B provides information on the Treasury's most recent proposals regarding industrial aid financing.

Stock market developments. After declining sharply from the all-time highs reached in mid-January, stock prices fluctuated within a narrow range from mid-February to late March. In late March, the New York Stock Exchange index was down about 9 per cent from the January peak, while the American Exchange index--which had shown a much larger rise in 1967--was off about 14 per cent from its high. The volume of trading--even after normal trading hours were restored March 4--has also moderated significantly.

AVERAGE DAILY TRADING VOLUME
(Millions of shares)

	New York Stock Exchange	American Stock Exchange
August 1967	9.0	4.4
September 1967- January 1968	10.9	5.7
February 1968	9.2	4.1
March 1968 p/	9.1	3.7

p/ Preliminary.

Although stock prices declined on a broad front from mid-January to mid-February, divergent changes among industry groups subsequently appeared. By the end of March, issues in the more stable industries--food, beverages, tobacco, and apparel--had declined significantly less than average. In contrast, stocks of industries with poor profit records--e.g., air transport and meat packing--plus former "high flyers"--such as electronics and motion pictures--had declined considerably more than average. The flight from the less secure issues is of course also evidenced by the American Exchange index which has declined substantially more than other indices. The defensive attitude reflected in these developments has been generally attributed to the course of the Vietnam war, international monetary developments, and the increased expectation of more restrictive public policy measures.

STOCK PRICES

	Dow-Jones Industrial Averages	New York Stock Exchange Index	American Stock Exchange Index
Level:			
Mid-January high	908.92	54.17	25.73
Mid-February	831.77	49.72	22.64
March 26	831.54	49.32	22.10
Range:			
Mid-February	849.80-	50.19-	23.82-
to March 26	825.13	48.99	21.94
Percentage:			
Mid-January			
to March 26	-8.5	-8.9	-14.1

Falling stock prices in February evidently encouraged additional margin traders to reduce their debt. During the month, margin debt contracted by \$90 million to \$6,060 million, and the number of margin accounts at brokerage houses declined 10,000.^{1/} A small reduction in securities loans at banks brought the total decrease in stock market credit for the month to over \$100 million. During January and February together, therefore about 15 per cent of the nearly \$2 billion net increase in stock market credit during 1967 was erased.

Falling stock prices also resulted in a decline in the equity status of accounts. Although the proportion of debt in the most vulnerable equity category--40 per cent or less--rose only 1 per cent, the proportion in the 40-59 per cent category rose from 14 to 20 per cent. This was the highest proportion in the 40-59 per cent category since February 1967, when the effects of the sharp 1966 stock price declines were still in evidence.

U.S. Government securities market. Yields in all maturity sectors of the Government securities market have risen substantially on balance during March, but are presently well below the peak levels reached at the height of the gold market crisis.

^{1/} These data are preliminary; final figures may show a larger decline.

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

	<u>1966</u>	<u>1967</u>	<u>1968</u>		
	<u>Highs</u>	<u>Highs</u>	<u>March 4</u>	<u>March 14</u>	<u>March 26</u>
<u>Bills</u>					
1-month	5.60 (9/19)	4.75 (1/4)	4.72	5.10	4.90
3-months	5.59 (9/21)	5.07 (12/15)	4.99	5.45	5.10
6-months	5.98 (9/19)	5.60 (12/1)	5.17	5.63	5.30
1-year	5.94 (8/21)	5.71 (12/29)	5.31	5.65	5.37
<u>Coupons</u>					
3-years	6.22 (8/29)	5.87 (11/13)	5.65	6.03	5.81
5-years	5.89 (8/29)	5.91 (11/13)	5.59	6.00	5.77
10-years	5.51 (8/29)	5.87 (11/13)	5.57	5.95	5.77
20-years	5.12 (8/29)	5.81 (11/20)	5.41	5.77	5.63

The sharpness of the general yield increases to March 14 reflected the growing general concern among market participants as to the effect of the stampede into gold on domestic monetary conditions. Dealers generally pressed to lighten their inventories of both bills and bonds, and expectations of an increase in the Federal Reserve discount rate to as much as 6 per cent were widespread at one point. Liquidation of Government security holdings by investors, however, apparently remained relatively light.

Following the discount rate increase--to 5 per cent, announcement of the two-price system for gold, presentation of Britain's new austerity program, and indications that some break in the stalemate on U.S. fiscal policy might be in the offing, yields

reversed most of the very rapid increase that had occurred at the height of the gold market crisis. Most recently, yields on Treasury notes and bonds have edged up again as market hopes of rapid U.S. fiscal action have lost some of their earlier conviction, and several large new bond issues have been added to the corporate calendar. Treasury bill yields have continued to decline, however, notwithstanding the persistence of higher dealer financing costs.

Recent downward pressures on bill yields have reflected the sharply reduced inventories of Government security dealers. Dealers would normally have built up their bill inventories in anticipation of reinvestment demands emanating from redemption of the \$2 billion of maturing March tax bills (only \$900 million of which were turned in for taxes). The uncertainties of the gold crisis period discouraged such a build-up, however, and dealer trading positions in bills recently dropped to an intra-weekly low of less than \$500 million, more than \$2 billion below the level a month ago. Treasury bills have been in demand recently from business corporations and from institutional investors switching out of stocks. And during March the Trading Desk has been a net buyer of around \$1 billion bills, for System and foreign accounts combined.

With Treasury yields and the discount rate higher, yields on short-term debt instruments other than Treasury bills have also risen considerably on balance during March.

Participation Certificates. The Federal National Mortgage Association offered \$1 billion of participation certificates on March 26; \$730 million were offered to the public, with the balance taken directly by Treasury trust accounts. Of the public portion, \$200 million will mature in 3 years, \$330 million in 5 years, and \$200 million in 20 years. Yields were set respectively at 6.30, 6.45, and 6.45 per cent, well above the 6.00 and 6.08 per cent rates set on the 3 and 20 year maturities of FNMA PC's sold in mid-January.

SELECTED SHORT-TERM RATES

	1966	1967	1968		
	High	High	March 4	March 14	March 26
<u>1-month</u>					
CD's (prime NYC)					
Highest quoted new issue	5.50 (12/31)	5.50 (12/29)	4.90	5.25	5.50
Secondary market	5.75 (9/28)	5.45 (1/18)	5.15	5.25	5.52
<u>3-months</u>					
Bankers' acceptances	5.75 (10/25)	5.63 (12/29)	5.25	5.63	5.63
Federal agencies	5.76 (9/21)	5.30 (12/29)	5.10*	5.47	5.30**
Finance paper	5.88 (12/31)	5.88 (1/6)	5.13	5.38	5.50
CD's (prime NYC)					
Highest quoted new issue	5.50 (12/31)	5.50 (12/29)	5.38	5.50	5.50
Secondary market	5.90 (9/21)	5.70 (12/29)	5.40	5.60	5.70
<u>6-months</u>					
Bankers' acceptances	6.00 (9/23)	5.88 (12/29)	5.38	5.75	5.75
Commercial paper	6.00 (12/31)	6.00 (1/16)	5.50	5.63	5.75
Federal agencies	6.04 (9/21)	5.55 (12/29)	5.40*	5.88	5.67**
CD's (prime NYC)					
Highest quoted new issue	5.50 (12/31)	5.50 (12/29)	5.50	5.50	5.50
Secondary market	6.30 (9/28)	6.00 (12/29)	5.62	5.88	5.90
<u>1-year</u>					
Federal agencies	6.13 (9/23)	5.95 (12/29)	5.50*	5.79	5.72**
Prime municipals	4.25 (9/21)	4.00 (12/29)	3.25*	3.60	3.60**

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

* - Rates on March 1.

** - Rates on March 22.

Federal finance. The Treasury operating balance is projected to total \$5.0 billion at the end of March, and then to decline seasonally to a low of about \$1.5 billion around mid-April. Thereafter, as April corporate and personal income tax payments are collected, the balance should rise again to a month-end level of around \$4.5 billion, as shown in the financing table.

To keep its balance from falling below the \$4.5 billion level by midyear, the Treasury would have to borrow about \$3.5 billion of new cash during the last two months of this fiscal year. Part of this cash is likely to be raised at the time of the mid-May refunding, and another smaller part may be covered by an offering of Export-Import Bank PC's. Because seasonal cash drains at the start of the new fiscal year are large, an end-of-June operating balance of only \$4.5 billion is relatively low and would require sizable further Federal cash financing sometime in July.

The preceding financing estimates are based on upward revisions of both Treasury receipts and spending from the projection shown in the February 28 Greenbook. The improved outlook for corporate profits and personal income in the first half of 1968 is expected to yield \$1.0 billion more in receipts than the staff previously projected. But this change would be largely offset by an increase in spending, as shown in the second table.

FEDERAL FINANCING AND TREASURY CASH BALANCE
 January-June 1968
 (In billions of dollars)

	January- March	April	May	June
Major new borrowing needed to keep cash balance as shown below:				
Unspecified new borrowing	--	--	2.0	1.5
Weekly and monthly bills	.9	.6	.5	--
Tax series	2.5	--	--	--
Coupon issues	4.1	--	--	--
PC's to public	.8	.7	--	--
Scheduled repayments (-)				
Tax bills	-2.0	-3.5	--	-5.5
1-1/2% notes	--	- .2	--	--
Other debt changes				
Attrition (-)	- .5	--	--	--
Foreign series	- .4	--	--	--
All other <u>1/</u>	<u>.2</u>	<u>--</u>	<u>--</u>	<u>--</u>
Total net borrowing from public	5.8	-2.4	2.5	-4.0
Cash operating balance:				
Change <u>2/</u>	- .6	- .5	.1	.1
Level at end of period	5.0	4.5	4.6	4.7

1/ Includes savings bonds and agency debt issues less trust account investments in marketable U.S. Government securities. Excludes agency transactions in participation certificates and debt transactions by Federal Land Banks and Federal Home Loan Banks.

2/ In addition to the Federal debt operations shown here, the Treasury operating balance is affected by the surplus or deficit between Federal receipts and expenditures and by various accrual items, such as deposit fund accounts and clearing accounts. The latter are shown as other means of financing in the following table.

NOTE: Details will not add due to rounding.

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

	Fiscal years				Calendar quarters			
	1966	1967	1968 ^e	1968	1967		1968	
			Budget Doc.	F.R.B.	III	IV	I ^e	II ^e
<u>Quarterly data, unadjusted</u>								
New Budget:								
Surplus/deficit	-3.7	-8.8	-21.7	-23.1	-8.5	-11.0	-8.3	4.8
Receipts	130.9	149.6	153.9	153.9	35.4	31.9	37.9	48.7
Total expenditures and net lending	134.6	158.4	175.6	177.0	43.9	42.9	46.3	43.9
Means of financing:								
Total borrowing from the public	6.0	3.6	22.7	21.0	9.0	10.1	5.8	-3.9
Decrease in cash operating balance	.6	5.2	-1.0	1.0	-1.0	1.1	.6	.3
Other <u>1/</u>	-2.9	--	--	1.1	.5	-.2	1.9	-1.2
Memorandum:								
Debt issued to public less investments in public securities by:								
Federal Land Banks	.6	.5	.7		.2	.1	n.e.]	n.e.]
Federal Home Loan Banks	1.3	-3.5	.9		.4	.2	n.e.]	n.e.]
<u>Seasonally adjusted annual rate</u>								
Federal surplus/deficit in national income accounts								
Receipts <u>2/</u>	.9	-7.5	-13.2	-12.2	-13.2	-10.5	-8.8	-12.8
Expenditures	132.9	147.6	157.9	159.6	152.7	157.4	164.2	167.6
	131.9	155.1	171.1	171.8	165.9	167.9	173.0	180.4

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e - Projections based on existing tax rates, including extension of telephone and auto taxes. Assumes President's proposed corporate tax acceleration. Budget Document has been adjusted to remove surtax collections. n.e. - not estimated

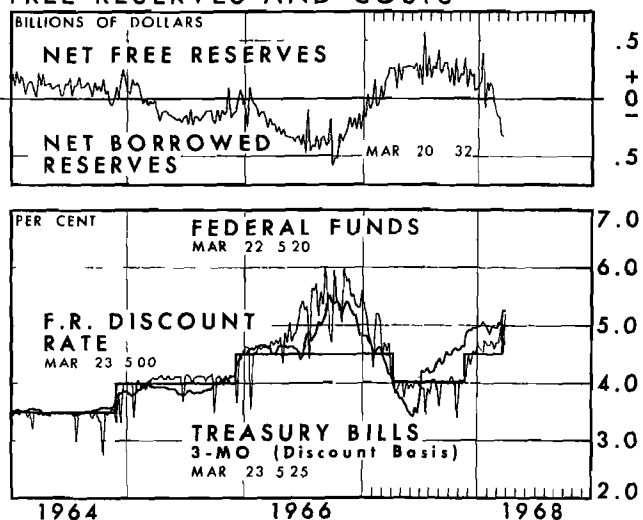
NOTE: The quarterly data for the new budget represent preliminary adjustment to new budget concepts and may be revised later.

1/ Includes deposit fund accounts, accrued, but unpaid interest and other miscellaneous items.

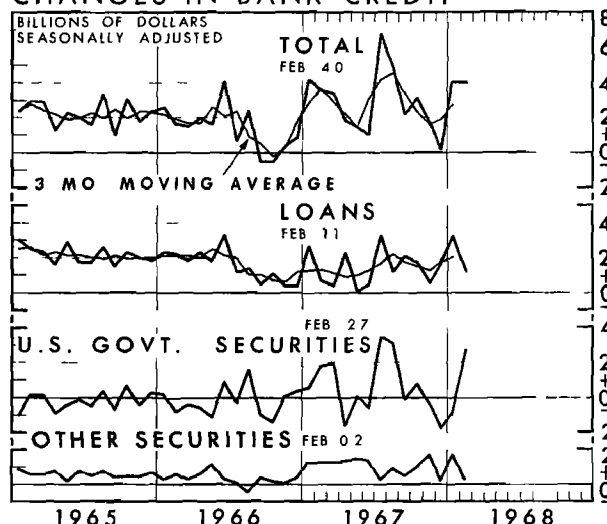
2/ Quarterly receipts do not add to fiscal year totals.

FINANCIAL DEVELOPMENTS - UNITED STATES

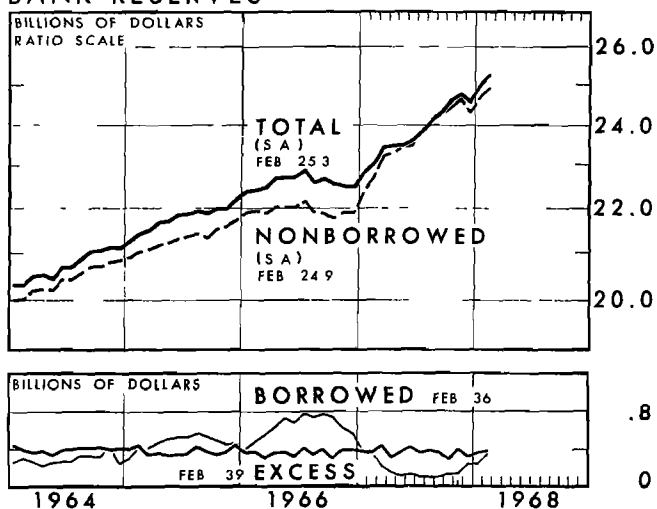
FREE RESERVES AND COSTS



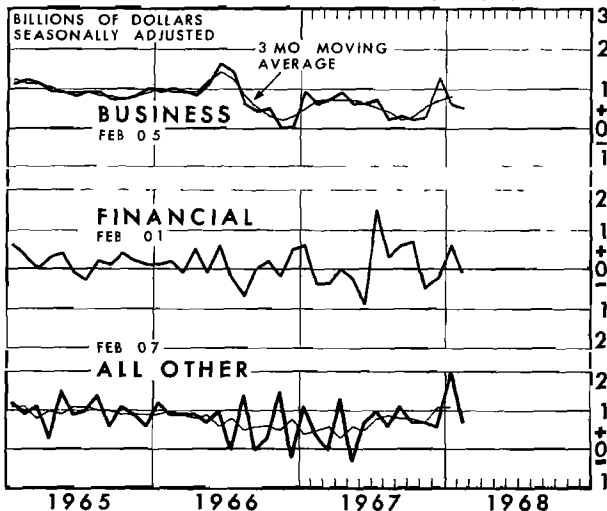
CHANGES IN BANK CREDIT



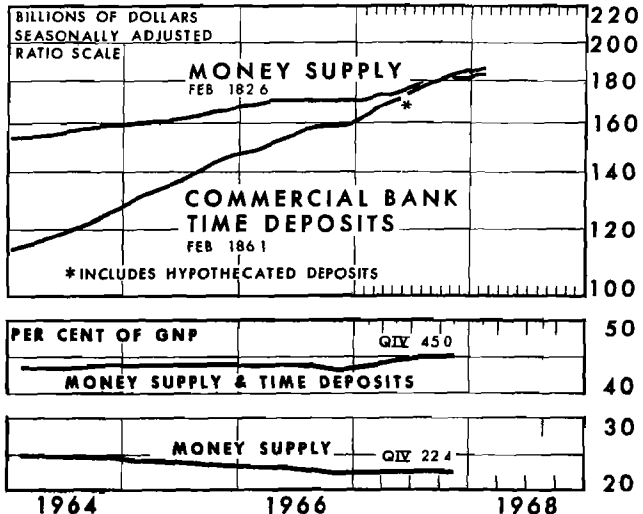
BANK RESERVES



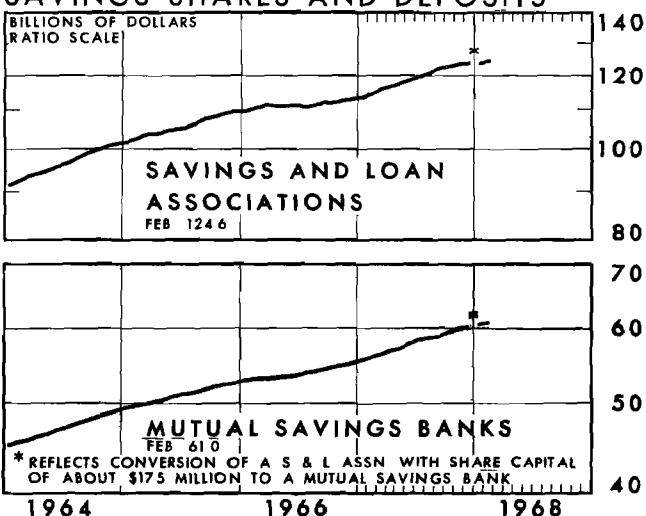
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

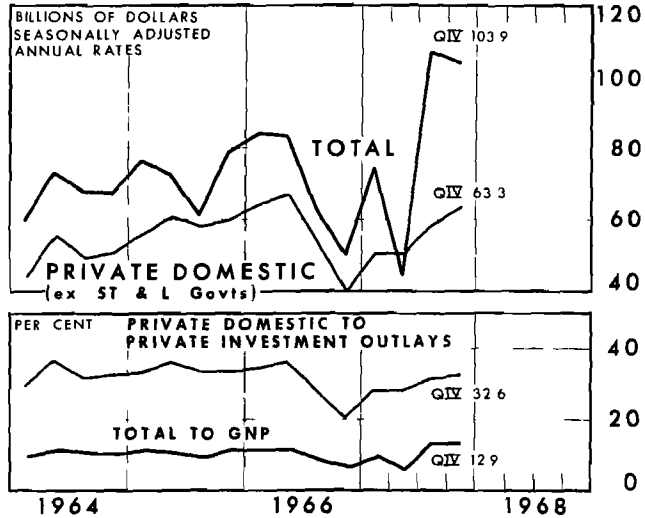


SAVINGS SHARES AND DEPOSITS

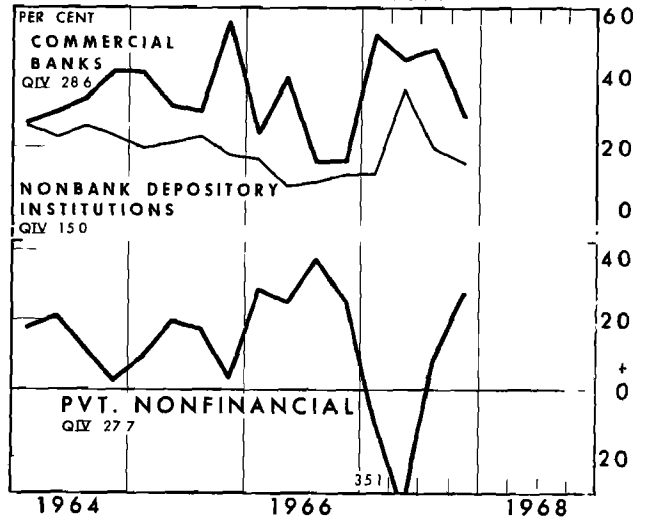


FINANCIAL DEVELOPMENTS - UNITED STATES

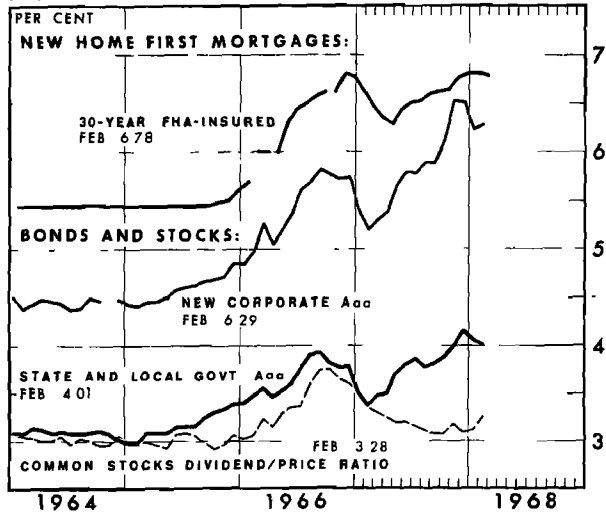
NET FUNDS RAISED-NONFINANCIAL SECTORS



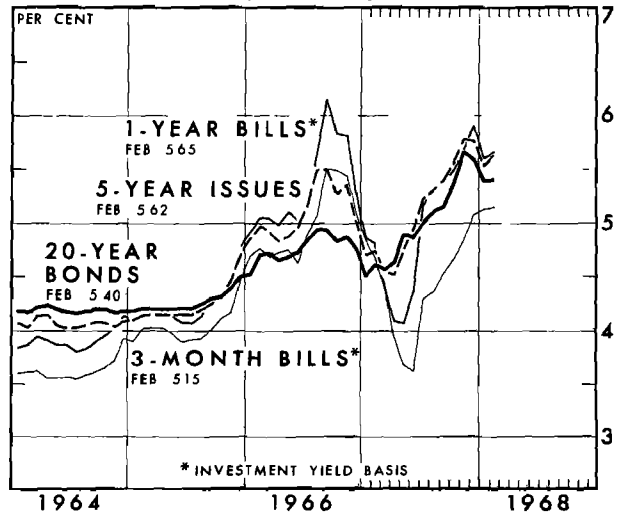
SHARES IN FUNDS SUPPLIED



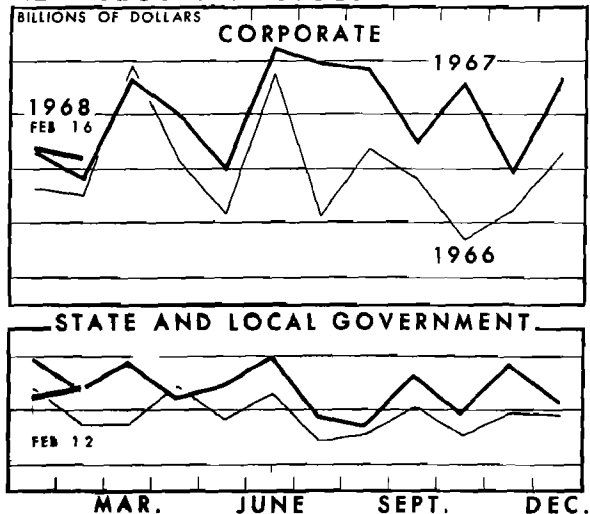
MARKET YIELDS



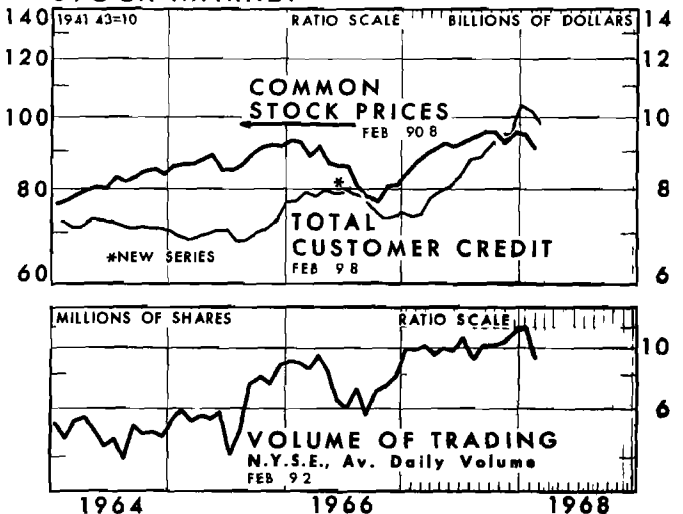
MARKET YIELDS—U.S. GOVT SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Very large outpayments during March have increased the apparent deficit substantially beyond the range indicated earlier. Preliminary figures for January, February and March through the 20th, together with known oil company payments to Libya on the 21st and the applicable seasonal adjustment for the quarter, point to a liquidity deficit, seasonally adjusted, of about \$1-1/4 billion. During the quarter, the German acquisition of another \$125 million of medium-term Roosa bonds was offset by other transactions in near-liquid U.S. liabilities. The liquidity deficit before special transactions (on the basis used in Appendix B of the January 31 green book) was therefore about \$1-1/4 billion, almost as large as the \$1-1/2 billion in the fourth quarter of 1967 and larger than the amount, under \$1 billion, in the first quarter a year ago.

On the official reserve transactions basis, the seasonally adjusted deficit in the first quarter this year is tentatively estimated at about \$1 billion.

Foreign trade data for January and February, discussed below, indicate a slight improvement from the extremely unsatisfactory fourth-quarter position. The trade surplus, however, was still at an annual rate below \$1-1/2 billion.

Tending to reduce the payments deficit as compared with the fourth quarter, net foreign purchases of U.S. corporate stocks reached a record monthly amount of \$160 million in January, compared with an

average of \$110 million in the three preceding months. Also bank claims on foreigners reported under the foreign credit restraint program were reduced in both January and February, with net reflows amounting to \$190 million and \$90 million. And Euro-bond issues by U.S. corporations to finance direct investments abroad, which had been \$120 million in the fourth quarter and \$450 million in 1967 as a whole, increased very sharply. Announced issues this year already exceed \$550 million; payments for these spill over partly into the second quarter.

Partly offsetting the foregoing favorable developments -- which in any case would not be sustainable over a long period -- it is likely that there have been adverse movements of private capital in March. These may have included shifts of funds to Canada after the lifting of restrictions on such transfers. There may also have been movements to Europe in the weeks when foreign exchange markets were most disturbed. Earlier, in February, there was a sizable outflow of bank-reported funds other than the inflow, mentioned above, of repayments on claims covered by the Federal Reserve program. The difference between the total bank-reported flow and the program figure, representing increases in claims held on behalf of U.S. customers and in loans with Export-Import Bank participation, guarantee, or insurance, indicates an outflow of about \$140 million during February.

U.S. foreign trade. The U.S. merchandise trade surplus in February improved only marginally from the low January level as exports increased slightly and imports remained unchanged, both from record

values in January. The surplus in January and February together averaged \$1.4 billion at an annual rate (balance of payments basis), a little higher than the exceptionally low \$1.0 billion rate of the fourth quarter but nearly \$3.0 billion below the \$4.0 billion rate in the first quarter of 1967.

Imports in January-February were running at an annual rate of \$31.4 billion, about 9 per cent above the fourth quarter rate and 18 per cent higher than in the first quarter of last year. Imports of steel and copper, the two commodities principally affected by domestic strikes, actual or potential, continued to advance in the first two months of the year. While the rate of advance was not particularly large in imports of steel, purchases of foreign refined copper in January-February were about 12 per cent greater than in the fourth quarter of last year. Now that the 8 month old copper strike is being settled, a gradual decline in copper imports can be anticipated in the next few months. Steel imports, on the other hand, can be expected to expand sharply in the next quarter.

Imports of coffee in the first two months of the year were also appreciably higher as roasters here replenished inventories which had been reduced to extremely low levels last fall.

A sharp spurt in automotive imports, particularly from Canada but also from Europe and Japan, was still another component of the record-breaking import totals of January and February. The accelerated inflow of cars from Canada may, in part, have been in anticipation of an automotive strike at GM plants there. The strike

is now in its sixth week and a sharp decline in imports of cars from Canada may therefore be expected.

Exports in January-February were at an annual rate of \$32.8 billion (balance of payments basis), about 10 per cent larger than in the fourth quarter, and 7 per cent above the rate in the corresponding quarter of last year.

Exports of both agricultural and nonagricultural commodities in January-February were 10 per cent above fourth quarter rates. Shipments of agricultural products were the largest since the fourth quarter of 1966. Deliveries of commercial passenger and combination passenger-cargo aircraft increased sharply to an annual rate of over \$1-1/4 billion, and accounted for about one-third of the total advance in nonagricultural exports in January-February. The current high rate of deliveries of such aircraft is expected to be maintained throughout the remainder of this year, but further increases are not likely.

The advances in exports in January-February were widely distributed by areas. The greatest gains were in shipments to Canada, Asian countries (other than Japan) and Latin America, with a more moderate rise in exports to Japan. Shipments to Western Europe, including the United Kingdom, were only slightly higher than in the fourth quarter.

As part of the new balance of payments program to stimulate exports, the President has asked Congress for a special \$500 million export financing fund to permit the Export-Import Bank to issue credit, guarantees and insurance on export transactions that do not meet the

Bank's criteria of a reasonable assurance of repayment. He has also requested \$2.5 million for the Department of Commerce's joint-export association program, to help finance joint operations by U.S. companies in export advertising, market research, sales and warehousing.

Gold. The termination of gold pool activities after March 15 and the communique issued by the March 16-17 meeting of central bank governors of seven gold pool members will be the subject of a separate memorandum.

Following a decline of \$165 million in the total U.S. gold stock in January and February, the daily reported Treasury gold stock fell further by \$1,398 million to March 22. Most of this represented gold pool settlements and sales to foreign central banks, so that Exchange Stabilization Fund holdings were only moderately replenished.

This gold drain served to hold down the net additions during March to foreign official claims on the United States to a very small total, if any. From the U.S. point of view the gold drain thus represented a means of financing the deficit. However, from the point of view of other countries whose residents were moving out of domestic-currency assets to buy gold, such private gold transactions tended to worsen those countries' balances of payments or hold down surpluses. How large an element in the total gold buying such foreign private purchases were can not be said, on the basis of presently available information. The possibility should not be overlooked that U.S. residents may have participated also.

Euro-dollar market developments. Euro-dollar interest rates, after dropping back in January to levels comparable with last October's,

began to move up again in late February, and more sharply in March. The 3-month rate reached its peak on Thursday, March 14, at 7-1/8 per cent, up 1-7/16 from March 1. This peak rate was the highest since November of 1966. Rate movements in the one-, six-, and twelve-month maturities were similar, as indicated in the table.

BROKERS' BID RATES FOR DOLLAR DEPOSITS IN LONDON
(per cent per annum)

	1-month	3-month	6-month	12-month
Jan. 2	6.26	6.50	6.63	6.75
Feb. 1	4.94	5.44	5.94	6.31
Mar. 1	5.63	5.69	6.00	6.44
Mar. 14	<u>7.00</u>	<u>7.13</u>	<u>7.25</u>	<u>7.38</u>
Change, Mar. 1 to Mar. 14	+1.37	+1.44	+1.25	+ .94
Mar. 26	<u>6.13</u>	<u>6.44</u>	<u>6.50</u>	<u>6.75</u>
Change, Mar. 14 to Mar. 26	- .87	- .69	- .75	- .63

Among the factors affecting Euro-dollar rates during the first two weeks of March may have been the following: (1) a reduced demand for dollar-denominated assets in general, related to growing international monetary uncertainties; (2) an increased demand for dollars with which to buy gold; (3) withdrawals by German banks to meet mid-March liquidity pressures in the German money market; and (4) bidding for deposits by U.S. banks' branches, which produced a rise of nearly \$300 million in head office liabilities to branches in the week ending March 13. In addition, the request by the Bank of Canada on March 4 that Canadian banks cease swap dollar deposit transactions may have operated to reduce the supply of funds in the Euro-dollar market, but no information is as yet available on Canadian bank activity during the period in question.

The Euro-dollar market was significantly influenced by the great uncertainty attached to holding dollar denominated assets which developed over the two weeks prior to March 15. During the week of March 11 to March 15 the cost of covering new placements of funds in dollar assets (or rolling over cover for reinvestment in maturing dollar assets) became very high. For example, the per annum cost of forward covering of dollars against Swiss francs rose from 2.1 per cent on March 1 to 3.5 per cent on March 14. The rise in three-month Euro-dollar interest rates was just about equal to this increase in the cost of forward covering.

Following the March 16-17 weekend change in gold policy, Euro-dollar rates moved down. From Thursday March 14 to Tuesday March 26 the rates on one-, three-, six-, and twelve-month deposits fell by an average of 74 basis points, but remained an average of 52 basis points above their March 1 levels.

The general reduction in rates in the past two weeks may be explained by a cessation of such pressures as those mentioned above. The liabilities of U.S. banks to their branches abroad fell by \$375 million in the week to March 20. It may well be that the U.S. banks had had their branches borrow in the Euro-dollar market the week before in order to prepare against large withdrawals by branch customers; the branches retained the funds temporarily as balances with head offices. To the extent that foreigners did move out of Euro-dollar deposits, or borrowed Euro-dollars -- to buy gold, or to buy assets being sold by gold purchasers, or perhaps to acquire German marks -- the running down

of branch balances in the United States after the 13th enabled the pressures on the Euro-dollar market to be absorbed without even greater rate advances than occurred. The pressures on the market reached their peak on the 14th, the day before the London market was closed.

Data are not available to indicate what other flows in or out of the Euro-dollar market have occurred this month. The Bundesbank entered into additional dollar-mark swaps with German commercial banks, but net changes in outstanding swaps and in the banks' net external assets are not known. It is possible that proceeds of new Euro-bond issues were put into Euro-dollar deposits, but here again figures are lacking. Preliminary and incomplete data suggest that changes during the month in U.S. liquid liabilities to private foreign persons and commercial banks other than the U.S. branches were relatively small.

Foreign trade of industrialized countries. International trade began to rise again in the fourth quarter of 1967, after a pause in the first three quarters of the year. The recession in Germany from mid-1966 to mid-1967, the slight decline in U.S. industrial production during the first half of 1967, and the British measures to deal with the balance of payments had been the principal retarding influences on world trade. Most European countries -- apart from Germany -- took little or no action to offset the deflationary effect of slackening foreign demand for fear of causing a loss of foreign exchange reserves or a new break-out of inflationary pressures in their economies. As a result, the value of world exports was only 3 per cent higher in the third quarter of 1967 than in the third quarter of 1966 -- after an increase of 10 per cent the year before -- and in fact growth had ceased by early 1967.

The upturn in world trade in the fourth quarter reflected sharp increases in imports of the United States and Germany and of some of Germany's neighbors. Meanwhile Japanese and Italian imports were continuing to rise strongly. As the following table shows, total imports of OECD countries -- including all the principal industrial countries and some smaller European countries -- rose 4 per cent from the third quarter to the fourth, with accelerated buying from each other and also from the rest of the world.

The rise in exports of OECD countries was smaller than the increase in their imports. Among individual countries, this was markedly the case for the United States and Germany, the two countries whose

rising imports were giving the main impetus to growth in world trade. But in several European countries, exports and imports rose more or less in step, while in two instances, in Canada and Switzerland, exports turned up sooner and rose more than imports. Britain was a special case, with deterioration in its trade balance (in terms of U.S. dollars) caused mainly by a drop in exports.

TRADE OF OECD COUNTRIES -- QUARTER-TO-QUARTER CHANGES
(in per cent of dollar values)

	1966				1967			
	I	II	III	IV	I	II	III	IV
Imports from:								
World	+2.3	+1.2	+3.3	+1.0	+1.1	+0.2	+0.6	+4.3
Intra-OECD	+3.9	+0.8	+2.6	+1.8	+1.7	+1.0	-0.7	+4.0
Non-OECD	-0.4	+2.8	+3.8	-1.2	+0.4	-1.3	+2.8	+4.4
Exports to:								
World	+2.4	+2.4	+2.2	+1.9	+2.8	-0.1	-0.7	+1.2
Intra-OECD	+3.1	+1.3	+1.4	+2.1	+2.9	+0.1	-0.6	+4.3
Non-OECD	+1.1	+2.5	+5.7	+2.0	+2.9	-1.1	-1.6	-5.4

The over-all shrinkage in the export surplus of the industrial countries reflected a decline in their exports to non-OECD countries. This export decline was concentrated in British exports; the initial effect of devaluation was to lower the dollar value of British exports, and the dock strike was another factor in the fourth quarter. Exports of other OECD countries to non-OECD areas were relatively level during the latter part of 1967.

It has generally been expected that 1968 will be a year of large expansion in world trade. Clearly the rise that has already occurred in imports of OECD member countries is enough to make total

imports this year considerably greater than last year's. Also, buying by the less developed countries is likely to expand, as a result not only of the rise in their export earnings in recent months but also of a considerable increase in their foreign exchange reserves over the past three years -- from \$9.5 billion at the end of 1964 to \$12.3 billion last December, according to an IMF estimate.

Uncertainties about the course of world trade within the year 1968 relate primarily to whether the further expansion of demand in Germany and other European countries will be enough to counter-balance any slackening that may develop in U.S. and U.K. imports. If over-all growth is maintained, the tariff reductions which will take place this year should help expand international trade. In January the U.S. reduced its tariffs by 20 per cent of the total reduction agreed upon in the Kennedy Round; European signatories to the agreement will reduce their tariffs by 40 per cent of the total in July. Also, in July, the remaining internal EEC tariffs will be abolished, and the EEC common external tariff will go into effect, necessitating additional tariff cuts in outside trade by France and Italy. German external tariffs are on the whole already at the appropriate level; Belgium and the Netherlands will have to make general upward adjustments of their tariffs.

In Britain, prospects for a substantial narrowing in the trade deficit during the balance of 1968 are considered good, despite the persistence of large trade deficits since the devaluation. The favorable impact of the devaluation is expected to be felt increasingly as the year progresses.

The monthly trade deficit (imports, c.i.f.) in December-February averaged a little over \$300 million, compared with \$216 million in the first three quarters of 1967. The October-November results had been even worse, partly because exports were hit especially badly by the dock strikes in those months.

One important reason for the sizable U.K. trade deficits since devaluation has been the relative movement of U.K. export and import prices. As measured in sterling terms, the published unit value indexes rose from September to January by 9 per cent for imports but by only 4 per cent for exports. The dollar equivalents were a 7 per cent decline in import prices and an 11 per cent decline for export prices. Relative changes of this sort are counted on eventually to restrain import buying and to promote growth of export volume, but the initial effects are unfavorable.

In volume terms, exports did pick up sharply in December and January, but this rise seems to have been partly a catching up after delivery delays during the dock strikes. The December-January average volume (seasonally adjusted) was slightly above the peak reached in the first quarter of 1967. Import volume in December-January was higher than in any two or three-month period last year, and there appears to have been a further rise in February. Probably imports have been stimulated by the increased stock building associated with economic recovery, as well as by stepped-up purchases of consumer goods from abroad connected with the consumer spending spree of recent months.

Optimism that the deficit will be drastically reduced in the remainder of 1968 rests on the likelihood (a) that import demand will be curtailed as a result of the restrictive budget and (b) that the combination of revived foreign demand and lower foreign currency prices of British goods will soon bring about a rapid increase in U.K. exports.

There are encouraging indications that exporters are taking advantage of the devaluation by making significant cuts in the foreign exchange prices of their goods. A recent survey by the Confederation of British Industry forecast an average export price reduction of about 8 per cent. While this is less than the decline shown by unit value indexes through January, the figures are not inconsistent in view of rising costs of materials. British exporters appear sanguine about their 1968 prospects. The National Institute's Industrial Inquiry in December found that the machinery, automobile, and chemical industries -- accounting for over half of Britain's total exports -- expected a marked improvement in their sales abroad this year.

The strength of German economic growth, important because of the significance of Germany as an export market for other European countries as well as for the United States, will be an important determinant of world trade expansion in 1968. German economic activity continued to advance strongly at the opening of 1968. Order inflows to industry, both domestic and foreign, but particularly domestic, rose sharply through December. Industrial production has risen steeply since mid-1967; in the fourth quarter it averaged 9 per cent above the second quarter. In January output fell back from the sharply

advanced December level, but was about equal to the October-November average. The number of workers unemployed dropped slightly below the number of registered job vacancies in January (seasonally adjusted) for the first time since the beginning of 1967.

The rise in German imports so far has been concentrated in raw materials and semi-finished products, as producers have sought to rebuild inventories from the low levels to which they had been allowed to fall through the first part of 1967. Germany's EEC partners and the EFTA countries have shared in the growth of sales to Germany, but suppliers of raw materials -- particularly Australia and New Zealand, Canada, Africa and Asia -- have gained the most in relative terms.

In France, there was a pick-up in economic activity in the second half of 1967 following the unexpected and disappointing slowdown of the economy earlier in the year. Imports, after having dropped sharply in the second quarter in reaction to the slowing in the French economy, moved up in September to a new high level and have been maintained near that level in subsequent months. Exports also rose strongly in September after an indifferent performance in the first eight months of 1967, and moved higher again in January and February. The predominant factor in the export revival has been the German recovery. Exports and imports both expected to expand by 7.5 per cent from 1967 to 1968, after growth from 1966 to 1967 at 4.1 and 4.3 per cent, respectively.

The main features of Italy's foreign trade in recent months were a sharp recovery of exports following last summer's slump and a

further acceleration of the long-continued rise in imports. The sharp rise in Italian exports in the fourth quarter and January appears to have resulted at least partly from a substantial increase in exports to Germany. A sharp import drop occurred in January, but this seems to have been a freak occurrence; economic activity and imports are expected to expand strongly in 1968 as a whole.

Canada's trade balance improved sharply in the fourth quarter, as exports rose about 10 per cent while imports declined 2 per cent. The decline in Canadian imports in the third and fourth quarters and the small rise for the year as a whole reflected a lack of buoyancy in the economy. Forecasts indicate that demand will grow only moderately in 1968, suggesting a rather modest growth of imports beyond that dictated by the automobile pact with the United States.

Canada's 1967 export performance was largely determined by special developments in its trade with us. The primary force behind the growth of Canadian exports was the continued adjustment of the automobile industry to the 1965 pact. Exports of copper also grew very strongly as a result of the U.S. copper strike.

Japanese exports were markedly higher in January-February than in preceding months. Imports, on the other hand, were somewhat below their November-December peak level.

The Japanese Government's import projection for the fiscal year beginning April 1, as revised late in January, foresees average imports 8.6 per cent above those in the 1967-1968 fiscal year now ending. Since the January-February level is already about 3 per cent

above the fiscal year average, this implies only a moderate rise from now on -- much slower than what occurred during 1966 and 1967, when Japanese imports rose more than 50 per cent in 2 years from late 1965. However, as has often been the case before, the import projection may be an underestimate.

The Japanese authorities look for a 15 per cent fiscal-year-to-fiscal-year rise in exports, reducing but not eliminating the Japanese trade deficit (with c.i.f. imports).

FOREIGN TRADE OF MAJOR INDUSTRIAL COUNTRIES -- QUARTER-TO-QUARTER CHANGES
(in per cent)

	Weight ^{1/}	1967				1967-1968
		I	II	III	IV	Dec.-Jan. over Oct.-Nov.
IMPORTS						
OECD Total	<u>100.0</u>	<u>+1.1</u>	<u>+0.2</u>	<u>+0.6</u>	<u>+4.3</u>	<u>n. a.</u>
OECD Europe	<u>66.6</u>	<u>+1.0</u>	<u>-0.2</u>	<u>+0.5</u>	<u>+3.7</u>	<u>n. a.</u>
Germany	11.9	-5	-0	+1	+8	+ 4
U. K.	12.1	+10	+3	-4	+2 <u>a/</u>	- 1 <u>a/</u>
France	8.5	+1	-7	+5	+4	+ 2
Italy	6.6	+2	+1	+4	+6	- 8
Netherlands	5.7	+2	+1	+0	+6	+ 6
Belgium-Lux.	4.9	-1	+1	-6	+15	n. a.
Sweden	3.2	+4	-5	+8	-5	+ 5
Switzerland	2.8	+1	-0	0	+1	+ 2
Austria	1.6	+1	0	-4	+6	n. a.
Canada	7.0	-1	+5	-1	-2	n. a.
Japan	8.0	+5	+5	+4	+7	+ 4
U.S.	18.3	-0	-2	-0	+10	+12
EXPORTS						
OECD Total	<u>100.0</u>	<u>+2.8</u>	<u>-0.1</u>	<u>-0.7</u>	<u>+1.2</u>	<u>n. a.</u>
OECD Europe	<u>62.9</u>	<u>+1.0</u>	<u>-0.9</u>	<u>-1.2</u>	<u>+1.5</u>	<u>n. a.</u>
Germany	15.4	+2	+1	-0	+5	- 1
U. K.	10.2	+1	-4	-2	+17 <u>a/</u>	+21 <u>a/</u>
France	8.1	+3	+1	-0	+4	+ 3
Italy	6.2	+6	-2	-3	+8	+ 6
Netherlands	5.2	+5	-2	+3	+2	+ 3
Belgium-Lux.	5.0	+2	+2	-6	+12	+ 1
Sweden	3.2	+4	+5	-9	+4	+ 9
Switzerland	2.4	+3	+0	-1	+7	+ 5
Austria	1.2	+4	+1	+3	0	n. a.
Canada	7.5	+8	+1	-8	+10	n. a.
Japan	7.5	+0	+0	+5	-3	+ 6
U.S.	22.1	+4	+1	-1	-2	+ 3

^{1/} Share in total OECD exports or imports in 1967.

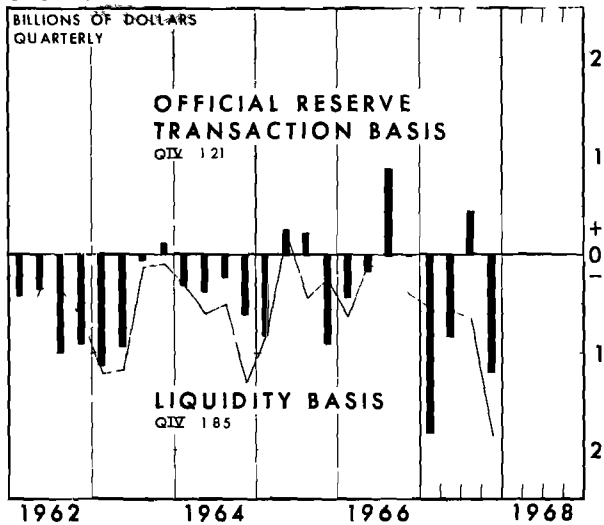
Source: OECD, except U.S. (data on balance of payments basis) and Japan last column (as seasonally adjusted by Bank of Japan).

a/ In terms of dollar values.

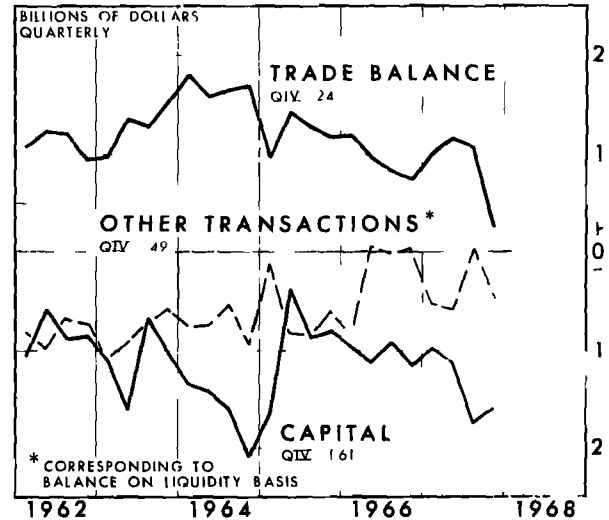
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

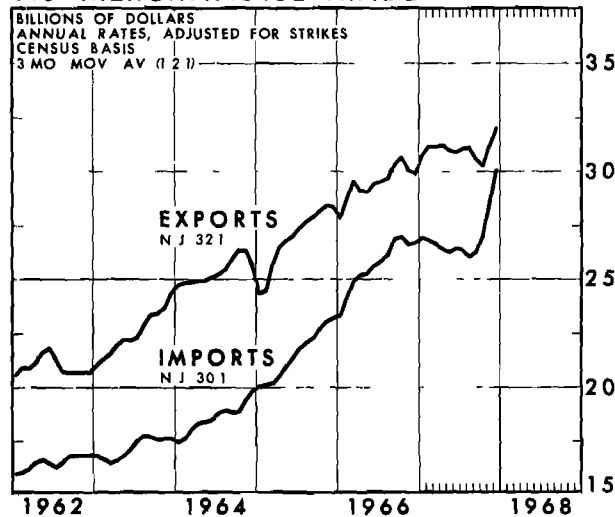
U.S. BALANCE OF PAYMENTS



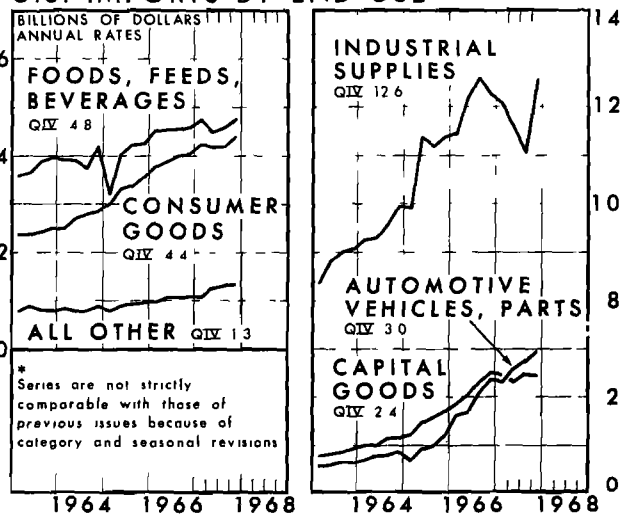
U.S. BALANCE OF PAYMENTS—CONT



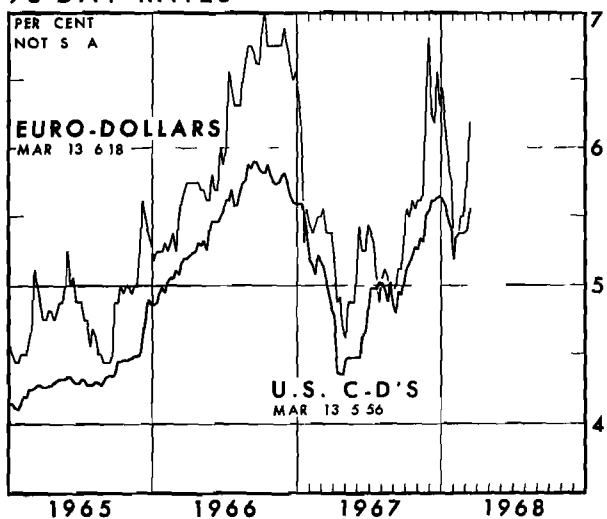
U.S. MERCHANDISE TRADE



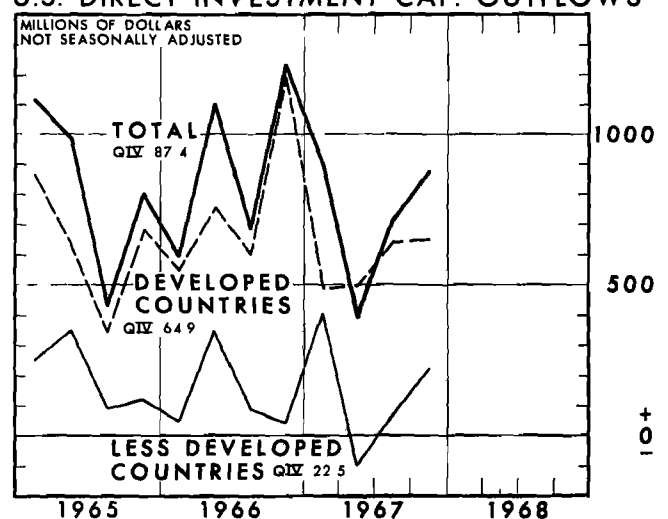
U.S. IMPORTS BY END USE*



90-DAY RATES



U.S. DIRECT INVESTMENT CAP. OUTFLOWS



APPENDIX A: MARKET YIELDS AND NONBANK DEPOSITARY INFLOWS*

The approaching March-April reinvestment period at the savings and loan associations and mutual savings banks once again poses the question of the ability of nonbank financial institutions to capture funds and extend credit under current market conditions. In summary, this appendix concludes the following:

1. Although rising market rates of interest increasingly have been pinching the inflows of funds to nonbank thrift institutions, the ceiling rate on consumer-type time deposits at commercial banks and the increased use of certificate accounts at savings and loan associations should moderate the impact of additional monetary restraint on depositary inflows as a whole.
2. Nevertheless, at current rate ceilings on nonbank financial institutions a significant further slowdown of inflows is likely to be produced at the level of market yields now available (e.g. a 5.10 per cent 90-day bill rate).
3. The cost of a 25 basis point increase in offering rates on certificate-type accounts, under revised ceilings, could be absorbed by most nonbank intermediaries, but not without an increase in the number of institutions who would fail to meet required allocations of earnings to reserves.

1966 vs. 1968

For a number of reasons, thrift institutions as a whole appear to be somewhat less vulnerable to intensified monetary restraint than in 1966--the last period when inflows to these institutions were reduced sharply.

During the earlier period, a large proportion of the reduced inflows to nonbank financial institutions--perhaps as much as two-fifths--reflected their altered competitive position vis-a-vis commercial banks, whose rates to depositors rose appreciably during the first half

* Prepared by the Capital Markets Section.

of 1966 when market yields were also rising sharply. Consumer-type time deposits at commercial banks are highly substitutable for both savings and loan shares and savings bank deposits, and the increase in commercial bank offering rates in 1966 helped the banks pull funds out of the nonbank institutions. These increases at banks also helped to reduce the relative impact of rising market yields on commercial bank deposit inflows.

The ceiling rates established in the fall of 1966 stemmed this tide and, as shown in chart 1, by 1967 the commercial bank share of household acquisition of interest-bearing deposits settled back to about pre-1966 levels, although the share remained above that obtained when banks were less active in the market for consumer time deposits. Thus, under present ceiling limits, inflows to nonbank institutions will be affected principally by the pull of market rates, rather than by inter-institutional competition.

In addition, the savings and loan associations have now greatly increased the use of minimum term-minimum balance certificate accounts at rates above those paid on regular accounts. In the first half of 1967, for example, about three-fourths of net increase in savings and loan share capital was accounted for by special accounts.^{1/} Moreover, in early 1968 such special accounts--because of their staggered maturities--apparently tended to reduce the concentration of withdrawals that might otherwise have occurred in a single reinvestment period.

Further, intermediaries are now in a much better position to weather reduced inflows and to meet their present high level of outstanding commitments than in 1966. Savings and loan associations have reduced their borrowing from the FHLB's by \$2.8 billion and both the associations and savings banks have increased their holdings of liquid assets.

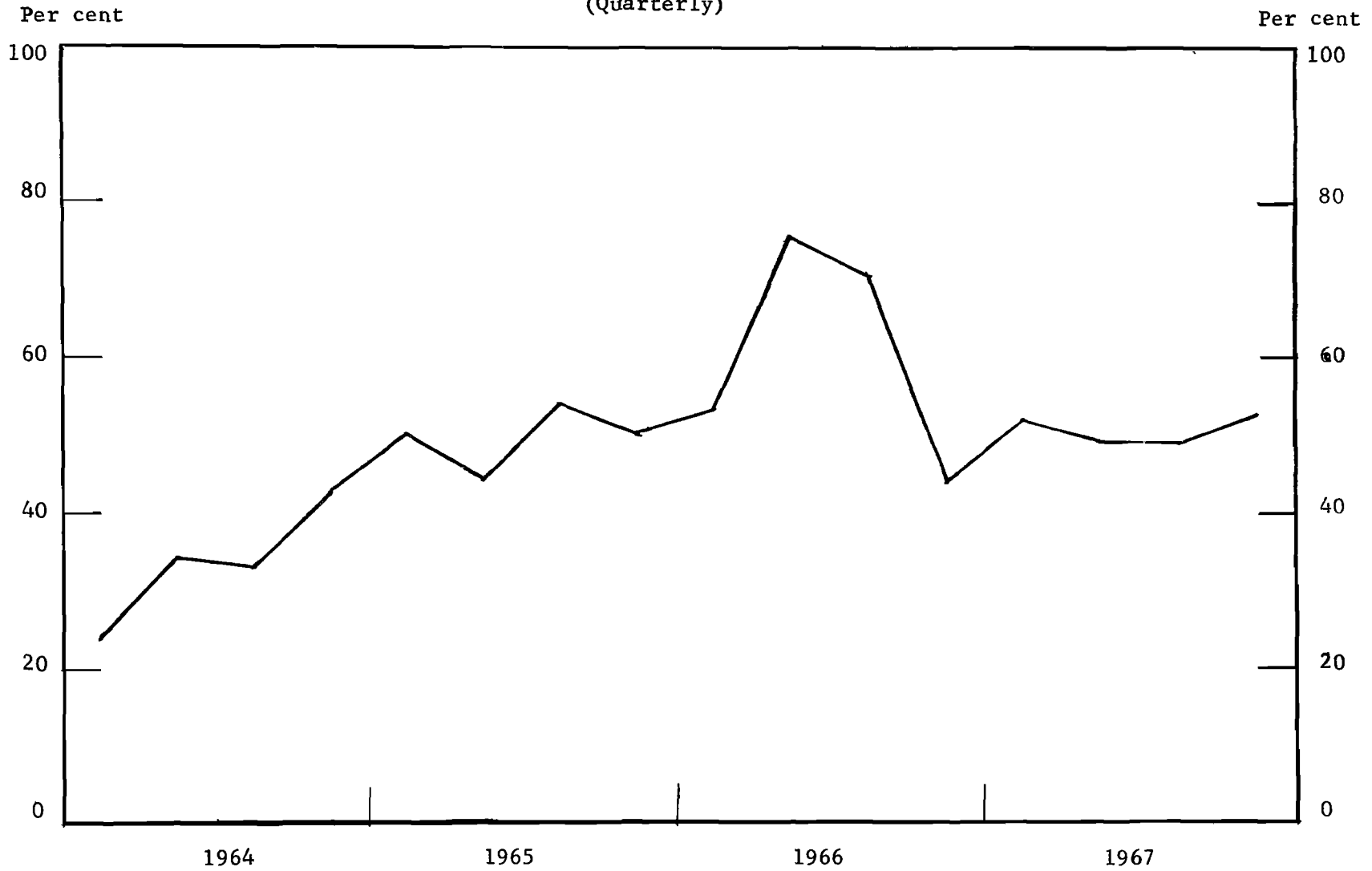
Some have also argued that there is less "hot money" at nonbank intermediaries now than was the case in early 1966. However, the degree of change may not be significant enough to be particularly meaningful at all institutions. For example, although the California savings and loan associations have somewhat reduced the share of savings capital from out-of-state funds, such interest-sensitive accounts still represent a large proportion of the total.^{2/}

^{1/} This overstates the effect on inflows since some regular accounts were transferred to special accounts.

^{2/} At the State-chartered savings and loan associations in California, out-of-state funds have declined from 23.5 per cent of the total in the fall of 1965 to 21.0 per cent in the fall of 1967. In December, the ratio rose to 21.9 per cent. Federally-chartered associations have lower ratios, but would show the same trend.

Chart 1
SHARE OF TOTAL INTEREST-BEARING DEPOSITS ACCOUNTED FOR BY COMMERCIAL BANKS
HOUSEHOLD SECTOR

1964-67
(Quarterly)



SOURCE: Flow of funds.

Another factor on the other side of the ledger is that mutual savings banks are now perhaps more exposed to rising market yields than they were in 1966; at that time they were able to accelerate inflows by raising rates at mid-year. Under current rate ceilings, not only do they have less room to maneuver, but unlike their competition, they cannot offer premium accounts above the passbook rate to retain and attract the most interest-sensitive deposits.

Past relationships

Although the factors just discussed tend to make it more difficult to read the future from the past, relationships during earlier years are still indicative of the effects of rising market yields on intermediary flows.

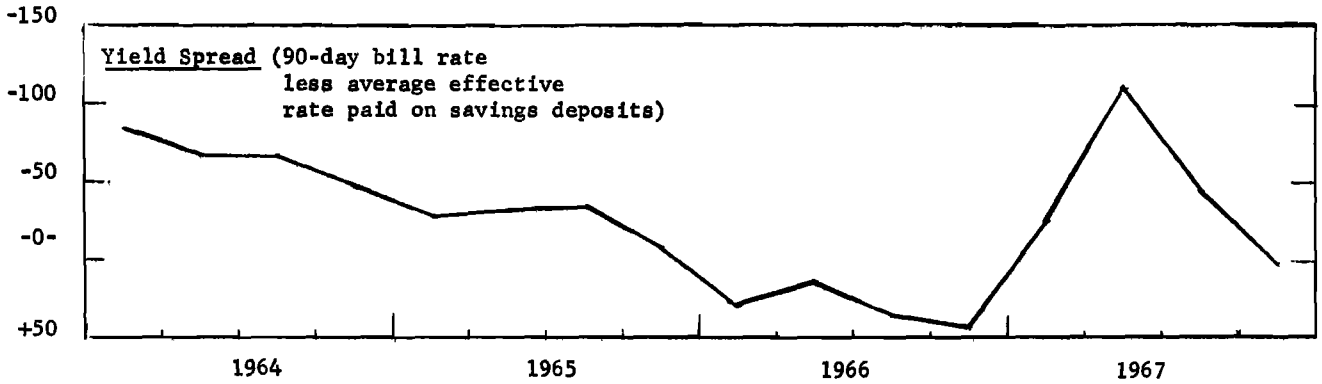
To illustrate the relationship in recent years, charts 2, 3, and 4 relate the quarterly spread between the 3-month bill rate and the average effective rate paid on nonbank claims--shown in the upper panel--to the inflow of funds to these institutions--shown in the lower panel. In each case the bill rate serves as a proxy for market interest rates in general. These charts show that as the yield spreads between average offerings rates and market instruments narrow, the inflow of funds to the institutions declines. However, while these charts are suggestive, institutional changes and data limitations reduce our ability to make quantitative predictions based on them. The rate relationships are calculated from quarterly interpolated average effective rates paid by intermediaries--the only series available for the entire time period. This series tends to lag offering rates and does not reflect the (supposedly) larger volume of fund flows associated with the highest rates being offered by the intermediaries.

Staff analysis (by Mr. Wendel)--using identical data--suggests that a 1 percentage point decrease in the yield spreads shown on the charts has been associated with reduced inflows to all nonbank intermediaries by about \$7 billion (annual rate). This preliminary statistical relationship is also suggestive but--like the charts--suffers from the problems arising out of institutional changes^{3/} and data limitations.

^{3/} A dummy variable did absorb some of the effect of changes in Regulation Q in 1965 and 1966.

Chart 2
Yield Spreads and Deposit Inflows
Mutual Savings Banks
1964-67
(Inflows at Seasonally Adjusted Annual Rates)

Basis Points



Billions of Dollars

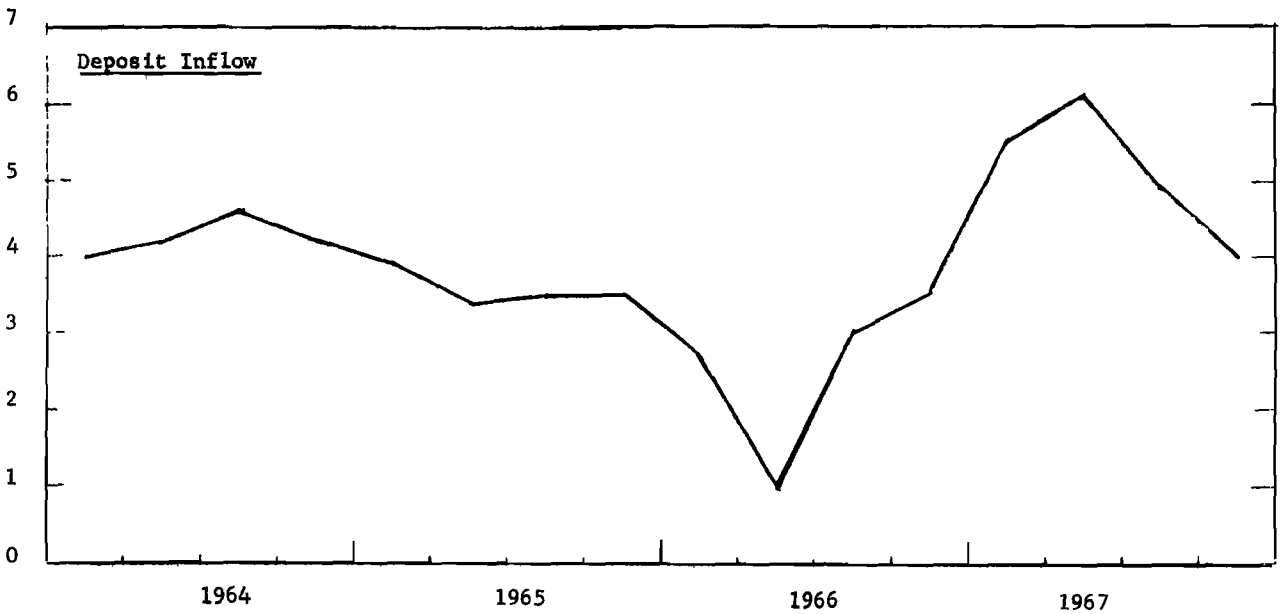
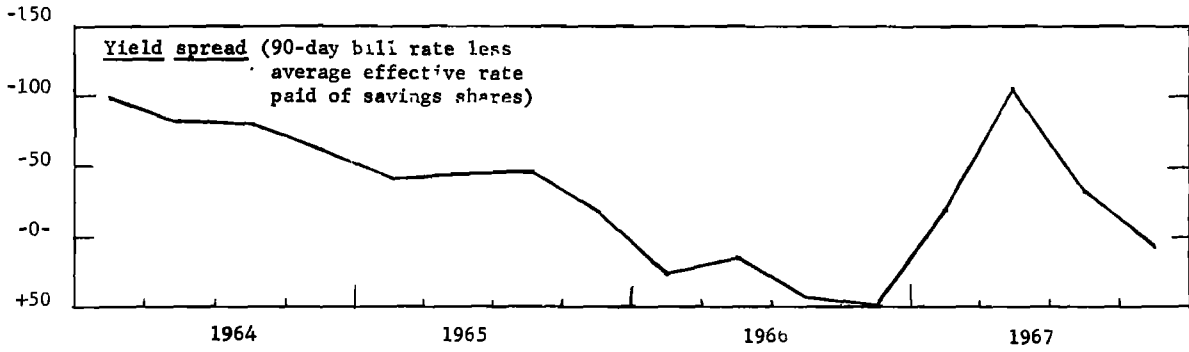


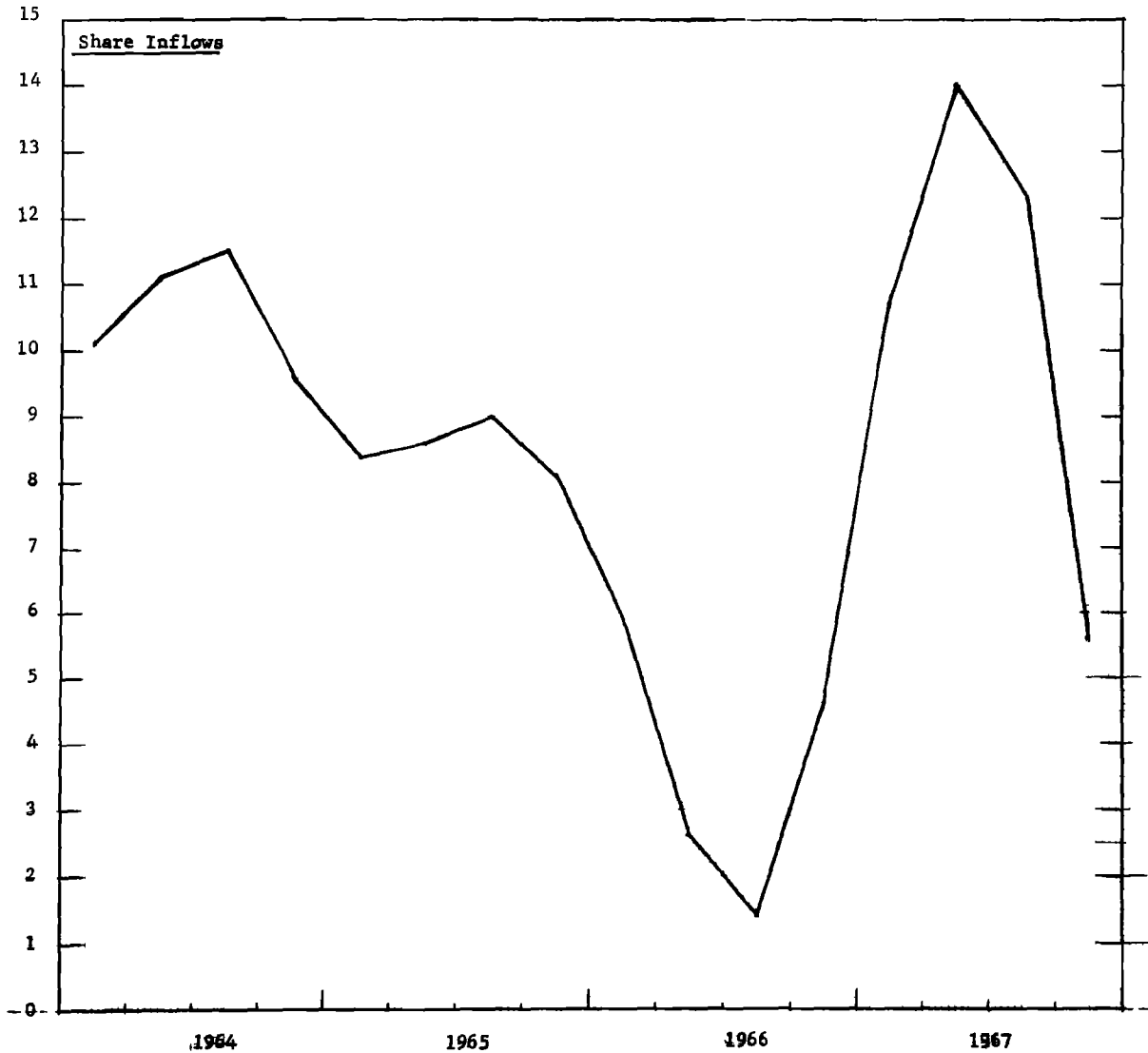
Chart 3

Yield Spreads and Deposit Inflows
Savings and Loan Associations
1964-67
(Inflows at Seasonally Adjusted Annual Rates)

Basis Points

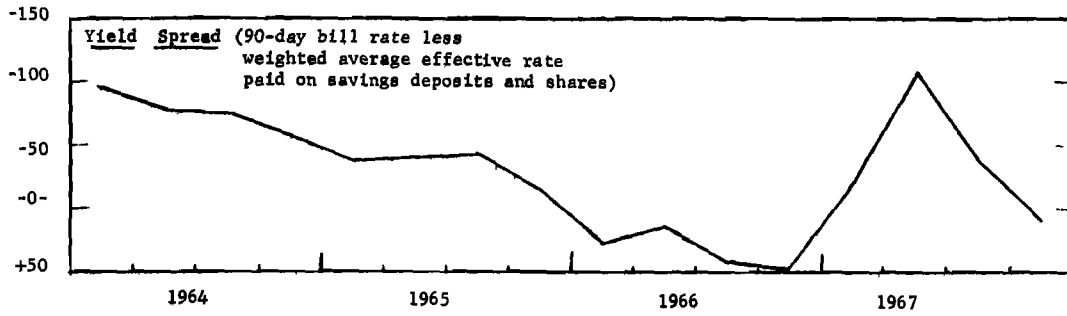


Billions of Dollars

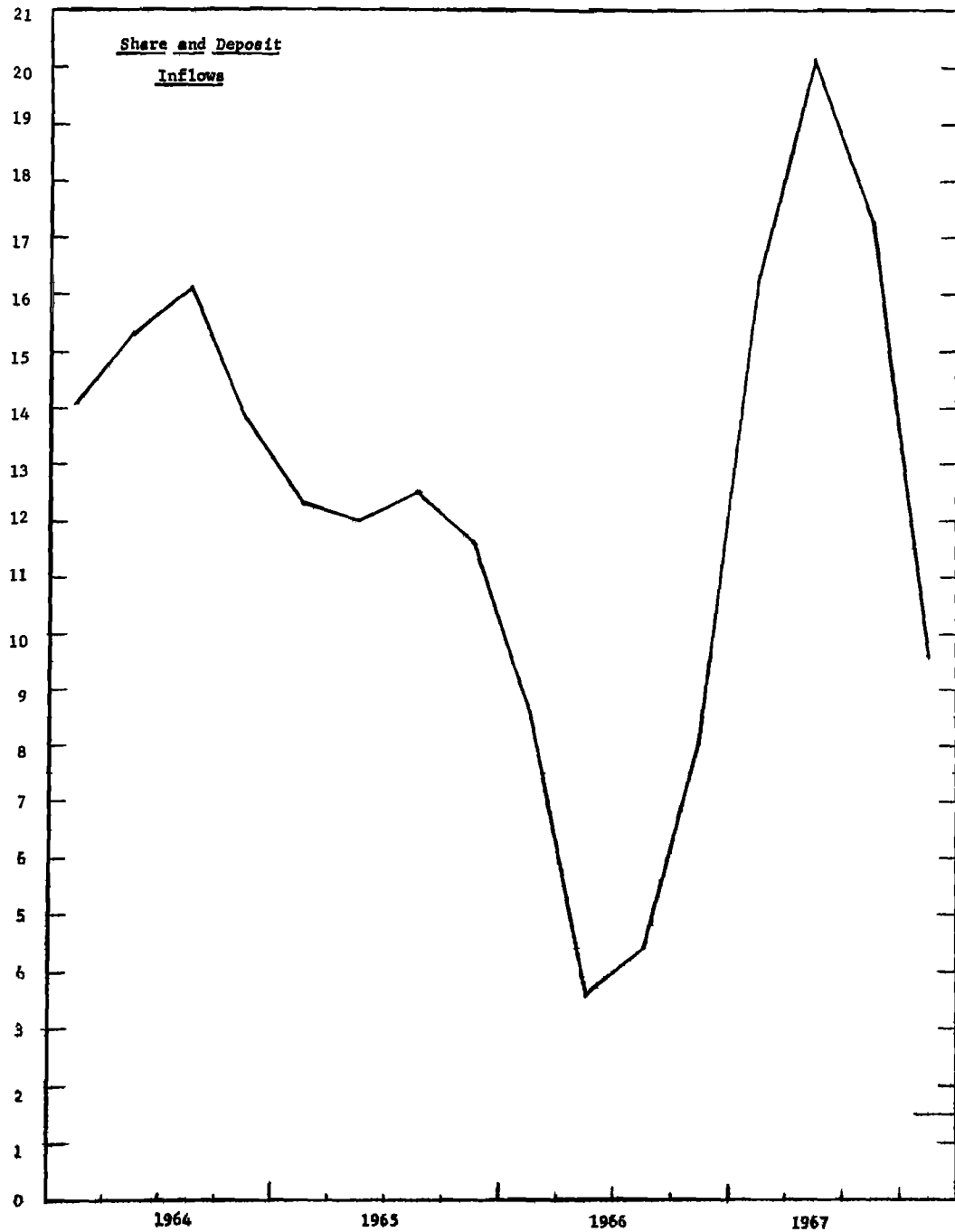


A-7
 Chart 4
 Yield Spreads and Deposit Inflows
 Mutual Savings Banks and Savings and Loan Associations Combined
 1964-67
 (Inflows at Seasonally Adjusted Annual Rates)

Basis Points



Billions of Dollars



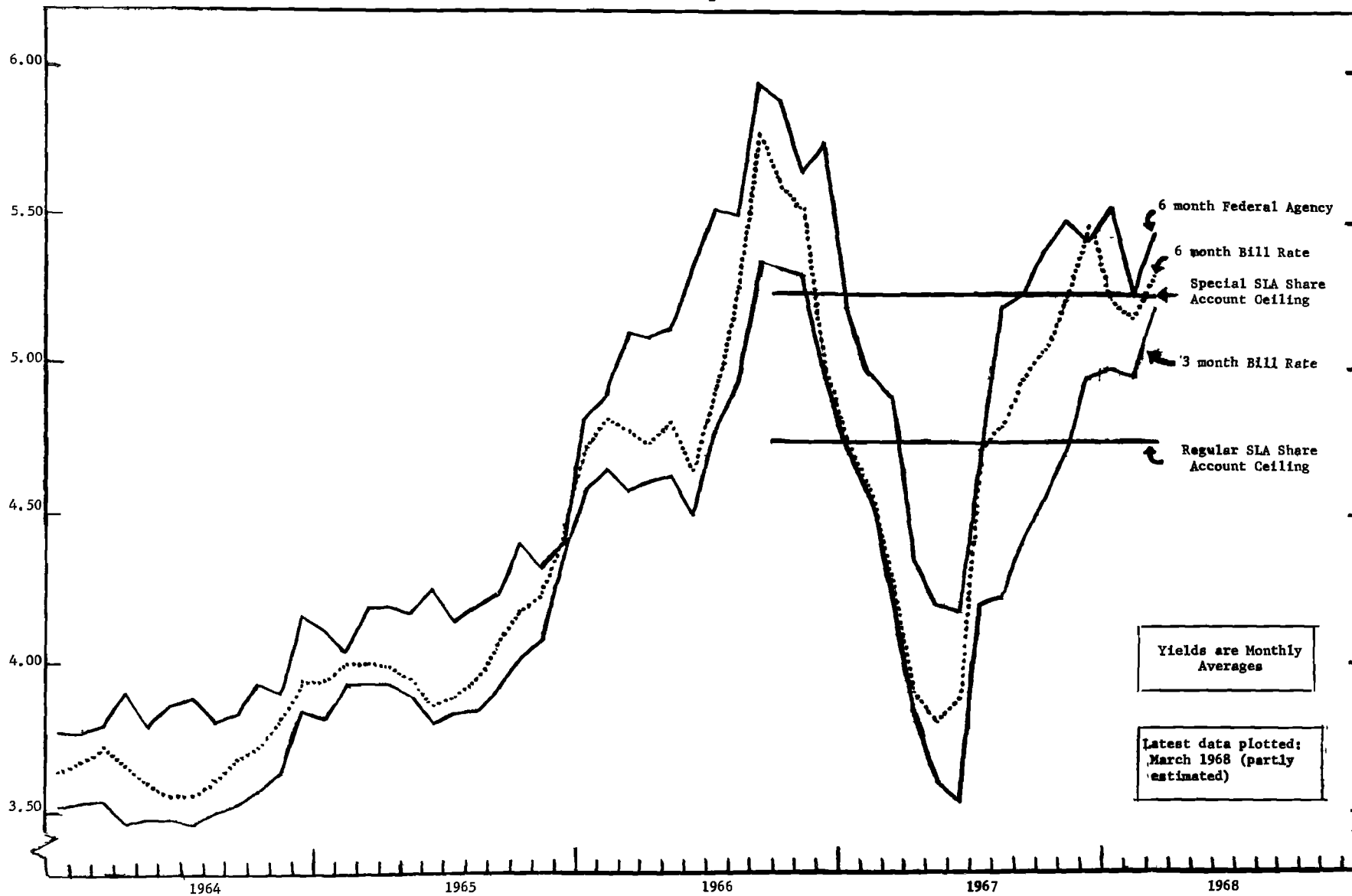
Recent and prospective developments

During the recent December-January reinvestment period, bill yields exceeded the average effective rate on savings and loan shares by 35 basis points and that on savings bank deposits by 20 basis points. Although depositary inflows did moderate, the deceleration was not so great as would have been expected from the 1966 experience alone. At this writing (just prior to the March-April reinvestment period), the 3-month bill rate at about 5.10 per cent is 35 to 45 basis points above the average effective rate paid on nonbank claims--a spread only somewhat lower than at the height of the pressures experienced in 1966. But the change in basic competitive factors, mentioned earlier, the high pace of personal savings, and the reduced volume of new security issues have so far tended to temper the effect of market yields on inflows.

However, the additional accommodation possible before a more pronounced effect from higher market yields is felt is now probably quite small. As seen in chart 5, market yields are now at or above the highest permissible rates that savings and loans may pay and they exceed the maximum rate that mutual savings and commercial banks may pay.^{4/} Moreover, based on the latest data available, a large proportion of intermediary funds are already earning the ceiling rate. To be sure, among associations outside California only an estimated one-third of share capital in regular and non-regular form is at the maximum rate. But, almost three-fourths of deposits at all savings banks and essentially all accounts at California and other Western savings and loans are already receiving the highest permissible rate. Moreover, it is entirely possible that those associations with room to raise their offering rates are in areas where interest rate competition is nominal. If it is assumed that the more sensitive institutions--the ones already at the ceiling--will be most affected by rising market yields, the number of institutions with room to raise rates may not be extremely significant in projecting future intermediary flows.

^{4/} In general, prevailing ceiling rates are as follows: For mutual savings banks, 5 per cent with no arrangement for special rates on differentiated accounts. For most savings and loan associations, 4-3/4 per cent on passbook accounts and 5-1/4 on certificate accounts of 6-month or longer. California and certain other Western associations may generally pay 5 per cent on passbook accounts but if they pay this rate--which most do--they may only offer 5-1/4 per cent on certificates with minimum maturity of 3 years. There are a great number of other small exceptions throughout the rest of the country. Commercial banks may pay 5 per cent for time deposits in denominations of less than \$100,000. This rate may be offered for maturities down to 90 days.

Chart 5
Market Yields
and
Ceiling Rates



Thus, despite the differences from 1966, it is quite likely that if further increases in market yields occur they may generate a significant reduction of inflows to nonbank intermediaries--particularly at the savings banks in New York and the savings and loan associations in California, both groups of which generally have little or no room to raise offering rates. Indeed, current market yields in the short- and intermediate-term spectrum are only marginally below, and long-term yields are already above, 1966 peaks and California associations and New York savings banks can now offer less than they could at that time; moreover, California associations now can only pay their highest rates for 3-year maturities. This does not mean that inflows will decline to the levels of 1966--for the reasons mentioned earlier--but nonetheless inflows probably will decline significantly and have already fallen to the pace of late 1965 and early 1966. Even with the decline in money market yields in late March^{5/} it is quite likely that nonbank institutions in the coming March-April reinvestment period will experience outflows of a size second only to 1966. In California, outflows may even be larger than in 1966 because of a large increase--of at least 100 per cent--in State income tax payments due April 15.

Rate ceiling on thrift institutions

Can thrift institutions afford to pay higher rates--under revised ceilings--if market yields continue to press hard on their inflows? As can be seen in Table 1, the higher level of rates on new mortgages has operated to increase the gross return on total institutional mortgage portfolios in recent years and the staff projects some further accelerations in gross returns for the current calendar year.

Table 1

Estimated Gross Returns on Mortgage Portfolios (Per cent)

	Savings and Loans	Mutual Savings Banks	Commercial Banks
1965	5.90	5.53	5.65
1966	5.97	5.60	5.80
1967	6.06	5.68	5.94
1968 (projected)	6.17	5.79	6.09

Note: FR estimates based so far as possible on FHLBB data on contract rates reported for conventional first mortgages made on new and existing homes by each of the institutional groups shown separately. Estimates now understate actual levels in all cases particularly because they do not reflect differences in the composition of mortgage portfolios between home and income properties or in fees and charges. The relative differences indicated for the individual groups largely reflect substantial variations in their mortgage-portfolio turnover rates. Such rates are highest for commercial banks, mainly because of the heavy incidence of relatively short-term construction loans, and lowest for mutuals.

^{5/} The decline in the bill rate has been largely technical and at the current time may not be indicative of market yields in general.

But as shown in Table 2, the rate of return to intermediaries on all assets--after all expenses including dividends and interest credited--has declined consistently since 1964, as the cost of obtaining and holding all deposits has risen still faster.

Table 2
Nonbank Depository Institutions Earnings Ratios
(After Dividends, Interest, and Taxes)
(Per cent)

	Insured Savings & Loan Associations ^{1/}		Mutual Savings Banks ^{2/}	
	All U.S. excluding California	California	All excluding N.Y. State	New York State
<u>Year Ending:</u>				
12/64	.64	1.08	.27	.50
12/65	.63	.76	.33	.49
12/66	.51	.37	.51	.15
12/67	.42 ^{3/}	.17 ^{3/}	.29 ^{e/}	.10 ^{e/}

^{e/} Estimated.

^{1/} Allocations to reserves and surplus as a percentage of average assets.

^{2/} Retained earnings as a percentage of average assets.

^{3/} Annualized ratios for 6-months ended 6/30/67.

SOURCES: Federal Home Loan Bank Board, National Association of Mutual Savings Banks and Savings Banks Association of New York State.

For the most recent period the "net profit" rate of thrift institutions has declined to post-war lows. Moreover, FHLB System member associations must allocate a certain percentage of net income to reserves. Generally, 10 per cent of net income must be so allocated, although the Board has temporarily reduced the percentage requirement for slow growing associations to 5 per cent. As indicated by Table 3, however, in the second half of 1967 almost 3 per cent of all insured associations paid dividends in excess of their income, and an additional 6 per cent or so could not meet even the 5 per cent requirement. Altogether, about one-third of the institutions were at or below a level of net income which would permit

meeting the 10 per cent requirement from current operations. Those institutions not able to meet even the reduced requirement out of income were forced to transfer funds from surplus accounts to reserves-- a source that for many of them is quite limited.

Table 3

Percentage Distribution of Insured Savings and Loan Associations

Ratio of Net Income Available for Reserves to Net Income ^{1/}	Per cent of insured associations		
	2nd half of 1966	1st half of 1967	2nd half of 1967
Dividends Exceed Net Income	4.4	4.5	2.7
0-5.00 per cent	7.5	9.2	6.1
5.01-10.00 per cent	24.8	32.3	25.0
Over 10.00 per cent	63.3	53.9	66.1
All Associations	100.0	100.0	100.0

^{1/} Net Income available for reserves is net income after dividends.
Net Income is after all expenses except dividends.

SOURCE: Federal Home Loan Bank Board.

Thus, even with higher returns on mortgages and other investments, the ability of savings and loans to offer higher rates for funds is limited. According to FHLBB staff estimates, an across the board increase of 25 basis points on all share capital--abstracting from offsetting increases in income or reductions in expenditures--would cost about 5 per cent of net income. Under these circumstances, an additional one-fourth or more of associations would have difficulty meeting even the 5 per cent reserve allocation requirement without dipping into surplus. A 25 basis point increase in the cost of certificate accounts alone would, of course, not have such a sharp impact. Assuming that transfers from regular to certificate accounts--as well as new inflows--raise the share of total capital in the form of certificate accounts to 25 per cent from the 15 per cent in mid-1967, total dividend costs would rise by 9 basis points--equivalent to about 2 per cent of the net income of associations, according to the FHLBB.

Moreover, the FHLBB staff estimates that increases in gross portfolio returns and reductions in expenses might offset a fairly substantial porportion of the increased dividend cost of a 25 basis point increase in certificate rates, but would offset only a small proportion

of the effect of a 25 basis point across the board increase in rates. But, they caution in their conclusion, even the former case would produce a "substantial" increase in the number of associations failing to meet reserve allocations from operations.

Mutual savings banks are generally required by State law to maintain minimum surplus-to-deposit ratios. In the event that these ratios are not met the banks are required to allocate a specified proportion of their income to surplus accounts. Unfortunately, data availability does not permit a quantification of the number of institutions that are currently below minimum ratios or the number of institutions who are unable to meet the minimum allocation to surplus out of current income. In New York State, however, the average surplus-to-deposit ratio is below the specified minimum and there are indications that at least some have been unable to make the minimum appropriations from current income.^{6/} Thus, like the savings and loans, an increase in the cost of deposits--even with higher yields on new portfolio acquisitions--would place at least some savings banks in a profits squeeze.

Yet no change in present ceilings also entails some risk. For if rising market yields substantially reduce nonbank institutions' inflows, not only would mortgage credit be severely reduced but the improved liquidity position of many institutions might also tend to deteriorate rapidly. Borrowing by savings and loans from the FHLB would then rise to cover not only mortgage commitments already made but also withdrawals.

In terms of the dilemma thus raised, an increase in the maximum rate on certificate-type accounts would at least serve two purposes. It would allow the institutions at the margin to reduce the effect of rising market yields on the availability of mortgage funds and on their liquidity. Second, it would help to minimize the over-all interest expense for those intermediaries who found it possible to take advantage of it. This would be particularly useful for the savings banks which are not able currently to realistically differentiate their accounts and to marginal savings and loan institutions that may already be near the brink of insolvency. However, even the resultant small net increase in interest cost would tend to increase the number of institutions unable to meet their reserve allocations from operations.

^{6/} In New York State, the legislature has already passed an amendment to the current regulations reducing the minimum required surplus-to-deposit ratio from 10 to 8 per cent. In 1967, many institutions in New York had ratios below 8 per cent and nearly all were below 10 per cent.

APPENDIX B: TAX STATUS OF INDUSTRIAL AID BONDS*

The tax exempt status of industrial aid bonds is still far from settled, but several recent developments in the continuing controversy deserve attention. On March 6, 1968, the Treasury announced that after March 15, 1968, all State and local governmental authority bonds issued to finance private industrial facilities would be subject to Federal income taxes. In order to beat the deadline, more than \$200 million of such bonds were subsequently rushed to market.

Substantial Congressional pressure resulted in the Treasury temporarily abandoning its initial proposal, however, and it belatedly substituted a set of regulations designed to provide a six-month transitional period. In this latest version, tax exemption would be permitted for industrial aid bonds sold by September 15, 1968, if these bonds met any of four conditions as of March 15, 1968. These conditions are:

- 1) The issue was approved by voters of the governmental unit involved.
- 2) A "significant financial commitment" had been made by the governmental unit.
- 3) A "binding contract" had been made by private parties involved in the issue.
- 4) Federal or state financial assistance for projects "concerned with economic development" had been approved or an application for such assistance was pending.

Hearings concerning these proposals were scheduled for May.

Congressional criticisms was not placated by these proposals and on March 26 the Senate voted to prohibit the Treasury from taking action on this matter without specific Congressional authority. It is possible that the House may soon join the Senate in passing a similar bill. It is rumored that a compromise solution may then be forthcoming which would permit economically depressed areas, as designated by the Commerce Department, to continue offering industrial aid bonds on a tax-exempt basis.

* Prepared by James L. Kichline, Economist, Capital Markets Section.

Given the current status of the issue, a significant volume of near-term sales of industrial bonds are highly unlikely. Underwriters are reluctant to undertake commitments until the matter is clarified. Moreover, even if Congressional action to restrain the Treasury from independently removing tax-exempt privileges on these bonds is approved, the sizeable volume of issues that came to market prior to March 15 largely exhausted offerings that were in an advanced planning stage.

APPENDIX : THE BRITISH BUDGET ^{1/}

The British government took decisive action last week to curb consumer demand by imposing a variety of tax increases and announcing plans to limit rises in wages and other forms of income to 3-1/2 per cent a year. Consumer expenditures have been increasing rapidly since mid-1967 and, since the devaluation, have jeopardized the effort to transfer resources into areas of benefit to the balance of payments.

The restrictive program was disclosed on March 19 by Chancellor of the Exchequer Jenkins in his presentation to Parliament of the Government's budget for the fiscal year beginning April 1.

The projected spending and revenue totals in the budget indicate the extent to which the government has moved in the direction of fiscal restraint. Expenditures in 1968-69 are scheduled to increase about 4 per cent over the estimated total for the current fiscal year, while revenue is slated to rise approximately 6.5 per cent. As a result, the government expects to run a surplus of almost £1.4 billion in the next fiscal year, compared to one of about £300 million this year.

Because the government plans virtually no increase in net outlays for loans -- most of which are made to local authorities and nationalized industries -- its borrowing requirement will be reduced to about £360 million in 1968-69, from about £1.45 billion in 1967-68. The amount the government intends to borrow, incidentally, is only about a third of the £1 billion borrowing maximum to which the Labor Government committed itself in negotiating the \$1.4 billion standby assistance agreement with the IMF in November.

Since the government's spending plans had been made public earlier this year^{2/}, attention last week was focused on the revenue side of the budget. Most of the increase in the government's intake next year will be obtained through higher indirect taxes. Duties on gambling, alcoholic beverages (excluding beer), tobacco and gasoline were raised, as were purchase taxes on a large array of consumer goods, ranging from necessities such as clothing to luxuries such as jewelry. These increases, together with boosts in licensing fees for motor vehicles, are expected to add about £400 million to the government's tax take in fiscal 1968-69.

The only major change in direct taxation announced on March 19 was a progressive levy on investment income in excess of £3,000. Imposed for only one year and expected to yield £70 million in 1968-69, this tax is likely to have minimal effects on consumption. It was probably included for the political purpose of demonstrating the government's willingness to deal harshly also with the rich.

1/ Prepared by Martin J. Kohn, Economist, Europe and British Commonwealth Section, Division of International Finance.

2/ See Greenbook of January 31, 1968, Appendix C.

Standard income tax rates were not altered. However, in order to offset a three shilling increase in family allowances which was announced in the Chancellor's speech on the 19th and which will take effect in October, allowable tax deductions for children will be reduced. Family allowances are already scheduled to rise seven shillings in April, and the increase in October is apparently intended to make the austerity measures announced last week somewhat more palatable to lower income groups.

The government estimates that the new tax measures announced in the budget speech will increase revenue in fiscal 1968-69 by £671 million over what it otherwise would have been. On a full year basis, the estimated increase is £766 million. The discrepancy between the two figures arises from the fact that not all of the tax changes will be imposed immediately and not all will exert their full effect in fiscal 1968-69.

When tax increases previously announced are taken into account -- most notably the rise in the corporation income tax rate from 40 to 42-1/2 per cent -- the net increment to revenue is expected to be £775 million in the forthcoming fiscal year and £923 million on a full year basis -- equal to a little less than 3 per cent of national income.

Cutback in consumption is a prime goal

The overriding objective of the new revenue measures is to restrict the volume of consumption and to free resources for use in expansion of exports and private business investment. The Chancellor on March 19 reiterated the goal of £500 million a year surpluses in the balance of payments, predicting that the basic balance would move into the black in the second half of 1968 and would reach an annual rate of £500 million some time in 1969. He asserted that a prerequisite of this aimed-for improvement was a reduction in real consumption, hammering home the point that the success of the devaluation requires a temporary decline in the standard of living.

According to the latest official government forecast -- which takes into account the effects of the budget and the restrictive measures presented with it -- real consumption in the second half of 1968 will be about 2 per cent lower than it was in the second half of 1967. A slight rise is foreseen in the first half of 1969, but it is expected that consumption will remain lower, by over 1.5 per cent, in that period than in the second half of last year.

The government makes no claim for precision in these forecasts, offering them only as mid-points in wide ranges of possibilities. However, it is indeed likely that the budget, combined with wage restraints, will decrease consumption from current levels. Even without further taxation, prices were expected to rise about 5.5 per cent during 1968. Since the indirect taxes imposed last week will undoubtedly be passed on in the form of higher prices, the rate of increase will now be greater. Assuming that wage rises will be successfully limited to 3-1/2 per cent, it is unlikely that annual earnings -- after allowing for more overtime and the emergence

of wage drift as economic recovery progresses -- will rise by more than 5.5 per cent. Since other forms of personal income are unlikely to increase more rapidly, real disposable income should fall. With no change -- or a rise -- in the proportion of income saved, real consumption would also fall.

A decline in the savings ratio seems unlikely at this juncture. A decrease has taken place since the middle of 1967. However, that decrease was associated first with the easing of installment buying regulations in June and August and, after the devaluation, with efforts to beat higher prices and new restrictions on consumer buying. Now that consumers have an increased backlog of installment debt to pay off and now that they know the government's stabilization program, the odds favor a rise in the savings ratio.

Overall growth goal is now only 3 per cent

On the strength of the budget and a more rigorous incomes policy, and in view of the general prospects for world trade, the government expects national income in real terms to grow at an annual rate of only about 3 per cent from the second half of 1967 to the first half of 1969. Only if exports grow more rapidly than expected -- an obviously desirable development -- is growth in excess of 3 per cent likely.

It had been widely anticipated that, despite admonitions -- particularly from Britain's creditors abroad -- to limit growth to 3 per cent a year, a target of at least 4 per cent would be adopted. Thus, in electing to hold expansion to the 3 per cent rate, the British -- as no doubt was their intention -- have done much to reassure the financial community about their determination to insure the success of the devaluation through the preservation of a large margin of slack in the economy. At the rate of growth now contemplated, the unemployment rate will probably not decline very much from its currently high level of over 2 per cent.

The modest expansion that is scheduled to take place will be export-led, with exports of goods and services slated to be the fastest growing sector in national income. Fixed investment ranks second with regard to projected rates of growth. Current expenditures on goods and services by public authorities will increase, but less rapidly than national income as a whole. Consumption, as was noted, is expected to fall during the rest of this year.

Union opposition to stabilization measures is a threat

The government's moves last week significantly enhanced the prospects that the devaluation will succeed. However, introduction of the severe austerity program entails risks. Perhaps the main domestic threat to the campaign to bring about permanent improvement in Britain's balance of payments is the possibility that labor union defiance of the government's restrictive measures -- principally those on wage increases -- could seriously

disrupt economic activity. Strikes have dealt crippling blows to Britain's trade account in the past and could conceivably do so again.

The government plans to expand its statutory powers so that it may delay wage and price rises it considers unwarranted by twelve rather than seven months. Details have not yet been published. Presumably when the government rejects a settlement for violating the 3-1/2 per cent ceiling it will have the authority to freeze wages at their existing level for as long as a year. However, the government has not indicated that it will request powers to ban work stoppages.

To make its restrictions on wages more acceptable to labor, the government has applied the 3-1/2 per cent ceiling to dividends also. Furthermore, it has stated its intention of blocking price, as well as wage, hikes it deems unjustified. However, it remains to be seen whether such moves will be sufficient to placate the more militant segments of the labor movement. Strong antagonism toward restrictions on wage settlements was evident at the conference of trade union executives last month and had much to do with the government's decision to abandon efforts to keep wage rises within acceptable limits through greater cooperation with labor unions rather than more stringent controls. A particular threat to the government's wage restraint program is posed by the contract negotiations this year involving the claims of about 2.5 million engineering workers, over a million of whom belong to the militant Amalgamated Engineering Union.

At the moment, however, the government appears confident that its program will succeed. This was implicit, for example, in the Bank of England's reduction of its discount rate on March 21 from 8 to 7-1/2 per cent. Bank Rate had been raised from 6-1/2 to 8 per cent when the pound was devalued in November.