Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

---

[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optical character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Content last modified 6/05/2009.

CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

September 9, 1968

The Domestic Economy

Labor market. Nonfarm payroll employment rose by 200,000 in August. The pickup was concentrated entirely in the nonindustrial sector, where there were increases of about 50,000 each in trade, State and local government, and services. Manufacturing showed no increase for the second month in a row and construction showed no change, remaining about 200,000 below the February figure.

NONFARM PAYROLL EMPLOYMENT
(In thousands, seasonally adjusted)

	August level	July to August change
Total	68,409	208
Manufacturing	19,775	-7
Durable goods	11,610	-14
Nondurable goods	8,165	7
Mining	635	-2
Construction	3,186	4
Transportation and public utilities	4,366	27
Wholesale & retail trade	14,171	52
Finance, insurance, and real estate	3,381	29
Services	10,541	54
Government	12,354	51

Among manufacturing industries, as expected, there were sizable declines in transportation equipment--where a later than usual auto model introduction had inflated the July estimate--and in the primary metals group. Employment also dropped somewhat in the food industry reflecting strike activity in some processing plants. Otherwise, there were widespread modest employment gains.

Weekly hours in manufacturing edged down o.1 hour over the month. There were work week reductions in both the transportation equipment and primary metals industries, however, both were smaller than expected and are likely to be revised downward. Hourly earnings averaged $2.99 in manufacturing, an increase of 6.0 per cent from a year earlier.

Housing vacancy rates (confidential until release) changed little in the second quarter of the year from the abnormally low rates reached in the first quarter. Rental vacancy rates, at 5.7 per cent of all rental units available and fit for use, were the lowest for any second quarter since 1957. Home-owner vacancy rates, which are much less sensitive than those for rental units, continued at only 1.0 per cent in the second quarter of the year. This compares with a second quarter high of 1.4 per cent in 1966 and some other earlier years and with 0.9 per cent in the second quarter of 1957.

RENTAL VACANCY RATES
(Per cent)

	Average for second quarter of:					
	1957	1964	1965	1966	1967	1968
All regions	4.9	7.4	7.5	6.8	6.3	5.7
Northeast	3.0	4.4	4.8	4.6	4.2	3.5
North Central	4.4	6.9	6.6	5.9	5.4	4.8
South	5.8	8.5	7.7	7.5	7.5	7.2
West	7.5	10.7	12.0	9.9	8.6	7.6

The Domestic Financial Situation

Bond yields. During the first week in September, the expectations of corporate security investors apparently shifted rather significantly. In the corporate bond market, yields on new issues, which had been relatively stable since early August, advanced sharply. In addition, although inventory positions were relatively moderate, corporate underwriters released from syndicate all previously offered bonds which had yet to be placed. The yields on these issues--originally offered only one to two weeks earlier--advanced from 8 to 15 basis points in free market trading.

BOND YIELDS
(Weekly averages, per cent per annum)

	Corporate Aaa		State and local Government	
	New	Seasoned		
	With call protection		S&L High Grade	Bond Buyer's (mixed qualities)
1968				
Low	6.12 (2/2)	5.97 (8/30)	4.15 (8/9)	4.07 (8/9)
High	6.83 (5/24)	6.29 (6/7)	4.68 (5/24)	4.71 (5/24)
Week ending:				
Aug. 2	6.36	6.15	4.18	4.11
9	--	6.07	4.15	4.07
16	6.13	6.00	4.29	4.22
23	6.13	5.98	4.34	4.27
30	6.13	5.97	4.45	4.38
Sept. 6	6.23*	5.95	4.48	4.44

* Does not reflect issues released from syndicate during the week.

Stock market. Meanwhile, in the stock market, prices and the pace of trading advanced sharply. By the close Friday, all price indices had nearly regained their mid-July all-time peaks.

KEY INTEREST RATES

	1967 High	1968 High	1968 Aug. 12	1968 Sept. 6
Short-Term Rates				
Federal funds (weekly average)	5.25 (1/11)	6.38 (5/15)	6.08 (8/7)	5,94 (9/4)
3-months				
Treasury bills (bid)	5.07 (12/5)	5.92 (5/21)	5.05	5.23
Bankers' acceptances	5.63 (12/29)	6.13 (5/24)	5.62	5.62
Euro-dollars	6.88 (11/28)	7.19 (6/4)	5.94	5.94
Federal agencies	5.30 (12/29)	6.11 (5/17)	5.45	5.45
Finance paper	5.88 (1/6)	6.13 (6/25)	5.75	5.62
CD's (prime NYC)				
Highest quoted new issue	5.50 (12/29)	6.00 (7/18)	5.75	5.75
Secondary market	5.70 (12/29)	6.20 (5/31)	5.88	5.85
6-months				
Treasury bills (bid)	5.60 (12/1)	6.08 (5/21)	5.25	5.24
Bankers' acceptances	5.88 (12/29)	6.25 (5/24)	5.75	5.75
Commercial paper	6.00 (1/16)	6.25 (7/25)	5.88	5.88
Federal agencies	5.55 (12/29)	6.25 (5/24)	5.49	5.56
CD's (prime NYC)				
Highest quoted new issue	5.50 (12/29)	6.25 (7/11)	5.75	5.75
Secondary market	6.00 (12/29)	6.40 (5/31)	6.00	5.90
1-year				
Treasury bills (bid)	5.71 (12/29)	6.03 (5/21)	5.19	5.19
Federal agencies	5.95 (12/29)	6.01 (5/31)	5.55	5.60
Prime municipals	4.00 (12/29)	3.90 (5/31)	3.00	2.90
Intermediate and Long-Term				
Treasury coupon issues				
5-years	5.91 (11/13)	6.21 (5/21)	5.52	5.49
20-years	5.81 (11/20)	5.77 (3/14)	5.22	5.26
Corporate				
Seasoned Aaa	6.25 (12/28)	6.29 (6/6)	6.01	5.95
Baa	6.98 (12/28)	7.10 (6/3)	6.81	6.79
New Issue Aaa				
With call protection	6.55 (12/7)	6.83 (5/24)	--	6.23
Without call protection	6.70 (12/1)	6.99 (6/3)	6.46	6.53
Municipal				
Bond Buyer Index	4.45 (12/7)	4.71 (5/24)	4.07	4.44
Moody's Aaa	4.15 (12/28)	4.42 (5/31)	3.80	4.25
Mortgage--Implicit yield in FNMA weekly auction 1/	-- --	7.72 (6/10)	7.31 (7/12)	7.23 (9/3)

1/ Yield on 6-month forward commitment after allowance for commitment fee and required FNMA stock purchase. Assumes discount on 30-year loan amortized over 15 years.

International Developments

France removes exchange controls. Late on Wednesday, September 4, the French Government unexpectedly announced the abolition of exchange controls imposed on May 31 at the height of the unrest. We have as yet very little official information on this move beyond confirmation of press reports, but it appears that the abolition was across the board and included restoration of gold transactions with foreign countries.

This daring policy step clearly seems to have been intended by the French to speed up the return of confidence in the franc. The exchange controls were far from being really effective; reserve losses continued at a moderate pace through most of August, but there was a marked acceleration during the last week of that month, probably connected with rumors of a mark revaluation. Frenchmen, vacationing abroad during August, were smuggling out large quantities of French banknotes either to supplement the meager official travel allowance of Fr. 1,000 ($200), or to get capital out of France. Consequently, an embarrassing black market in franc notes developed in several centers abroad with francs selling at discounts of up to 20 per cent. This development was caused by the refusal of the Bank of France to purchase French banknotes automatically from foreign banks.

It seems to us that the French authorities felt that they would be losing little of real value in removing exchange controls and that the move should accelerate the return of confidence in the franc. Concurrently with last Wednesday's announcement, the preliminary budget estimates for calendar 1969 were also made public. The estimated budget deficit is Fr. 11.6 billion ($2.3 billion) and the budget offers strong incentives for private investment. The timing of the two announcements indicates that the strongly reflationary budget was designed to support the avowed official confidence that the franc is strong enough to remain at its present parity.

The announcement of exchange controls removal appears to have come as a complete surprise to the markets. On Wednesday, September 4, the franc moved sharply from the floor and at the close settled comfortably above the support level. The Bank of France did not intervene on that day. On Thursday, September 5, the franc remained just above the floor, but the Bank of France reported a loss of $18 million. The French stock market reacted to the official moves by bidding up prices of domestic shares by some 3 to 4 per cent, while quotations for foreign stocks declined sharply, by nearly 10 per cent. Turnover on the Paris gold market on Thursday was $26 million compared with only $7 million on Wednesday. The gold price in Paris declined rapidly and settled down at approximately the London level of $40.27 per ounce.

On Friday, September 6, the French reported reserve losses of $166 million for the day. Most of this loss appears to reflect capital movements into the German mark, but some may have been due to gold purchases abroad and to purchases of French banknotes from foreign banks.

The French reserve losses on Friday, though admittedly large, need not prejudice the success of the French move. Some losses may have been a non-recurring variety (e.g., banknote redemption), while some were clearly connected with speculation on a German revaluation and thus do not reflect speculation against the franc--in fact the forward discount on the franc narrowed sharply on Friday. Finally, an acceleration of adverse capital flows in the now virtually free exchange market must have been expected by the French. It is quite possible that, as a further show of confidence, the French may remove import quotas in the very near future, and may even abandon the controversial export subsidies before September 14, the date on which U.S. countervailing duties go into effect.

However, should the move backfire and reserve losses continue to be large, the result may be a strengthening of the hand of those many Frenchmen, including former Finance Minister Giscard d'Estaing, who argue that the franc should be devalued.

Exchange Market Developments since September 5. On Thursday (September 5) and Friday of last week the speculative flow of funds to the German mark continued at a very heavy rate; the pressure on Friday, however, was somewhat diminished relative to Thursday. Thursday's spot market purchases of $426 million and Friday's purchases of $216 million raised total Bundesbank spot intervention, from August 26 to September 6, to about $1.7 billion. In the last two days of last week the Bundesbank engaged in over $500 million in "swaps" (spot sales of dollars against forward repurchase) with German commercial banks, raising total "swap" business since August 26 to about $1.2 billion. Thus the net increment to Bundesbank reserves (spot purchases less swaps) in the two-week period amounted to about $500 million.

As of Monday, September 9, the speculative atmosphere in marks has (at least for the moment) subsided. The mark rate is now well below the Bundesbank's current intervention point although the Bundesbank will probably continue to reduce its current dollar balances by offering "swaps" to the German banks.

On Thursday and Friday of last week selling pressure against sterling and the French franc (which had been very light earlier in the week) intensified and in those two days the Bank of England sold over $100 million while the Bank of France sold about $185 million. However, as of Monday of this week the spot sterling market has been bolstered significantly by the news coming out of Basle this past weekend that negotiations had been successful in setting up the $2 billion "sterling balances" assistance package for the British. On Monday, spot sterling moved up to about 238.68 after having been quoted at approximately 238.30 on Thursday and Friday of last week. The French franc is now quoted modestly above its lower support limit, presumably reflecting the current cessation of speculative purchases of marks.

The Euro-dollar market has remained remarkably stable throughout this recent period of pronounced instability in exchange markets. Euro-dollars rates advanced modestly toward the end of the last week of August but declined by a roughly equal amount the following week and are little changed as of the first day of the current week. The "swap" activities of the Bundesbank appear to have returned as much, or more, money to the Euro-dollar market as had been withdrawn by parties moving funds to marks. The foreign branches of U.S. banks apparently experienced no large scale net change in the demand for their deposit liabilities. They did reduce their credits to U.S. head offices by about $100 million between August 28 and September 4, but this represents a relatively small decline from the record outstanding level of about $7.1 billion on August 28. The New York banks, in fact, increased their Euro-dollar use by about $50 million during the week ended September 4, while banks outside New York reduced these takings by about $150 million.

Corrections

Page II - 4, lines 6-8 should read: "Housing starts, according to revised Census reports, have been at a somewhat faster rate in the second quarter than the preliminary figures had shown. This plus a sharp . . . ."

Page III - 16, line 9 should read "2 to 4 basis points".

Page IV - 16. Short-term interest rates

	1968 Low
United Kingdom:	
Treasury bill	6.88 (August 23)
Canada:	
91-day Treasury bill	5.31 (August 30)

Page IV - 17. Long-term interest rates

	1968 Low
Euro-bonds:	
Foreign governments	7.38 (February 23)
Canada:	
4-1/2% 1972	6.24 (August 28)
4-1/2% 1983	6.45 (August 28)