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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff  
Board of Governors  
of the Federal Reserve System

September 4, 1969

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**SUMMARY AND OUTLOOK**

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**Outlook for economic activity**

Growth of total GNP in the current quarter is anticipated to about equal the \$16 billion increase of the second quarter, but a marked slowing is still expected in the fourth quarter. There has been increasing evidence recently of the impact of fiscal and monetary restraints in dampening private demands, although substantial price pressures persist and some economic indicators are still relatively strong. Residential construction activity has continued to decline sharply, with housing starts off by almost one fourth from the first quarter. Retail sales through late August have shown little or no growth, with real takings continuing below year-earlier levels; unit sales of domestic cars in July and August were down by about half a million from the second quarter average. Moreover, revised data will show no increase in employment and slower growth of income and industrial production in July than was originally reported.

The third quarter rise in GNP is being sustained by the increase in Federal expenditures associated with the recent pay raise. Growth in private final sales appears to be slowing and is likely to be over \$3 billion less than in the second quarter. In the fourth quarter Federal purchases are expected to resume their downtrend of earlier this year, with sharp cuts in prospect for defense spending. In addition, the recent Commerce-SEC survey indicates that growth in business fixed investment outlays is likely to continue to slow.

Residential construction activity is now expected to drop more than had formerly been projected, given the cumulative impact of credit restraint and high interest rates. Housing starts are now projected to decline to a rate of 1.2 million units in the fourth quarter.

A further cut in GNP growth is anticipated in the first half of 1970. Inventory accumulation in the latter part of 1969 is expected to be partly involuntary, as final demands for goods weaken. This is likely to lead to production cutbacks and to a sharply reduced rate of inventory accumulation. With employment leveling off and expansion in wages and salaries dampened, only modest increases in consumer spending are anticipated, despite the projected reduction of the tax surcharge to 5 per cent on January 1. In these circumstances, real GNP growth would probably halt, or turn slightly negative, and the rise in costs and prices should moderate somewhat.

#### Outlook for resource use and prices

The large downward revision in the initial employment estimates, concentrated in manufacturing, is resulting in a sizable reduction in the preliminary July estimate of industrial production, and thereby in a reduction in the rate of capacity utilization in manufacturing. Our projections for GNP and industrial production suggest that, with capacity continuing to rise about as much as in recent years, the capacity utilization rate by mid-1970 is likely to be well below its recent level.

With the rate of real economic growth expected to slow and possibly turn negative, the advance in employment will also slow, with no increase expected in the first half of next year. The unemployment rate is likely to continue to edge irregularly higher to mid-1970. Currently, however, the labor market remains relatively tight and the August unemployment rate may be little changed from July.

The sharp rise in consumer prices has put a high floor under workers' wage demands, but collective bargaining has involved relatively few workers this year--thus limiting the impact of large settlements on average hourly earnings--and it will continue light until early 1970. Moreover, pressures on wages are likely to ease as demand for labor weakens. We therefore anticipate a further slowing of the increase in average hourly earnings.

Prices have continued to rise rapidly this summer, apart from the recent decline in wholesale farm and food prices. In the face of rising costs, wholesale prices of industrial commodities are unlikely to level off or decline unless demands weaken appreciably further. As to consumer prices, it appears unlikely that foods will continue to push up the over-all index as much as they have so far this year, although prospects for meat supplies are still unclear. Prices of most services will continue to rise rapidly. In summary, we continue to project a moderate slowing in the pace of price increase to mid-1970, with softening demands and easing availability of resources offsetting the influence of further increases in costs.

Prospective demand for funds

With corporate liquidity already at a reduced level and business outlays continuing to exceed internally generated funds by a wide margin, payments on September income taxes and for Alaskan oil leases are likely to extend the rate of business loan growth evident at banks during August. Corporate tax payments in September are expected to be larger than a year ago partly because catch-up payments are now due for the period in which the surtax was allowed to lapse. Beyond September, however, growth in business loans at banks should moderate, even though credit demands may be augmented somewhat by inventory accumulation.

With lendable funds at banks limited, some of the enlarged September business demands will undoubtedly spill-over from banks to the commercial paper market. Banks themselves, in fact, are likely to remain active on the demand side of commercial paper markets through operations of their holding companies.

While corporate financing now estimated for September and October in longer-term capital markets is larger than the seasonally low August volume, total security offerings are expected to remain well below the average monthly volume evident earlier this year, and underwriters report no widespread pick-up of security offerings by industrial firms. Apparently most of the underwriters' large industrial customers have enough financial flexibility--given the expected leveling off capital outlays over the next few quarters--to await the better market conditions still generally anticipated later in the year.

State and local government demands on capital markets, while potentially very large, continue to be heavily rationed by market yields in excess of official interest rate ceilings. Moreover, with the ultimate tax treatment of interest on State and local securities still uncertain, there is little immediate prospect of significant near-term yield declines. Thus, the volume of new municipal bond offerings in September should remain relatively low. While a part of this expected short-fall in bond volume will probably continue to be made up through short-term financing, total borrowing is likely to remain well below State and local government plants. Looking farther ahead, however, if yields should turn down appreciably, municipal bond volume would respond quickly.

The Federal Government is not expected to be a cash borrower again until late October or early November. But refinancing of the large October 1 Treasury debt maturities (\$5.7 billion of which are held by the public) will be exerting a substantial near-term influence on securities markets. The terms of this financing are expected to be announced around mid-September. Total borrowing in the public sector will also be augmented by the Federal Home Loan Bank System and the FNMA which together may be acquiring as much as \$1.3 billion of additional new money in September and October.

Consumer instalment credit rose more moderately in July than in over a year apparently because of reduced auto sales, and with auto sales expected to remain at a lower level, instalment credit growth should continue moderate.

Prospective supplies of funds

Given current monetary policy, deposits at commercial banks and thrift institutions will remain under pressure. Attrition in large negotiable time CD's at banks is likely to remain relatively large, influenced in part by the generally reduced corporate liquidity and the quarterly bulge in corporate tax payments.

While net drains from consumer-type time and savings deposits should be halted in September, the reversal of trend is not likely to proceed far enough to provide any appreciable net deposit growth at banks. Nor is growth of demand deposits likely to add much to their lending power. Since inflows of funds from nondeposit sources have moderated as changes in reserve regulations have gone into effect and are likely to continue less expansive, banks should be forced to continue liquidating securities and retaining other types of loans in order to meet the demands of their preferred business customers.

Savings flows to thrift institutions will come under particular pressure in the late September and early October quarterly reinvestment period. There is some concern that these pressures may be aggravated by high yielding new Treasury and Federal agency issues being offered in September and early October. Through the fall period, therefore, there appears to be little prospect that the thrift institutions will show much, if any, improvement in savings flows from their recent weak experience.

Given this outlook, and with insurance companies also strapped for funds, further curtailment would appear to be in prospect for new residential mortgage lending commitments. This seems probable even with the recently enlarged support given to the market by FNMA, in addition to continued lender efforts to supplement savings flows by drawing down liquidity and borrowing from the Federal Home Loan Banks.

In the weeks ahead, limitation on the availability of funds may lead to some further yield advances in the municipal bond and mortgage markets; expanded FHLB and FNMA borrowing will tend to maintain upward pressures on the Federal agency market; and yields on U.S. Government securities may not yet have adjusted fully to the imminent refinancing. But given the extent to which interest rates have already risen, further increase of rates may be moderate. Indeed, any significant economic news which lends support to expectations of a near-term cooling of the economy might trigger a general rate decline, particularly in long-term markets.

#### International Outlook

The summer months do not seem to be bringing much relief from the unsatisfactory performance of the U.S. balance of payments in the first half. Moreover, the devaluation of the French franc has raised

the possibility of further devaluations against the dollar but has not increased the likelihood of a German revaluation. Nevertheless, the market and the press have not been registering much concern about the dollar, and are apparently favorably impressed by progress toward the introduction of SDR's.

In July, and probably again in August, the liquidity deficit (not seasonally adjusted) was a little over \$1 billion. Allowing for adverse seasonal factors in the third quarter, this may be a little better than the huge second quarter deficit rate. Early estimates of the second quarter accounts suggest that while there have been temporary factors that tend to inflate this deficit measure (especially flows of U.S. funds to the Euro-dollar market) most of the worsening in the accounts through June occurred in the basic current and capital accounts. Early estimates for direct investment transactions in the first half show a sharp rise in capital outflows while income receipts were levelling off.

Merchandise trade showed a bare surplus in July, and the balance for the rest of the year is not expected to be large enough to raise the annual figure above the low rate of 1968. However, modest gains in the trade and service accounts are expected from the extraordinarily weak first half.

Most of the expected positive effects of monetary and fiscal restraint on the current account of the balance of payments still lie ahead. In spite of monetary restraint, the outflow of U.S. private capital (apart from circular flows) was apparently quite substantial in the first half, and is likely to ease off in the rest of the year. Drawdowns of funds from the Euro-dollar market by U.S. banks were still large in July but moderated somewhat in August. The official settlements balance showed only a small surplus in July and probably registered a deficit last month. While taut credit markets underpin the effort to reduce outflows of U.S. private capital through direct controls, there are also significant short-term balance of payments costs involved as interest payments rise and inflows of foreign capital to buy U.S. stocks are discouraged.

## SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per Cent Change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Yrs. Ago*
Civilian labor force (mil.)	Jul'69	80.8	80.4	78.9	2.3	4.2
Unemployment (mil.)	"	2.9	2.8	2.9	-0.5	-3.6
Unemployment (per cent)	"	3.6	3.4	3.7	--	--
Nonfarm employment, payroll (mil.)	"	70.3	70.3	67.9	3.4	6.8
Manufacturing	"	20.2	20.2	19.8	1.9	4.6
Other industrial	"	8.5	8.6	8.2	4.0	5.2
Nonindustrial	"	41.6	41.5	39.9	4.1	8.3
Industrial production (57-59=100)	"	175.2	173.9	166.0	5.5	12.0
Final products	"	173.3	171.7	164.7	5.2	10.5
Materials	"	177.3	176.1	167.4	5.9	13.7
Wholesale prices (57-59=100) <sup>1/</sup>	"	113.3	113.2	109.1	3.8	6.4
Industrial commodities (FR)	"	111.4	111.2	108.0	3.1	5.9
Sensitive materials (FR)	"	111.6	112.3	106.3	5.0	11.6
Farm products, foods & feeds	"	115.5	115.5	109.4	5.6	7.6
Consumer prices (57-59=100) <sup>1/</sup>	"	128.2	127.6	121.5	5.5	10.0
Commodities except food	"	118.1	118.0	113.2	4.3	8.2
Food	"	126.7	125.5	120.0	5.6	9.2
Services	"	144.0	143.3	134.9	6.7	12.8
Hourly earnings, mfg. (\$)	"	3.20	3.17	3.01	6.3	13.1
Weekly earnings, mfg. (\$)	"	130.37	129.00	123.15	5.9	13.8
Personal income (\$ bil.) <sup>2/</sup>	"	752.3	746.1	691.0	8.9	19.3
Corporate profits before tax (\$ bil.) <sup>2/</sup>	QII'69	94.7	95.5	90.7	4.4	19.7
Retail sales, total (\$ bil.)	Jul'69	29.2	29.4	28.7	1.7	10.8
Autos (million units) <sup>2/</sup>	"	8.1	8.9	9.1	-11.1	0.4
GAF (\$ bil.)	"	8.1	8.0	7.8	4.1	18.5
Selected leading indicators:						
Housing starts, pvt. (thous.) <sup>2/</sup>	"	1,336	1,464	1,531	-12.7	-2.4
Factory workweek (hours)	"	40.7	40.7	40.9	-0.5	0.5
New orders, dur. goods (\$ bil.)	"	30.5	29.2	26.9	13.4	22.5
New orders, nonel. mach. (\$ bil.)	"	5.5	5.6	4.9	11.1	24.0
Common stock prices (1941-43=10)	"	94.18	94.81	98.11	-4.0	-0.3
Manufacturers' inventories, book val. (\$ bil.)	"	93.1	92.2	85.8	8.5	14.3
Gross national product (\$ bil.) <sup>2/</sup>	QII'69	924.8	908.7	858.7	7.7	18.0
Real GNP (\$ bil., 1958 prices) <sup>2/</sup>	"	726.7	723.1	705.8	3.0	8.4

\* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.

## SELECTED DOMESTIC FINANCIAL DATA

	Week ended	4-week	Last 6 months	
	August 30, 1969	average	High	Low
<b>Money Market <u>1/</u> (N.S.A.)</b>				
Federal funds rate (per cent) <u>9/</u>	9.50	9.15	10.18	6.71
U.S. Treas. bills, 3-mo., yield (per cent)	7.06	6.97	7.10	5.93
U.S. Treas. bills, 1-yr., yield (per cent)	7.30	7.27	7.33	5.96
Net free reserves <u>2/</u> (\$ millions)	-1,043	-1,045	- 527	-1,242
Member bank borrowings <u>2/</u> (\$ millions)	1,201	1,210	1,634	759
<b>Capital Market (N.S.A.)</b>				
Market yields (per cent)				
5-year U.S. Treas. bonds <u>1/</u>	7.11	7.03	7.11	6.25
20-year U.S. Treas. bonds <u>1/</u>	6.28	6.22	6.41	5.93
Corporate new bond issues, Aaa adj. <u>8/</u>	7.82	7.63	7.82	7.02
Corporate seasoned bonds, Aaa <u>1/</u>	6.98	6.98	7.10	6.75
Municipal seasoned bonds, Aaa <u>1/</u>	5.80	5.74	5.80	4.90
FHA home mortgages, 30-year <u>3/</u>	--	8.36	8.36	7.99
Common stocks, S&P composite series <u>4/</u>				
Prices, closing (1941-43=10)	95.51	94.85	105.94	91.96
Dividend yield (per cent)	3.31	3.34	3.44	3.02

		Latest month	Amount	3-month average	Change from year earlier			
					Latest 3-month month	average		
<b>New Security Issues (N.S.A., \$ millions)</b>								
Corporate public offerings <u>5/</u>	Sept. '69e	1,500	1,487	377	230			
State & local govt. public offerings	Sept. '69e	850	921	-594	-616			
Comm. & fin. co. paper (net change in outstandings) <u>6/</u>	July '69	+2,227	+1,267	+1,279	+521			
		Latest month	Out-standings Latest month	Change Latest month	3-month average	Annual rate of change from		
						Preceding month	3 months ago	12 months ago
<b>Banking (S.A.)</b>								
		(\$ billions)			(per cent)			
Total reserves <u>1/</u>	Aug. '69 p	27.32	- 0.21	- 0.3	- 9.1	-13.0	0.4	
Credit proxy <u>1/ 10/</u>	"	285.6	- 2.4	- 3.2	-10.0	-12.9	- 0.3	
Bank credit, total <u>6/</u>	July '69	395.7	0.5	0.3	1.5	1.0	6.7	
Business loans	"	102.6	--	0.5	--	5.5	13.0	
Other loans	"	166.2	0.8	0.6	5.8	4.4	9.6	
U.S. Govt. sec.	"	56.6	0.6	- 0.3	12.9	- 7.0	-10.3	
Other securities	"	70.3	- 0.9	- 0.4	-15.2	- 6.7	9.5	
Total liquid assets <u>1/ 6/ 11/</u>	July '69	715.6	- 1.3	- 0.2	- 2.2	- 0.4	5.1	
Demand dep. & currency <u>1/</u>	Aug. '69 p	198.8	- 0.4	0.5	- 2.4	2.8	4.0	
Time & sav. dep., comm. banks <u>1/</u>	"	193.4	- 2.4	- 2.2	-14.7	-13.4	- 0.2	
Savings, other thrift instit. <u>5/</u>	July '69	200.3	0.3	0.5	1.8	2.8	5.4	
Other <u>6/ 7/ 11/</u>	"	120.3	0.8	0.4	8.0	4.0	8.9	

N.S.A. - Not seasonally adjusted. S.A. - Seasonally adjusted. e - Estimated.  
1/ Average of daily figures. 2/ Average for statement week ending August 27. 3/ Latest figure is monthly average for July. 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. 9/ Federal funds data are 7-day averages for week ending Sunday; latest figure is for week ending August 31. 10/ Reflects \$400 million reduction in member bank deposits resulting from withdrawal of a large country bank from System membership in January 1969. Percentage annual rates are adjusted to eliminate this break in series. 11/ Reflects \$1.7 billion increase beginning January 1969 in U.S. Government securities maturing within 1 year to conform to the new Budget concept. Percentage annual rates are adjusted where necessary.  
p - Preliminary.

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

	Year	1968				1969			
		II	III	IV	I <sup>1</sup>	II <sup>2</sup>	June <sup>2</sup>	July <sup>2</sup>	
Goods and services, net <sup>1/</sup>	2,516	841	909	301	365	n.a.	n.a.	n.a.	
Trade balance <sup>2/</sup>	626	264	313	-75	-103	-30	-17	55	
Exports <sup>2/</sup>	33,598	8,395	8,879	8,383	7,474	9,590	3,163	3,100	
Imports <sup>2/</sup>	-32,972	-8,131	-8,566	-8,458	-7,577	-9,619	-3,180	-3,045	
Service balance	1,890	577	596	376	468				
Remittances and pensions	-1,159	-274	-325	-285	-283				
Govt. grants & capital, net	-3,955	-1,055	-968	-835	-783				
U.S. private capital	-5,157	-1,537	-1,868	-947	-1,201				
Direct investment	-3,025	-1,009	-1,262	-283	-776				
Foreign securities	-1,266	-164	-337	-455	-325	-412			
Banking claims	269	243	-90	-120	78	-482	*-178	*335	
Other	-1,134	-607	-179	-89	-178				
Foreign capital	9,352	2,705	2,538	2,894	3,351				
Official foreign, nonliquid	2,407	937	433	709	-37				
Official foreign, liquid	-3,100	-2,186	-55	21	-1,138				
Int'l and reg., liq. & nonliq. <sup>3/</sup>	243	-97	78	281	95				
Foreign private non-bank, liq.	374	102	45	223	-23				
Foreign commercial banks, liq.	3,450	2,358	724	-89	3,001				
New direct invest. issues <sup>4/</sup>	2,129	585	586	378	401				
Other	3,849	1,006	727	1,371	1,052				
Errors and omissions	-717	-540	286	-52	-1,398				
Balances, with and without seasonal adjustment (deficit -)									
Official settlements balance, S.A.		1,553	97	368	1,150	1,249			
Seasonal component		-3	-25	-442	560	-35			
Balance, N.S.A. <sup>5/</sup>	1,639	1,550	72	-74	1,710	1,214	2,497	297	
Liquidity balance, S.A.		-51	-162	870	-1,704	-3,792			
Seasonal component		96	-269	-124	388	58			
Balance, N.S.A.	93	45	-431	746	-1,316	-3,734	-1,283	-1,160	
Adjusted over-all balance, S.A. <sup>6/</sup>		-812	-635	480	-1,859	-3,485			
Seasonal component		96	-269	-124	388	58			
Balance, N.S.A.	-1,811	-716	-904	356	-1,471	-3,427	-1,043	-990	
Financed by: Liab. to comm. banks abroad, N.S.A. (decrease -)	3,450	2,266	976	-430	3,181	4,641	3,540	1,287	
Official settlements, N.S.A. <sup>7/</sup>	-1,639	-1,550	-72	74	-1,710	-1,214	-2,497	-297	
Reserve changes, N.S.A. (decrease -)									
Total monetary reserves	880	137	571	1,076	48	299	-13	-121	
Gold stock	-1,173	-22	74	137	-56	317	--	-9	
Convertible currencies	1,183	-267	474	575	73	-246	-119	-189	
IMF gold tranche	870	426	23	364	31	228	106	77	

<sup>1/</sup> Equals "net exports" in the GNP, except for latest revisions.<sup>2/</sup> Balance of payments basis which differs a little from Census basis.<sup>3/</sup> Long-term deposits and Agency securities.<sup>4/</sup> New issues sold abroad by U.S. direct investors.<sup>5/</sup> Differs from liquidity balance by counting as receipts (+) increase 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.<sup>6/</sup> Represents the net result of all international transactions of the U.S. other than changes in reserve assets, in all liabilities to foreign monetary authorities and in liabilities to commercial banks abroad (including U.S. bank branches) reported by banks in the U.S.<sup>7/</sup> Minus sign indicates decrease in net liabilities.

\* Not seasonally adjusted.

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THE ECONOMIC PICTURE IN DETAIL

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Domestic Nonfinancial Scene

Gross national product. Inflationary pressures continue widespread and some economic indicators are still relatively strong. But there has also been additional evidence in recent weeks of a further easing of private demands. Residential construction activity has moved sharply downward--with housing starts dropping faster than expected--and retail sales have continued to show little strength. Earlier indications of some easing of the labor market have become more pronounced, with a sharp downward revision in the July nonfarm employment figures. This revision will weaken the July rise in private wage and salary income and trim away part of the increase in industrial production.

Over-all GNP in the current quarter is now expected to rise by about \$16 billion, slightly more than we had previously projected and about equal to the revised second quarter increase. But this largely reflects the rise in Federal spending associated with the pay raise; growth in private final sales expected to be smaller, by over \$3 billion.

Last quarter turned out to be a bit weaker than had been estimated earlier in the first official report. Revised GNP figures now show a \$16.1 billion increase, about the same as in the two preceding quarters. In real terms, however, growth in total output is now estimated to have edged down for the fourth consecutive quarter to about a 2 per cent annual rate.

An appreciable further decline in the rate of growth of GNP in both current dollars and in real terms is anticipated in the fourth quarter. After year-end, with most sectors either declining or expanding less than earlier, a further loss of momentum in GNP growth is expected. Little or no increase is likely in real output during the first half of 1970.

Although the Federal pay raise in July, along with completion of payments on 1968 income tax liabilities, should increase disposable income sharply this quarter, consumer expenditures now appear unlikely to show any exceptional strength. This would imply a rise in the saving rate from the relatively low second quarter level. Retail sales have been sluggish since last fall and in real terms have apparently been below year-earlier levels for the past three months. Sales of new domestic autos dipped to about an 8 million rate in July and also in the first 20 days of August from 8.5 million in the second quarter; a sales rate of about 8.1 million now seems a reasonable projection for the current quarter as a whole.

Construction has reacted more sharply to tighter money market conditions than we had earlier thought probable. Housing starts in July dropped again--by 9 per cent--for the sixth consecutive month to a seasonally adjusted annual rate of 1.34 million units, and construction outlays are now projected to drop somewhat faster and further than we had estimated. Starts in the third quarter are now projected to dip to a 1.25 million annual rate, and residential construction spending to be off by over \$2 billion. For the fourth quarter, starts may be down to a

1.2 million rate, and outlays off an additional \$2 billion, to a level about 15 per cent below the first quarter.

A slightly more rapid rate of inventory accumulation is expected to add slightly to GNP growth in the current quarter. Book value of manufacturer's inventories rose by almost \$900 million in July, and with retail sales continuing sluggish through both July and August, a somewhat larger accumulation of stocks at retail also probably is taking place.

Looking beyond the present quarter, growth of business fixed capital outlays--a major spur to over-all expansion this year--appears likely to weaken perceptibly. Gains in new orders for machinery and equipment in the second quarter--partly reflecting anticipation of the requested repeal of the investment tax credit--and a pick up in manufacturer's capital appropriations, do suggest a further moderate rise in plant and equipment spending. But the most recent Commerce-SEC survey (taken mainly in August) indicates a leveling off in these expenditures by about year-end. Both the recent Commerce-SEC and McGraw-Hill surveys show a downward revision of anticipated 1969 expenditure levels, and the influence may be drawn that some of the shortfall from earlier spending plans is being pushed forward into 1970. Although the recent McGraw-Hill survey indicates a 5 per cent increase for 1970 as a whole, this implies little if any increase in physical volume. With credit conditions tight and with the expected slowing in over-all growth, it is quite possible that even in current dollars little further increase may occur in the first half of 1970.

Federal government purchases of goods and services have declined steadily in the past few quarters and apart from the pay raise, these expenditures are expected to continue to edge down in the next several quarters. Although new defense orders rebounded in July after two months of decline, this was probably a temporary surge reflecting a bunching of orders. In fact, it seems clear from recent announcements that defense spending is likely to be reduced by more than had generally been assumed earlier. On the other hand, commitments for non-defense programs suggest an offsetting rise in civilian expenditures, rather than the level rate of spending previously projected. However, a recent statement by the Administration suggests the distinct possibility of a cut in Federal construction expenditures as well. As a temporary measure until the expenditures outlook is clearer, we have revised the distribution of Federal spending between defense and non-defense but have kept the over-all projected levels consistent with a \$192.9 billion unified budget level for fiscal 1970.

In summary, a substantially slower growth in final sales is projected for the fourth quarter, as the decline in Federal purchases is resumed along with a further sharp cut in residential construction activity and a tapering-off of the rise of fixed investment spending. However, the dip in final sales may be partly offset for a time by a higher rate of inventory accumulation, to some extent unintended. GNP growth is thus projected to drop to under \$12 billion in the fourth quarter and real growth to about a one per cent annual rate.

But with final sales continuing to show relatively little growth, business inventory policies are likely to come increasingly into question. Thus, we have projected inventory accumulation to dip sharply after year-end. Gains in employment and income would be reduced substantially by this and other retardent factors and only modest increases in consumer spending are expected. In these conditions--with real GNP showing little or no increase--pressure on resources would lessen significantly, and the advance in prices would be expected to moderate. We estimate the GNP deflator to be easing to about a 3 per cent rate of increase by mid-year.

These projections assume that the tax surcharge will be extended at a 5 per cent rate for the first half of 1970 and that the investment tax credit will be eliminated. We are also assuming that a generally restrictive monetary policy will be maintained somewhat longer than formerly expected. Elimination of the surcharge entirely on January 1 would result in an additional rise in disposable income of about \$4.5 billion, which would likely be reflected in a significant extra increase in consumption of perhaps \$3.5 billion. Corporate after-tax earnings would also be somewhat higher, although it is questionable what effect this would have on business spending in the near term.

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.)

	1967	1968	1969 Prof.	1969				1970	
				I	II	Projected		I	II
						III	IV		
Gross National Product	793.5	865.7	931.7	908.7	924.8	940.8	952.5	960.2	967.6
Final sales	786.2	858.4	924.1	902.1	917.9	932.8	943.5	955.2	965.6
Private	606.1	658.1	708.6	692.1	705.0	714.6	723.0	732.4	741.5
Excluding net exports	600.9	655.6	706.7	690.6	703.4	712.2	720.5	728.4	737.0
Personal consumption expenditures	492.3	536.6	577.1	562.0	572.8	582.2	591.6	600.1	608.0
Durable goods	73.0	83.3	89.2	88.4	90.6	89.0	88.8	88.0	87.3
Nondurable goods	215.1	230.6	245.2	238.6	242.1	247.8	252.4	256.7	260.5
Services	204.2	222.8	242.7	235.0	240.1	245.4	250.4	255.4	260.2
Gross private domestic investment	116.0	126.3	137.1	135.2	137.4	138.0	137.9	133.3	131.0
Residential construction	25.0	30.2	31.2	33.3	32.7	30.5	28.4	27.3	28.0
Business fixed investment	83.7	88.8	98.3	95.3	97.8	99.5	100.5	101.0	101.0
Change in business inventories	7.4	7.3	7.6	6.6	6.9	8.0	9.0	5.0	2.0
Nonfarm	6.8	7.4	7.6	6.6	6.7	8.0	9.0	5.0	2.0
Net exports of goods and services	5.2	2.5	2.0	1.5	1.6	2.4	2.5	4.0	4.5
Gov't. purchases of goods & services	180.1	200.3	215.5	210.0	212.9	218.2	220.5	222.8	224.1
Federal	90.7	99.5	101.9	101.6	100.6	102.9	102.4	102.0	100.7
Defense	72.4	78.0	79.2	79.0	78.5	80.1	79.1	78.1	76.7
Other	18.4	21.5	22.7	22.6	22.1	22.8	23.3	23.9	24.0
State & local	89.3	100.7	113.6	108.5	112.3	115.3	118.1	120.8	123.4
Gross national product in constant (1958) dollars	674.6	707.6	728.0	723.1	726.7	729.9	732.1	731.6	731.4
GNP implicit deflator (1958=100)	117.6	122.3	128.0	125.7	127.3	128.9	130.1	131.2	132.3
Personal income	629.4	687.9	746.6	724.4	740.5	755.8	765.6	774.7	784.3
Wages and salaries	423.5	465.0	509.5	493.3	504.3	516.2	524.0	530.1	536.0
Disposable income	546.5	590.0	628.4	610.2	622.0	637.1	644.3	655.8	663.3
Personal saving	40.4	38.4	35.2	32.5	33.3	38.6	36.2	38.9	38.2
Saving rate (per cent)	7.4	6.5	5.6	5.3	5.3	6.1	5.6	5.9	5.8
Corporate profits before tax	80.3	91.1	93.5	95.5	94.7	92.7	91.0	88.0	85.0
Federal government receipts and expenditures (N.I.A. basis)									
Receipts	151.1	176.3	201.1	198.1	201.9	201.3	203.0	197.3	198.0
Expenditures	163.8	181.5	191.7	188.5	189.3	193.9	194.9	196.6	198.0
Surplus or deficit (-)	-12.7	-5.2	9.4	9.6	12.5	7.4	8.1	0.7	0.0
Total labor force (millions)	80.8	82.3	84.2	83.7	83.8	84.4	84.7	85.0	85.2
Armed forces "	3.4	3.5	3.5	3.5	3.5	3.5	3.5	3.5	3.5
Civilian labor force "	77.2	78.7	80.7	80.2	80.3	80.9	81.2	81.5	81.7
Unemployment rate (per cent)	3.8	3.6	3.6	3.3	3.5	3.7	3.9	4.1	4.5
Nonfarm payroll employment (millions)	65.9	67.9	70.1	69.5	70.0	70.4	70.6	70.8	70.7
Manufacturing	19.4	19.8	20.1	20.1	20.1	20.2	20.1	20.0	19.8
Industrial production (1957-59=100)	158.1	165.4	173.5	170.2	172.8	174.8	176.0	175.2	174.5
Capacity utilization, manufacturing (per cent)	85.3	84.5	84.3	84.5	84.6	84.2	83.8	82.4	81.0
Housing starts, private (millions A.R.)	1.29	1.51	1.42	1.72	1.51	1.25	1.20	1.20	1.30
Sales new domestic autos (millions, A.R.)	7.57	8.62	8.25	8.37	8.54	8.10	8.00	8.00	8.00

CHANGES IN GROSS NATIONAL PRODUCT  
AND RELATED ITEMS

	1967	1968	1969 Proj.	1969				1970	
				I	II	III	Projected IV	I	II
-----In Billions of Dollars-----									
Gross National Product	43.6	72.2	66.0	16.2	16.1	16.0	11.7	7.7	7.4
Inventory change	-7.4	-0.1	0.3	-3.9	0.3	1.1	1.0	-4.0	-3.0
Final sales	51.1	72.2	65.7	20.1	15.8	14.9	10.7	11.7	10.4
Private excluding net exports	27.9	54.7	51.1	16.5	12.8	8.8	8.3	7.9	8.6
Net exports	-0.1	-2.7	-0.5	0.3	0.1	0.8	0.1	1.5	0.5
Government	23.3	20.2	15.1	3.3	2.9	5.3	2.3	2.3	1.3
GNP in constant (1958) dollars	16.5	33.0	20.4	4.6	3.6	3.2	2.2	-0.5	-0.2
Final sales	23.5	33.3	20.3	8.2	3.5	2.4	1.0	3.2	2.5
Private	10.0	24.9	18.4	7.8	3.9	2.1	1.6	2.8	3.4
-----In Per Cent Per Year-----									
Gross National Product	5.8	9.1	7.6	7.3	7.1	6.9	5.0	3.2	3.1
Final sales	7.0	9.2	7.7	9.1	7.0	6.5	4.6	5.0	4.4
Private	6.1	8.5	7.7	9.9	7.5	5.4	4.7	5.2	5.0
Personal consumption expenditures	5.6	9.0	7.5	8.2	7.7	6.6	6.5	5.7	5.3
Durable goods	3.1	14.1	7.1	9.7	10.0	-7.1	-0.9	-3.6	-3.2
Nondurable goods	4.0	7.2	6.3	7.3	5.9	9.4	7.4	6.8	5.9
Services	8.3	9.1	8.9	8.5	8.7	8.8	8.1	8.0	7.5
Gross private domestic investment	-4.4	8.9	8.6	3.9	6.5	1.7	-0.3	-13.3	-6.9
Residential construction	0.0	20.8	3.3	17.6	-7.2	-26.9	-27.5	-15.5	10.3
Business fixed investment	2.6	6.1	10.7	16.6	10.5	7.0	4.0	2.0	0.0
Gov't. purchases of goods & services	14.9	11.2	7.5	6.4	5.5	10.0	4.2	4.2	2.3
Federal	16.6	9.7	2.4	-1.2	-3.9	9.1	-1.9	-1.6	-5.1
Defense	19.3	7.7	1.5	-1.5	-2.5	8.2	-5.0	-5.1	-7.2
Other	7.6	16.8	5.6	1.8	-8.9	12.7	8.8	10.3	1.7
State & local	13.0	12.8	12.8	14.1	14.0	10.7	9.7	9.1	8.6
GNP in constant (1958) dollars	2.5	4.9	2.9	2.5	2.0	1.8	1.2	-0.4	-0.1
Final sales	3.6	5.0	2.9	4.6	2.0	1.3	0.6	1.8	1.4
Private	1.9	4.7	3.3	5.6	2.8	1.5	1.1	2.0	2.4
GNP implicit deflator	3.2	4.0	4.7	4.7	5.1	5.1*	3.8	3.5	3.2
Personal income	7.2	9.3	8.5	7.4	8.9	8.3	5.2	4.8	5.0
Wages and salaries	7.4	9.8	9.6	9.3	8.9	9.4	6.0	4.7	4.4
Disposable income	6.8	8.0	6.5	3.9	7.7	9.7	4.5	7.1	4.6
Corporate profits before tax	-4.6	13.4	2.6	4.2	-3.3	-8.4	-7.3	-13.2	-13.6
Federal government receipts and expenditures (N.I.A. basis)									
Receipts	6.0	16.7	14.1	23.1	7.7	-1.2	3.4	-11.2	1.4
Expenditures	14.7	10.8	5.6	2.3	1.7	9.7	2.1	3.5	2.8
Nonfarm payroll employment	3.0	3.0	3.2	4.7	2.9	2.3	1.1	1.1	-0.6
Manufacturing	1.0	2.1	1.5	4.0	0.0	2.0	-2.0	-2.0	-4.0
Industrial production	1.2	4.6	4.9	6.7	6.1	4.6	2.7	-1.8	-1.6
Housing starts, private	10.9	16.7	-6.0	28.2	-48.3	-67.8	-16.0	0.0	33.3
Sales new domestic autos	-9.7	14.0	-4.3	-20.4	8.4	-20.8	-4.9	0.0	0.0

\* Excluding Federal pay increase 4.0 per cent.

Industrial production. An unusually large downward revision in the July manufacturing manhours data, as shown in the table, (confidential until release September 8) indicates a substantial downward revision in the preliminary July production index.

PRODUCTION WORKER MANHOURS  
Per cent change

	June to July Preliminary	June to July Revised	Amount of July Revision
Manufacturing, total	.6	-.2	.9
Durable	.9	-.2	-1.3
Nondurable	.0	-.2	-.2

Revisions in manhours were widespread but were especially large in the durable goods industries, including electrical and nonelectrical machinery, in which manhour data are used extensively in estimation of the current index. Both production worker employment and average weekly hours were revised and, as indicated in the table, a .6 per cent rise in total manufacturing manhours from June to July was revised to a .2 per cent decline.

On the basis of the July manhours revision and the sketchy output data now available for August, it appears that the upward momentum in production shown in the first half of the year has moderated considerably. Unless manufacturing employment was significantly stronger in August than in July, the production index, at best, rose only fractionally in August. Available data on physical volume do not suggest much renewed strength. Auto assemblies, after allowance for the model changeover

period, were maintained at an annual rate of 9.0 million units, but sales of domestic autos in the first 20 days of August continued at an 8.0 million rate. Output of television sets in early August remained at the reduced July level. Production of raw steel declined. Output of crude oil and activity at petroleum refineries continued at about the July rate. Coal production was curtailed somewhat in August because of wildcat strikes.

Retail sales. Retail sales are estimated to have increased about 1 per cent in August, on the basis of weekly data through August 23. But this increase follows a likely downward revision in the advance July estimate, and on balance sales have edged up only slightly over the past few months. In real terms, sales have probably run below year-earlier levels, at least from June through August this year.

Sales apparently increased at both durable and nondurable goods starts in August. In the durable goods category, increased sales in the automotive groups were only partially offset by considerably weaker furniture and appliance sales. Sales were up at most types of nondurable good stores; a decline at department stores was apparently the major exception.

Dealer deliveries of new domestic autos in the first 20 days of August were at a seasonally adjusted annual rate of 8.0 million units, little changed from July but 10 per cent below a year earlier. Sales of new imported cars in July totaled 97,000 units; an increase of 9 per cent over a year earlier. Stocks of new domestic autos, at 1.3 million units, were five per cent larger than a year ago.

Used car sales in July were at a seasonally adjusted annual rate of 9 million units, moderately larger than in July and 4 per cent below a year earlier. Used car stocks were unchanged from a year earlier. Seasonally adjusted auction prices in July continued to show little change.

Consumer credit. Growth in consumer instalment credit slackened markedly in July, after the substantial rise experienced in the spring quarter. Instalment credit outstanding expanded at a seasonally adjusted annual rate of about \$7-1/2 billion in July compared with \$9.6 billion in the second quarter and \$8.3 billion in the first.

Weakness in unit sales of domestic autos was reflected in a sharp reduction in auto credit growth. Other factors dampening expansion of auto credit in July may have been a shift toward smaller and less expensive models (import sales were strong and Maverick sales enabled Ford to expand its market share), and lower selling prices for used cars.

GROWTH IN CONSUMER INSTALMENT CREDIT OUTSTANDING  
(Billions of dollars, seasonally adjusted annual rates)

	Total	Automobile	Other consumer goods	Personal loans	Home repair and modernization
1968 - QI	\$ 7.0	\$2.8	\$1.9	\$2.4	\$ 0
QII	8.4	3.0	2.8	2.4	.1
QIII	10.0	3.9	2.6	3.3	.2
QIV	10.2	3.8	2.7	3.5	.2
1969 - QI	8.3	2.7	2.5	3.0	.2
QII	9.6	3.1	2.9	3.2	.4
July	7.5	1.3	3.2	3.0	0

Cyclical indicators. The Census composite leading indicator decreased slightly in July but remained near its April peak; in addition, revised data virtually eliminated the June increase previously reported. Recent movements of this indicator do not lead to any obvious interpretation. Hesitation at an advanced level is somewhat uncommon in this series, though at the time of the 1957 downturn it had showed little change for a year and a half.

The preliminary coincident and lagging composites also increased. The coincident composite does not yet incorporate the revision in the July employment data, which will lower three of its five components.

COMPOSITE CYCLICAL INDICATORS  
1963 = 100

	12 Leading Indicators	5 Coincident Indicators	6 Lagging Indicators
1969 - April	148.5	167.7	183.5
May	148.1	169.0	185.8
June	148.2	170.8	186.6
July (prel.)	147.6	171.6	186.8

Of the individual leading indicators available for July, decreases occurred in nonagricultural job placements, contracts and orders for plant and equipment, housing permits, and common stock prices. The manufacturing workweek was unchanged, although it declined in durable goods industries. Durable new orders, industrial materials prices, and the ratio of price to unit labor cost were up. It is true that the July

decrease in the leading composite was mainly caused by the drop in housing permits, but it is also true that this drop was almost offset in the composite by the spurt in defense orders, which is not likely to be sustained.

The preliminary indexes of common stock and materials prices rose in August, the latter rather sharply. Of all twelve leading indicators, only the industrial materials price index can be said to look strong in recent months.

Manufacturers' orders and shipments. An increase of over \$1 billion in new orders for defense products was the principal factor raising July orders for durable goods 5 per cent above the reduced June level. Defense orders had been unusually low in May and June owing to major defense contract cancellations, and the July spurt may reflect some bunching of new contract awards in the aerospace and communications equipment industries at the beginning of the new fiscal year. The July level of defense orders is about the same as previous highs reached over the past year and a half in this volatile series.

Iron and steel orders increased \$200 million to the highest level since the stockpiling of a year and a half ago--perhaps partly in anticipation of the price increases expected (and later realized) in August.

Factory orders for consumer household durables also increased in July, by \$100 million. The value of orders for construction materials was off \$100 million, and orders for machinery and equipment declined about \$150 million.

Durable shipments changed little, and the durables order backlog increased, owing to higher unfilled orders at primary and fabricated metals and machinery industries. In spite of the spurt in defense orders, backlogs fell in the aerospace industry, as work stoppages ended and shipments jumped.

Inventories. The book value of manufacturers' inventories rose by nearly \$900 million in July, following little change in June. The increase was all at durable manufacturers, where the accumulation was the largest of any month since August 1966. Durable manufacturers' ratios of inventories to sales and to order backlogs, already high, rose further. Much of the inventory increase was in work in process at business and defense equipment industries; durable manufacturers' materials holdings increased by only \$100 million.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES  
Monthly, seasonally adjusted, millions of dollars

	1969		
	QI average	QII average	July
Manufacturing & trade, total	877	925	n.a.
Manufacturing, total	579	632	891
Durable	518	500	923
Nondurable	61	132	-32
Trade, total	298	293	n.a.
Wholesale	182	148	n.a.
Retail	116	145	n.a.
Durable	27	-59	n.a.
Nondurable	89	204	n.a.

Trade inventories increased by a substantial \$500 million in June, but for the second quarter as a whole accumulation was about the same as in the first quarter. The distributors' inventory-sales ratio rose in June back to the April level; this ratio, at 1.36 months' sales, is fairly high by historical standards, but still below levels recorded early this year and in late 1966.

Plant and equipment. Recent surveys of planned capital spending by business suggest a lower level of expenditures for 1969 than had been indicated by previous surveys this year. Anticipated spending for 1970 was revised up, but in real terms the expected year to year increase is nominal.

The August Commerce-SEC survey of capital spending plans reveals that businessmen plan to invest \$70.9 billion in new plant and equipment in 1969, 10.6 per cent more than in 1968. This is substantially greater than the 4 per cent increase of 1968, but it is a further downward revision from the 14 per cent planned in February and the 12.6 per cent planned in May. A special recheck of their Spring survey by McGraw-Hill shows a similar downward revision for 1969--a reduction from a 13 per cent increase planned in late April to an 11 per cent increase anticipated in August.

PLANNED 1969 PLANT AND EQUIPMENT EXPENDITURES  
RESULTS OF SUCCESSIVE COMMERCE-SEC SURVEYS  
(Billions of dollars)

Survey taken in:	All Business	Manufacturing	Nonmanufacturing
February	73.0	30.7	42.3
May	72.2	30.0	42.2
August	70.9	29.7	41.2

The quarterly pattern of spending for 1969 in the Commerce-SEC survey now shows a downward revision of \$2 billion in the third quarter, but an increase of about that magnitude is planned for the third quarter, followed by a leveling off in the fourth. There has been a fairly consistent pattern thus far in 1969 of actual spending falling short of anticipations; most, but not all, of the shortfall has been shifted into the following quarter's anticipation. Commerce-SEC extended the period covered by the August survey by one quarter, and the results indicate an increase in spending in the first quarter of 1970. However, these results are quite tentative and will not be published.

1969 PLANT AND EQUIPMENT EXPENDITURES ANTICIPATIONS  
 COMMERCE-SEC AUGUST SURVEY  
 (Billions of dollars)

	1968	1969	1969			
	Actual	Estimated	I Actual	II	III Estimated	IV
All business	64.08	70.85	68.90	70.20	72.25	72.10
Manufacturing	26.44	29.68	28.20	29.30	30.45	30.55
Durable	13.51	15.43	15.00	15.35	15.80	15.50
Nondurable	12.93	14.25	13.20	13.95	14.60	15.05
Nonmanufacturing	37.64	41.17	40.70	40.90	41.80	41.55
Mining	1.42	1.56	1.55	1.65	1.60	1.45
Railroad	1.34	1.47	1.35	1.35	1.70	1.50
Nonrail transp.	4.31	4.52	4.80	4.00	4.65	4.85
Public util.	11.54	12.74	13.05	13.20	12.70	12.20
Communications	6.36	7.55	7.25	7.40		
Comm'l & other	12.67	13.33	12.75	13.30	21.20	21.55

Among the industries covered in the Commerce-SEC survey, the largest relative cutbacks in planned increases in 1969 were in nondurable

manufacturing, railroad and nonrailroad transportation, and public utilities. All manufacturing plans are off somewhat more than nonmanufacturing.

The recent McGraw-Hill survey indicates an upward revision in plans for next year. In April all businesses combined planned to spend 1 per cent more in 1970 than in 1969; in the recheck they indicated plans for a 5 per cent increase. Taking into consideration recent and prospective price rises this would suggest little or no increase in physical volume for 1970 as a whole.

The downward revisions in 1969 plans indicated by the two surveys (and also by the informal Federal Reserve survey) reflect a variety of influences including labor and/or capacity shortages which have delayed installations, the proposed repeal of the 7 per cent investment tax credit--especially in the case of transportation companies; inability to obtain financing on satisfactory terms, and in some cases probably a less optimistic view of future prospects. It is possible that some of these factors will still be affecting investment decisions in early 1970, and even the moderate current dollar spending increase indicated by the McGraw-Hill survey may not be realized.

In another study, capital authorizations of the 1,000 largest manufacturing firms surveyed by the NICB rose 12.6 per cent in the second quarter. Some of this increase was attributed by the NICB to the proposed repeal of the investment tax credit, and they indicated that the third and fourth quarter authorizations are likely to be lower. Authorizations are generally expended over a period of six to nine months after

approval. This suggests that spending by these firms, which accounted for about 9 per cent of the Commerce-SEC second quarter total, could remain high through the first quarter of 1970 unless the reasons mentioned above force delays or cancellations of already approved projects. Backlogs of unspent appropriations rose sharply in the second quarter as did actual capital expenditures.

Construction and real estate. The value of new construction put in place during August was little changed from the downward-revised July rate. However, reflecting the continued decline in housing starts, residential outlays fell for the fifth consecutive month in August, and at \$28.5 billion were more than 11 per cent below the high reached in March. Nonresidential outlays showed no change from the advanced July pace. Offsetting a part of the decline in the private sector, public construction rose to a near record level.

NEW CONSTRUCTION PUT IN PLACE  
(Confidential FRB)

	August 1969 (\$ billions) <sup>1/</sup>	Per cent change from	
		July 1969	August 1968
Total	89.8	--	+ 7
Private	60.1	-2	+ 6
Residential	28.5	-3	--
Nonresidential	31.6	--	+11
Public	29.7	+2	+10

<sup>1/</sup> Seasonally adjusted annual rates; preliminary. Data for the most recent month (August) are confidential Census Bureau extrapolations. In no case should public reference be made to them.

Seasonally adjusted private housing starts declined in July for the sixth consecutive month, to an annual rate of 1.34 million units-- the lowest since June 1967. Unlike most earlier months this year, the July decline was most pronounced in the multifamily sector. Regionally, it was sharpest in the Northeast, which is still hampered by relatively low usury ceilings, but all regions showed some drop-off from June.

PRIVATE HOUSING STARTS AND PERMITS

	July 1969 (thousands of units) <u>1/</u>	Per cent change from	
		June 1969	July 1968
Starts	1,336	- 9	-13
1-family	739	- 8	-18
2-or-more-family	597	-10	- 5
Northeast	183	-22	-43
North Central	284	- 1	-24
South	541	-10	-10
West	328	- 4	+36
Permits	1,206	-10	- 6
1-family	559	-11	-16
2-or-more-family	647	- 9	+ 3

1/ Seasonally adjusted annual rates; preliminary.

Seasonally adjusted building permits also fell 10 per cent in July from the upward-revised June rate and, at 1.21 million, were at the lowest rate in over a year. The July declines in starts and permits appear to reflect mainly the increasing stringency of funds available to both builders and home-buyers, but labor disputes in some local areas of the West and Mid-west, as well as further rapid increases in construction and land costs, also probably tended to dampen starts activity. Because

of the limited supply of credit and the reluctance or inability of some buyers to pay the current high mortgage interest rates, field reports indicate that more builders are now starting a dwelling only after it has been sold and permanent financing has been arranged.

The quarterly starts projection has been further reduced, principally on the basis of a less optimistic outlook for savings inflows to thrift institutions over the remainder of the year along with continued high mortgage interest rates. It is now expected that starts will decline to an annual rate of 1.2 million units in the fourth quarter and remain at or near this level through at least the winter months.

While increased financial market pressures are curtailing the outlook for starts activity this year, basic shelter demand remains quite strong. Average vacancy rates in the second quarter changed little from the low first quarter levels for the nation as a whole. In the second quarter, both rental and homeowner vacancy rates were the lowest for any comparable period since 1957, with an uninterrupted decline since 1965.

VACANCY RATES  
(Per cent)

	Average for second quarter of:					
	1957	1965	1966	1967	1968	1969
Rental units	4.9	7.5	6.8	6.3	5.7	5.1
Northeast	3.0	4.8	4.6	4.2	3.5	2.9
North Central	4.4	6.6	5.9	5.4	4.8	4.8
South	5.8	7.7	7.5	7.5	7.2	6.4
West	7.5	12.0	9.9	8.6	7.6	6.4
Homeowner units	0.9	1.4	1.4	1.2	1.0	0.9
Northeast	0.7	0.7	0.8	0.8	0.7	0.6
North Central	0.8	1.0	1.1	0.8	0.8	0.8
South	1.0	1.9	1.8	1.6	1.3	1.1
West	1.3	1.8	2.0	1.8	1.3	1.1

Labor market. The only new labor market information presently available for August is the weekly insured unemployment series. Initial claims for unemployment insurance had risen quite sharply through late July but now appear to have edged back slightly since early August, suggesting a leveling off of the over-all unemployment rate near the July figure. The over-all rate had moved up to 3.6 per cent in July from 3.4 per cent in June.

Indications of some easing in the labor market in July were reinforced by a large downward revision of the July payroll employment estimate. The revised data (confidential until Sept. 8) show a slight decline in nonfarm payroll employment, whereas the preliminary figures had shown an increase of nearly 200,000.

There were small downward revisions in most industry sectors, but the main adjustment was in manufacturing, where an initially reported advance of 94,000 was replaced by a decline of 12,000. Within manufacturing, the downward revisions were widely distributed and the July data now show only marginal employment advances in the capital-goods industries, stability or very slight declines in the consumer-goods and defense industries, and employment reductions in construction-related industries such as stone, clay and glass, and lumber.

Average weekly hours in durable-goods manufacturing were also revised. They now show a decline of one-tenth of an hour in July and are off three-tenths of an hour from this year's high of 41.5 hours in March.

Income and wages. Because of the extra stimulus provided by the Federal pay increase, personal income rose by \$6 billion in July to a seasonally adjusted annual rate of \$752.3 billion. Exclusive of the government sector, however, the rise in wages and salaries slowed markedly further and we anticipate a downward revision in these figures as a result of the reduction in the July nonfarm payroll employment figures.

PERSONAL INCOME  
(Average monthly increase in billions of dollars, seasonally adjusted)

	1968	1969		
	QIV	QI	QII	July
Personal income	5.0	4.9	5.1	6.2
Wage and salary disbursements	3.8	4.0	3.5	5.0
Government	0.5	0.5	0.5	3.0
Private	3.3	3.5	3.0	2.0
Manufacturing	1.1	1.0	1.0	1.1
Nonmanufacturing	2.2	2.5	2.0	0.9
Other sources of income	1.2	0.8	1.7	1.1

Growth of private wage and salary payments has dropped off steadily since early in the year, with all the slowing in the nonmanufacturing industries. The small July advance reflects the impact of employment reductions in construction and services, and unusually slow growth in several other industries.

Increases in average hourly earnings of production and non-supervisory workers on private nonfarm payrolls also have slowed somewhat. Hourly earnings increased at an annual rate of 7.3 per cent in the fourth quarter of 1968, but slowed to a 6.6 per cent rate of increase in the

second quarter, and continued at a slower pace in July. The comparatively light schedule of collective bargaining activity this year accounts for much of the slowing. At the same time, however, settlements concluded thus far in 1969 have featured very large first-year wage increases--averaging nearly 7-1/2 per cent--which are intended to compensate for the effect of rapidly rising prices on workers' purchasing power. In addition, recent settlements have tended to include larger deferred wage increases--automatic raises provided in second and third contract years--than in 1967 and 1968, suggesting continued concern about price prospects.

Wholesale prices. According to preliminary BLS estimates, the wholesale price index edged off 0.1 per cent from mid-July to mid-August--the first decline in a year. Not much comfort can be found here, however, since average prices of industrial commodities rose by 0.3 per cent (the largest monthly increase since March). Prices of farm and food products, which have exerted a major influence on the WPI in recent months, dropped 0.9 per cent.

WHOLESALE PRICES  
(Per cent changes, annual rates)

	1968	1969		
	June- December	December- March	March- June	June- Augustp
All commodities	2.0	6.9	5.4	0.0
Industrial commodities	2.6	6.5	0.7	2.7
Farm products, & processed foods and feeds	0.7	8.5	17.3	-5.2

Price increases for steel mill products, copper, and brass and aluminum products were mainly responsible for the increase in the industrial average, but other important increases were registered for machinery, apparel, rubber, and rubber products. Preliminary data indicate, however, that price increases were not quite as widespread as during the preceding several months. Prices of lumber and wood products continued to fall for the fifth consecutive month, and gasoline prices declined. The sharp drop in farm and food prices was mainly attributable to lower prices for cattle, grains, eggs, meat, and vegetable oils, reflecting improved supplies.

Among the price increases for the metals group, higher prices for flat-rolled steel products were of particular importance. The increases were the broadest since those established a year ago following the wage settlement in the steel industry. Strong domestic and foreign demand and reduced competition from imports were reflected in the August increases, which maintained the upward trend in steel mill prices which began last December. Other influences included the second round of wage increases negotiated a year earlier and a sharp drop in second quarter profits. Steel analysts expected some price increases in August, but the broad range of products covered was generally not anticipated.

Increases for some industrial products have been announced since mid-August, the most important being for automobiles and some non-ferrous metals. The 1970-model automobiles, which will be introduced later this month, are expected to be at least 2 per cent more expensive than last year's models. Prices for copper and zinc have been increased

by some companies as strong domestic demand, high prices on the London Metal Exchange, and strikes in Canada have put pressure on prices. Copper has been increased 4 cents a pound--the fourth price increase this year--to a record 52 cents a pound, and the price of zinc has been raised for the third time this year. Several copper fabricators have increased the price of copper products. Given present market conditions, these increases are likely to become industry-wide.

Prices of farm and food products usually increase somewhat in the August-September period, but with diverse trends among individual components, a leveling in the farm and foods index seems possible.

Consumer prices. The consumer price index advanced at an annual rate of 6.0 per cent in July to a level 5.5 per cent above a year ago. About half the increase was due to higher food prices, mainly for meats. Of the food price increase, about 90 per cent was seasonal. But a rough estimate suggests that the increase for the entire index on a seasonally adjusted basis was only moderately smaller than the 6.0 per cent in the published index. Consumer prices increased in the first 7 months of 1969 at an annual rate greater than 6 per cent, the fastest increase of any 7-month period since 1951.

Commodities other than food rose at a moderate 1.2 per cent annual rate in July as higher prices for a number of items were nearly offset by decreases for used cars, gasoline and apparel. Apparel prices dropped less than seasonally because of fewer than usual summer clearance sales.

Charges for services rose at a 6.0 per cent annual rate, reflecting marked further increases in mortgage interest, property taxes and insurance, and home maintenance and repair services. Medical care services rose 7.2 per cent, continuing their sharp upward trend.

Consumer prices are expected to rise less in August than in July because a smaller increase is anticipated for food. Prices of fruits and vegetables are expected to decline seasonally in August.

CONSUMER PRICE INDEX

	Per cent change at annual rates to July 1969 from:		
	June 1969	April 1969	July 1968
All items	6.0	5.6	5.5
All items less food	3.6	4.0	5.5
Food (unadjusted)	12.0	11.2	5.6
Meat, poultry, fish	21.6	31.2	11.9
Fruits and vegetables	13.2	13.6	.1
Food (adjusted)	2.4	7.2	5.6
Commodities	3.6	5.6	4.8
Apparel (unadjusted)	-2.4	4.0	5.9
Apparel (adjusted)	7.2	6.0	6.1
Services	6.0	5.6	6.7
Insurance and finance <sup>1/</sup>	10.8	7.6	10.6
Housekeeping and home maintenance	7.2	10.0	8.2
Medical care	7.2	6.8	8.6

<sup>1/</sup> Includes mortgage interest, taxes and insurance, auto insurance, other auto expenses.

Agricultural production prospects. Another year of record production of livestock products and crops is predicted on the basis of August 1 indications. Prices of livestock products are expected to continue

above a year earlier although the margin should narrow in the fall when marketings increase seasonally. Production of crops, particularly some of the world-traded crops, may exceed demand and prices stay close to price support loan rates.

Crop output is predicted to be 2 per cent larger than last year with acreage 2 per cent smaller. Hurricane Camille apparently did not affect national output prospects very much. Food grain production is predicted to be 7 per cent lower with record yields partially offsetting a 13 per cent cutback in acreage. The feed grain and soybean crops are likely to be little different from last year and the cotton and tobacco crops will be larger. The deciduous fruit crop is expected to be up 11 per cent.

USDA analysts think that the 1969 feed grain and cotton crops may equal utilization in the 1969/70 marketing year if the small increases in exports now in prospect materialize. Net additions to stocks of soybeans and wheat are likely. Surplus wheat supplies have led to price-cutting among the exporting nation members of the International Grains Arrangement and U.S. export prospects are hard to assess at present. It is still hoped that wheat exports will be somewhat larger than the 542 million bushels exported in 1968/69.

INDEX NUMBERS OF FARM OUTPUT AND RELATED VARIABLES  
(1957-59 = 100)

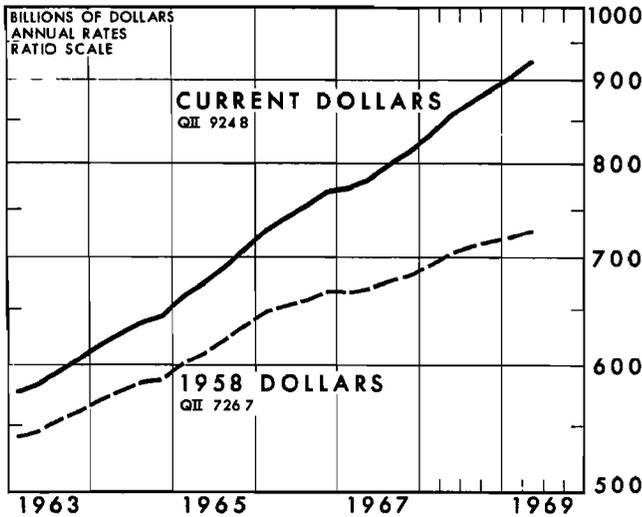
Item	1968	1969 <sup>1/</sup>	Per cent change
Farm output	120	121	.8
All livestock products	118	119	.8
Meat animals	123	124	.8
Dairy products	98	.97	-1.0
Poultry and eggs	135	138	2.2
All crops	119	121	1.7
Feed grains	118	118	0
Food grains	141	131	-7.1
Cotton	88	96	9.1
Tobacco	99	107	8.1
Oil crops	188	189	.5
Acreage for harvest (59 crops)	93	91	-2.2
Yield per acre (28 crops)	128	131	2.3

<sup>1/</sup> Based on August 1 conditions.

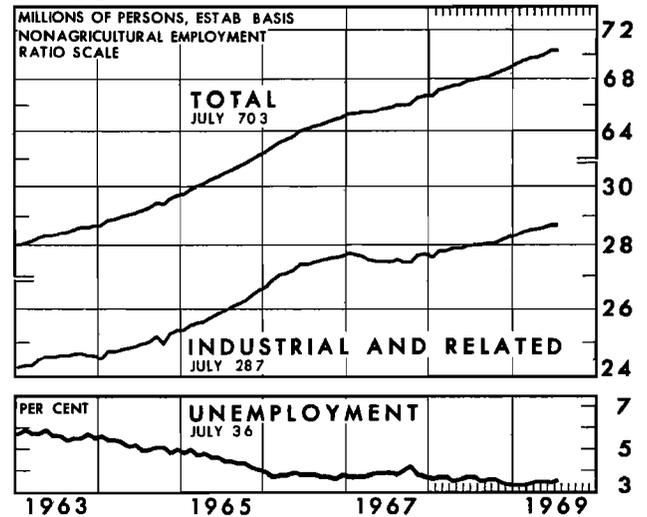
# ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

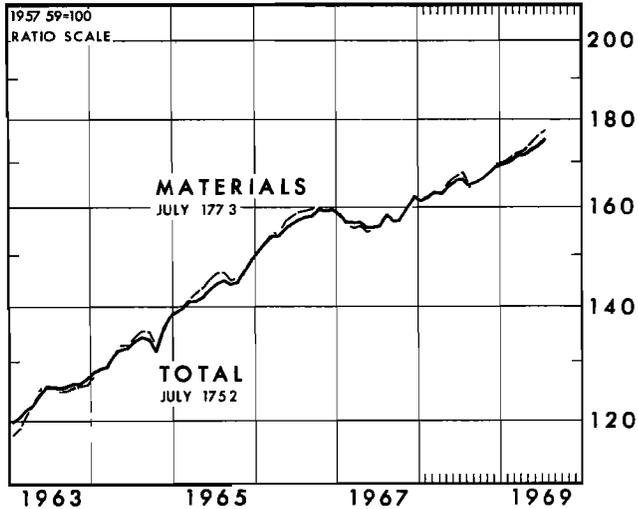
## GROSS NATIONAL PRODUCT



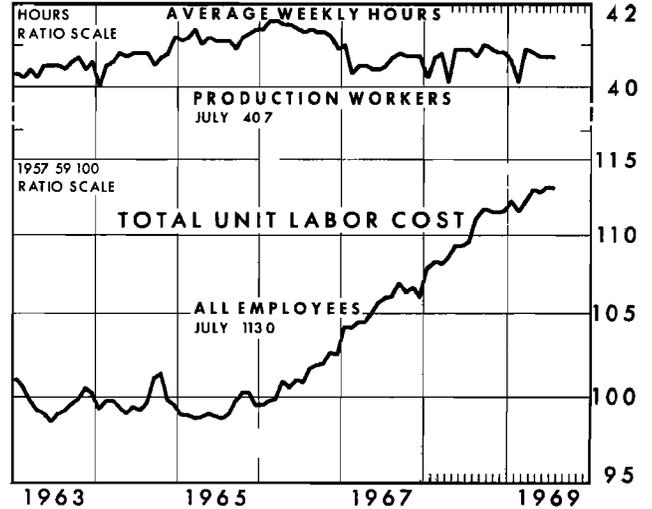
## EMPLOYMENT AND UNEMPLOYMENT



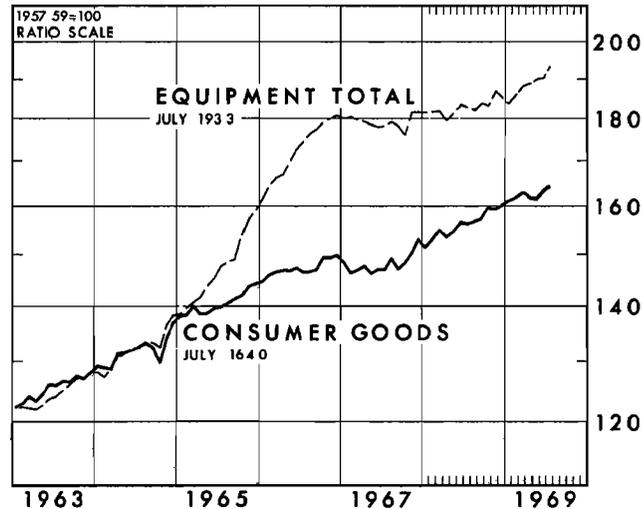
## INDUSTRIAL PRODUCTION-I



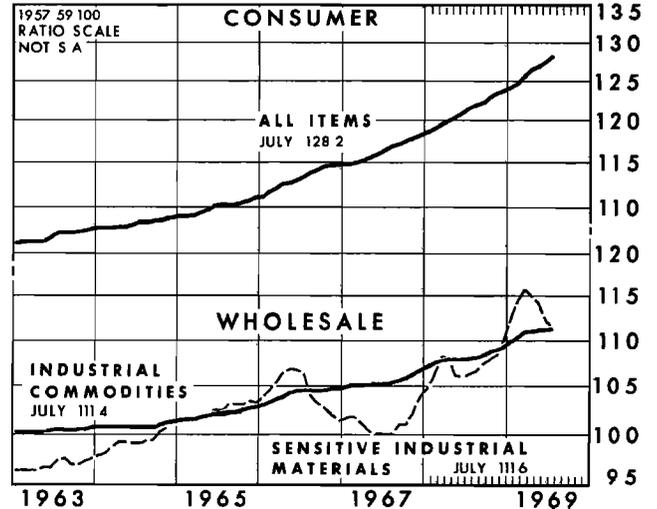
## WORKWEEK AND LABOR COST IN MFG.



## INDUSTRIAL PRODUCTION-II



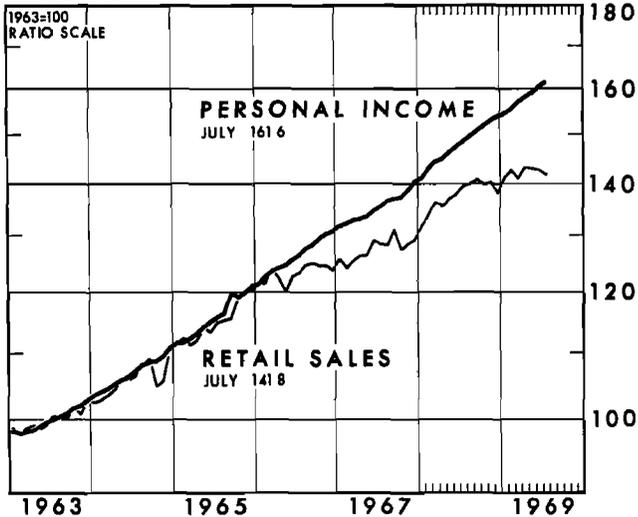
## PRICES



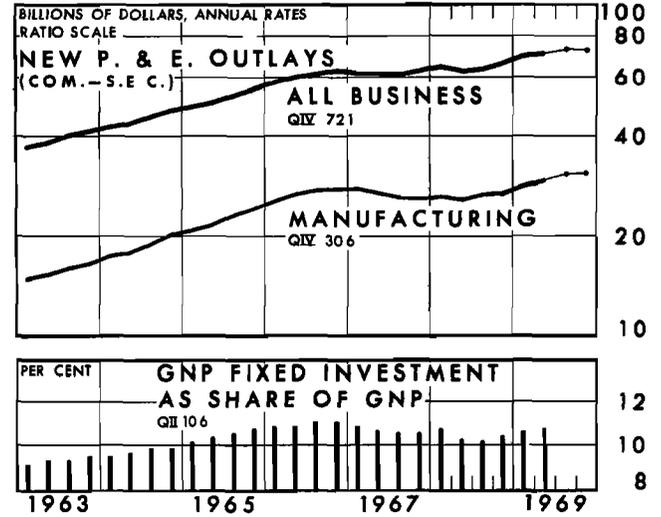
# ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

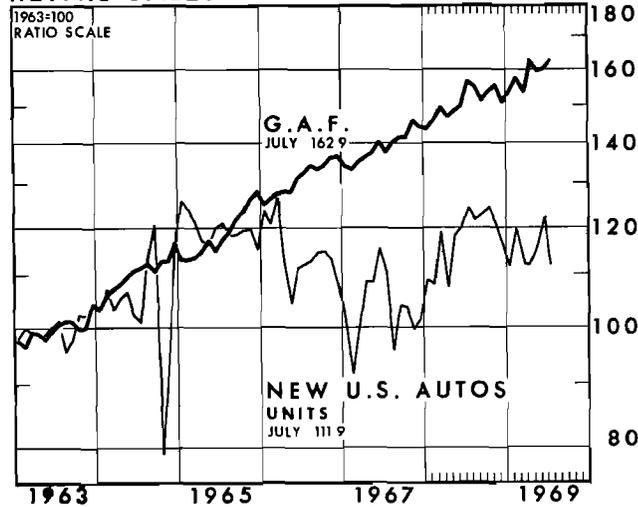
## INCOME AND SALES



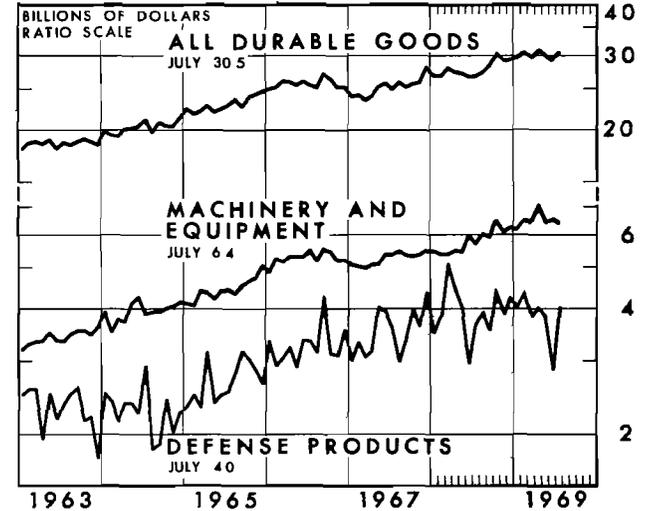
## BUSINESS INVESTMENT



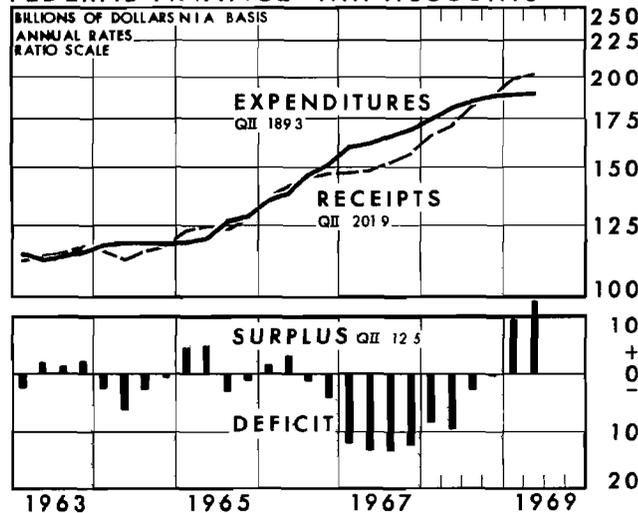
## RETAIL SALES



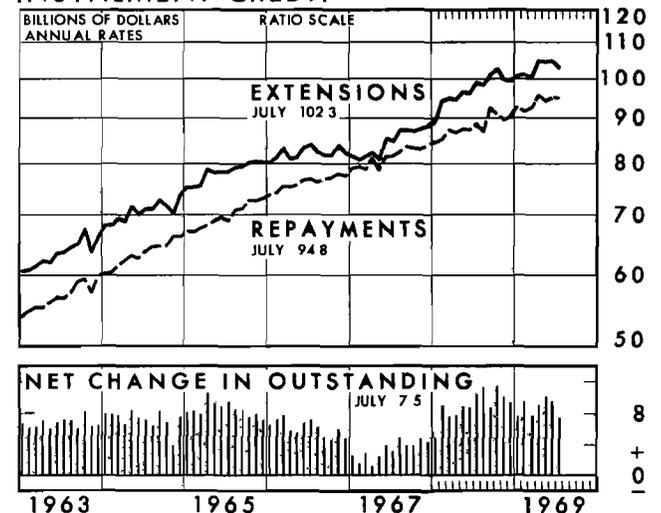
## MANUFACTURERS' NEW ORDERS



## FEDERAL FINANCE—N.I. ACCOUNTS



## INSTALMENT CREDIT



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 THE ECONOMIC PICTURE IN DETAIL
 

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Domestic Financial Situation

Bank credit. Total loans and investments at all commercial banks are estimated to have risen slightly in August--after exclusion of the effects of System matched sale-purchase transactions near the end of July--but bank credit still has declined since the end of May. With lendable funds extremely limited, banks liquidated a large amount of municipals for the second month in a row, although they again added to their holdings of U.S. Government securities as they underwrote another Treasury financing. Business loans increased substantially, but most other types of loans changed very little, on balance, in August.

## NET CHANGE IN BANK CREDIT

All Commercial Banks

(Seasonally adjusted percentage change, at annual rates)

	1968		1969	
	Q IV	1st 5 months	June- August	August
Total loans & investments <sup>1/</sup>	10.7	3.9	- 0.4	- 1.5(2.1) <sup>2/</sup>
U.S. Gov't. securities	-15.6	-21.5	6.4	6.4
Other securities	26.9	--	-10.7	-15.4
Total loans	13.1	11.2	0.9	0.4(5.8) <sup>2/</sup>
Business loans	15.2	16.8	4.3	12.9
All other loans	11.9	7.7	- 1.2	- 7.2(1.5) <sup>2/</sup>
-----				
MEMO:				
Business loans adjusted <sup>3/</sup>	15.2	18.5	9.3	14.9

<sup>1/</sup> Last Wednesday of month series. Data for August are preliminary estimates and are subject to revision.

<sup>2/</sup> Figures in parentheses are adjusted to exclude the effect of \$1.2 billion of System matched sale-purchase transactions near the end of July.

<sup>3/</sup> Includes business loans sold outright by banks to holding companies and affiliates.

Total bank holdings of securities have continued to decline even though banks underwrote two sizable Treasury financings recently--for \$3.5 billion in July and \$2.1 billion in August--both payable in full by credits to tax and loan accounts. The financing-related increases in bank holdings of U.S. Government securities were more than offset by heavy bank liquidation of other securities in both July and August. At large banks the August run-off took place primarily at banks outside of New York City and continued to consist mainly of reductions in holdings of short- and long-term municipals--although a sizable volume of agency issues were also liquidated.

The August rise in business loans primarily reflected less than usual declines in bank loans to machinery, transportation equipment, service, and retail trade industries, the latter probably related to financing of new car inventories by automobile dealers. Inclusive of business loans sold by banks to holding companies and affiliates, the rate of growth in business loans since the end of May still has been only about one-half of that earlier in the year.

Security loans, exclusive of the effects of the matched sale-purchase transactions, remained unchanged in August, while real estate loans continued to expand at the sharply reduced pace of July and consumer loans maintained the moderate rate of expansion of the previous three months. The average monthly increase in total bank loans in the June-August period--including loans sold by banks to holding companies and affiliates--was only about 30 per cent of that earlier in the year.

Bank sources of funds. Total member bank deposits, measured on a daily average basis, fell sharply further in August, reflecting mainly continued large declines in time and savings deposits. A small decline in private demand deposits was nearly offset by a rise in U.S. Government deposits. Nondeposit sources of funds provided little relief to these deposit outflows as the net increase in bank borrowing in the Euro-dollar market through foreign branches was relatively small and banks raised virtually no additional funds from other nondeposit sources.

NET CHANGE IN TIME AND SAVINGS DEPOSITS  
Weekly Reporting Banks  
(Millions of dollars, not seasonally adjusted)

	Dec. 11- July 30 <sup>1/</sup>			July 30 - August 27 <sup>1/</sup>		
	1967	1968	1969	1967	1968	1969
Total time & savings deposits	11,971	3,018	-12,035	1,096	1,848	-1,572
Consumer-type depts.	6,139	3,013	- 330	540	483	- 595
Savings	850	- 302	- 1,819	121	- 5	- 243
Time depts., IPC (other than CD's, IPC)	5,289	3,315	1,489	419	488	- 352
Negotiable CD's	4,711	335	-10,721	624	854	- 863
All other time depts. <sup>2/</sup>	1,121	-330	- 984	- 68	511	- 114
-----						
MEMO:						
Euro-dollar borrowings <sup>3/</sup>	- 979	1,492	6,968	606	878	226

- <sup>1/</sup> Dates are for 1969, comparable dates used for other years.
- <sup>2/</sup> Consists primarily of time deposits held by State and local governments and by foreign institutions.
- <sup>3/</sup> Liabilities of major U.S. banks to their foreign branches, Wednesday figures.

The decline in time and savings deposits at banks in August reflected in large part continued heavy CD attrition, with outstanding CD's falling by an additional \$860 million. As in July, most of the August attrition occurred at banks outside of New York and Chicago, as these outside banks lost a significantly higher proportion of maturing issues than earlier in the year.

Consumer-type time and savings deposits at large banks also declined substantially in August, although by much less than in July-- following midyear interest-crediting. The declines continued to be very large at banks in New York City, and were due principally to further sizable losses of time certificates and open accounts. Other large banks experienced further outflows of consumer-type deposits in August, but at a slower rate than in July. Small inflows of time and savings deposits reappeared at country banks in early August following the huge decline in July.

In spite of these deposit losses, banks made relatively little use of nondeposit sources of funds in August, at least partly in response to changes in regulations concerning these funds that have gone into effect recently or are about to go into effect in the near future. Banks with foreign branches borrowed only an additional \$226 million in the Euro-dollar market during the first three weeks of August, as compared with a net increase of \$1.1 billion in July and \$3.4 billion in June. Moreover, as indicated by the chart on the following page, banks have raised virtually no additional funds, on

balance, from other nondeposit sources since the end of July, as the moderate increase in outstanding commercial paper issued through holding companies or other bank affiliates was nearly offset by reductions in loans sold under repurchase agreement. New issues of the latter became subject to reserve requirements and Regulation Q ceilings on August 28.

As shown in the following table, a relatively few banks hold most of the funds obtained from these nondeposit sources. Banks outside New York and Chicago account for nearly 70 per cent of these funds, in contrast to only 15 per cent of the outstanding borrowings in the Euro-dollar market through foreign branches. Indeed, the heavier reliance of outside banks on these other nondeposit sources of funds may reflect the fact that only a relatively few of them have access to the Euro-dollar market through foreign branches.

CONCENTRATION OF NONDEPOSIT SOURCES OF FUNDS

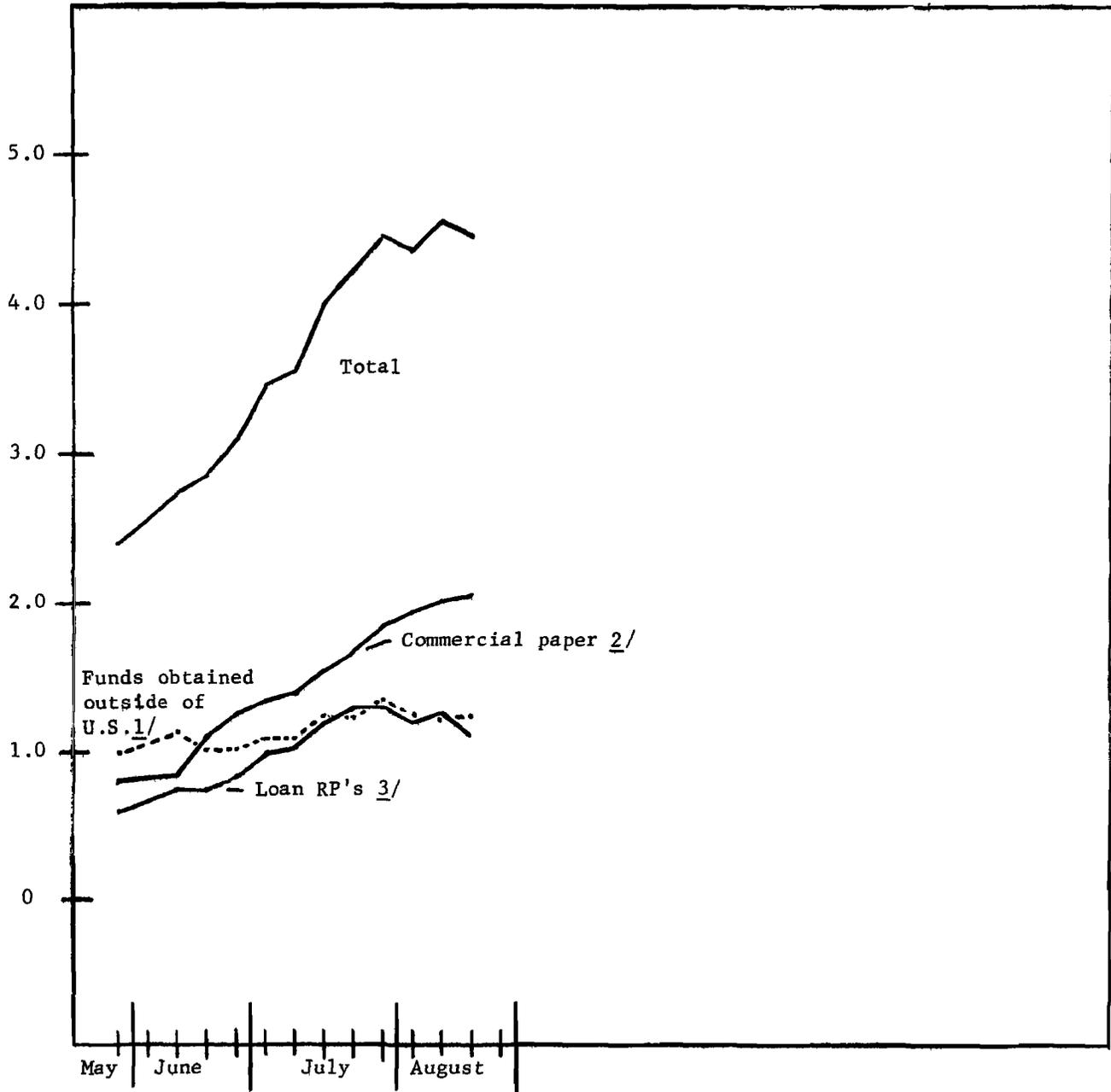
	Outstandings on August 20 (in millions of dollars)	Number of banks that hold the following per cent of these outstandings		
		50%	75%	100%
Commercial paper <sup>1/</sup>	2,078.4	6(3) <sup>2/</sup>	13(3)	39(5)
Loans RP's <sup>1/</sup>	1,123.6	5(1)	12(1)	45(5)
Funds obtained outside of U.S. <sup>1/</sup>	1,270.0	3(1)	8(3)	33(9)
Total	4,472.0	10(4)	23(6)	81(12)

<sup>1/</sup> See definitions in footnotes to chart on preceding page.

<sup>2/</sup> Figures in parentheses indicate the number of these banks that are in New York and Chicago.

SELECTED NONDEPOSIT SOURCES OF FUNDS

(Outstandings in billions of dollars)



1/ Euro-dollars borrowed directly or through brokers or dealers, and liabilities to bank's own branches in U.S. territories and possessions. Does not include liabilities to own foreign branches.

2/ Issued by a bank holding company or other bank affiliate.

3/ Loans or participations in pools of loans sold under repurchase agreement to other than banks and other than banks' own affiliates or subsidiaries.

III - 7

The money stock, measured on a daily average basis, fell at about a 2.5 per cent annual rate in August, following a 6 per cent rate of increase in July and a 3.8 per cent rise over the first half of the year. U.S. Government deposits rose slightly after declining by \$3.5 billion in the previous two months.

Nonbank depository intermediaries. Considerable weakness in net savings flows to the thrift institutions continues to be manifest, at least at institutions in the San Francisco and New York areas which actually lost funds on balance during the first half of August. It is clear that withdrawals continued well after the close of the reinvestment period. Although savings patterns in the two locations cited tend to be too sensitive to provide a basis for generalization of thrift flows in total, the marked year-over-year shortfall suggests that the slowdown evident since the first quarter of this year is at least continuing, if not accelerating.

EARLY-AUGUST SAVINGS FLOWS<sup>1/</sup>  
(Millions of dollars)

	New York City Mutual Savings Banks <sup>2/</sup>	San Francisco District S&Ls <sup>3/</sup>
1966	42	n.a.
1967	47	90
1968	32	62
1969	-7	-9

<sup>1/</sup> Deposits minus withdrawals.

<sup>2/</sup> 15 largest MSBs in New York City, for the first 15 days of August.

<sup>3/</sup> First 10 calendar days of August.

**SAVINGS GROWTH AT NONBANK THRIFT INSTITUTIONS\***  
**Seasonally Adjusted Annual Rate, in Per Cent**

	MSBs	S&Ls	BOTH
1968 - I	7.1	5.6	6.1
II	6.7	5.7	6.0
III	6.5	5.9	6.1
IV	7.1	6.2	6.5
1969 - I	6.2	6.1	6.1
II	4.2	3.5	3.8
1969 - May	6.6	4.5	5.2
June	2.9	4.4	3.9
July	-0.8	0.1	-0.2

\* Because of seasonal adjustment difficulties, monthly patterns may not be significant.

Since March, mortgage activity of the savings and loan associations has been maintained at a very high volume, particularly in the face of extremely modest support from savings flows. Although mortgage return flows remain the largest single source of funds, they have shown essentially no growth; high interest rates have inhibited prepayments and encouraged assumptions of existing mortgages. Rather, the \$1.5 billion drawdown of liquid assets since the spring, combined with a somewhat larger volume of borrowing, has instead provided key support for expanded mortgage activity. Emphasis on borrowings and reductions in liquid assets has apparently continued during August, when savings and loan associations borrowed the \$201 million of 5-year funds raised by the FHLB System under its new policy of providing longer-term advances. Other borrowing by the industry showed the characteristic abatement from the heavy July pace, but the pattern nevertheless

suggests that relatively strong reliance continues to be placed on this source of funds.

INSURED SAVINGS AND LOAN ASSOCIATIONS  
FUND FLOWS, APRIL - JULY  
(Billions of dollars)

	1966	1967	1968	1969
<b>SOURCES</b>				
Liquid assets*	.9	- .2	.7	1.5
Borrowed funds	1.8	- 1.1	.8	1.7
Mortgage return flows	4.9	4.9	4.9	5.1
Savings received	- .7	3.5	1.5	.4
Loans in process and other	- <u>.3</u>	<u>.6</u>	<u>.4</u>	<u>.5</u>
	6.6	7.7	8.3	9.2
Gross mortgages made <sup>1/</sup>	6.6	7.7	8.3	9.2
Memo: Net increase in mortgages	1.7	2.8	3.4	4.1

\* Liquid assets as a positive source indicates reduction in cash and Government holdings.

1/ Include loans in process.

The resulting decline in associations' liquidity ratios has been large, and these ratios are now as low as they have been since 1966. Liquid assets net of borrowed funds, for instance, amounted to less than 3 per cent of share capital in July, down from over 5 per cent as recently as March. FHLBB policy has encouraged the decline in net liquidity this year, both by reducing minimum required liquidity and by maintaining a lenient stance on advances.

FHLBank and FNMA borrowing. The Federal Home Loan Banks and the Federal National Mortgage Association have stepped up their support of the mortgage market substantially this year in an attempt to ease the pressures on housing caused by the reduction in net savings inflows at thrift institutions. As a result of this increased activity, financing needs have risen sharply, and these institutions together have borrowed in excess of \$2.9 billion in net new money so far this year. Their new fund requirements are expected to accelerate further over the next four months, and the Board staff now estimates that net new funds raised by the FHLBanks and FNMA, in the September-December period, may total as much as \$2.7 billion.

FHL BANK - FNMA MARKET BORROWINGS IN 1969

	Total		FHL Banks		FNMA	
	Jan.- Aug.	Sept.- Dec. p/	Jan.- Aug.	Sept.- Dec. p/	Jan.- Aug.	Sept.- Dec. p/
Gross Borrowing	7.0	4.6	5.1	2.3	2.9	2.3
Net New Money	2.9	2.7	1.9	1.0	1.0	1.7*
Refinancing	4.1	1.9	3.2	1.3	.9 <sup>1/</sup>	.6 <sup>1/</sup>

p/ Projected.

\* Includes \$600 million sold 8/27/69 but dated 9/10/69.

<sup>1/</sup> Exclusive of roll-over of short-term discount notes.

With the backlog of outstanding mortgage commitments at savings and loan associations still quite large, the reduced pattern of savings inflows suggests that associations may borrow heavily from

the Federal Home Loan Banks during the remainder of the year. To meet the anticipated demand for advances, the Federal Home Loan Banks are expected to borrow an additional \$1.0 billion in new money in the open market over the next four months. Some of the short-term liquid assets of \$1.0 billion held by FHLBanks at the end of August are also available for lending. Meanwhile, refinancing of maturing issues will total \$1.3 billion over the period.

Since January, FNMA has more than doubled the weekly volume of commitments it will accept, and is currently committing funds, including a limited volume outside the auction system, at the rate of \$10 billion a year. Because FNMA committed a larger volume of funds per week during the March-June period (mostly for takedown in six months) as compared to earlier months, the volume of FNMA commitments scheduled to mature over the next four months will rise sharply. To finance its operation during the final third of the year, FNMA will need to borrow an estimated \$1.7 billion (including \$600 million already raised on August 28) in new funds and refinance \$550 million. Moreover, FNMA must continue to roll-over more than \$900 million each month in short-term discount notes.

Mortgage market. The availability of new commitments for residential mortgages tightened considerably further in August, judging from unofficial field reports and trade sources. Pressure on lender cash flows has increased to the point that some mortgage investors have delayed takedowns of completed mortgages ready for delivery by originators under prior agreements. These delays, in

turn, have intensified already mounting cost pressures on such loan originators as mortgage companies. Ever since the prime rate increase last June in fact, costs of carrying completed mortgages in warehouse pending delivery to final investors have substantially exceeded net yields on warehoused loans--unlike the case in 1966.

In the secondary market for Government-underwritten mortgages, average yields in FNMA's weekly auction--which had declined more than 20 basis points in July--drifted higher through the September 2 auction. Yields edged up even though the weekly volume of commitments accepted by FNMA increased during this period. At the same time, demands for commitments slackened as discounts on FHA and VA mortgages rose further. The enlarged volume of FNMA's auction brought its backlog of commitments to a record \$3-1/2 billion by the end of August.

FNMA WEEKLY AUCTION

	<u>Amount of total offers</u>		<u>Implicit private market yield</u>
	<u>Received</u>	<u>Accepted</u>	<u>6-month commitments</u>
	(Millions of dollars)		
Highs			
1968	\$232(6/3)	\$ 89(7/1)	7.71(6/10)
1969	410(6/16)	151(8/25)	8.47(7/7)
Aug. 4	282	125	8.28
11	272	129	8.29
18	270	129	8.31
25	251	151	8.32
Sept. 2	253	151	8.34

NOTE: Average secondary market yield after allowance for commitment fee and required purchase and holding of FNMA stock, assuming prepayment period of 15 years for 30-year Government-underwritten mortgages. Yields shown are gross, before deduction of 50 basis point fee paid by investors to servicers. The first auction date was May 6, 1968.

Over the month of July, average contract interest rates on new-home mortgages rose further in the primary market to exceed the usury ceilings of 8 per cent or below prevailing in more than 20 States. In the secondary home-mortgage market, yields and discounts edged higher. As in other recent months, however, investment in home mortgages continued unattractive relative to returns on new issues of high grade corporate bonds.

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)	Discounts (points)
<u>1968</u>					
Low	6.75(Jan.,Feb.)	23(Mar.)	6.78(Feb.)	26(Mar.)	4.4(Sept.)
High	7.40(Dec.)	115(Aug.)	7.52(June)	120(Aug.)	7.9(April)
<u>1969</u>					
January	7.55	63	7.85e	93e	2.8e
February	7.60	69	7.99	108	3.9
March	7.65	28	8.05	68	4.4
April	7.75	58	8.06	89	4.5
May	7.75	53	8.06	84	4.5
June	8.00	42	8.35	77	6.7
July	8.10	47	8.36	73	6.8

NOTE: FHA series: Interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points. Data for FHA loans in January 1969 estimated by Federal Reserve for 7-1/2 per cent regulatory interest rate, on which a change of 1.0 points in discount is associated with a change of 12 to 14 basis points in yield. Gross yield spread is average mortgage return, before deducting servicing fees, minus average yield on new issues of high grade corporate bonds with 5-year call protection.

e/ Estimated.

In addition to curtailed loan availability, sharply higher costs of mortgage credit--especially since last June--have increasingly discouraged market transactions, and have forced recourse to other credit arrangements such as loan assumptions and instalment sales contracts. Even as early as the first quarter of 1969, a considerably larger-than-usual share of all new mortgage commitments written by reporting life insurance companies called for partial amortization and balloon payments, in order to ease the burden of high credit costs on income-property borrowers of all types.

During July, outstanding mortgage commitments at all S&Ls and New York State mutual savings banks--chiefly for residential loans on new and existing properties--edged down for the third consecutive month. By the end of July, the dollar volume of their combined commitment backlogs was about 5 per cent below the April peak. Meanwhile, the amount of current loans actually disbursed by the thrift institutions was sharply reduced. Indications are that new mortgage commitments approved by these same lenders in July were running at a rate well below most earlier months of the year.

Life insurance companies. Cash flow available for investment by life insurance companies during the second quarter fell short of earlier low projections. The most obvious drain in loanable funds has come from policy loans, which were even larger than had been anticipated.

SOURCES OF FUNDS INVESTED  
BY LIFE INSURANCE COMPANIES<sup>1/</sup>

Second Quarter 1969  
(Billions of Dollars)

	Expected on 3/31/69	Actual	Actual Minus Expected
Ledger assets <sup>2/</sup>	1.3	1.1	- .2
Cash *	.5	.3	- .2
Policy loans *	-.3	- .5	- .2
Mortgages	.8	.8	0
Securities return flows	.6	.6	0
Securities sales	.1	.4	.3
All other	.1	.1	0
Total	3.1	2.8	-.3

<sup>1/</sup> Sample of life insurance companies with assets over \$1 billion. The sample represents more than 60 per cent of industry assets.

<sup>2/</sup> Reflects primarily premium flows and investment income, net of expenses.

\* An increase in cash or policy loans represents a negative influence on invested funds.

But perhaps an even more disquieting shortfall in fund flows has come from the insurance side of the business, in the slowdown in "ledger asset" flows. While not necessarily connoting a decrease in insurance sales or coverage, this slowdown does reflect several factors related to the attractive yields and credit stringency in the money and capital markets. For example, there has been a reported increase in the amount of benefits withdrawn in a lump sum by beneficiaries rather than left with the companies for an annuity payout; also, refunds of corporate pension premiums are no longer just automatically applied to future premiums, but instead are temporarily withdrawn by financial officers to purchase short-term money instruments. Part of the shortfall in the ledger asset

category may also reflect factors peculiar to this second quarter; with the surcharge, life companies may have made unexpectedly large income tax payments in April and/or June.

It is noteworthy that sales of securities--long-term non-Governments--a previously unplanned supply of funds, permitted a smaller than planned decrease in cash position. Whether the securities sold were bonds or stocks, publicly-held or direct placements--and whether they were sold privately or on the open market--is not known.

More recent reports from life insurance companies indicate that pressures on loanable funds had intensified during July and August. The net drain from policy loans continued to accelerate. There has apparently been some use made of commercial bank lines of credit, particularly as the weakening in the bond and stock markets has made it necessary to take sizeable losses on most securities sold from portfolios.

NET CHANGE IN POLICY LOANS AT 15 LIFE INSURANCE COMPANIES<sup>1/</sup>  
In Millions of Dollars

	Monthly Average		June	July
	Q 1	Q 2		
1965	27	34	34	28
1966	52	70	73	70
1967	63	54	51	38
1968	60	82	89	75
1969	90	138	151	195

<sup>1/</sup> These companies account for almost two-thirds of industry policy loan activity.

The volume of new commitments made has continued to decline as it has become clear that even the earlier modest fund flow estimates now require further trimming. Total commitments made during the second quarter were somewhat lower than the reduced year-earlier pace, with the cut-back fairly evenly divided between securities and mortgages in general--but heavily concentrated on 1- to 4-family mortgages.

NEW COMMITMENTS MADE BY LIFE INSURANCE COMPANIES<sup>1/</sup>  
(Millions of dollars)

	Second Quarter		Change
	1968	1969	
Securities	1,112	998	- 114
Mortgages & real estate (1-4 family)	2,433 (412)	2,346 (200)	- 87 (-212)
Total	3,545	3,344	- 201

<sup>1/</sup> Reporting companies account for 80 per cent of industry assets. Because of an increase in the sample, data for earlier years are not comparable.

Corporate security and municipal bond markets. Stock prices on the two major exchanges rose about 7-1/2 per cent in August from their July 29 lows and at the same time corporate and municipal bond yields advanced to new record levels. In both bond markets, investor uncertainties appeared to play a major role in the latest run-up of yields. (The increase in the corporate new-issue yield series is somewhat understated for technical reasons.)

STOCK PRICES AND BOND YIELDS

	Stock Prices 1/		Bond Yields	
	NYSE	AMEX	New Corporate Aaa 2/	Long-term
				State and Local Bonds 3/
<u>1968</u>				
Low	48.66(3/4)	21.58(3/5)	6.13(8/30)	4.07(8/9)
High	61.27(11/29)	33.25(12/20)	6.92(12/13)	4.85(12/29)
<u>1969</u>				
Low	49.31(7/29)	25.02(7/29)	6.90(1/10)	4.82(12/24)
High	59.32(5/14)	32.91(1/3)	7.82(8/29)	6.26(8/28)
<u>Week of:</u>				
Aug. 1	51.62	26.20	7.75	5.93
8	51.90	26.33	7.57	5.80
15	51.98	26.37	7.53	5.91
22	53.11	26.89	7.61	6.02
29	52.94	26.84	7.82	6.26

- 1/ Prices as of the day shown. NYSE is New York Stock Exchange. AMEX is American Stock Exchange.
- 2/ With call protection (includes some issues with 10-year call protection).
- 3/ Bond Buyer (mixed qualities).

In late July and early August, some market participants had begun to feel that perhaps yields had reached their highs, associated with the long-awaited slowdown in economic expansion. Underwriters priced bonds relatively aggressively, but some issues moved slowly and a good portion of investor demand centered on small purchases of individuals who were ostensibly shifting funds from thrift institutions and the stock market. As dealer inventories mounted, several large corporate syndicates were terminated, with upward yield adjustments as high as 25 basis points.

Similar difficulties occurred in the tax-exempt market, where the pressure of commercial bank run-offs of municipal bonds was combined with continued concern regarding tax-exemption and fear of greatly reduced demand by fire and casualty companies because of hurricane losses. Most of the market pressures centered in the last two weeks of August when bond yields rose about 35 basis points.

Reflecting the pressures in financial markets, corporate long-term financing declined sharply in August. Flotations of corporate bonds in the public market in August declined to an estimated \$700 million, the lowest level this year; all of the \$300 million decline from the staff's projection a month ago reflects postponements or cancellations of convertible bond offerings associated with the sharp decline in stock prices in June and July. The weakness in stock prices has also reduced new stock offerings to a level sharply below the high second quarter pace.

CORPORATE SECURITY OFFERINGS<sup>1/</sup>  
 Monthly or Monthly Averages  
 (Millions of dollars)

	Public Bond Offerings		Private Bond Offerings		Stocks		Total	
	1968	1969	1968	1969	1968	1969	1968	1969
YEAR	894	--	554	--	382	--	1,830	--
Q I	821	886	574	513	330	674	1,726	2,073
Q II	1,035	1,136	548	526	319	709	1,902	2,371
Q III	869	987e	454	517e	389	467e	1,711	2,003e
July	1,244	1,360e	528	500e	372	500e	2,144	2,360e
August	637	700e	400	500e	396	400e	1,433	1,600e
September	727	1,000e	433	550e	398	500e	1,556	2,050e
-----								
Memo:								
Jan. - July	973	1,016e	556	517e	331	644e	1,861	2,242e
Aug. - Sept.	682	850e	417	525e	397	450e	1,495	1,825e

e/ Estimated.

1/ Data are gross proceeds.

In September, corporate security offerings are estimated to rise a little more than seasonally. However, after the registration of two large bond issues of tobacco firms, underwriters report no new large offerings in the pipeline and a general willingness and ability of corporations to await better market conditions. As shown in the bottom panel of the table, the August-September estimated total security offerings of corporations, including private placements, is expected to average \$1,825 million, or about one-fifth below the average pace of the first 7 months of the year. If the level of capital outlays

now being projected by the Board's staff is realized, these security estimates imply that the financing gap of corporations is widening further in the third quarter. Consequently, there will have to be continued sharp reductions in corporate holdings of liquid assets, or perhaps some stepped-up borrowing at banks and in the commercial paper market.

STATE AND LOCAL GOVERNMENT OFFERINGS  
 Monthly or Monthly Averages  
 (Millions of dollars)

	Long-term 1/		Net Short-term 2/		Total 3/	
	1968	1969	1968	1969	1968	1969
YEAR	1,381	--	- 38	n.a.	1,343	n.a.
Q I	1,246	930	- 56	328	1,190	1,258
Q II	1,285	1,208	5	394e	1,290	1,602
Q III	1,537	921e	- 38	n.a.	1,499	n.a.
July	1,469	1,063	523	190e	1,992	1,253e
August	1,699	850e	204	575e	1,963	1,425e
September	1,444	850e	-902	n.a.	542	n.a.

e/ Estimated.

1/ Data are for principal amounts of new issues.

2/ EXCLUDES note offerings of Housing Assistance Administration and Renewal Assistance Administration.

3/ Combines GROSS long-term and NET short-term issues.

The marked increase in tax-exempt yields has further reduced gross long-term tax-exempt offerings in August to about \$850 million, \$200 million below July, and the same reduced volume is expected in September. (Even this volume would not have been possible, however,

without some recent increases in maximum allowable rates in some jurisdictions.)

As shown in the table, a pick-up in net short-term offerings (exclusive of Federally-assisted issues) has more than offset the August drop-off in long-term offerings. But even with the step-up in short-term financing, total recent tax-exempt issues appear to be about \$200 million below the second quarter pace. Moreover, total financing is certainly well below earlier planned levels. The first Federal Reserve Board survey of borrowing plans of State and local governments, described in Appendix A, suggests that the midyear plans of these units was for gross long-term borrowing in the third quarter of over \$5 billion, or about \$1.7 billion a month. The staff estimates that financial conditions will now keep such offerings at only about one-half the rate of these midyear plans; even including short-term offerings, third quarter financing could still fall well below--perhaps 20 per cent or more--the desired volume,

Government securities market. Yields on U.S. Government securities generally declined in the first week after the last FOMC meeting. Since then, however, rates on most issues have moved irregularly higher and are now about 10 to 20 basis points above their August 11 levels in the coupon sector and mostly 5 basis points higher to 5 basis points lower in the bill area.

MARKET YIELDS ON U. S. GOVERNMENT SECURITIES<sup>1/</sup>  
(Per cent)

	Lows	Highs	Aug. 11	Aug. 25	Sept. 2
<u>Bills</u>					
1-month	5.30(3/25)	7.20(8/27)	6.41	7.04	7.12
3-month	5.87(4/30)	7.16(8/26)	7.01	7.00	7.03
6-month	5.96(4/30)	7.38(7/15)	7.23	7.26	7.23
1-year	5.86(1/16)	7.47(7/1)	7.39	7.25	7.32
<u>Coupons</u>					
3-year	6.02(1/20)	7.42(9/2)	7.33	7.30	7.42
5-year	6.11(1/20)	7.18(9/2)	7.04	7.05	7.18
10-year	5.95(1/20)	6.87(9/2)	6.69	6.72	6.87
20-year	5.91(5/5)	6.46(5/28)	6.18	6.24	6.36

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

Around mid-August, the lower yields reflected a more hopeful view of market participants that the economy might begin to cool before the end of the year. At the same time, the market reacted calmly to news of the French devaluation, and demand for bills by foreign accounts added to the easing of rates in the short-term market. More recently, however, the release of some key economic indicators showing continued strength and remarks by Administration officials indicating the need for a continued Government effort to combat inflation contributed to a change in market expectations and to a back-up of yields.

The market's technical condition remains strong, though, as dealers have continued to move out acquisitions fairly quickly and have maintained positions at relatively low levels. In the note and bond sector, dealers' positions in securities maturing in 1 to 5

years have declined some \$250 million on balance over the past three weeks, while holdings of issues due in over 5 years are down around \$95 million. Some of these declines have reflected buying in connection with investment demands from the forthcoming September 10 auction of Alaskan oil lease rights.

Part of the recent price declines in intermediate-term issues was attributed to the offering of two Federal Agency issues of over \$200 million each in the 5-year area. Moreover, the market has begun to focus its attention more on the need to refinance the \$5.6 billion of publicly-held October 1 maturities.

The bill area was affected recently by actual and anticipated bank selling of the strip bills auctioned on August 20. The Treasury sold a \$2.1 billion strip, consisting of \$300 million additions to the weekly bills maturing between September 18 and October 30. With the new supply of strip bills already overhanging the market, rates adjusted higher in the last week of August when three bill auctions were scheduled in a single week and as the market began to look forward to the mid-September tax and dividend date.

Dealer bill positions increased in the 3-month and under category as banks sold some of their awards of strip bills into the Street, reaching a peak of over \$700 million on August 26--compared with net short holdings of about \$100 million just before the auction. Most recently their holdings of short-dated bills totalled about \$625

million. Positions in longer bills are down slightly since August 11, despite positioning of bills from last week's three auctions.

DEALER POSITIONS IN GOVERNMENT SECURITIES  
(In millions of dollars)

	Aug. 11	Aug. 25	Sept. 2
Total	<u>2,130</u>	<u>2,111</u>	<u>2,772</u>
Treasury bills (total)	<u>1,359</u>	<u>1,556</u>	<u>2,233</u>
Due in 92 days or less	- 269	409	628
93 days or over	1,628	1,146	1,605
Treasury notes and bonds (Total)	<u>771</u>	<u>555</u>	<u>539</u>
Due within 1 year	149	233	257
1-5 years	329	95	82
over 5 years	294	227	200

Rate declines in the short-term Federal Agency market have not been as large as those of most other short-term credit instruments, reflecting the continued substantial supply of new offerings in the Agency market. By mid-August short-term Agency rates were about 20 basis points below their July peaks, but by the month's end there was evidence of an upturn in rates in response to a large FNMA issue and market nervousness about September Agency demands, with the prospect of a large Treasury refinancing also overhanging the market. The August 13 1-year FHLB offering, for example, carried a yield of 8.20 per cent whereas the 14-month FNMA offering of August 28 yielded 8.30 per cent.

NEW MONEY FROM THE PUBLIC IN THE  
FEDERAL AGENCY MARKET

	1966	1967	1968	1969
May	1,363	285	188	983
June	1,151	275	1,107	1,247
July	494	272	822	755
August	234	-28	- 145	1,101
September	-306	-83	111	

Other short-term credit markets. During August, rates on private short-term credit instruments gradually backed off from the highs reached in July despite the upward movement in Treasury bill rates late in the month. Rates at the end of August were generally 25 to 50 basis points below their highest levels with 3-month commercial paper, for example, offered at 8.25. Most recently, however, the bankers' acceptance rate has again begun to increase.

The rise in commercial paper rates in July coincided with the increase in the volume of commercial paper outstanding, which rose by \$937 million to a total of \$27.6 billion. Dealer placed paper actually declined in the month, but commercial paper placed directly increased by \$1,175 million during July, probably largely reflecting issues of bank holding companies, which rose by \$618 million in July in further reflection of the squeeze on bank reserves and deposits.

Commercial and Finance Paper and Bankers'  
Acceptances Outstanding  
(In millions of dollars)

	May	June	July
Commercial and finance paper <sup>1/</sup>			
Total	24,838	26,693	27,630
Placed through dealers	9,941	10,549	10,311
Paper placed directly <sup>2/</sup>	14,897	16,144	17,319
Bankers' acceptances	4,668	4,880	4,991

<sup>1/</sup> Data for commercial and finance paper are seasonally adjusted: data published in the Bulletin are seasonally unadjusted. Adjustment factors are revised at the end of each year.

<sup>2/</sup> As reported by companies that place paper directly with investors. As of June, 1969, these figures include directly placed commercial paper issued by bank holding companies. Dealer totals have always included bank holding company paper.

SELECTED SHORT-TERM INTEREST RATES  
(discount basis)

	July 30	August 13	August 27
<u>3-month</u>			
Commercial paper	8.38	8.38	8.25
Finance paper	8.25	8.00	7.63
Bankers' acceptances	8.13	8.13	8.00
Federal agencies (secondary market)	7.76	7.70	7.73
Treasury bill	7.11	7.08	7.15
<u>6-month</u>			
Commercial paper	8.38	8.38	8.25
Finance paper	7.75	7.75	7.36
Bankers' acceptances	8.13	8.25	8.00
Federal agencies	8.14	7.95	7.93
Treasury bill	7.20	7.31	7.36
<u>12-month</u>			
Prime municipals <sup>1/</sup>	5.30	5.60	5.75
Treasury bill	7.31	7.34	7.37

1/ Bond yield basis.

Federal finance. The outlook for fiscal 1970 receipts and outlays remains largely unchanged. Staff estimates of Budget receipts at \$195.9 billion are smaller than Administration figures because we are projecting slower economic growth, while estimated outlays, at \$192.9 billion, accept Administration forecasts. Defense Secretary Laird's recent announcement that he intends to cut the 1970 defense budget \$3 billion to \$77 billion reflects the Administration's determination to offset anticipated overruns in "uncontrollable" programs with corresponding cutbacks in other areas.

Since the Treasury cash balance at the end of August was only \$4.0 billion, the Treasury may not be able to maintain a positive balance at the Federal Reserve through the mid-September low point without borrowing by means of special certificates. The lowest ebb of the total tax and loan and Federal Reserve balance should be about \$1.3 billion on September 10-12, before strong tax receipts, especially corporate, carry the balance to about \$9.3 billion at the end of the month.

In light of renewed upward yield pressures, attrition in the \$6.3 billion October debt refinancing (\$5.6 billion of which is publicly held) could well exceed \$1 billion. The October 1 operation is expected to be announced in mid-September, and since the financing comes during the S&L quarterly reinvestment period, a regular rights refunding would be helpful in minimizing the outflow from savings institutions. Despite this important attrition, the Treasury will probably not have to borrow new money until late October or early November, when a substantial amount of cash will probably be raised through tax anticipation bills.

PROJECTION OF TREASURY CASH OUTLOOK  
(In billions of dollars)

	Aug.	Sept.	Oct.	Nov.
<u>Borrowing operations</u>				
New cash raised:				
Weekly and monthly bills	2.1	--	--	--
Tax bills	--	--	--	4.0
Coupon issues	--	--	--	--
Other (agency, debt repayment, etc.)	-1.2	--	-1.4	--
Total net borrowing from public	.9	--	-1.4	4.0
Plus: Other net financial sources <sup>b/</sup>	- .9	.7	.7	- .8
Plus: <u>Budget surplus or deficit (-)</u>	-1.7	4.6	-4.9	-1.1
Equals: <u>Change in cash balance</u>	-1.7	5.3	-5.6	2.1
Memoranda: Level of cash balance end of period	4.0 <sup>a/</sup>	9.3	3.7	5.8
Derivation of budget surplus or deficit				
Budget receipts	15.0	21.0	12.0	14.6
Budget outlays	16.7	16.4	16.9	15.7

a/ Actual

b/ Checks issued less checks paid and other accrual items.

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

	FY 1969 Actual	Calendar year 1969e/	Fiscal 1970		Calendar quarter					
			May Budget Bureau est.	F.R. Bd	1969				1970	
					I	II	IIIe/	IVe/	Ie/	IIe/
<b>Quarterly data, unadjusted</b>										
New budget:										
Surplus/deficit	3.1	9.9	6.3	3.0	-2.0	15.3	-0.3	-3.1	-3.5	9.9
Receipts	187.8	197.9	199.2	195.9	44.1	60.8	48.5	44.5	43.8	59.1
Total expenditures and net lending	184.8	188.0	192.9	192.9	46.1	45.5	48.8	47.6	47.3	49.2
Means of financing:										
Total borrowing from the public	-1.4 <sup>1/</sup>	-8.6	} n.a. }	-2.2	.2	-12.6	3.8	--	2.7	-8.7
Decrease in cash operating balance	-.6	-1.4		-.1	-.1	-1.1	-3.4	3.2	.1	--
Other <sup>2/</sup>	-1.1	--		-.7	1.9	-1.7	-.1	-.1	.7	-1.2
Cash operating balance, end of period	5.9	6.1		6.0	4.8	5.9	9.3	6.1	6.0	6.0
<b>Seasonally adjusted annual rate</b>										
Federal surplus/deficit										
in national income accounts <sup>3/</sup>	4.8	9.4	6.3 <sup>3/</sup>	4.1	9.6	12.5	7.4	8.1	.7	0.0
Receipts	192.2	201.1	202.8	199.9	198.1	201.9	201.3	203.0	197.3	198.0
Expenditures	187.4	191.7	196.5	195.9	188.5	189.3	193.9	194.9	196.6	198.0
High-employment surplus/deficit <sup>4/</sup>	2.0	8.7	n.e.	6.7	7.9	10.5	7.4	8.9	4.3	6.2

e--Projected. Assumes extension of surcharge at 10 per cent through end of calendar year 1969 and at 5 per cent for January to June 1970. Also assumes repeal of investment tax credit.

n.e. - Not estimated.

n.a. - Not available.

<sup>1/</sup> Excludes effect of conversion of agencies to private ownership.

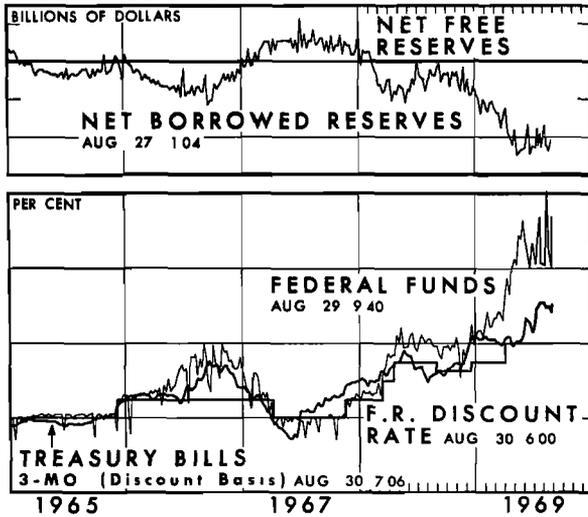
<sup>2/</sup> Includes various accrual items, such as deposit fund accounts and clearing accounts.

<sup>3/</sup> National Income account translation estimated by Federal Reserve staff.

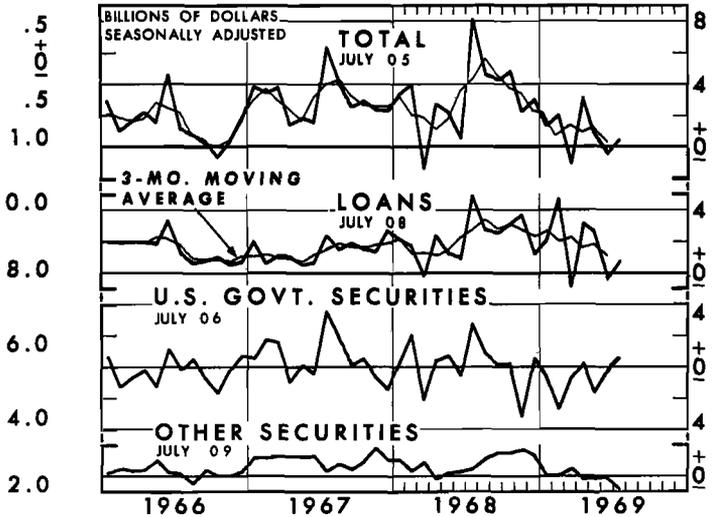
<sup>4/</sup> Estimated by Board staff using QIII 1969 as the base quarter that represents high employment.

# FINANCIAL DEVELOPMENTS - UNITED STATES

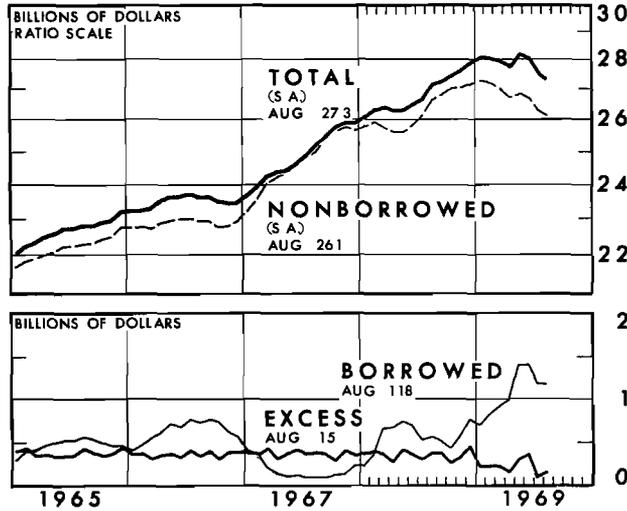
## FREE RESERVES AND COSTS



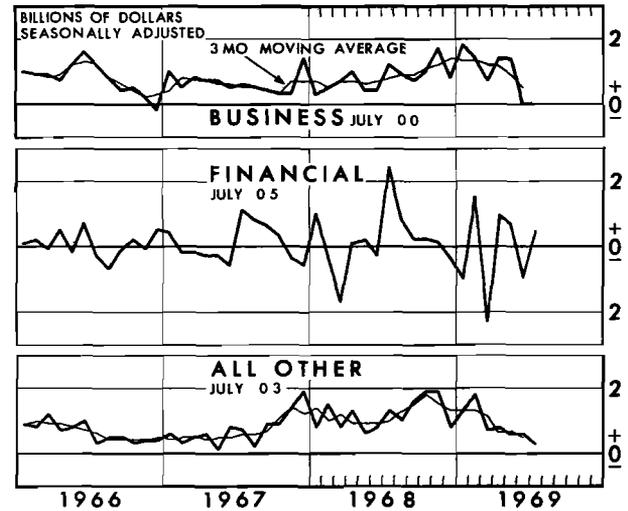
## CHANGES IN BANK CREDIT



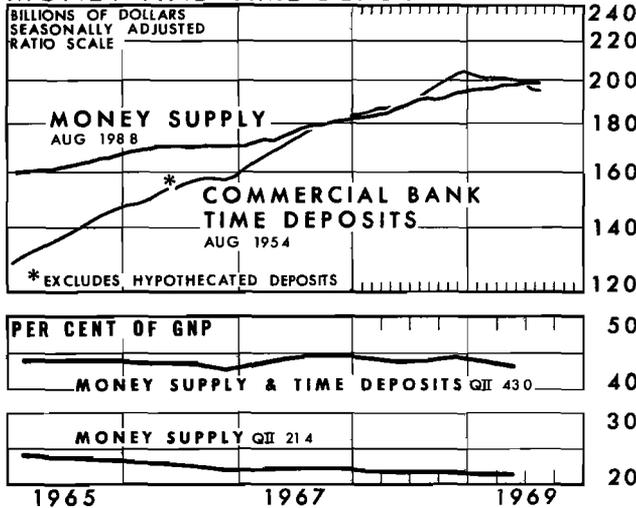
## BANK RESERVES



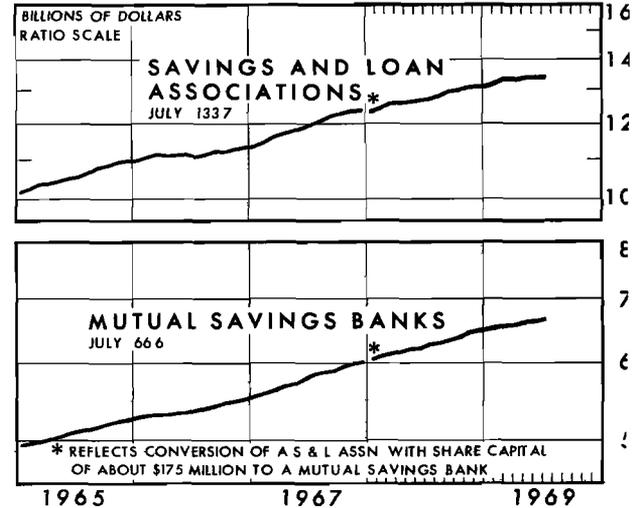
## CHANGES IN BANK LOANS-BY TYPE



## MONEY AND TIME DEPOSITS

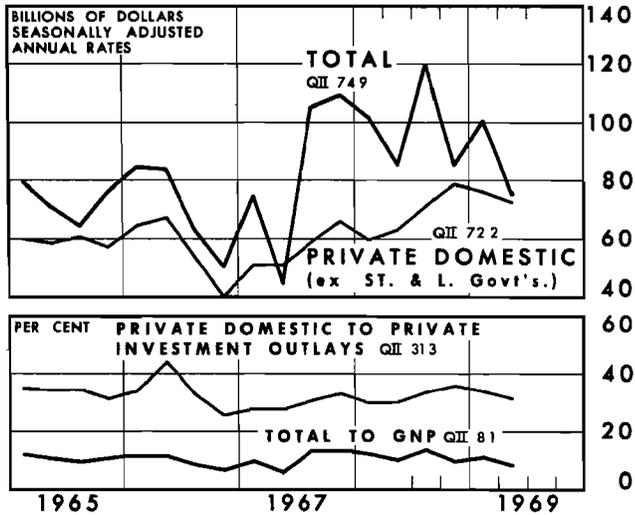


## SAVINGS SHARES AND DEPOSITS

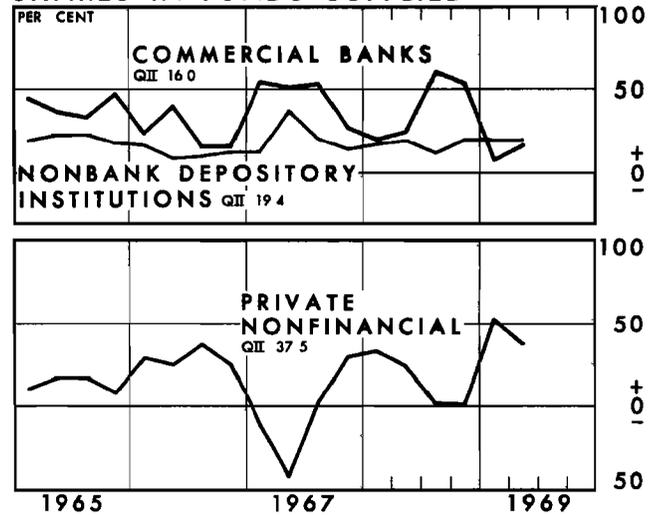


# FINANCIAL DEVELOPMENTS - UNITED STATES

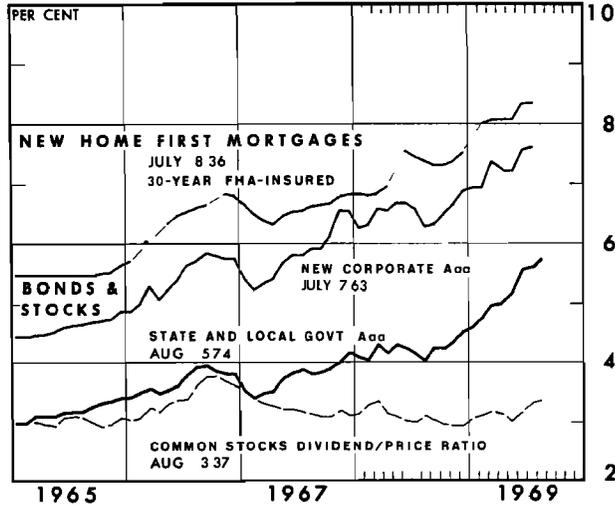
## NET FUNDS RAISED - NONFINANCIAL SECTORS



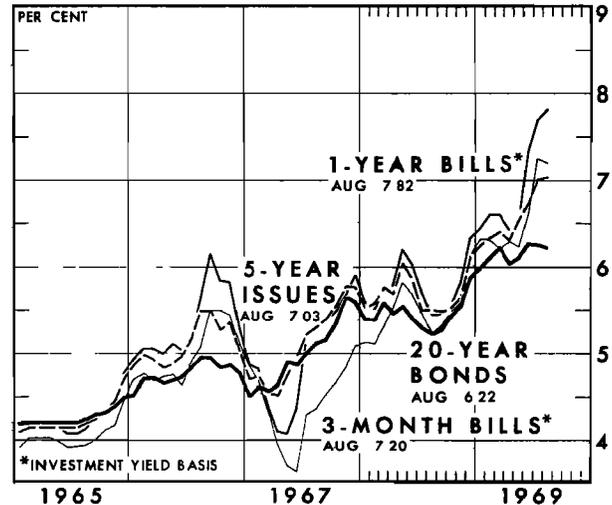
## SHARES IN FUNDS SUPPLIED



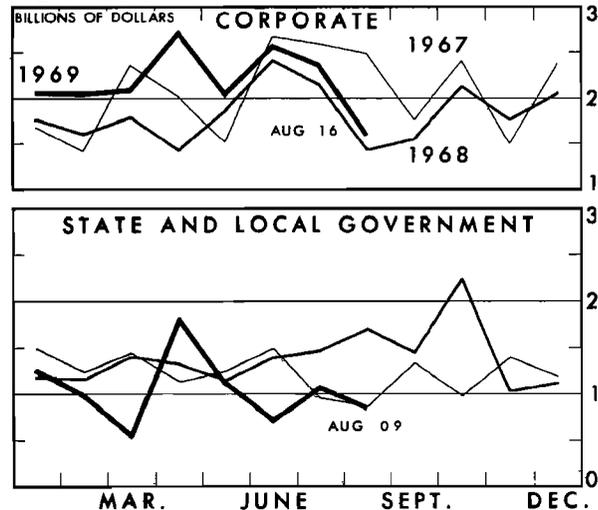
## MARKET YIELDS



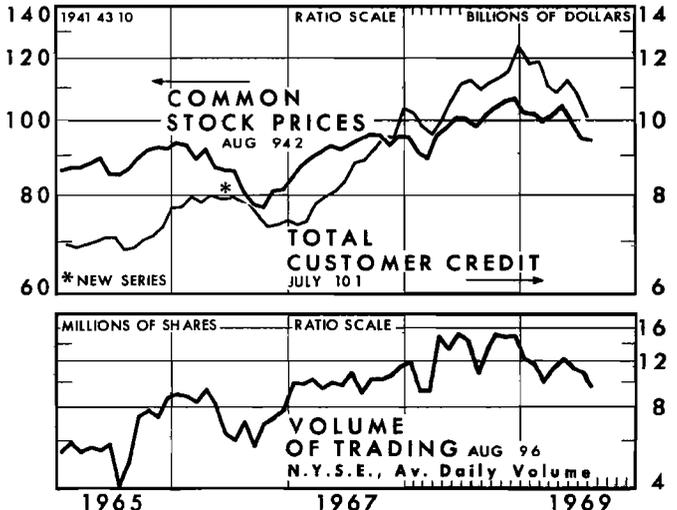
## MARKET YIELDS—U.S. GOVT. SEC.



## NEW SECURITY ISSUES



## STOCK MARKET



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THE ECONOMIC PICTURE IN DETAIL

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International Developments

U.S. balance of payments. As the figures accumulate for the third quarter there is scant indication of an early return to liquidity deficits of the size that had become customary in the past few years. In July the liquidity deficit was \$1.2 billion (not seasonally adjusted), and the partial weekly figures for August -- which in recent months have been considerably off the mark -- point to another deficit of comparable dimensions.

A very preliminary (and confidential) set of estimates of all the balance of payments entries for the second quarter, and some revisions of the first quarter accounts, suggests that although a considerable part of the liquidity deficit -- and especially the rise from the first to the second quarter -- can be ascribed to transitory factors, there has in addition been a weakening of the basic position.

The transitory factors in the first quarter were some reversal of the year-end inflows of corporate capital and possibly some outflows of U.S. funds to the Euro-dollar market. In the second quarter outflows of U.S. funds for D-mark speculation and investment in the Euro-dollar market probably continued -- but the evidence now available, either from statistics on capital flows or by implication from the size of the unrecorded element in the balance-of-payments accounts, indicates that this outflow probably did not exceed \$1 billion for the quarter. An

additional negative factor in the second quarter was the reversal of "special" transactions with foreign governments. As rough orders of magnitude, these transitory elements in the first half might have accounted for \$2-1/2 billion of the total liquidity deficit of \$5-1/2 billion (not at annual rates).

The basic elements in the first half deficit were the extremely feeble current account surplus (the second quarter annual rate is now estimated at about \$1 billion, which is lower than the \$1.6 billion rate now included in GNP estimates), larger outflows of U.S. private capital, and lower inflows of foreign capital for long-term investment. The trade balance is discussed below in some detail; the weakness in the rest of the current account seems to reflect mainly a sizable increase in interest payments to foreigners while income received on direct investments scored only a small increase. A major increase is reported to have occurred in direct investment outflows -- especially to continental Europe -- with the half-year total reaching nearly 80 per cent of the total for 1968, even after deducting the use of proceeds of foreign borrowings. Some of this outflow was probably anticipatory, however, reflecting movements into D-mark assets and Euro-dollars.

In July and August there has probably been a continuation of many of these elements, though some changes are occurring in individual components. The July trade balance was still very small, and a further reversal of "special" transactions worsened the liquidity balance by about \$100 million in both July and August. Other known negative elements

in July were an increase in net purchase of new foreign bonds (mainly Canadian), and a second month of liquidations of U.S. equity securities by foreign investors, though net sales appear to have been less than the \$100 million reported for June. Also, much higher interest rates are now being paid on the swollen amount of U.S. short-term debt to foreigners.

A favorable development in July was a reduction of over \$300 million in claims on foreigners reported by U.S. banks, in contrast to sizable outflows in May and June. About \$90 million of the July inflow was from Japan and the remainder was spread over many countries.

The over-all balance in July on the official settlements basis registered a surplus of \$300 million, and differed from the liquidity deficit mainly because of an increase of about \$1 billion in liabilities to foreign branches, as well as some increase in other liabilities to private foreigners. Weekly data for August suggest a smaller increase in private foreign accounts, so that a deficit on the official settlements basis is likely.

U.S. foreign trade. The trade balance in July was a small surplus (balance of payments basis) as exports fell less than imports. For January-July combined, however, a small deficit was recorded compared with a \$1/2 billion surplus at an annual rate in the second half of 1968. The rate of both exports and imports in the first seven months changed very little from the rate in the last six months of last

year; exports were about the same while imports increased by less than 2 per cent. These rates of change are far below those which occurred from the first to the second half of 1968.

In view of the economic boom in Europe, Japan and other foreign industrial countries, and the continued strength in output and consumption here, the sluggishness in U.S. trade activity so far this year was unexpected. The dock strike was probably partly responsible for this slowdown. A further decline in shipments of agricultural products because of weaker demand abroad was an additional factor in the case of exports while supply limitations in Europe may have dampened imports. Whether some goods not shipped because of the strike may eventually be shipped is still uncertain. But most ports have been in full operation for 4-5 months since the end of the strike so that the possibility of further additional strike-related expansion in trade activity during the remainder of the year seems remote.

A major element in the failure of exports to expand this year has been the continuing decline in agricultural shipments. Exports of such products had fallen slightly from the first to the second half of 1968, as P.L. 480 shipments of grains were sharply reduced. In January-July, agricultural exports slumped by a further 10 per cent. Shipments under the P.L. 480 programs this year have shown little change from the second half of 1968. The most recent drop is partly the result of the dock strike, and partly attributable to large world crops and the

resultant weakening in demand for U.S. grains. More recently, cutting of wheat prices by major world exporters to 15-20 per cent below the minimum stipulated under the International Grains Arrangement has increased the difficulty of marketing U.S. wheat.

Exports of nonagricultural products in January-July were at a rate about 2 per cent higher than in the second half of 1968, but this is considerably below the 3 per cent advance from the first to the second half of last year. Particularly disappointing has been the failure of machinery exports to respond to the economic boom in Europe where capacity-utilization rates in manufacturing are close to the previous peak rates of 1964-65.

Although total imports of most European countries continued to expand in the first half of this year, U.S. exports to Western Europe during this period fell by 6 per cent from the level in the second half of 1968. Exports to Latin America and to other developing countries also were lower. Shipments to Canada and Japan, however, increased by 9 and 5 per cent, respectively.

Exports of both agricultural and nonagricultural products to continental Western Europe have declined so far this year. Agricultural shipments (20 per cent of total exports to this area) fell sharply by 15 per cent; the drop in nonagricultural commodities was much less -- 4 per cent. However, if deliveries of civilian aircraft, which rose by over 25 per cent, are excluded, the decline in exports of other

nonagricultural products would have been close to 10 per cent, compared to a 20 per cent gain in such exports from the first to the second half of last year.

The small over-all increase of 5 per cent in exports to Japan this year included a very sharp drop -- 18 per cent -- in agricultural products and a nearly equally large rise in shipments of nonagricultural items.

The sizable expansion in exports to Canada this year was in both agricultural and nonagricultural products. However, exports of most nonagricultural products declined from last year, with the over-all gain this year based on larger shipments of automobiles and of machinery related to rising Canadian fixed investment outlays.

Imports in January-July were at an annual rate of \$34.7 billion, less than 2 per cent higher than the rate in the second half of 1968. The major commodity categories, however, showed divergent movements. Imports of nonfood consumer goods, other than automobiles, expanded by nearly 15 per cent from the second half of 1968, an even greater rate of advance than from the first to the second halves of last year. Imports of cars in total also increased -- by 5 per cent; automobiles from Canada expanded further but arrivals from other areas, principally Germany, decreased appreciably.

Imports of foods and industrial materials in the first half of the year were down from the rates in the second half of last year. Coffee imports declined by nearly a third as inventories built up last year in

anticipation of the dock strike were reduced to more normal levels this year. Although domestic industrial output has accelerated this year, imports of industrial materials have decreased. The value of steel imports was about 20 per cent less than in the second half of 1968, although import unit values (a rough indicator of price movements) rose by 10 per cent. Supply stringency in Europe, particularly Germany and Belgium, was the principal reason for the decline. Imports of capital equipment continued to advance this year, keeping pace with the very sharp expansion in domestic expenditures on 'producers' durable equipment.

Euro-dollar and exchange markets. The moderate and steady decline in Euro-dollar rates that occurred during July and the first few days of August was reversed following the devaluation of the French franc, announced on August 8. The three-month deposit rate, for example, declined from about 11-1/4 per cent per annum in early July to an average of 10-1/4 per cent in the week ending August 6; since then, however, the rate for three-month deposits has advanced steadily and averaged 11-1/4 per cent in the week ending September 3. Rates in other maturities have advanced similarly since early August.

The speculative atmosphere that developed in the exchange markets following the devaluation of the French franc -- in combination with the market's general uneasiness in advance of the forthcoming elections in Germany -- probably put upward pressure on Euro-dollar market yields. Beyond this influence, however, various other developments

help to explain the recent firming of Euro-dollar rates: (1) U.S. banks' borrowings of Euro-dollars through their foreign branches advanced (net) by \$475 million in the three weeks ending August 27, in contrast to a net decline of about \$85 million in such borrowings during the three previous weeks (July 16 to August 6). (2) At the same time, conditions in most major European money markets appear to have remained tight, by recent standards, throughout August. The German money market, for example, remained quite illiquid and the Bundesbank -- even though offering swaps at rates well below the rate obtainable in the private forward market -- took in \$400 million more from maturing forward contracts than it sold under newly contracted swaps. The Bank of Italy, in mid-August, raised its basic discount rate by 1/2 per cent to 4 per cent and Italian banks, apparently in response to tighter domestic credit market conditions, reduced their holdings of foreign currency assets covered by swaps with the Italian authorities by \$65 million in August. The Swiss money market has remained tight with very short-term funds recently quoted at 6 to 7 per cent per annum, or higher. Short-term money rates in France have only recently moved to below 9 per cent per annum. Dutch and Belgian money markets remained firm in August while short-term rates in Canada advanced further and interest rates in Britain remained at recent historic highs.

SELECTED EURO-DOLLAR AND U.S. MONEY MARKET RATES  
(weekly average of daily figures)

Average for week ending Wednesday	(1) Call Euro-\$ Deposit	(2) Federal Funds	(3) =(1)-(2) Differ- ential	(4) 3-month Euro-\$ Deposit	(5) 3-month Treasury Bill	(6) =(4)-(5) Differ- ential
June 11	10.88	9.13	1.75	11.51	6.50	5.01
July 9	10.60	9.07	1.53	11.20	6.93	4.27
23	9.25	8.50	0.75	10.84	7.08	3.76
Aug. 6	8.98	9.57	-0.59	10.25	6.99	3.26
13	9.88	9.18	0.70	10.55	7.04	3.51
20	9.66	8.79	0.87	10.83	6.86	3.97
27	9.13	8.82	0.31	10.91	7.04	3.87
Sept. 3	10.35	9.57	0.78	11.25	7.02	4.23

Devaluation of the French franc on August 8 unsettled foreign exchange markets considerably although no massive flows of funds were involved. Sterling, the Belgian franc and the Italian lira came under heavy selling pressure the week following the change in the French franc parity, and the German mark, Swiss franc and Dutch guilder were in strong demand. The Bank of England lost \$500 million during the week, while the National Bank of Belgium sold \$250 million and the Bank of Italy, \$130 million. The Bundesbank, on the other hand, purchased about \$500 million. (During the same week it swapped out about \$340 million.)

The heavy sales of sterling were at least partly associated with the fact that the U.K. trade data for July, announced the week following the French franc devaluation, were disappointing. The Belgian franc came

under speculative selling as a result of the widespread view that that currency would have to follow the French franc in devaluation because of the close economic and financial ties between Belgium and France. While the Belgian current account is in approximate equilibrium in contrast to that of France, outflows of capital from general currency uncertainty and interest rate differentials have put pressure on Belgian reserves. The heavy sales of Italian lire largely reflected purchases of Swiss francs and German marks by Italian residents with outstanding liabilities in these currencies.

Since mid-August foreign exchange activity has been much reduced and exchange rates have moved narrowly. Over-all demand for sterling has remained quite weak although the Bank of England was able to purchase small amounts of dollars at times when the market would rebound from a deeply oversold position. The discount on 3-month forward sterling widened to over 9 per cent per annum at one point and has remained generally above 8 per cent. This weakness reflects considerable pessimism over sterling, which seems to have grown in the four weeks since the French franc devaluation. The Bank of England's net market losses in August totalled \$500 million, \$50 million of which was offset by spot dollar purchases in conjunction with swap transactions. The remaining \$450 million was partly financed by increased swap drawings on the System, additional borrowings from a European central bank, and advance military offset payments by the Germans.

The Belgian National Bank was able to recoup later in August only about \$30 million of its earlier \$250 million loss as the market for francs continued quite weak. On September 2 the System swap facility with the Belgian National Bank was increased from \$300 million to \$500 million. The Bank of Italy recouped about \$35 million late in August, leaving its net monthly loss at about \$100 million.

Demand for the French franc has been firm at its new parity and the Bank of France has been able to purchase around \$250 million since devaluation. Demand for the German mark -- although firm -- has not prompted any Bundesbank market purchases of dollars since mid-August. That bank's net spot dollar purchases in August were \$215 million and it had receipts from maturing swap contracts of about \$785 million; this \$1,000 million of receipts was partly offset by swap dollar sales totalling \$330 million, leaving an increase in its reserves of over \$600 million for the month.

The Devaluation of the French franc

The continuing overheating of the French economy and the large current account deficit--this year averaging \$150 million a month--coupled with rapidly declining reserves lead to the Pompidou Government's decision to devalue the franc by 11.1 per cent on August 8. Although there had been speculation that devaluation was unavoidable and would possibly be linked to other parity changes, particularly a revaluation of the German mark, the timing of the French move was unexpected.

By early August, French official reserves, net of assistance, were down to less than \$1.5 billion. Very wide discounts on forward francs enabled a part of foreign trade to be financed at a rate substantially below the official parity and devaluation was in part a recognition of market realities. Since devaluation, French reserves have increased modestly, perhaps by \$250 million, because of a favorable shift in leads and lags, and some capital reflow.

Post-devaluation information does not suggest that French exporters will significantly lower their prices. Foreign currency prices of France's major exports will remain largely unchanged, with the increase in franc profits stemming from devaluation being absorbed by exporters, probably as insurance against higher costs resulting from wage increases which are likely to be granted in the fall.

Devaluation ended a period of suspense, but did not solve the basic problems of the French economy. The decision to devalue came at a time when the economy was operating nearly at full capacity, making it

difficult to increase output. Moreover, factor mobility in France is very low and considerable time will elapse before sufficient resources can be shifted to production for export and for import substitution. Longer-range problems of rationalization of the industrial sector remain and are to some degree in conflict with the short-run need for retrenchment.

The 1967 British experience shows the need for backing devaluation immediately with an austerity program. However, the French Government deferred announcing details of new restraining measures until this month. The French authorities are trying to steer a narrow course between a possible renewal of social unrest and a dissipation of devaluation benefits through excessive cost and price rises. In the meantime, a general--but reportedly not fully effective--price freeze is in force until September 15, and some restraining measures have been announced. Medium-term interest rates on loans granted by public lending entities were raised to discourage investment, and installment-buying terms were tightened for the next 5 months in an effort to cut down on imports of consumer durables and make an additional part of production available for exports.

It is uncertain if the Government is prepared to take restrictive measures that will curb domestic demand sufficiently to restore equilibrium to the current account. Moreover, wage settlements later this year may result in excessive cost push on prices. In addition, the French economy needs a period of calm on the international markets and exchange controls--the major inhibitor against capital reflows--cannot be lifted until the uncertainty on the DM parity is resolved. At best, the French adjustment process will be gradual and lengthy.

To shore up reserves during the transition period the French government has applied for a stand-by arrangement of \$985 million from the IMF; it is expected that \$500 million of this sum will be drawn within about 30 days, and the remainder early in 1970. In addition, standby swap assistance available to the Bank of France still amounts to \$1.6 billion. This is composed of the currently unused \$1 billion facility with the System and newly established additional facilities of \$400 million from the other EEC countries and \$200 million from the BIS. Short-term assistance drawings by the Bank of France now total \$1.5 billion, with published reserves amounting to about \$3.8 billion. The Bank of France also has some undisclosed, but sizable, dollar swaps with French commercial banks.

Trade developments in Europe, Canada and Japan

Despite some deceleration in the rate of increase, foreign trade of the European OECD countries continued to grow at a rapid pace during the first half. Exports rose by 12 per cent and imports by 14 per cent (annual rates) from the second half of 1968 to the first half of 1969. The annual rates of increase for exports and imports between the first and second halves of last year were 23 per cent and 20 per cent, respectively.

IMPORTS AND EXPORTS OF OECD COUNTRIES, 1967-1969<sup>a/</sup>  
(per cent per annum change from preceding period)

	Imports				Exports			
	1967	1968	Semi-annual		1967	1968	Semi-annual	
			1968	1969			1968	1969
			II	I			II	I
OECD ex U.S.	5	10	19	14 <sup>b/</sup>	6	14	21	14 <sup>b/</sup>
OECD Europe	3	10	20	14 <sup>b/</sup>	5	12	23	12 <sup>b/</sup>
U.K.	6	7	9	2	-2	7	19	7
EEC	2	13	26	19 <sup>b/</sup>	7	14	27	13 <sup>b/</sup>
France	4	13	55	18	4	12	41	13
W. Germany	-4	16	19	27	8	14	30	5
Italy	13	6	20	13 <sup>b/</sup>	8	17	24	26 <sup>b/</sup>
Japan	22	11	17	4	7	24	21	27
Canada	8	14	13	23	18	10	14	14
United States	5	23	13	3	4	9	15	-4

<sup>a/</sup> Seasonally adjusted and measured by dollar changes.

<sup>b/</sup> January-May average compared to second half monthly average.

The deceleration in the growth of exports is traceable in part to an 8 per cent decline in shipments to the United States between the last half of 1968 and the first half of 1969. A reduction in European steel exports to the United States, resulting primarily from tight capacity conditions in Europe, accounted for most of the decline. The U.S. dock strike in the first part of the year also contributed to the decrease both through delayed shipments and cancelled orders.

European exports to other major areas did not decline, but the rates of increase in exports to Japan and the less developed countries fell sharply. Reflecting continued boom conditions in Europe, intra-OECD

TRADE BALANCES FOR OECD COUNTRIES, 1967-1969<sup>a/</sup>  
(millions of U.S. dollars, seasonally adjusted monthly averages)

	1967	1968	Semi-annual			Quarterly		July 1969
			1968		1969	1969		
			I	II	I	I	II	
OECD Europe	-730	-651	-711	-634	-765 <sup>b/</sup>	-768	-760 <sup>c/</sup>	--
U.K.	-279	-301	-331	-288	-270	-275	-266	-216
EEC	99	188	140	207	35 <sup>b/</sup>	-13	108 <sup>c/</sup>	--
France	-89	-106	-100	-142	-81	-149	-214	-259
W. Germany	365	391	318	453	274	195	353	413
Italy	-83	-6	-4	-27	26 <sup>b/</sup>	11	48 <sup>c/</sup>	--
Japan	-102	-1	-16	8	134	103	166	--
Canada	41	93	109	86	46	67	25	14
United States <sup>d/</sup>	368	83	40	117	43	-15	102	--

<sup>a/</sup> The trade balance equals exports f.o.b. minus imports c.i.f. except for the United States and Canada, where both exports and imports are f.o.b.

<sup>b/</sup> January-May only.

<sup>c/</sup> April-May only.

<sup>d/</sup> As compiled by OECD; does not correspond to U.S. balance of payments basis used elsewhere in the Green Book.

European trade advanced at the very high annual rate of about 20 per cent, down only slightly from the 24 per cent annual rate of increase between the two halves of 1968. European shipments to Canada, where economic expansion was very rapid late last year and early this year, increased at an annual rate of 20 per cent over the second semester of 1968.

The deceleration in Europe's import growth was largely attributable to a 6 per cent decline in shipments to Europe from the United States from the second half of 1968 to the first half of 1969. The dock strike was also an important factor in this decrease, but inflationary price advances in the U.S. may also have discouraged purchases.

Imports from non-OECD countries rose, but at a slower rate, a development probably reflecting a shift in demand, as the boom in Europe wears on, from raw materials to manufactured goods. Imports from Japan and Canada rose at about the same rate in the first half as they had in the second half last year.

Elsewhere in the OECD, Japanese exports rose at an annual rate of 27 per cent from second half 1968 to first half 1969, compared to a 21 per cent annual rate rise between the first and second halves of last year. Imports rose by only 4 per cent between the last semester of 1968 and the first of 1969. In Canada, imports grew more rapidly than exports from the second half of 1968 to the first half of this year, though the government's anti-inflation program succeeded in decreasing imports in the second quarter. Exports followed a similar pattern, growing in the

early part of the first half and declining thereafter. Exports were adversely affected by strikes and the world wheat surplus.

Trade developments in OECD countries thus far this year have contributed little to rectifying payments imbalances. Among countries in overall balance of payments surplus, Italy and Japan experienced an improvement in the trade balance and Germany's trade surplus, after a temporary reduction in the first quarter, surged again in the spring. Both in Germany and Japan in recent months trade balance movements have run counter to cyclical developments. In Japan, moreover, the trade surplus widened after the first quarter despite an acceleration in economic activity, which prompted the Bank of Japan to increase the discount rate from 5.84 to 6.25 per cent on September 1. Among countries in overall deficit, only the U.K. has recently shown some narrowing of the trade deficit.

The economic boom is likely to continue in Continental Europe well into 1970--except, possibly in France, where restraint measures are being adopted following the devaluation of the franc. Generally buoyant economic activity in Europe should expand intra-European trade and attract imports from outside Europe as well.

Developments in the trade of individual countries were as follows:

Germany's swollen trade surplus shrank significantly from the fourth to the first quarter, but only in reaction to adjustments in the fourth quarter when traders had acted in anticipation of changes in

border taxes. These changes were designed to reduce the price of imports into Germany and make German goods more expensive to foreign buyers.

Exports again surged in April-July, and import growth, though still rapid, retreated to less spectacular rates after the first quarter. As a result, the German trade surplus almost doubled from the first to the second quarter. For the year as a whole the German trade surplus is expected to total about \$4 billion. This is not a great deal less than the \$4.4 billion surplus in the recession year of 1967 and indicates the inadequacy of cyclical forces in eroding the trade surplus.

The commodity composition of German trade changed in the first half, as finished goods and foodstuffs gained in relative importance in both exports and imports at the expense of raw materials and semi-finished goods. Data on orders indicate that this trend will continue for exports.

In connection with the change in the commodity composition of German import demand, there was a decline in the relative importance of the less developed countries as suppliers of Germany and a corresponding gain in the market share of such countries as France, the Netherlands and the United States.

On the export side, demand from industrial countries was the prime stimulus to growth from the fourth quarter of 1968 to the second quarter of 1969.

Though quarterly changes in trade reflect the severe distortions caused by the border tax changes and the U.S. dock strike, both exports and imports are rising at an annual rate of about 17 per cent.

French imports rose very rapidly during the first seven months of 1969, averaging 10 per cent more a month than in August-December. Imports were stimulated both by the high level of economic activity in France and by speculative buying in anticipation of devaluation. Imports of steel were notably higher. French exports also increased this year, but at a slower rate than imports. The composition of French exports has altered somewhat, with shipments of agricultural goods increasing more rapidly than those of manufactured goods. There was an especially sharp rise in exports of wheat and wheat products to Germany.

French trade developments in coming months largely depend on the effects of the devaluation. Dramatic changes seem unlikely. Allowing for substantial buying of French goods with discounted francs before the devaluation, the effective parity change in August was less than 11.1 per cent. Much of the French economy is operating at full capacity, making rapid expansion of exports virtually impossible in the near future. Moreover, devaluation will increase the pressure for wage boosts, which could lead to cost increases nullifying the price advantage stemming from the new franc parity. Even without wage rises, the profit squeeze in recent months makes unlikely any major reduction in foreign currency prices of French goods.

However, restraints on the domestic economy have already been imposed and more are expected soon. This, coupled with an end to anticipatory import buying, could significantly reduce the rate of growth of imports, although the French current account deficit this year may reach \$1.5 billion.

In Italy, the trade deficit of the second half gave way to a surplus in the first half, as export growth speeded up slightly, while the rate of import expansion fell.

Italian exports are on a strong upward trend. The annual rate of growth since early 1968 has been about 25 per cent, resulting in a sizable increase in Italy's market share. For example, Italian exports to other OECD countries have increased at about twice the rate at which total imports of these countries have increased.

Italian imports are also rising, though less steeply than exports. The strength of import demand is primarily the result of the expansion of economic activity. Growth sharply accelerated in the last few months of 1968 and apparently continues to be rapid this year. The faster pace of expansion reflects the fiscal measures adopted last year to stimulate private investment, as well as the success of the monetary authorities thus far this year in preventing rises in interest rates.

Recent restraint measures are not expected to significantly cool the current Italian economic boom, so that the prospects are good for continued vigorous import demand.

Britain's trade deficit--on a balance of payments basis, that is, with both exports and imports f.o.b.--declined by about \$125 million from the second half of 1968 to the first half of 1969, totaling about \$550 million in January-June. (The latter figure does not take into account the under-recording of exports which, the government announced

last spring, had occurred since 1963 at about \$25 million a month.) The decrease in the trade deficit, combined with a reduction in payments for U.S. military aircraft and a rise in net earnings from invisibles, has yielded a small surplus on current account thus far in 1969.

Much of the improvement in the trade deficit has occurred since April. In January, the deficit was sharply reduced to \$29 million, but for the next three months averaged \$140 million. In May-July, however, the average was reduced to about \$60 million, in spite of an unfavorable turn in the terms of trade in recent months. From the first to the second quarter, export prices remained unchanged while import prices rose by about 1.5 per cent. During the same interval, export volume increased by 5 per cent, compared to only a 2 per cent rise in imports.

The improvement in Britain's trade position occurred despite a sharp 11 per cent decline this year in U.K. exports to the United States-- which buys more British goods than any other country. Total British exports nevertheless rose by 3.4 per cent, down sharply from the 8.8 per cent increase from the first to the second half of 1968. Continued strong demand from Western Europe coupled with a surge in exports to the sterling area and Canada helped offset the drop in shipments to the U.S. Imports between the two halves increased by a modest 1.7 per cent, compared to a 2.9 per cent rise between the first and second halves of last year. The slow growth in imports reflected the damping influences of the imposition of the import deposit scheme at the end of November and the reduction in aggregate output during the first quarter of 1969.

The outlook is for continued rapid growth in exports and probably for an increased rate of growth in imports. There is a substantial accumulation of orders from abroad for British machinery and transport equipment. Imports are likely to expand after--or if--the import deposit scheme expires in November and because of the expansion in economic activity which began after the first quarter dip.

Exports of the Netherlands rose by 11 per cent from the second half of 1968 to the first half of 1969, while imports rose by 8 per cent. The corresponding rates of increase between the first two halves of 1968 were 14 and 11 per cent. Most of the increase in exports and imports was accounted for by Dutch transactions with other members of the Common Market. The strength of exports is attributable to the high levels of demand among the Netherlands' main trading partners and to substantial productivity gains in Dutch export industries. The productivity increases have helped prevent domestic inflation from impairing the competitive position of Dutch exports.

Exports of Belgium-Luxembourg have continued to grow very rapidly, helping to underpin the strong expansion of economic activity there. Shipments abroad in the first five months of 1969 were 18 per cent higher than they had been in January-May 1968. The largest increases have been in shipments to other Common Market countries, in particular, to France and Germany.

Imports have also risen rapidly and were over 16 per cent higher in January-May than in the same period a year ago. Although a number of restrictive monetary and fiscal measures have been adopted in the last several months, there is little prospect for a slackening of Belgian economic activity--and import demand--this year.

Canada's trade surplus declined for the second consecutive half in January-June, as rapid export growth was outstripped by rising imports. In the first half, however, there was an abrupt turn-around for both exports and imports, as steep increases during the first part of the period gave way to declines in the second part. The decrease in exports was very sharp, reflecting the world wheat surplus and cutbacks in shipments of iron ore because of strikes in that industry in May and June.

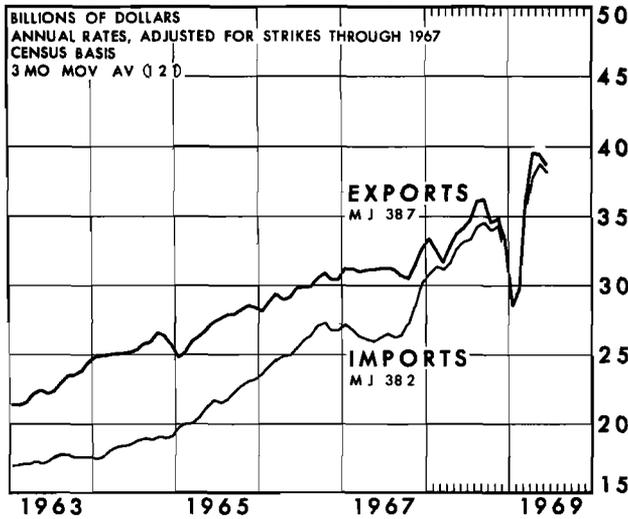
The decrease in imports, which was much more moderate than for exports, resulted in part from the government's anti-inflationary measures, though other factors also played a part. Imports, however, are likely to increase at a 10 per cent annual rate in the second half over the first.

Renewed growth in exports is also likely, but at a modest 3 per cent annual rate this semester. The glut in world wheat markets, strike-induced reductions in nickel ore output, and an easing of demand from the United States will affect Canada's exports. The trade surplus for 1969 as a whole is likely to decline substantially.

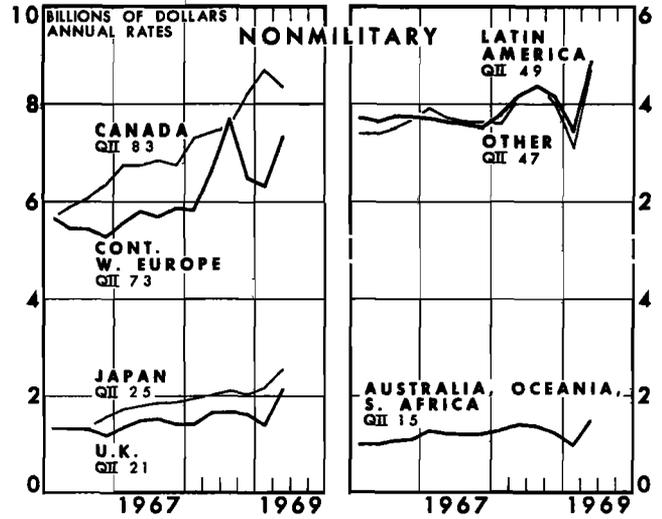
# U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

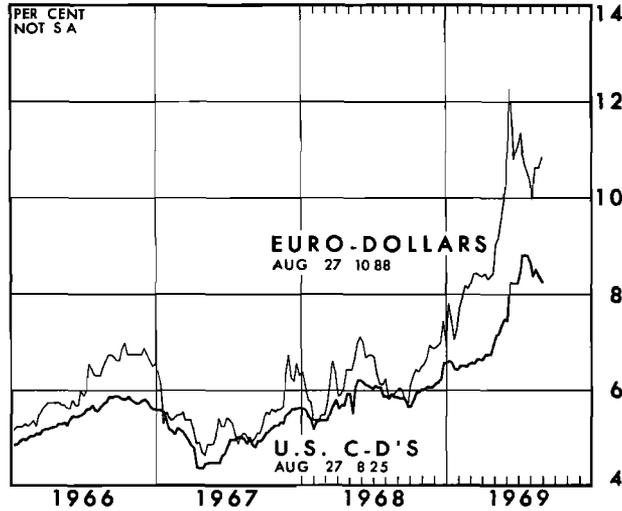
## U.S. MERCHANDISE TRADE



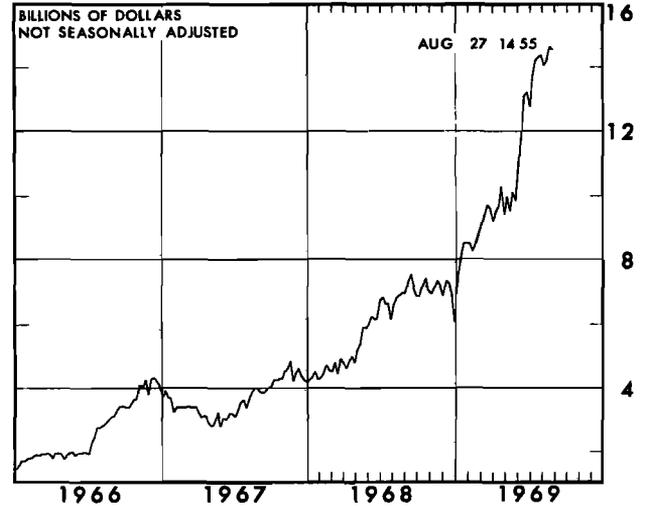
## U.S. EXPORTS BY AREA - NONAGRICULTURAL



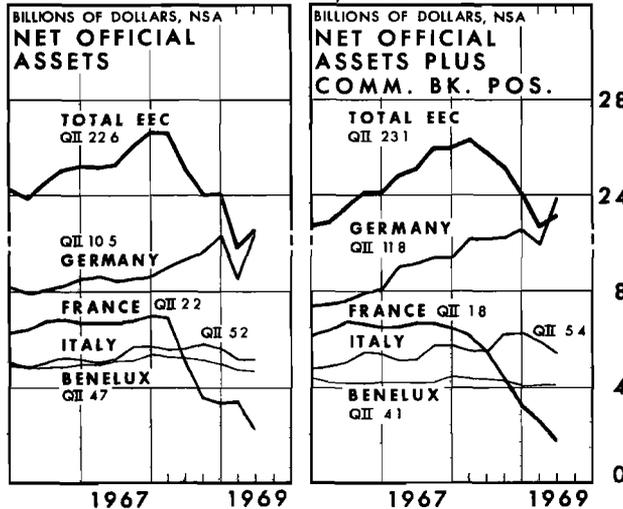
## 90-DAY RATES



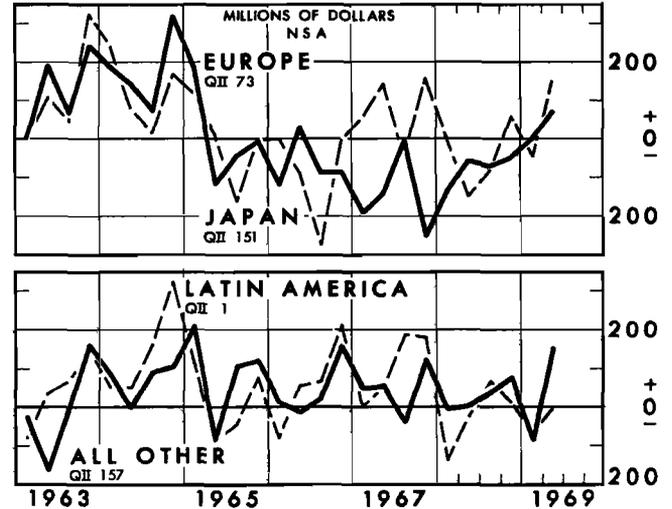
## LIAB. OF U.S. BANKS TO FOR. BRANCHES



## INTERNATL RESERVES, EEC COUNTRIES



## U.S. BANK CREDIT OUTFLOWS



APPENDIX A: STATE AND LOCAL GOVERNMENT BORROWING ANTICIPATIONS\*

The first survey of State and Local Government Borrowing Anticipations by the Federal Reserve Board indicates that these governments are planning gross long-term borrowing of approximately \$19 billion in fiscal year 1970 (July 1969 to June 1970). Over \$15 billion of the total represents debt issues already authorized by bond election or legislative approval. The remaining \$4 billion is the estimated amount of debt not yet authorized that will likely be approved and could come to market if conditions were favorable.

The \$19 billion figure is based on the anticipations of a sample of 4,100 respondent units as of mid-year 1969.<sup>1/</sup> Implicit in these plans are not only the experiences resulting from the stringent capital market conditions of the first half of 1969, but also interest-rate expectations for the coming four quarters. Many respondents, particularly those from larger units, volunteered that their plans were contingent upon (1) an easing of municipal bond yields or (2) a lifting of legal ceilings on interest rates. Further deterioration of conditions in the municipal bond market in the past few weeks clearly will reduce actual borrowing to well below what borrowers anticipated as of mid-1969 for the third quarter of this year.

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<sup>1/</sup> On a unit basis, response was about 90 per cent. However, in terms of the largest units and heaviest borrowers, it is much higher than this. While the analysis of response is not yet completed, it appears that all the State government units of any significant size were reached. Among the local units, those not responding represent only a small share of potential borrowing. Even after application of the blow-up factors, it is unlikely that an adjustment for nonresponse would increase the over-all estimates by more than 3 or 5 per cent, or \$500 million to \$1.0 billion for the year.

\* Prepared by John E. Petersen, Economist, Capital Markets Section.

Planned Borrowing by Quarter

Table 1 presents the survey results for fiscal year 1970, by quarter. The authorized issues form a "hard kernel" of debt that will be sold if possible. Of the debt planned but not yet authorized by respondents, it is estimated that only half will be approved and could be brought to market at the specified time.<sup>1/</sup>

Table 1

ANTICIPATED GROSS LONG-TERM BORROWING  
BY STATE AND LOCAL GOVERNMENTS  
BY QUARTERS OF FISCAL 1970  
(Billions of Dollars)

	1969		1970		F.Y. 1970
	III	IV	I	II	Total
Authorized	4.40	4.76	3.35	2.67	15.19
Not yet authorized	<u>1.32</u>	<u>2.30</u>	<u>1.85</u>	<u>1.72</u>	<u>7.19</u>
Total	5.72	7.07	5.20	4.39	22.38
ADJUSTED TOTAL <sup>1/</sup>	<u>5.06</u>	<u>5.92</u>	<u>4.28</u>	<u>3.53</u>	<u>18.78</u>

<sup>1/</sup> Authorized plus 50 per cent of unauthorized, assuming that 50 per cent of unauthorized borrowing is approved and sold according to schedule.

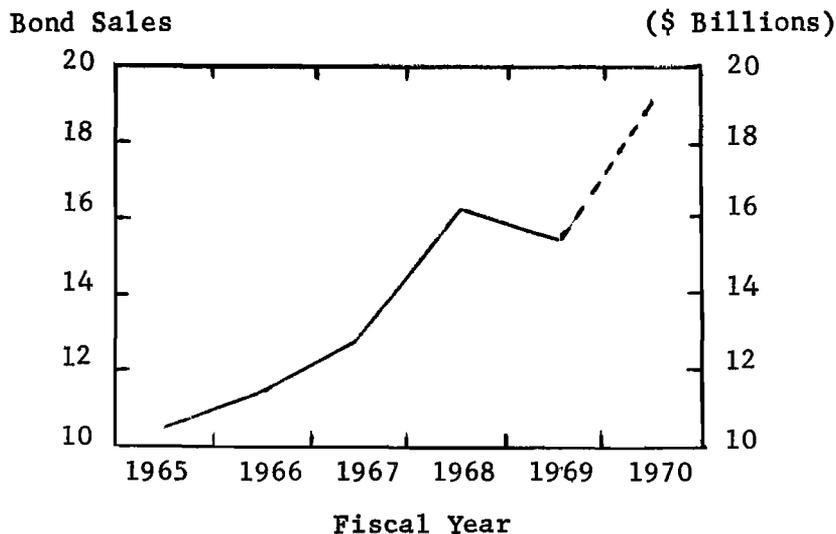
The last two quarters of calendar-year 1969 show a large lump of already authorized debt scheduled for sale. Three factors account for

<sup>1/</sup> This estimate is based on the assumption that the bulk of the not yet authorized debt represents scheduled bond elections. Lately, about 60 per cent of the dollar volume of issues have been approved in these elections. But, there is also the possibility that (1) some of these elections will not be held at all or on time, and (2) respondents may not have allowed enough time for the developing of issues after the approval at bond election (i.e., treated the election and sale as occurring in the same quarter). Altogether, a 50 per cent inclusion of unauthorized borrowing is a reasonable approximation. Experience with the panel should improve our ability to weight the unauthorized debt and to predict in this area.

this lumpiness. First, there is a substantial overhang of debt that has been postponed over the past year and that will be brought to market as soon as conditions permit.<sup>1/</sup> Second, there will be movement of unauthorized issues into the authorized category as issues are approved over the course of the year. Third, plans naturally will be more vaguely held for the last half of the fiscal year. It is to be expected that some borrowing plans are just now being initiated that may be executed by the end of the fiscal year.

Figure 1

STATE AND LOCAL LONG-TERM BORROWING  
 FISCAL YEARS 1965-1969 AND ESTIMATED  
 PLANNED BORROWING IN F.Y. 1970



<sup>1/</sup> Published postponements were \$1.5 billion for the 10 months ending mid-1969. But results of the 1966 State and local borrowing survey suggested that the published sources pick up only about half of the actual delays and reductions in long-term borrowings. Consequently, the staff estimates that about \$3 billion of issues were postponed or reduced from September 1968 through June 1969. Allowance must be made for a siphoning off of perhaps a third of these postponements through later comebacks, alternative financing arrangements, or project cancellations. But it is likely that \$2 billion or so of the authorized sales scheduled (as of mid-1969) for the last two quarters of 1969 represents either issues that were not sold earlier as planned or that were sold as short-term notes and will be in need of refunding.

Comparison With Earlier Periods and Recent Developments

As is shown in Figure 1, the estimated borrowing for fiscal year 1970 is somewhat above longer-term trends--trends which were breached by the stringent market conditions of fiscal 1969. Reported gross borrowing for fiscal year 1969 equalled \$15.5 billion. As may be seen in Table 2, the annual rate of borrowing dropped precipitously over the past fiscal year period, from approximately \$18 billion in the second half of 1968 to \$13 billion in the first half of 1969. To accomplish an anticipated \$19 billion in long-term borrowing in fiscal 1970, therefore, would require a dramatic upsurge in municipal bond sales for the next three quarters. Indeed, the implied increase in such sales for the remaining three quarters of fiscal 1970 over the volume sold in the first half of calendar 1969 is approximately 50 per cent.

Table 2

RECENT AND ANTICIPATED  
GROSS LONG-TERM BORROWING  
BY STATE AND LOCAL GOVERNMENTS 1/  
(Billions of Dollars)

Quarter	Calendar Year		
	1968	1969	1970
I	3.7	2.8	4.3
II	3.9	3.8	3.5
III	4.6	5.1	--
IV	4.4	5.9	--

1/ Investment Bankers Association data through 1969 II, adjusted anticipations thereafter.

High interest rates and generally stringent market conditions already have reduced actual bond offerings to well below the planned levels for the third quarter of 1969. It now appears that actual long-term bond sales will not exceed \$2.8 billion for the third quarter or over \$2 billion below the planned levels indicated by the survey. Most of these delayed issues will probably be shifted to subsequent quarters and can be expected to come to market as soon as monetary pressures subside. This continued buildup of unsatisfied borrowing demand and the accumulating overhang of postponed issues will tend to reduce some current expenditure plans as well as the financial holdings of State and local units. The nature and extent of these impacts as well as revisions in future borrowing plans will be the subject of quarterly follow-up surveys of units in the panel planning to borrow.<sup>1/</sup>

Borrowing by Type of Government

Table 3 gives the estimated anticipated borrowing levels of State and local governments by type of units. State government borrowing constitutes about one-third of the planned total and the bulk of this has already been authorized. Because of the relative high proportion of planned amounts not yet authorized, the estimates for local governments (especially special districts and school districts) are more uncertain. The last column presents the actual borrowing figures for those units in fiscal 1968 as reported by the IBA. Although there are some problems of classification

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<sup>1/</sup> The quarterly follow-up surveys (at the end of September, December, and March) will give a clear picture on (1) the amount postponed, (2) the revised borrowing plans, and (3) the consequences of the postponement for alternative financing and for expenditures. Item (2) will be used to make a rolling revision of planned borrowing for the remainder of the year.

making the figures not completely comparable, it would appear that State governments are maintaining their long-term borrowing expectations in line with recent experience while local units are hoping for a substantial increase in borrowing.<sup>1/</sup>

Table 3

ANTICIPATED LONG-TERM BORROWING BY TYPE  
OF GOVERNMENTAL UNIT, FISCAL 1970  
(Billion of Dollars)

	Authorized	Not Yet Authorized	Total	Adjusted Total 2/	1968 Fiscal 3/
State <sup>1/</sup>	5.42	1.24	6.66	6.04	6.55
County	1.09	.56	1.65	1.37	1.63
City & Town	4.58	2.18	6.76	5.67	3.85
Spec. Districts	1.34	1.03	2.37	1.85	1.08
Sch. Districts	<u>2.76</u>	<u>2.17</u>	<u>4.93</u>	<u>3.85</u>	<u>2.44</u>
Total	15.19	7.19	22.38	18.78	15.55

<sup>1/</sup> Includes State Authorities and Colleges.

<sup>2/</sup> Authorized plus 50 per cent of Unauthorized.

<sup>3/</sup> IBA figures. Unit classification discrepancies make the local government figures not completely comparable.

<sup>1/</sup> The State data represents a 100 per cent canvass and has not been blown up. The very largest local units, approximately 1,000 were also canvassed. The remainder of the local unit data was based on a sample of approximately 3,000 units which were subsequently blown up to form universe estimates. The average blow-up factor (including the large-unit canvass) was 1.40 for cities and towns, 1.21 for counties, 1.45 for special districts, and 2.90 for school districts. Overall, the blown-up figures were 1.39 times the reported amounts (including State and local units in the 100 per cent canvass). Adjustments for local unit nonresponse should increase the final figures only fractionally (circa 5 per cent) when it is completed.