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Content last modified 6/05/2009.

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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

October 14, 1970

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SUMMARY AND OUTLOOK

Nonfinancial

The overall performance of the economy last quarter was sluggish. Real GNP apparently increased slightly less than the quite modest rise we had previously projected. The GM strike, beginning in mid-September, contributed to the weakness in activity later in the quarter. On balance, upward price pressures appear to have lessened a bit.

Industrial production declined 1.7 per cent further in September. The General Motors strike accounted for about two-thirds of this but reductions were widespread in sectors not affected by the strike, including both business and defense equipment, some nonautomotive consumer goods, and a number of materials. The September index is nearly 5 per cent below the high of July 1969, while business equipment is down 10 per cent from its October 1969 high. Retail sales in September were unchanged from August and for the third quarter as a whole were less than 1 per cent above the second quarter.

New orders for durable goods for July-August were up 5 per cent from the second quarter average, and orders for capital equipment leveled out following earlier declines. The durable goods backlog, however, has declined further. Book values of business inventories in July and August increased at a far more rapid rate than in the second quarter, suggesting the possibility of some involuntary accumulation. The composite of 12 leading indicators declined in August after two months of increase.

The labor market turned out to be very weak this past summer. The unemployment rate rose to 5.5 per cent in September from 5.1 per cent in August. Preliminary nonfarm employment estimates for July and August were revised down sharply and although employment in September remained at the August level, the average for the quarter was down 436,000, with declines widespread. The manufacturing workweek was off further in September. Output per manhour in the private nonfarm economy apparently increased appreciably for the second consecutive quarter.

Large swings in prices of farm products recently have resulted in an uneven pattern of change in the wholesale price index, with September up sharply. Average prices of industrial commodities have increased at a fairly even pace--somewhat slower over the third than the second quarter. The marked slowing of the rise in consumer prices from May to August provides some basis for optimism with respect to progress against inflation. Retail food prices are still expected to continue to change relatively little over the remainder of this year, notwithstanding the reduction in the corn crop because of the corn blight. But substantially higher prices of 1971 model autos will impart an upward fillip to the CPI in October and probably November as well.

Outlook. The weakness evident in recent economic data adds support to the prospect of a relatively slow recovery in economic activity. Consumer expenditures have been sluggish and inventory data imply some backup of stocks in the hands of manufacturers and retailers. The general economic situation, including capacity utilization rates and

profits, seems conducive to prospective declines in business fixed investment spending. However, gradually easing credit conditions are still expected to result in further increases in residential construction activity and larger purchases by State and local governments.

The pattern of economic recovery will be distorted by the GM strike over this and the next two quarters. Growth in real GNP will be considerably dampened this quarter, but the makeup of strike losses is expected to raise the rate of expansion in real GNP to near 4 per cent in the first quarter of next year. In the second quarter of 1971, auto sales are expected to decline from the post-strike peak level and real GNP growth to fall back to a rate of about 3 per cent.

On balance, the increase in real GNP from second quarter 1970 to second quarter 1971 may turn out to be smaller than projected. This suggests the possibility of more slack in resource use than had been anticipated, with the unemployment rate now projected at 5.9 per cent in the spring of 1971 and the capacity utilization rate in manufacturing dropping to about 75 per cent. Slower growth and more unused resources lend support to the projected slowing of the increase in the GNP deflator to a 3.0 per cent annual rate next spring.

Financial

Interest rates have declined on balance since the last meeting of the Committee, partly in response to a further easing of money market conditions. Early in the inter-meeting period, a sharp drop in the Federal funds and 3-month Treasury bill rates below the discount rate

created widespread expectations of an imminent cut in the discount rate as well. But when Federal funds then traded above 6 per cent again, these expectations disappeared, and the bill rate also moves slightly above 6 per cent.

In capital markets, the downward drift of interest rates was inhibited by a significant further build-up in the calendar of new bond offerings, both municipals and corporates. Investor reception of the expanded new issue flow has been generally favorable, however, and yields have advanced only on longer-term municipal issues--in which bank interest has remained limited.

In contrast to the heavy volume of long-term corporate financing, business borrowing at banks weakened abruptly in September--especially after the tax date--apparently due in part to expanded loan repayments. With loan demands weak and deposits at banks continuing to grow rapidly, the prime rate cut initiated at mid-September was quickly adopted by all major banks.

Deposit expansion in September was centered wholly in time and savings deposits. Growth of consumer-type accounts accelerated to about a 15 per cent annual rate, and although bidding for large negotiable CD's was less aggressive, outstandings still grew by nearly as much as in August. Since the bulk of this deposit growth was used to repay bank-related commercial paper and Euro-dollar borrowing, and demand deposits actually contracted slightly, total bank credit adjusted for non-deposits sources grew less than half as fast in September as in August.

With market interest rates declining, the personal saving rate high, and consumers concerned about the safety and liquidity of their financial assets, nonbank thrift institutions also maintained their much improved inflow of savings funds during September. Moreover, in the early days of the September-October reinvestment period (the latest for which data are available), net savings losses at these institutions were quite modest.

Securities market outlook. The pattern of recent large additions to the forward calendar of corporate and municipal security offerings suggests that the weight of such financing will remain very large through the fourth quarter. In the corporate market, this sustained large volume apparently reflects continued emphasis on such considerations as funding shorter term liabilities, rebuilding liquid assets, improving debt-equity ratios, and leaving bank lines open for future use. In addition, of course, the relationship between investment expenditures and internal generation of funds implies continuing needs for a large volume of external financing. In the tax exempt market, the enlarged calendar continues to be heavily weighted with issues previously postponed because of high interest rates.

In the Federal sector, plans for refinancing large November debt maturities are expected to be announced on October 22--probably in the form of a rights-cash operation. The Treasury has just raised $2.5 billion of new money through a tax bill. But additional cash borrowing of about $2.5 billion is likely to be needed before year-end,

not counting the $1.7 billion already scheduled to be raised through further additions to weekly and monthly bill auctions.

A bunching of corporate and municipal bond offerings is now scheduled to occur at about the same time the Treasury will be engaged in its November refinancing. Some temporary increases in note and bond yields could, therefore, develop at that time. But over the quarter as a whole, the combination of sluggish economic growth and a moderate continuing expansion of money and bank credit seems likely to encourage some further down drift of interest rates. If expectations of a cut in the discount rate were revived, the decline would accelerate, particularly among short-term rates.

Banking outlook. With market rates expected to drift lower, the ability of banks to attract a large volume of both CD's and consumer-type deposits should improve. In fact, if market rates drop off very much, CD rate ceilings would cease to be a restraint on the choice of CD maturities. Banks will probably continue the process of rebuilding liquidity positions and repaying alternative high cost funds, although perhaps bidding less aggressively for CD's as time goes on. Overall bank credit growth is, therefore, likely to be dampened by further reductions in commercial paper and Euro-dollar borrowings. With business loan demands expected to be sluggish--in view of heavy capital market borrowings and the projection of only limited economic growth--banks should be in a position favorable to the acquisition of municipal securities, Treasury issues, and mortgages. In this environment, banks

would probably also relax business loan policies and might become more willing to extend term loans.

Mortgage markets. Outstanding mortgage commitments have grown further under the stimulus of the good third-quarter savings performance at nonbank thrift institutions, and there are field reports of greater mortgage availability. We would expect this trend to continue, although some temporary moderation of the forward momentum could develop if S&L's and savings banks become concerned about deposit losses associated with the possible issuance of a savings bond-type instrument by AT&T.

Balance of payments

The latest data on merchandise imports, for August, were disappointingly high--virtually at the May peak level again. With exports off somewhat, the trade balance was only half as large as it had been in June and again in July. However, a change in this direction was not unexpected, in view of the erratic character of the series, and (at least until September data become available) our views of the trade outlook have not changed substantially.

Imports are expected to be lower again in September and then to rise gradually in coming months, reflecting both strengthening domestic demand and easing of the supply position for various materials abroad. Exports are still expected to rise in the fourth quarter and on into next year. Taking account also of service transactions and

investment income, net exports of goods and services are expected to increase somewhat beyond the $4-1/2 billion annual rate that was achieved in the second quarter. This compares with about $2 billion in the year 1969.

The improvement in net exports between 1969 and 1970 should carry through to the overall balance on the liquidity basis (adjusted). But since net capital outflows, even without counting changes in liabilities to commercial banks abroad, may be nearly as adverse this year as in 1969, the deficit will remain large. Through the first three quarters it has cumulated to about $4-1/2 billion. There is a possibility of very large and partly reversible repartriations of U.S. corporate investment funds at the end of the year--larger than would be counted as seasonal--and, if this occurs, there might be a surplus in the fourth quarter, cutting the year's liquidity deficit (adjusted) below $4 billion. This would compare with about $6-1/2 billion for the year 1969. Last year's deficit was enlarged by a considerable outflow, partly identified but largely unidentified, of private (nonbank) liquid funds from the United States, and thus far in 1970 there have again been some net outflows of such kinds.

The official settlements deficit cumulated through the first three quarters of 1970 now exceeds $7 billion (before counting the SDR allocation). This deficit has been covered to the extent of $2.4 billion by a net reduction in U.S. reserve assets. Official

holdings of convertible currencies are down by $1.7 billion, and the U.S. reserve position in the IMF has contracted by $0.4 billion. Gold holdings have been reduced by $0.4 billion, while SDR holdings have increased (apart from the initial allocation) by $0.1 billion. The remainder of the financing, amounting to about $5 billion, has taken the form of additions to foreign reserve claims against the United States, with very large net acquisitions by Germany (over $4 billion) and Canada (over $1 billion).

Prospects for the remainder of the year depend greatly on whether or not U.S. banks continue to maintain their Euro-dollar borrowings despite the interest rate incentives that push them toward making repayments. Euro-dollar interest rates, influenced by continued tightness in European financial markets, have lagged behind the decline in U.S. market rates. In recent months moderate declines have occurred in short-term rates in some European countries, but long-term yields have remained very high and the policies of governments and central banks are still directed predominantly at resisting inflation. Some signs of easing in the expansion of aggregate demand are now evident in several countries, but these have not been sufficient to bring major changes in monetary policy.

October 13, 1970

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SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1970				Per Cent Change* From		
	June	July	August	September	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	82.1	82.8	82.7	83.0	0.4	1.1	2.1
Unemployment rate (%)	4.7	5.0	5.1	5.5	--	--	[3.8] 4/
Insured unempl. rate (%)	3.7	3.6	3.7	n.a.	--	--	[2.2] 4/
Nonfarm employment, payroll (mil.)	70.6	70.5	70.4	70.4	0.0	-0.3	-0.3
Manufacturing	19.5	19.4	19.3	19.3	0.0	-1.0	4.8
Nonmanufacturing	51.1	51.1	51.1	51.1	0.0	0.0	1.6
Industrial production (57-59=100)	168.8	169.2	168.9	166.0	-1.7	-1.7	-4.5
Final products, total	167.1	167.5	166.8	162.9	-2.3	-2.5	-5.4
Consumer goods	162.8	164.7	164.2	160.3	-2.4	-1.5	-1.5
Business equipment	188.0	186.1	184.9	181.1	-2.1	-3.7	-9.6
Materials	171.2	171.8	170.9	168.8	-1.2	-1.4	-4.1
Capacity util. rate, mfg.	77.3	77.3	76.8	n.a.	--	--	[84.2] 4/
Wholesale prices (57-59=100) 1/	117.0	117.7	117.2	117.8	0.5	0.7	3.7
Industrial commodities (FR) 5/	115.7	115.9	116.1	n.a.	0.2	0.5	3.8
Sensitive materials (FR)	115.9	114.7	114.5	114.0	-0.4	-1.6	0.4
Farm products, foods & feeds	117.5	119.3	117.0	118.5	1.3	0.9	3.7
Consumer prices (57-59=100) 1/ 5/	135.2	135.7	136.0	n.a.	0.2	1.0	5.7
Food	132.7	133.4	133.5	n.a.	0.1	0.8	4.8
Commodities except food	122.8	122.9	123.0	n.a.	0.1	0.6	4.1
Services	155.0	155.8	156.7	n.a.	0.6	1.7	8.1
Hourly earnings, pvt. nonfarm ($)	3.21	3.23	3.26	3.26	0.0	1.6	5.5
Hourly earnings, mfg. ($)	3.36	3.38	3.41	3.43	0.6	2.1	5.9
Weekly earnings, mfg. ($)	133.73	135.82	135.21	134.69	-0.4	0.7	2.5
Net spend. weekly earnings, mfg. (3 dependents 57-59 $) 1/ 5/	86.12	85.84	85.41	n.a.	-0 5	-0.3	-1.6
Personal income ($ bil.) 2/ 5/	798.2	803.3	807.4	n.a.	0.5	1.0	6.4
Retail sales, total ($ bil.)	30.5	30.7	30.7	30.8	0.2	0.8	5.1
Autos (million units) 2/	8.6	8.5	8.4	7.2	-14.6	-16.9	-21.0
GAAF ($ bil.) 3/	8.2	8.3	8.3	8.3	0.0	0.9	4.9
12 leaders, composite (1967=100) 5/	114.0	115.8	115.4	n.a.	-0.3	1.4	-1.8
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/ 5/	1,393	1,591	1,431	n.a.	-10.1	15.2	4.0
Factory workweek (hours) 5/	39.8	40.1	39.8	39.4	-1.0	-1.0	-3.2
Unempl. claims, initial (thous.) 5/	312	270	290	n.a.	-7.4 6/	7.6 6/	-46.2 6/
New orders, dur. goods, ($ bil.) 5/	30.0	31.4	30.6	n.a.	-2.7	1.9	-2.9
Producers' capital goods indus.	6.3	6.4	6.1	n.a.	-4.4	-2.7	-2.6
Common stock prices (41-43=10)	75.59	75.72	77.92	82.58	6.0	9.2	-12.6

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l. merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ Per cent calculated to August 1970. 6/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	Averages					1970
	1969	1970				Week ended
	QIV	QI	QII	QIII	Sept.	Oct. 7
Interest rates, per cent						
Federal funds	8.94	8.56	7.88	6.71	6.29	6.36
3-mo. Treasury bills	7.36	7.21	6.67	6.33	6.13	5.95
3-mo. Federal agencies	7.92	7.72	7.09	6.67	6.56	6.17
3-mo. Euro-dollars	10.48	9.26	8.87	8.34	8.03	8.18
3-mo. finance co. paper	7.89	7.94	7.41	7.31	7.12	6.76
4-6 mo. commercial paper	8.63	8.55	8.16	7.73	7.32	7.08
Bond buyer municipals	6.40	6.35	6.81	6.33	6.25	6.39
Aaa corporate-new issues	8.32	8.45	8.94	8.51	8.42	8.37
20-year Treasury bonds	6.71	6.78	7.14	6.96	6.88	6.79
FHA mortgages, 30-year	8.53	9.25	9.12	n.a.	n.a.	--

	1969	1970			
	QIV	QI	QII	QIII	Sept.
Change in monetary aggregates (SAAR, per cent)					
Total reserves	1.4	-2.9	2.6	19.0	26.9
Nonborrowed reserves	-0.1	-0.4	4.1	24.2	39.5
Credit proxy	0.1	0.6	6.0	23.7	17.8
Credit proxy + nondep. funds	2.0	0.5	6.5	16.8	8.6
Money supply	1.2	3.8	4.2	4.5	-0.6
Time and savings deposits	--	0.4	13.8	31.6	28.9
Deposits at S&L's and MSB's	1.4	1.9	7.1	9.4	9.4
Bank credit, end-of-month 1/	4.9	2.5	5.3	13.2	7.1
Treasury securities	-20.5	-12.3	30.2	23.7	2.1
Other securities	4.5	9.5	9.9	20.3	31.3
Total loans 1/	10.0	3.4	-0.3	9.3	2.1
Business 1/	7.5	5.5	5.8	2.2	-10.6

	1969	1970			
	QIV	QI	QII	QIII	Sept.
Change in commercial paper in millions of dollars					
Total (SA)	3,236	3,185	2,091	-4,298	-1,413
Bank related (NSA)	1,699	2,226	1,033	-2,967	-2,670

	1968	1969			1970	
	Year	Year	HI	QIII	HI	QIII
New security issues (NSA, $ mil.)						
Total corp. issues	21,965	26,965	13,572	6,332	18,445	8,775e
Public offerings	15,314	21,131	10,360	4,984	15,899	7,725e
State and local government bond offerings	16,574	11,881	6,435	2,464	7,816	4,348e
Fed. sponsored agency debt (change)	3,354	9,292	3,605	2,717	4,947	1,822e
Fed. gov't. debt (change)	15,301	-2,559	-12,370	4,740	-4,415	7,413e

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

1/ Adjusted for loans sold to bank affiliates.

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U.S. Balance of Payments

In millions of dollars; seasonally adjusted

	1969 r/ Year	1970 P I	1970 P II	1970 P JULY*	1970 P AUGUST*
Goods and services, net 1/	1,949	851	1,119	421	207
Trade balance 2/	638	518	847	3,640	3,552
Exports 2/	36,473	10,241	10,714	-3,219	-3,345
Imports 2/	-35,835	-9,723	-9,867		
Service balance	1,311	333	272		
Remittances and pensions	-1,191	-328	-359		
Govt. grants & capital, net	-3,828	-855	-785		
U.S. private capital	-5,233	-1,686	-1,813		
Direct investment	-3,070	-1,411	-1,363		
Foreign securities	-1,494	-133	64	-144	-147
Banking claims	-541	147	-459	345	183
Other	-128	-289	-55		
Foreign capital	12,330	1,679	1,547		
Official foreign, liquid	-517	3,044	450	1,285	14
Official reserve holders, nonliquid	-996	-422	506	-71	-108
Other official foreign, nonliquid	259	-32	-175		
Foreign commercial banks, liquid	9,217	-1,916	-118	-1,067	365
New direct investment issues 3/	1,029	155	267		
U.S. corporate stocks	1,565	-85	-123	54	104
Other	1,773	935	740		
U.S. monetary reserves (inc.-)	-1,187	481	1,022	263	269
Gold stock	-967	-44	14	-45	117
Special drawing rights	--	-53	-37	-4	--
IMF gold tranche	-1,034	-253	227	-104	131
Convertible currencies	814	831	818	416	21
Errors and omissions	-2,841	-144	-729		
BALANCES (deficit -) 4/					
Official settlements, S.A.		-3,103	-1,978		
" " , N.S.A.	2,700	-2,829	-2,061	-1,477	-175
Liquidity, S.A.		-1,598	-1,420		
" , N.S.A.	-7,012	-1,496	-1,411	-438	-742
Adjusted over-all, S.A.		-1,187	-1,860		
" " , N.S.A.	-6,517	-1,093	-1,858	-410	-540
Financed by: 5/					
Liab. to comm. banks	9,217	-1,736	-203	-1,067	365
Official settlements	-2,700	2,829	2,061	1,477	175

* Only exports and imports are seasonally adjusted.

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/ Excludes initial allocation of SDRs on January 1, 1970; total $867 million, quarterly S.A., $217 million.

5/ Minus sign indicates decrease in net liabilities. Data not seasonally adjusted.

Gross national product. Recent data suggest that underlying economic forces may be somewhat weaker than had been anticipated earlier. The unemployment rate rose sharply in September. Nonfarm employment figures for July and August have been revised down, substantially so for August, and manhours in manufacturing dropped significantly further in September. Consumer spending has continued sluggish, and the personal saving rate remained at a high level in the third quarter. Inventory accumulation, according to data for July and August, has been taking place at a more rapid pace than expected, and in part may have been involuntary.

These indications of weakness pre-date the GM strike which curtailed auto production and aggregate output in the last half of September. The impact of the auto strike on total third quarter GNP was relatively mild, however, with total product estimated to be down by only $2 billion, annual rate, on this account. If, as we are assuming, the strike lasts until the end of October, it will have a larger dampening effect on fourth quarter GNP even though production schedules for November and December will be stepped-up. However, we expect that a considerable portion of the strike loss will be made up in early 1971.

The third quarter GNP increase amounted to $14 billion, annual rate. This was about the same as in our previous projection, but the composition differs in some respects. Consumer spending rose only $8 billion, rather than the $10-1/2 projected in the previous Greenbook. Unit sales of new domestic autos remained at the second quarter

annual rate of 8.0 million, but dropped to 7.2 million in September. (Our previous projection assumed such sales at an 8.5 million rate.) Sales of other durable goods were apparently off a little in the quarter. Spending on nondurable goods rose moderately. The somewhat larger-than-expected rise in inventory investment seems to be associated in part with the lack of ebullience in consumer spending.

Changes in the other major GNP components from our previous third-quarter projection were on balance upward. These include a small rise in business fixed investment rather than a decline, a larger-than-anticipated rise in State and local government purchases, and a smaller rise in residential construction outlays. Altogether, in real terms, GNP rose at an annual rate of 1.4 per cent, compared with 0.6 per cent in the second quarter. The implicit price deflator is estimated to have increased at an annual rate of 4.4 per cent, little different from the second quarter rise.

CHANGES IN GNP AND RELATED ITEMS, 1970, 1970
(Seasonally-adjusted, annual rates)

	Third Quarter		Fourth Quarter	
	Projection of 9/9/70	Commerce Preliminary Estimate	Projection of 9/9/70	Current Projection
	Billions of dollars			
GNP	13.9	14.1	15.0	12.5
Final sales	13.9	13.1	15.0	14.0
Personal consumption	10.6	8.0	11.0	9.9
Residential construction	1.6	.7	2.7	2.6
Business fixed investment	- .5	.9	- .5	- .5
Net exports	.6	.6	.3	.3
Federal purchases	- .7	- .7	- 1.5	-1.3
State and local purchases	2.3	3.7	3.0	2.9
Inventory change	- .1	.9	0.0	-1.5
	Per Cent			
Real GNP	1.7	1.4	2.5	1.5
GNP deflator	4.0	4.4	3.6	3.6

The continued cautious spending attitudes of consumers along with the assumption that supplies of G. M. autos will be limited hold GNP growth to $12.5 billion, annual rate in the fourth quarter as compared with $15 billion projected previously. Even if GM resumes production at high rates at the beginning of November, all of the strike loss is not likely to be made up by the end of the quarter, and sales of autos and trucks as well as dealer stocks are likely to be lower

than otherwise. The loss of income by workers on strike will also result in some secondary effects on production, employment, and income. We therefore expect that the increase in consumption expendtiure will be a little smaller than previously projected.

Inventory investment is expected to be lower than in the third quarter, mainly because of the auto situation. Other major components of GNP change are about the same as projected earlier. The anticipated small decline in business fixed investment appears consistent with the moderately lower level of new orders for machinery and equipment and the downward trend in physical output of business equipment. On balance, we anticipate some lessening of price pressures. And we project real GNP to grow at an annual rate of about 1.5 per cent.

CHANGES IN GNP AND RELATED ITEMS, 1971
(Seasonally adjusted, annual rates)

	First Quarter		Second Quarter	
	Projection of 9/9/70	Current Projection	Projection of 9/9/70	Current Projection
	Billions of dollars			
GNP	17.5	20.5	17.1	15.0
Final sales	17.0	20.2	16.1	12.1
Personal consumption	11.2	13.5	11.5	9.0'
Residential construction	2.0	2.4	1.4	1.4
Business fixed investment	-1.0	-1.0	-1.0	-1.0
Net exports	.6	.6	.1	.1
Federal purchases	.7	1.2	.3	-1.2
State and local purchases	3.5	3.5	3.8	3.8
Inventory change	.5	.3	1.0	2.9
	Per Cent			
Real GNP	2.8	3.8	3.7	2.9
GNP deflator	4.2 1/	4.3 1/	3.0	3.0

1/ Excluding effects of Federal pay increase, 3.3 per cent per year.

The assumed catch-up early next year from the GM strike accounts for the projected large first quarter increase of $20.5 billion in GNP. Purchases of consumer durables are projected to rise about $4.5 billion, annual rate, as the result of an increase in domestic auto sales to about a 9 million annual rate. Inventory investment is projected at a slightly lower level than in the previous Greenbook, as the strike-deferred build-up at GM dealers is limited by a high sales rate. On the other hand, accumulation of steel as a hedge against a possible strike is likely.

In the second quarter of next year, GNP is expected to increase by only $15 billion, as consumption drops back from its high first quarter rate of gain. However, inventory investment is likely to be larger than in the first quarter, reflecting a further build-up of auto stocks and some further precautionary buying of steel. Residential construction activity and State and local governments should continue to provide strength to the economy, assuming a moderate monetary expansion and an associated gradual easing in overall credit conditions. The GNP deflator is expected to slow to about a 3 per cent annual rate of increase and we are projecting real GNP growth in the second quarter at about a 3 per cent rate.

Real GNP is projected to increase 2.4 per cent from the second quarter of 1970 to the second quarter of 1971, compared with 2.7 per cent in our previous projection. This is well below the prospective growth rate of the nation's productive resources. This prospect along with the high September unemployment rate have led us to raise our projected unemployment rate, with a 5.9 per cent rate now judged likely in the second quarter of 1971.

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 Proj.	1970 I	1970 II	1970 IIIp	1970 IV	1971 Projected I	1971 Projected II
Gross National Product	931.4	978.4	959.5	971.1	985.2	997.7	1018.2	1033.2
Final purchases	922.9	975.6	957.9	968.1	981.2	995.2	1015.4	1027.5
Private	710.7	755.0	738.3	749.7	759.9	772.2	787.7	797.2
Excluding net exports	708.8	750.7	734.8	745.6	755.2	767.2	782.1	791.5
Personal consumption expenditures	577.5	618.1	603.1	614.4	622.4	632.3	645.8	654.8
Durable goods	90.0	91.1	89.1	91.9	91.4	91.8	96.3	95.8
Nondurable goods	245.8	264.2	258.8	262.6	265.5	270.0	274.0	278.0
Services	241.6	262.8	255.2	259.9	265.4	270.5	275.5	281.0
Gross private domestic investment	139.8	135.4	133.2	134.3	136.8	137.4	139.1	142.4
Residential construction	32.0	29.6	29.1	28.4	29.1	31.7	34.1	35.5
Business fixed investment	99.3	103.1	102.6	102.8	103.7	103.2	102.2	101.2
Change in business inventories	8.5	2.8	1.6	3.1	4.0	2.5	2.8	5.7
Nonfarm	8.0	2.3	0.9	2.6	3.5	2.3	2.8	5.7
Net exports of goods and services	1.9	4.3	3.5	4.1	4.7	5.0	5.6	5.7
Gov't. purchases of goods & services	212.2	220.6	219.6	218.4	221.3	223.0	227.7	230.3
Federal	101.3	99.7	102.3	99.7	99.0	97.7	98.9	97.7
Defense	78.8	76.2	79.3	76.8	75.2	73.4	73.0	71.1
Other	22.6	23.5	23.0	22.9	23.8	24.3	25.9	26.6
State & local	110.8	121.0	117.4	118.7	122.4	125.3	128.8	132.6
Gross national product in constant (1958) dollars	727.1	726.6	723.8	724.9	727.5	730.1	737.0	742.3
GNP implicit deflator (1958 = 100)	128.1	134.7	132.6	134.0	135.4	136.6	138.2	139.2
Personal income	748.9	802.0	782.3	801.3	807.1	817.3	833.5	846.0
Wages and salaries	509.0	541.1	531.9	539.5	543.8	549.3	561.3	568.8
Disposable income	631.6	685.8	665.3	683.6	693.0	701.1	715.1	725.2
Personal saving	37.6	49.8	44.8	51.5	52.5	50.3	50.5	51.3
Saving rate (per cent)	6.0	7.3	6.7	7.5	7.6	7.2	7.1	7.1
Corporate profits before tax	91.2	83.2	82.6	82.0	83.5	84.8	83.8	85.3
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	200.6	196.1	195.9	196.7	194.6	197.0	203.8	207.1
Expenditures	191.3	206.7	197.7	200.9	207.7	210.5	217.6	221.3
Surplus or deficit (-)	9.3	-10.6	-1.7	-14.2	-13.1	-13.5	-13.8	-14.2
High employment surplus or deficit (-)	4.5	-1.6	2.9	-5.5	-3.0	-0.1	3.9	3.1
Total labor force (millions)	84.2	85.9	85.8	85.7	86.0	86.2	86.5	86.8
Armed forces "	3.5	3.2	3.3	3.2	3.1	3.1	3.0	3.0
Civilian labor force "	80.7	82.8	82.4	82.5	82.8	83.1	83.5	83.8
Unemployment rate (per cent)	3.5	4.9	4.1	4.8	5.2	5.6	5.8	5.9
Nonfarm payroll employment (millions)	70.3	70.7	71.1	70.9	70.4	70.3	70.5	70.8
Manufacturing	20.2	19.5	20.0	19.6	19.3	19.2	19.3	19.4
Industrial production (1957-59=100)	172.8	168.9	170.7	169.3	168.0	167.6	168.5	170.0
Capacity utilization, manufacturing (per cent)	83.7	77.1	79.8	77.9	76.0	74.5	74.5	74.5
Housing starts, private (millions A.R.)	1.47	1.39	1.25	1.28	1.50	1.53	1.65	1.75
Sales new domestic autos (millions, A.R.)	8.46	7.70	7.35	7.95	8.02	7.48	9.10	8.50

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1969	1970 Proj.	1970 I	1970 IIp	1970 Projected III	1970 Projected IV	1971 I	1971 II
	Billions of Dollars							
Gross National Product	66.4	47.0	7.8	11.6	14.1	12.5	20.5	15.0
Inventory change	0.9	-5.7	-5.6	1.5	0.9	-1.5	0.3	2.9
Final purchases	65.5	52.7	13.4	10.2	13.1	14.0	20.2	12.1
Private	53.5	44.3	10.1	11.4	10.2	12.3	15.5	9.5
Excluding net exports	54.1	41.9	9.2	10.8	9.6	12.0	14.9	9.4
Net exports	-0.6	2.4	0.9	0.6	0.6	0.3	0.6	0.1
Government	12.0	8.4	3.3	-1.2	2.9	1.7	4.7	2.6
GNP in constant (1958) dollars	19.9	-0.5	-5.4	1.1	2.6	2.6	6.9	5.3
Final purchases	19.6	4.2	-0.5	-0.5	2.4	3.5	6.7	2.4
Private	20.1	9.8	1.1	3.3	2.0	4.6	7.2	2.4
	In Per Cent Per Year							
Gross National Product	7.7	5.1	3.3	4.8	5.8	5.1	8.2	5.9
Final purchases	7.6	5.7	5.7	4.3	5.4	5.7	8.1	4.8
Private	8.1	6.2	5.5	6.2	5.4	6.5	8.0	4.8
Personal consumption expenditures	7.8	7.0	7.1	7.5	5.2	6.4	8.5	5.6
Durable goods	7.1	1.2	-7.5	12.6	-2.2	1.8	19.6	-2.1
Nondurable goods	6.8	7.5	10.8	5.9	4.4	6.8	5.9	5.8
Services	9.0	8.8	8.6	7.4	8.5	7.7	7.4	4.4
Gross private domestic investment	10.5	-3.2	-20.0	3.3	7.4	1.8	5.0	9.5
Residential construction	5.6	-7.5	-17.1	-9.6	9.9	35.7	30.3	16.4
Business fixed investment	12.0	3.8	0.0	0.8	3.5	-1.9	-3.9	-3.9
Gov't. purchases of goods & services	6.0	4.0	6.1	-2.2	5.3	3.1	8.4	4.6
Federal	1.8	-1.6	0.8	-10.2	-2.8	-5.3	4.9	-4.9
Defense	1.0	-3.3	2.5	-12.6	-8.3	-9.6	-2.2	-10.4
Other	5.1	4.0	-5.2	-1.7	15.7	8.4	26.3	10.8
State & local	10.0	9.2	11.2	4.4	12.5	9.5	11.2	11.8
GNP in constant (1958) dollars	2.8	-0.1	-3.0	0.6	1.4	1.5	3.8	2.9
Final purchases	2.8	0.6	-0.4	-0.3	1.3	2.0	3.7	1.3
Private	3.6	1.7	0.8	2.3	1.4	3.2	4.9	1.7
GNP implicit deflator	4.7	5.1	6.4 1/	4.3	4.4	3.6	4.3	3.0
Personal income	8.7	7.1	6.1	9.7	2.9	5.1	7.9	6.0
Wages and salaries	9.5	6.3	5.0	5.7	3.2	4.0	8.7	5.3
Disposable income	6.8	8.6	9.0	11.0	5.5	4.7	8.0	5.7
Corporate profits before tax	2.8	-8.8	-26.7	-2.9	7.3	6.2	-4.7	7.2
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.4	-2.2	-12.1	1.6	-4.3	4.9	13.8	6.5
Expenditures	5.3	8.1	3.7	26.7	-6.1	5.4	13.5	6.8
Nonfarm payroll employment	3.5	0.6	1.7	-1.1	-2.8	-0.6	1.1	1.7
Manufacturing	2.0	-3.5	-2.0	-8.0	-6.1	-2.1	2.1	2.1
Industrial production	4.4	-2.3	-2.8	-3.3	-3.1	-1.0	2.1	3.6
Housing starts, private	-2.7	-5.0	-31.0	10.9	66.9	8.5	30.5	24.2
Sales new domestic autos	-1.9	-9.0	-38.1	32.3	4.1	-27.3	86.6	-26.4

1/ Excluding effects of Federal pay increase, 5.5 per cent per year.

2/ Excluding effects of Federal pay increase, 3.3 per cent per year.

Industrial production. Industrial production in September was 166.0 per cent, down 1.7 per cent from August and 4.5 per cent from a year earlier. The decline in the total index since the July 1969 high is 4.9 per cent. The September decline of 2.9 index points reflects an estimated loss of -1.9 points because of the direct effects of the G.M. strike on the auto and supplying industries, and a loss of another point because of widespread declines in utput of consumer goods other than autos, business and defense equipment, and materials.

INDUSTRIAL PRODUCTION
(Per cent changes)

	August 1970 to September 1970	July 1969* to September 1970
Total index	-1.7	-4.9
Consumer goods	-2.4	-14.7
Autos	-33.6	-39.3
Home goods	- 2.8	- .4
Apparel	- 1.0	- 4.6
Staples	NC	2.5
Business equipment	- 2.1	- 8.1
Defense equipment	- 2.8	-26.4
Materials	- 1.3	- 4.4
Construction	- .6	- 4.0
Metal goods	- 4.0	-10.7
Nondurables	.3	- .3

* July 1969 is previous high for total index.

Auto assemblies declined 34 per cent in September to an annual rate of 5.7 million units, from 8.5 million units in August. If the G.M. strike continues through October, auto output will be at an estimated 4.1 million unit rate that month.

G.M. STRIKES AND INDUSTRIAL PRODUCTION
(Change in points in total index
from preceding month)

	1964		1970	
	September	October	September	October
Motor vehicles & parts	- .5	-2.6	-1.6	-1.0
Supplying industries est*	- .1	- .6	- .3	- .4
TOTAL	- .6	-3.2	-1.9	-1.4

* est= estimated

In 1964, the strike began September 25; a national agreement was reached on October 25, but full production was not attained until mid-November. In 1970, the strike began September 15 and, in the above table, it is assumed that the strike continues through October.

Among other consumer goods, output of furniture continued to decline in September and production of some appliances and apparel were curtailed. Production cutbacks in business equipment industries were widespread and since the Sept.-Oct. 1969 peak, output has declined 10 per cent.

Among materials, production of steel changed little in September, but trade reports indicate some curtailments in October. Output of most other durable materials was reduced, as well as nondurable materials such as textiles, paper, and rubber products. Production of chemicals changed little but crude oil production rose further.

In addition to a September decline of 1.3 per cent in production worker manhours, the August data have been revised sharply downward. In August both employment and average hours work declined, but in September the decline was concentrated in the workweek. Since the BLS reporting week included the Labor Day holiday, about a dozen series, for which the August to September appear overstated, have been modified for inclusion in the index.

Retail sales. Retail sales in September were virtually unchanged from August with a .2 per cent increase, according to the advance partial-sample estimate. Sales of durable goods rose .4 per cent, as the automotive group reported an increase of close to 1 per cent (despite the decline in unit sales of domestic autos to an annual rate of 7.2 million from 8.4 million in August); sales of the building materials group advanced 5.9 per cent. Sales of nondurables were unchanged (up .1 per cent); sales at general merchandise (and department) stores were up about .7 per cent and sales at apparel stores were down nearly 2 per cent.

Sales in the third quarter were only .7 per cent above the second, the smallest quarterly change since the third quarter of 1969. Durable goods sales increased 1.3 per cent; both the automotive and building materials groups were up but sales of furniture and appliance stores declined (2.8 per cent). Sales at nondurable goods stores were .4 per cent higher for the quarter with most major categories virtually unchanged.

RETAIL SALES
(Percentage change from previous period)

	July	August	September	I Q	II Q	III Q
Total	.7	- .1	.2	1.0	2.5	.7
Durable	.8	- .4	.4	-2.5	3.3	1.3
Automotive	1.1	- .9	.9	-5.2	3.2	1.7
Furniture & appl.	-1.3	- .1	- .1	5.1	.1	-2.8
Nondurable	.6	.0	.1	2.5	2.1	.4
Food	-1.0	.5	- .1	3.6	1.6	- .1
Dept. stores	3.0	-2.7	.6	.6	3.5	- .4

The UAW strike by limiting dealers' stocks of cars which usually account for over half of total domestic auto sales will cause some consumers to delay--or forego until the next model year--auto purchases. As can be seen in the following table, sales generally drop in a strike affected period and then recover subsequently to a rate above pre-strike experience. The strike in 1964 is closest to the present strike in the large number of manhours lost. Compared with other strike periods, dealers' stocks going into the strike were relatively high but GM production in the 1971 model year, even before the strike, was lagging relative to other makes. As a result, the customer wedded to a GM purchase is likely to be disappointed in his choice of model, at least until late in the fourth quarter.

SALES OF U.S.-MADE AUTOS IN PERIODS OF STRIKE ACTIVITY
(Seasonally adjusted, annual rate)

Year	Date of strike	II Quarter	III Quarter (Year of strike)	IV Quarter (Year of strike)	I Quarter (Year after strike)
1958	Sept. 17-30 Oct. 2-28	4.10	3.99	4.66	5.50
1961	Sept. 6-26 Oct. 3-22	5.43	5.63	6.10	6.47
1964	Sept. 25-Nov. 9	7.68	8.17	7.07	9.05
1967	Sept. 7-Nov. 11	8.11	7.57	7.44	8.19
1970	Sept. 15-	7.95	8.02		

Consumer credit. Consumer instalment credit outstanding increased at a seasonally adjusted annual rate of only $2.8 billion in August, compared with a $5.3 billion rise in July and a first half average of $4.3 billion. In the first half of 1969 the rate of expansion was $9.0 billion. Nonautomotive consumer goods credit outstanding and personal loans rose moderately in August but auto credit showed the largest decline for any month since April 1961.

There have been some sizable shifts recently in the pattern of change in consumer instalment credit by holder. Many of the large independent sales finance companies have indicated their intention to curtail both dealer and consumer financing of new and used cars. Even after allowance for substantial sales of paper to commercial banks, there has been a reduction in consumer auto lending by sales finance companies that has not been offset by gains in other areas of finance company lending operations.

NET CHANGE IN CONSUMER INSTALMENT CREDIT
OUTSTANDING, BY HOLDER
(Billions of dollars, seasonally adjusted annual rates)

	Commercial Banks	Sales Finance Companies	Credit Unions	All Other 1/
1969 - QI	3.5	1.7	1.5	1.6
QII	3.8	2.2	1.6	2.0
QIII	3.0	.8	1.4	2.5
QIV	2.8	1.4	1.1	1.4
1970 - QI	.9	.8	.8	1.5
QII	1.9	.7	1.0	1.1
July-Aug. 2/	1.4	- .4	1.1	1.9
July-Aug. 3/	3.9	-2.9	1.1	1.9

1/ Includes consumer finance companies, retail outlets, and other.
2/ Excluding sales of automotive and other consumer goods paper by sales finance companies to commercial banks.
3/ Including sales of automotive and other consumer goods paper by sales finance companies to commercial banks.

Inventories. The book value of business inventories rose at a $7.6 billion annual rate in August, substantially less than the July rate of $15.1 billion. However, the average rate of book value growth at manufacturing and trade establishments in the first two months of the third quarter was more than double the second-quarter average rate.

Close to half of the July-August increase in accumulation took place at automotive retailers; this probably was in anticipation of the strike, and may be reversed in September and October. Elsewhere, there is some evidence of involuntary accumulation. Stocks of home goods and apparel manufacturers rose at a $1.6 billion rate in the face of declining orders and shipments. GAAF stores, which had changed their inventories little in the second quarter, added to them at a $1.2 billion annual rate in July and August, more than proportionately to sales.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES
(Seasonally adjusted annual rates, billions of dollars)

	1970			
	Q II	July-August	July	August Prelim.
Manufacturing and trade, total	4.9	11.4	15.1	7.6
Manufacturing, total	2.9	3.3	6.6	.9
Durable	.5	4.6	8.2	1.0
Nondurable	2.4	- .8	-1.6	- .1
Trade, total	2.0	7.6	8.5	6.7
Wholesale	1.2	2.0	3.2	.8
Retail	.8	5.6	5.3	5.9
Durable	.3	3.4	2.3	4.6
Automotive	1.0	3.8	2.4	5.3
Nonautomotive	- .7	- .4	- .1	- .7
Nondurable	.5	2.2	3.0	1.3

No general increase in inventory imbalance was evident in the overall manufacturing and trade inventory-sales ratio, although it remained at a high level; the biggest increase in component ratios in August was a result of the auto pre-strike buildup. However, the ratio of inventories to unfilled orders at durable goods manufacturers, already at an all-time high in July, continued to climb in August as order backlogs were worked down.

INVENTORY RATIOS[1/]

	1970	
	July	August prel.
Inventories to sales:		
Manufacturing and trade, total	1.56	1.56
Manufacturing, total	1.72	1.73
Durable	2.08	2.08
Nondurable	1.29	1.30
Trade, total	1.37	1.38
Wholesale	1.23	1.24
Retail	1.46	1.48
Durable	2.08	2.13
Automotive	1.73	1.83
Nonautomotive	2.57	2.54
Nondurable	1.19	1.19
Inventories to unfilled orders, durable manufacturing	.800	.809

1/ Revision of the retail inventory data to levels indicated by the 1968 and 1969 Annual Retail Trade Survey has lowered current levels of inventories and inventory-sales ratios. Back data were not available in time to calculate earlier ratios for comparison or to evaluate the effects of this revision on past patterns,

Manufacturers' new orders. New orders received by producers of durable goods dropped 2.7 per cent in August, after a July increase of 4.6 per cent. The July-August average is 5.1 per cent above the second quarter, mainly as a result of increases in orders for defense products and autos, with smaller increases for construction materials and some other industry groups.

Defense orders were a major factor in both the July increase and the August decline in durable goods orders. The July-August average

of defense orders is sharply above the low second quarter average; even on a six-month average basis, which minimizes the effects of this series' highly erratic movements, defense hardware orders averaged 2.5 per cent above year-earlier levels.

Orders for capital equipment have declined moderately this year. The July-August average, about unchanged from the second quarter, was 6.5 per cent below the peak in the fourth quarter of last year.

VALUE OF MANUFACTURERS' NEW ORDERS
(Seasonally adjusted, averages of monthly data, millions of dollars)

	1970			
	Q II	July-August average	July	August (prel.)
Manufacturing, total	54.8	56.6	57.1	56.1
Durable	29.5	31.0	31.4	30.6
Nondurable	25.3	25.6	25.7	25.6
Selected groups:				
Home goods and apparel	4.6	4.7	4.8	4.7
Household durables	2.1	2.0	2.0	2.0
Defense products	1.7	2.5	3.1	1.9
Capital equipment	8.2	8.2	8.1	8.2
Producers' capital goods industries*	6.2	6.3	6.4	6.1
Automotive equipment	4.5	5.0	5.0	5.0
Construction materials	4.5	4.7	4.5	4.8
Primary metals	4.8	4.9	4.9	4.8
Iron and steel	2.2	2.3	2.4	2.3

* Formerly titled, "machinery and equipment industries".

Durable goods shipments declined less than new orders in August and the backlog of unfilled orders was reduced by .9 per cent. The durable goods backlog has declined 7.3 per cent from its July 1969 peak, the biggest decline since 1960-61.

Cyclical indicators. The preliminary leading indicator composite declined slightly in August, to a level 1.4 per cent above its May low, after two months of increase. The coincident composite also declined slightly, after two months of slight increase, and the lagging composite rose 1 per cent, coming close to its December peak.

COMPOSITE CYCLICAL INDICATORS
(1967 = 100)

	12 Leading Trend Adjusted	5 Coincident	6 Lagging
1969:			
December	117.6	122.2 (H)	132.3 (H)
1970:			
January	115.8	121.7	131.8
February	116.5	121.9	131.2
March	114.9	122.0	130.6
April	115.0	122.0	130.7
May	113.8	121.2	130.9
June	114.0	121.4	130.6
July	115.8	121.5	130.7
August (prel.)	115.4	121.3	131.9

(H) Current high value.

The August decline in the leading composite resulted from declines in materials prices, the manufacturing workweek, new orders for durable goods, contracts and orders for plant and equipment, and the ratio of price to unit labor cost, and from an increase in initial claims for unemployment insurance. Although six out of the eight series were down, the declines were moderate in amount. Housing permits

and common stock prices increased, and as it does each month, the trend adjustment provided a +.3 effect. Since the composites were calculated, August declines have been reported in two more of the component series - inventory change and change in consumer installment debt.

In September, a further downward effect on the leading indicators will be felt from declines in industrial materials prices and the manufacturing workweek and an increase in initial claims for unemployment insurance. Common stock prices, however, rose in September.

Construction and real estate. Total value of new construction put in place rose further in September. The increase, which was associated with an upward revision of about 2 per cent for August, was to a seasonally adjusted annual rate of $92.7 billion. While this was 2 per cent above a year earlier in current dollar terms, in real terms, as measured by the Census Bureau, it was 5 per cent below.

Within the private sector, residential construction outlays in current dollars advanced further in September, but were about 8 per cent under the peak in April 1969. Outlays for nonresidential construction apparently also rose and were within 3 per cent of the high reached last March. Outlays for public construction changed little in September. Although expenditures for State and local projects were revised upward appreciably for July and August, the level in September was 4 per cent short of the high achieved in February of 1969.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	September 1970 ($ billions) 1/	Per cent change from August 1970	Per cent change from September 1969
Total	92.7	+ 1	+ 2
Private	64.3	+ 2	+ 1
Residential	30.5	+ 3	+ 4
Nonresidential	33.8	+ 1	- 2
Public	28.4	--	+ 4
Federal	3.3	--	- 5
State and local	25.1	--	+ 5

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

Seasonally adjusted private housing starts turned down in August but still left the July-August average somewhat above a 1.5 million unit rate. The August decline was concentrated entirely in multifamily units, which had been exceptionally high in July. In view of the rise in building permits in August and other factors, total starts in September may have increased at least enough to yield a 1.5 million unit average for the third quarter as a whole. Such an average would be a fifth above the first quarter 1970 low and the highest rate since the second quarter of 1969.

PRIVATE HOUSING STARTS AND PERMITS

	August 1970 (Thousands of units) 1/	Per cent change from July 1970	Per cent change from August 1969
Starts 2/	1,431	-10	+4
1-family	833	+2	+11
2-or-more-family	598	-23	-4
Northeast	173	-34	-7
North Central	301	-8	-24
South	644	-1	+23
West	313	-11	+16
Permits	1,342	+5	+8
1-family	668	+8	+17
2-or-more-family	674	+3	--

1/ Seasonally adjusted annual rates; preliminary.
2/ Apart from starts, mobile home shipments for domestic use in August were at seasonally adjusted annual rate of 407 thousand, down 6 per cent from July, though virtually as high as in August 1969.

A conspicuous feature of developments this year has been the increased importance of Government-underwritten starts in the total. This shift has been related to a number of factors, including rapid growth in some of the new subsidy programs developed earlier for low-income groups, the advanced level of FNMA support to the market and, especially, the comparatively more attractive yields available to lenders on home mortgages at a time when usury ceiling limits on conventional mortgage rates still remain particularly restrictive in a number of States. Altogether, Government-underwritten

starts have accounted for more than a third of total starts in most recent months. This compares with only one-fifth in all of 1969 and with even smaller proportions in virtually every other year of the previous decade.

Partly reflecting this development, the increased concentration in the lower-cost categories of new-home sales by merchant builders has also been marked. While the number of new homes sold rose in August to the highest rate in more than four years, the median price at which they were sold held at a level of $23,800--more than $1,000 under comparable prices a year earlier and more than $3,000 under the median prices of units still being held by builders for sale. Evidence of a similar shift in composition of demand in the existing home market has not been so sharp, with median prices in August running $23,500 or about 4 per cent higher than a year earlier, according to the National Association of Real Estate Boards. Even so, until July, the year-to-year rise in prices of existing homes sold during 1970 had consistently averaged in excess of 5 per cent.

Labor market. The labor market has shown marked further easing over the summer and more slack appears in prospect in the months ahead. In September, the unemployment rate rose to 5.5 per cent, while average hours of work in manufacturing declined sharply further. The preliminary estimates showed no change in payroll employment in September, but the estimates for July and August were revised down substantially; this is usually a sign of weakness. (These

data relate to a period prior to the beginning of the General Motors strike.) The size of the September changes may have reflected inadequate seasonal factors and an unusually early survey week, but the direction of change in recent months cannot be in doubt. Moreover, layoffs, as reflected in claims for unemployment compensation, have increased further since mid-September--partly because of secondary strike effects--suggesting that the unemployment rate may rise again in October.

The growing slack has been most clearly reflected in a wider diffusion of employment declines this past summer. In the third quarter, nonfarm payroll employment dropped by 436,000, compared with an increase of 318,000 in the same quarter last year. The third quarter declines totaling 75,000 in service-type industries--trade, finance and services-- is particularly noteworthy, indicating both the widening impact of easing demand and the disappareance of significant employment growth in other sectors to offset the continuing erosion in manufacturing jobs. Within manufacturing, moreover, there have been sizable and persistent reductions in nonproduction worker employment.

CHANGES IN NONFARM PAYROLL EMPLOYMENT
(Seasonally adjusted, in thousands)

	(Change from previous quarter)				
	1969		1970		
	III	IV	I	II	III
Total	318	342	298	-256	-436
Government	17	127	124	141	- 18
Private industry	301	215	174	-397	-418
Manufacturing	40	-115	-167	-351	-297
Nonproduction workers	21	24	-1	-62	-82
Production workers	19	-140	-165	-289	-215
Nonmanufacturing	261	330	340	-45	-121
Mining	7	3	2	-5	-4
Contract construction	-4	39	-24	-80	-85
Transportation	31	9	35	-15	43
Trade	107	100	162	-7	-37
Finance	35	34	44	21	-3
Services	85	145	121	41	-35

The manufacturing workweek fell .4 hour to 39.4 hours in September. Part of the drop was probably due to the occurrence of the Labor Day holiday during the reference week, but the further downdrift of hours in recent months and the widespread nature of the September declines also attest to the underlying weakness.

Unemployment and labor force. After showing no growth for five months, the labor force increased in September while total employment showed little change. As a result, the overall unemployment rate rose sharply to 5.5 per cent from 5.1 per cent in August. The bulk of the rise in joblessness occurred among those 16 to 24 years of age. The very large increases in the unemployment rates of

various important labor force groups compared to a year earlier are indicative of the pronounced deterioration of labor demand in 1970.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	September		
	1968	1969	1970
Total	3.5	3.8	5.5
Men aged:			
20 to 24 years	5.1	6.4	11.0
25 and over	1.8	1.8	3.0
Women aged 20 and over	3.7	3.9	5.1
Teenagers	12.2	12.9	16.8
White workers	3.2	3.5	5.1
Negroes and other races	6.6	6.7	9.0
Insured Unemployment	2.2	2.2	4.1*

* Estimated monthly average.

Erratic labor force changes may have partly obscured the underlying upward trend of unemployment this summer. Between March and August, the civilian labor force showed little change, despite a rise in the population of working age and a cut of 200,000 in the Armed Forces. Slow labor force growth is generally expected during periods of economic contraction, but the recent complete halt in growth was unusual and the September labor force increase may presage some catch-up.

Labor force participation rates for most groups showed larger declines or much smaller increases in the past year than in the year before, with the changes probably due mainly to easing demand. Among men early retirement probably accounts for some of the year-to-year drop for older workers, but the declines among men aged 25 to 54 years seem unlikely to continue, since family responsibilities tend to keep such men in the work force. Any firming of male participation rates, or step-up of labor force growth for women, would likely cause unemployment to rise further, unless employment were to grow more sharply than currently anticipated.

CIVILIAN LABOR FORCE PARTICIPATION RATES

	Participation rate			Change from a year earlier	
	September			September	
	1968	1969	1970	1969	1970
TOTAL MALES	79.5	79.7	79.1	.2	-.6
16 to 19	49.9	53.1	51.9	3.2	-1.2
20 to 24	82.6	83.1	83.9	.5	.8
25 to 54	96.3	96.1	95.7	-.2	-.4
55 to 64	84.4	83.6	82.5	-.8	-1.1
65 and over	27.8	28.1	26.5	.3	-1.6
TOTAL FEMALES	41.5	42.8	43.1	1.3	.3
16 to 19	39.7	41.4	42.8	1.7	1.4
20 to 24	54.3	56.2	57.6	1.9	1.4
25 to 54	48.2	49.7	49.9	1.5	.2
55 to 64	42.5	43.1	43.0	.6	-.1
65 and over	9.4	9.8	9.7	.4	-.1

Productivity. With real output rising slightly in the third quarter and employment and hours dropping significantly, another strong rise in output per manhour in the private nonfarm economy is indicated. This will be the second successive large rise after five quarters of some net downdrift. The resumption of productivity growth reflects intensified efforts to reduce costs and has resulted in significant improvement in the unit labor costs picture over the past two quarters.

Industrial relations. The strike at General Motors is now in its fifth week. About 350,000 UAW members are on strike and another 35,000 have been laid off at GM plants exempted from the strike by the UAW. Outside of GM plants, layoffs do not appear to have spread widely as yet, although data on this aspect of the strike are fragmentary.

GM and the UAW have resumed their bargaining on economic issues, for the first time since the strike began September 15. In the interim, local bargaining activity was stepped up, but relatively few of the local bargaining units have reached settlements (27 of 155). The main national econimic issues to be resolved center on wages, cost-of-living adjustments, and the union proposal that workers with 30 years service be allowed to retire at any age with a minimum monthly pension of $500. On wages, the company has offered a first year increase of 38 cents while the union seeks 62 cents an hour. On changes in the cost-of-living escalator provisions, the union wishes to eliminate the ceiling on the amount; the company offers a maximum of 28 cents and

minimum of 16 cents over the life of the contract. On the "30 and out out" provision, GM has offered $500 a month for retirement from age 58 to age 62, with reduced pensions both for earlier retirement and after age 62.

Farm machinery contracts with about 95,000 UAW members expired at the end of September. Contracts were extended at Caterpillar Tractor, Deere and International Harvester. A strike at Caterpillar Tractor was avoided when the company agreed to an unlimited cost-of-living clause in return for an indefinite contract extension. Settlements in this industry are patterned on auto contracts.

Wholesale prices. After declining in August, seasonally-adjusted wholesale prices rose at an annual rate of 6 per cent from mid-August to mid-September, almost as fast as in July. As in the earlier month, a large rise in farm and food prices was the major cause of the upswing, but industrials rose 3.4 per cent, faster than had been reported in the advance estimate.

WHOLESALE PRICES
(Seasonally adjusted percentage changes at annual rates)

	Dec. 1969 to June 1970	June 1970 to Sept. 1970	July 1970 to Aug. 1970	Aug. 1970 to Sept. 1970
All commodities	2.5	3.9	-.8	5.8
Farm and food products	-1.9	8.9	-5.4	16.5
Industrials	3.9	2.9	2.3	3.4

The sharp rise in prices of farm products and foods in September was caused by increases for corn and related grains in anticipation of the effects of the corn blight, and also by eggs, and fruits and vegetables. Egg prices have receded since the pricing date, which was almost a month ago. Fresh vegetable prices have also come down.

Fuel price increases accounted for over 50 per cent of the increase in industrial wholesale prices in September, and for almost 40 per cent in the third quarter as a whole. A shortage of coal and residual fuel oil, especially low-sulfur varieties of these products, accounts for the steady upward pressure on prices. Crude petroleum is in ample supply worldwide but American refineries are adapted to produce the much more profitable gasoline from the crude rather than fuel oil, on which no quota exists.

Continued increases in fuel prices can be anticipated as there is little hope of increasing supplies of coal, fuel oil, or natural gas by significant amounts in the short-run. Moreover, a severe winter, transportation tie-ups or wild-cat strikes could precipitate a crisis. Some utilities which have almost no reserves of low-sulfur coal, could switch to ordinary coal, but with resultant high pollution.

FUEL AND POWER PRICES
(Per cent changes, annual rates)

	June 1969 to Dec. 1969	Dec. 1969 to June 1970	June 1970 to Sept. 1970	Aug. 1970 to Sept. 1970
Total	2.1	4.7	8.8	15.3
Coal	18.2	45.3	32.7	57.0
Coke	11.0	20.0	4.0	0
Gas fuels	16.4	6.8	19.4	49.8
Electric power	1.6	1.7	6.9	6.8
Crude petroleum	·0	0	- 4.6	0
Petroleum products, refined	-2.1	0	6.3	8.1

Many materials prices are reflecting the decline in industrial production, but prices of finished industrial goods are continuing to rise strongly. Among finished goods, substantial increases were recorded in September for producers' equipment--including non-electrical and electrical machinery--and transportation equipment, and for apparel and footwear.

Prices of nonferrous metals declined in September for the fourth consecutive month. Steel mill products were unchanged in September but sharp advances were posted for more highly fabricated metal products such as containers, hardware, heating equipment, and plumbing fittings. Tinplate prices were raised October 1, according to advance announcements. On the other hand, companies have made what is considered a de facto reduction in cold-rolled steel sheet prices by putting a sub-prime grade on the market. Fuel prices have risen further since mid-September.

SELECTED PRICES
(Per cent changes, annual rates)

	June 1969 to Dec. 1969	Dec. 1969 to June 1970	June 1970 to Sept. 1970	August 1970 to Sept. 1970
Metals and products	10.0	8.6	- 1.2	- .9
Steel mill products	6.4	9.6	2.6	0
Nonferrous metals	21.5	6.5	-17.0	-21.4
Machinery and equipment	5.6	3.6	3.9	4.8
Motor vehicles & equipment	4.5	.9	.7	2.2

Prices of motor vehicles will increase appreciably in October and the increase in the fourth quarter may exceed the 11 per cent annual rate of rise in the comparable period of last year.

The corn blight has worsened the outlook for meat prices in 1971, but the situation is not so gloomy as to justify prophesies quoted in the Wall Street Journal that meat prices are likely to be 30 to 40 per cent higher by mid-1971. The carryover of grain and the size of other crops appear sufficient to restrain prices from rising by such extravagant amounts; however, meat prices are likely to rise, starting in the first or second quarter of next year--after declining in the present quarter. A second low corn crop next year would be more critical, since two years of scarce supplies would result in a sharp drop in meat animal numbers. Seed companies will not be able to supply all needs for blight-proof or resistant strains of seed, prices of which have already risen sharply.

Consumer prices. Consumer prices rose in August at an annual rate of less than 3 per cent, seasonally adjusted, the smallest increase since December 1968. This contrasts with a rate of rise of about 3-1/2 per cent in July and of about 6 per cent over the previous year and a half.

PER CENT CHANGES IN CONSUMER PRICES
(Seasonally adjusted, annual rates)

	Dec. 1969 to Mar. 1970	Mar. 1970 to June 1970	June 1970 to July 1970	July 1970 to Aug. 1970
All items	6.3	5.8	3.4	2.8
Food	5.4	1.3	.3	- .3
Nondurable commodities less food	2.5	4.7	3.4	1.1
Apparel	2.4	3.5	- 1.0	5.9
Other	3.0	5.3	6.9	.0
Durables	3.0	8.1	2.1	3.5
Services 1/	11.2	7.3	6.4	7.2
Services less home finance 1/ 2/	7.9	6.2	7.4	6.2

1/ Not seasonally adjusted
2/ Confidential - not for publication

The relatively moderate August increase reflected a basic improvement in food supplies, leading to a leveling in food costs, as well as transient declines in some non-food commodities. Two erratic items--used cars and gasoline prices--dropped, offsetting an increase in seasonally adjusted apparel prices and a less than seasonal decline in new car prices.

Much of the 3.5 per cent rate of increase in durable goods prices in August, as well as the 4.6 per cent rise over the last year, resulted from sharp increases in prices of new and used houses. These rose .9 per cent at an annual rate in August, and about 8 per cent over the year. (The table below presents for the first time in the Greenbook a breakdown of durable goods price changes showing "home purchase" separately. Estimates of the latter are unofficial and confidential.) Used car prices declined in August but increased 3 per cent, and new car prices about 2.5 per cent, over the 12 month period. Much of the erratic movement in consumer durables prices over the past year has been attributable to swings in used car prices. (The present series for used car prices has not been available long enough to permit seasonal adjustment.)

Among nondurables, apparel prices rose in August after declining in July. The large group of "other nondurables," which has been rising at an accelerated rate in recent months, failed to advance in August as gasoline price reductions offset continued increases for cigarettes and alcoholic beverages.

DURABLE GOODS PRICES
(Per cent change, seasonally adjusted annual rates)

	Aug. 1969 to Aug. 1970	Dec. 1969 to Mar. 1970	Mar. 1970 to June 1970	June 1970 to July 1970	July 1970 to Aug. 1970
All durable goods	4.6	3.0	8.1	2.1	3.5
Used cars 1/	3.0	-18.8	58.7	-1.8	-21.3
Home purchase 1/2/	8.2	9.3	8.4	4.6	9.4
New cars	2.5	2.5	1.3	2.4	6.4
Household durables 2/	2.3	2.6	3.0	2.4	2.4
Addendum:					
Durable goods less used cars and home purchase 2/	2.5	2.7	2.0	2.4	4.8

NOTE: "Home purchase" has a weight of 6 per cent in the CPI, compared to 2 per cent for used cars, over 2 per cent for new cars, and 5 per cent for household durables. Total durables include sport goods, tires, auto parts, etc., not shown separately.

1/ Not seasonally adjusted
2/ Confidential - not for publication

Services less home finance rose somewhat less rapidly in August than in earlier months of the year. In the fourth quarter a one-time downward adjustment will be made in the level of medical care costs to compensate for over-estimates of the increase over the past year. A similar adjustment had a marked effect in slowing the rise in the CIP last October.

Present estimates indicate that retail food prices rose on a seasonally adjusted basis in September. Food prices may be fairly stable in the present quarter with meat, especially pork, lower in price and fruits and many processed foods higher.

October 1 crop outlook. The survey of crop conditions on October 1 was reassuring in that it showed no additional deterioration in the corn blight situation since the special survey of September 23. The crop is forecast at 4,188 million bushels, 5 per cent and 13 per cent, respectively, below the September 1 and July 1 forecasts. The crop is down 9 per cent from 1969 and output of all feed grains is down 8 per cent from 1969, considerably below requirements. Substantial drafts on old crop stocks of feed grains and wheat will be required to feed the large numbers of livestock on farms during the coming year.

Total crop output prospects declined slightly during September with reduced corn and cotton yields offset in part by small gains in soybeans, tobacco and sugar crops. Pasture conditions improved.

Compared with 1969, crop output is down 2 per cent. Cuts in wheat and rice were planned to adjust supplies with demand prospects. Disappointing yields cut down the feed grain, cotton, hay and flaxseed crops and all of the noncitrus fruits except apples and plums. Among the crops equaling or exceeding last year's output were soybeans, peanuts, tobacco, and vegatables. Plentiful supplies of citrus fruits, potatoes and fall vegetables are in prospect.

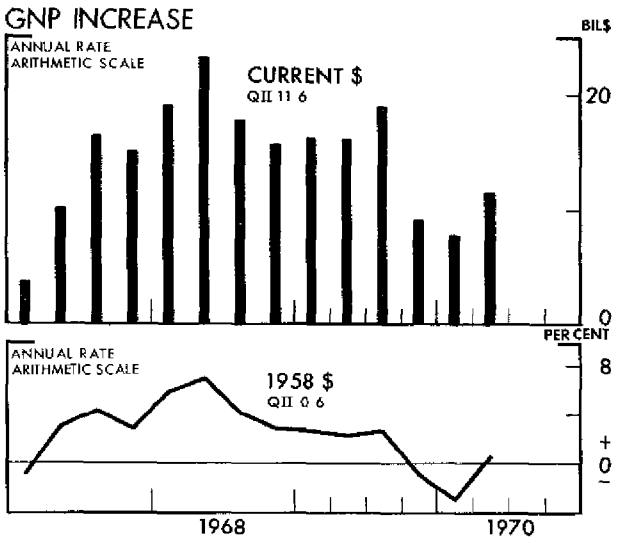
OCTOBER 1 CROP PRODUCTION PROSPECTS
(1957-59 = 100)

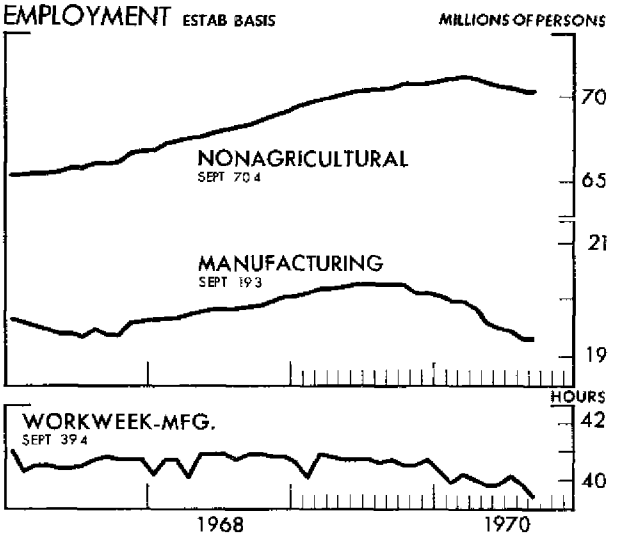
	Output	Percentage change from:	
	Oct. 1 forecast	Sept. 1 estimate	1969 crop
Total crop output	118	- .9	-2.5
Feed grains	114	-3.4	-7.3
Food grains	122	1/	-6.2
Oilseed crops	200	.5	2.0
Cotton	86	-1.2	4.9
Tobacco	108	.9	3.8
Sugar crops	171	2.4	-2.3
Yields (28 crops)	126	- .8	-4.6

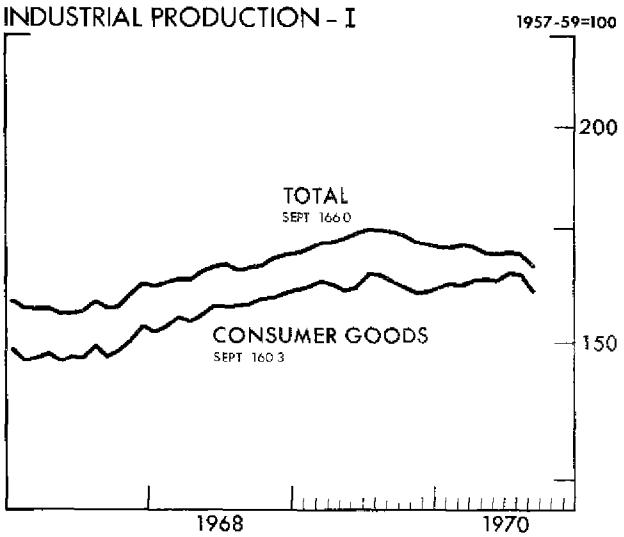
1/ No change from preceding month.

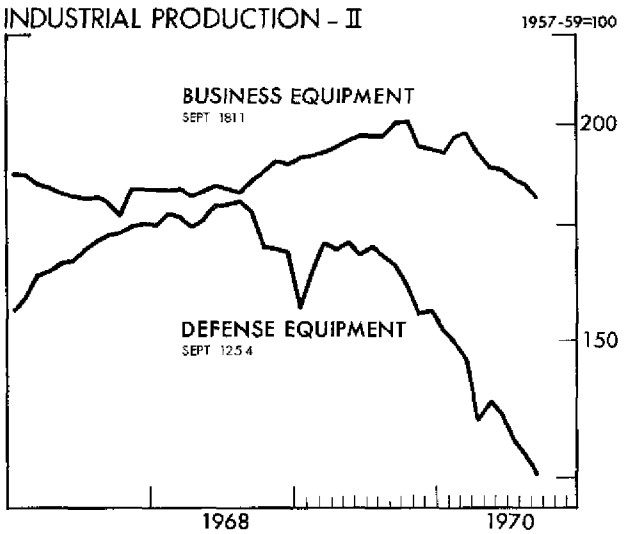
ECONOMIC DEVELOPMENTS - UNITED STATES

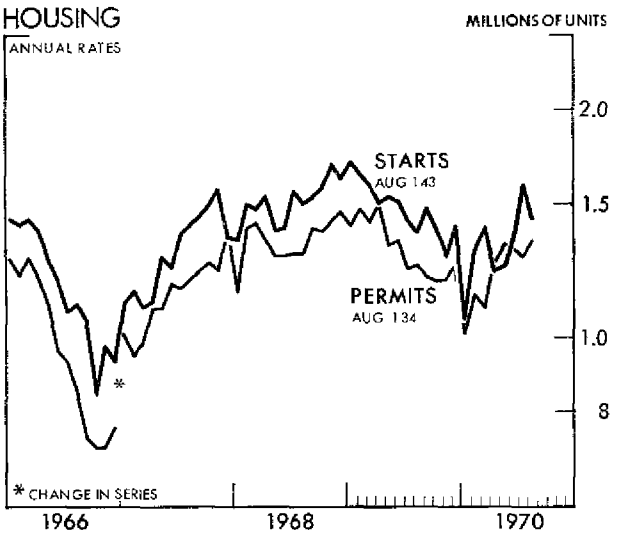
SEASONALLY ADJUSTED, RATIO SCALE





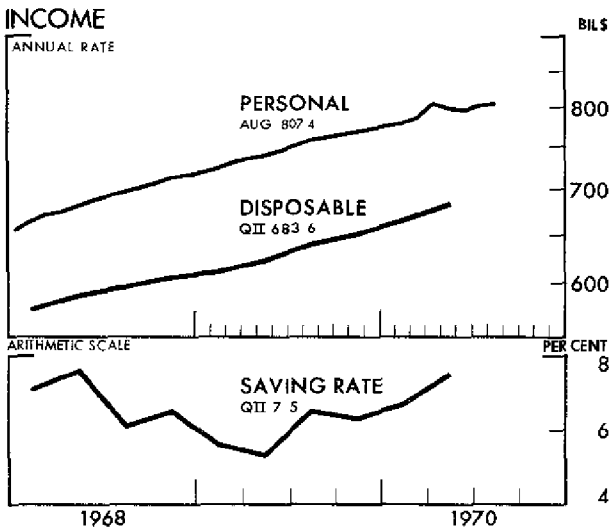


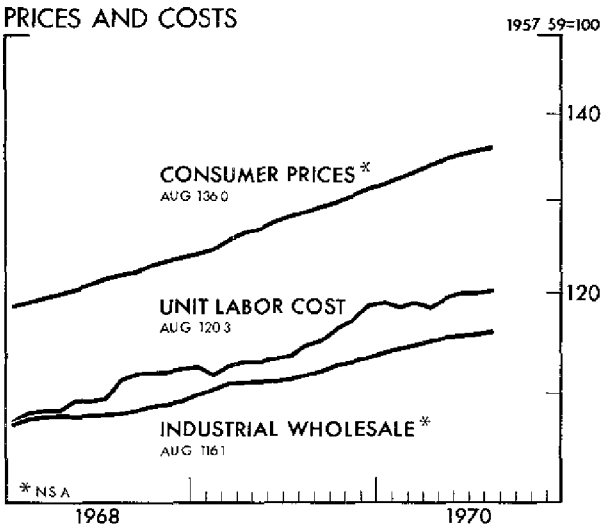


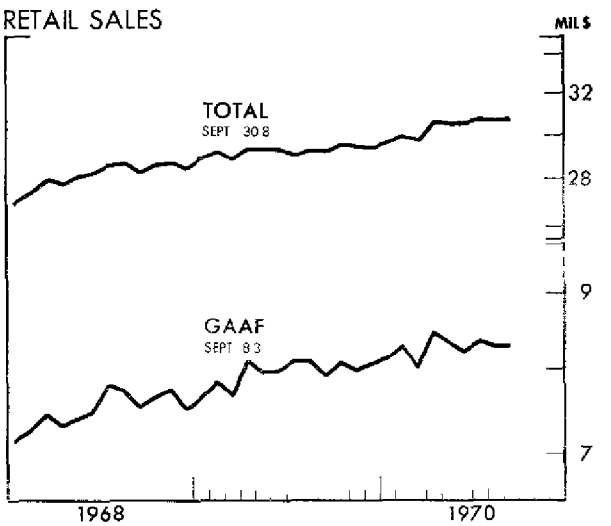


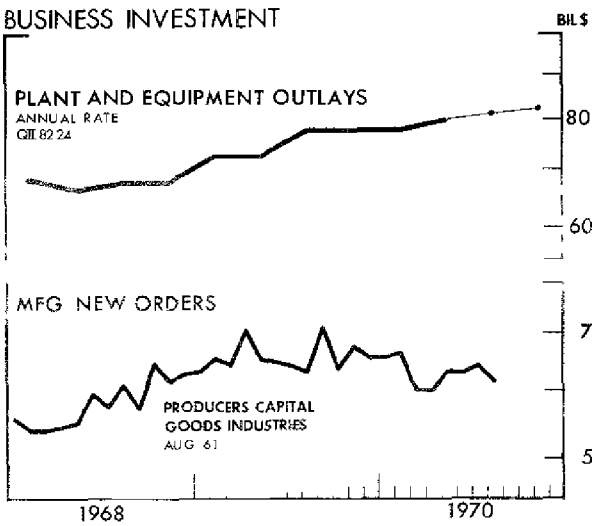
ECONOMIC DEVELOPMENTS - UNITED STATES

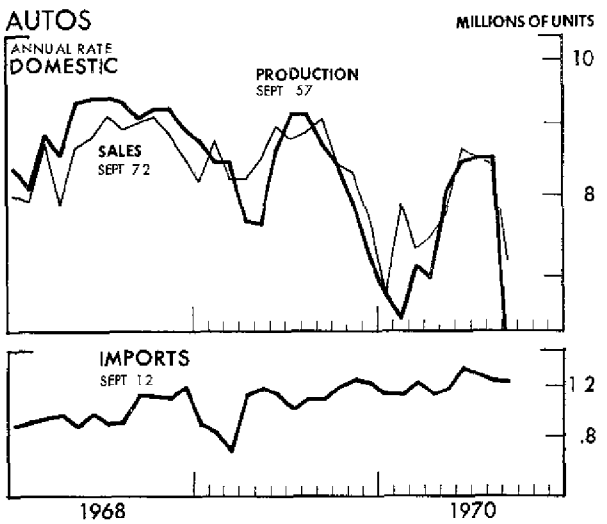
SEASONALLY ADJUSTED, RATIO SCALE

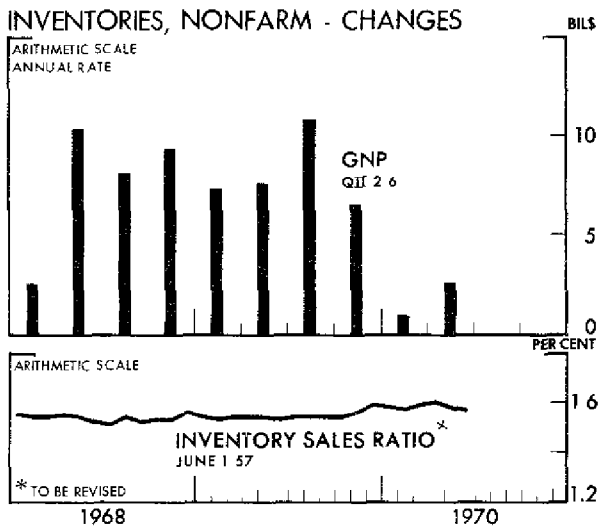












THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Monetary aggregates. The money supply declined slightly in September, as private demand deposits edged downward while currency holdings increased at a modest pace for the second month in a row. The September decline offset part of the August bulge in money balances and growth for the third quarter was held to a seasonally adjusted annual rate of 4.5 per cent (using published data), up only slightly from the rate of advance in the second quarter.

MONETARY AGGREGATES
(Seasonally adjusted percentage changes, at annual rates)1/

	1970		1970		
	QII	QIII	July	August	Sept.p
Money stock	4.2	4.5	4.1	10.0	-0.6
Commercial bank time and savings deposits	13.8	31.6	35.2	28.4	28.9
Member bank deposits	6.0	23.7	22.7	29.2	17.8
Member bank deposits plus nondeposit sources 2/	6.5	16.8	18.1	23.2	8.6

p/ Preliminary.
1/ Based on monthly average of daily figures for deposits and monthly average of weekly figures for nondeposit funds. Quarterly changes are calculated from the average amounts outstanding in the last months of each quarter.
2/ Includes all deposits subject to reserve requirements plus the following nondeposit sources: commercial paper issued by a holding company or bank affiliate; loans or participation in pools of loans sold under repurchase agreement to other than banks and other than banks' own affiliates or subsidiaries; Euro-dollars borrowed directly through brokers or dealers; liabilities to banks' own branches in U.S. territories and possessions; and liabilities to banks' own foreign branches.

Time deposits increased at nearly a 30 per cent annual rate in September, about the same as in August but somewhat slower than in July. Sales of large CD's were again quite strong, increasing on a seasonally unadjusted basis at large commercial banks by slightly more than $2 billion. The great bulk of the September sales was concentrated in the less than 90-day maturity range as in other recent months, but sales also picked up significantly in all other principal maturity ranges, as CD's became more attractive to investors with the drop in rates on other money market instruments.

Consumer-type time and savings deposits also rose sharply in September. On a seasonally unadjusted basis flows into passbook savings accounts and other time accounts at large commercial banks substantially exceeded the inflows in July, when growth was quite favorable. Country member banks also recorded a pick-up in time and savings deposit inflows in September, but the incoming volume of funds failed to match the very strong July increase at these banks.

NET CHANGE IN TIME AND SAVINGS DEPOSITS
(Billions of dollars, not seasonally adjusted)

	July 29-August 26 1/		Aug. 26-Sept. 30 1/	
	1967-69 average	1970	1967-69 average	1970
Weekly reporting banks				
Total time and savings	.4	3.2	--	3.7
Consumer-type	.1	.6	.7	1.7
CD's	.2	2.3	-.5	2.0
All other	.1	.3	-.2	.1
Country banks				
Total time and savings	.5	1.0	.6	1.1

1/ Dates are for 1970; comparable dates used for other years.

The adjusted credit proxy (member bank deposits adjusted for nondeposit sources of funds) advanced at a much slower seasonally adjusted annual rate in September than in August. In part, this reflected the down drift in demand deposits. In addition, however, U.S. Treasury deposits dropped slightly and, more importantly, banks cut back sharply on their use of nondeposit sources of funds. Outstanding commercial paper of affiliates declined steadily throughout the month and in the last week of the month averaged about $2.7 billion less than in the last week in August (and about $3.1 billion below the average established in the week prior to the mid-August change in reserve requirements). Bank borrowings from foreign branches was also subject to steady attrition which cumulated to nearly $.6 billion for the month. Modest further reductions also took place in borrowings from other foreign lenders and in the volume of loan RP's outstanding.

Bank credit. Commercial bank credit adjusted for loan sales to affiliates is estimated to have increased at a 7.1 per cent seasonally adjusted annual rate from the last Wednesday in August to the last Wednesday in September. This is down substantially from the rapid pace in July and August. Holdings of U.S. Treasury securities continued to rise, but at a decidedly slower rate than in July and August, and loan growth was also much weaker. Total loans, after adjustment for loan sales increased at only a 2.1 per cent seasonally adjusted annual rate. In contrast, bank investment in "other securities" (mainly municipal and Federal agency issues) advanced markedly further in September. Banks

appear to have channelled a somewhat larger portion of their investible funds into longer dated municipals, but acquisitions for the most part remained heavily concentrated in short-term and intermediate-term issues.

COMMERCIAL BANK CREDIT ADJUSTED
TO INCLUDE LOAN SALES TO AFFILIATES[1/]
(Seasonally adjusted percentage changes, at annual rates)

	1969	1970		1970	
	H2	H1	Q3	August	Sept.
Total loans & investments[2/]	2.9	3.9	13.2	15.5	7.1
U.S. Govt. securities	-15.6	8.5	23.7	36.8	2.1
Other securities	- 1.4	9.8	20.3	20.7	31.3
Total loans[2/]	7.8	1.6	9.3	9.6	2.1
Business loans[3/]	9.5	5.7	2.2	10.7	-10.6

1/ Last Wednesday of month series.
2/ Includes outright sales of loans by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
3/ Includes outright sales of business loans by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

A sharp drop in business loans (adjusted for loan sales) was mainly responsible for September's weak loan picture. Loans to nonbank financial institutions also edged off further during the month, however, while the modest uptrend in consumer and real estate loans continued. In contrast, a comparatively sharp gain was recorded in loans to securities brokers and dealers for the third month in a row.

The decline in business loans followed a comparatively sharp rise in August. For the two months combined such loans remained essentially unchanged, a considerably weaker showing than the generally moderate growth recorded earlier in the year. Conversations with bankers

suggest that reduced loan demands are mainly responsible for the recent weak loan growth. Because banks have been reacquiring loans previously sold in substantial volume, data reflecting business loans by industry do not provide an accurate picture of recent developments and thus it is not possible to trace the recent weakening to specific industry sectors. It seems likely, however, that at least part of the subsidence in loan growth can be attributed to the strike in the auto industry.

Nonbank depositary institutions. Data now available indicate that deposit outflows were quite modest from the thrift institutions during the early part of the September-October reinvestment period. Lower short-term market yields, perhaps consumer uncertainty with respect to the employment outlook, and the reduced growth in consumption spending have served to support flows into the savings and loan associations and--to a lesser extent--the mutual savings banks.

EARLY PART OF THE SEPTEMBER-OCTOBER REINVESTMENT PERIOD[1/]
DEPOSIT FLOWS EXCLUDING INTEREST CREDITED
(Dollar amounts are in millions)

	Savings and Loan Associations 2/		
	All U.S.	San Francisco District	U.S. except San Francisco
1966	-618	-366	-252
1967	- 37	- 13	- 24
1968	-280	-159	-121
1969	-714	-213	-501
1970	-205	- 31	-174

	15 Largest New York City Mutual Savings Banks 3/	
	Dollars	As per cent of deposits
1966	-67	- .43
1967	-60	- .35
1968	-72	- .40
1969	-230	-1.22
1970	-95	- .50

1/ The reinvestment period includes the last three business days in September plus, generally, the first ten days in October.
2/ The October portion covers 2 business days in 1970, 3 in 1969, 4 in 1968, and 5 in 1966 and 1967. Data for each year also include the last three business days in September.
3/ Adjusted for repayment of passbook loans made earlier to save interest credited. Data cover the last three business days in September and the first five business days in October.

These factors are also manifested in the sharply improved deposit growth rate for the third quarter as a whole--again, particularly at S&Ls. Estimates for September deposit flows, which are based upon usually reliable sample data, suggest that total nonbank deposit growth during the third quarter was the highest for any quarter since the comparable period in 1967.

DEPOSIT GROWTH AT NONBANK THRIFT INSTITUTIONS
(Seasonally adjusted annual rates, in per cent)

	Mutual Savings Banks	Savings and Loan Associations	Both
1970 - QI	2.6	1.5	1.9
QII	6.6	7.4	7.1
QIII p/	6.2	10.9	9.4
July*	7.8	14.6	12.4
August* p/	4.9	6.8	6.2
September* p/	6.0	11.0	9.4

* Monthly patterns may not be significant because of difficulties with seasonal adjustment.
p/ Preliminary. September data are estimated on the basis of a sample.

Savings and loan associations, with their liquidity largely restored and their deposit growth strong, borrowed only a modest amount from the FHLB during September, continuing the trend of the past several months. The liquidity of the FHLBanks stood at $1.5 billion at the end of September, down about $300 million during the month in reflection of the FHLBanks' payment for mortgage purchases contracted previously for its GNMA-backed mortgage pool. These funds will be replenished when the GNMA security is issued by the FHLB, now tentatively scheduled in November. Reflecting a downward revision, the FHLB now plans to borrow a modest amount of new money during the fourth quarter, and to repay some of its maturing debt during the first quarter of 1971 to reduce its liquidity to about $1 billion.

Mortgage market. With savings flows to the thrift institutions holding up in September and early October, trade opinion and field

reports both suggest a continuation of the gradual recovery underway in the pace of new residential mortgage commitments. Mortgage terms may also have eased somewhat. However, most data series for the period are not yet available.

Although savings flows to nonbank thrift institutions had slackened during August, the backlog of outstanding mortgage commitments at savings and loan associations increased for the fifth consecutive month, on a seasonally adjusted basis. This increase at S&Ls more than offset a further decline in outstanding mortgage commitments at New York State mutual savings banks, where a downtrend has continued throughout the year as savings flows have recovered less than for the industry as a whole whereas liquidity has been built up more. By the end of August, the mortgage commitment backlog at both S&Ls at savings banks combined reached the highest level in 10 months.

An improvement in residential mortgage market conditions during September and early October was implied by a modest reduction in yields on Government underwritten mortgages in FNMA's bi-weekly auction. By the October 6 auction, yields on 6-month forward commitments had declined to 8.92 per cent. This was more than 40 basis points below the high posted earlier in the year, and was the lowest since December 1969. Although continuing in a relatively modest volume that implied increased private availability of mortgage funds, offers to FNMA in the most recent auction picked up as some sellers attempted to replace older, lower-priced commitments with higher-priced ones.

FNMA AUCTION

	Amount of total offers		Implicit private market yield on 6-month commitments
	Received	Accepted	
	(Millions of dollars)		(Per cent)
Weekly			
1969 high	$410 (6/16)	$152 (9/8)	8.87 (12/29)
1970 high	705 (1/5)	151 (1/12)	9.36 (1/12)
Bi-weekly			
1970 high	581 (1/26)	298 (1/26)	9.33 (6/29)
Aug. 10	441	180	9.03
24	493	215	9.03
Sept. 8	384	200	9.04
21	208	195	9.01
Oct. 5	268	150	8.92

NOTE: Average secondary market yield after allowance for commitment fee and required purchase and holding of FNMA stock, assuming prepayment period of 15 years for 30-year Government-underwritten mortgages. Yields shown are gross, before deduction of fee paid by investors to servicers of 50 basis points prior to August 10 auction, and 38 basis points thereafter. At least partially offsetting the effect of the reduction in servicing fees on bid prices and gross yields in the August 10 and following auctions was another FNMA regulatory change permitting mortgage servicers to retain all escrow funds received on mortgage serviced under the reduced fee schedule. Under earlier practice, FNMA had retained most of these funds itself.

Indications are that the cut in the prime rate in late September has been followed by a reduction in costs of short-term credit to finance construction as well as in costs of interim credit to carry mortgages being warehoused. Although the staff feels it to be unlikely, trade expectations have persisted that ceiling rates on FHA-insured and VA-guaranteed mortgages, now 8-1/2 per cent, will be lowered before the November elections. These expectations have caused

a number of mortgage companies to warehouse Government underwritten mortgages while awaiting more favorable prices anticipated for such loans.

Life insurance companies. Although increases in policy loans outstanding appear to have passed their peak, such loans nevertheless remain a significant drain on life insurance funds available for investment. Life insurance loanable funds have shown virtually no growth in the past three years, and companies' projections of funds available for

NET INCREASE IN POLICY LOANS AT 15 LIFE INSURANCE COMPANIES*
(Millions of dollars, not seasonally adjusted)

	Monthly Average		July	August
	First Quarter	Second Quarter		
1966	42	70	70	108
1967	63	54	38	49
1968	60	82	75	75
1969	90	138	195	180
1970	154	138	118	105

* These companies account for nearly two-thirds of policy loans held by the industry.

the third quarter continued in that pattern. Indeed, as shown in the last line of the table, funds available for the bond and mortgage markets have actually decreased as separate account business--invested predominantly in common stocks--has begun to grow rather rapidly. Policy loan increases are only one of the factors serving to keep down the industry's gross cash flow into market instruments; other factors include the absence of growth in return flows from mortgages and

securities despite the substantial growth in those portfolios over the period, and the lack of growth in funds from premium receipts and income from investments and operations.

LIFE INSURANCE COMPANIES SOURCES OF INVESTMENT FUNDS
(Billions of dollars)

	Second Quarter			Third Quarter		
	1968	1969	1970	1968	1969	1970 4/
Net change in ledger assets 1/ assets 1/ and cash 2/	1.6	1.6	1.4	1.5	1.4	1.8
Return flows from securities and mortgages	1.8	1.9	1.9	2.0	2.0	1.6
Borrowed funds 3/	*	.1	.2	-.2	*	-.1
Total sources before policy loans	3.4	3.6	3.5	3.3	3.4	3.3
Net increase in policy loans	.3	.5	.5	.3	.7	.5
Total available for all investments	3.1	3.1	3.0	3.0	2.7	2.8
Amount for separate accounts 5/	.1e	.1e	.4	.1e	.2e	.4
Total available for commitment disbursements	3.0e	3.0e	2.6	2.9e	2.5e	2.4

1/ Includes premium receipts, gain or loss from sales of investments, and other income.
2/ An increase in cash position is a negative source of investment funds.
3/ Includes also a usually minimal amount from sales of assets. During the third quarter of 1969, a .1 billion decrease in borrowed funds was offset by sales of assets.
4/ This is what the reporting companies, which represent about 80 per cent of industry assets, expected as of 6-30-70.
5/ Separate accounts are the vehicle through which variable annuity funds are invested; their predominant asset is common stocks.
e/ Estimated by LIAA.
* Less than $50 million.

Forward investment commitments continue to be made in very limited volume; in August, for example, new commitments amounted to only

three-fourths of the reduced year-earlier total. Significantly, of the current total of commitments outstanding, an unusually small share is scheduled to be disbursed within the next six months. The flexibility that this commitment disbursement scheduling implies is manifested in the low ratio of these scheduled disbursements to cash flow expected during the same period. Despite industry efforts to maintain leeway, that ratio had increased in late 1969 and early 1970; but by the second quarter of 1970, commitments scheduled for near-term disbursement had been worked down to more comfortable proportions with a cash flow projection that continues to show minimal growth.

LIFE INSURANCE COMPANIES PROJECTIONS OF OUTSTANDING COMMITMENTS SCHEDULED FOR DISBURSEMENT WITHIN 6 MONTHS

	As per cent of cash flow expected during 6 months	As per cent of total outstanding commitments
1966 - QI	88.8	48.5
QII	88.7	44.0
QIII	88.5	41.8
QIV	84.1	43.5
1967 - QI	74.6	40.5
QII	73.5	39.8
QIII	74.1	41.8
QIV	79.2	39.6
1968 - QI	78.8	37.9
QII	75.4	35.1
QIII	72.3 (76.7)*	39.3 (40.3)*
QIV	77.9	36.7
1969 - QI	75.9	34.2
QII	79.2	34.0
QIII	80.6	36.0
QIV	88.4	36.5
1970 - QI	85.4	34.3
QII	75.2	31.8

* Data for the third quarter of 1968 and earlier represent 60 per cent of industry assets, while data from that time forward represent nearly 80 per cent of industry assets.

Corporate and municipal security markets. Long-term securities markets absorbed a substantial volume of both corporate and municipal bonds in September and early October. Although the increase in final demand for municipal bonds was impressive, the three-month decline in long-term tax-exempt yields was reversed, with rates rising about 20 basis points during September and then levelling off in early October. Yields on high-grade corporate bonds, after some backup in mid-September, stabilized in early October at about the same level as a month earlier. In the equity markets, a strong stock price rally begun in late September failed to persist, and the market averages closed on October 9 essentially unchanged from their month-earlier levels. Sharply increased trading activity during the last three weeks of September appears to have been caused by institutions making adjustments to their end-of-quarter portfolios in preparation for reports to shareholders.

BOND YIELDS

	New Aaa Corporate Bonds 1/	Long-term State and Local Bonds 2/
1969		
Low	6.90 (2/21)	4.82 (2/23)
High	8.85 (12/5)	6.90 (12/18)
1970		
Low	8.20 (2/27)	5.95 (3/12)
High	9.30 (6/18)	7.12 (5/28)
Week of:		
September 4	8.40	6.16
11	8.52	6.30
18	8.50	6.26
25	8.35	6.28
October 2	8.37	6.39
9	8.35	6.38

1/ With call protection (includes some issues with 10-year protection).
2/ Bond Buyer (mixed qualities).

Although institutional investors showed some resistance to attempts by underwriters to test the market with aggressive pricing, particularly on utility bonds, most corporate issues sold out quickly in September and early October. Aside from the general easing of financial markets, the large number of high quality industrial bonds and the judicious mixture of long and intermediate term maturities were probably important factors in the market's absorption of the large volume without further rate increases. In the last 6 weeks, over $500 million of bonds, or about one-fifth of total public bond sales, have had maturities of 7 years or less. Furthermore, almost half of all public bond issues in the 6-week period was accounted for by very large issues--$100 million or more. At the same time, however, in the last few weeks the volume of Baa and lower-rated issues has begun to recover from the May-June lows, and in recent weeks convertible bond sales and announcements have picked up, reflecting the improved situation in the stock market.

The staff now estimates that public bond offerings in October will be about $2.6 billion, a significant increase from the projection of $1.9 billion made in the last Greenbook. The October calendar was boosted by an unusual number of industrial offerings, some of them in the $150 to $250 million size class. While offerings in the public market have picked up, private placements of bonds seem to be continuing at only a moderate pace, as insurance company commitments have remained below normal for some time. However, new issues of stock in October are expected to rise sharply, primarily as a result of a number of large

utility offerings. Indeed, utility use of the equity market has been a significant factor in stock sales for several months. Sales of stock by nonutility companies also increased recently as the equity market improved. In summary, the staff estimates that total corporate security offerings in October and November will be well above theeexpected yearly average of $3 billion, with a seasonal decline in December when the market virtually shuts down in the last two weeks of the year.

CORPORATE SECURITY OFFERINGS
(Monthly or monthly averages in millions of dollars)

	Bonds			
	Public Offerings	Private Placements	Stocks	Total
1969 - entire year	1,061	468	700	2,229
1970 - entire year	1,993e	428e	699e	3,120e
1970 - QI	1,525	420	712	2,659
QII	2,331 1/	427	730	3,489 1/
QIII	1,991e	433e	583e	3,025e
QIV	2,133e	433e	766e	3,333e
September	2,400e	500e	700e	3,600e
October	2,600e	400e	1,000e	4,000e
November	2,300e	400e	800e	3,500e
December	1,500e	500e	500e	2,500e

e/ Estimated.
1/ The second quarter "Public Offerings" and "Total" figures include the $1.569 billion AT&T offering. The monthly averages for the second quarter, excluding AT&T, would be $1,808 for "Public Bond Offering" and $2,966 for "Total Offerings."

These staff projections for the fourth quarter imply a level of total security offerings exceeded only by that of the second quarter, which had been swollen by the massive AT&T issue. Apparently, corporations

continue to be motivated by the desire to increase their long-term capital, repay short-term debt, and perhaps increase their holdings of liquid assets. But, in addition, underwriters report that issuers of long-term securities--many of whom had been intending to finance earlier this year--now are obtaining funds to finance current operations.

If staff estimates for the fourth quarter are correct, total gross corporate security offerings for 1970 will be approximately $37.5 billion, a 40 per cent increase from 1969 and a new record high. Most of this increase would be accounted for by the surge in public bond financing. It appears that public debt offerings this year will be about $24 billion, 60 per cent higher than the previous record for corporate debt financing, set in 1967.

Sales of long-term bonds by State and local governments jumped to about $1.7 billion in September. With dealer inventories relatively heavy and the forward calendar still building, the summer decline in the Bond Buyer yield index was reversed and in early October the index stood about 20 basis points above the early September level. Bank purchases of municipals have been substantial, but they have been concentrated in issues maturing in under 10 years, and the spread between rates on short and long maturities has widened appreciably.

The staff estimates that municipal offerings will remain around the $1.7 to $1.8 billion level in October and November. This projection assumes that bank participation in the market will be sustained, making possible a level of yields at least no higher than the present one. New issue volume in December can be expected to show the usual seasonal decline.

STATE AND LOCAL GOVERNMENT OFFERINGS
(Monthly or monthly averages, in millions of dollars)

1969 - entire year	990
1970 - entire year	1,389e
1970 - QI	1,368
QII	1,237
QIII	1,449e
QIV	1,500e
September	1,700e
October	1,800e
November	1,700e
December	1,000e

e/ Estimated.

If fourth quarter tax-exempt volume is maintained at levels expected by the staff, gross municipal long-term debt offerings will be about $16.7 billion for the year 1970, an increase of about 40 per cent over the previous year, but only marginally higher than the previous record 1968 total.

Government securities market. Yields on Government securities are generally 20 to 30 basis points below their levels at the time of the last Committee meeting. However current rate levels are somewhat above their lowest levels reached immediately following the meeting when the market rallied sharply on expectations of a discount rate cut. More recently as day-to-day money costs have risen from the very low levels prevailing just after the meeting, these expectations have lessened and market rates have tended to increase from their lows, particularly in shorter maturities.

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

	1970		Week ending			
	Highs	Lows	Sept. 22	Sept. 29	Oct. 6	Oct. 13
Bills						
1-month	7.84 (1/28)	5.58 (9/28)	6.01	5.62	5.64	5.60
3-month	7.93 (1/16)	5.71 (9/23)	6.03	5.78	5.90	6.05
6-month	7.99 (1/5)	6.18 (3/23)	6.37	6.34	6.41	6.29
1-year	7.62 (1/30)	6.19 (9/23)	6.29	6.29	6.33	6.25
Coupons						
3-year	8.42 (1/7)	6.81 (9/23)	7.00	6.91	6.96	6.92
5-year	8.30 (1/7)	7.00 (3/10)	7.24	7.15	7.16	7.08
7-year	8.12 (4/26)	6.98 (3/25)	7.34	7.29	7.30	7.28
10-year	8.22 (5/26)	6.90 (2/27)	7.32	7.28	7.27	7.25
20-year	7.73 (5/26)	6.55 (2/27)	6.81	6.79	6.80	6.80
Agencies						
6-month	8.65 (1/27)	6.89 (9/23)	7.08	6.95	6.94	6.87
1-year	8.75 (1/2)	7.03 (9/24)	7.21	7.05	7.07	7.03
3-year	8.54 (1/2)	7.29 (9/23)	7.54	7.36	7.29	7.26
5-year	8.43 (1/15)	7.55 (9/24)	7.66	7.56	7.56	7.52

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

Activity in the Treasury note and bond market has been relatively uneventful in recent weeks, with yields reacting largely to investors' shifting to and from the corporate market. The fact that the announcement of the Treasury's November financing operation will be advanced by a week has produced some activity in the maturing November issues, and dealers' positions in issues due within a year have increased accordingly. At the very beginning of the month trading was also influenced by the fact that many felt that the Treasury would offer a note at auction in its October cash operation. In the event, however,

the Treasury opted for an auction of $2.5 billion of June tax anticipation bills since this would put less strain on savings flows to nonbank financial institutions.

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

	September daily average	Sept. 21	Sept. 28	Oct. 5	Oct. 13
Treasury securities					
Total	4,021	3,084	3,906	3,400	3,820
Treasury bills (total)	2,949	2,098	2,845	2,477	2,809
Due in 92 days or less	646	205	424	715	907
93 days or over	2,303	1,893	2,421	1,762	1,902
Treasury notes and bonds (total)	1,072	986	1,061	924	1,011
Due within 1 year	377	361	404	432	521
1-5 years	245	204	210	110	99
over 5 years	450	422	447	381	391
Agency securities					
Total	723	800	803	891	975
Due within 1 year	505	558	551	456	506
other 1 year	217	242	252	435	470

Demand for Treasury bills has been quite good recently, with corporate buying particularly strong--perhaps reflecting reinvestment of some of the proceeds of the heavy volume of corporate bond offerings--and with some bank portfolio investment as well. Shortly after the last Committee meeting, the easing in the Federal funds rate to below 6 per cent resulted in speculation of an imminent discount rate reduction, and

investment demands for bills were augmented by sizeable professional speculative buying. With the firming of the funds rate toward the end of September, however, most of this speculation evaporated; and Treasury bill rates, which in a number of instances had reached new lows for the year, retraced about half of their earlier declines. With bill demands holding up and with many having become convinced by the announcement's delay that the Treasury had in fact decided to postpone experimentation with a note auction in favor of a tax bill, the Treasury's announcement of a $2.5 billion tax bill auction for October 15 produced very little market reaction.

The Federal agency market has been fairly quiet, but on average the downward movement in yields has been somewhat greater than on Treasury issues with the result that spreads have narrowed slightly. There have been only two issues of more than routine note: a $750 million FNMA offering, consisting of a $400 million 26-month and a $350 million 4-year 11-month issue; and a 10-year $200 million (GNMA guaranteed) FHLB offering. While the FNMA issues were initially well received at yields of 7.20 and 7.50 per cent, some investor hesitancy developed in sales of the longer issue and, despite the general improvement in the agency market, some price cutting was reported. The FHLB issue, priced to yield 7.80 per cent and directly competitive with a large volume of new corporate issues at higher yields, was not particularly well received, and a number of underwriters reported having difficulty moving the issue.

Other short-term credit markets. Preliminary commercial paper data for the month of September show a seasonally adjusted decline of $1.3 billion. This decline is more than accounted for by the drop in bank-related paper which fell $2.6 billion over the month. The overall decline in bank-related commercial paper since the Board's mid-August announcement of the new reserve requirement has been $3.1 billion.

Nonbank commercial paper rose $1.3 billion (seasonally adjusted) in September. During the last week of the month, however, finance company paper fell $1.1 billion (unadjusted), reducing somewhat the seasonally adjusted rise for the month in this category of paper. The drop-off, which is largely seasonal, also reflects a decline in automobile sales, partly attributable to the General Motors' strike and the later introduction of new models in much of the industry this year.

Rates on all maturities of commercial and finance company paper, bankers' acceptances and certificates of deposit have continued to move down since early September, generally following the overall decline in the bill rate. The decline in rates on one-month commercial paper was, however, more than that on Treasury bills, and substantially greater than those on other short-term paper. By October 7 one-month commercial paper was being quoted at 6-7/8 per cent and finance paper at 6-3/4 per cent, the spread between the two having narrowed substantially.

Quotations on commercial paper maturing in three months have fallen to 7-3/8 per cent and certificates of deposit to 6-7/8 per cent,

sharper declines than on other short-term instruments in this maturity range, further eliminating the earlier yield premium on commercial paper.

COMMERCIAL AND FINANCE COMPANY PAPER
(End-of-month data, in millions of dollars)

	July	August	September
		Amounts Outstanding	
Total commercial and finance paper 1/	36,464	35,612	34,283p
Bank related 2/	7,685	7,172	4,586p
Nonbank related 3/			
Placed through dealers	11,449	10,872	11,365p
Placed directly	17,330	17,568	18,332p
		Net Change	
Total commercial and finance paper 1/	-2,033	-852	-1,329p
Bank related 2/	217	-513	-2,586p
Nonbank related 3/			
Placed through dealers	-1,033	-577	493p
Placed directly	-1,217	238	764p

p/ Preliminary.
1/ Combines seasonally adjusted nonbank-related paper and seasonally unadjusted bank-related paper.
2/ Seasonally unadjusted.
3/ Seasonally adjusted.

SELECTED SHORT-TERM INTERST RATES
(Wednesday Quotation - Discount Basis)

	1969 Nov.-Dec. highs1/	Sept. 2	Sept. 23	Oct. 7	Net change (Sept. 2-Oct. 7)
1-month					
Commercial paper	9.25 (12/31)	7.68	7.00	6.88	-.80
Finance paper	9.00 (12/31)	7.25	6.88	6.75	-.50
Bankers' acceptances	9.00 (12/31)	7.25	7.13	6.88	-.37
Certificate of deposit--new issue 2/	6.25	7.25	7.00	6.75	-.50
Treasury bill	7.54 (12/31)	6.29	5.65	5.63	-.66
3-month					
Commercial paper	9.25 (12/31)	8.25	7.68	7.38	-.87
Finance paper	8.13 (12/31)	7.13	6.75	6.88	-.25
Bankers' acceptances	9.00 (12/31)	7.00	7.00	6.88	-.12
Certificate of deposit--new issue 2/	6.50	7.50	7.13	6.88	-.62
Treasury bill	8.00 (12/29)	6.40	5.71	6.06	-.34
6-month					
Bankers' acceptances	9.00 (12/31)	7.00	7.00	6.88	-.12
Treasury bill	8.09 (12/29)	6.61	6.20	6.32	-.29
12-month					
Certificates of deposit--new issue 2/	7.50	7.50	7.00	7.00	-.50
Treasury bill	7.86 (11/24)	6.54	6.19	6.26	-.28
Prime municipals 2/	6.25 (12/12)	4.00	3.95	3.90	-.05

1/ Dates of highs in parentheses; latest date used if high occurred on more than one date.
2/ Investment yield basis.

Source: Wall Street Journal's Money Rates for commercial and finance paper and bankers' acceptances; all other data from the Federal Reserve Bank of New York.

Federal finance. The staff estimate of Federal budget receipts for fiscal 1971 has been lowered further to $197.4 billion in light of receipts experience and legislative activity since the last Greenbook. Estimates of tax receipts have been reduced somewhat to adjust to the smaller growth in personal income that is now projected by the staff, and to take into account a somewhat smaller inflow of corporate taxes indicated in September receipts. Since the last Greenbook, the staff also has eliminated revenue effects for the proposed speed-up of estate and gift taxes for the current fiscal year. Although chances for enactment of this speed-up seem fairly good, any major revenue effect would now be postponed until fiscal year 1972. The table on the next page lists the tax rate changes that the staff expects to be forthcoming during the remainder of the current fiscal year--most of them already legislated--as well as tax rate changes that were recommended by the Administration but are now not included in the staff estimates.

The outlook for budget outlays is still uncertain, as illustrated in the second table. The current staff projection of $210.6 billion in budget outlays for fiscal 1971 reflects the House version of the boost in Social Security benefits, but a Senate Committee provides a larger increase. On the other hand, House Committee action on defense appropriations could require a cut of $1.5 billion in spending relative to the budget rather than the $0.7 billion cut incorporated in staff estimates. Outlays of the Commodity Credit Corporation are now projected lower than previously by at least $0.5 billion, mainly reflecting smaller support purchases because of the corn blight.

TAX LAW ASSUMPTIONS IN STAFF REVENUE
ESTIMATES, FISCAL YEAR 1971
(In billions of dollars)

	Effect on Budget Receipts	Effect on NIA receipts (annual rates)
Future tax rate changes incorporated in staff estimates		
Increase in payroll tax from 9.6% to 10.4% - January 1971 1/	1.6	3.3
Increase in taxable wage base from $7,800 to $9,000 (requires legislation) 2/	.2	2.5
Income tax reform and relief - January 1971 1/		
Individual	-1.5	-3.0
Corporations	.3	.7
Total 2/	.6	3.5
Tax rate changes recommended by Administration, not included in staff estimates		
Estate and gift tax speed-up	1.5	
Lead tax	1.6	
Highway user tax	.3	
Total	3.4	
Memorandum:		
Total receipts, May 19 budget estimate	204.3	
Less: tax rate changes recommended by Administration, but not included by staff	3.4	
Less: effect of reduced income assumption in staff estimates	3.5	
Budgets receipts, current staff estimate	197.4	

1/ Legislation for these changes has already been enacted.
2/ The cash flow effect of this tax change is small during the first half of the calendar year, and large in the second half. In the NIA accounts the effect of this tax change is smoothed out for the entire calendar year. This explains the large annual rate effect in the NIA accounts.

MAJOR AREAS OF UNCERTAINTY IN FEDERAL OUTLAYS, FISCAL YEAR 1970
(In billions of dollars)

	Differences from May 19 Budget Estimates	
	Staff estimate	Possible tentative additions resulting from Congressional proposals
Social Security benefit increase	1.5	1.0 1/
Federal pay raise	1.3	
Defense	-.7	-.8 2/
CCC	-.5	
Delay of postal rate increase 3/	1.1	
Interest on debt	.5	
Unemployment insurance	.4	
Other nondefense	1.4	
Total revision	5.0	.2
Total outlays		
May 19, Budget	205.6	
Staff estimate	210.6	

1/ Senate Committee action provides 10 per cent benefit boost and $100 minimum monthly benefits.
2/ House Committee action provides a total cut of $1.5 billion in defense outlays estimated on the basis of a $2.1 billion cut in appropriations.
3/ Reflects a reduction in negative expenditures.

As a result of the current re-assessment of receipts and outlays, the staff is now projecting a fiscal year unified-budget deficit of about $13 billion, and an NIA Federal sector deficit closer to $14 of $15 billion. The high employment surplus, however, is now estimated at $1.0 billion. This estimate of the high employment surplus has been considerably reduced--particularly in the first half of calendar year 1971--relative to the previous Greenbook, partly because tax revenues from the speed-up in estate and gift taxes are now being

excluded and partly because the social insurance programs are now calculated to result in a higher level of NIA transfers than was allowed for previously. The current estimate of the high employment budget surplus for fiscal year 1971, in the amount of $1.0 billion, is precisely the same as in fiscal year 1970. Quarter by quarter, however, the high employment surplus moves from a large deficit of around $4 billion at annual rates in the 2nd and 3rd quarters of calendar 1970 to a small deficit in the fourth quarter and a surplus of around $3.5 billion during the first half of 1971. This is a significantly smaller shift toward surplus than was expected earlier.

The Treasury cash balance at the end of October is estimated to be $6.9 billion, after receipt of $2-1/2 billion of payments for June tax anticipation bills in the latter half of the month. The Treasury is expected to announce the November refunding on October 22, and some net new cash may be obtained in this operation if a combined rights and cash financing is decided on. In total the Treasury is expected to need another $2-1/2 billion of new financing during the fourth quarter in addition to the continuing additions to the regular bill auctions and the October offering of tax anticipation bills mentioned above. The bulk of the additional cash need will probably be met in a cash financing at the beginning of December.

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

	Fiscal Year 1970*	Calendar Year 1970	Fiscal Year 1971		Calendar Quarters					
					1970				1971	
		F.R. Board	Revised Budget 1/	F.R. Board	I*	II*	IIIe/	IVe/	Ie/	IIe/
Federal Budget										
(Quarterly data, unadjusted)										
Surplus/deficit	-2.9	-9.1	-1.3	-13.2	-3.5	8.7	-6.6	-7.7	-6.2	7.3
Receipts	193.8	192.5	204.3	197.4	44.4	58.7	47.0	42.4	47.0	61.1
Outlays	196.8	201.5	205.6	210.6	47.8	50.0	53.6	50.1	53.2	53.8
Means of financing:										
Net borrowing from the public 2/	3.8	10.0		11.1	2.0	-6.4	7.4	7.0	3.3	-6.6
Decrease in cash operating balance	-2.1	-1.2		2.4	-1.6	-1.1	- .8	2.3	.1	.8
Other 3/	1.2	.4	n.a.	-.3	3.1	-1.1	--	-1.6	2.8	-1.5
Cash operating balance, end of period	8.0	6.5		5.6	6.9	8.0	8.8	6.5	6.4	5.6
National Income Sector										
(Seasonally adjusted annual rate)										
Surplus/deficit	-.4	-10.6	.1	-13.7	-1.7	-14.2	-13.1	-13.5	-13.8	-14.2
Receipts	198.9	196.1	208.7	200.6	195.9	196.7	194.6	197.0	203.8	207.1
Expenditures	199.3	206.7	208.6	214.3	197.7	210.9	207.7	210.5	217.6	221.3
High employment surplus/ deficit 4/	1.0	-1.4	n.a.	1.0	2.9	-5.5	-3.0	-.1	3.9	3.1

* Actual
e--projected
n.a.--not available
1/ Official Budget Revision: May 19, 1970
2/ Excludes effect of reclassification of $1.6 billion of CCC certificates of interest, as of July 1, 1969. This reclassification increased Federal debt, but is not treated as borrowing from the public.
3/ Includes such items as deposit fund accounts and clearing accounts.
4/ Estimated by Federal Reserve Board Staff.

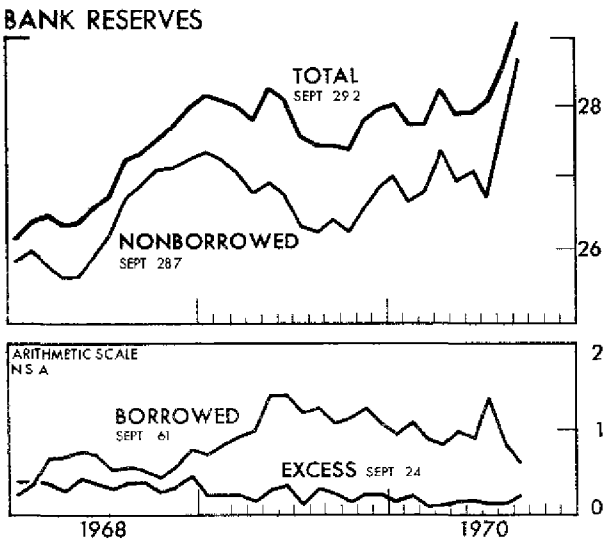
PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

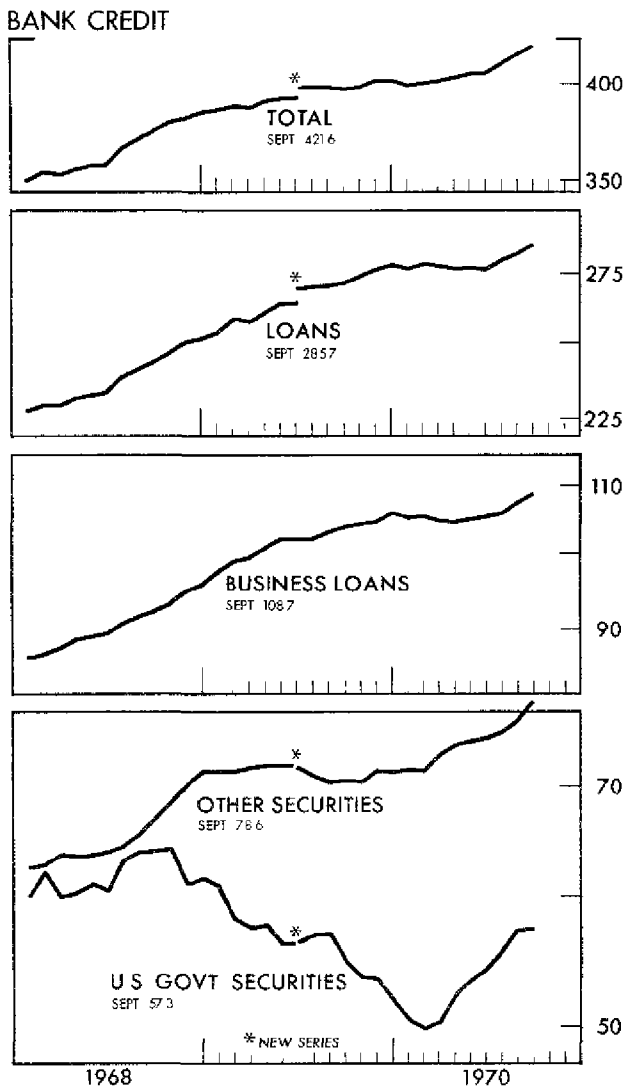
	Sept.	Oct.	Nov.	Dec.
Total net borrowing:	-1.3	3.0	1.2	2.8
Weekly and monthly bills	.6	.5	.8	.7
Tax bills	--	2.5	--	--
Coupon issues	--	--	--	--
As yet unspecified new borrowing	--	--	.5	2.0
Other (agency, debt repayment, etc.)	-1.9	--	-.1	.1
Plus: Other net financial sources[a/]	.4	.6	-.6	-1.6
Plus: Budget surplus or deficit (-)	2.4	-5.5	-2.7	.5
Equals: Change in cash balance	1.5[b/]	-1.9	-2.1	1.7
Memoranda: Level of cash balance, end of period	8.8[b/]	6.9	4.8	6.5
Derivation of budget surplus or deficit:				
Budget receipts	19.2	11.9	14.4	16.1
Budget outlays	16.8	17.4	17.1	15.6
Maturing coupon issues held by public	--	--	6.0	--

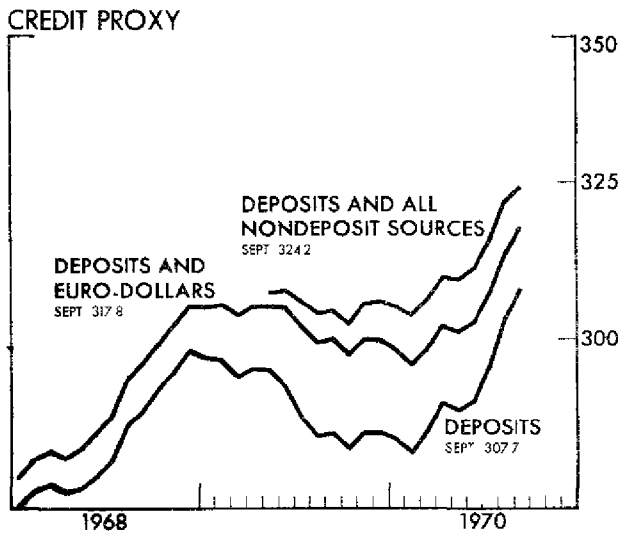
a/ Checks issued less checks paid and other accrual items.
b/ Actual.

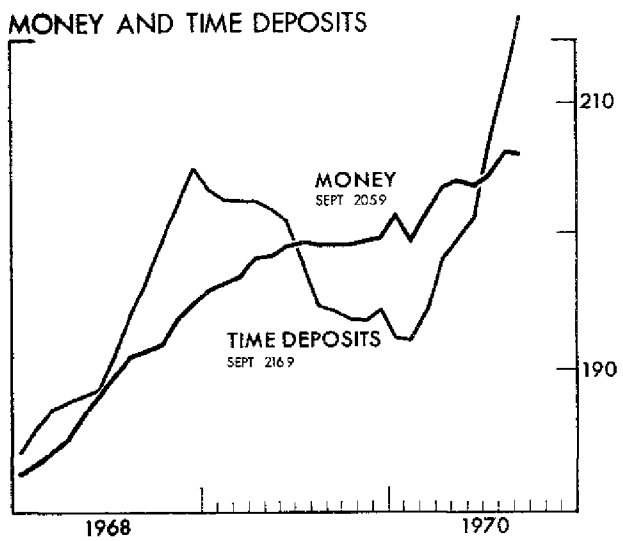
FINANCIAL DEVELOPMENTS - UNITED STATES

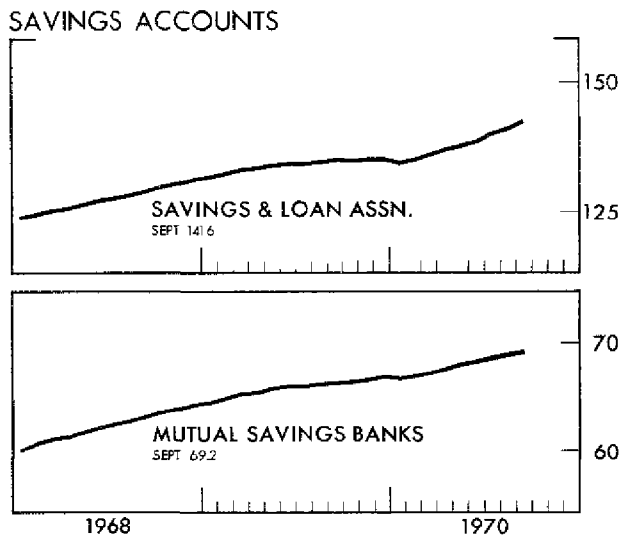
BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE



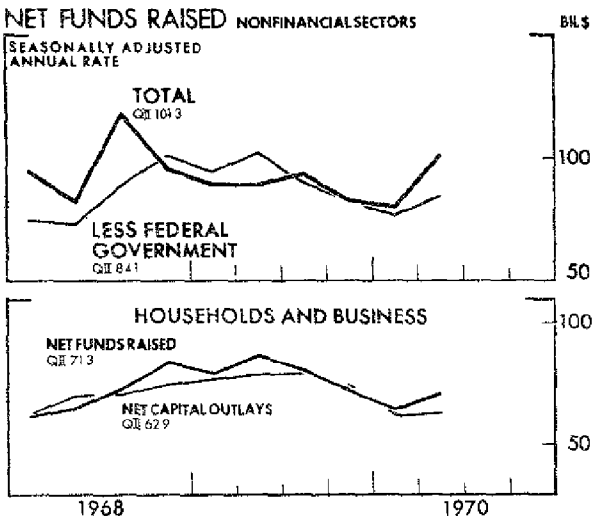


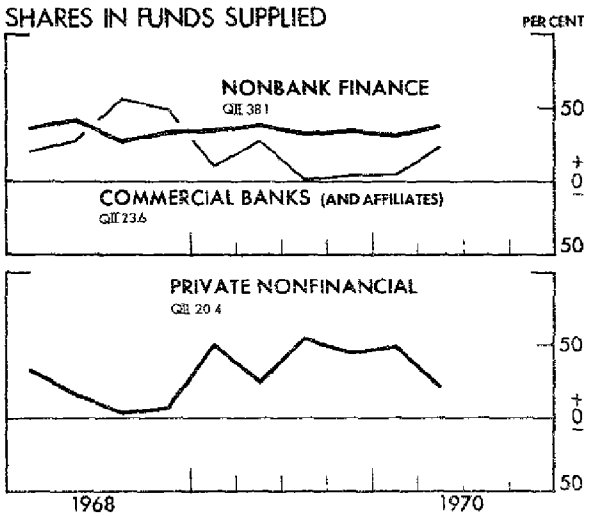


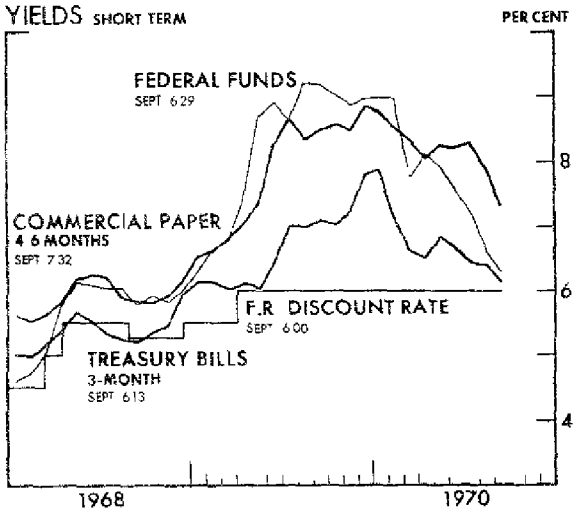


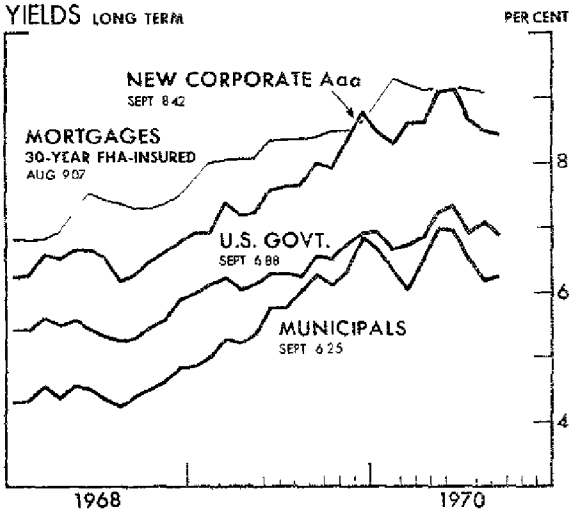


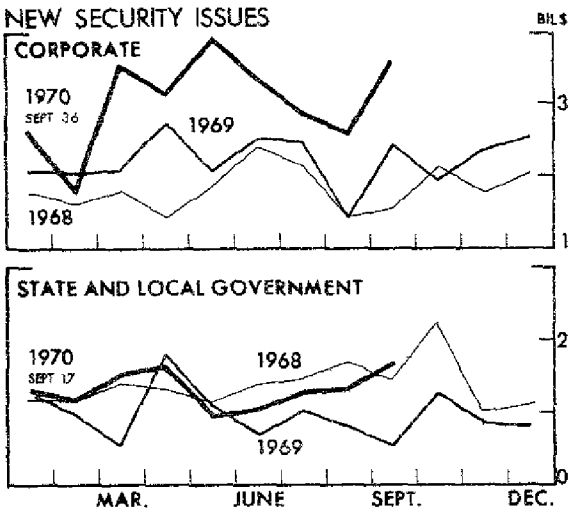
FINANCIAL DEVELOPMENTS - UNITED STATES

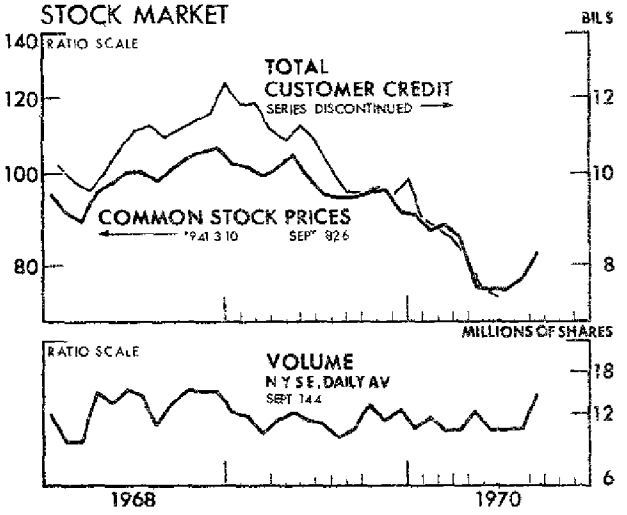












THE ECONOMIC PICTURE IN DETAIL

International Developments

U.S. balance of payments. Preliminary data suggest that the deficits on both conventional measures of the balance increased in September. On the liquidity basis, however, the September deficit (seasonally adjusted and before special transactions) was probably only a little larger than the $450 million in August. On the official settlement basis the deficit in September was $1 billion compared to a small surplus in August.

For the third quarter, the liquidity deficit is estimated at about $1 billion, compared with $2.1 billion in the second quarter. No data for specific transactions are available beyond August, but a major element in the $1 billion reduction in the liquidity deficit from the preceding quarter appears to have been a sharp reversal in the flow of U.S. bank credit to foreigners. In the second quarter an outflow of $450 million occurred, building up bank-reported claims on foreigners; in July-August there was an outflow of $375 million (roughly seasonally adjusted). A factor contributing to this reversal was the policy of the Japanese government to shift the financing of imports from dollars to yen. Beginning in June the Bank of Japan provided dollar funds to private Japanese banks that enabled them to repay U.S. bank credits. In July-August U.S. bank claims on Japan decreased $150 million, following increases through June.

A second factor in the third quarter improvement was renewed buying of U.S. stocks by foreigners. In July-August foreign net purchases of U.S stocks totaled $160 million; with the further rise in the stock market in September, there may have been further net purchases. During the second quarter there had been $130 million of net sales by foreigners. The improvements in bank claims and sales of U.S. stocks were offset, in part, by a moderate reduction in sales of securities abroad by U.S. corporations to finance their investments in foreign countries, and a substantial increase in U.S. purchases of new foreign security issues. The latter increased from $100 million in the second quarter to $500 million in the third quarter. About half of the increase was in issues of the World Bank. Purchases of issues of Canadian provincial governments, previously postponed in anticipation of lower U.S. interest rates, were also greater than in the second quarter.

It appears that only a small part of the improvement in the liquidity balance in the third quarter stemmed from further improvement in the trade surplus (discussed below).

On the <u>official settlements basis</u>, the deficit in the third quarter is estimated at about $2 billion (seasonally adjusted), about the same as in the second quarter. Liabilities to foreign branches of U.S. banks were reduced by about $1-3/4 billion in the third quarter, mainly in July but with some further decline in September. In the second quarter there had been virtually no net change in liabilities to branches. By the end of September most banks were very close to their reserve-free bases on their Euro-dollar borrowings.

MEASURES OF THE OVER-ALL BALANCE OF PAYMENTS
(In millions of dollars; seasonally adjusted; deficit, -)

	1969				1970		
	Q-1	Q-2	Q-3	Q-4	Q-1	Q-2	Q-3e
Liquidity balance 1/	-1,559	-3,427	-1,761	363	-1,344	-2,112	-1,000
Official settlements balance 1/	1,467	1,281	-420	450	-3,176	-2,120	-2,200
Adjusted over-all balance 2/	-1,485	-3,524	-1,731	301	-1,260	-2,002	-1,000
Memo: Net transactions excluded above							
Liquidity basis							
Special transactions	207	-374	-518	57	-254	692	--
Seasonal fluctuations	84	-15	-693	624	102	9	-700
Official settlements basis							
Special transactions	-14	34	-162	64	73	142	75
Seasonal fluctuations	258	-111	-458	311	274	-83	-460

1/ Before special transactions and allocation of SDR's.
2/ The balance financed by official reserve transactions (as adjusted) and changes in liabilities to foreign commercial banks.
e/ Estimated.

U.S. foreign trade. In August, the export surplus declined to $2.5 billion at a seasonally adjusted annual rate (balance of payments basis) from the exceptionally high $5 billion rates of June and July. For the two months of July-August together the surplus was at a $3.8 billion annual rate, compared with rates of $2.1 and $3.4 billion, respectively, in the first and second quarters. Exports increased only very slightly in July-August from the second quarter level, while imports were unchanged.

Exports in July-August were at a seasonally adjusted annual rate of $43.2 billion, less than 1 per cent above the rate in the second

quarter of this year. Agricultural exports exceeded the high second quarter level in the July-August period by over 3 per cent. Especially strong showings were made by wheat, corn, and rice, as increases in exports of these products more than offset declines in exports of cotton, tobacco, and hides and skins. The rise in exports of wheat in July-August was largely in response to indications that crops abroad may not be as good as they were last year. Corn exports increased as a result of the unusually buoyant foreign demand in July; August exports of corn, although still fairly high, dropped somewhat from the July level. The current U.S. corn blight probably did not affect the quantity of corn exported in August, but it did affect the export unit price which rose abruptly in that month. The volume of corn exports in the marketing year beginning in October may be lower than last year but the value will probably be sustained by higher prices.

Exports of non-agricultural commodities as a whole showed almost no change in July-August from the second quarter level. Shipments of both electrical and non-electrical machinery made significant advances because of the continued heavy foreign demand for such equipment. Exports of most other major non-agricultural products, however, declined during the July-August period. The easing of steel supply conditions in Western Europe and Japan caused exports of steel-mill products to fall from the peak levels of the second quarter. Exports of other industrial materials, such as steel scrap, aluminum, and copper,

decreased as well. A very sharp reduction in aircraft exports occurred mainly because of cancellations and deferments of purchases. Automotive exports were also lower -- both to Canada and to other areas -- as earlier-than-usual model changeovers reduced U.S auto production.

Imports in July-August averaged a $39.4 billion seasonally adjusted annual rate (balance of payments), a rate virtually the same as that of the second quarter. With few exceptions, the major groups of commodities were also imported at rates little changed from those of the second quarter. However, developments in steel, automotive, and petroleum imports are particularly significant.

Steel imports in July-August were at a rate greater than in either the second quarter or the entire first half. Tight supply conditions for steel in Europe have eased somewhat and EEC producers are now better able to expand their steel exports to the United States, especially since their 1970 shipments to the United States are thus far well under voluntary quota levels. During the first eight months of 1970 the value of U S. steel imports were 4.7 per cent greater than in January-August 1969 but were 6.5 per cent less than during the same period in 1968.

Automotive imports in July-August declined rather sharply. This reflected reduced imports from Canada (a relatively early model changeover cut Canadian production) as well as fewer new car imports from Europe. European car producers, particularly Volkswagen, are

experiencing severe supply shortages resulting from plant shutdowns (generally due to vacation schedules), labor shortages, and a strong European demand for new cars. In September Volkswagen sales in the United States were nearly cut in half. During the past few months the level of European foreign car sales in the United States has been maintained by running down inventories. Japanese-made cars, however, continue to be produced at record levels and their sales in the United States have increased steadily. For the first eight months of 1970, European and Japanese made cars accounted for about 14 per cent of all new cars sold here compared to 12 per cent for the same period last year.

In the fuels and lubricants group, crude petroleum imports declined moderately while imports of petroleum products, largely fuel oils, increased slightly. However, anticipated fuel shortages in the United States this winter and some increases in oil quotas may result in a sharp increase in imports of petroleum in the coming months.

Foreign exchange markets. In the period since the last Green Book, sterling recovered from the speculative attack in early September, while the Canadian dollar declined sharply. The lira continued to show strength, and the German mark was generally somewhat softer.

Sterling has been fairly steady at around 238.60-65 following the period of speculative selling in early September when the Bank of

England sold $435 million in support operations. The discount on three-month forward sterling fell from around 2½ per cent per annum in the second week in September to about 1¼ per cent at mid-October. On October 14, the spot rate spurted up to the low 80's following the release of relatively favorable British trade figures for September. The Bank of England purchased almost $100 million in themarket in the last half of September, but sold $80 million in official transactions, as an oil-producing country switched some reserves from sterling into dollars. To replenish its liquid dollar balances and to avoid showing in its published reserves the extent of its early September exchange market losses, the Bank of England on September 30 drew $400 million on the swap facility with the System. Britain's published reserves for September showed a decline of $86 million. Thus far in October the Bank of England has made only very small intervention purchases of dollars.

The German mark eased significantly during the last ten days of September, as the maturing of forward contracts with the Bundesbank, totaling nearly $300 million, added to the supply of marks. After purchasing $525 million spot in the first three weeks of September, the Bundesbank purchased only $90 million in the succeeding three weeks. An additional $270 million of Bundesbank forward purchases will mature during October 9-19, again tending to depress the spot rate for the mark.

The Dutch guilder remained firm near its upper limit during the last half of September, and the Netherlands Bank purchased $50 million,

which it covered through a System drawing on the reciprocal swap facility. The System's outstanding swap indebtedness to the Netherlands Bank now stands at $270 million -- the amount of the facility is $300 million.

In early October the Netherlands Bank announced to the market that it would purchase dollars (sell guilders) on a swap basis from the banks at terms favorable to the banks. (The purpose of the swaps is to meet domestic seasonal liquidity demands while avoiding a flow of uncovered dollars into the central bank's reserves.) During the first ten days of the month, the Netherlands Bank did $85 million of such swaps, resulting in some easing of the spot guilder exchange rate.

The spot rate for the Swiss franc declined steadily in late September as the Swiss National Bank (BNS) accommodated Swiss banks' quarter-end liquidity demands, in large part by foreign exchange transactions. The BNS purchased $425 million in over-month-end swaps, and an additional $180 million in outright spot transactions. Despite the reversal of these market swaps in the first week in October, the domestic market remains very liquid, and the spot exchange rate has firmed very little. The BNS obtained cover for part of its uncovered dollar holdings through a System swap drawing on the BNS for $300 million equivalent.

The Italian lira continued its recovery begun in late August. The Bank of Italy purchased nearly $200 million in September,

its largest monthly intervention purchases in over two years, and thus far in October has purchased an additional $50 million. The forward discount on three-month lire is currently running at less than 2½ per cent per annum, down from nearly 6 per cent a month ago and as high as 13 per cent in July.

The Canadian dollar declined sharply from its peak of 99.7 cents on September 17 to a low of 97.6 cents on October 14. The decline, which began when a Canadian auto company decided that the exchange rate was too high and sold C$30 million forward, accelerated the following week when Finance Minister Benson indicated in Copenhagen that Canada would not re-peg its currency for some time, i.e., until Canada's current account surplus returned to more normal levels and the exchange rate to a more defensible rate. The Bank of Canada sold (U.S.) $105 million from September 17 to September 23. Since then it has intervened in small amounts on both sides of the market.

Euro-dollar market. Euro-dollar interest rates firmed in late September, largely reflecting normal quarter-end window dressing by foreign commercial banks. The three-month deposit rate, which has been within about 20 basis points on either side of 8-1/8 per cent since late July (on a weekly average basis) rose to 8-1/2 per cent at the end of September but declined to average 8.18 per cent in the week ended October 14.

Gross liabilities of U.S. banks to their foreign branches (including domestic loan participations) changed little on balance from late July through Wednesday, September 23, averaging about $10.5 billion. These borrowings declined by about $0.4 billion in the last week of the third quarter but have since advanced by about half that amount.

Preliminary data for the New York and Chicago Federal Reserve Districts indicate that in the reserve computation period ended September 30, three of the banks using an historical base for calculation of required reserves against Euro-dollar positions gave up a total of about $200 million of their reserve-free bases. The spread between the cost of three-month Euro-dollar funds to U.S. banks and rates on 60-89 day funds obtained in the domestic CD market (adjusted for the cost of holding required reserves against the latter) widened to roughly one percentage point in late September and early October -- primarily as a result of the marking down of CD offer rates which declined from about 7-3/8 per cent in early September to about 6-7/8 per cent in early October. (See table.)

Swiss banks repatriated a sizable amount of funds at the quarter-end (see Foreign Exchange Markets). Outright spot purchases of dollars at the quarter-end by the BNS increased liquidity in the Swiss money market and interest rates there reportedly remain low. The German money market, however, has remained tight throughout

the last six weeks or so and rates on three-month inter-bank money have remained well above 9 per cent. Dutch authorities expect their domestic money markets to be tight in coming weeks and the Netherlands Bank has offered swaps to Dutch banks, buying dollars spot and selling them three-months forward. A more detailed picture of recent developments in European credit markets is presented in the following section.

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

Average for month or week ending Wednesday	(1) Call Euro-$ Deposit	(2) Federal Funds	(3) (1)-(2) Differential	(4) 3-month Euro-$ Deposit	(5) 60-90 day CD Offer Rate 1/	(6) =(4)-(5) Differential
August	7.26	6.61	0.65	8.19	7.68	0.51
Sept. 2	7.35	6.46	0.89	7.94	7.44	0.50
9	7.63	6.64	0.99	7.97	7.38	0.53
16	7.75	6.46	1.29	8.10	7.38	0.72
23	7.68	5.84	1.84	7.96	7.13	0.83
30	7.88	6.05	1.83	8.18	7.00	1.18
Oct. 7	7.73	6.36	1.37	8.35	6.88	1.47
14	7.13	6.25p	0.88	8.18	n.a.	n.a.

p/ Preliminary.
1/ Median rate offered by prime banks in New York (not adjusted for the cost of holding required reserves).

Interest rates in major industrial countries. Since last spring, short-term interest rates have declined in several, but not all, of the principal industrial countries outside the United States, and where this has occurred rates are now at or near their lows for the year. In Canada, short-term rates have come down about 2-1/2 percentage points from their all-time highs of last January. More moderate declines of between 1/2 and 1 percentage point, measured from highs established in the first quarter, have been registered in the United Kingdom, Belgium, France and the Netherlands. In Germany, short-term rates are below 1970 highs set in July, but have moved up somewhat since mid-August.

A lessening of demand pressures has provided the basis for reductions in short-term rates in some countries, particularly in Canada where the Bank of Canada has acted to reduce the cost of money concomitantly with the elimination of excess demand from the domestic economy. Somewhat less buoyant demand conditions have also been part of the background for rate declines in France and Belgium. However, the main consideration in France may have been a desire to avoid unwanted inflows of short-term funds. Different circumstances have prevailed in Germany, where a tightening of fiscal policy made possible a cut in official interest rates designed to discourage capital inflows and thereby, as also in France, to facilitate the control of bank liquidity. In Britain, where short-term rates have also declined, the central bank

Table 1. SHORT-TERM INTEREST RATES IN MAJOR INDUSTRIAL COUNTRIES 1/

	1969	1970						
	Dec.	High	Low	May	June	Aug.	Sept.	Latest
France	10.41	10.63 (1/2)	7.88 (9/3)	8.90	9.34	8.13	8.13	7.88 (10/9)
Germany	9.00	9.88 (7/13)	9.00 (8/18)	9.56	9.56	9.17	9.25	9.19 (10/9)
Italy	7.50	8.25 (8/31)	7.50 (2/28)	8.00	8.00	8.25	8.25	8.25 (8/31)
Belgium	8.50	8.50 (1/31)	7.65 (10/5)	8.00	8.00	7.91	7.75	7.60 (10/12)
Netherlands	9.09	8.75 (3/20)	7.00 (8/21)	8.34	8.38	7.34	7.63	8.06 (9/30)
Switzerland	5.00	5.50 (10/2)	5.00 (3/6)	5.50	5.50	5.50	5.50	5.50 (10/2)
United Kingdom	8.92	10.25 (3/4)	7.25 (9/18)	8.14	7.93	7.53	7.37	7.00 (10/13)
Japan	8.50	8.50 (9/26)	8.25 (10/1)	8.25	8.50	8.50	8.50	8.25 (10/1)
Canada	7.78	7.83 (1/7)	7.26 (10/2)	6.38	5.71	5.50	5.33	5.27 (10/9)
Euro-dollar	11.20	10.50 (1/9)	7.94 (9/25)	8.94	9.38	8.14	7.99	8.31 (10/13)
United States	7.72	7.93 (1/2)	5.74 (9/25)	6.72	6.63	6.34	6.14	6.01 (10/9)

Note: Actual dates are indicated below the high, low and latest rates. If a high or low rate prevailed on more than one date, the latest date is shown. For months, the monthly average of end-of-week rates is shown.

1/ Rates quoted are generally for 3-month funds as follows: Italy and Switzerland, time deposits; Germany, interbank loan; the United Kingdom, local authority deposit; the Netherlands, local authority loan; Canada and the United States, Treasury bills; Belgium, tap rate on Treasury bills; Euro-dollar, deposit. For France and Japan, the call money rate is shown.

Table 2. LONG-TERM BOND YIELDS IN MAJOR INDUSTRIAL COUNTRIES 1/

	1969	1970						
	Dec.	High	Low	May	June	Aug.	Sept.	Latest
France 2/	8.01	8.08 (3/13)	7.63 (8/14)	7.94	7.92	7.64	n.a.	7.79 (9/25)
Germany	7.38	8.40 (7/3)	7.35 (1/2)	7.99	8.30	8.04	8.12	8.15 (10/2)
Italy	7.28	8.43 (July)	7.30 (Jan.)	8.72	9.17	9.19	n.a.	9.19 (Aug.)
Belgium	7.73	8.01 (9/1)	7.64 (4/1)	7.78	7.77	7.76	8.01	8.05 (10/1)
Netherlands	7.88	8.62 (4/24)	7.93 (9/11)	8.53	8.46	7.98	n.a.	7.93 (9/11)
Switzerland	5.34	6.10 (7/10)	5.31 (1/9)	6.04	5.99	5.95	5.88	5.91 (10/2)
United Kingdom	9.02	9.83 (6/12)	8.44 (3/6)	9.37	9.53	9.26	9.46	9.37 (10/2)
Japan	8.77	8.89 (Apr.)	8.68 (July)	8.81	8.77	n.a.	n.a.	8.68 (July)
Canada	8.33	8.37 (1/7)	7.79 (4/15)	8.17	8.06	7.99	n.a.	7.89 (10/7)
Euro-bonds 3/	8.13	9.38 (6/30)	8.05 (4/30)	8.75	9.38	8.89	n.a.	8.89 (8/31)
United States	6.65	7.23 (5/29)	6.23 (2/27)	6.88	6.97	6.69	6.61	6.43 (10/9)

Note: Actual dates are indicated below the high, low and latest rates. If a high or low rate prevailed on more than one date, the latest date is shown. The monthly average of end of week rates is shown for most individual monthly rates. For Italy and Japan the monthly average rates are shown, while for Belgium the beginning-of-month yield is cited, and for Euro-bonds the yield is for the end of the month.

1/ Yields generally apply to long-term government and public sector bonds. For Germany, the yield is the composite yield on all bonds with a 6 per cent coupon, while for Japan the yield refers to a composite of private industrial bonds. For Italy the composite yield is for all bonds except Treasury bonds.

2/ Net of witholding tax; gross yields are about one percentage point higher.

3 Composite yield on 10 long-term dollar-denominated issues of U.S. companies.

has supported the government bond market during periods of weakening bond prices, although perhaps in more restrained fashion than in earlier periods. This has been a factor in an expansion of bank liquidity and in increases in bank credit and the money stock that were much more rapid than in the preceding 12 months.

Three important exceptions to the general downward tendency of short-term interest rates have been Italy, Switzerland, and Japan, where rates have changed little or, in the case of Italy, have risen further. There appears to have been no diminution of demand pressures in any of these countries, and in Italy the balance of payments situation -- while improved since last winter -- has also called for maintaining tight money.

Declines in bond yields have not been as widespread or as large as those in short-term rates. Investor expectations that inflation would continue to be rapid for some time has probably been a major influence limiting the recovery of bond prices. Bond prices in a given country are affected not only by such sentiments on the part of domestic investors in that country but also by the attitudes of investors abroad, notably in the United States. Since the spring, long-term bond yields have moved to new highs in Britain, Germany, Switzerland, and Belgium, and have subsequently declined little or not at all. Declines in Canada and France from highs early this year have been far smaller than the decreases in short rates. And in Italy, bond yields have moved sharply higher in recent months.

Accumulating evidence that excess demand in Canada was being squeezed out of the economy led to further easing in the second and third

quarters of monetary policy and of the very tight monetary conditions that had prevailed at the beginning of 1970. Price indexes show a drop in wholesale prices since early in the year and a slowing of the rise in consumer prices to an annual rate of less than 3 per cent in the first eight months of 1970 (down from over 5 per cent in the same period of 1969). Soon after the turn of the year the Bank of Canada began to allow Canada's newly-enlarged external surplus to affect domestic monetary conditions, and declines in short-term interest rates in the United States exerted additional downward pressure on Canadian rates. Canadian Government foreign currency accruals became larger in May, when speculation on a Canadian dollar revaluation intensified; by June 1, when the floating exchange rate was adopted, the Treasury bill had fallen by 1-1/2 percentage points. Two reductions of 1/2 percentage point each in the discount rate on May 12 and June 1 brought that rate closer in line with short-term market rates.

Even though the move to a floating exchange rate has reduced Canada's reserve gains, thereby tempering what had been one of the two main downward influences on Canadian interest rates, the cost of short-term funds in Canada has continued to drop in response to the lower but still substantial reserve increases, and declining short-term rates in the United States after early June. A third 1/2 point discount rate reduction occurred on September 1 (bringing that rate to 6.5 per cent). The Canadian Treasury bill yield was 5.27 per cent on October 9, compared

with the January high of 7.83 per cent. Since early June, the Canadian bill yield has averaged some 80 basis points under the U.S. bill yield, a relationship that is the reverse of the usual.

Bond yields in Canada are still at very high levels about 60 basis points below January peaks, and above 1970 lows touched briefly in April. The persistence of high yields in the United States has of course been the principal element limiting the decline in Canadian yields.

In France, the day-to-day money rate has been moving downward since January, with an interruption in May-June when Euro-dollar rates also interrupted their decline. Since May 1968 the Bank of France has kept the day-to-day money rate under very tight control through its open-market operations, and has adjusted it daily in the light of changes in rates for Euro-dollar deposits of very short maturity. Rates in the day-to-day money market are at present some 60 basis points below their April average. The Bank of France lowered its discount rate from 8 to 7.5 per cent on August 27, at least partly to obviate or lessen inflows of short-term funds, which in the view of the French authorities would have complicated their task of keeping credit expansion within desired bounds. The Bank of France has experienced large accruals of official reserves continuously since the mark revaluation a year ago. To prevent excessive additions to bank liquidity, the central bank raised banks' cash reserve requirements in June and again in July by 1 percentage point each time; the requirements are now 7.5 per cent against sight and 2.5 per cent against time deposits.

The discount rate reduction in August was consistent with fresh evidence that the pace of consumer spending had moderated considerably -- and total spending to a lesser degree -- during the first half of the year; it followed earlier moves indicative of some relaxation in the official monetary posture. Ceilings on the expansion of banks' medium-term loans were raised in April; they were removed, as regards loans for the purchase of equipment, on July 1, when new ceilings were set for other types of credit which would allow some acceleration of credit expansion in the second half. A liberalization of credit terms for the purchase of most consumer goods, including in particular new and used automobiles, went into effect on October 6.

Short-term interest rates in Belgium have continued their slow but steady retreat, the 3-month bill rate being now 90 basis points less than in January. There has been no change in the National Bank of Belgium's discount rate this year despite the fact that a change in the bill rate of this magnitude (and usually less) has usually led to a discount rate change in the past. Falling short-term rates in Belgium have reflected Belgium's balance of payments surplus and related reserve gains; the drop in Euro-dollar rates; and somewhat less vigorous expansion of economic activity this year than last. In mid-September ceilings on bank credit expansion were extended through the end of the year but liberalized to allow a more rapid overall credit expansion (banks being asked not to increase further their consumer credit and personal loans or loans to

financial companies). In contrast, long-term bond yields in Belgium held at around April levels before moving to new highs in September and October.

The monetary situation in Germany has been characterized by continuing efforts on the part of the Bundesbank to contain the expansion of domestic liquidity. Through May, increases in Bundesbank external reserves were not large enough to require offsetting measures. From June onward, however, official reserve increases have been much larger than earlier this year -- a result of stepped-up net foreign borrowing by German business firms and, in smaller degree, by German banks -- and have come at a time when the public sector has been exerting an expansionary effect on bank liquidity through drawdowns of cash balances at the Bundesbank. Consequently, in July banks' minimum reserve requirements were stiffened and their rediscount quotas were lowered slightly. Soon thereafter, effective September 1 banks were subjected to high marginal reserve requirements, ranging up to 40 per cent, against increases in all deposits (domestic or foreign) from second-quarter average levels.[1/]

The intense demand for funds fueled by the boom in economic activity caused German bond yields to advance further in the spring and early summer, and interbank loan rates to move up in July (after several months of stability) even as funds flowed in more heavily from abroad.

1/ Total reserve requirements must not exceed the statutory maximum of 30 per cent on demand deposits, 20 per cent on time deposits and 10 per cent on savings deposits.

The Bundesbank cut its discount rate from 7.5 to 7 per cent on July 15. The purpose of this measure was to facilitate the control of bank liquidity (and hence of bank credit expansion); by lowering the cost of bank credit in Germany it was hoped to blunt the incentive for German companies to go abroad for funds and thereby to curtail official reserve acquisitions, which create bank reserve funds. The discount rate reduction did not and was not intended to ease German credit conditions. However, the Bundesbank was unwilling to take this step until fiscal policy had been tightened, in order to avoid giving the false impression that demand management policies were being eased. Thus, the discount rate cut followed closely a government decision to apply a temporary 10 per cent surcharge on personal and corporation income taxes and to suspend accelerated depreciation allowances.

The discount rate reduction failed to stem the inflow of funds from abroad during the succeeding six weeks, a condition which led to the imposition of the new marginal reserve requirements. Both short- and long-term market interest rates came down from mid-July to mid-August in response to the discount rate cut, but since mid-August have reversed part of those declines. Recent announcements of new bond flotations suggest that long-term rates, at least, will not decrease again this year.

The discount rate in the United Kingdom has been unchanged since the two reductions on March 5 and April 15 which together brought the rate from 8 to 7 per cent. But those short-term interest rates that

are not rigidly tied to Bank rate have since undergone declines; rates for 3-month local authority and hire purchase deposits are each down more than one-half percentage point from their levels just after the April Bank rate reduction. Bank liquidity increased in the second and third quarters when the Bank of England provided heavy support to the government bond market. A balance of payments surplus was an additional source of liquidity for the banking system in the second quarter, although the surplus was much smaller than in any of the preceding three quarters.

Monetary conditions in Britain since March show striking changes in the rates of expansion of bank credit and the money stock. The money stock (broadly defined) rose at a seasonally adjusted annual rate of more than 16 per cent in the second quarter, compared with a 2 per cent rise over the previous 12 months, the acceleration being largely the consequence of stepped-up bank lending. In the third quarter the rate of money stock expansion was probably less than in the second but still several times the rate of increase in the year up to March. From mid-June to mid-September, credit expansion by the clearing banks was at a much faster rate than could be regarded as consistent with Bank of England hortatory guideposts. Advances to the private sector by the clearing banks -- which extend about 60 per cent of all bank advances to U.K. residents -- rose in this period at a 12 per cent annual rate. The Bank of England has indicated to the clearing banks that it would frown on a rise of more than 5 per cent in their advances in the 12 months to mid-March 1971, but the ceiling implied by this moral suasion was nearly reached in September.

The expansion in bank lending has been marked by substantial increases in both personal and business loans. Companies have sought funds from banks rather than from bond issues because of the high interest rates on bonds -- now considerably higher than rates on bank loans -- and possibly by expectations of interest rate declines. To curb clearing bank lending the Bank of England may soon raise the requirement for special deposits maintained by the clearing banks with the Bank.

Bond yields in Britain rose sharply following the mid-April presentation of the late Labor Government's budget which, by confirming the abandonment of incomes policy, weakened hopes of curbing the wage-price spiral. The slide in bond prices continued until the general election on June 18, when the War Loan yield of 9.0 per cent showed a rise of about 140 basis points over its 1970 low in March. Following the Conservatives' election victory yields fell until early August, but some of that decline has now been reversed. The War Loan yield is currently about one-half percentage point below the historic high in June.

In Italy, the Bank of Italy has not taken further active measures to raise interest rates since Bank of Italy lending rates were upped last March, but market interest rates have been allowed to rise in response to expanding credit demands, adverse expectations for near-term bond prices, and the elimination of artificial limits on some rates. Bank of Italy acquiescence in higher rates of interest has mirrored continuing concern over the balance of payments and recognition that domestic demand pressures were threatening to become excessive.

In July, Italian banks raised their rate on large time deposits (in lire) from 8 to 8.25 per cent. The existing annual interbank agreement stipulating maximum interest rates paid for funds and minimum rates on loans to customers expired at the end of February, and a new agreement did not go into effect until September. The published rate paid by banks for interbank loans of up to one month held through April at 5 per cent, the upper limit under the expired agreement, but by the end of June this rate had soared to 9.25 per cent, where it has remained at least through August. The rate of 8.25 per cent currently being paid for 3-month lira deposits compares with a rate of only 2.25 per cent under the expired agreement, a limit which was universally violated by increasingly large margins in 1969.

The new interbank agreement, effective September 1, which this time does not cover interbank loans, sets realistic minimum rates on loans to customers. It stipulates a maximum rate of 6 per cent on large lira time deposits of all maturities, a level much below rates now being paid on Euro-dollar deposits and domestic currency time deposits in most industrial countries (notably excluding Switzerland). But the ceiling rate on large-size demand deposits is higher, at 7 per cent; because of differential tax treatment, the higher gross rate of interest on demand deposits gives approximately the same after-tax rate of interest on the two types of deposits. The savings banks and cooperative banks, which hold 55 per cent of total bank deposits in Italy, have yet to sign the new agreement. In a related move, effective

October 1 the Bank of Italy raised from 3.75 to 5.5 per cent the rate of interest it pays on banks' compulsory cash reserves, which currently must equal 10 per cent of total deposits. In addition, the portion of required reserves held in Treasury bills or (within limits) long-term bonds issued by State enterprises and the special credit institutes is being modified to permit a large portion to be held in bonds.

The composite yield on all bonds excluding Treasury bonds advanced from 8.36 per cent in April (monthly average) to 9.43 per cent in July, a figure that compares with 6.53 per cent 14 months earlier before the recent large rise in yields. Bank demand for long-term bonds was weakened by the surge in interbank loan rates. In August the composite bond yield dropped sharply to 9.19 per cent, probably in favorable reaction to the tax increases proposed by the new Colombo government to reduce the budget deficit and contain the expansion of domestic demand.

Financial market conditions in Japan remain tight, with business demand for both fixed investment and working capital funds continuing to be strong. The reserve positions of the large city banks have been tight and companies are continuing to experience a liquidity squeeze. In the third quarter there was a slight easing of Bank of Japan restraints on commercial bank credit expansion, but in mid-September the Governor of the Bank of Japan announced his intention of maintaining both the present discount rate level and strict controls on the volume of bank lending.

The call money rate has continued at 8.25 or 8.50 per cent, while the average rate charged by banks on loans and discounts has shown a slight further rise, climbing from 7.64 per cent in April to 7.67 per cent in July (compared with 7.35 per cent in July 1969). The average yield on private industrial bonds, shown in the table, has dipped, but other yields do not suggest an easing of bond market conditions. In fact, interest rates on long-term bank loans continued to rise through July, and on September 1 the Japan Development Bank increased its interest rate on most new loans from 8.2 to 8.5 per cent.

U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS