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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

February 4, 1970

TABLE OF CONTENTS

SUMMARY AND OUTLOOK

Outlook for economic activity

The weakness in over-all economic activity evident in late 1969 has carried into 1970. Tentative estimates suggest that industrial production declined again in January--for the sixth consecutive month. The decline reflected further cutbacks in output of autos and other consumer durable goods, and probably in defense equipment, with a major new element introduced by a sharp reduction in output of steel. Retail sales remained sluggish in January, according to available weekly data, and auto sales declined sharply further.

These developments and others lend substantial support to the view that real GNP is likely to show an absolute decline in the current quarter, even with the GE strike coming to an end. With employment and income gains slowing, only a modest rise can be anticipated in consumer spending this quarter despite the reduction of the surtax to 5 per cent. Federal defense spending is estimated to decline significantly, consistent with the Budget document, and residential construction activity is likely to fall sharply in lagged reflection of the previous declines in housing starts. Inventory accumulation is also expected to decline further in the first quarter, as businessmen adjust production to the general weakening in demand.

The main expansive force in the economy continues to be business spending for fixed capital. For some time, however, additions to business capacity--with certain exceptions such as public utilities--

have exceeded the rise in demands for current output. Given this growing imbalance and in light of the prospects for sharply reduced profits, expenditures for plant and equipment still seem likely to fall short of those reported in the Commerce-SEC survey; we have assumed a modest shortfall.

We envisage little change in real GNP between the first and second quarters. On the one hand, the very large and retroactive increase in social security benefits to be paid in April will have a stimulating effect on consumer spending. On the other hand, the further weakness in residential construction that already appears in train, continued declines in defense spending, and a further downward adjustment in inventory investment are likely to preclude any significant economic expansion in the second quarter.

Outlook for resource use and prices

Demands for labor have eased considerably in recent months, and the manufacturing capacity utilization rate has fallen sharply. More easing in resource use is anticipated. Even if the G.E. strikers return to work in the very near future, the industrial production index is expected to decline further for the first quarter as a whole.

In the labor market, additional cutbacks in auto and defense production probably resulted in a further reduction of manufacturing employment in January. Claims for unemployment insurance continued to rise sharply, suggesting that the over-all unemployment rate will also show a sizable increase in January. Over the first half of 1970, our projections continue to show little change in total nonfarm employment, some decline in manufacturing employment, and a rise in the unemployment rate to over 4.5 per cent by mid-year.

The tentative G.E. settlement provides for an average annual increase in wages and fringes of around 7.0 per cent. This has been characterized as relatively moderate, which indicates something about the intensity of expèctations about upward wage business this year. Major contracts covering about 2-1/2 million workers are scheduled for renegotiation by mid-year. With living costs continuing to rise rapidly, union pressure for large wage increases will continue strong and settlements are likely to be substantial. Nevertheless, we still anticipate some slowing this year in the rate of increase of private nonfarm hourly earnings, primarily because easing demands for labor are likely to result in shorter workweeks and less overtime pay at premium rates.

Despite the softening in over-all demands, price developments continue to be disappointing. Upward pressures on prices are being maintained by increases in unit labor costs throughout the economy, by continued increases in costs of materials and transportation, and by attempts to limit erosion to profit margins. But a slowing of the price advance is likely to become progressively more evident if, as now expected, over-all demands remain relatively sluggish and manpower and industrial resources become more ample. We are still projecting some moderation over the year in the rate of price advance.

Prospective Financial Developments

A few signs of lessened pressure seem to be developing both in demands for bank credit and in the supply. But thus far these tendencies have been very limited. For the over-all squeeze on bank deposits to moderate significantly, sizeable additional declines in short-term market rates are probably necessary, not withstanding the higher Regulation Q ceiling rates. Nevertheless, bankers seem to have become somewhat less tense about the extent they expect bank reserve positions to be subjected to near-term pressures.

The backlog of outstanding loan commitments at banks has apparently been reduced, and there are reports from some quarters that current business loan demands are falling short of bankers' forecasts. These reports are consistent with the staff projection of further slackening in economic activity and inventory growth. Also, it is probable that some part of the heavy continuing volume of capital market financing by corporations is being used to repay short-term debt.

Even so, the actual volume of business loan growth seems unlikely to slow appreciably in the near-term from its reduced pace of the second half of last year. Many businesses are continuing to carry through on capital expansion programs at a time when their liquidity has been substantially depleted and their profits are being squeezed. Consequently, total external financing needs of businesses remain large; and there are probably many would-be borrowers in the wings ready to respond to any relaxation of bank lending policies, if one were to develop.

If rates on short term market securities remain close to their current levels, the supply of deposits available to meet demands for bank credit is not likely to grow and may even contract. While liberalization of ceiling rates on bank time and savings deposits has apparently helped to slow the rate of deposit attrition at some banks, any significant net increase in outstanding time and savings deposits will probably depend on a sizeable further drop in market yields. Some moderate growth in private demand deposits may develop, but this would be unlikely to offset a contraction in time deposits. Over the near-term, therefore, banks are likely to continue to rely heavily on non-deposit sources of funds.

Securities markets. In securities markets, a heavy flow of security offerings seems likely throughout the first quarter, reflecting the pressing continuing needs for funds of nonfinancial corporations, State and local governments, and Federal agencies. Projected corporate demands on capital markets are the largest for any first quarter on record--totaling over $4 billion in publicly offered bonds and over $2 billion in stocks. This heavy volume reflects both the general financial squeeze on businesses already noted and the sustained demand by public utilities, communications companies, and the petroleum industry--all of which are now in the midst of large long-range expansion programs.

New security offerings by State and local governments are expected to remain close to the recently expanded rate of $1 billion or so a month. As rate ceilings are removed in additional States, the leeway for expanded borrowing will grow despite the high levels of current yields. However, with bank funds still constrained, the backlog of unsatisfied State and local financing needs will probably continue to mount. Similarly, the FNMA and the FHLBB can be expected to continue pressing to raise whatever new money the market will bear.

With the current quarterly Treasury refinancing coming to an apparently highly successful conclusion, pressures from Federal financing will not be especially large over the rest of the quarter. Net cash needs of the Treasury have been variously estimated at $3.5 to $5 billion for the remainder of the fiscal year, depending partly on the size of attrition assumed in the refinancing. This amount is likely to be raised in the Treasury bill market in two operations--one around the end of February and the other around the end of March.

Mortgage markets. As in the case of commercial banks, the recent liberalization of ceiling rates at nonbank thrift institutions seems unlikely to produce any very significant step up of savings flows to such institutions over the current quarter unless there is a rather substantial further decline of rates on market securities. Without such a change, and even with continuing massive support from the quasi-public Federal agencies, mortgage commitments should continue to decline. In the near-term, therefore, mortgage credit should become still less available and more costly.

Interest rates. The just-published Federal Budget and the President's comments on its possible implications for monetary policy have contributed very recently to an easing of upward pressures on market interest rates. In most market sectors there have been significant yield declines. This strengthening of market expectations about the prospects for some near-term lessening of monetary restraint may carry the declines still further. But the heavy near-term financing calendar in securities markets will act as a brake on any such development. Thus, unless the current market expectations of a lessening in monetary restraint seem to be being confirmed, it appears unlikely that rate declines will proceed far enough over the next few weeks to make the new liberalized rate ceilings at banks and nonbank thrift institutions fully competitive.

Balance of payments outlook

Prospects remain good for some moderate improvement in the U. S. balance on goods and services in coming months. The December dip in imports to less than we had expected. Somewhat surprisingly, imports of machinery as well as consumer durables were smaller in the fourth quarter than in the third; in the case of machinery this perhaps reflected tightening supply conditions abroad. Economic activity in leading industrial countries abroad has accelerated in recent months and further advances in U.S. exports can reasonably be expected.

The over-all balance of payments is likely to continue in fairly heavy deficit on the liquidity basis. The exceptionally large December surplus--which reflected further reflows of corporate and unidentified U.S. funds that had moved into German marks before the revaluation, as well as year-end corporate movements -is irrelevant as a guide to current developments, even if averaged together with the rather large January deficit. Such an averaging is justified only with respect to whatever part of the inward movement of corporate funds in December went out again in January; such flows were presumably mainly from, and then back to, the Euro-dollar market.

Large question marks attach to any projection of the official settlements balance. Liabilities of U. S. banks to their foreign branches, after declining in December and then rising part way back, leveled off after mid-January. At current interest rate relationships it is doubtful whether the rise in these liabilities will be renewed. So long as no significant runoff occurs, the official settlements balance will tend to be close in magnitude to the liquidity deficit.

February 3, 1970

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1969				Per Cent Change * From		
	Sep.	Oct.	Nov.	Dec.	1 Mo. ago	3 Mos. ago	Year ago
Civilian labor force (mil.)	81.4	81.5	81.3	81.6	0.4	0.3	2.8
Unemployment rate (%)	4.0	3.9	3.4	3.4	--	--	[3.3] 4/
Insured unempl. rate (%)	2.2	2.2	2.3	2.3	--	--	[2.1] 4/
Nonfarm employment, payroll (mil.)	70.4	70.7	70.7	70.6	0.0	0.4	2.6
Manufacturing	20.2	20.2	20.0	20.0	-0.2	-1.0	0.2
Nonmanufacturing	50.2	50.5	50.6	50.7	0.0	0.9	3.5
Industrial production (57-59=100)	173.9	173.1	171.4	170.9	-0.3	-1.7	1.3
Final products, total	172.2	170.7	168.0	167.6	-0.2	-2.7	-0.2
Consumer goods	162.8	160.8	159.6	159.1	-0.3	-2.3	-0.7
Business equipment	200.4	200.8	194.6	194.6	0.0	-2.9	2.8
Materials	176.0	175.9	174.6	174.0	-0.3	-1.1	3.1
Capacity util. rate, mfg.	83.7	82.9	81.6	80.9	--	--	--
Wholesale prices (57-59=100) 1/	113.6	114.0	114.7	115.1 5/	0.3	1.3	4.8
Industrial commodities (FR)	112.2	112.8	113.1	113.5	0.4	1.2	3.8
Sensitive materials (FR)	113.5	113.5	114.2	114.9	0.6	1.2	4.4
Farm products, foods & feeds	114.3	114.3	115.7	116.4 6/	0.6	1.8	7.4
Consumer prices (57-59=100) 1/	129.3	129.8	130.5	131.3	0.6	1.5	6.1
Food	127.5	127.2	128.1	129.9	1.4	1.9	7.2
Commodities except food	118.7	119.8	120.2	120.3	0.1	1.3	4.4
Services	146.0	146.5	147.2	148.3	0.7	1.6	7.4
Hourly earnings, pvt. nonfarm ($)	3.09	3.10	3.12	3.13	0.3	1.3	6.5
Hourly earnings, mfg. ($)	3.24	3.25	3.26	3.27	0.3	0.9	5.5
Weekly earnings, mfg. ($)	131.79	131.34	131.70	132.43	0.6	0.5	5.0
Net spend. weekly earnings, mfg. (3 dependents 57-59 $) 1/	88.17	87.50	87.07	87.61	0.6	-0.6	-2.1
Personal income ($ bil.) 2/	760.7	763.7	767.4	769.7	0.3	1.2	7.5
Retail sales, total ($ bil.)	29.3	29.6	29.5	29.6	0.1	1.1	4.4
Autos (million units) 2/	9.1	8.4	8.3	7.7	-7.2	-15.2	-9.5
GAAF ($ bil.) 3/	7.9	8.1	8.0	7.9	-1.8	-0.5	4.8
12 leaders, composite (1963=100)	153.6	153.3	151.6	151.3	-0.2	-1.5	1.8
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/	1,542	1,392	1,297	1,245	-4.0	-19.3	-17.4
Factory workweek (hours)	40.8	40.5	40.5	40.6	0.2	-0.5	-0.5
Unempl. claims, initial (thous.)	20.1	20.2	21.4	21.0	1.9 7/	-4.5 7/	-10.5 7/
New orders, dur. goods, ($ bil.)	32.1	31.8	30.9	29.7	-4.0	-7.7	1.0
Machinery & equipment	7.4	6.5	6.4	6.4	-0.1	-13.0	2.6
Common stock prices (41-43=10)	94.51	95.52	96.21	91.11 8/	-5.3	-3.6	-14.4

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ January prel., 115.9. 6/ January prel., 118.0. 7/ Sign reversed.
8/ January figure, 90.30.

SELECTED DOMESTIC FINANCIAL DATA

	1969 Averages QI	QII	QIII	QIV	1970 Jan.	1970 Week ended Jan. 28
Interest rates, per cent						
Federal funds	6.56	8.33	8.98	8.94	8.98	9.04
3-mo. Treasury bills	6.09	6.20	7.02	7.36	7.87	7.89
3-mo. Federal agencies	6.39	6.80	7.63	7.92	8.27	8.29
3-mo. Euro-dollars	7.98	9.69	10.89	10.48	9.96	9.53
3-mo. finance co. paper	6.28	6.72	7.74	7.89	8.15	8.23
4-6 mo. commercial paper	6.65	7.54	8.49	8.63	8.78	8.63
Bond buyer municipals	5.03	5.43	6.00	6.40	6.68	6.78
Aaa corporate-new issues	7.06	7.32	7.75	8.32	8.46	8.60
20-year Treasury bonds	6.10	6.14	6.34	6.71	6.92	6.94
FHA mortgages, 30-year	8.04	8.17	8.38	8.53	n.a.	--

	Change during period QI	QII	QIII	QIV	Jan.'70
Change in monetary aggregates (SAAR, per cent)					
Total reserves	.1	1.2	-9.3	1.3	2.5
Nonborrowed reserves	-2.8	-4.7	-4.8	-0.2	7.9
Credit proxy	-4.8	-2.2	-9.4	--	-2.9
Credit proxy + nondep. funds	n.a.	n.a.	-4.0	2.0	-2.7
Money supply	4.1	4.5	--	1.4	10.2
Time and savings deposits	-5.1	-3.0	-13.3	--	-6.0
Deposits at S&L's and MSB's	6.0	3.9	2.1	1.2	n.a.
Bank credit, end-of-month	2.1	6.1	-0.8	2.1	-7.8e
Treasury securities	-26.7	-8.4	-11.4	-21.2	-37.1e
Other securities	2.2	0.6	-7.2	--	6.9e
Total loans	9.1	10.9	3.1	7.2	-5.7e
Business	15.4	10.8	5.1	5.0	-9.2e

	QI	QII	QIII	QIV	Dec.
Commercial paper (SA change, $ mil.)	1,296	3,683	3,552	2,973	935
Bank related (NSA)	n.a.	n.a.	1,254	1,713	130

	1968 Jan.	1968 QIV	1969 Jan.	1969 QIV	1970 Jan.
New security issues (NSA, $ mil.)					
Total corp. issues	1,771	5,951	2,075	7,460e	2,600e
Public offerings	903	2,555	980	3,365e	1,550e
State and local government bond offerings	1,178	4,366	1,262	2,952e	1,300e
Fed. sponsored agency debt (change)	526	594	322	2,970	467e
Fed. gov't. debt (change)	4,082	-1,143	1,626	5,061	100e

n.a. - Not available. e - Estimated. p - Preliminary.
SAAR - Seasonally adjusted annual rate. NSA - Not seasonally adjusted.

U.S. BALANCE OF PAYMENTS
In millions of dollars; seasonally adjusted

	1968	1969				
	Year	Year p/	II	III p/	IV p/	Dec. p/*
Good and services, net 1/	2,516		303	736		
Trade balance 2/	626	639	-3	328	417	207
Exports 2/	33,598	36,429	9,588	9,560	9,800	3,194
Imports 2/	-32,972	-35,790	-9,591	-9,232	-9,383	-2,987
Service balance	1,890		306	408		
Remittances and pensions	-1,159		-286	-307		
Govt. grants & capital, net	-3,955		-1,155	-1,052		
U.S. private capital	-5,157		-2,002	-1,333		
Direct investment	-3,025		-1,057	-1,095		
Foreign securities	-1,266		-427	-562		
Banking claims	269	-559	-501	205	-345	-525
Other	-1,134		-17	119		
Foreign capital	9,277		4,525	3,532		
Official foreign, nonliquid	2,407		-278	-592		
Official foreign, liquid	-3,099	-649	-570	2,127	-1,073	-140
Foreign commercial banks, liquid	3,382	9,166	4,801	1,253	150	-1,518
New direct investment issues 3/	2,129		150	216		
U.S. corporate stocks	2,084	1,515	127	169	468	8
Other	2,374		295	359		
U.S. monetary reserves (increase -)	-880	-1,254	-299	-686	-221	-964
Gold stock	1,173	-967	-317	-11	-695	-688
Convertible currencies	-1,183	747	246	-442	1,016	84
IMF gold tranche	-870	-1,034	-228	-233	-542	-360
Errors and omissions	-642		-1,088	-891		
BALANCES, (deficit -)						
Official settlements balance, S.A.			1,236	-918	1,463	
" " " , N.S.A. 4/	1,638	2,925	1,202	-1,038	1,050	1,120
Liquidity balance, S.A.			-3,871	-2,555	1,391	
" " , N.S.A.	168	-6,705	-3,812	-2,923	1,305	2,667
Adjusted over-all balance, S.A. 5/			-3,572	-2,179	1,336	
" " " , N.S.A.	-1,744	-6,241	-3,513	-2,547	1,250	2,638
Financed by:						
Liab. to comm. banks (decrease -)	3,382	9,166	4,715	1,509	-200	-1,518
Official settlements 6/	-1,638	-2,925	-1,202	1,038	-1,050	-1,120

1/ Equals "net exports" in the GNP, except for latest revisions.
2/ Balance of payments basis which differs a little from Census basis.
3/ New issues sold abroad by U.S. direct investors.
4/ 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.
5/ 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.
6/ Minus sign indicates decrease in net liabilities.
* Only exports and imports are seasonally adjusted.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. Real growth in the economy halted in the fourth quarter, according to the official preliminary GNP estimates. Lack of growth resulted from a slowing in inventory accumulation, as well as continued sluggishness in consumer outlays, weakness in residential construction, and curtailed spending for defense.

Recent weeks have brought further signs of weakening demand and additional downward adjustments in production. Retail sales apparently changed little in January, with durable goods sales particularly weak. New car sales dropped sharply, auto production was again cut, and industrial production apparently declined for the sixth month in a row. There have been increasing reports of employment layoffs and shorter workweeks, particularly in durable goods manufacturing industries. Insured unemployment continued to rise and by the end of January had shot up to the highest level in five years.

With the lagged effects of monetary policy continuing to restrict private expenditures and the new Budget proposing additional cuts in Federal purchases of goods and services, a pattern of weakness in economic activity in the immediate future is even more likely than it seemed earlier. We now expect current dollar increases in GNP of only $7 billion in the current quarter and $9 billion in the second quarter, as compared with $18 billion in the third quarter of 1969. In real terms, this implies an actual decline in GNP of about 1-1/2 per cent, annual rate, this quarter, and no increase in the second quarter.

Federal defense outlays in the new Budget are projected to continue to drop throughout 1970. Estimated reductions of the armed forces, from 3.5 million in the fourth quarter of 1969 to 3.2 million in the second quarter of 1970, cuts in Federal civilian defense employment and curtailed demand for military goods are expected to reduce defense purchases by about $4-1/2 billion, annual rate, between the fourth and second quarters. Moreover, nondefense purchases are projected about $1 billion below our previous estimates.

Residential construction continued to weaken toward year-end, and with the flow of savings shrinking and building permits dropping, a further reduction in construction activity is anticipated during the first half of this year. Total residential outlays in the fourth quarter were maintained at the third quarter level only by an estimated increase in expenditures for alterations and additions. Housing starts dropped to 1.25 million units, annual rate, in December, the lowest since late 1967, and for the quarter as a whole averaged 1.3 million units. Assistance from FNMA and the FHLB should moderate somewhat the decline in activity in coming months, but starts are nevertheless projected to dip to one million units in the spring quarter with outlays for residential structures down about $5-1/2 billion, annual rate, from the fourth quarter.

Expenditures by States and localities also continue to be affected adversely by the high cost and limited availability of funds.

Outlays in the first half of this year may increase somewhat more rapidly than the unusually slow rate in the last half of 1969. Federal grants are expected to increase and tax rates are being adjusted upward, but with tax receipts held down by slower economic expansion and bond markets continuing tight, growth of these outlays is expected to continue below the increases typical of most recent years.

As far as consumers are concerned, there is little in the current situation to suggest a change in underlying factors which eroded consumer buying attitudes and weakened retail sales in the past half year. The recent tax reform measure should have a stimulative effect on growth of disposable income and, thus, on consumption, particularly in the second quarter when retroactive Social Security benefits are paid out. But these income gains may be offset in part by further weakness in employment and reduced hours of work. Moreover, an atmosphere permeated by reduced overtime, production cutbacks and rising unemployment is not likely to be conducive to stimulating expenditures, and only moderate gains in consumption are projected for the first half. Consequently, the saving rate is expected to rise from the already relatively high fourth quarter level.

In contrast, business fixed investment is expected to remain an expansive sector during the first half of 1970, although the effect of the G.E. strike may dampen the increase somewhat in the current quarter. But, with sales continuing weak and widespread reports of reduced profits, we are holding to our projection of progressively smaller quarterly increases and a somewhat more modest rise in these outlays for the first half (and the year as a whole) than indicated by the recent Commerce-SEC survey.

In summary, we look for final sales to grow by only about $9 billion in the present quarter, and by about $11-1/2 billion in the second quarter, when the increased Social Security payments support a larger rise in consumer outlays. In addition, a reduced rate of inventory accumulation also is now expected in the next few months--as further production adjustments are made as a result of continued weak durable goods sales, additional cuts in defense outlays and high costs of carrying inventories--which should reduce the growth of GNP in the first quarter of 1970 slightly below our previous estimate.

Despite the halt in real economic growth, prices continued to increase at a rapid rate in the fourth quarter. Apathetic retail sales, reduced defense purchases, and excessive production capacity, should tend to moderate price increases somewhat in the future, but food prices appear likely to continue to move up for a time and no significant slowdown is evident in prices of services. We are now projecting somewhat less slowing of the GNP deflator, to about a 4 per cent annual rate in the second quarter of 1970 compared with a rise of 4.4 per cent in the fourth quarter of 1969.

Growth in GNP is still expected to resume after midyear, but the Budget proposed postponement of the Federal pay raise from July 1 to the end of the year, and the larger cuts now planned in defense outlays than anticipated are likely to dampen somewhat the rebound earlier predicted for the third quarter. Nevertheless, recovery of construction activity that would be expected to follow after a lag, an assumed easing of monetary restraint plus elimination of the surcharge on July 1 should stimulate recovery of final sales and output, and help to stabilize inventory investment during the second half. However, with Federal purchases expected to continue declining, and business fixed investment likely to level off, we anticipate only modest gains in over-all output. As a result, pressure on resources should continue to moderate, and some further slackening of price increases is projected by yearend.

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February 4, 1970

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.)

				1969			1970			
			1970				Projected			
	1968	1969	Proj.	II	III	IV	I	II	III	IV
Gross National Product	865.7	932.3	976.8	924.8	942.8	953.1	960.0	969.0	981.5	996.5
Final sales	858.4	924.3	972.5	917.9	932.0	945.3	954.5	966.0	977.5	991.9
Private	658.1	709.6	751.4	705.0	715.0	726.4	735.5	746.2	756.0	768.0
Excluding net exports	655.6	707.5	747.9	703.4	712.3	723.8	731.5	742.1	753.3	764.6
Personal consumption expenditures	536.6	576.0	612.8	572.8	579.8	589.2	597.1	608.6	618.5	627.0
Durable goods	83.3	89.6	89.3	90.6	89.8	89.6	88.3	89.0	89.5	90.5
Nondurable goods	230.6	243.8	260.8	242.1	245.1	249.4	253.8	259.4	263.8	266.3
Services	222.8	242.5	262.7	240.1	244.9	250.2	255.0	260.2	265.2	270.2
Gross private domestic investment	126.3	139.6	139.4	137.4	143.3	142.4	139.9	136.5	138.8	142.2
Residential construction	30.2	32.2	27.6	32.7	31.4	31.6	28.9	26.0	26.3	29.1
Business fixed investment	88.8	99.3	107.5	97.8	101.1	103.0	105.5	107.5	108.5	108.5
Change in business inventories	7.3	8.0	4.3	6.9	10.7	7.8	5.5	3.0	4.0	4.6
Nonfarm	7.4	7.8	4.3	6.7	10.3	7.6	5.5	3.0	4.0	4.6
Net exports of goods and services	2.5	2.1	3.6	1.6	2.7	2.6	4.0	4.1	2.7	3.4
Gov't. purchases of goods & services	200.3	214.7	221.0	212.9	217.0	218.9	219.0	219.8	221.5	223.9
Federal	99.5	102.0	97.5	100.6	103.2	102.7	100.0	98.1	96.6	95.5
Defense	78.0	79.3	74.2	78.5	80.3	79.2	77.3	74.9	73.1	71.6
Other	21.5	22.8	23.3	22.1	22.9	23.5	22.7	23.2	23.5	23.9
State & local	100.7	112.7	123.5	112.3	113.8	116.2	119.0	121.7	124.9	128.4
Gross national product in constant (1958) dollars	707.6	727.7	730.3	726.7	730.6	730.5	728.1	727.8	730.3	735.0
GNP implicit deflator (1958 = 100)	122.3	128.1	133.7	127.3	129.0	130.5	131.9	133.2	134.4	135.6
Personal income	687.9	747.1	793.4	740.5	756.5	766.9	775.4	791.7	798.1	808.4
Wages and salaries	465.0	509.8	539.9	504.3	516.9	524.8	530.3	535.9	542.4	550.8
Disposable income	590.0	629.6	675.2	622.0	639.0	647.1	657.5	671.5	681.9	689.7
Personal saving	38.4	37.6	45.6	33.3	43.1	41.6	44.0	46.3	46.5	45.7
Saving rate (per cent)	6.5	6.0	6.8	5.3	6.7	6.4	6.7	6.9	6.8	6.6
Corporate profits before tax	91.1	94.3*	85.3	95.4	92.5	92.5*	87.5	85.0	84.0	84.5
Federal government receipts and expenditures (N.I.A. basis)										
Receipts	176.3	201.5*	196.5	202.8	201.3	203.4*	197.2	198.5	193.9	196.5
Expenditures	181.5	191.9	201.1	189.3	193.6	196.2	197.4	205.2	201.0	200.9
Surplus or deficit (-)	-5.2	9.6*	-4.6	13.5	7.7	7.2*	-0.2	-6.7	-7.1	-4.4
Total labor force (millions)	82.3	84.3	85.6	83.8	84.6	84.9	85.1	85.3	85.7	86.1
Armed forces "	3.5	3.5	3.2	3.5	3.5	3.5	3.4	3.2	3.1	3.1
Civilian labor force "	78.7	80.8	82.4	80.3	81.1	81.5	81.8	82.1	82.6	83.1
Unemployment rate (per cent)	3.6	3.6	4.7	3.5	3.7	3.6	4.2	4.6	4.9	5.1
Nonfarm payroll employment (millions)	67.9	70.1	70.8	70.0	70.4	70.6	70.7	70.6	70.6	71.2
Manufacturing	19.8	20.1	19.7	20.1	20.2	20.1	19.9	19.7	19.5	19.7
Industrial production (1957-59=100)	165.5	172.7	168.8	172.6	174.3	171.8	168.7	167.5	168.5	170.5
Capacity utilization, manufacturing (per cent)	84.6	83.8	78.3	84.5	84.2	81.8	79.7	78.2	77.7	77.5
Housing starts, private (millions A.R.)	1.51	1.46	1.15	1.51	1.43	1.31	1.13	1.03	1.15	1.30
Sales new domestic autos (millions, A.R.)	8.62	8.46	7.75	8.54	8.45	8.13	7.50	7.75	7.75	8.00

* Estimated.

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February 4, 1970

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1968	1969	1970 Proj.	1969 II	1969 III	1969 IV	1970 Projected I	1970 Projected II	1970 Projected III	1970 Projected IV
	-----	-----	-----	-----	In Billions of Dollars	-----	-----	-----	-----	-----
Gross National Product	72.2	66.6	44.5	16.1	18.0	10.3	6.9	9.0	12.5	15.0
Inventory change	-0.1	0.7	-3.7	0.3	3.8	-2.9	-2.3	-2.5	1.0	0.6
Final sales	72.2	65.9	48.2	15.8	14.1	13.3	9.2	11.5	11.5	14.4
Private	52.0	51.5	41.8	12.9	10.0	11.4	9.1	10.7	9.8	12.0
Excluding net exports	54.7	51.9	40.4	12.8	8.9	11.5	7.7	10.6	11.2	11.3
Net exports	-2.7	-0.4	1.5	0.1	1.1	-0.1	1.4	0.1	-1.4	0.7
Government	20.2	14.4	6.3	2.9	4.1	1.9	0.1	0.8	1.7	2.4
GNP in constant (1958) dollars	33.0	20.1	2.6	3.6	3.9	-0.1	-2.4	-0.3	2.5	4.7
Final sales	33.3	19.8	5.8	3.5	0.6	2.5	-0.4	1.7	1.8	4.2
Private	24.9	18.4	9.3	3.9	1.4	2.9	1.2	3.0	2.1	3.8
	-----	-----	-----	-----	In Per Cent Per Year	-----	-----	-----	-----	-----
Gross National Product	9.1	7.7	4.8	7.1	7.8	4.4	2.9	3.7	5.2	6.1
Final sales	9.2	7.7	5.2	7.0	6.1	5.7	3.9	4.8	4.8	5.9
Private	8.5	7.8	5.9	7.5	5.7	6.4	5.0	5.8	5.3	6.3
Personal consumption expenditures	9.0	7.3	6.4	7.7	4.9	6.5	5.4	7.7	6.5	5.5
Durable goods	14.1	7.6	-0.3	10.0	-3.5	-0.9	-5.8	3.2	2.2	4.5
Nondurable goods	7.2	5.7	7.0	5.9	5.0	7.0	7.1	8.8	6.8	3.8
Services	9.1	8.8	8.3	8.7	8.0	8.7	7.7	8.2	7.7	7.5
Gross private domestic investment	8.9	10.5	-0.1	6.5	17.2	-2.5	-7.0	-9.7	6.7	9.8
Residential construction	20.8	6.6	-14.3	-7.2	-15.9	2.5	-34.2	-40.1	4.6	42.6
Business fixed investment	6.1	11.8	8.3	10.5	13.5	7.5	9.7	7.6	3.7	0.0
Gov't. purchases of goods & services	11.2	7.2	2.9	5.5	7.7	3.5	0.2	1.5	3.1	4.3
Federal	9.7	2.5	-4.4	-3.9	10.3	-1.9	-10.5	-7.6	-6.1	-4.6
Defense	7.7	1.7	-6.4	-2.5	9.2	-5.5	-9.6	-12.4	-9.6	-8.2
Other	16.8	6.0	2.2	-8.9	14.5	10.5	-13.6	8.8	5.2	6.8
State & local	12.8	11.9	9.6	14.0	5.3	8.4	9.6	9.1	10.5	11.2
GNP in constant (1958) dollars	4.9	2.8	0.4	2.0	2.1	-0.1	-1.3	-0.2	1.5	2.6
Final sales	5.0	2.8	0.8	2.0	0.3	1.4	-0.2	0.9	1.0	2.3
Private	4.7	3.3	1.6	2.8	1.0	2.0	0.8	2.1	1.5	2.6
GNP implicit deflator *	4.0	4.7	4.4	5.1	5.6 1/	4.4	4.2	4.0	3.7	3.5
Personal income	9.3	8.6	6.2	8.9	8.6	5.5	4.4	8.4	3.2	5.2
Wages and salaries	9.8	9.6	5.9	8.9	10.0	6.1	4.2	4.2	4.8	6.2
Disposable income	8.0	6.7	7.2	7.7	10.9	5.1	6.4	8.5	6.2	4.6
Corporate profits before tax	13.4	3.5	-9.5	0.4	-12.2	0.0	-21.6	-11.4	-4.7	2.4
Federal government receipts and expenditures (N.I.A. basis)										
Receipts	16.7	14.3	-2.5	8.5	-3.0	4.2	-12.2	2.6	-9.3	5.4
Expenditures	10.8	5.7	4.8	1.7	9.1	5.4	2.4	15.8	-8.2	-0.2
Nonfarm payroll employment	3.0	3.2	0.9	2.9	2.3	1.1	0.6	-0.6	0.0	3.4
Manufacturing	2.1	1.5	-2.1	0.0	2.0	-2.0	-4.0	-4.0	-4.1	4.1
Industrial production	4.7	4.4	-2.3	5.6	3.9	-5.7	-7.2	-2.8	2.4	4.7
Housing starts, private	16.7	-3.3	-20.4	-48.3	-21.5	-33.8	-56.8	-35.6	48.8	52.2
Sales new domestic autos	14.0	-1.9	-8.4	8.4	-4.2	-15.1	-31.0	13.3	0.0	12.9

* Based on deflators calculated to three decimals.

1/ Excluding Federal pay increase 4.3 per cent.

<u>Industrial production</u>. Industrial production in January is estimated to have declined about .5 per cent to an index level of around 170 per cent--down 2.5 per cent from July and only 0.5 per cent above a year earlier. The decline since July--an annual rate of 5 per cent, of which almost 1 per cent represents the direct effects of the G.E. strike--mainly reflects curtailments in output of consumer durable goods--including autos, appliances, television, and furniture--and defense equipment.

Sales of new domestic autos in January were down one-tenth from December--and one-sixth from a year earlier--to an annual rate of 6.8 million units, the lowest level in almost 3 years. Auto output was cut 7 per cent further in January to an annual rate of 6.8 million units and February production schedules have been revised downward to a 6.3 million unit rate. Unit stocks of autos declined about 7 per cent seasonally adjusted, over January (and were 8 per cent below a year earlier); but the stock/sales ratio remained unusually high, at 64 days.

Among other final products, output of defense equipment apparently declined further in January and truck production, after holding at record levels through December, appears to have slowed somewhat. Television production, however, rose from the reduced December level.

With respect to materials, output of raw steel was down sharply in January. The fall-off stemmed from large inventories held by producing mills (at the end of December they were close to the early 1968 peak reached in anticipation of a nationwide strike), sharp curtailments in steel consumption in the consumer durable goods industries, and some cutbacks in farm equipment and construction industries. Decreased domestic demand has been only partly offset by a continued sharp rise in steel exports. Production of other materials used to produce consumer durable goods also is estimated to have declined further in January.

The mainstay to industrial production since mid-1968 has been the record levels of output of industrial and commercial equipment, excluding the effects of the G.E. strike, and, at least until recently, output of nondurable materials. Cutbacks in production of consumer durable goods have been large and further reductions are anticipated in the first quarter of 1970, in line with the staff projection of a 2 per cent decline in personal consumption expenditures for these goods.

Auto assemblies in the first quarter are scheduled at an annual rate of around 6.5 million units, down 15 per cent from the fourth quarter. Output of home goods is estimated to be down somewhat further in the first quarter, even after allowance for the G.E. settlement, in view of the anticipated sluggishness of retail sales and efforts to cut back factory and retail inventories.

CONSUMER DURABLE GOODS
Per cent change from previous quarter

	1969			1970
	II	III	IV	Ie
Personal consumption, in constant dollars (GNP)	1.9	-1.4	- .7	- 2.0
Production (FRB)				
Total, consumer dur. goods	- .7	1.4	- 7.0	- 6.0
Automotive products	-3.0	5.9	- 7.4	-12.0
Autos	-6.7	12.9	-12.9	-15.0
Home goods	.8	-1.4	- 6.7	- 1.0
Inventories				
Autos	-9.2	9.8	1.9	- 5.0
Home goods				
Factory	0.1	7.8	- 8.4	- 8.0
Retail stores*	-4.2	1.9	2.0	- 2.0

e - Estimated.
* Current dollars.

If the G.E. strike is settled this week, the rise in output of home goods in February should about offset the decline indicated in automotive products. The settlement would also result in an increase in production of business and defense equipment and industrial materials which should counter-balance decreases in other industrial materials and products. The net result of the return to work at G.E. would appear to be little changed in February in the total industrial production index.

Retail sales. Weekly figures suggest that January sales may have been about unchanged both from the December level and the fourth quarter average. A sizable decline is indicated in sales at durable goods stores, largely because of the sharp drop in deliveries of new cars. Sales at most types of nondurable goods stores apparently rose in January.

A continued plateau of retail sales--with perhaps some further weakness in durable goods--is suggested by recent declines in the University of Michigan index of consumer sentiment. The more sluggish pace of sales in 1969--only 4 per cent higher than in 1968, and in real terms half a per cent below 1968--apparently had been foreshadowed by the Michigan index of consumer sentiment.

SALES OF RETAIL STORES

	1968	1969			
	IV	I	II	III	IV
	-----------In Billions of Dollars-----------				
All stores	28.6	29.1	29.4	29.2	29.6
Durable	9.3	9.5	9.5	9.2	9.3
Automotive	5.5	5.6	5.6	5.5	5.6
Nondurable	19.3	19.6	19.8	20.0	20.3
Food	6.2	6.3	6.3	6.3	6.5
Dept. stores	2.9	2.9	3.0	3.1	3.1
	----Per Cent Change From Previous Quarter---				
All stores	.1	1.6	1.2	- .6	1.2
Durable	.4	1.9	.6	-3.2	..8
Automotive	·.8	1.1	.1	-1.3	1.8
Nondurable	.0	1.4	1.4	.7	1.4
Food	.2	2.3	- .6	1.0	2.1
Dept. stores	1.7	.8	4.6	1.9	- .4
Real sales - total	- .9	.8	- .4	-1.9	- .1

Consumer credit. There was a dramatic deceleration of the rise in consumer instalment credit outstanding during December. On a seasonally adjusted annual rate basis, the increase for the month was only $5.0 billion compared with $7.4 billion in November and $9.3 billion in December a year ago. For 1969 as a whole, outstanding instalment credit rose $8.3 billion, somewhat less than in 1968.

Other consumer goods paper and personal loans accounted for all of the advance during December. Auto credit outstanding declined for the first time since April 1967 and only the third time in the past 8 years; home improvement credit fell back for the fifth time in the past six months.

On a holder basis, the increase in outstandings at sales finance companies was the smallest in nearly two years. Commercial banks accounted for about one-half of the over-all increase in consumer paper during December, a larger share than in other recent months. The relatively strong showing of commercial banks in December is traceable in large part to a record advance in nonautomotive consumer goods paper which, in turn, was mainly attributable to an exceptionally sharp rise in bank credit card outstandings. Similarly, the increase in check-credit outstandings, while much smaller in volume, accounted for about one-half of the rise in bank personal loans--the category in which check-credit is included.

INCREASE IN CONSUMER INSTALMENT CREDIT OUTSTANDING
(Seasonally adjusted annual rates, in billions of dollars)

	1965	1966	1967	1968	1969
QI	8.0	7.1	2.2	7.0	8.3
QII	9.4	6.0	2.4	8.4	9.6
QIII	8.7	6.0	3.9	10.1	7.7
QIV	7.5	5.0	4.3	10.2	6.8
Year	8.6	6.2	3.4	9.0	8.3

Cyclical indicators. The Census leading composite indicator (trend adjusted) declined slightly in December, according to preliminary calculations. This was the third successive monthly decline and the series is now 1.5 per cent below the September peak. The coincident composite also dropped slightly in December from its November peak.

Most previous declines of comparable magnitude in the leading composite have been followed by adjustments in general business activity, ranging from a decreased rate of growth, as in late 1962, to declines as large as the postwar recessions. The size and duration of declines in the composite index have not indicated reliably what the magnitude of the subsequent adjustment was likely to be.

COMPOSITE CYCLICAL INDICATORS
1963 = 100

		12 Leading Indicators	5 Coincident Indicators	6 Lagging Indicators
1969:	August	151.7	172.3	193.9
	September	153.6	171.4	195.0
	October	153.3	172.5	196.4
	November	151.6	173.6	197.6
	December (prel.)	151.3	173.1	200.4

Leading series declining in December included new orders for durable goods, private housing building permits, common stock prices, and the ratio of price to unit labor cost. There were partly offsetting increases in the manufacturing workweek, initial unemployment claims (inverted), contracts and orders for plant and equipment (reflecting a jump in commercial and industrial building contracts, which have fluctuated widely all year around an advanced level), and industrial materials prices. But except in the case of the materials price index, such increases as occurred in individual leading indicators were slight. All of the leading series except the materials price index are below levels reached earlier in the year.

New orders and shipment. New orders for durable goods declined 4 per cent further in December. It was the third successive decline and the drop since September was about the size as that during the same period in 1966. A substantial part of the reduction was in motor vehicles and parts, but defense products, capital goods, and iron and steel also contributed. Shipments and unfilled orders for durable goods also fell.

NEW ORDERS FOR DURABLE GOODS
Seasonally adjusted monthly averages, billions of dollars

	1969 QIV (prel.)	Per cent change: QIV from QIII
Total durable goods	$30.8	-1.4
Primary metals	4.9	-4.1
Iron and steel	2.2	-9.2
Other primary metals	2.7	.7
Motor vehicles and parts	4.1	-11.7
Other consumer durable goods	2.0	-9.6
Defense products (new series)	2.0	14.4
Business equipment (total less defense)	8.7	1.3
All other durable goods	9.1	1.6

Total durable goods orders were off by 1.4 per cent for the fourth quarter as a whole, about the same as the decline in the fourth quarter of 1966, and the first significant drop since early 1967. The decline was mainly in autos, other consumer durables and steel. Ordering of defense goods, while below year-ago levels, was up from the sharply reduced average of the second and third quarters, and ordering of business equipment continued at a high level, above the third quarter average, although below the September peak.

Inventories. Book value of manufacturers' inventories rose in December at about the reduced November rate. Durable goods inventory growth slowed, reflecting in part the G.E. strike, but stocks of nondurable goods increased.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES
Seasonally adjusted annual rate, billions of dollars

	1969		
	October	November	December (prel.)
Manufacturing and trade, total	18.2	8.9	n.a.
Manufacturing, total	8.5	6.0	6.2
Durable	7.2	5.3	3.0
Nondurable	1.3	.7	3.2
Trade, total	9.7	2.9	n.a.
Wholesale	2.9	1.0	n.a.
Retail	6.8	1.9	n.a.
Durable	5.8	.5	n.a.
Automotive	5.0	- .1	n.a.
Nondurable	1.0	1.4	n.a.

Sales were weak in December, and both the total and the durable goods manufacturing inventory-sales ratios rose to the highest levels since the slowdown of 1967. The ratio of durable goods inventories to unfilled orders also continued to rise.

INVENTORY RATIOS

	1966		1969		
	November	December	October	November	December
Inventories to sales:					
Manufacturing and trade, total	1.54	1.56	1.54	1.56	n.a.
Manufacturing	1.69	1.72	1.67	1.70	1.75
Durable goods	1.95	2.00	1.97	2.04	2.12
Nondurable goods	1.38	1.37	1.29	1.29	1.31
Trade, total	1.38	1.39	1.39	1.39	n.a.
Wholesale	1.61	1.61	1.53	1.53	n.a.
Retail	2.10	2.10	2.20	2.23	n.a.
Inventories to unfilled orders, durable goods mfg.	.633	.639	.726	.731	.736

Construction and real estate. Seasonally adjusted private housing starts continued to decline in December and, at an annual rate of 1,245 thousand (including farm starts) were the lowest since June 1967. While multifamily starts, which had accounted for most of the reduction in other recent months, turned slightly upward in December, single family starts dropped to a new low for the year. Among regions, only the South failed to decline. Based on the continued downward pressures on outstanding commitments and on total building permits at the year's turn some further decline in housing starts was indicated for January, possibly to less than a 1.2 million annual rate.

PRIVATE HOUSING STARTS AND PERMITS

	December 1969 (Thousands of units) 1/	Per cent change from	
		November 1969	December 1968
Starts	1,245	- 4	-17
1-family	718	- 8	-22
2-or-more-family	527	+ 3	-10
Northeast	142	- 3	-28
North Central	254	- 5	-26
South	567	+ 2	-14
West	282	-15	- 8
Permits	1,177	- 1	-20
1-family	631	+ 6	-14
2-or-more-family	546	- 8	-25

1/ Seasonally adjusted annual rates; preliminary.

With starts for the fourth quarter as a whole at a 1.31 million annual rate, starts for 1969 totaled 1,463,000. Although well below basic requirements, this number came close to the improved 1968 total; including an addition 390,000 mobile home shipments (compared with 317,000 in 1968), the combined count of new residential units for the year was actually the largest since 1950. Other striking developments last year included: multifamily starts reached a record 548,000, despite an accelerated decline in the fourth quarter, and accounted for an unprecedented 44 per cent of total starts. Also, Government-underwritten starts, benefiting particularly from sustained support of FNMA in the market for Government-underwritten mortgages, averaged a fifth of total starts. While this share was only moderately greater than in 1968, it was the highest since 1962.

Labor market. Signs of reduced demands for labor have become increasingly evident and total unemployment is expected to rise in January. Increased layoffs of experienced blue-collar workers--especially in the auto, aircraft, and aerospace industries--caused initial claims for unemployment insurance payments to rise sharply in January, extending the increases which began last spring. About 1.4 million workers were drawing unemployment insurance benefits last month, an increase of 22 per cent from the comparable period a year earlier and the highest number since early 1965. The higher levels of insured unemployment probably include disproportionate numbers of adult men, and both their jobless rate and the over-all unemployment rate are likely to rise in January.

STATE INSURED UNEMPLOYMENT
(Weekly average, in thousands, seasonally adjusted)

	Initial claims	Insured unemployment
1969		
May	180	1,031
July	197	1,148
September	201	1,142
November	214	1,195
December	210	1,214
1970		
January*	238	1,400

* Estimates based on data for first three weeks of January.

Aggregate wage and salary payments rose at an annual rate of 6 per cent in the fourth quarter, or less than two-thirds as rapidly as earlier in 1969. The slowing--which mainly reflected developments in manufacturing, where wages and salaries rose only 1 per cent (annual rate)--was caused by smaller over-all growth, reductions in average weekly hours, and the G.E. strike.

PER CENT CHANGES IN SELECTED MEASURES OF EARNINGS

	Change from a year earlier		Change from QIII 1969 to QIV (annual rate)
	1968	1969	
Wages and salaries:			
Total	9.8	9.6	6.1
Private nonfarm industries	9.4	9.8	5.9
Manufacturing	8.7	8.0	1.0
Compensation per manhour:			
Private nonfarm economy	7.4	6.8	7.1
Manufacturing	6.8	6.6	5.2
Hourly earnings1/:			
Private industry	6.3	6.7	6.8
Manufacturing	6.4	6.0	4.0

1/ Data relate to production and nonsupervisory workers only.

Lessening demands for consumer durables (especially autos) and cuts in Federal spending on defense and space programs reduced manufacturing production, employment and hours of work in the fourth quarter. Employment levels and income flows were further affected by the G.E. strike which has kept about 130,000 workers off payrolls since late October. As a result of these factors, manufacturing employment declined at a 3-1/2 per cent annual rate from the third to the fourth quarter while cuts in overtime reduced average weekly hours.

AVERAGE WEEKLY HOURS
(Seasonally adjusted)

	1968	1969	
	IV	III	IV
Private nonfarm industries	37.7	37.8	37.6
Manufacturing	40.8	40.7	40.5
Average overtime	3.7	3.7	3.5

The rise in average hourly earnings of factory production workers slowed to a 4 per cent annual rate in the fourth quarter, as compared with an annual rate in excess of 6 per cent during the first three quarters of 1969. The slowing was due almost entirely to reductions in overtime work. The impact of reduced overtime was especially apparent in durable goods industries, where average overtime work was sharply curtailed. Straight-time hourly wages of factory workers, however, appear to be rising at about the same rate as in early 1969, or even slightly faster. In private nonmanufacturing industries, also, hours of work declined slightly but average hourly earnings and compensation per manhour continued to rise about as rapidly as earlier in 1969.

The moderate fourth quarter reduction in working hours and the slowing of employment growth were accompanied by a resumption of productivity gains in the nonfarm sector, after three quarters of decline. Employers were apparently reluctant to adjust employment to the slower growth of demand early in 1969, but erosion of profits and weakness of demand appear to have resulted in adjustments in the fourth quarter. These adjustments in employment and hours, in turn, resulted in slower growth in aggregate wages and salaries, which together with the still rapid rise of consumer prices resulted in virtually no change in real disposable personal income in the fourth quarter, compared to a 3 per cent annual rate of increase over the first three quarters of 1969.

Industrial relations. After over 3 months of strike, a tentative 40-month agreement has been reached in the G.E. dispute which provides increases in wages and benefits that are relatively moderate in the light of recent major settlements. Wage rates would be increased by about 7-1/2 per cent (25 cents) in the first contract year, as compared with a median first-year increase of 8.3 per cent in major contracts negotiated in all industries during 1969. Additional wage increases of 15 cents each after 13 and 27 months, and a maximum cost-of-living adjustment of 8 cents a year are also provided. Over the life of the contract, the increase in wages and fringes is estimated to average around 7 per cent a year, also less than the median life-of-the contract increase for all major agreements reached in 1969.

With many large--and very strong--unions negotiating new contracts this year (teamsters, construction, rubber, and auto workers), the increase received in the G.E. settlement is not likely to prove to be pattern-setting.

<u>Wholesale prices</u>. Wholesale prices increased at an estimated annual rate of 8.3 per cent from mid-December to mid-January--faster than any month since last May--with the acceleration largely the result of an exceptionally sharp increase in prices of processed foods and feeds. The average price of industrial commodities rose at a rate of 4.2 per cent, about the same as the average of the last six months.

WHOLESALE PRICES
(Percentage changes at annual rates)

Commodity Groups	Dec 1968 to June 1969	June 1969 to Sept 1969	Sept 1969 to Dec 1969	Dec 1969 to Jan 1970
All commodities	6.1	1.5	5.4	8.3
Industrial commodities	3.6	3.6	4.6	4.2
Farm products, and processed foods and feeds	13.0	- 4.0	7.4	16.5
Farm products	15.2	-10.0	12.4	5.4
Processed foods and feeds	11.6	.1	4.3	23.5

Note: These percentage changes may differ from those derived from figures published by the BLS owing to differences in rounding procedures.

The large rise in the price of foods and farm products resulted from increases for a wide variety of agriculturally-based commodities including meats, animal feeds, sugar, grains, milk, and coffee, although declines for livestock, fresh fruits, and eggs held down the extent of the rise. Some of the increases may be reversed this month and help produce a smaller increase in the February index for foods and farm products. The price of raw sugar already has dropped below the quotation on the January pricing date. If weather conditions do not deteriorate over central U.S., a reversal in the prices of manufactured animal feeds and grains can be expected.

Among the more important increases in prices of industrial commodities were those for metals, paper products, and machinery and equipment. Lumber and wood products declined further and motor vehicles were reported slightly lower.

Since the January pricing date, price announcements have centered on steel products. Increases of about 4.6 per cent on steel plates, structurals, and sheet piling are slated for March 1. Sheet products prices rose 3-4 per cent on February 1, eliminating the savings available under a new billing system put into effect on January 1. Extras were also raised on sheet products, which account for more than one-third of the steel industry's total shipments and are a major material used by manufacturers of such items as automobiles, appliances, machinery, and farm buildings. With the announced February and March increases, prices will have been increased this year on about two-thirds of the tonnage shipped by the industry, and average prices of steel mill products will have been raised about 1-1/2 per cent.

Prices of steel scrap are also higher as a result of the unexpectedly large demand for scrap for domestic use and export and the reduced supply resulting from transportation problems and curtailed output.

Over the past year, farm commodities accounted for about 40 per cent of the rise in wholesale prices, and industrial commodities for about 60 per cent. Almost one-half of the industrial price rise was accounted for by metals, and about 20 per cent by machinery and equipment.

WHOLESALE PRICES

Commodity groups	December 1968 to December 1969 Percentage increase	Percentage contribution to increase in total WPI
All commodities	4.8	100
Farm products, and processed foods and feeds	7.4	41
Industrial commodities	4.0	59
Metals and metal products	9.8	26
Machinery and equipment	4.5	11
Other	2.2	22

Consumer prices. Consumer prices rose at an annual rate of over 7 per cent in December--slightly faster than in the fourth quarter or over the year 1969. About half the increase reflected higher food prices, with most of the remainder due to service costs.

The unusually large increase in food prices from mid-November to mid-December in large part reflected adverse weather conditions. Fresh vegetable and egg prices were up very sharply. Bakery and dairy products also increased while meat prices were unchanged.

CONSUMER PRICES
(Percentage changes)

	Annual rates, 1969				Dec. to Dec.	
	Dec. 1968 to June 1969	June to Sept.	Sept. to Dec.	Nov. to Dec.	1967 to 1968	1968 to 1969
All items	6.3	5.3	6.2	7.4	4.7	6.1
Commodities	5.6	4.0	6.2	6.8	3.8	5.5
Durables	5.5	- .4	7.2	1.1	2.5	4.5
New cars	-1.8	-9.0	21.7	-2.3	1.4	2.1
Household durables	5.4	1.5	1.1	0	3.9	3.4
Nondurables	5.6	5.5	6.0	9.5	4.4	5.8
Food	7.1	6.4	7.5	16.9	4.3	7.2
Apparel	4.4	5.4	6.9	.9	6.7	5.3
Services	7.5	7.5	6.3	9.0	6.1	7.4
Addendum:						
All items, except food	5.9	5.0	5.8	4.6	4.9	5.8

Since the pricing date, prices of food have risen further. Meat prices at retail resumed their rise in the first half of January and fresh fruits and vegetables also moved higher as the weather continued severe. Egg prices remain high.

Among non-food commodities, new and used car prices declined in December and household durable goods prices--which had been decelerating--were unchanged.

Service prices in December advanced more than in the previous two months. Medical care costs continued to rise at a rate somewhat below that earlier in the year, but public transportation costs, and insurance and financing charges moved up rapidly. January service prices will reflect the increase in mortgage rates on government-underwritten mortgages and the rise in subway fares in New York.

Over the past year, food prices rose 7 per cent compared to about 6 per cent for all components except food. Apparel prices rose 5.3 per cent over the past year, somewhat less than in 1968. Over the last four years food prices at retail have moved up 17.5 per cent, about the same as other prices measured by the CPI.

Prices of new cars rose only 2.1 per cent in 1969 and household durables, 3.4 per cent. However, the index for consumer durable commodities as a whole rose 4.5 per cent. The disparity reflects for the most part the influence of "home purchase" prices, which are not made available separately by the BLS. Costs of home-ownership rose over 10 per cent last year compared to 3.7 per cent for rent.

CONSUMER SERVICE PRICES
(Percentage change over the year

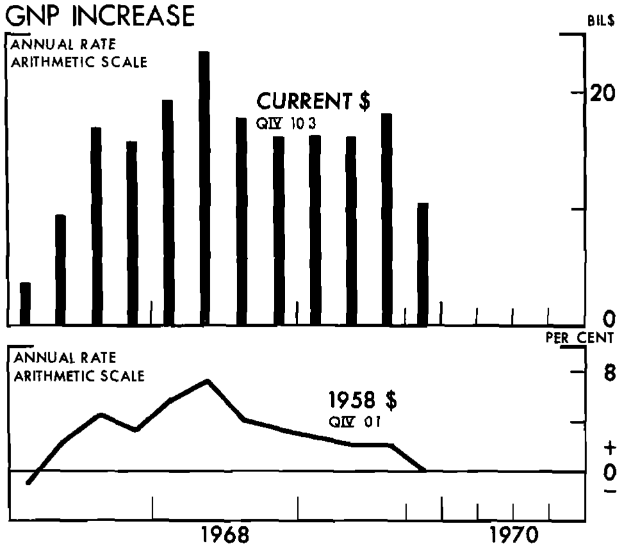
	1968	1969
Total	4.7	7.4
Rent	2.8	3.7
Household services less rent	7.8	9.5
Transportation	4.9	8.5
Medical care	7.3	7.1
Other	5.7	4.9
Addendum - Homeownership costs[1/]	7.7	10.2

1/ Includes home purchase and materials used in repair in addition to the following services: mortgage interest, insurance, property taxes, home-maintenance.

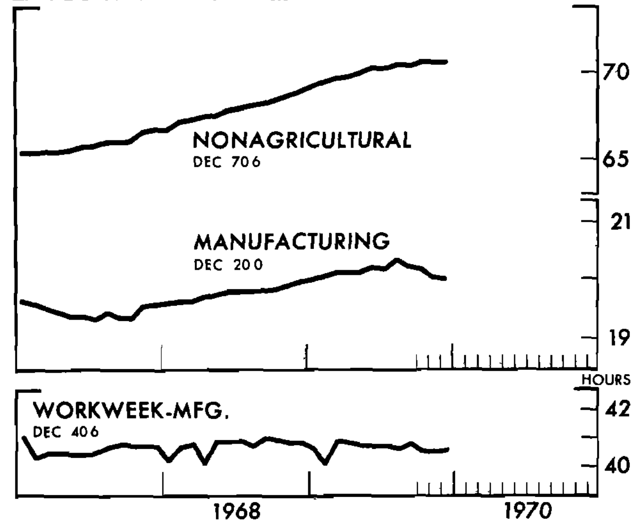
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

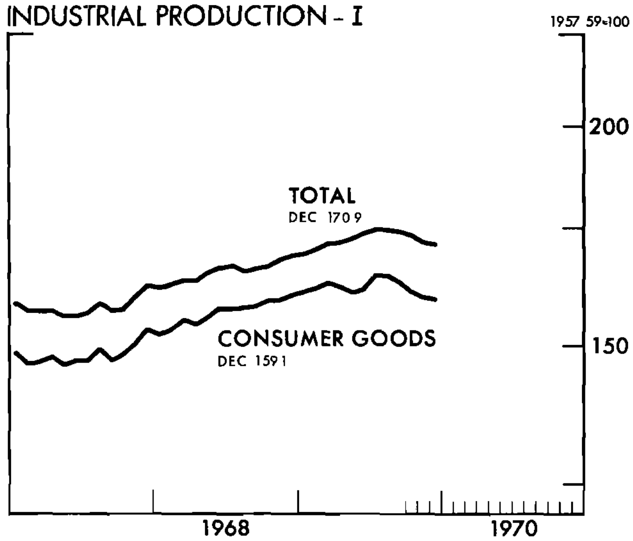
GNP INCREASE



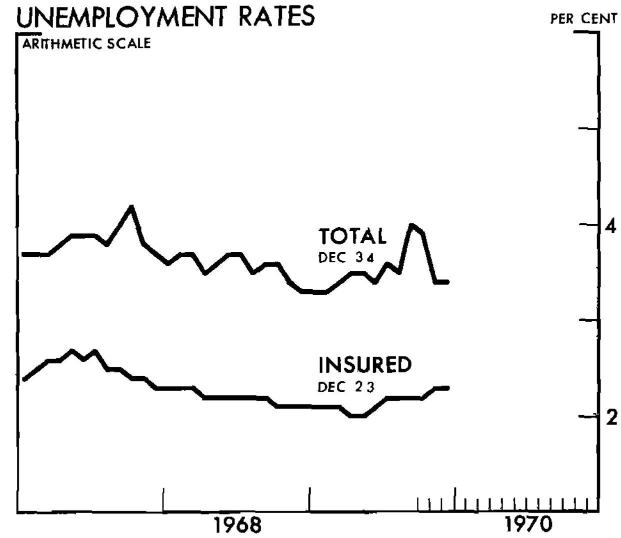
EMPLOYMENT ESTAB BASIS



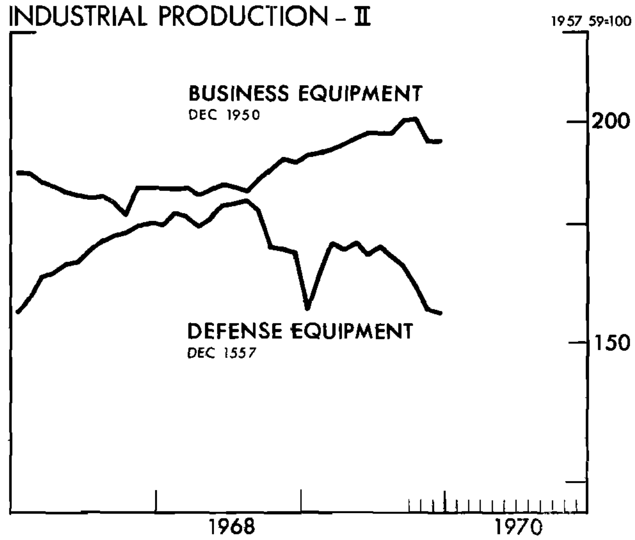
INDUSTRIAL PRODUCTION - I



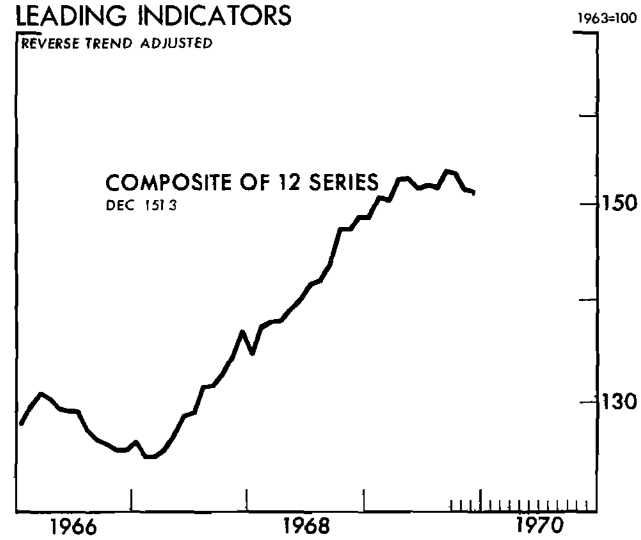
UNEMPLOYMENT RATES



INDUSTRIAL PRODUCTION - II

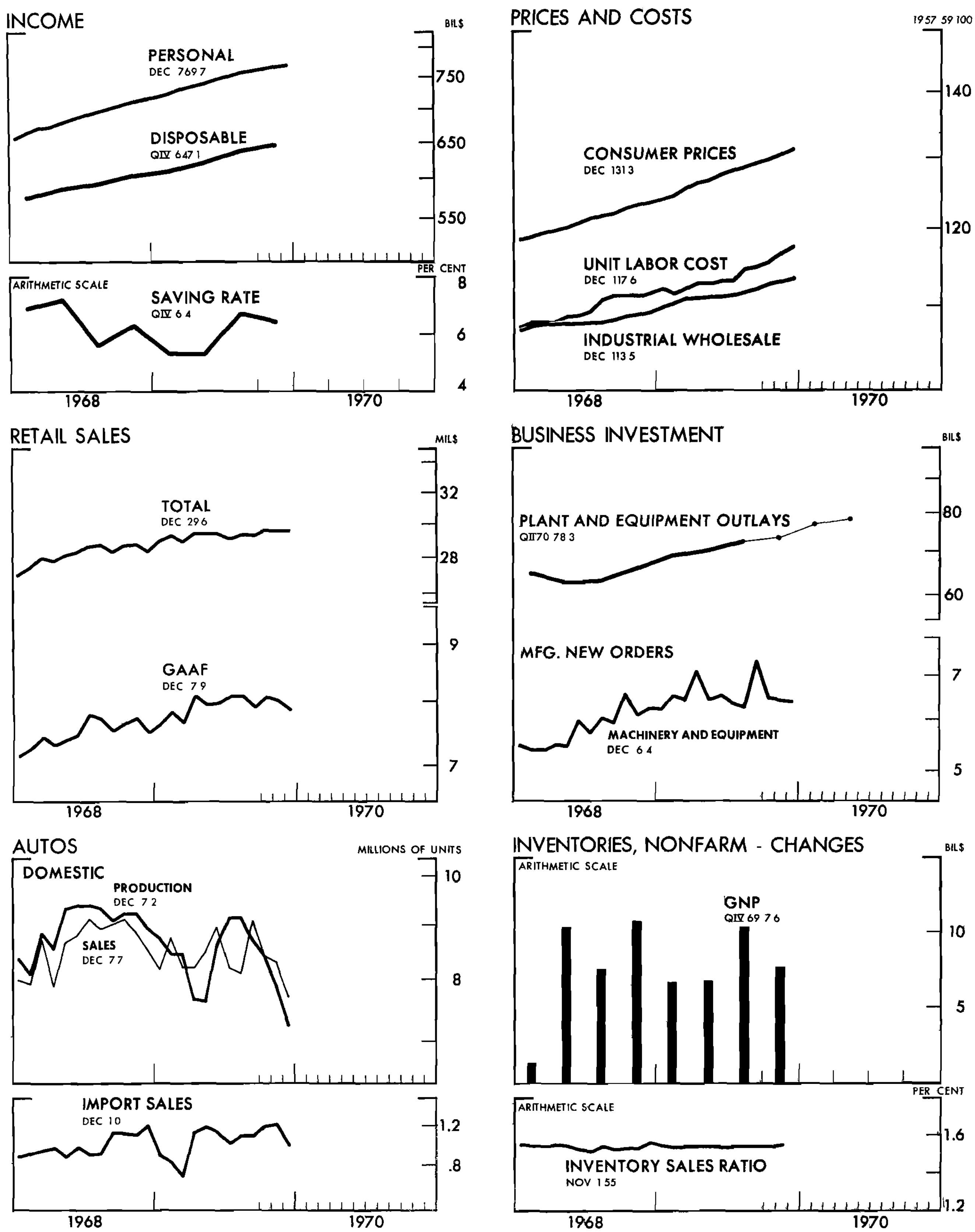


LEADING INDICATORS



ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Bank credit. Commercial bank credit on a seasonally adjusted basis, dropped sharply in January, with declines recorded in both loans and investments. The decline in loans reflected substantial loan sales to affiliates. Total bank credit adjusted for such sales declined at a 3 per cent annual rate.

The decline in investment holdings was attributable to a continued runoff of U.S. Treasury securities, with holdings of other securities increasing moderately over the month. The January seasonally adjusted deciine in governments, which reflects in part the absence of the usual Treasury January financing, marks the fifth consecutive month of decline in these investments, which for these months aggregated more than $7 billion. Over the same period, holding of other securities increased about $600 million.

Total loans on bank books declined $1.3 billion in January, with bank loan sales to affiliates amounting to $1.6 billion. The January loan sales reversed the $900 million loan purchase transactions made with affiliates in December that were undertaken to augment the loan base used for computing loan reserves for tax purposes. The December-January average of loan sales was about $350 million, a little more than half the average rate for the preceding six months.

As in December, security loans in January dropped sharply and are now below their level prior to the October-November bulge in these accounts. Loans to nonbank financial institutions also showed a decline, while real estate and consumer loans continued to advance at the moderate rates of other recent months.

NET CHANGE IN BANK CREDIT 1/
All Commercial Banks
Seasonally Adjusted

		1969		1970
	Year	2nd Half	4th Qtr.	Jan. 2/
		Billions of dollars		
Total loans & investments	9.2	1.3	2.1	-2.6
U.S. Gov't. securities	-9.8	-4.5	-2.9	-1.6
Other securities	-0.8	-1.3	--	0.4
Total loans	19.7	7.0	4.9	-1.3
Business loans	9.0	2.6	1.3	-0.8
Memoranda:				
Total loans & investments plus loan sales 3/	13.1	3.1	2.3	-1.0
Total loans plus loan sales 3/	23.6	8.8	5.1	0.3
Business loans plus business loan sales 4/	11.5	3.8	1.4	0.7
		Percentage change, in annual rates		
Total loans and investments	2.4	0.7	2.1	-9.3
U.S. Gov't securities	-15.9	-16.0	-21.2	-46.3
Other securities	- 1.1	- 3.6	--	6.9
Total loans	7.7	5.2	7.2	- 6.1
Business loans	9.4	5.1	5.0	- 9.2
Memoranda:				
Total loans & investments plus loan sales 3/	3.4	1.6	2.3	- 3.0
Total loans plus loan sales 3/	9.2	6.5	7.4	0.9
Business loans plus business loan sales 4/	12.0	7.3	5.3	10.1

1/ Last Wednesday of month series.
2/ All January rates are preliminary estimates based on incomplete data and are subject to revision. Loan sales are through January 21.
3/ Includes outright bank sales of loans to their own holding companies, affiliates, subsidiaries, and foreign branches.
4/ Includes outright bank sales of business loans to their own holding companies, affiliates, subsidiaries, and foreign branches.

In contrast to this general picture, business loans including loans sold to affiliates increased in January at a considerably stronger pace than established recently. The pace of increase for December and January combined may be more indicative of underlying conditions. In the past two months together, the rate of expansion in business loans (adjusted for loan sales) averaged about 6 per cent, which is slightly below the average rate of advance maintained in the second half of last year.

Bank sources of funds. Daily average deposits at all member banks together with their nondeposit sources of funds declined from December to January at a seasonally adjusted annual rate of about 3 per cent. A sharp drop in time and savings deposits was primarily responsible for this decline. Bank indebtedness to the Euro-dollar market was also lower on average in January than in December. In contrast, private demand deposit balances averaged significantly higher, reflecting the holdover effects of the year-end bulge in these balances.

Within the month of January, a large decline in time deposits occurred in the first few days immediately following the year-end interest crediting period, but the outflow of deposit balances continued at a slower pace throughout the month. Private demand deposits also displayed a relatively steady downtrend throughout January, as balances, sharply inflated in the last week of December, were worked down during the month of January. However, the rate of decline was moderate relative to the late December buildup. The money stock moved similarly, dropping to below its year-end total by the end of January, but still the daily average level was about 10 per cent higher in January than in December.

CHANGES IN MONETARY AND DEPOSIT AGGREGATES
(Seasonally adjusted, percentage change, annual rates)1/

	1969				1970
	Year	2nd Half	4th Qtr.	Dec.	Jan. 2/
Total deposits (all member banks)	-4.1	-4.7	--	- .4	-2.9
Total deposits (all member banks) plus Euro-dollars and non-deposit sources	n.a.	n.a.	2.0	1.2	-2.7
Private demand deposits (all commercial banks)	1.5	- .6	--	2.3	13.3
Total time and savings deposits (all commercial banks)	-5.3	-6.7	.0	4.3	-13.0
Money supply	2.5	.7	1.4	2.4	10.2

1/ Based on monthly average of daily figures for deposits and monthly average of weekly figures for nondeposit sources.
2/ Preliminary estimate based on data through January 21.

An idea of the shifting composition of this year's January decline in time and savings deposits can be obtained by examining seasonally unadjusted data for all weekly reporting banks. Outstanding CD's declined much less than a year earlier at banks in New York and Chicago continuing the moderate pace of other recent months. In addition, the rundown in CD's outside New York and Chicago was also considerably below last year's large decline. This year's smaller attrition is partly attributable to a reduced level of outstandings.

However, it also appears that banks were more successful in January, as they have been in other recent months, in getting domestic depositors to renew their maturing certificates. The recent hike in Regulation Q ceilings should serve to at least sustain this situation.

While the negotiable CD picture in January was much improved over a year ago, the situation was entirely the reverse with regard to developments in consumer-type deposits, with the decline this year of $1.1 billion contrasting with a very small runoff a year ago. Time and savings deposits also dropped sharply at country member banks in January as a large reduction in passbook savings deposits--only slightly smaller in magnitude than last year's substantial decline--considerably exceeded a moderate advance in all other time deposits. Some moderation in the outflow of consumer-type deposits can also be expected to result from the recent increase in Regulation Q ceiling rates on these deposits. However, the outflow of these deposits at large banks in New York and Chicago during the week of January 28--the only banks for which data are available--was as large as the average reduction recorded earlier in the month.

DEPOSIT CHANGE AT WEEKLY REPORTING BANKS 1/
(Billions of dollars, not seasonally adjusted)

	4th Quarter			January		
	1967	1968	1969	1968	1969	1970
Total deposits	15.2	25.5	20.8	-11.2	-17.4	-16.5
Demand deposits--total	14.1	22.3	22.1	-12.3	-15.6	-15.0
Private demand deps.--total 2/	7.3	12.2	12.3	-4.7	-7.3	-8.1
Time & savings deps.--total	1.1	3.2	-1.3	1.1	-1.8	-1.5
Consumer-type	.9	1.9	- .5	.3	- .1	-1.1
Savings	.4	.7	*	- .3	- .7	- .6
Other time 3/	.5	1.2	- .5	.6	.6	- .4
Negotiable CD's	.2	.6	- .9	.8	-1.5	- .4
All other time	*	.8	.1	*	- .2	*

* - Less than $50 million.
1/ Figures are derived from data for the last Wednesdays of the periods.
2/ All demand deposits except U.S. Government and domestic commercial banks, less cash items in process of collection.

The course of developments during January in bank borrowing in the Euro-dollar market or through affiliates in the domestic market moved counter to the deposit trends. Bank indebtedness to the Euro-dollar market rose substantially during January--but not sufficiently to offset the December decline recorded in these borrowings. Commercial paper indebtedness of bank subsidiaries, affiliates, and holding companies also advanced at a comparatively sharp pace in January.

NET CHANGES IN NONDEPOSIT SOURCES OF FUNDS
(Billions of dollars, not seasonally adjusted)

	1969 2nd Half	1969 4th Quarter	1970 January 4/
Selected nondeposit funds--total	3.0	.6	1.6
Euro-dollars 1/	.5	-.7	.7
Affiliate commercial paper 2/	3.0	1.6	.9
Borrowings secured by loan RP's	-.5	-.3	5/

1/ Borrowed through foreign branches, through branches in U.S. territories and possessions, directly from foreign banks, and through domestic brokers and dealers. Includes an indeterminate amount of Federal funds purchased from U.S. Agencies of foreign banks. Prior to May 1969, data include only those funds borrowed through foreign branches.
2/ Issued by bank subsidiaries, holding companies, and other bank affiliates.
3/ Includes loan RP borrowing from bank holding companies, affiliates, or subsidiaries and to the nonbank public. Examination of individual bank reports indicates that virtually all of the loans sold under repurchase agreement to bank affiliates were at banks whose affiliates had no commercial paper outstanding, so that the possibility of double counting is minimal.
4/ Through January 21.
5/ Less than $50 million.

<u>Nonbank depositary intermediaries</u>. Paralleling the experience in July and October last year, deposit outflows at nonbank depositaries in January apparently continued after the close of the reinvestment period. The large volume of non-competitive Treasury bill tenders and of individual purchasers of bonds suggests that the pull of market yields was the major factor responsible for the continued retardation of deposit growth at these institutions. Unfortunately, the available data pre-date the late January change in interest rate ceilings applicable to these deposits. However, whatever the longer-run effect of these higher ceilings may be, it seems clear that there was a sizeable net outflow from both savings banks and savings and loan associations during the month of January.1/

THRIFT INSTITUTIONS DEPOSIT FLOWS 1/
Reinvestment Period and Early January
(Millions of dollars, not seasonally adjusted)

	December Grace Days 2/	January 1-9 3/	January 10-16 3/	January 16-21 3/
<u>Savings and Loans</u>				
1966-67	-558	-421	619	n.a.
1967-68	-442	-507	317	n.a.
1968-69	-553	-401	214	n.a.
1969-70	-580	-840	-196	n.a.
<u>Mutual Savings Banks</u> 4/				
1966-67	-124	60	53	n.a.
1967-68	-186	- 3	46	10
1968-69	-198	- 27	14	2
1969-70	-223	-101	- 14	-23

n.a. Not Available.
1/ Excluding dividends and interest credited.
2/ The last three business days of December.
3/ Dates shown are for 1970.
4/ 15 largest savings banks in New York City, which account for 29 per cent of industry deposits.

1/ Although there has been no systematic survey of industry responses to the new rate ceilings, scattered reports and advertising content suggest a rather widespread and immediate move to raise rates.

During January, savings and loan associations substituted advances from the FHLB System, which increased contra-seasonally by about $600 million, for a sizeable portion of their deposit outflows. The Federal Home Loan Bank System reserve or liquid assets available for advances reached a recent low on January 23 of about $800 million, but by the end of January had been replenished by proceeds from its January financing to a more usual level of $1.1 billion.[2/]

For the fourth quarter of 1969, the growth in thrift institution deposits on a seasonally adjusted basis was at little more than a one per cent annual rate, continuing the downward trend that had persisted all year.

DEPOSIT GROWTH AT
NONBANK THRIFT INSTITUTIONS*

(Seasonally adjusted annual rates, in percent)

	Mutual Savings Banks	Savings and Loan Associations	Both
1966	4.9	3.2	3.8
1967	9.3	9.4	9.4
1968	7.1	6.0	6.3
1969p/	3.9	3.1	3.3
1969 Q I	6.1	6.0	6.0
Q II	4.3	3.7	3.9
Q III	2.0	2.1	2.1
Q IVp/	2.9	0.4	1.2
October	0.9	-1.5	-0.8
November	4.9	2.4	3.2
Decemberp/	2.9	0.5	1.3

p/ Preliminary.
* Deposit growth data include interest credited because of seasonal adjustment difficulties, monthly patterns may not be significant.

2/ The recent financing, from which the FHLB System received $400 million in new money, consisted of two issues: one for one year at 8.625 per cent and the other for 4 years at 8.40 per cent.

Despite the substantial reduction in deposit growth in 1969, however, savings and loan associations were able to maintain their year-earlier pace of net mortgage acquisitions at slightly above $9 billion. By far the most important factor contributing to this stability was the $4 billion in FHLB System advances, which were actually as large as the growth in S&L deposits. An additional factor contributing to the maintenance of the pace of S&L mortgage acquisitions was also attributable to FHLBB policy; in large part as a result of two successive reductions in the required minimum of S&L liquid asset holdings, slightly more than $1 billion was freed during the year for mortgage lending. A note of interest is that despite an $18 billion net increase in S&L mortgage holdings since the end of 1967, there has been virtually no change in the volume of mortgage repayments, which are an important source of funds for gross mortgage acquisitions. This development reflects the large volume of assumptions of mortgages by buyers of existing properties and the reduction in prepayments, which resulted from the reduced availability and higher cost of mortgage credit.

INSURED SAVINGS AND LOAN ASSOCIATIONS
SOURCES AND USES OF FUNDS
(Billions of dollars, not seasonally adjusted)

	Annual				Fourth Quarter			
	1966	1967	1968	1969	1966	1967	1968	1969
Deposit accounts 1/	3.5	10.5	7.3	4.0	2.2	2.6	2.7	.9
Borrowed funds	1.0	-2.8	1.0	4.1	-.2	.3	.3	1.5
Subtotal	4.5	7.7	8.3	8.1	2.0	2.9	3.0	2.4
Mortgage sales and repayments 2/	13.8	14.2	14.5	14.1	2.9	3.6	3.7	3.3
Reductions in liquid assets 3/	.1	-1.6	--	1.3	-1.0	-.5	-.4	-.2
Other sources, net 4/	-.9	1.3	.8	--	-1.0	-.1	-.2	-.6
Gross mortgage acquisitions	17.5	21.6	23.6	23.4	2.9	5.9	6.1	4.8
Memo: Net mortgage acquisitions	3.7	7.4	9.1	9.3	0.0	2.3	2.4	1.5

1/ Includes fnterest credited.
2/ Includes funds from sales of loans and participations, loan repayments, and miscellaneous credits. Excludes interest, taxes, etc.
3/ A drawdown of liquid assets (cash and government holdings) is shown as a positive source of funds and an increase as a negative source.
4/ "Other" includes the net amount of loans in process, allocations to reserves and surplus, accruals of dividends and other loans and investments.
Note: Components may not add to totals because of rounding.

Mortgage market. The maintenance of mortgage lending by the thrift institutions, despite their reduced deposit growth, has, of course, been reflected in the working down of their backlog of mortgage commitments. The latest data available for all S&Ls and N.Y. State mutual savings banks indicate that the combined seasonally adjusted backlog of outstanding mortgage commitments declined in December for the eighth consecutive month and is now at its lowest level in two years.

In January, discounts associated with FNMA forward purchase commitments increased substantially in each of the first two auctions conducted after the upward adjustment in the FHA and VA ceilings to 8-1/2 per cent. In the auction of January 19, had the bids been accepted, the discount on 6-month commitments would have exceeded 7 points as the volume of bids received remained unusually high. However, FNMA rejected all bids because it felt that they were for the most part speculative and damaging to FNMA's effectiveness. In addition, FNMA also introduced certain changes in its auction procedure aimed at stabilizing bid prices. These changes limit bidding to originating mortgagees who have previously obtained an agreement from FHA or VA to underwrite the mortgage. In addition, FNMA has tentatively changed from a weekly to a bi-weekly auction in order to allow bidders more time to assess current market developments and to give them more of an opportunity to solicit funds from outside FNMA. In the first bi-weekly auction following the change in procedure (January 26), the level of discounts fell somewhat as the implicit private market yield declined for the first time in nearly three months. One reason for the decline in yields was the fact that FNMA accepted a much greater proportion of bids than in the two preceding auctions. However, once an initial period of adjustment to the new auction rules takes place, yields may be expected to rise again, unless market pressures ease.

FNMA AUCTIONS

		Amount of total offers Received	Amount of total offers Accepted	Implicit private market yield on 6-month commitments	Average discount on 6-month commitments
		(Millions of Dollars)		(Per cent)	(Points)
Highs					
1968		$ 232(6/3)	$ 89(7/1)	7.71(6/10)	8.1(5/6)
1969		410(6/13)	152(9/8)	8.87(12/29)	9.6(12/29)
1970- Jan.	5	705	123	9.19	4.5
	12	672	151	9.36	5.7
	19 1/	(480)	--	(9.70)	(7.1)
	26	581	298	9.29	5.2

Note: Average secondary market yield after allowance for commitment fee and required purchase and holdings 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. Data for the January 19 auction are confidential.

1/ All bids rejected.

Corporate security and municipal bond markets. Public offerings of corporate bonds in January amounted to an estimated $1.6 billion the largest volume since mid-1967. Some issues were shifted forward on the calendar, and recent announcements suggest that offerings will remain high during the first quarter. Paralleling the recent rise in new issue bond yields, stock prices have declined quite sharply as corporate profit reports for the fourth quarter became available. By the end of January, the NYSE stock price index had declined almost to the levels of February 1967, while the Dow-Jones index of quality issues fell to the lowest level in 7 years.

STOCK PRICES AND BOND YIELDS

	Stock Prices 1/			Bond Yields	
	Dow-Jones	NYSE	AMEX	New Corporate 2/	Long-term State and local Bonds 3/
1969					
Low	769.93(12/17)	49.31(7/29)	25.02(7/29)	6.90(1/10)	4.82(1/24)
High	968.85(5/14)	59.32(5/14)	32.91(1/3)	8.85(12/5)	6.90(12/19)
1970					
Week ending:					
Jan. 2	809.20	52.10	26.71	--	6.79
9	798.11	51.82	26.97	8.48	6.61
16	782.60	50.94	26.55	8.41	6.53
23	775.61	49.93	26.31	8.32	6.67
30	744.06	47.54	25.46	8.60	6.78

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

Despite the large volume of new bonds, yields on high-grade new corporate bond issues declined 30 to 45 basis points from mid-December to mid-January. The drop in yields apparently resulted from a low level of dealer inventories at year-end, a seasonally large flows of reinvestment. funds from institutions, and sustained support of the public bond market by individuals withdrawing funds from financial intermediaries and the stock market. However with institutional investors hesitant to pay the higher prices, a mounting volume of new issues reversed the short-lived decline in yields. Dealer inventories began to build, syndicates with large unsold balances were terminated after mid-month with upward yield adjustments of 11 to 26 basis points, and the announcement of a $1.6 billion issue of AT&T debentures for the second quarter reduced market enthusiasm further. All these factors produced substantial upward yield pressures late in the month.

Although there was some decline in new stock offerings in January, probably reflecting the decline in stock prices, gross new corporate financing for the month is estimated to have been about $2.6 billion. Staff projections for the balance of the quarter assume that low corporate liquidity, reduced cash flow, and limited availability of bank credit will continue to result in a high pace of new issue volume. February public bond issues are now estimated at about $1.3 billion. Underwriters report that stock issue volume will rise from the January level, as a number of utilities seek to reduce their debt-equity ratios. This quarter's stock total will also be swelled by a $500 million rights offer by a major oil company in March. Taking into account a probable downward drift in private placements, reflecting prior decreases in insurance company commitments,[1/] the staff estimates that total corporate security offerings will be about $2.4 billion in February and somewhat higher in March.

CORPORATE SECURITY OFFERINGS[1/]
(Monthly or monthly averages in millions of dollars)

	Bonds				Stocks		Total	
	Public Offerings		Private Placements					
	1969	1970	1969	1970	1969	1970	1969	1970
Year	1,052e	--	513e	--	711e	--	2,280e	--
Q I	886	1,417e	513	433e	674	750e	2,073	2,600e
January	980	1,550e	636	500e	460	550e	2,075	2,600e
February	842	1,300e	395	400e	807	700e	2,045	2,400e
March	835	1,400e	509	400e	755	1,000e	2,098	2,800e

1/ Data are gross proceeds.
e/ Data estimated.

1/ For full information on the activity of life insurance companies in 1969, see Appendix A.

The anticipated monthly average of total security offerings for the first quarter of 1970 is thus about $2.6 billion, as compared with a $2.1 billion average for the first quarter of 1969. The expected rise in corporate financing is particularly evident in the public bond sector, where the estimated monthly average for the first three months of this year is $1.4 billion, as compared with a $900 million average for the first quarter of 1969. At this time, it appears that proposed financing by industrial, mortgage and transportation firms will dominate early 1970 financing. It is estimated that for the first quarter of 1970 only about 45 per cent of the volume of public bonds will represent issues by public utilities and communications firms, whereas these industries accounted for about 70 per cent of the bond volume in the year 1969.

Long-term borrowing by state and local governments in January was about $1.2 billion. Much of the difference between this and the earlier staff estimate of $900 million is accounted for by a $177 million New York City offering, the timing of which was uncertain when the last Green Book was prepared. Furthermore, the decline in the tax-exempt yields, which continued through mid-month, facilitated the reoffering of previously postponed issues. As in the case of the corporate bond market, this early January decline in yields was fostered by a favorable turn-of-the-year dealer inventory situation and a relatively high proportion of high-grade, shorter-term issues. The volume of municipal issues was also rather light for the first two weeks of the month. More recently, however, a heavy calendar and concentration of buying interest on shorter maturities have caused a reversal of earlier optimism and municipal yields have risen 25 basis points from the low. At the end of January the Bond Buyer index was only 12 basis points below its December 1969 peak.

LONG-TERM STATE AND LOCAL GOVERNMENT OFFERINGS
(Monthly or monthly averages
in millions of dollars)

	1969	1970
Year	983	--
QI	929	1,067e
January	1,262	1,200e
February	987	1,000e
March	538	1,000e

e -- Estimated.

Because of the ever-growing backlog of displacements and the steady build-up in the forward calendar, the staff estimates that February and March volume will decrease only slightly, if at all.[1/] In addition to the raising of interest rate ceilings by several large borrowers in late 1969, legislation to relax rate limitations is now under consideration in a number of other areas.

1/ The results of the Board's survey of state and local borrowing plans for the fourth quarter will not be available until mid-February.

<u>Government securities market</u>. Further news of weakening in the economy and an easing of year-end pressures moved yields on Treasury coupon issues lower on average over the first three weeks of January; but the cumulative effect of large Agency borrowing and the increasing corporate calendar gave rise to a good deal of uncertainty and caution in the market just prior to the Treasury's refunding announcement. As a result by the last week in January, yields had retraced a large part of their earlier declines. At the beginning of February, however, an abrupt shift in market psychology toward expectations of a less restrictive monetary policy turned yields down once again. Treasury bill rates followed much the same pattern as coupon issues in January, declining until just after mid-month, rising thereafter to month end, and then moving sharply lower. On longer bill issues, for which non-competitive bidding in the regular auctions has been extraordinarily heavy, the late January rise in rates was somewhat less pronounced, and the recent decline sharper than for short bills.

WEEKLY AVERAGE MARKET YIELDS ON U.S. GOVERNMENT AND AGENCY SECURITIES[1/]
(Per cent)

	1969 Lows	1969 Highs	Week ending: Jan. 13	Jan. 27	Feb. 3
Bills					
1-month	5.80(3/25)	7.54(12/31)	7.51	7.52	7.70
3-month	5.87(4/30)	8.08(12/29)	7.88	7.87	7.82
6-month	5.96(4/30)	8.09 (12/29)	7.78	7.75	7.75
1-year	5.86(1/16)	7.86(11/24)	7.54	7.46	7.54
Coupons					
3-year	6.02(1/20)	8.51(12/29)	8.28	8.18	8.20
5-year	6.11(1/20)	8.33(12/29)	8.20	8.11	8.22
7-year	6.09(1/16)	7.77(12/29)	7.74	7.72	7.84
10-year	5.95(1/20)	8.05(12/29)	7.89	7.69	7.71
20-year	5.91(5/5)	7.14(12/29)	6.90	6.93	6.93
Agencies					
6-month	6.47(1/21)	8.70(12/29)	8.62	8.60	8.59
1-year	6.33(1/20)	8.76(12/29)	8.69	8.63	8.68
3-year	6.53(1/28)	8.55(12/31)	8.49	8.44	8.50
5-year	6.57(1/22)	8.47(12/31)	8.41	8.36	8.38

1/ Latest dates of high or low rates in parentheses and refer to single dates.

Dealer financing costs, which have continued to average around 9-1/2 per cent in New York, remain a strong influence in maintaining the general level of bill rates and coupon yields, despite the fact that dealer financing needs over the last three weeks have averaged somewhat less than in late December and early January. Of more immediate influence in the coupon market--in addition to the factors mentioned above--have been the market's preparations for the Treasury's February refunding operation. As shown in the table on dealer positions, the professional portion of the market had built up its short coupon holdings while depleting positions in both 1-5 year and over 5-year categories. Dealers were thus in a good technical position for the financing. There was, however, a good deal of uncertainty about the extent to which banks would participate in the refunding as well as about the reception that might be accorded any long option. In these circumstances, the Treasury decided to offer a 3-option "rights" exchange: an 18-month issue at 8-1/4 per cent; a 39-month note at 8-1/8 per cent; and a 7-year issue at 8 per cent. All three issues appear to have been favorably received and have moved to substantial premiums on a "when-issued" basis.

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

	January 12	January 26	February 2
Treasury securities			
Total	2,417	2,450	2,821
Treasury bills (total)	2,093	2,152	2,188
Due in 92 days or less	217	350	95
93 days or over	1,876	1,802	2,093
Treasury notes & bonds (totals)	325	298	633
Due within 1 year	259	354	718
1-5 years	- 1	- 71	4
over 5 years	67	15	- 88
Agency securities			
Total	467	513	543
Due within 1 year	331	335	298
over 1 year	136	178	244

Bill rates have moved in a fairly narrow range since the January meeting of the Committee as dealers have shown little interest in adding to positions and have thus remained as sensitive as earlier to shifts in supply or demand conditions. The Board's action to increase Regulation Q ceilings had virtually no effect on the bill market. It is likely that some bill demand may be forthcoming in connection with demands from investors choosing not to exchange their maturing issues in the Treasury refunding. While these demands may account for some of the latest sharp decline in bill rates, they have not yet been a major factor in the market, and the recent improvement in bill rates is more the result of the market's generally increased optimism about a relaxation of monetary policy.

As shown in the table on average weekly market yields, there have been only minor net changes in yields on outstanding Federal agency securities, despite quite heavy new issue activity. Agencies have offered a total of $3.3 billion in new issues, of which $1.4 billion represented new money. For the most part these issues have been well received by the market.

NEW ISSUE ACTIVITY BY
FEDERAL AGENCIES IN JANUARY
(millions of dollars)

Date	Agency	Rate	Maturity and Amounts: less than 1-yr	1-3	3-5	more than 5	Of Which New Money:
Jan. 8	FLB	8.45			198		-11
14	FHLB	8.625	600				400
		8.40			300		
15	COOPS	8.65	420				20
20	FHA	8.875			200		350
		8.90				150	
21	FICB	8.65	656				130
27	FNMA	8.75		500			550
		8.70		300			
Totals			1,676	800	698	150	1,439

<u>Other short-term credit markets.</u> Yields on private money market instruments decreased sharply in January. Commercial paper rates declined 75 basis points to 8.50 per cent and 1-month finance paper rates also fell by the same amount to 8.25 per cent. Bankers' acceptance rates declined 50 basis points to 8.50 per cent. These declines more than reversed the run up in yields during December in these markets, and by the end of January more normal yield spreads prevailed between these instruments and Treasury bills where yields rose in the second half of the month. There are indications that the drop in bill yields over the first few days in February has carried through to finance company and commercial paper rates.

The decline in rates in January, as well as the rise in December, was at least partly seasonal. Because many corporate investors are unwilling to position commercial paper on December 31, yields over the year-end are bid up and the volume of paper outstanding generally declines. During December, the volume of dealer- and directly-placed paper declined on a seasonally unadjusted basis by about 5-1/2 per cent. After seasonal adjustment, however, such paper showed a December increase of $935 million, or 3 per cent.

Commercial paper issued by bank affiliates and holding companies grew by only $130 million in December. But through the first three weeks in January it rose by an unusually large $925 million, in part reflecting a reversal of the reduced rate of issuance in December but also possibly facilitated by the more receptive short-term market. The various proposed Federal Reserve regulations on bank-related commercial paper were again postponed, to February 26.

COMMERCIAL AND FINANCE COMPANY PAPER AND BANKERS' ACCEPTANCES OUTSTANDING
(End of month data--in millions of dollars)

	1969		1970	
	October	November	December	January 1/
Total Commercial and finance paper 2/	31,576	32,286	33,221	n.a.
Placed through dealers	11,644	12,109	12,677	n.a.
Placed directly 3/	19,932	20,177	20,544	n.a.
Note: Bank related paper (unadjusted)	3,642	4,079	4,209	5,134
Bankers' acceptances	5,256	5,212	5,451	n.a.

1/ Bank related paper as of January 21, 1970.
2/ Data for commercial and finance paper are seasonally adjusted, in contrast to similar data published in the Bulletin that are seasonally unadjusted.
3/ As reported by companies that place paper directly with investors. As of June 1969, these figures include directly-placed commercial paper issued by bank-related companies. Dealer totals have always included paper issued by bank-related companies.

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

	1969 Highs 1/	January 2	January 16	January 30
1-Month				
Finance paper	8.50(7/18)	9.00	8.63	8.25
Bankers' acceptances	8.50(12.5)	9.00	8.63	8.50
Treasury bill	7.25(7/3)	7.50	7.50	7.70
3-Month				
Commercial paper	9.13(12/26)	9.25	8.75	8.50
Finance paper	8.50(7/18)	8.13	8.25	8.13
Bankers' acceptances	8.75(12/26)	9.00	8.63	8.50
Treasury bill	7.20(8/1)	7.96	7.82	7.92
6-month				
Commercial paper	9.13(12/26)	9.25	8.75	8.50
Finance paper	8.38(11/21)	8.13	8.25	8.00
Bankers' acceptances	8.75(12/26)	9.00	8.63	8.50
Treasury bill	8.00(11/21)	7.98	7.64	7.80
12-month				
Prime municipals 2/	6.25(12/12)	5.80	5.50	5.40
Treasury bill	7.75(11/21)	7.60	7.45	7.62

1/ Dates of highs in parentheses; latest date used if high occurred on more than one date.
2/ Bond yield basis.
Source: Salomon Brothers & Hutzler's Bond Market Roundup.

Federal finance. The Administration's new Budget projects small unified budget surpluses in the current fiscal year and in Fiscal 1971, are as follows:

UNIFIED BUDGET
(Billions of Dollars)

	Fiscal years		
	1969 Actual	1970 estimated	1971 estimated
Receipts	187.8	199.4	202.1
Outlays	184.6	197.9	200.8
Expenditures	(183.1)	(195.0)	(200.1)
Net lending	(1.5)	(2.9)	(0.7)
Budget surplus	3.2	1.5	1.3

Growth of Federal outlays is expected to slow sharply in fiscal 1971 to an increase of \$2.9 billion (compared to increases of \$5.8 billion and \$13.3 billion in fiscal 1969 and 1970, respectively) despite an expected \$6.8 billion increase in outlays for social security and public assistance. To achieve this small net increase in outlays the Administration plans, among other things, a \$5.8 and \$.5 billion cut in the defense and space programs, respectively, as well as \$2.2 billion reduction in net lending and a \$.9 billion reduction in net outlays for the Post Office.

CHANGES IN TOTAL BUDGET OUTLAYS FROM YEAR PRECEDING
(In billions of dollars)

	Fiscal Year	
	1970	1971
Total outlays	13.3	2.9
Net lending	1.4	-2.2
Expenditures, excluding net lending	11.9	5.1
National defense	- 1.8	-5.8
Space	- .4	- .5
Post Office	.3	- .9
Social insurance trust funds	5.8	6.0
Public assistance (including medicaid)	1.2	.8
Future federal pay raises 1/	.2	1.2
Family assistance and revenue sharing programs	--	.8
All other, net 2/	6.6	3.5

1/ Includes certain postal pay adjustments projected for fiscal year 1970.
2/ For fiscal 1971, includes negative expenditures in the amount of $0.8 billion resulting from sales of stockpiled commodities.

As indicated in the table some of the Administration's new proposals, such as the family assistance and revenue sharing programs, are scheduled to be introduced only on a modest scale in fiscal 1971, and thus their major impact will be delayed until after that. The Budget also calls for the Federal pay increase to be deferred six months beyond the present schedule, that is, until January 1971.

The $197.9 billion estimate of outlays for the current fiscal year is $5.0 billion above the level projected in the Summer Budget Review and about $2.2 billion above the estimated level of the Congressionally imposed ceiling on outlays. The President requested a change in the ceiling in his budget message.

The $5 billion upward revision in current year outlays is chiefly accounted for by increased payments for social security programs, higher interest costs, and a postponement until the next fiscal year of planned sales of financial assets, such as Farmers' Home Administration loans.

Total tax receipts in the budget message are expected to increase $11.6 billion in the current fiscal year and by $2.7 billion in fiscal 1971. The lower increase in receipts in fiscal 1971 results from the expiration of the surtax and the recent enactment of the Tax Reform Act of 1969--a total reduction of $9.6 billion from fiscal 1970 levels--and from reduced economic expansion. Partially offsetting the effect of tax rate reductions and lessened growth are (1) a planned Administration action to speed up the collection of excise taxes and withheld income taxes, yielding a one-time $1.2 billion increase in fiscal 1971 and (2) several new legislative proposals to increase tax receipts by a total of $1.6 billion, which are listed in the following table.

CHANGES IN BUDGET RECEIPTS
FISCAL 1970 to FISCAL 1971
(Billions of dollars)

	Changes	
Growth in receipts under Dec. 1969 tax rates		8.5
Change in receipts under existing laws		-7.4
Speed up of collections of excise and income taxes	1.2	
Social security rate increase (Jan. 1, 1971)	1.6	
Expiration of surcharge	-8.5	
Other effects of Tax Reform Act, net	-1.1	
Scheduled decrease in excise tax rates (Jan. 1, 1971)	- .6	
Total receipts under existing law		1.1
Increased receipts under proposed legislation		1.6
Transportation user charges	.7	
Extension of excise tax rates (to Jan. 1, 1972)	.6	
Increased social security wage base (Jan. 1, 1971)	.2	
Increased railroad retirement revenues	.1	
Total projected change in receipts		2.7

The Administration's economic assumptions underlying the new Budget include a $53 billion increase in GNP to a level of $985 billion in calendar 1970 and a decrease in corporate profits from $94.3 billion in calendar 1969 to $89.0 billion in calendar 1970. Personal income is estimated at $800 billion in calendar 1970, an increase of 7 per cent for the year.

The Board's staff currently is using lower projections for these 1970 magnitudes: $977 billion for GNP, $85 billion for corporate profits and $793 billion for personal income. Partly as a result of these lower income assumptions and partly due to a slightly lower projection of effective tax rates, the staff's forecast of Federal budget receipts in the current fiscal year is about $2.4 billion lower than the Administration's (as shown in the Budget table at the end of this section). Because of its lower estimate of receipts, the staff continues to forecast a small budget deficit ($.9 billion) in the current fiscal year, even after taking into account that in the month of January Treasury receipts--apparently in the form of withheld taxes--were about $1.2 billion above the level projected in the last Greenbook.

Turning to the Federal Sector in the National Income Accounts, the Budget forecasts a NIA surplus of $3.6 billion in fiscal 1970 and $1.6 billion in fiscal 1971. Due to its lower estimate of private income and, hence, tax receipts, the Board staff is presently projecting a smaller surplus--$2.0 billion--for the current fiscal year, as shown in the budget table at the end of this section. For <u>calendar</u> 1970 the Staff expects a $4.6 billion deficit in the national income accounts budget, a $14.2 billion shift from the previous calendar year, which is due in part to the assumed slowdown in economic growth. The slowdown in economic activity is reflected more quickly in the Federal Sector of the NIA accounts than in the unified budget, because of the practice of accrual accounting for corporate taxes in the NIA accounts.

With respect to the current situation, the Treasury cash balance at the end of January was $6.4 billion and will probably decline to $5.4 billion by the end of February. By late February or early March, the Treasury will need to raise additional new cash--according to Board staff estimates--of $2.0 to $2.5 billion. A further cash financing operation of about the same size--and the last one for the fiscal year--will probably be needed by early April to offset the seasonal decline in the Treasury balance that occurs just prior to the heavy April inflow of income taxes payments.

NOTE: The budget document also indicates a continued high level of activity by the five government-sponsored agencies that are not included in the Budget proper, FNMA, FHLB and three Farm Credit Administration enterprises. Their net borrowing is estimated to be nearly $11.0 billion in fiscal 1970 and $7.7 billion in fiscal 1971, as compared to $4.0 billion in fiscal 1969.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	Jan.	Feb.	March	April
Borrowing operations				
New cash raised				
Unspecified new borrowing	--	--	2.5	2.5
Weekly and monthly bills	.5	--	--	--
Tax bills	--	--	--	--
Coupon issues	--	--	--	--
Other (agency, debt repayment, etc.)	-.4	-.3	-2.2	-3.1
Total net borrowing from public	.1	-.3	.3	- .6
Plus: Other net financial sources a/	.8	-.5	1.3	-1.1
Plus: Budget surplus or deficit (-)	.2	-.2	-2.9	5.2
Equals: Change in cash balance	1.1 b/	-1.0	-1.3	3.5
Memoranda: Level of cash balance end of period	6.4 b/	5.4	4.1	7.6
Derivation of budget surplus or deficit				
Budget receipts	16.5	15.3	14.0	23.2
Budget outlays	16.3	15.5	16.9	18.0

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

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

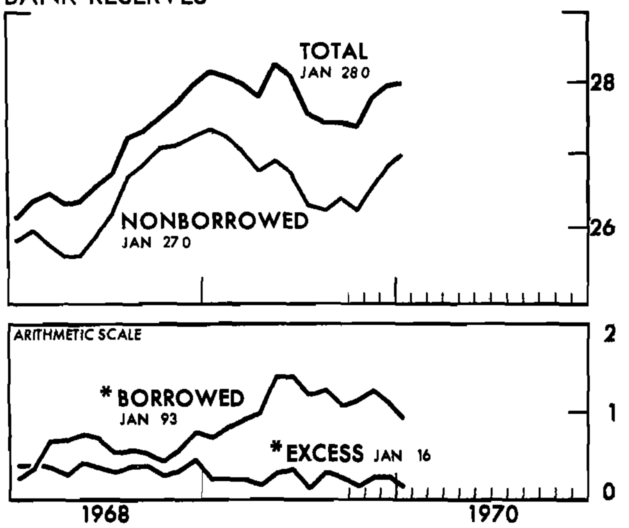
	Fiscal 1970e/		Fiscal 1971e/	Calendar Years		Calendar Quarters				
						1969	1970 1/			
	Jan. Budget	F.R. Board	January Budget	1969	1970 1/	IV	I	II	III	IV
Quarterly data, unadjusted										
New budget:										
Surplus/deficit	1.5	-.9	1.3	5.3	-3.3	-5.7	-2.9	10.2	-2.3	-8.3
Receipts	199.4	197.0	202.1	195.6	195.2	42.9	45.8	60.5	47.2	41.7
Total expenditures and net lending	197.9	197.9	200.8	190.3	198.5	48.5	48.7	50.3	49.5	50.0
Means of financing:										
Total borrowing from the public	-2.6	2.7 2/	-1.2	-4.1	4.2	5.1	.1	-5.7	1.7	8.1
Decrease in cash operating balance		-1.7		-.6	-.7	1.3	1.2	-3.5	.6	1.0
Other 3/	n.a.	-.2	n.a.	-.7	-.2	-.8	1.6	-1.0	--	-.8
Cash operating balance, end of period		7.6		5.3	6.0	5.3	4.1	7.6	7.0	6.0
Seasonally adjusted annual rate										
Federal surplus/deficit in national income accounts	3.6	2.0	1.6	9.6	-4.6	7.2	-.2	-6.7	-7.1	-4.4
Receipts	201.7	200.1	205.4	201.5	196.5	203.4	197.2	198.5	193.9	196.5
Expenditures	198.1	198.1	203.8	191.9	201.1	196.2	197.4	205.2	201.0	200.9
High employment budget surplus/deficit 1/	n.a.	6.6	n.a.	9.6	5.2	10.0	6.1	2.7	4.1	8.0

e--Projected.
n.a.--Not available.
1/ Estimated by Federal Reserve staff.
2/ Excludes effect of reclassification of $1.6 billion of CCC certificates of interest from Budget transactions to borrowing from the public.
3/ Includes such items as deposit fund accounts and clearing accounts.

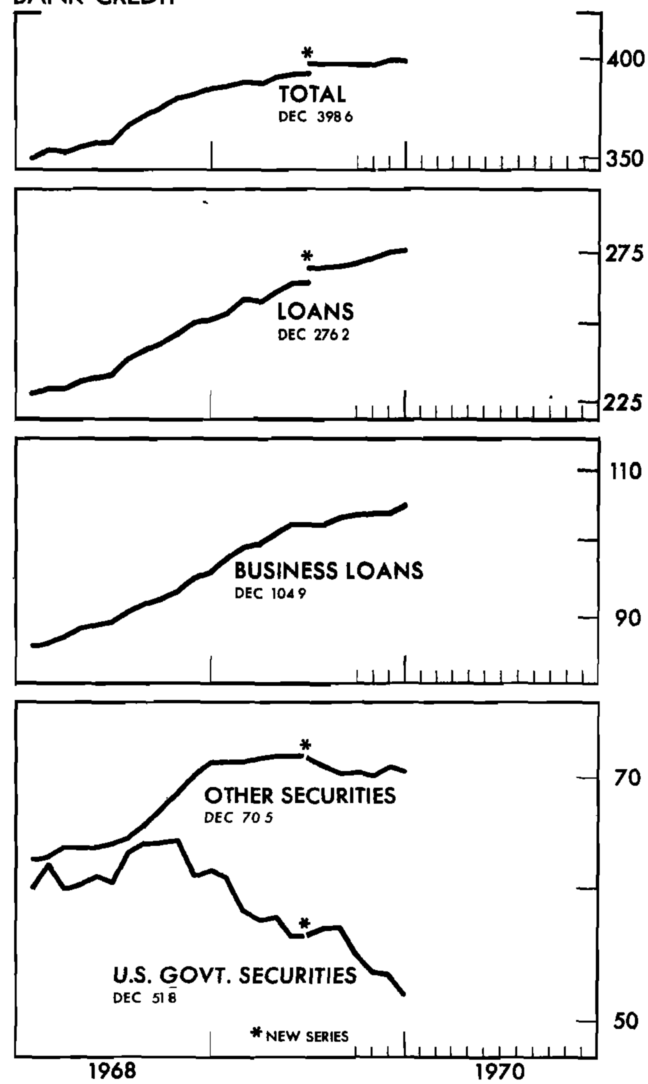
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

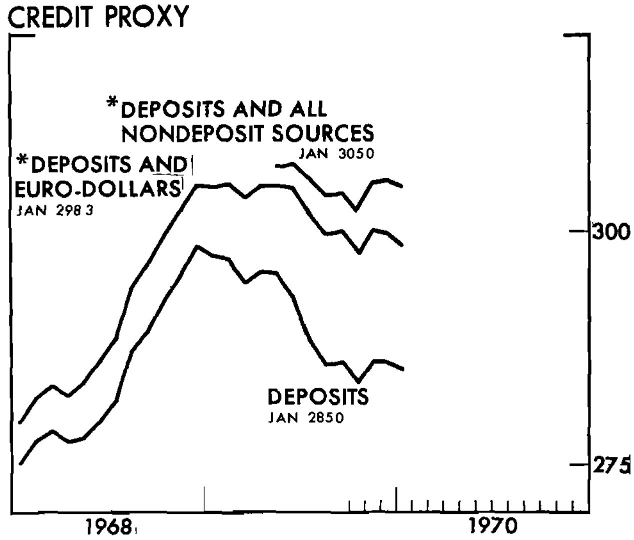
BANK RESERVES



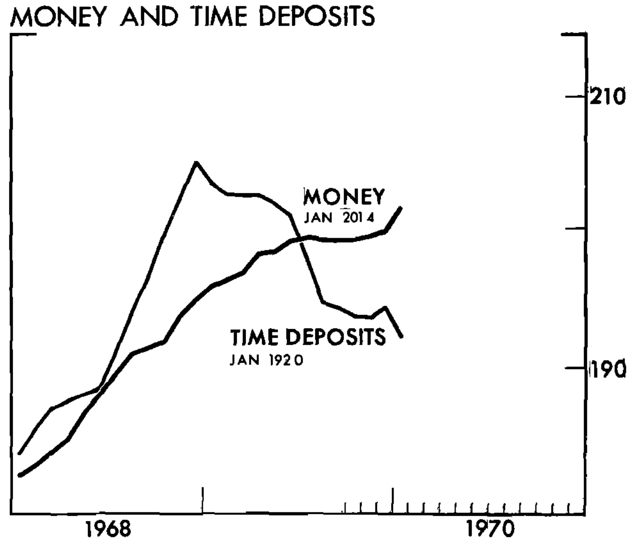
BANK CREDIT



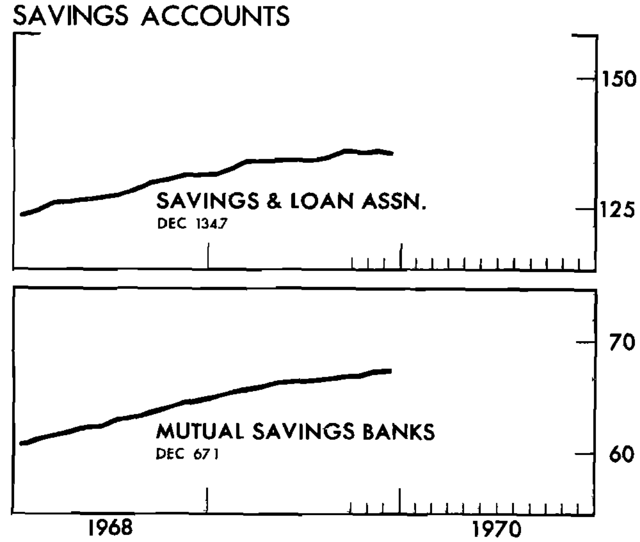
CREDIT PROXY



MONEY AND TIME DEPOSITS

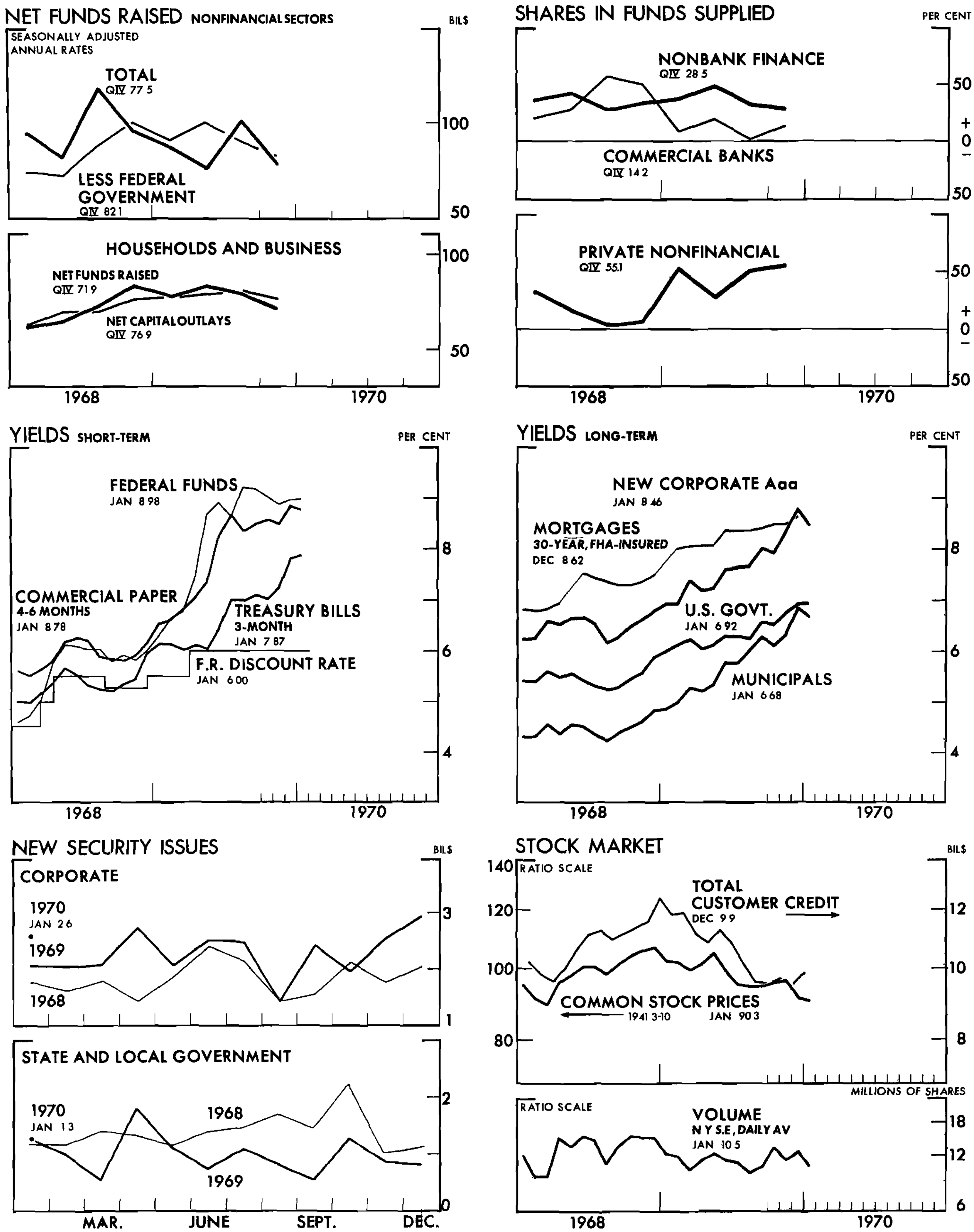


SAVINGS ACCOUNTS



* NOT SEASONALLY ADJUSTED

FINANCIAL DEVELOPMENTS - UNITED STATES



THE ECONOMIC PICTURE IN DETAIL

International Developments

Balance of payments. Last year ended with a tremendous return flow to the United States of funds that had been attracted abroad earlier in the year by higher interest rates and an opportunity to profit from a revaluation of the German mark. The result, well known by now, was a surplus in the liquidity balance in the fourth quarter. This amounted to $1.4 billion (seasonally adjusted), according to preliminary figures, and the deficit for the year was held down to $6.7 billion. Most of the year-end activity is attributed to corporate investors who were required to comply with controls limiting both their direct investments in foreign affiliates and their holdings of liquid funds abroad, but actual data on such flows will not be available for a month or more.

The data now available for several other major types of transactions present a rather mixed picture of tendencies in the balance of payments. The trade surplus rose strongly to $1.7 billion (annual rate) in the fourth quarter of last year, as detailed below, responding to cyclical developments here and abroad. Another favorable development was a reduction in the outflow of U.S. capital to purchase foreign securities; net outflows of this type in the fourth quarter were about $50 million (seasonally adjusted), compared to an average of over $400 million in the first three quarters. On the other hand, foreign purchases of U.S. corporate stocks were apparently only about $10 million in December; such purchases had held up well in October and November, so that the fourth quarter total was about $470 million. There were net liquidations in the summer during the speculation on a mark revaluation. The poor performance of the U.S. stock market, the enhanced attraction of stronger equity markets elsewhere, and continued high yields on Euro-dollar and other alternative investment assets help to explain the recent shrinkage of this inflow. For the year as a whole the inflow was nearly $1-1/2 billion, less than in 1968 but far higher than in any earlier year.

An unexpected development at yearend was an outflow of credit in December reported by U.S. banks amounting to over $1/2 billion (not seasonally adjusted). For the fourth quarter as a whole the outflow (seasonally adjusted) was about $350 million. The year-end surge appears to have included sizable drawdowns on credit lines by Japan and some Latin American countries, a sizable outflow to Canada, and some very short-term overdrafts that were probably repaid early in January. A large part of the outflow reflected foreign collections and other claims held for account of banks' customers, rather than credits by the banks themselves. In fact, the entire increase for the year 1969 in these bank-reported claims on foreigners, which amounted to $560 million, was accounted for by types of claims not subject to the Federal Reserve voluntary credit restraint program. However, banks increased certain other foreign investments subject to these guidelines but not reported on Treasury's Foreign Exchange forms.

As 1970 began, the balance of payments was dominated by the backwash of some of the extraordinary year-end flows. Weekly data for the January 1-28 period show a liquidity deficit of $1.8 billion. In that period the deficit was worsened to the extent of about $500 million as the Treasury redeemed mark-denominated Treasury notes issues under the military offset agreement with Germany. Before that "special" transaction, and with a rough seasonal adjustment, the liquidity deficit for the period would be about $1.5 billion.

On January 1, the U.S. received the first allocation of SDR's, amounting to $867 million; this addition to reserve assets is not taken into account in this deficit figure for the month.

A though the Januarh liquidity deficit as suggested by these early figures was apparently extremely large (last year the January deficit with comparable adjustments was about $700 million), it should be regarded as partly offsetting the large December surplus rather than indicating any major change from an underlying situation of substantial deficit.

The balance as measured by official settlements did not gyrate quite so widely at yearend as the liquidity balance, but it shifted nevertheless from a surplus of $1.1 billion in December 1969 to a deficit of $0.5 billion in the January 1-28 period (not seasonally adjusted, and before taking account of the SDR allocation on January 1). This balance was not affected by the redemption of nonliquid Treasury issues in January. As in the case of the liquidity balance, the month-to-month swing was dominated by flows of corporate funds, but it was damped by the accompanying change in U.S. banks' Euro-dollar borrowings. After a $1.6 billion reduction in December, the liquid liabilities of U.S. banks to foreign banks increased by $0.7 billion in the January 1-28 period. Most of the change in liabilities to foreign banks relates to accounts of U.S. banks with their own foreign branches.

U.S. foreign trade. In December the export surplus rose sharply as imports fell steeply while exports declined only moderately. For the fourth quarter the export surplus was at an annual rate of $1.7 billion (balance of payments basis), much improved from the $1.3 billion of the third quarter and the small deficit recorded in the first half of 1969. For the year 1969, the balance was only a little over $1/2 billion, about the same as in 1968. In both years the surplus was reduced to the extent of perhaps $1/2 billion by the effects of strikes.

Much of the recent strength in exports stemmed from larger shipments of agricultural commodities -- soybeans, corn and tobacco -- as foreign buyers shifted to the United States as supplies from other sources were becoming more limited. Increased deliveries of commercial aircraft also boosted exports in the fourth quarter, while shipments of automotive equipment to Canada fell sharply.

Despite the rise in foreign orders for machinery throughout 1969, exports of such equipment have had virtually no growth since

August. There is some indication that delivery times for these exports have lengthened, perhaps as a result of the continued strength in domestic demand for producers' equipment, so that export gains have been delayed.

While monthly imports have fluctuated considerably, the December drop suggests that imports are starting to respond to the weakening of domestic demand. The ratio of imports to GNP in the fourth quarter was still very high at 3.94 per cent but about the same as in the third quarter. Supply stringencies abroad may also be tending to reduce the imports of some industrial materials, such as steel, as well as those of capital equipment. The value of imports in the fourth quarter was buoyed by higher prices -- for coffee and metals particularly -- as well as by renewed stockbuilding of coffee in anticipation of further price rises resulting from frost damage to the Brazilian coffee crop.

Exports in the fourth quarter of 1969 were $39.2 billion at an annual rate (balance of payments basis), about 2.5 per cent higher than in the third quarter. Agricultural commodities accounted for 40 per cent of the increase but there was a downward drift in their monthly values within the quarter. In addition to higher deliveries of commercial aircraft, which were about 20 per cent greater in the fourth quarter, coal, steel and chemicals accounted for the expansion in nonagricultural exports. Exports of machinery were unchanged from the third quarter level, as were those of consumer goods. Shipments of electrical machinery fell much more sharply than those of nonelectrical machinery between October and December; the G.E. strike may possibly have been a factor.

By areas, exports to Western Europe, Japan and Australia and New Zealand showed the greatest expansion from the third to the fourth quarter. Exports to Latin America increased slightly while shipments to other developing countries fell. Deliveries of automotive equipment to Canada were also lower as car output there was cut back, paralleling cuts at U.S. plants. Shipments of other products to Canada rose as output there turned up with the ending of the steel, iron ore and nickel strikes.

Most of the increase in exports to Continental Western European countries was in nonagricultural commodities while the rise in exports to the United Kingdom and Japan was about equally distributed between agricultural and nonagricultural commodities.

Imports in the fourth quarter were at an annual rate of $37.5 billion (balance of payments basis), about 1.5 per cent higher than in the third quarter. Preliminary unit-value indexes for October-November (a rough proxy for prices) indicate an acceleration in the prices of imported products -- particularly for coffee and metals, but also for finished manufactures.

Imports of foodstuffs rose in the fourth quarter, reflecting increased prices and stocks of coffee, and greater arrivals of sugar. The value of imports of durable industrial materials was also higher, because of higher prices for copper and nickel and greater quantities of iron ore. Imports of petroleum increased, but purchases of materials associated with nondurable manufacturing -- textiles, chemicals -- dropped as domestic output of these products leveled off.

Imports of machinery and of nonfood consumer goods (other than automobiles) declined from the third to the fourth quarter and represented a smaller share of total domestic expenditures on these products than in the third quarter. The drop in imports of consumer goods is associated with the slackening in domestic demand for TV and household appliances, and other durable consumer goods. In view of the continued expansion in investment outlays both here and abroad, the slowdown in arrivals of foreign machinery may result from difficulties of foreign producers in meeting delivery schedules.

Although imports of cars from Europe and Japan declined from the third to the fourth quarter, sales of these cars in the United States increased in the fourth quarter. As a result, the customary seasonal buildup in stocks was less than usual. Sales of foreign (non-Canadian) cars accounted for about 12 per cent of total car sales in the United States in the fourth quarter. For calendar 1969, sales of these cars were 8.5 per cent greater than in 1968, and their share of the U.S. market rose to over 11 per cent from 10 per cent in 1968. Increasing popularity of compacts may help to explain the continued strength in sales of foreign cars. In December 1969 compact cars accounted for 13.5 per cent of all U.S. sales compared with 8.5 per cent in early 1969.

<u>Foreign exchange markets</u>. Foreign exchange trading was active during the latter half of January following the lull after the turn of the year. Stronger demand for sterling developed about mid-month, and the Canadian dollar came under buying pressure late in January. The French franc exchange rate pushed higher during the month,enabling the Bank of France to purchase a substantial amount of dollars. The Italian lira, on the other hand, was under selling pressure throughout the month.

The strong demand for sterling -- which pushed the pound's exchange rate to its highest level in almost two years -- included in large part seasonal oil company demand for that currency for royalty payments. In addition, some of the increased demand for sterling may have been triggered by the elevation of Regulation Q ceilings, which seem to have been generally interpreted in the exchange market as taking some of the pressure off the Euro-dollar market and hence reducing potential Euro-dollar competitiveness with sterling investments. Early in February heavy buying of sterling developed in anticipation of the announcement of January reserve gains.

The Bank of England announced that its reserves, including a $410 million allocation of SDR's, increased $50 million during January, after "exceptionally heavy debt repayments." The Bank of England's receipts from market intervention totaled about $550 million in January. It made debt repayments in the month of about $900 million, including $300 million on its System swap debt, reducing the swap debt to the Federal Reserve to $350 million.

Increased demand for the Canadian dollar -- which caused the Bank of Canada to purchase $75 million during the last week of January as the Canadian dollar rate rose to its upper limit -- appeared to be the result of some recent moderation in short-term capital outflows. The Canadian basic balance of payments has been quite strong for more than a year but there have been large short-term capital outflows, mainly to the U.S. Late in January the Bank of Canada took measures to stop up loopholes in its "swapped deposit" ceilings on commercial banks, which are intended to check the outflows.

The Bank of Italy's reserves declined about $375 million during January, roughly half representing market losses and half payments by the Italian Government to the Common Market Agricultural Fund. The weakness in the lira reflects in part continued large outflows of capital, mainly through bank note export, reflecting in part political uncertainties. Growing demand for the French franc, on the other hand, enabled the Bank of France to purchase about $150 million in the market during January, we roughly estimate. The National Bank of Belgium also made dollar purchases amounting to $60 million. Demand for the German mark was generally firm, reflecting in part tight financial market conditions in Germany; the mark rate held above its lower limit except for a day or two early in the month when the Bundesbank sold about

$130 million. The Bundesbank's cash position was strengthened during the month by redemption ahead of maturity of DM 2 billion of medium-term U.S. Treasury notes and by the repayment of short-term credits it had earlier made available to other European central banks.

The Euro-dollar market. Euro-dollar rates declined more than seasonally during January, and by the first few days of February had reached their lowest level since late October. The one-month rate averaged about 9-3/8 per cent in the statement week ended February 4, down from 10-3/8 per cent in the first week of January.

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) Differential	(4) 3-month Euro-$ Deposit	(5) 3-month Treasury Bill	(6) =(4)-(5) Differential
Dec. 31	10.17	8.71	1.46	10.44	8.00	2.44
Jan. 7	10.28	8.45	1.85	10.35	7.92	2.43
14	9.97	8.96	1.01	10.34	7.88	2.46
21	8.97	9.30	-0.33	9.90	7.82	2.08
28	8.62	9.04	-0.42	9.52	7.89	1.63
Feb. 4	9.06	9.21p	-0.15p	9.49	7.76p	1.73p

p = Preliminary.

One factor tending to produce lower rates was the reduced demand for Euro-dollars on the part of U.S. banks. Liabilities of all U.S. banks to their foreign branches stood at $13,837 million on January 28, up $850 million since year-end, but some $750 million lower than at mid-December. New York commercial banks, which raised large amounts of funds in January through commercial paper issued by their holding companies, by the end of January reduced their liabilities to their foreign branches even below year-end levels. Some of the early January increase in liabilities to branches no doubt represented the reversal of transactions undertaken prior to yearend, i.e., the shifting of deposits back to branches from head office accounts, and the repurchase of loans previously sold to the branches by head offices. Such transactions have little effect on conditions in the market.

On the supply side, the Bank of Italy suffered a large reserve loss during January through exchange market intervention -- estimated at about $200 million -- and although this loss mostly reflected the movement of bank notes to Switzerland, some of these funds may have found their way into the Euro-dollar market. On the other hand, German commercial banks did not rebuild their net foreign asset positions during January by nearly as much as they drew them down in December. Furthermore, large reserve gains by the Bank of England and the Bank of France reflected movements of private funds that may have tended to reduce the supply of funds to the Euro-dollar market.

<u>GNP in major industrial nations</u>. Capital investment and exports were the primary sources of growth of output in the major European countries, and in Canada and Japan in 1969. In 1970, expansion of these GNP components will be slower and, in general, the rate of growth of GNP seems bound to slow down.

In Europe, growth was most rapid in Germany, where demand pressures steadily intensified. After a brief weakening of the boom early in 1969 the Japanese economy resumed a vigorous upward trend. In France and Canada growth was rapid during the first part of the year, but restraint measures applied by the authorities helped to slow expansion of demand in the second half; some production was also lost through strikes in those countries. Strikes sharply reduced second-half growth in Italy. In the United Kingdom, the economy was flat through the first half of the year but economic activity turned up in the second half.

In Germany, France and Italy, concern over inflation and--in France and Italy--over balance of payments deficits led the authorities to apply restrictive measures last year. However, in Germany these measures are not expected to take full effect before the second half of 1970. In France, expansion should slow down again in 1970; but in Italy the economy will probably continue to expand rapidly, with output close to full capacity throughout 1970. In Japan, restrictive action was taken starting in September, and the expectation is that growth--though still vigorous--will slacken throughout 1970.

GROWTH IN REAL GNP
(per cent)

	Actual 2nd half 1967 to 2nd half 1968	Estimated 2nd half 1968 to 2nd half 1969	Projections[c] 2nd half 1969 to 2nd half 1970
United States	5.1	2.1	0.3
Canada	6.2[b]	3.5	1.8
Germany	8.7	8.1	3.3[d]
U.K.	4.2	1.3	3.0
France[a]	8.6	4.2	3.0
Italy[a]	5.2	4.1	11.3
Japan	14.2	7.0	13.2

a/ All figures for France and Italy are estimates since neither country gives semi-annual data on GNP.
b/ FRB staff estimate.
c/ FRB staff projections.
d/ OECD estimate.

In the United Kingdom, no further significant moves in the direction of restraint have been taken since the budget last April. With the balance of payments substantially improved--large surpluses are now being recorded--and with the government required to call an election no later than the spring of 1971, some easing of restraints seems likely this year. Thus the expansion of demand begun in the third quarter is likely to continue in 1970, very possibly at an accelerated rate.

In Canada, growth is apt to be held to very moderate levels throughout the year, with perhaps a slight pickup in the second half as a result of the projected slackening in aggregate demand in the United States and the broad array of stabilization measures adopted last year.

Germany's expansion, moving from an export-led investment phase towards a consumption boom, resulted in real GNP rising by 8.1 per cent from the second half of 1968 to the second half of 1969, compared to 8.7 per cent in the same 1967-68 period. Through 1969 the rate of expansion showed no appreciable signs of flagging, despite government efforts to keep total demand within tolerable bounds.

Growth in 1970 is expected to slow down, with the projected increase for the second half of 1970 over the second half of 1969 about 3.3 per cent. Within the year, growth should remain quite brisk during the first half as the economy continues to meet the still very substantial backlog of orders, domestic and foreign. By the second half of the year, however, it is anticipated that the combined effects of revaluation and deflationary fiscal and monetary policies will be reflected in a decelerated rate of growth. In particular, investment growth may taper off--if cost increases erode profit margins, credit becomes less easily available and pressures on productive capacity diminish--and demand for exports should be softer as the price effects of revaluation make themselves felt.

One sector of demand the growth of which is not expected to decline is consumption, largely because of liberal wage settlements concluded and anticipated. The government is encouraging arrangements to mitigate the inflationary effects of the large pay boosts primarily through employer contributions to a capital--or investment--fund, thus deferring the increase in disposable incomes. A recently concluded wage agreement between the government and a union representing 1.2 million public service workers included such a provision.

German financial markets have tightened considerably as the Bundesbank has acted to offset only a small part of the liquidity drain caused by the outflow of capital in the wake of the revaluation last October. It now seems unlikely that the monetary authorities will put additional upward pressure on Germany's already very high short-term interest rates. Until recently the Bundesbank Council had been considering an increase in the discount rate, which is unusually far below money market rates at present. However, the recent steps to increase the restrictiveness of fiscal policy make such a move a good deal less likely.

Fiscal policy is to be tightened this year through the blocking of some originally planned government expenditures and the sterilization of some public revenues. This type of budgetary action has the advantage of flexibility and, if the slowdown in the second half becomes too pronounced--as some German experts fear--the sterlized funds could be quickly released.

In France, real GDP was 4.2 per cent higher in the second half of 1969 than in the same period in 1968. Within 1969, growth in real output in the first half year was at an annual rate of about 5 per cent but slowed to a little less than 4 per cent in the second half. Growth factors last year were a very rapid expansion in fixed investment, an inventory build-up in the first half, and, in the last third of the year, a steep rise in exports, partially in response to the devaluation of the franc in August. In addition, consumer demand intensified in the months before devaluation in the expectation of devaluation, associated price inflation, and restrictive consumer credit measures.

The gradual deceleration of growth of output in 1969 resulted from both the intensification of restraint measures applied by the authorities to check inflation and eliminate the balance of payments deficit, and the effects of a large number of strikes in the second half. During the summer, labor and material shortages held back expansion. Thereafter, monetary policy, tightened in the first half of 1969, was made even more stringent following the devaluation in early August. Further expansion of short-term bank credit until mid-1970 was prohibited, and strict limits were placed on the permissible expansion of medium- and long-term credit. Fiscal policy was made more restrictive in the government's stabilization plan announced in September, with a plan to eliminate the budget deficit in 1970 and with the abolition of tax incentives for investment. Installment buying regulations were severely tightened. (They were slightly relaxed, however, in early February.)

Despite all these restraint measures, growth is likely to continue to be relatively rapid in at least the first half of this year because of the overhang of past orders. In the second half, however, growth should slow down as orders are unwound and as the effects of the restrictive actions taken last year intensify.

In Italy, real GNP, after growing at an annual rate of almost 8 per cent in the first half of 1969, barely increased at all in the second half as output was sharply reduced by strikes in manufacturing industries and construction in September-December. The strikes were reflected in a substantial decline in inventories and a slowdown in the rate of increase of personal consumption owing to loss of wages by those on strike.

The Italian economy will be subject to severe demand pressures in 1970. The wage settlements concluded at the end of last year, providing for increases of 13 to 14 per cent in 1970 in such key industries as metals, engineering, chemicals and construction, are expected to boost consumption sharply. In addition, capital investment is also expected to contribute heavily to economic expansion.

Real GNP in the first half may increase by as much as 15 per cent (annual rate), a figure that reflects a return to full production after the strikes. The depletion of inventories in 1969 should be made up for in the first half of this year. In the second half, the annual rate of expansion may be about 7 per cent, which will probably press on capacity limitations. The rise in prices will probably accelerate in the second half despite some slowing of investment and a deterioration of the foreign balance.

The increase in aggregate demand this year is likely to exceed what the Italian authorities consider desirable. Treasury Minister Colombo has warned that inflationary pressures will make 1970 a "difficult year." However, the authorities are not expected to intensify restraints on the economy to slow the rate of expansion. While an attempt will be made to keep the budget deficit from increasing, it is unlikely that action will be taken to reduce it. Political considerations may make it difficult for monetary policy, progressively tightened since May, to be made more stringent. Bond yields rose about 60 basis points between May and November and substantially further in the past two months. Increases in short-term interest rates occurred last summer.

After registering no increase from the second half of 1968 to the first half of 1969, British gross domestic product--in real terms--resumed growth in the second half of last year. The first to second half increase appears to have been about 2.5 per cent, or slightly more, at an annual rate. Consequently, GDP in 1969 was somewhat less than 2 per cent greater than in 1968.

Major contributors to the second half recovery were exports, which advanced sharply in the third quarter before leveling off in the fourth, and fixed capital formation, which rebounded from its first half decline largely because of a marked upturn in manufacturing investment. Consumer spending rose in the second half. Depressing factors were home-building and inventory accumulation, both hampered by the government's tight money policy. Government consumption appears to have grown at about the same rate as overall GDP.

The outlook for 1970 is for continued growth of real GDP at a rate of perhaps 3 per cent--or slightly faster than in the second half of last year. Recent surveys of investment intentions suggest that manufacturing investment will be the prime growth stimulant in 1970, with an increase of about 10 per cent from 1969 to 1970 now indicated. Continuation of monetary stringency could produce cutbacks of currently ambitious plans, though manufacturing investment does not appear to have been inhibited by tight money in the second half last year.

Investment surveys do not point to a comparable surge in investment in the distributive, service and shipping industries, where the increase will probably be somewhat less than 3 per cent. Some revival in homebuilding is expected, though again the rate of increase is apt to be small. The same appears true of government consumption.

The slowdown in world trade and capacity limitations in key export sectors in the United Kingdom may slow the rate of increase in British exports, but an increase in real terms of at least 5 per cent this year seems likely.

With wages rising at least 6 to 7 per cent a year--and perhaps faster, given the virtual abandonment of incomes policy and the pattern of large wage increases that was emerging at the end of last year--disposable income and consumption seem certain to rise by at least 3 per cent in real terms in 1970. In fact, a rise in real consumption considerably in excess of 3 per cent seems more than a remote possibility, since the government--faced with an election no later than May next year--will probably ease its restrictive policies to benefit the consumer. The government may well lower indirect taxes and ease installment buying regulations in the near future.

A 3 per cent rate of growth in GDP would appear compatible with maintenance of a sizable balance of payments surplus. If, however, a surge in consumer spending pushes the rate of increase substantially over 3 per cent, Britain's balance of payments position might deteriorate.

Real GNP in Canada grew at an annual rate of almost 6 per cent during the first half of 1969 but then slowed to an annual rate of just over 1 per cent in the second half. The decleration in the second half reflected both the adoption of stabilization measures by the government and output lost because of strikes in such important industries as nickel and steel. The principal sources of stimulus to growth in 1969 were investment and exports.

With the likelihood of slow growth in the United States, and with domestic policies aimed at a further easing of demand pressures, growth in real GNP this year is expected to be low. The Canadian economy may expand at perhaps a 1.5 per cent annual rate in the first half and at a 2 per cent annual rate in the second. In their battle against rising prices, the Canadian authorities have used a variety of measures, including a relatively tight fiscal policy, a very tight money policy--the money supply has not grown for the last six months--an acceleration of Kennedy Round tariff cuts, promotion of a voluntary price and wage restraint program, and threats of compulsory wage and price controls.

In Japan the increase in real GNP in the fiscal year ending March 31, 1970 will be about 14 per cent. A slight slowdown in the following fiscal year is expected primarily because of an anticipated slowdown in industrial investment. However, a rise in the growth rate of consumer expenditures and increased government expenditures on social improvement programs are expected to take up much of the slack.

The main Japanese domestic economic issue is inflation. Consumer prices rose by 6.5 per cent in 1969, a somewhat faster rate than in 1964-68. The increase in 1970 is expected to be only slightly less than in 1969.

Wholesale prices also rose rapidly in 1969--by 4.1 per cent, the largest rise in a decade. The spread of inflation to wholesale prices has raised fears in Japan about threats to Japanese competitiveness in export markets (despite the fact that Japan is expected to achieve a balance of payments surplus in the current fiscal year of $2.1 billion and a comparable surplus next year).

Large wage increases in 1970-71 are expected to contribute to inflation with Japanese workers reportedly demanding pay hikes of 18 to 20 per cent, well in excess of anticipated productivity gains.

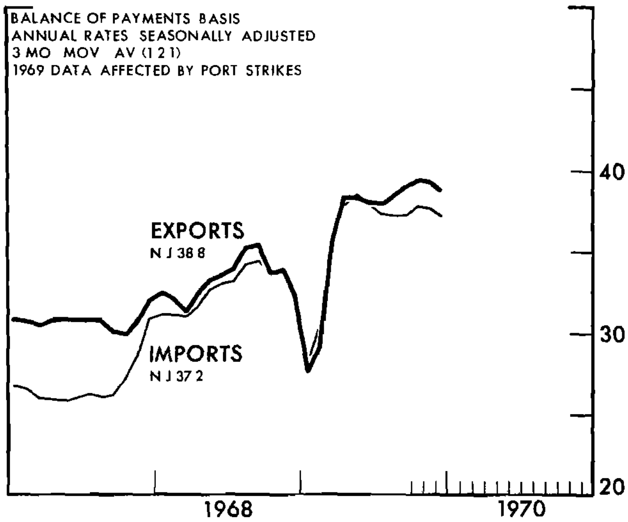
The burden of curbing inflation has been placed on monetary policy, which was tightened in September. The discount rate and reserve ratios were raised and quantitative restrictions on bank lending were imposed. Fiscal policy will be somewhat expansionary this year with government expenditures expected to rise by 18 per cent primarily because of commitments to various projects intended to meet urgent social needs.

The tighter money policy introduced in September is expected to cause a slowdown in growth by the second quarter. Current forecasts indicate the slowdown will continue in the second half, despite the expansionary effects of consumer and government spending.

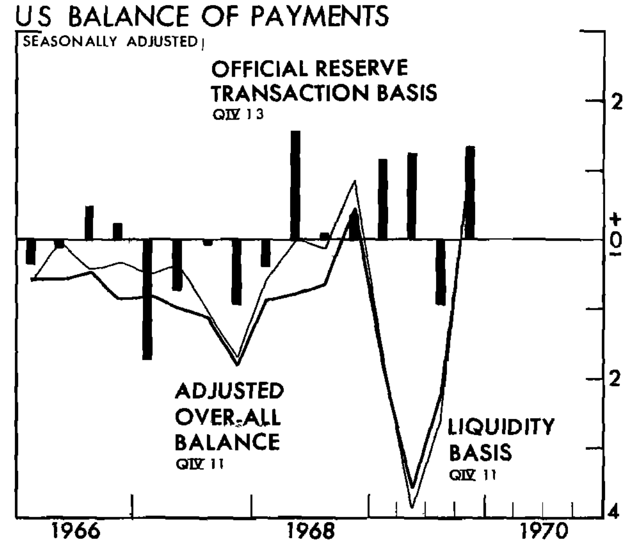
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

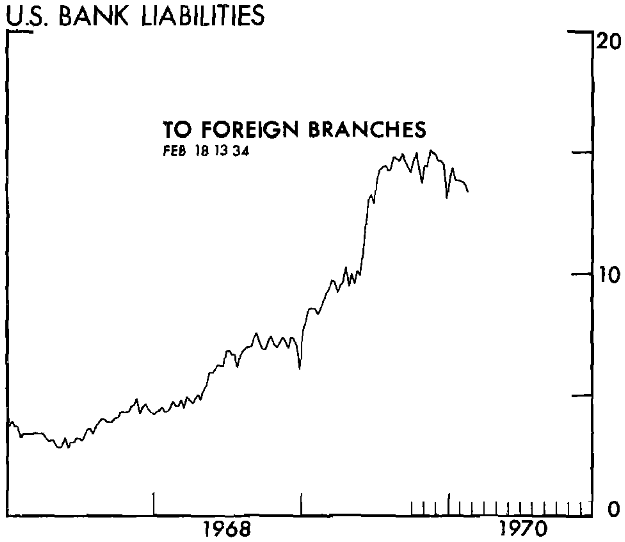
U.S MERCHANDISE TRADE



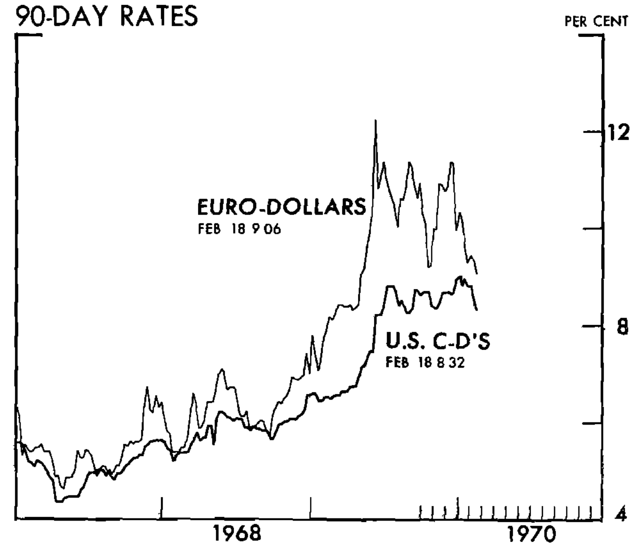
U.S BALANCE OF PAYMENTS



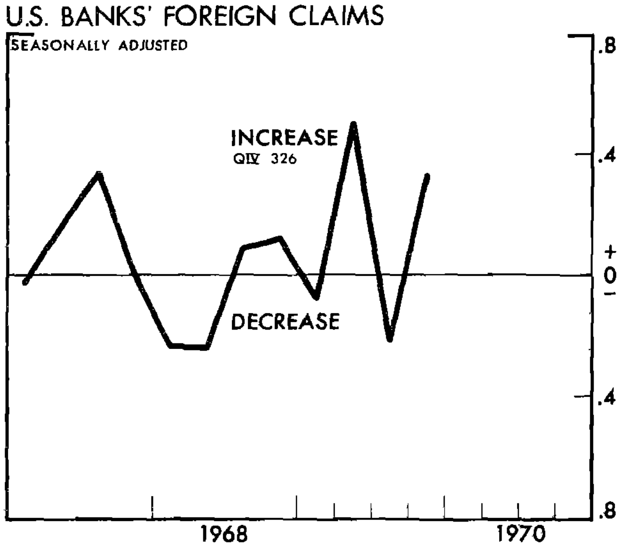
U.S. BANK LIABILITIES



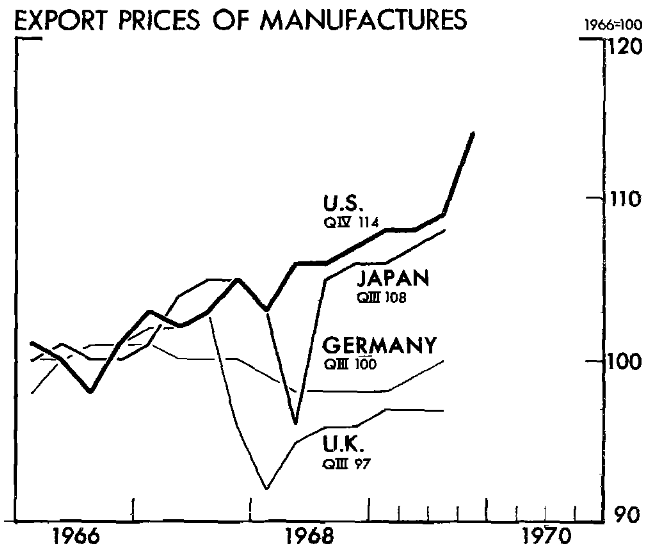
90-DAY RATES



U.S. BANKS' FOREIGN CLAIMS



EXPORT PRICES OF MANUFACTURES



APPENDIX A: LIFE INSURANCE COMPANIES DURING 1969*

During 1969, with intensification of the pressures that had been apparent in 1968, the volume of funds the life insurance industry was able to direct to the capital markets--and particularly to the long-term debt markets--was reduced markedly. Continued restriction on the total volume of funds available for investment was only one feature of industry investment activity during the year. Other manifestations of the market environment during 1969 included continued uncertainty regarding the outlook for future fund flows and a corresponding attempt to maintain flexibility in commitment scheduling, as well as further emphasis away from fixed-income investments into equities or instruments with equity or contingent-interest features.

Sources of funds

The volume of funds available during 1969 for investment in the capital markets was constrained by a variety of forces, all of which were related to the general economic and financial environment of the period.

Table 1

GROSS SOURCES OF FUNDS INVESTED IN THE CAPITAL MARKETS BY LIFE INSURANCE COMPANIES 1/

(Billions of Dollars)

	1966	1967	1968	1969 p/
Ledger assets 2/	7.8	8.4	8.5	8.0
Return flows 3/	7.3	7.4	7.8	7.9
Security sales 4/	3.4	2.0	2.2	2.0
Policy loans	-1.7	-1.2	-1.4	-2.7
Other, net 5/	.1	.2	.2	.5
TOTAL	16.9	16.8	17.3	15.7

1/ Estimated for the entire industry, with the components derived from a sample representing 80 per cent of industry assets.
2/ Net increase in ledger assets reflects primarily receipts from insurance premiums and net investment income (including net gain or loss from securities sold).
3/ Return flows from existing mortgage and securities holdings.
4/ Consists only of sales out of long-term portfolio; reflects primarily sales of non-Government securities.
5/ "Other" includes miscellaneous sources of funds and adjustments to liquid assets (cash, commercial paper, and short-term Governments).
p/ Preliminary.

* Prepared by Barbara Negri Opper, Economist, Capital Markets Section, Division of Research and Statistics.

Funds received from basic insurance operations (the net change in ledger assets) were actually smaller than during either 1967 or 1968. While insurance premium receipts have experienced some retardation in growth, the actual shortfall in this source probably reflects the losses realized on long-term securities sold during the year. Similarly, return flows from existing investments have grown extremely slowly since 1968; while the volume of maturing bonds has maintained its growth, this has been partially offset by the continued decline (as at nonbank depositary institutions) in the funds received from mortgage prepayments.

The industry had anticipated the kind of cash flow pressures that materialized during the year, and had been prepared to adapt its investment activity accordingly. Although the actual volume of policy loans had been under-estimated by them, the modest new commitment activity carried out the year earlier, as well as the degree of flexibility that had been incorporated in scheduling of commitment disbursements vis-a-vis projected cash flow, provided little need to employ extraordinary adjustments. Thus, although sales of securities from long-term portfolio once again represented a fairly important source of funds during 1969, their volume was little changed from 1968.

The increase in policy loans, which during 1969 represented fully 17 per cent of funds invested elsewhere, was even larger than the recent peak year of 1966, when policy loans accounted for 10 per cent of funds otherwise invested. At the end of 1969, policy loans outstanding accounted for 7 per cent of the total assets of all life insurance companies--equal to their holdings of corporate common and preferred stock.

There has been some attempt to analyze the composition of policy loans. According to results from a sample survey, more than half of the volume outstanding at mid-1969 was in small amounts, and most loans had been made for cash disbursement--i.e., not as payment for insurance premiums. This confirms that these loans, granted at a contractually-guaranteed 5 per cent interest rate, have been used either in lieu of other borrowing or for direct investment by policyholders in the capital market.

New commitment activity

The industry apparently expects its cash flow to remain relatively modest over the next several quarters at least. Although policy loans have tended to abate somewhat from mid-summer peaks, volume nevertheless remains high and is expected to continue so over the near term. Return flows from existing investments, particularly mortgages, are also expected to remain reduced. Projected total funds available for gross market investment therefore remain modest; scheduling of new investment acquisitions not only is correspondingly low, but continues to afford leeway in the event that projected fund flows prove to have been overestimated.

Table 2

SIX-MONTH PROJECTIONS 1/
COMMITMENT DISBURSEMENTS AS PER CENT OF EXPECTED AVAILABLE FUNDS

	I	II	III	IV
1965	76	82	82	89
1966	89	89	89	84
1967	75	74	74	79
1968	79	75	72	75
1969	71	75	76	78p/

1/ This represents what the reporting companies expected in takedowns of commitments as a per cent of funds available for investment. The sample represents about two-thirds of life insurance industry assets.
p/ Preliminary.

In addition to the reduced overall volume of new commitments made, there has been a significant shift in the allocation of future funds between corporate debt and mortgages. As shown in Table 3, the differential between the contract interest rate on new mortgage commitments and direct placements actually favored direct placements during 1969. (These average rates do not allow for the generally higher costs of servicing mortgages, which have been estimated at between 25 and 50 basis points higher than the costs for direct placements.) Despite this apparent incentive, however, there has been a far larger reduction in new commitments for corporate direct placements than for mortgages.

Table 3

LIFE INSURANCE COMPANIES
AVERAGE CONTRACT INTEREST RATES ON NEW FORWARD
INVESTMENT COMMITMENTS

	Mortgages 1/	Direct Placements 2/	Differential
1966 - I	6.08	5.70	.38
II	6.25	5.97	.28
III	6.63	6.28	.35
IV	7.01	6.56	.45
1967 - I	6.88	6.51	.37
II	6.79	6.39	.40
III	6.90	6.64	.26
IV	7.06	6.73	.33
1968 - I	7.35	7.14	.21
II	7.58	7.36	.22
III	7.84	7.60	.24
IV	7.87	7.60	.27
1969 - I	8.11	7.95	.16
II	8.51	8.44	.07
III	8.98	9.08	-.10
IV p/	9.30	9.35	-.05

1/ Commitments on multifamily and nonresidential properties of $100,000 and over made by 15 companies that represent 57 per cent of industry assets. Average is weighted by loan amount.
2/ Average, weighted by amount, of commitments on straight debt placements on which the issuer corresponds to publicly-offered quality grades of Aaa-Baa. From a sample representing two-thirds of industry assets.
p/ Preliminary

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VOLUME OF NEW COMMITMENTS MADE
BY LIFE INSURANCE COMPANIES
(Millions of dollars)

	Corporate Direct Placements 1/		
	Total	With Warrants or Convertible	Large Mortgages 2/
1966	4,061	153	2,516
1967	4,647	291	3,027
1968	3,587	451	3,244*
1969	2,637	737	2,827*p/

1/ Sample of companies accounting for two-thirds of industry assets.
2/ Commitments of $100,000 and over on multifamily and nonresidential mortgages made by 15 life insurance companies that account for 57 per cent of industry assets.
* Includes commitments under the "Billion Dollar Program" to invest in inner-city areas.
p/ Preliminary.

Part of this apparent anomaly is accounted for by the industry's "Billion Dollar Program" to invest in the inner city, commitments for which are overwhelmingly in mortgages. However, the most telling reason for the relative emphasis on mortgages is the potential income, in addition to the fixed interest, that is available on income-property mortgages. Equity features--such as contingent interest geared to a property's earnings, or the life insurer's ownership of the land which is then leased to the mortgagor--have become increasingly common; about half of the volume of income property mortgage commitments made during 1969 is estimated to have provided such contingent interest features. In contrast, only a small--albeit growing--portion of corporate direct placements offers such equity-type participation; during 1969, about one-fourth of new direct placement commitments carried either warrants to purchase common stock or convertible features.

Acquisitions of investments

As a consequence of the shortfall in cash flow, as well as reduced commitment activity since 1967, net acquisitions of corporate debt were reduced by about 25 per cent from the year-earlier volume. Mortgage acquisitions on income-producing properties were relatively better maintained, but continuing a recent trend, the industry's holdings of single-family home mortgages were reduced, net.

Table 5

LIFE INSURANCE COMPANIES*
NET CHANGES IN SELECTED ASSETS

(Billions of Dollars)

	1966	1967	1968	1969p/
Corporate bonds	2.6	3.9	3.7	2.7
Mortgages	4.6	2.9	2.5	2.1
1-4 family	.6	-.5	-.7	-.9
Other	4.0	3.4	3.2	3.0

* Entire industry data. Net asset changes reflect valuation adjustments as well as net investment; however, such adjustments are inconsequential for the asset categories shown above.
p/ Preliminary.

In contrast to the behavior of the other more traditional forms of investment, gross acquisitions of common stock were made in record volume. Although the rapid growth of separate accounts1/ undoubtedly was a factor underlying this pattern, there is no doubt that a major

1/ Separate accounts are the vehicle through which variable annuities are managed, and are invested primarily in common stock.

force also was the industry's shift away from fixed income obligations.

LIFE INSURANCE COMPANIES*
GROSS ACQUISITIONS OF COMMON STOCK
($ Millions)

1963	530
1964	807
1965	1,043
1966	997
1967	1,676
1968	2,979
1969p/	3,800

* Entire industry data.
p/ Preliminary.