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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

April 2, 1971

The Domestic Economy

Construction. Expenditures for new construction put in place showed little month-to-month change in March. But based on the data now available, the seasonally adjusted annual rate for February had already reached a record $103.7 billion--6 per cent higher than initially indicated--as a result of substantial upward revisions for February and some earlier months. (These revisions related mainly to the "additions and alterations" component of residential construction and to outlays for State and local government projects, by far the major component of the "public" sector.)

Compared with a year earlier, total construction outlays in March averaged 14 per cent higher in current dollars and 5 per cent more in 1957-59 dollars. The 9 per cent year-to-year increase in construction costs in March was about the same rate of increase as during all of 1970.

Even though current dollar outlays for none of the major groups apparently expanded further in March, all reached new highs in the first quarter as a whole. Particularly striking was the advance registered by the public sector. Reflecting the appreciably increased availability of funds--discussed in Supplemental Appendix A on State and local financing developments--outlays in this sector actually exceeded the further increase in residential construction expenditures from the fourth quarter of 1970, as indicated in the table.

NEW CONSTRUCTION PUT IN PLACE

	All	Private			Public
		Total	Residential	Non-residential	
	Billions of dollars				
Annual					
1970 (r)	91.3	63.1	29.3	33.8	28.3
Quarterly (SAAR)					
1970 - IV (r)	94.4	65.3	31.9	33.4	29.1
1971 - I (p)	103.0	70.0	35.1	35.1	32.8
Monthly (SAAR)					
1971					
January (r)	101.7	69.8	33.4	35.5	31.9
February (r)	103.7	70.3	35.4	34.9	33.4
March (p) 1/	103.4	70.2	35.4	34.8	33.2
	Per cent change in March from year earlier				
In current dollars	14	9	21	--	25
In 1957-59 dollars	5	2	15	-10	13

1/ Data for most recent month (March) are confidential Census Bureau extrapolations. In no case should public reference be made to them.

Labor market. Nonfarm payroll employment was unchanged between February and March at 70.6 million--about the same level as in September just before the GM strike began. Employment rose slightly in March in nonmanufacturing activities but manufacturing employment declined further in part because of increased strike activity. Except for the period of the GM strike, manufacturing employment was at its lowest level in March since January 1966.

Nonmanufacturing employment is somewhat higher than a year ago. In manufacturing, however, employment has declined about 1.3 million, including a drop of over a quarter of a million white-collar and technical people, many more than in earlier economic contractions.

NONFARM PAYROLL EMPLOYMENT
(Seasonally adjusted, in thousands)

	1970		1971
	March	September	March
Total	71,242	70,531	70,568
Government	12,503	12,585	12,879
Private	58,739	57,946	57,689
Nonmanufacturing	38,795	38,661	39,034
Manufacturing	19,944	19,285	18,655
Production workers	14,512	14,000	13,480
Nonproduction workers	5,432	5,285	5,175

The average workweek rose 0.2 hours in March for rank-and-file workers on private nonfarm payrolls and 0.4 hours for production workers in manufacturing. These workweek increases followed declines of about the same size in February, when the workweek figures appear to have been distorted by holidays (Lincoln's birthday during the survey week and the Washington's birthday holiday on the following Monday.)

The unemployment rate rose to 6 per cent in March from 5.8 per cent in February. The rise in unemployment occurred largely among 16 to 24 year-olds--the same group that accounted for the decline of 0.2 percentage points in the over-all unemployment rate in February. On balance, the unemployment situation appears little changed since the end of the GM strike. At 83.5 million in March, the civilian labor force has declined since the end of last year and increased only one million over the past year.

LABOR FORCE, EMPLOYMENT AND UNEMPLOYMENT
(Seasonally adjusted, in thousands)

	1970			1971		
	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
Civilian labor force	83,300	83,473	83,609	83,897	83,384	83,475
Total employment	78,691	78,550	78,463	78,864	78,537	78,475
Total unemployment	4,609	4,923	5,146	5,033	4,847	5,000
	----------------(Per cent)--------------------					
Unemployment rates:						
Total	5.5	5.9	6.2	6.0	5.8	6.0
Men aged 20-24 years	10.6	10.4	10.9	10.4	9.7	10.0
Men aged 25 and over	3.2	3.4	3.7	3.5	3.4	3.4
Women aged 20 and over	5.0	5.6	5.8	5.7	5.6	5.8
Teenagers	17.0	17.6	17.8	17.6	16.7	17.8

Wholesale prices. Wholesale prices rose at a seasonally adjusted annual rate of 3.4 per cent between early February and early March--about half the average rate of increase in the first two months of the year. Farm products dropped somewhat after their sharp February surge, but increases for processed foods and feeds more than offset the decline. The rise in industrial prices was faster than in February, but the increase of about 3 per cent (annual rate) was about the same as the 3-month average and below both the first and second half of 1970.

WHOLESALE PRICES
(Per cent changes, seasonally adjusted annual rates)

	6 months		3 months	Monthly	
	Dec. 1969 to June 1970	June to Dec.	Dec. 1970 to Mar. 1971	Jan. 1971 to Feb.	Feb. to Mar.
All commodities	2.6	2.0	6.1	9.1	3.4
Farm and food 1/	-1.8	-.5	13.7	33.5	1.1
Industrials	3.9	3.4	2.9	1.6	3.0
Crude materials 2/	8.7	.7	1.7	-1.0	-7.6
Intermediate materials 2/	4.5	1.6	4.4	3.3	6.6
Finished goods 2/					
Producer	3.7	6.4	3.5	3.2	2.1
Consumer 2/	2.5	5.5	1.5	0.0	-1.1
Durable	2.7	5.9	2.6	5.6	-4.3
Nondurable 2/	2.6	4.9	1.1	-3.2	0.0

1/ Farm products, and processed foods and feeds.
2/ Excludes foods.

The rise in prices of both consumer and producer nonfood finished goods slowed in the first quarter and increases were substantially below those in the last half of 1970.

Lumber and wood products prices rose sharply in March reflecting heavy demand for softwood lumber and plywood. However, inventories have been replenished and, more recently, there has been little change in spot prices for softwood lumber and plywood.

Nonferrous metals prices fell last month but more recently nonferrous metal markets have firmed. Copper, zinc and tin prices have gone up and further increases for copper and probably for aluminum may follow the reopening of labor contracts in May and June.

Steel mill products prices have been raised 1.2 per cent since December compared to 2.5 per cent in the first quarter of last year. However, judging by the pattern of recent and announced future increases on products covered by the one-year price guarantee (which will expire for all products by the end of June), the steel price increase in the first six months of this year may exceed the 6 per cent rise in the same period last year.

Consumer credit. The February increase in consumer instalment credit outstanding amounted to $1.2 billion at a seasonally adjusted annual rate. Almost all of the gain occurred in automobile credit and in personal loans. Automobile credit outstanding rose $0.6 billion, the largest monthly increase for this component since November 1969. On the other hand, nonautomotive consumer goods credit declined for the first time since June 1961.

Seasonally adjusted extensions of instalment credit during February exceeded the previous high reach last July. Repayments were at a record level for the second month in a row.

The Domestic Financial Situation

Monetary aggregates. The narrowly defined money supply, currency plus private demand deposits, (M_1) is now estimated to have increased in March at an annual rate of about 9.5 per cent--below the unusually sharp February increase but substantially above the late 1970 pace. Over the first quarter, growth was at an annual rate of about 8 per cent compared with 3.4 per cent in the fourth quarter of 1970 and 6.1 per cent in the third.

The rate of growth in M_2 (M_1 plus commercial bank time and savings deposits other than large CD's) also slowed somewhat in March--an annual rate of about 18 per cent compared with 22 per cent in February. Over the first quarter, however, expansion at an annual rate of 17.5 per cent was almost double the rate of growth in the fourth quarter.

MONETARY AGGREGATES
(Seasonally adjusted percentage changes at annual rates)

Concepts of money	1970	1971			
	QIV	January	February	March e/	QI e/
M_1 Currency plus private demand deposits	3.4	1.1	14.0	9.5	8.0
M_2 M_1 plus commercial bank time and savings deposits other than large CD's	9.2	11.5	22.1	18.0	17.5

e/ Estimated.

<u>Bank credit</u>. Preliminary estimates now available for March indicate that commercial bank credit, adjusted for transfers of loans between banks and their affiliates (and also for System matched sale-purchase transactions outstanding at the February month-end) increased at an annual rate of 11.6 per cent--somewhat below the rate earlier in the first quarter. Expansion in loans slowed reflecting principally weakness in business loans. Borrowing by businesses declined at an annual rate of 6-1/2 per cent in March following growth at an annual rate of about 10 per cent earlier in the year.

Growth in investment holdings accounted for two-thirds of the total credit growth in March--a somewhat higher proportion than in January or February. Expansion in holdings of municipal and Federal agency issues--which had slackened in February--accelerated in March to an annual rate of over 33 per cent--not too far below the high late 1970-early 1971 rates. But the pace of expansion in holdings of U.S. Government securities declined somewhat despite two Treasury financings.

COMMERCIAL BANK CREDIT ADJUSTED TO INCLUDE OUTSTANDING AMOUNTS OF LOANS SOLD TO AFFILIATES 1/
(Seasonally adjusted percentage changes, at annual rates)

	1970	1971			
	Q IV	Jan.	Feb.	Mar.	QI
Total loans & investments 2/	6.1	14.9	13.1 4/	11.6 4/	13.3
U.S. Government securities	2.8	8.3	24.7	10.1	14.5
Other securities	34.5	39.3	19.0	33.4	31.3
Total loans 2/	-1.0	9.1	9.4 4/	4.9 4/	7.8
Business loans 3/	-9.2	5.4	14.0	-6.4	4.3

1/ Last Wednesday of month series.
2/ Includes outstanding amounts of loans sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
3/ Includes outstanding amounts of business loans sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
4/ Excludes $814 million of System matched sale-purchase agreements outstanding on February 24.

Nonbank depositary institutions. Mutual savings banks in New York City have, as expected, incurred only very modest outflows during the beginning of the current reinvestment period, the three grace days at the end of March. Similar data are not yet available for savings and loan associations but there is every reason to expect that they also will experience only minimal outflows. In fact, according to a usually reliable FHLBB sample of associations, the industry received a net deposit inflow of about $2.5 billion during the first three weeks of March. That amount is almost two-and-one-half times as great as the inflow during the corresponding period in 1967--a similar period of large deposit growth--and already matches the savings received during all of February (not seasonally adjusted).

15 LARGEST NEW YORK CITY SAVINGS BANKS
Net Deposit Flows during the Three-Day End-of-March Grace Period[1/]

	Millions of dollars	As per cent of deposits outstanding
1966	-121	-.78
1967	- 55	-.34
1968	- 72	-.40
1969	- 99	-.53
1970	-146	-.78
1971	- 42	-.20

1/ These savings banks account for 28 per cent of industry deposits. These data have been adjusted for repayments of passbook loans made earlier to save interest credited.

INTEREST RATES

	1970 Highs	1970 Lows	1971 Mar. 8	1971 Apr. 1
Short-Term Rates				
Federal funds (weekly averages)	9.39 (2/18)	4.82 (12/30)	3.41 (3/3)	4.02 (3/31)
3-month				
Treasury bills (bid)	7.93 (1/6)	4.74 (12/17)	3.32	3.65
Bankers' acceptances	8.75 (1/13)	5.25 (12/31)	3.75	4.00
Euro-dollars	10.50 (1/9)	6.50 (12/31)	5.05	5.32
Federal agencies	8.30 (1/9)	4.81 (12/18)	3.33 (3/5)	3.64
Finance paper	8.25 (2/1)	5.38 (12/10)	3.88	3.75
CD's (prime NYC)				
Most often quoted new issue	6.75 (10/30)	5.50 (11/25)	4.00	3.75
Secondary market	9.25 (1/23)	5.38 (12/23)	3.90	3.90
6-month				
Treasury bills	7.99 (1/5)	4.78 (12/17)	3.42	3.74
Bankers' acceptances	8.88 (1/13)	5.50 (12/4)	3.88 (e)	4.12 (e)
Commercial paper (4-6 months)	9.13 (1/8)	5.63 (12/4)	4.25	4.50
Federal agencies	8.50 (1/28)	5.12 (12/18)	3.66 (3/5)	3.78
CD's (prime NYC)				
Most often quoted new issue	7.00 (10/7)	5.50 (12/23)	4.00	4.13
Secondary market	9.38 (1/23)	5.50 (12/23)	3.70	4.05
1-year				
Treasury bills (bid)	7.62 (1/30)	4.74 (12/31)	3.60	3.67
CD's (prime NYC)				
Most often quoted new issue	7.50 (9/16)	5.50 (12/23)	4.38	4.50
Prime municipals	5.60 (1/9)	2.95 (12/17)	2.35 (3/5)	2.30
Intermediate and Long-Term				
Treasury coupon issues				
5-years	8.30 (1/7)	5.85 (12/4)	5.16	5.16
20-years	7.73 (5/26)	6.15 (12/16)	6.16	5.85
Corporate				
Seasoned Aaa	8.60 (6/24)	7.47 (12/29)	7.18	7.23
Baa	9.47 (8/28)	8.57 (3/10)	8.44	8.46
New Issue Aaa	9.30 (6/19)	7.68 (12/18)	7.79 (3/3)	7.15
Municipal				
Bond Buyer Index	7.12 (5/28)	5.33 (12/10)	5.37 (3/5)	5.15
Moody's Aaa	6.95 (6/18)	5.15 (12/10)	5.15 (3/5)	5.00
Mortgage--implicit yield in FNMA biweekly auction 1/	9.36 (1/2)	8.36 (12/28)	7.43 (3/1)	7.45 (3/29)

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

International developments

Monetary policy actions abroad. In Germany, the Bundesbank reduced its discount rate from 6 to 5 per cent, and its rate on advances ("Lombard" rate) from 7-1/2 to 6-1/2 per cent, effective April 1. At the same time, however, it reduced the banks' rediscount quotas by 10 per cent (while allowing banks which had been using more than 90 per cent of their previous quotas to adjust to the new quotas by June 30), and announced that open-market operations with non-banks to absorb liquidity would be intensified. These actions are intended to reduce short-term interest rate differentials between Frankfurt and the Euro-dollar market, and thus to reduce the incentive for inflows of foreign funds, without relaxing domestic credit restraints. They are similar to the actions taken last November, when the Bundesbank lowered the discount rate but increased reserve requirements. Money market rates in Frankfurt are likely to remain relatively high; in recent months they have tended to stay near the Bundesbank's Lombard rate (now 6-1/2 per cent).

In the United Kingdom, the Bank of England reduced its discount rate from 7 to 6 per cent on April 1. The main aim, as in Germany, was to narrow international interest rate differentials and discourage inflows of funds which have been very large in recent months. But in Britain, unlike Germany, some easing of domestic credit restraints is now thought to be justified by economic prospects. In the Chancellor's budget speech of March 30, he indicated that bank loans and the money supply would be allowed to increase more rapidly over the year ahead than had earlier been thought appropriate. (See Appendix B for a discussion of the U.K. budget and related measures.)

The Netherlands Bank lowered its discount rate from 6 to 5-1/2 per cent effective April 5, and the Bank of Italy reduced its rate from 5-1/2 to 5 per cent effective April 5. Earlier, the Swedish Riksbank had cut its discount rate from 7 to 6-1/2 per cent effective March 19, and the National Bank of Belgium had cut its rate from 6-1/2 to 6 per cent effective March 25. In all these cases, a main consideration was the decline in rates in other countries and in the Euro-dollar market; but in Sweden and Italy some easing of domestic restraints was also intended.

The Reserve Bank of South Africa raised its discount rate from 5-1/2 to 6-1/2 per cent on March 31. South Africa has been experiencing a gathering inflation domestically and a large balance of payments deficit.

Foreign exchange markets. Following the announcement on March 31 of the German monetary actions described above, speculative pressures on the dollar, which had been building for several weeks, intensified. Market participants interpreted the German actions as implying that market interest rates in Germany would remain high, and that German reserve gains would continue. After an initial easing, the mark moved back to the ceiling on March 31 and the

Bundesbank purchased $292 million. On April 1, it purchased an additional $430 million spot and swapped out $608 million. By Friday morning, April 2, the 3-month forward mark, which had been at a discount of 3/4 to 1 per cent per annum last week, had moved up to the spot ceiling rate, and the Bundesbank entered the forward market, selling forward marks outright, to keep the forward rate from moving to a premium. On that day, April 2, it purchased $137 million forward and $598 million spot. The Federal Reserve Bank of New York also sold a small amount of marks forward for Open Market account on April 2.

Other EEC currencies and the Swiss franc firmed along with the German mark. By Friday, all were at their official ceilings except for the lira. Forward rates for the Netherlands guilder and the Swiss franc, which had been above their spot ceiling rates for several weeks, moved even higher.

Total dollar purchases by the central banks of the Netherlands, Switzerland, France, and Belgium swelled to roughly $450 million on April 2, with Switzerland alone accounting for $360 million.

Euro-dollar market. The U.S. Treasury announced on April 1 that it will sell (for payment April 9) $1.5 billion of 3-month certificates of indebtedness to foreign branches of U.S. banks, at 5-3/8 per cent; allocations to individual banks will be based on their average Euro-dollar borrowings from branches and Ex-Im security holdings of branches in the computation period ended March 17. The Federal Reserve amended its regulations to permit U.S. banks to count toward maintenance of their reserve-free Euro-dollar bases any funds invested by their overseas branches in U.S. Treasury securities offered under this program.

Correction. The liquidity deficit of about $2-1/2 billion in the first quarter of 1971 was not a record, as stated in the Greenbook on page I-6 and suggested on page IV-1. A larger liquidity deficit ($3.8 billion) was registered in the second quarter of 1969, and a deficit about as large ($2.3 billion) in the third quarter of 1969.

U.S. PAYMENTS BALANCES, SEASONALLY ADJUSTED, 1969-71 1/
(In billions of dollars, quarterly)

Quarter	Liquidity basis	Official settlements basis
1969 - I	-1.4	+1.5
II	-3.8	+1.3
III	-2.3	-.6
IV	+.4	+.5
1970 - I	-1.7	-3.1
II	-1.5	-2.0
III	-.8	-2.0
IVp	-.8	-3.5
1971 - Ie	-2-1/2	-5

p Preliminary. e Partly estimated.
1/ Excluding new allocations of Special Drawing Rights.

Correction:

Section I, page 1. Add "little" after changed at the end of line 3 from the bottom.

APPENDIX A: STATE AND LOCAL GOVERNMENT LONG-TERM BORROWING ANTICIPATIONS AND REALIZATIONS: FOURTH QUARTER 1970*

Results of the FRB-Census[1/] survey of long-term borrowing anticipations and realizations of State and local governments for the fourth calendar quarter of 1970[2/] indicate that individual units postponed or cancelled about $1.8 billion of the borrowing they had planned for that quarter. Approximately 30 per cent of this amount was induced by a combination of the levels of long-term municipal yields then prevailing and expectations of further declines in interest rates. Because of the substitution of other financial expedients, these interest rate induced borrowing setbacks led to only a $60 million postponement or cancellation of capital projects. Moreover, expectations of continued favorable market conditions were reflected in a marked increase in long-term borrowing anticipations for the first half of calendar 1971.

Partly offsetting the $1.8 billion of planned borrowing that did not occur, about $1.1 billion of the long-term borrowing actually undertaken during the fourth quarter had not been included in plans by borrowing units as of the end of the third quarter. A falling level of yields was responsible for at least a third of these accelerations.

Borrowing Short-falls

The level of long-term municipal yields during the fourth quarter of calendar 1970 induced about $534 million in short-falls from borrowing plans. As indicated in Table 1, about one-half of this short-fall was experienced by units that deferred plans mainly

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1/ The Bureau of the Census is responsible for the design of the sample as well as the polling of respondents.

2/ The respondents to the survey accounted for $5.2 billion or about 90 per cent of the $5.8 billion borrowed during the fourth quarter. The difference is fully accounted for by non-response; non-respondents are excluded from this report.
The response rate for units in the anticipations survey was about 76 per cent. It is felt that the non-respondents generally had no plans to report and thus anticipations totals are most likely accurate. An 84 per cent response rate was experienced in the realizations survey. Although it is felt that non-respondent performance paralleled the experiences of the respondents, they are not represented in the tables or text.

* Prepared by Paul Schneiderman, Economist, Capital Markets Section, Division of Research and Statistics.

Table 1

REASONS FOR BORROWING SETBACKS
FOURTH CALENDAR QUARTER, 1970
(Millions of dollars)

	Interest Rate Induced							
	Total	Rate Ceilings	Too High	Expected to Fall	Admin. or Legal Delay	All Other	Total	Per cent
States and State Colleges	202.3	17.3	163.5[1/]	21.5	194.9	29.6	426.8	23.5
Counties	42.8	26.2	0.0	16.6	112.4	75.2	230.4	12.7
Cities & Towns	71.5	1.5	28.7	41.3	274.9	170.5	516.9	28.5
Special Districts	111.3	8.1	1.6	101.6	89.4	23.1	223.8	12.3
School Districts	106.0	12.3	19.3	74.4	137.2	173.2	416.4	23.0
Total	533.9	65.4	213.1	255.4	808.8	471.6	1,814.3	100.0
Per cent	29.4	3.6	11.7	14.1	44.6	26.0	100.0	

1/ This amount is the result of reports by three State agencies.

in anticipation of lower interest rates. The largest volume of borrowing setbacks, however, was not directly related to interest rates. Administrative and legal delays caused a larger than normal $800 million in borrowing postponements and cancellations during the period. Questions concerning the constitutionality of some bond authorizations affected all types of units, while bond limit laws had an additional effect on local units facing expanding needs and fixed tax bases.

It is notable that State and local governments now have firm plans to reenter the long-term bond market over the course of calendar 1971, planning to make-up 80 per cent of their fourth quarter borrowing setbacks. The planned make-up rate for those units influenced by interest rates in their decision to cancel or postpone was almost 90 per cent.

Capital Outlay Postponements and Cancellations

It appears that $385 million of capital projects were postponed or cancelled due to long-term borrowing setbacks in the fourth quarter. Approximately $234 million are currently scheduled to be reinitiated during calendar year 1971, however, leaving a potential net loss for the current year due to fourth quarter 1970 borrowing short-falls of about $151 million.

Interest rate induced short-falls in borrowing accounted for only about 16 per cent of the total capital project cutbacks. Indicative of borrowing expectations regarding future interest rates, only $8 million of these projects were expected to be cancelled for the rest of calendar 1971.

Long-term borrowing setbacks of about $800 million caused by legal or administrative delays induced postponements of almost $100 million of capital projects. As earlier analysis suggests, a substantial amount of these delayed capital projects is due to be reinitiated during calendar 1971.

Alternative Financing

Further evidence of State and local governments' expectations regarding financial market conditions in 1971 can be read from the survey results. Approximately $760 million in borrowing short-falls for the fourth quarter of 1970 reflected lack of current need. An attempt to gain better market terms and resolve local legal problems

Table 2

CAPITAL OUTLAY POSTPONEMENTS AND CANCELLATIONS
FOURTH CALENDAR QUARTER, 1970
(Millions of dollars)

	Interest Rate Induced			All Other Reasons			Total		
	Gross 1/ Cutback	Postponed	Cancelled	Gross 1/ Cutback	Postponed	Cancelled	Gross 1/ Cutback	Postponed	Cancelled
States and State Coll.	55.5	52.0	3.5	24.0	19.0	5.0	79.5	71.0	8.5
Counties	0.0	0.0	0.0	11.9	0.0	11.9	11.9	0.0	11.9
Cities and Towns	0.0	0.0	0.0	63.8	28.5	35.3	63.8	28.5	35.3
Special Districts	0.0	0.0	0.0	17.7	17.7	0.0	17.7	17.7	0.0
School Districts	4.5	0.0	4.5	207.4	116.3	91.1	211.9	116.3	95.6
Totals	60.0	52.0	8.0	324.8	181.5	143.3	384.8	233.5	151.3

1/ Gross = Postponed & Cancelled

was apparent as 86 per cent of this short-fall has been tentatively rescheduled.

Table 3

EFFECTS OF BORROWING SETBACKS
FOURTH CALENDAR QUARTER, 1970

	Per Cent	Millions of Dollars	
Capital Outlay Reductions			385.3 1/
Funds Not Currently Needed			759.8
Alternative Financing:			
Short-term Financing	60.3	405.2	
Reduction of Liquid Assets	27.1	182.3	
Reduction or Postponement of Other Cash Outlays	11.6	77.9	
Other	.9	6.1	
	100.0		671.5
Total Effect			1,816.6 1/

1/ A borrowing short-fall may cause a capital project of a larger magnitude to be cancelled or postponed. Thus the total is larger than the levels of shortfalls.

State and local units with $672 million of borrowing setbacks were able to maintain expenditures by using other financial expedients, as shown in Table 3. Units utilizing these alternatives plan to fund, long-term, about 80 per cent of these alternative financing expedients. As in the past, most of the respondents in this group indicated use of low cost short-term financing to cover their long-term borrowing short-falls.

Accelerations in Long-term Borrowing

A decline in bond yields over the course of the fourth quarter induced an additional $343 million in long-term borrowing above plans already formed at the inception of the quarter. As indicated in Table 4 an additional $300 million of accelerations resulted from early authorization, some of which may have reflected the lower level of rates. In all, approximately $1.1 billion was borrowed ahead of schedule during the fourth quarter.

Table 4

LONG-TERM BORROWING ACCELERATIONS
FOURTH QUARTER, 1970
(Millions of dollars)

	Authorized Sooner than Expected	Interest Rate Induced	All Others	Total
States & State Colleges	111.8	135.2	36.2	283.2
Counties	13.7	16.3	58.7	88.7
Cities & Towns	68.2	98.7	113.5	280.4
Special Districts	65.8	70.2	152.1	288.1
School Districts	42.6	22.5	46.5	111.6
Total	302.1	342.9	407.0	1,052.0
Per cent	28.7	32.6	38.7	100.0

Borrowing Anticipations

The optimistic outlook for bond yields and the firming of plans by State and local units have been associated with an increase in long-term borrowing anticipations for the first half of calendar 1971 of 40 per cent.

Table 5

LONG-TERM BORROWING ANTICIPATIONS
AS OF DECEMBER 31, 1970
(Billions of dollars)

Anticipations	Jan.-Mar. 1971 Auth.	Jan.-Mar. 1971 Unauth.	Jan.-Mar. 1971 Total	Apr.-June 1971 Auth.	Apr.-June 1971 Unauth.	Apr.-June 1971 Total
As of September 30	2.45	1.94	4.39	2.22	1.61	3.83
As of December 31	7.00	.94	7.94	3.42	2.33	5.75
Net Change	4.55	-1.00	3.55	1.20	.72	1.92

Table 6 reflects the growing volume of State and local borrowing, the continued moderating impact of monetary policy on postponements and cancellations of such borrowing, and the subsequent reduced impacts on capital projects. Maintenance of present credit market conditions is expected to push long-term borrowing by these governments to a record level in calendar 1971 as projects which have been previously postponed are reinitiated and capital needs continue to accumulate.

Table 6

SUMMARY OF STATE AND LOCAL LONG-TERM BORROWING, SHORTFALL
OF BORROWING AND CAPITAL OUTLAYS DUE TO INTEREST RATES
(Billions of dollars)

	Gross Actual Long-term Borrowing	Gross Shortfalls Due to High Int. Rates	Cutbacks in Capital Outlays Initiated Due to High Int. Rates
1969 - III	2.5	1.67	0.68
IV	3.0	2.24	1.20
1970 - I	4.1	0.97	.20
II	3.7	1.10	.25
III	4.4	0.59	.06
IV	5.9	0.53	.06
1970 - 1	6.6 e/	n.a.	n.a.

e/ Estimated

SUPPLEMENTAL APPENDIX B: THE UNITED KINGDOM BUDGET FOR FISCAL 1971-72*

The British budget for fiscal 1971-72 -- which began April 1 -- moves British economic policy in an expansionary direction. The immediate goal of the budget, presented to Parliament on March 30, is to raise the rate of growth of real gross national product, currently running below 2 per cent.

This aim is to be achieved mainly through reductions in both personal and business taxes that will reduce revenue by about £550 million (equal to a little less than 1-1/2 per cent of GNP) in 1971-72 and £680 million a year when the reductions are fully operative. Monetary policy will also be eased somewhat. The ceiling on non-priority bank lending is raised to 10 per cent for 1971-72, compared to 5 per cent in the previous year. On April 1, the Bank of England lowered its discount rate from 7 to 6 per cent.

The budget presentation also outlined a plan of broad tax reform aimed primarily at simplifying Britain's tax system. As part of that reform, Britain will introduce a value added tax in April 1973.

The Budget in Relation to the Current State of the Economy

Growth in 1970 was disappointing in light of the widely held expectation a year ago that GNP would expand by at least three per cent a year. The increase from the second half of 1969 to the second half of 1970 was no more than 1-1/2 per cent, and there has been little if any growth thus far in 1971. Seasonally adjusted unemployment has climbed steadily since October and reached 2.9 per cent in March -- exceedingly high by British standards. With growth expected to be sluggish again in 1971, the outlook was for a continued rise in unemployment in the absence of new stimulative measures. The need to check the rise in unemployment -- which is about all achievement of the government's 3 per cent growth target can do -- was noted by Chancellor Barber in his budget speech and undoubtedly was a major factor in the government's decision to reflate.

The Chancellor acknowledged that inflation remains a serious problem but maintained -- with little evidence -- that the rapid rise in wages that has been the root-cause of inflation would henceforth slow down. He also said that, in any event, the stimulus the government was preparing to administer to the economy would not aggravate what was essentially a cost-push variety of inflation. Wage earnings in 1970 rose by about 14 per cent, while wholesale prices of manufactured goods and retail prices increased by over 8 per cent.

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The balance of payments remains strong, thus permitting the government to enact expansionary measures without fear of provoking a sterling crisis. The current account is in substantial surplus, and heavy capital inflows into sterling in the last six months have enabled Britain to reduce its short- and medium-term external debt by $2.3 billion to about $1.7 billion, all but $56 million of it owed to the IMF. On March 31, the British repaid in advance $604 million of the $1.4 billion IMF drawing of June 1968.

Principal Stimulative Measures for 1971-72

About half of the tax relief for 1971-72 announced in the budget speech is to be provided directly to business. The corporate income tax, which was reduced from 45 to 42-1/2 per cent in October, will be cut by another 2-1/2 percentage points in 1971-72. The selective employment tax (SET) -- which affects mostly service industries and requires employers to pay a fixed sum per employee -- will be halved in July. The tax reductions for business are almost certainly designed to stimulate investment. Little growth in industrial investment expenditures is expected this year, with a decline from 1970 forecast for investment in the manufacturing sector.

The largest reduction in personal taxation will result from an increase in child allowances permitted to payers of income tax. This move will lower revenue by an estimated £163 million in 1971-72 and by £207 million on a full-year basis.

Pensions will be raised, effective September 20, with the additional payments expected to total £560 million annually. Though most of the increase will be financed by higher social insurance contributions, the net effect should be stimulative, given the high marginal propensity to consume of pension recipients.

In addition to the reductions disclosed March 30, the cut in the standard rate of income tax from 41.25 to 38.75 per cent announced last October will take effect April 6. In general, the standard rate applies to the taxable income of persons with a gross annual income up to £5,500.

The cut in the standard rate was not represented, when announced last autumn, as a stimulative measure. It was explained as a counterpart of the reduction in government spending being made in accordance with the Conservatives' long-term program for diminishing the role of the government in the economy, particularly in providing subsidies for welfare purposes.

The government also announced several tax reductions, allegedly intended to promote savings and remove inequities, which will ease the tax burden of the wealthy. These measures include: a reduction in the steep progression of marginal income tax rates, with the peak rate lowered from

88.75 per cent to 75.4 per cent; elimination of the distinction between short- and long-term capital gains, with the lower long-term rate to apply to all capital gains; and an increase in the amount of an estate that is exempt from taxes. The revenue loss from these measures is expected to be small.

The central government expects to run a deficit of about £600 million in 1971-72, and a deficit of £1.2 billion for the public sector as a whole -- which includes, in addition to the central government, local authorities and public corporations -- is predicted. In 1970-71, the central government ran a surplus of about £50 million, while the public sector was in deficit by about £600 million.

Monetary stringency will be relaxed in 1971-72, as is indicated by the liberalization of the bank lending ceiling and the cut in Bank rate on April 1. The latter measure came one day after the Bundesbank reduced its discount rate by a full point and was intended at least in part to prevent an intensification of hot money flows into sterling as a result of interest differentials in favor of sterling assets. However, cutting Bank rate is consistent with the expansionary policy laid out on March 30.

The money supply will be allowed to expand at an annual rate of 12 per cent in 1971-72, the same rate at which it grew from the end of March to the end of December. The government has thus accepted a rate of increase hitherto considered too rapid.

Long-term Tax Reform

Chancellor Barber's speech set forth plans for extensive tax reform, to be implemented for the most part two years from now. These reforms are intended to simplify the tax system and encourage savings, in the interest of promoting economic growth. A value added tax is to be instituted in April 1973, accompanied by the abolition of the SET and purchase taxes. The latter are excises, collected at the wholesale level, on a variety of consumer goods, with the rates varying according to categories of goods.

The personal income tax system is to be simplified effective April 1973. A single set of progressive rates will apply to both earned and investment income. The distinction between the two types of income will be retained, however, with a surtax to be imposed on investment income. But the maximum amount of investment income subject only to the basic rate of taxation will be raised.

In the business sphere, starting in 1973 corporate income will be taxed in such a way as to remove the current incentive for corporations to retain earnings. The method by which this objective is to be accomplished has not yet been determined. At present, all corporate profits are taxed at the same rate, regardless of the amount distributed in dividends. This, the Conservatives maintain, leads to inefficient allocation of capital investment.