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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

June 2, 1971

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SUMMARY AND OUTLOOK

Nonfinancial

The staff is now projecting a rise in real GNP at an annual rate of about 3 per cent in the current quarter, compared to the (upward) revised) 7 per cent of the first quarter. This slowing represents mainly the termination of the strike-induced surge in auto output in the first quarter. Apart from residential construction, the pace of expansion has been modest. Industrial production showed only a small increase in April and is expected to change little in May. Increases in both auto assemblies and output of steel and steel products in May are likely to be largely offset by continued declines in output of business and defense equipment.

Residential construction activity has risen rapidly and housing starts in April remained at a very advanced level. But recently retail sales have shown less vigor, with sales in April and May on average estimated to be around the advanced March level. Unit domestic auto sales, in the first 20 days of May were close to the 8.3 million annual rate prevailing in most months this year.

New orders for durable goods declined appreciably in April, with orders for capital equipment off 6 per cent after some months of stability. Book value of manufacturers' inventories was up a little in April, mostly because of steel stockpiling, but after allowance for higher prices the physical volume of stocks declined. Demands for labor have apparently continued on the soft side. Initial unemployment claims in May are estimated to have changed little while total insured unemployment edged up further.

Consumer prices in April continued to rise at about the slower pace prevailing this year. As in earlier months of 1971, much--but not all--of the improved performance stemmed from a further decline in mortgage interest rates, which are not included in the GNP deflator.

Outlook. The staff is projecting an increase of $19.5 billion in current dollar GNP this quarter, about the same as in the last Greenbook. We have raised our estimate of residential construction activity on the basis of the continued strength of starts, and Federal defense purchases are apparently declining much less in the current quarter than had been anticipated. Increased estimates for these two sectors are about offset by somewhat lower projections in several other areas of final demand.

In the latter half of the year, growth in GNP is expected to be somewhat slower than we had earlier projected. Real GNP nevertheless is expected to rise at a 3.7 per cent annual rate, moderately more than in the current quarter. The rate of consumer spending is expected to pick up, and the pattern of strengthened residential construction is assumed to persist.

But business spending for fixed capital is now projected to increase only minimally in the second half of the year, with some decline in prospect in real terms. The May Commerce-SEC survey indicates an increase of only 2.7 per cent in spending for plant and equipment in 1971, compared with an increase of 4.3 per cent indicated in

February. The lack of expansive strength in this area is also attested by continued weakness in manufacturers' capital appropriations and by the recent decline in new orders for capital equipment. With respect to defense spending, the military pay raise bill approved by the Senate provided for a much smaller increase than did the House version, and, as a result, we have cut back our earlier estimates.

In sum, we still believe that real output is likely to rise at less than the long-run potential growth rate over the last three quarters, despite the size of the first quarter rebound. The unemployment rate therefore seems likely to increase further, to around 6.5 per cent in the second half of the year. In view of the substantial underutilization of labor and industrial capacity, we continue to expect some slowing of the advance in the GNP deflator, even though wage rate increases will no doubt continue quite substantial.

Financial

Developments in foreign exchange markets in early May intensified the degree of hesitancy and uncertainty that has characterized U. S. financial markets since mid-March, and both short- and long-term interest rates rose further. In the latter part of May, however, interest rates declined somewhat. This reversal was partly influenced by Chairman Burns' mid-month Congressional testimony which reinforced the developing market view that the possibility of a further near-term tightening of monetary policy had been overdiscounted. Also, as rates had moved up in early May, about $750 million of scheduled corporate bond issues were postponed.

Business loans at commercial banks increased sharply last month, although some of this rise reflected unusual seasonal patterns. For April and May together, business loan growth was at a 9 per cent annual rate, but since the first of the year--which may represent a better averaging out of seasonal adjustment problems--such loans have increased at about a 5 per cent annual rate. Loans to wholesalers and retailers were particularly strong last month. Moreover, an increase in commercial paper rates to a level that eliminated most, if not all, of the rate advantage of that market vis-a-vis bank loans may have contributed to the recent business loan strengthening.

The increase in interest rates in April and May created uncertainties for mortgage bankers and others about their future ability to place mortgages with permanent holders. As a result, market participants began to bid aggressively for the protection of forward purchase commitments from FNMA, leading to a sharp increase in FNMA's commitment yield. More generally, however, the supply of mortgage funds available remained large as cash flows to depositary institutions continued unusually strong in April and apparently in May, and there were only scattered reports of increases in mortgage rates in the primary market.

Outlook. A large volume of offerings in bond markets over the early summer is likely and this should tend to limit the rally that began in late May. Although much of the urgent, non-delayable capital restructuring of business firms is now reported to be over, underwriters suggest that a sizable volume of desired corporate capital market financing remains. Similarly, the volume of State and local borrowing demands shows little sign of abatement from its record pace.

After reducing security acquisitions in late April - early May, commercial banks are reported to have begun acquiring tax-exempt securities again in late May, but with shorter-maturities and in significantly smaller volume than during the first quarter. The pace of bank security purchases over coming weeks will, of course, be influenced by their interest rate expectations and business loan demands. Business loan growth may be a little stronger than the average pace since the first of the year, given continued economic recovery and the high level of market rates relative to the prime rate. Under such circumstances, the basis could be laid for another increase in the prime rate.

Barring a dramatic rise in short-term interest rates, consumer-type time and savings deposit inflows at commercial banks are not expected to moderate significantly further into early summer. But inflows to the thrift institutions--which have remained unusually large thus far--are likely to begin to be influenced by the higher level of market yields. In addition, the $1.4 billion AT&T convertible preferred stock rights offering could result in some deposit withdrawals in late June and early July.

Even after allowing for competition from market instruments inflows--including repayment flows--to the nonbank thrift institutions are still expected to remain large by historical standards. With S&L's no longer repaying maturing term FHLB advances or building liquidity, their flows available for mortgage takedowns are likely to be virtually unchanged this summer from the pace of the first five months of 1971. Thus, there are strong countervailing pressures to keep interest rates in the primary market for conventional mortgages from rising during the early summer months.

On the other hand, yields offered in the more sensitive secondary mortgage market for government underwritten mortgages, as reflected in the FNMA auction, may remain under upward pressure. Developers, mortgage bankers, and others are likely to continue bidding aggressively for FNMA purchase commitments in order to protect themselves against the risk of rising rates and the possibility of _future_ difficulty of placing mortgages. And with discounts in the FHA-VA mortgage market already near 8 points, HUD may be forced to raise--possibly by one-half of a percentage point--the 7 per cent ceiling on government under-written mortgages.

Balance of payments

After the withdrawal of the Bundesbank from the foreign exchange market early in May, the weekly U. S. balance of payments deficits were far smaller than before, but still uncomfortably large. There was no possibility of a net private capital inflow or outflow in Germany or the Netherlands (unless balanced by current transactions) so long as the central banks of these two countries refrained from intervening in the foreign exchange markets. The relatively small market premiums for the DM and guilder over their par exchange rates seem to have indicated that further purchases by some hedgers and speculators were largely matched by profit-taking sales by others aware of the risks of a return to the old parity as well as risks of a revaluation to a higher parity.

Today's announcement by the Bundesbank that it was prepared to buy marks (sell dollars) at yesterday's closing rate was followed initially by a rise in the rate. (Apparently the Bundesbank hopes to sell dollars to offset the domestic money market effects of its deliveries of marks on forward contracts made three months ago.)

In the two weeks through May 12 the U. S. official settlements deficit was $5.1 billion; in the next two weeks (through May 26) it was $ .6 billion. In addition to the unfavorable U. S. balance on current and long-term capital transactions, the figure for the later two-week period would reflect movements of funds from the United States attracted by relatively high Eurodollar interest rates and any movements into Japanese yen. There were some withdrawals of funds from the Swiss franc, which was revalued by 7 per cent.

While short-term capital flows have probably been continuing in recent weeks, the current and long-term capital accounts combined are undoubtedly still heavily in dificit. Merchandise imports rose sharply in April while exports fell; the trade balance for the month was a $300 million excess of imports, compared with a $100 million average export surplus in the first quarter. For the second quarter as a whole we are projecting a zero trade balance and a goods and services net export balance of about $2-1/2 billion, annual rate.

An interagency group has recently completed new projections of the U.S. balance of payments on into next year without, however, attempting to include the effects of recent or possible future changes in exchange rates. For the twelve months beginning July the over-all deficit before taking account of changes in U.S. banks' liabilities to commercial banks abroad (including branches) was projected at about $4 billion (on an assumption of "normal" errors and omissions of $1 billion). A tendency toward further worsening of the trade balance would be expected as GNP rises more rapidly, but there should be improvements in net investment income and in some types of capital transactions.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1971				Per Cent Change* From		
	Jan.	Feb.	March	April	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	83.9	83.4	83.5	83.8	0.4	-0.1	1.2 4/
Unemployment rate (%)	6.0	5.8	6.0	6.1	--	--	4.7 4/
Insured unempl. rate (%)	3.7	3.8	3.9	4.0	--	--	3.1 4/
Nonfarm employment, payroll (mil.)	70.7	70.6	70.7	70.7	0.1	0.1	-0.6
Manufacturing	18.8	18.7	18.7	18.6	-0.2	-0.9	-5.8
Nonmanufacturing	51.8	51.9	52.0	52.1	0.2	0.4	1.4
Industrial production (57-59=100)	165.6	165.2	165.5	166.0	0.3	0.2	-2.5
Final products, total	163.4	163.0	163.4	163.1	-0.2	-0.2	-3.2
Consumer goods	164.5	164.6	166.2	166.7	0.3	1.3	2.1
Business equipment	174.3	173.0	170.5	169.8	-0.4	-2.6	-12.0
Materials	168.0	167.8	168.0	169.1	0.7	0.7	-1.6
Capacity util. rate, mfg.	73.3	72.8	72.9	72.8	--	--	78.9 4/
Wholesale prices (1967=100) 1/	111.8	112.8	113.0	113.3	0.3	1.3	3.1
Industrial commodities (FR)	112.0	112.3	112.6	113.1	0.4	1.0	3.7
Sensitive materials (FR)	108.8	109.9	111.1	113.1	1.8	4.0	-1.8
Farm products, foods & feeds	110.7	113.6	113.4	113.3	-0.1	2.3	1.3
Consumer prices (1967=100) 1/	119.2	119.4	119.8	120.2	0.3	0.8	4.3
Food	115.5	115.9	117.0	117.8	0.7	2.0	2.8
Commodities except food	115.2	115.2	115.5	115.8	0.3	0.5	3.9
Services	126.3	126.6	126.6	126.8	0.2	0.4	5.6
Hourly earnings, pvt. nonfarm ($)	3.34	3.35	3.38	3.40	0.6	1.8	6.6
Hourly earnings, mfg. ($)	3.49	3.50	3.52	3.54	0.6	1.4	6.6
Weekly earnings, mfg. ($)	139.30	139.69	140.02	140.67	0.5	1.0	6.1
Net spend. weekly earnings, mfg. (3 dependents 1967 $) 1/	101.13	100.76	101.39	101.11	-0.3	0.0	1.8
Personal income ($ bil.) 2/	827.4	830.4	836.8	841.3	0.5	1.7	4.4
Retail sales, total ($ bil.)	31.2	31.6	32.2	32.3	0.5	3.8	5.9
Autos (million units) 2/	8.3	8.3	8.6	8.3	-4.0	-0.2	6.6
GAAF ($ bil.) 3/	8.6	8.8	8.9	8.9	0.0	4.0	5.4
12 leaders, composite (1967=100)	118.5	119.9	122.4	124.1	1.4	4.7	8.0
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/	1,725	1,754	1,950	1,903	-2.4	10.3	55.5
Factory workweek (hours)	39.8	39.5	39.9	39.8	-0.3	0.0	-0.5
Unempl. claims, initial (thous.)	283	284	297	283	4.7 5/	0.2 5/	13.3 5/
New orders, dur. goods, ($ bil.)	31.4	31.9	31.8	30.6	-3.7	-2.6	7.5
Capital equipment	8.8	8.8	8.9	8.4	-5.6	-4.5	4.7
Common stock prices (41-43=10)	93.49	97.11	99.60	103.04	3.5	10.2	19.9

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

SELECTED DOMESTIC FINANCIAL DATA

	1970 Averages		1971 Averages			1971
	QIII	QIV	QI	March	April	Week ended May 26
Interest rates, per cent						
Federal funds	6.71	5.57	3.86	3.71	4.15	4.68
3-mo. Treasury bills	6.33	5.35	3.76	3.38	3.86	4.40
3-mo. Federal agencies	6.67	5.50	3.78	3.45	4.00	4.68
3-mo. Euro-dollars	8.34	7.46	5.50	5.11	5.92	6.86
3-mo. finance co. paper	7.42	6.12	4.48	4.05	4.27	4.93
4-6 mo. commercial paper	7.85	6.28	4.57	4.19	4.57	5.25
Bond buyer municipals	6.33	5.92	5.25	5.17	5.37	5.96
Aaa corporate-new issues	8.51	8.26	7.33	7.46	7.57	8.23
20-year Treasury bonds	6.96	6.57	5.98	5.94	6.00	6.32
FHA mortgages, 30-year	9.06	8.76	--	7.32	7.37	n.a.

	1970		1971		
	QIII	QIV	QI	March	April
Change in monetary aggregates (SAAR, per cent)					
Total reserves	19.1	6.6	11.0	9.2	2.7
Nonborrowed reserves	24.4	9.4	11.0	8.8	9.7
Credit proxy	24.1	15.1	17.0	14.9	12.2
Credit proxy + nondep. funds	17.2	8.3	10.9	8.9	5.3
Money supply	6.1	3.4	8.9	11.6	9.8
Time and savings deposits	32.2	21.8	27.3	25.9	10.7
Deposits at S&L's and MSB's	9.3	11.6	23.3	24.9	21.7
Bank credit, end-of-month 1/	13.9	6.1	13.8	10.8	-0.5
Treasury securities	25.9	2.8	22.1	32.2	-25.5
Other securities	20.3	34.5	30.4	30.7	22.2
Total loans 1/	9.8	-1.0	7.3	--	-2.4
Business 1/	1.8	-9.2	2.5	-11.7	1.1

	1970		1971		
	QIII	QIV	QI	March	April
Change in commercial paper ($ millions)					
Total (SA)	-4,232	-760	-2,581	-1,620	209
Bank-related (NSA)	-2,985	-2,269	-657	-209	102

	1969	1970			1971	
	April	H2	QI	April	QI	April
New security issues (NSA, $ millions)						
Total corp. issues	2,748	18,445	7,977	3,170	12,190	3,910 e
Public offerings	2,098	15,900	6,715	2,723	10,675	3,460 e
State and local government bond offerings	1,801	7,837	4,109	1,647	6,642	1,888 e
Fed. sponsored agency debt (change)	841	3,057	3,635	627	-1,031	37 e
Fed. govt. debt (change)	-2,456	16,257	1,981	-4,691	1,575	-221

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.

I -- T - 3
U.S. Balance of Payments
In millions of dollars; seasonally adjusted

	1970	1 9 7 0 P/				
	Year	I	JAN.*	FEB.*	MAR.*	APR.*
Goods and services, net 1/	3,672					
Trade balance 2/	2,185	290	-20	95	215	-290
Exports 2/	42,041	11,040	3,655	3,630	3,755	3,450
Imports 2/	-39,856	-10,750	-3,675	-3,535	-3,540	-3,740
Service balance	1,487					
Remittances and pensions	-1,387					
Govt. grants & capital, net	-3,235					
U.S. private capital	-6,351					
Direct investment	-3,967					
Foreign securities	-878	-375	-313	-34	-56	-130
Banking claims	-883	111	529	-102	-171	-64
Other	-623					
Foreign capital	5,232					
Official foreign, liquid	7,613	5,048	427	1,787	2,543	2,445
Official reserve holders, nonliq.	-271	-224	-60	-73	-83	-92
Other official foreign, nonliq.	-437					
Foreign commercial banks, liquid	-6,511	-2,987	-173	-1,426	-1,208	
New direct investment issues 3/	840	373				
U.S. corporate stocks	702	62	130	-35	-26	11
Other	3,297					
U.S. monetary reserves (inc.-)	3,344	862	505	165	192	35
Gold stock	787	109	32	1	76	38
Special drawing rights 4/	16	125	100	--	25	--
IMF gold tranche	389	255	235	--	20	-2
Convertible currencies	2,152	373	138	164	71	-1
Errors and omissions	-1,274					
BALANCES (deficit -) 4/						
Official settlements, S.A.		-5,686				
" " , N.S.A.	-10,686	-5,401	-872	-1,879	-2,652	-2,388
Liquidity, S.A.		-3,258				
" , N.S.A.	-4,715	-3,147	-1,021	-512	-1,614	-2,219
Adjusted over-all, S.A.		-2,699				
" " , N.S.A.	-4,175	-2,594	-699	-453	-1,444	
Financed by: 5/						
Liab. to comm. banks	-6,511	-2,807	-173	-1,426	-1,208	
Official settlements	10,686	5,401	872	1,879	2,652	

* 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 allocations of SDRs; $867 million on Jan. 1, 1970, and $717 million on Jan. 1, 1971.

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

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. Although first quarter GNP estimates were revised upward by OBE and now show an increase of $30.8 billion, the overall outlook has not changed significantly since the preceding Greenbook. We are still projecting a quite moderate gain in output for the remainder of 1971. Several sectors now appear to show less potential strength than we had anticipated--domestic-type auto sales have been disappointing, there are indications of an even smaller increase in capital investment later this year, and somewhat less stimulus from a military pay raise is now in prospect for the second half. On the other hand, residential construction activity has been stronger than expected, and we are projecting a significantly higher level of housing activity by year-end than we had earlier. Our GNP projection for the year as a whole is now about $1,051 billion, a bit higher than a month ago, reflecting primarily the upward revision of the first quarter figures.

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rates)

	First Quarter		Second Quarter	
	Prel. OBE Estimate	OBE Revised	Proj. of 4/28/71	Current
	---------Billions of dollars-----------			
GNP	28.5	30.8	19.0	19.5
Final sales	29.7	33.0	16.4	16.4
Personal consumption	17.7	19.4	12.3	11.6
Residential construction	3.2	3.6	1.8	2.4
Business fixed investment	3.8	3.8	1.0	.9
Net exports	.2	.7	- .3	- .8
Federal purchases	- .1	.2	-2.1	- .7
State & local purchases	4.9	5.2	3.7	3.1
Inventory change	-1.2	-2.2	2.6	3.1
	----------Per Cent Per Year------------			
Real GNP	6.5	7.1	3.1	2.9
GNP deflator	5.2 1/	5.6 2/	4.3	4.7

1/ Excluding effects of Federal pay increase, 4.2 per cent.
2/ Excluding effects of Federal pay increase, 4.6 per cent.

The first quarter GNP revision increased personal consumption expenditures by about $1-3/4 billion, and some smaller upward adjustments were made in residential construction, net exports, and government purchases. On the other hand, estimated inventory change was revised down and the rate of accumulation is now placed at only $1.4 billion for the quarter. Apart from post-strike restocking of autos and accumulation of steel in anticipation of a possible strike, inventories were actually reduced in the first quarter. The price advance was somewhat more rapid than indicated earlier and the rise in the GNP deflator is now estimated at

5.6 per cent, annual rate. The fixed weight price index for private GNP, which excludes the impact of compositional shifts and the Federal pay raise, was also revised upward, and now shows a 5.2 per cent annual increase--about unchanged from the previous quarter.

We continue to project a much smaller rise in GNP in the second quarter than in the first--$19-1/2 billion, $1/2 billion more than estimated last month. The upward revision reflects stronger residential construction activity. Housing starts are now expected to increase by 140,000 (annual rate) from the advanced first quarter rate to a 1.95 million annual rate this quarter, suggesting a larger gain in residential expenditures than we had formerly projected. A slightly larger pickup in inventory investment also now seems probable following attainment of improved inventory-sales positions in the first quarter and in anticipation of the possible steel strike.

Most other sectors of demand are showing little ebullience. Personal consumption expenditures are projected to rise slightly less than was formerly estimated, primarily because of the less-than-expected rise in domestic-type auto sales during April and the first 20 days of May. There are also indications of a slower rise in State and local government construction expenditures. However, Federal defense purchases are projected to dip slightly less than projected last month. Real growth in the second quarter, at 2.9 per cent, annual rate, is now projected to be fractionally lower than we had indicated last month, with a more rapid increase in the deflator.

The outlook for the second half of the year still suggests a moderate strengthening of the economy, although by somewhat less than we had projected in the last Greenbook. We continue to assume a steel strike of about 60 days duration beginning August 1. Inventory accumulation should drop sharply as a result of a runoff of steel stocks in the third quarter, but rebound in the fourth.

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rates)

	Third Quarter		Fourth Quarter	
	Proj. of 4/28/71	Current	Proj. of 4/28/71	Current
	---------Billions of dollars-----------			
GNP	19.0	18.5	26.0	24.5
Final sales	23.0	22.0	21.0	19.0
Personal consumption	13.4	13.0	12.9	13.0
Residential construction	.8	1.4	.7	1.3
Business fixed investment	1.0	.5	1.5	.5
Net exports	.0	.0	.0	.0
Federal purchases	3.6	2.9	1.7	.0
State & local purchases	4.2	4.2	4.2	4.2
Inventory change	-4.0	-3.5	5.0	5.5
	-----------Per Cent Per Year-------------			
Real GNP	2.4	2.1	6.0	5.3
GNP deflator	4.9 1/	4.9 2/	3.8	3.9

1/ Excluding effects of Federal pay increase, 4.0 per cent.
2/ Excluding effects of Federal pay increase, 4.25 per cent.

For the third quarter, we are projecting a GNP increase of $18-1/2 billion, about the same as last month. Recent survey results suggest an even more modest growth in capital spending than we had been projecting for the second half. We continue to anticipate a pay raise for the military, but recent Senate action suggests that the amount will be smaller than we had expected. We are now assuming a compromise between the House and Senate versions of the pay bill, with outlays totaling about $1-3/4 billion, $.6 billion less than projected last month.

On the other hand, in view of the recent strength in housing starts and the continued heavy inflows of funds to savings institutions we have raised starts in the third quarter to 2.05 million units, annual rate, 100,000 above the upward revised second quarter rate; the increase in residential construction expenditures for the third quarter has also been raised by $0.6 billion.

We still expect a fairly vigorous post-strike rebound of activity in the fourth quarter, reflecting largely some resurgence of inventory investment and continued expansion in residential construction. However, the GNP increase has been trimmed by $1-1/2 billion, to $24.5 billion. A smaller gain is now expected in business fixed investment, in line with the latest Commerce-SEC survey, and recent estimates indicate a somewhat sharper decline in defense outlays than previously projected.

For the second half of 1971 real GNP growth is now projected to average 3.7 per cent, annual rate--somewhat less than expected in the Greenbook a month ago. We are now projecting the GNP deflator to slow to a 3.9 per cent rate of increase in the fourth quarter. With growth in real output averaging below potential through the last three quarters and assuming a return of labor force growth to somewhat nearer "normal", we anticipate a continued edging up of unemployment to about a 6-1/2 per cent rate.

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June 2, 1971

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income figures are billions of dollars, with quarter figures at annual rates.)

	1970	1971 Proj.	1970 III	1970 IV	1971 I	1971 Projection II	1971 Projection III	1971 Projection IV
Gross National Product	976.5	1050.7	985.5	989.9	1020.7	1040.2	1058.7	1083.2
Final purchases	973.1	1047.3	980.0	986.3	1019.3	1035.7	1057.7	1076.7
Private	752.6	812.3	759.0	763.1	790.6	804.7	819.6	834.4
Excluding net exports	749.0	809.6	754.8	760.5	787.3	802.2	817.1	831.9
Personal consumption expenditures	616.7	664.9	622.1	627.0	646.4	658.0	671.0	684.0
Durable goods	89.4	99.8	91.2	85.3	97.5	98.5	100.5	102.5
Nondurable goods	264.7	280.5	265.8	271.5	272.8	278.0	283.0	288.0
Services	262.6	284.6	265.1	270.2	276.1	281.5	287.5	293.5
Gross private domestic investment	135.7	148.1	138.3	137.1	142.4	148.7	147.1	154.4
Residential construction	29.7	38.6	29.2	32.2	35.8	38.2	39.6	40.9
Business fixed investment	102.6	106.1	103.6	101.3	105.1	106.0	106.5	107.0
Change in business inventories	3.5	3.4	5.5	3.6	1.4	4.5	1.0	6.5
Nonfarm	2.9	3.3	5.0	3.0	1.2	4.5	1.0	6.5
Net exports of goods and services	3.6	2.7	4.2	2.6	3.3	2.5	2.5	2.5
Gov't. purchases of goods & services	220.5	235.0	221.0	223.2	228.7	231.0	238.1	242.3
Federal	99.7	99.3	98.6	98.2	98.4	97.7	100.6	100.6
Defense	76.6	73.4	75.8	74.6	74.0	73.0	73.9	72.9
Other	23.1	25.9	22.9	23.5	24.5	24.7	26.7	27.7
State & local	120.9	135.7	122.4	125.0	130.2	133.3	137.5	141.7
Gross national product in constant (1958) dollars	724.1	741.1	727.4	720.3	732.7	738.0	742.0	751.8
GNP implicit deflator (1958 = 100)	134.9	141.8	135.5	137.4	139.3	140.9	142.7	144.1
Personal income	801.0	857.4	807.2	813.3	831.5	851.2	864.2	882.6
Wage and salary disbursements	540.1	576.5	543.8	545.2	560.6	570.2	580.9	594.4
Disposable income	684.8	734.9	693.0	697.2	715.1	731.5	740.7	752.4
Personal saving	50.2	50.7	52.7	51.8	49.8	54.3	50.1	48.7
Saving rate (per cent)	7.3	6.9	7.6	7.4	7.0	7.4	6.8	6.5
Corporate profits before tax	81.3	90.5	84.4	76.3	86.4p	89.5	91.0	95.0
Corp. cash flow, net of div. (domestic)	69.9	77.2	70.7	67.7	74.1p	76.3	77.9	80.6
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	194.8	208.5	194.9	191.7	200.8p	205.3	209.8	217.9
Expenditures	206.3	223.5	206.7	209.9	214.2	222.8	227.3	229.9
Surplus or deficit (-)	-11.5	-15.0	-11.8	-18.1	-13.3p	-17.5	-17.5	-12.0
High employment suprlus or deficit (-)	-0.8	0.3	-1.7	1.3	1.3	-1.8	-1.0	2.6
Total labor force (millions)	85.9	87.0	86.0	86.5	86.5	86.8	87.1	87.5
Armed forces "	3.2	2.8	3.1	3.0	3.0	2.9	2.8	2.7
Civilian labor force "	82.7	84.2	82.8	83.5	83.6	84.0	84.3	84.8
Unemployment rate (per cent)	4.9	6.2	5.2	5.9	5.9	6.2	6.4	6.4
Nonfarm payroll employment (millions)	70.7	70.9	70.5	70.2	70.6	70.8	70.9	71.1
Manufacturing	19.4	18.7	19.3	18.7	18.7	18.7	18.6	18.9
Industrial production (1957-59=100)	168.2	167.3	167.9	162.7	165.4	166.5	167.2	170.0
Capacity utilization, manufacturing (per cent)	76.6	72.8	76.2	72.4	73.1	72.8	72.3	72.8
Housing starts, private (millions A.R.)	1.43	1.97	1.51	1.78	1.81	1.95	2.05	2.08
Sales new domestic autos (millions, A. R.)	7.12	8.42	7.58	5.44	8.39	8.40	8.40	8.50

NOTE: Projection of related items such as employment and industrial production index are based on projection of deflated GNP. Federal budget high employment surplus or deficit (N.I.A. basis) are staff estimates and projections by method suggested by Okun and Teeters.

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1970	1971 Proj.	1970 III	1970 IV	1971 I	1971 Projection II	1971 Projection III	1971 Projection IV
	-----------------Billions of dollars-----------------							
Gross National Product	45.1	74.2	14.4	4.4	30.8	19.5	18.5	24.5
Inventory change	-5.0	-0.1	2.4	-1.9	-2.2	3.1	-3.5	5.5
Final purchases	50.2	74.3	11.9	6.3	33.0	16.4	22.0	19.0
Private	41.9	59.7	9.3	4.1	27.5	14.1	14.9	14.8
Excluding net exports	40.2	60.6	9.2	5.7	26.8	14.9	14.9	14.8
Net exports	1.7	-0.9	0.1	-1.6	0.7	-0.8	0.0	0.0
Government	8.3	14.5	2.6	2.2	5.5	2.3	7.1	4.2
GNP in constant (1958) dollars	-3.0	17.0	2.5	-7.1	12.4	5.3	4.0	9.8
Final purchases	1.2	17.3	0.9	-5.7	14.4	3.0	6.6	5.3
Private	7.2	18.6	1.6	-5.4	14.6	3.5	5.2	5.1
	-----------------In Per Cent Per Year-----------------							
Gross National Product	4.8	7.6	5.9[1]	1.8[1]	13.1[1]	7.6	7.1	9.3
Final purchases	5.4	7.6	4.9	2.6	13.4	6.4	8.5	7.2
Private	5.9	7.9	5.0	2.2	14.4	7.1	7.4	7.2
Personal consumption expenditures	6.8	7.8	5.0	3.1	12.4	7.2	7.9	7.7
Durable goods	-0.7	11.6	-3.0	-25.9	57.2	4.1	8.1	8.0
Nondurable goods	7.7	6.0	4.9	8.6	1.9	7.6	7.2	7.1
Services	8.7	8.4	8.0	7.7	8.7	7.8	8.5	8.3
Gross private domestic investment	-2.9	9.2	11.9	-3.5	15.5	17.7	-4.3	19.8
Residential construction	-7.2	30.0	11.3	41.1	44.7	26.8	14.7	13.1
Business fixed investment	3.3	3.4	3.1	-8.9	15.0	3.4	1.9	1.9
Gov't. purchases of goods & services	3.9	6.6	4.8	4.0	9.9	4.0	12.3	7.1
Federal	-1.6	-0.4	-4.4	-1.6	0.8	-2.8	11.9	0.0
Defense	-2.8	-4.0	-5.2	-6.3	-3.2	-5.4	4.9	-5.4
Other	2.2	12.1	0.0	10.5	17.0	3.3	32.4	15.0
State & local	9.1	12.2	12.5	8.5	16.6	9.5	12.6	12.2
GNP in constant (1958) dollars	-0.4	2.4	1.4[1]	-3.9[1]	7.1[1]	2.9	2.1	5.3
Final purchases	0.2	2.4	0.5[1]	-3.2[1]	8.1	1.6	3.6	2.9
Private	1.3	3.2	1.1[1]	-3.7[1]	10.1	2.4	3.5	3.4
GNP implicit deflator	5.3	5.1	4.6[1]	5.9[1]	5.6[1]	4.7	4.9[2]	3.9
Private GNP fixed weight index[3]	4.9	4.8	4.6[1]	4.9[1]	5.2[1]	4.6	4.1	3.9
Personal income	7.0	7.0	2.9	3.0	9.0	9.5	6.1	8.5
Wage and salary disbursements	6.1	6.7	3.2	1.0	11.3	6.8	7.5	9.3
Disposable income	8.4	7.3	5.5	2.4	10.3	9.2	5.0	6.3
Corporate profits before tax	-10.9	11.3	14.6	-38.4	52.9	14.4	6.7	17.6
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	-2.9	7.0	-2.4	-6.6	19.0	9.0	8.8	15.4
Expenditures	7.8	8.3	11.5	6.2	8.2	16.1	8.1	4.6
Nonfarm payroll employment	0.6	0.3	-2.0	-1.8	2.5	1.1	0.6	1.1
Manufacturing	-3.9	-3.4	-6.0	-13.1	1.1	0.0	-2.1	6.5
Industrial production	-2.7	-0.5	-3.3	-12.4	6.6	2.5	1.7	6.7
Housing starts, private	-2.6	37.7	70.3	70.1	7.4	31.2	20.3	6.4
Sales new domestic autos	-15.9	18.3	-18.3	-112.7	216.4	0.6	0.0	4.8

1/Compounded rates.

2/Excluding effects of military pay increase, 4.25 per cent.

3/Using expenditures in 1965-IV as weights.

<u>Industrial production</u>. Available output data for May are quite limited, but suggest the possibility of another month of small change in industrial production. If output of business and defense equipment declined about as much in May as in April, the rise in autos and steel, and, probably, in consumer staples would be more than offsetting, but not by much. If so, a larger increase in industrial production in May than in March and April would require a rise in production of consumer durable goods other than autos and in such materials as textiles, chemicals, and construction materials other than steel mill products.

Auto assemblies in May are estimated to have been at an annual rate of about 8.5 million units, up 5 per cent from April and not quite equivalent to a .2 of one point increase in the total production index. June output schedules indicate little change from the May rate. Output of raw steel rose 1 per cent further in May but production of steel mill products probably increased about 4 per cent, the same as in April, and equivalent to about .3 of a point rise in the total production index. Some cutbacks in raw steel production in June have been announced by several mills (a seasonal decline of 5 per cent in output from May to June is usual) but reductions in steel mill finishing operations have not yet been announced. Output of television sets, which rose 25 per cent from February to April, changed little in the first two weeks of May. Other weekly data for the first two weeks of May suggest little change in production of paper and crude oil and declines in coal and refined petroleum products.

INDUSTRIAL PRODUCTION
1957-59=100, seasonally adjusted

	1969	1971			Per cent change	
	July1/	Feb.	March	April	July 1969 to April 1971	QIV 1970 to QI 1971
Total index	174.6	165.2	165.5	166.0	-4.9	1.7
Consumer goods	164.4	164.6	166.2	166.7	1.4	4.0
Autos	178.7	168.1	167.3	153.9	-13.9	71.2
Home goods	184.4	175.9	180.2	185.0	.3	-.3
Apparel & staples	158.1	161.2	162.3	163.0	3.1	1.3
Business equipment	196.9	173.0	170.5	169.8	-13.8	-3.1
Defense equipment	169.9	113.1	112.2	107.5	-36.7	-4.5
Materials, total	176.5	167.8	168.0	169.1	-4.2	1.8
Durable	167.0	150.3	151.4	152.6	-8.6	4.2
Steel	145.3	132.9	138.3	143.8	-1.0	11.1
Nondurable	186.4	185.8	185.2	186.3	- .1	.0

1/ Pre-recession peak.

Retail sales. Retail sales in May were about 0.5 per cent lower than in April, according to estimates based on data for three weeks. Sales of durable goods may have fallen by about 3 per cent--largely because of a decline in the automotive group. Excluding autos and nonconsumer items (lumber, building materials, and farm equipment), sales may have increased between 1/2 and 1 per cent. Nondurable goods sales are estimated to have risen 1/2 to 1 per cent, mainly because of apparel and foods. General merchandise sales apparently were unchanged. Compared with a year earlier, total sales were up about 5-1/2 per cent.

RETAIL SALES
Seasonally Adjusted
Percentage change from previous period

	1971					
	QI	Jan.	Feb.	March	April	May*
Total sales	4.1	2.2	1.5	1.8	.5	- .5
Durable	13.2	9.5	3.2	3.5	1.4	-3.0
Auto	24.1	16.3	7.2	4.7	1.6	-5.5
Furniture & appl.	5.3	6.1	- .2	2.7	.7	.0
Nondurable	.5	- .7	.7	1.0	.1	.8
Apparel	-1.5	-2.2	1.7	.9	.5	2.0
Food	.9	- .4	- .6	.9	- .1	2.0
General merchandise	3.1	- .2	3.1	1.7	- .4	.0
Total less autos and nonconsumer items	.5	- .4	.6	1.0	.1	.8
Total real**	3.3	2.1	1.4	1.4	.1	n.a.

* Estimated from three weeks data.
** Deflated by all commodities CPI, seasonally adjusted.

Unit auto sales and stocks. Sales of new domestic type autos in the first 20 days of May were at an annual rate of 8.2 million units, little changed from the rate prevailing since January but 8 per cent above a year earlier.

Dealers inventories, which have been rising since January, at the end of April totaled 59 days supply compared to 57 days a year ago.

Consumer surveys. The latest surveys by the Michigan Survey Research Center (SRC) and the Conference Board (CB) reaffirm the more optimistic findings of their reports earlier this year. The Conference Board in the March-April survey reported a significant improvement in buying plans for homes, autos, and major appliances; this continues an upturn first indicated by the January-February survey. The SRC also reported that the index of consumer sentiment increased from 78.2 in February to 81.6 in May, raising the index 6 percentage points above the November 1970 low.

There are a number of conflicting items in the survey results, however. Michigan reported that intentions to buy new cars were only moderately higher than the very low level a year earlier and an additional question suggests that high car prices are depressing purchase plans. The Conference Board reported a deterioration in consumer attitudes about both current and expected economic conditions. The percentage of respondents saying that business conditions were bad and that jobs were hard to get increased greatly as compared with both the previous survey and that of a year earlier. In looking ahead six months, more families expected worse business conditions and fewer job opportunities than in the previous survey.

Reduced pessimism, rather than increased optimism, appropriately describes the change in the Michigan index of sentiment between February and May. The proportion of families expecting bad times during the next 12 months declined and not as many people believe that they are financially worse off than a year ago. While more people think business conditions are better than a year earlier, the proportion saying business is worse than a year ago still exceeds the proportion saying it is better.

CONFERENCE BOARD
CONSUMER EXPECTATIONS AND INTENTIONS
Seasonally adjusted - percentage of households

	1970			1971	
	March-April	Sept.-Oct.	Nov.-Dec.	Jan.-Feb.	March-April
		Plans to Buy Within 6 Months			
Automobile	9.4	7.5	7.2	8.0	8.8
Home	2.1	2.6	2.1	2.6	3.1
Major appliances	35.9	32.8	33.2	35.2	40.2
		Appraisal of Present Situation			
Business conditions					
Good	22.2	14.6	13.8	12.9	12.8
Bad	18.3	25.3	35.0	31.2	36.2
		Expectations for 6 Months Hence			
Business conditions					
Better	20.7	22.3	24.8	27.1	25.0
Worse	14.3	11.5	14.3	12.0	13.5
Income					
Increase	27.1	23.8	23.8	22.1	23.7
Decrease	7.4	7.9	8.3	8.1	7.2

MICHIGAN SURVEY RESEARCH CENTER
INDEX OF CONSUMER SENTIMENT
February 1966 = 100

Date of Survey	Index
1970	
May	75.4
August	77.1
November	75.4
1971	
February	78.2
May	81.6

Construction and real estate. New construction put in place, which was revised upward 1 per cent to a new peak for April, changed little in May. Within the private sector, outlays for residential structures slightly eclipsed the previous high reached in April and were more than two-fifths above the low in July of 1970. Expenditures for non-residential construction as a whole remained very close to the improved rate which has prevailed since January. Outlays for public construction--very largely State and local projects--declined somewhat from the downward revised rate now reported for April and earlier months this year and were 5 per cent below the record rate in December.

Total outlays for May were 16 per cent above a year earlier. However, with construction costs still continuing to rise rapidly, the year-to-year advance in constant dollars amounted to 7 per cent as measured by the Census Bureau.

NEW CONSTRUCTION PUT IN PLACE
(Seasonally adjusted annual rate)

	All	Private Total	Private Residential	Private Non-residential	Public
			Billions of dollars		
1970 - Annual	91.3	63.1	29.3	33.8	28.3
1970 - IVQ (r)	94.8	65.3	31.9	33.4	29.5
1971 - IQ (r)	101.6	71.0	35.6	35.3	30.6
1971					
March (r)	102.2	72.2	36.9	35.3	30.0
April (r)	104.5	73.7	38.1	35.7	30.8
May (p) 1/	104.4	73.8	38.3	35.5	30.6
	Per cent change in April from a year earlier				
In current dollars	+16	+18	+31	+6	+13
In 1957-59 dollars	+7	+9	+24	-4	+1

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

Seasonally adjusted private housing starts dipped in April, but at 1.9 million units, the annual rate was one of the highest on record. Moreover, single-family starts continued moderately upward for the third successive month; and while multifamily starts declined, their April rate was second only to the all-time peak--822 thousand--reached in March.

With mortgage commitments outstanding at savings and loan associations continuing to expand and building permits high, some further over-all increase in housing starts is indicated over the near term, probably enough to push the second quarter average toward a 1.95

million rate. If attained, this would mark a rise of more than 50 per cent from the low in the first quarter of 1970. In the first quarter of this year, the expansion had already amounted to 45 per cent.

PRIVATE HOUSING STARTS AND PERMITS
(Seasonally adjusted annual rates, in thousands of units)

	Starts			Permits
	Total 1/	Per Cent Single-family	Per Cent FHA-insured 2/	
		(Census Bureau)	(FHA Seried)	
1970 - Annual	1,434	57	29	1,324
1970				
IQ	1,252	54	23	1,085
IIQ	1,286	58	28	1,257
IIIQ	1,512	56	28	1,358
IVQ	1,777	58	35	1,593
1971				
IQ	1,810	55	24	1,608
1971				
February (r)	1,754	56	27	1,563
March (r)	1,950	55	20	1,627
April (p)	1,903	57	22	1,618

1/ Apart from starts, mobile home shipments for domestic use in March--the latest month for which data are available--were at a seasonally adjusted annual rate of 419,000, 4 per cent higher than in the previous month as well as the average in 1970.
2/ Based on unadjusted totals for all periods. FHA-insured starts include both subsidized and nonsubsidized units.

Seasonally adjusted sales of new homes by speculative builders soared to a new peak in March and were four-fifths above the reduced rate of a year earlier. Stocks of homes held for sale by such builders meanwhile continued little changed from last year's lows. Used home sales, an important support to new-home demands, were also exceptionally high in March, according to the National Association of Real Estate Boards.

The surge in sales through March, the latest month for which data are available, was apparently associated with some upgrading in the composition of demands under the more favorable financing terms prevailing. Reflecting this development as well as further increases in construction and land costs, the median price of new homes sold in March--at $24,100--was almost a tenth higher than it was last October. Even so, it was still no higher than a year earlier and about $2,000 below the reduced median price of new homes available for sale. At the same time, the median price of used homes sold in March was $24,270--6 per cent above a year earlier and somewhat more than the year-to-year rise averaged during 1970.

Manufacturers' orders and shipments. New orders for durable goods declined 3.7 per cent in April, according to preliminary data, following a smaller March decline. In addition to expected reductions at motor vehicle plants and iron and steel companies, orders for capital equipment dropped to the lowest point since last October. Orders for household durables showed a modest further increase, but all other groups were down. When autos, steel, and defense are excluded--to obtain a series for private demands for durable goods relatively free from special influences--the remaining components of orders declined in April from an advanced March level but remained slightly above the levels that prevailed from January 1970 through February 1971. Durable goods prices have continued to increase, however, and in constant dollars these orders may still be declining.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
Seasonally adjusted monthly averages

	1970	1971			
	Q IV	Q I (prel.)	March (rev.)	April (advance)	Change, April from March
	-------Billions of dollars-------				-Per cent-
Durable goods, total	29.4	31.7	31.8	30.6	- 3.7
Excluding autos, steel, and defense	21.9	22.4	22.9	22.3	- 2.7
Primary metals	4.6	5.2	5.2	5.0	- 3.7
Motor vehicles and parts	3.2	4.6	4.8	4.4	- 8.1
Household durable goods	2.1	2.2	2.3	2.3	1.6
Defense products	2.1	2.0	1.6	1.5	- 5.8
Capital equipment	8.7	8.8	8.9	8.4	- 5.6
All other durable goods	8.8	8.8	9.0	8.9	- .5

NOTE: Detail may not add to totals because of rounding. Per cent changes calculated from unrounded data.

Total shipments of durable goods declined and unfilled orders were off 1.5 per cent, following a March decline of 0.4 per cent.

<u>Inventories</u>. Book value of manufacturers' inventories rose at a $1.5 billion annual rate in April (preliminary), after a $1.2 billion (revised) decline in March. The March decline was not so sharp as had been indicated by preliminary data. The April increase in durable goods was all in sectors affected by steel stockpiling.

CHANGE IN BOOK VALUE OF MANUFACTURERS' INVENTORIES
(Seasonally adjusted annual rate)
Billions of dollars

	1970 Q IV	1971 Q I (rev.)	1971 March (rev.)	1971 April (prel.)
Manufacturing, total	3.8	- .8	-1.2	1.5
Durable	.9	- .8	.1	2.2
Materials	1.5	.9	.2	2.1
Nondurable	2.9	.0	-1.3	- .7

The April inventory-shipments ratio for manufacturing was unchanged from the reduced March level, with a decline at nondurable goods plants offset by an increase at durable goods establishments. The increase in the durable goods ratio reflected steel stockpiling and a sharp drop in shipments of durable goods other than iron and steel, particularly autos and capital equipment. In spite of the April increase, the level of durable materials stocks does not appear higher relative to shipments than in the 1965 and 1968 stockpiling periods. Relative to unfilled orders, however, materials and total durable goods inventories were higher and rising faster than in 1965 or 1968.

MANUFACTURERS' INVENTORY RATIOS

	1970 March	1970 April	1971 March (rev.)	1971 April (prel.)
Inventories to shipments				
Manufacturing, total	1.76	1.79	1.70	1.70
Durable	2.16	2.18	2.04	2.06
Materials to end product shipments	.92	.92	.88	.91
Nondurable	1.28	1.33	1.29	1.27
Inventories to unfilled orders				
Durable manufacturing	.769	.786	.812	.826
Materials to end product orders	.298	.306	.329	.335

Retail dealers' stocks of new autos changed little in April, but sales declined and the stock-sales ratio rose above year-earlier levels.

Cyclical indicators. The preliminary Census composite index of leading indicators rose 1.4 per cent in April. In addition, the March increase is now reported to be 2.1 per cent, revised up from the preliminary rise of .6 per cent. The April index is 9 per cent above its October 1970 low. The coincident and lagging composites rose slightly in April.

The rapid increase in the leading composite since October reflects rebounds of several leading indicators from GM-strike lows as well as apparent cyclical upturns in a number of series not affected by the strike. The magnitude of the recovery in the leading composite has not been a reliable indicator of the magnitudes of cyclical recovery in the economy in previous cycles, and the presence of the strike-rebound factor in the recent data make it even more difficult to gauge the significance of this indicator with respect to prospective rates of recovery.

COMPOSITE CYCLICAL INDICATORS
(1967 = 100)

	12 Leading Trend Adjusted	5 Coincident	6 Lagging
1970:			
October	113.8	118.8	130.8
November	114.1	117.9	128.9
December	116.3	119.1	128.9
1971:			
January	118.5	121.1	129.2
February	119.9	121.8	130.1
March	122.4	122.3	130.8
April (Prel.)	124.1 (H)	122.5 (H)	130.9

(H) Current high value. The lagging composite reached its high in September 1970.

The revisions of the first quarter leading composites reflected mainly the inclusion of corporate profits for the quarter and fairly strong increases in March in net business formation, inventory change, and the change in consumer instalment debt. The rise in the preliminary April composite came from initial unemployment insurance claims, contracts and orders for plant and equipment, industrial materials prices, common stock prices, and the ratio of price to unit labor cost. There were declines in the manufacturing workweek, new orders for durable goods, and housing permits.

In May, according to preliminary averages, both materials prices and common stock prices declined.

Plant and equipment. The May Commerce-SEC survey indicates that business plans a 2.7 per cent increase in 1971 spending for new plant and equipment. The February survey had indicated an increase of 4.3 per cent.

All of the downward revision is in manufacturing where a decline of 4.2 per cent in expenditures is now anticipated for 1971--rather than the no change expected earlier. Within manufacturing, large downward revisions are reported in the electrical and nonelectrical machinery, aircraft, food and beverages, and chemicals industries. Non-manufacturing, as a whole, still indicates a 7.3 per cent planned gain. However, transportation firms--especially airlines--and gas utilities now expect larger declines than in February, while commercial and other firms have increased their anticipated spending.

PLANT AND EQUIPMENT EXPENDITURES
(Per cent change from prior year)

	1969 Actual	1970 Actual	1971 Dec. plans	1971 Feb. plans	1971 May plans
Total	11.5	5.5	1.4	4.3	2.7
Manufacturing	11.7	.9	-2.7	- .3	-4.2
Durable goods	13.0	-1.0	-3.1	-2.5	-7.2
Nondurable goods	10.3	2.7	-2.4	1.9	-1.4
Nonmanufacturing 1/	11.4	8.8	4.1	7.4	7.3
Transportation	8.0	- .2	-16.8	-7.8	-17.2
Public utilities 1/	13.8	13.2	14.3	17.5	16.6
Electric	16.7	19.1	18.7 2/	22.4 2/	21.0 2/
Communications	21.5	21.7	14.0 2/	10.3 2/	11.2 2/
Commercial and other	6.0	3.4	-2.0 2/	3.8 2/	6.8 2/

1/ Includes series not shown separately.
2/ Confidential, not published separately.

Spending in the first quarter of 1971 was $1.2 billion less than business had anticipated with the shortfall concentrated in airlines, utilities and communications firms. A sharp increase is expected in the second quarter, however, as nonmanufacturing concerns make up their first quarter shortfall. Thereafter, little change is anticipated in most industries.

QUARTERLY PATTERN OF EXPENDITURE
FOR NEW PLANT AND EQUIPMENT
(Billions of dollars, seasonally adjusted, annual rates)

	1970		1971			
	III	IV	I	II	III	IV
	Actual		Actual	Anticipated		
Total	81.9	78.6	79.3	82.4	82.8	82.7
[Addendum: Total as shown in February 1971 survey	81.9	78.6	80.6	82.5	84.6]	
Manufacturing	32.2	31.0	30.5	30.5	30.7	30.7
Durable goods	15.7	14.9	14.2	14.7	14.9	14.9
Nondurable goods	16.4	16.1	16.3	15.9	15.8	15.8
Nonmanufacturing	49.7	47.7	48.9	51.8	52.2	52.0

Continued weakness in capital spending is also suggested by the latest Conference Board survey of manufacturers appropriations for new plant and equipment. Manufacturers reduced appropriations by 6 per cent in the first quarter--the sixth decline in the last seven quarters. However, excluding petroleum appropriations (which are quite volatile) the total showed an increase of about 2-1/2 per cent in the first quarter. Appropriations by durable goods producers were off by about 3 per cent.

MANUFACTURERS NEW CAPITAL APPROPRIATIONS
(Seasonally adjusted)

	1971	1970				1971
	Ip	I	II	III	IV	Ip
	Millions of $	Per Cent Change From Preceding Quarter				
All manufacturing	5,618	-13.4	-1.1	1.6	-9.3	-6.4
Ex petroleum	4,438	- 3.5	- .5	-3.6	-14.0	2.6
Durable goods	2,628	-10.6	-2.2	3.8	-18.9	-3.1
Nondurable goods	2,990	-15.9	.0	- .5	.5	-9.1

Labor market. The labor market continues slack. In May, initial claims for unemployment insurance benefits continued at about the same level as in earlier months of the year, but insured unemployment apparently moved up further.

STATE INSURED UNEMPLOYMENT
(Seasonally adjusted, in thousands)
Weekly averages for month

	Initial claims	Insured unemployment
1970:		
April	326	1,650
May	314	1,885
October	340	2,371
November	334	2,388
December	292	2,158
1971:		
January	283	1,993
February	284	2,008
March	297	2,060
April	283	2,120
May*	290	2,210

* Estimated by FR staff on basis of weekly data.

Total unemployment increased by over 2 million from December 1969 to December 1970. But thus far in 1971 the overall unemployment rate has shown relatively little change. Between December 1969 and this past April, the jobless rate for men aged 25 and over rose from 1.9 per cent to 3.5 per cent and among men aged 20 to 24 years from 5.8 per cent to 10.5 per cent, partly reflecting large reductions in the Armed Forces and the return of veterans to the civilian labor force. Between the first quarters of 1970 and 1971, the jobless rate of 20 to 24 year-old veterans rose to 14.6 per cent from 9.1 per cent while the rate for nonveterans of the same age rose to 10.8 per cent from 7.3 per cent (not seasonally adjusted).

Unemployment increases have been widespread among occupations. Cutbacks in aerospace and defense expenditures have contributed to an unusually large rise in joblessness among white-collar workers, whose rate increased from 2.1 per cent in December 1969 to 3.8 per cent this April, equalling the highest rate since the series began in 1958. The rate for professional and technical workers was 3.3 per cent in April, more than three times as high as at its lowest point back in 1968 when demands for professional workers were strong. The blue-collar rate moved from 4.4 to 7.4 per cent over this period.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted, in per cent)

	December 1969	April 1970	April 1971
Total	3.6	4.7	6.1
Men aged 20-24 years	5.8	7.8	10.5
25 years and over	1.9	2.6	3.5
Women aged 20-24 years	6.3	7.6	10.3
25 years and over	3.1	3.8	5.0
Teenagers	12.1	15.3	17.2
White	3.3	4.2	5.6
Negro and other races	5.8	8.3	10.0
White-collar workers	2.1	2.8	3.8
Blue-collar workers	4.4	5.6	7.4
Service workers	3.7	4.9	6.3

A relatively new measure of labor market conditions is the BLS series on job vacancies in manufacturing. Monthly data are now available (unadjusted) since April 1969. These vacancy data confirm that job openings are extremely scarce and have not increased since the turn of the year. In March, vacancies comprised only .4 per cent of all manufacturing job slots, about the same percentage as in the preceding four months but down by half from the .8 per cent rate in March 1970. Vacancy rates were down by half or more from a year earlier in the machinery, transportation equipment and primary metals industries. Nearly one-third of job vacancies in March were in the apparel and textiles industries, with another one-fifth in the remaining soft-goods industries. Durable goods manufacturers accounted for about 45 per cent of all vacancies, down from about 55 per cent a year earlier.

Collective bargaining. The major aluminum companies and 40,000 workers agreed to a new three-year contract on May 31. The settlement parallels the wage provisions of the can industry settlement but apparently provides greater improvements in fringe benefits. The more liberal fringe benefits in the aluminum contract result from larger pension and insurance increases, a 25-cent an hour bonus for week-end work and a winter vacation bonus. Wage increases total an estimated $1.11 (9 per cent a year) over the life of the contract. As in the can settlement, the wage package includes an unlimited cost-of-living escalator clause effective in the second and third contract years with a guaranteed minimum 12.5 cent adjustment in both years. The first-year wage increase is 50 cents or close to 14 per cent. Changes in job classifications are estimated to add 11 cents to wages over the contract term.

Congress passed emergency legislation on May 18 to halt a two-day strike by 10,000 railroad signalmen. The new strike ban, which extends until October 1, also provided a 13.5 per cent retroactive wage increase; 5 per cent is retroactive to January 1, 1970 and 8-1/2 per cent retroactive to November 1, 1970. The retroactive pay increase closely followed the wage package recommendations of the Presidential emergency board.

The likelihood of local and national telephone company strikes increased as the Communication Workers Union rejected the company's proposed pattern offer in the Washington, D.C. area of an 11 per cent first-year wage increase and 3 per cent increases plus a cost-of-living escalator clause effective in the second and third contract years. The union immediately called for a strike vote of its 450,000 members, with any walkout likely to occur about June 14.

The Construction Industry Stabilization Committee issued a formal opinion on May 16 in which it approved a three-year settlement by a painter's union in Little Rock, Arkansas. The contract provided for a 13-1/2 per cent first-year wage increase, 11.9 per cent the second year and 10.6 per cent the third year. The opinion stated that these increases do not set "new and relatively higher rates" and "preserve the traditional craft relationships". The Committee also approved deferred increases of up to 14.5 per cent effective this year under contracts negotiated earlier by most other construction crafts in the area. Deferred increases effective in 1971 under prior major contract settlements in the construction industry average 13.3 per cent.

Wages. Wage rates in manufacturing rose rapidly in the first quarter of 1971 and the increase over a year ago was the largest since 1951. Average hourly earnings exclusive of overtime and the effects of interindustry employment shifts were up 7.0 per cent from a year earlier. In the corresponding periods of 1968, 1969, and 1970, the increases were about 6 per cent.

AVERAGE HOURLY EARNINGS
(Seasonally adjusted)

	Per Cent Increase From: First Quarter A Year Earlier			
	1968	1969	1970	1971
Manufacturing	5.8	6.0	5.6	6.5
Excluding effects of overtime and interindustry shifts	5.9	5.9	6.1	7.0
Trade, wholesale and retail	6.2	6.6	6.6	5.8
Services	6.1	7.7	8.2	7.8

The recent more rapid rise in manufacturing hourly earnings partly reflects the emphasis on large first-year increases in long-term contract settlements reached late in 1970 and early in 1971 in the automobile, farm and construction equipment and can industries. First-year increases in the auto worker settlements averaged about 12-1/2 per cent, with most of the rise specifically designated as a "catch-up" for the rise in consumer prices over the three-year term of the previous contract.

Largely as a result of the wage increase in the auto industry late last year, hourly earnings exclusive of overtime pay were up 9-1/2 per cent in March from a year earlier in the transportation equipment industry compared with a 6 per cent rise in each of the preceding three years. In contrast, the rate of increase in wages in the less-unionized and lower-wage manufacturing industries has slackened somewhat.

In some important nonmanufacturing industries, increases in average hourly earnings do not appear to have accelerated. In trade, the increase in the first quarter from a year earlier was less than over the preceding year. In the service industries, the rise in average hourly earnings was close to the 8 per cent increase of the previous year.

Consumer prices. In April consumer prices increased at an annual rate of 3.4 per cent, continuing the slower rate of rise that has characterized previous months this year. Although improvement has been due mainly to the decline in mortgage interest rates, prices of both durable and nondurable goods--except foods--have risen at slower rates this year. Among nondurables, declines in gasoline prices have been an important factor. Among durable goods, the steep rise in home purchase prices has abated and new car prices have receded more than seasonally from the January peak. (The unusual, sharp January increase reflected delayed incorporation of 1971 models into the sales mix.)

CONSUMER PRICES
(Percentage change at seasonally adjusted annual rates)

	Dec. 1969 to Dec. 1970	Dec. 1970 to Mar. 1971	Mar. 1971 to April 1971
All items	5.5	2.8	3.4
Food	2.2	6.0	10.7
Commodities less food 1/	4.8	1.0	2.1
Apparel	3.7	1.0	4.1
Gasoline 2/	2.6	-5.8	-21.4
New cars	6.7	4.7	.0
Used cars 2/	7.4	-9.5	39.5
Services	8.2	3.2	1.9

1/ Includes items not listed.
2/ Not seasonally adjusted.

Note: Seasonally adjusted rates are based on revised seasonal factors.

On the unfavorable side, food prices, which were relatively flat during most of last year, rose steeply in March and April. Higher prices for fresh vegetables and fruits were a major factor in both months; in April cereal and bakery products advanced rapidly. Increases of these magnitudes are not expected to continue, but the trend over the remainder of the year may compare unfavorably with 1970.

The cost of services, excluding home finance, has advanced faster this year than last, but the rise in April was more moderate than the average over the first quarter. Nevertheless, substantial increases continued in April for medical care, rent, and home maintenance and reapirs, while insurance and residential gas rates rose sharply.

Estimates of the effect of mortgage interest costs on the CPI furnished by the BLS for confidential use show that if these costs are excluded the average annual rate of price rise over the first four months of this year amounts to 4.4 per cent, 1.6 percentage points more than the official CPI. In 1970, in contrast, when mortgage costs were rising, their exclusion reduces the price increase from 5.5 per cent to 5.1 per cent. (The December-April change, based on unadjusted indexes, is only slightly affected by seasonal factors; for all items the seasonally adjusted figure is 0.1 per cent higher at an annual rate.)

EFFECTS OF MORTGAGE COSTS ON CONSUMER PRICES
(Percentage changes at annual rates, not seasonally adjusted)

	Dec. 1969 to Dec. 1970	Dec. 1970 to April 1971
All items, CPI	5.5	2.8 2/
All items less mortgage costs 1/	5.1	4.4
Services	8.2	2.9
Services less home finance 1/3/	7.0	7.9

1/ Confidential.
2/ Seasonally adjusted, 2.9.
3/ Excludes mortgage interest costs, property taxes and homeowners' insurance.

Price indexes for GNP. GNP price indexes suggest little abatement recently in the pace of overall price advance. The GNP deflator increased in the first quarter at an annual rate of 5.6 per cent, somewhat below the fourth quarter rate. But a large favorable shift in weights, as production and sales of automobiles recovered, helped to moderate the rise in the deflator, offsetting the effects of the Federal pay raise. A fixed-weighted price index for private GNP, which is not affected by these factors, rose at an annual rate of 5.2 per cent in both the fourth and first quarters. One reason for the continued rapid rate of price rise in the first quarter was a sharp climb in farm and food prices, following a three-quarter decline.

GNP PRICE INDEXES
(Percentage changes from previous quarter at seasonally adjusted annual rates)

	1969		1970				1971
	III	IV	I	II	III	IV	I
GNP Deflator	5.6	4.9	6.4	4.3	4.6	5.9	5.6
Private GNP: fixed-weighted index 1/	5.1	4.8	4.8	4.8	4.6 2/	5.2 2/	5.2 2/

1/ Fourth quarter of 1965 weights.
2/ Confidential.

The cost of fixed investment, which had been accelerating throughout 1969 and 1970, did slow notably in the first quarter of 1971. A reduced price rise for producers' equipment reflected the leveling off in automotive product prices after the large fourth-quarter increase. The slowdown in the construction sector was very sharp, but probably temporary in view of climbing wage rates and materials prices.

PRICE CHANGES IN PRIVATE FIXED INVESTMENT
(Seasonally adjusted annual rates computed from fixed-weighted indexes 1/)

	Four-quarter change to: Q IV 1969	Four-quarter change to: QIV 2/ 1970	One-quarter change to: 1970 QIII 2/	One-quarter change to: 1970 QIV 2/	One-quarter change to: 1971 QI 2/
Private fixed investment	5.3	6.6	8.4	7.5	4.3
Non-residential structures	8.5	10.2	13.4	11.7	6.1
Producers' durable equipment	3.6	4.9	4.4	6.8	3.6
Residential structures	5.1	5.7	9.6	4.1	3.4

1/ Fourth quarter of 1965 weights.

2/ Confidential.

An accelerated price rise in the personal consumption sector offset the slowing in the investment area last quarter. This reflected in part large automobile price increases early in the quarter. Food prices also rose more rapidly, offsetting a slower rise for other nondurables. Service costs rose at a record rate.

PRICE CHANGES IN PERSONAL CONSUMPTION EXPENDITURES
(Seasonally adjusted annual rates computed from fixed-weighted indexes 1/)

	Four-quarter change to: Q IV 1969	Four-quarter change to: Q IV 2/ 1970	One-quarter change to: 1970 Q III 2/	One-quarter change to: 1970 Q IV 2/	One-quarter change to: 1971 Q I 2/
Personal consumption expenditures	4.7	4.5	3.9	4.9	5.2
Durable goods	2.5	3.5	3.8	6.4	7.1
Nondurable goods	5.1	3.5	2.4	2.9	2.9
Services	5.0	6.0	5.6	6.4	7.1

1/ Fourth quarter of 1965 weights.

2/ Confidential.

<u>Comparison of CPI with the PCE price index.</u> The continued rapid increase in the GNP fixed-weight index for the consumer sectors in the first quarter contrasts markedly with the slowing of the Consumer price index. This contrast is largely the result of differences in the coverage of the two measures. The CPI includes mortgage interest costs, which rose steeply in 1969 and part of 1970 preceding a sharp drop in early 1971. Interest and other home financing costs are not directly reflected in the PCE price index, which uses the slower-rising rent index to indicate price movements for both owner- and tenant-occupied housing. Prices of new and used homes are also excluded from the PCE index but included in the durable goods component of the CPI. (Indirectly they also affect the estimate for mortgage financing costs). Home prices rose sharply in 1969 and 1970, but much less so this year. A third inclusion in the CPI but not in PCE is used cars, which have contributed very substantially to the occasionally erratic movement of the CPI in the last 2 years, but have had little effect on the trend.

An approximate adjustment for these differences in coverage can be made by using confidential series for the durables and service components and making some compensating changes in weights. The "modified CPI" so obtained (see Table below) shows changes much closer to those of the PCE fixed-weight price index.

Sensitive materials prices. Two sensitive indicators of price change are: (1) the index of prices of sensitive industrial materials prepared by the staff of the Federal Reserve Board using BLS data and (2) the index of raw industrial prices published by the Bureau of Labor Statistics as part of the Bureau's Tuesday Spot Market Price Indexes and Prices. The BLS weekly index is now an unweighted geometric average of Tuesday spot prices for 13 commodities. The FRB monthly index has a broader commodity coverage and is a weighted arithmetic average incorporating BLS price aggregates (i.e., weighted prices) which are not available until after the wholesale price index for a given month is released. The FRB index is less volatile than the BLS index, primarily because it includes a substantial weight of fabricated products.

Although the two indexes differ greatly in coverage and weighting, they have traced broadly similar patterns of price movements in recent years. Following an extended period of decline last year, both indexes climbed fairly consistently through April of this year. The movements of both series reflect to a considerable degree price changes in nonferrous metals. Nonferrous metals have a weight of more than one-third in the FRB index and nearly one-third in the BLS index, where they are represented by 4 series, 3 of which are highly volatile scrap metals.

The most important differences in coverage between the two indexes is lumber and plywood, which has a large weight in the FRB index but is not included in the BLS index. The strong rise in prices

Foreign agricultural trade. Exports of farm products are soaring to a new high this fiscal year, led by record shipments of soybeans and soybean products and by the largest movement of grains since the world food crisis of 1966. Through March, value of exports was 18 per cent above a year earlier, reflecting increases both in quantities shipped and in prices received. Value of imports was also moderately higher, due to higher prices, as volume was down slightly from last year. Reduced volume of imports of beef, coffee, tea, crude rubber and wool were offset in part by larger imports of sugar, cacao, bananas and nuts.

U. S. FOREIGN AGRICULTURAL TRADE
July-March 1970-71

	Value (mil. dol.)	Percentage change from year earlier		
		Value	Quantity	Price (derived) 1/
Exports, total	5,877	18.0	11.4	5.9
Grains & feeds	2,112	19.2	13.3	5.3
Veg. oils & oilseeds	1,540	29.5	12.8	14.8
Animal products	684	13.9	14.9	-0.9
Tobacco, unmfg'd	441	-1.9	-5.6	3.9
Cotton & linters	345	42.8	33.3	7.1
Fruits & vegetables	405	0.2	-6.4	7.0
Imports, total	4,271	3.3	-2.0	5.3
Supplementary (Meat, sugar, etc.)	2,698	5.9	2.1	3.7
Complementary (Coffee, cacao, rubber, etc.)	1,573	-0.9	-8.2	7.9
Agricultural trade balance	1,616 3/	89.0	n.a.	n.a.
Net contribution to balance of payments	1,183 2/	175.8	n.a.	n.a.

Source: May 1971 issues of two USDA-E.R.S. publications--Foreign Agricultural Trade of the U.S., and Foreign Gold and Exchange Reserves.

1/ Aggregate values/quantity indexes.

2/ Agricultural trade balance minus noncommercial exports plus amounts recouped from earlier credit and P.L. 480 transactions. July-December contribution was $766 million and January-March, an estimated $417 million.

3/ $1,696.1 including preliminary April data, 82% above a year earlier.

Terms of trade (export/import price ratios) were more favorable than last year with export prices rising from late fall onward and import prices edging down in the spring. The margin of farm exports over imports widened to \$1.6 billion (\$1.7 billion including preliminary April data) from \$0.9 billion in the comparable period last year. All of the increase in exports this year has been in commercial sales. The proportion of exports under P.L. 480 programs declined from 15 per cent of the total to about 10 per cent. Agriculture's net contribution to the U.S. balance of payments amounted to almost \$1.2 billion, nearly triple the July-March contribution a year earlier.

A major development this year is the sharply expanded demand for grains for food and livestock feed in the developed countries. Poor wheat crops and low carry-in stocks increased demand for U.S. wheat by the European countries and the third countries usually supplied by them. Exports of wheat through March amounted to 513 million bushels compared with 385 million last year. Despite prices a fourth above last year, U.S. corn exports were only 13 per cent below last year's record shipment, and larger exports of other feed grains boosted total feed grain tonnage to 6 per cent above last year. Soybean and soybean products benefited from short supplies of competing products. Through March, shipments of soybeans were up 12 per cent, meal and cake, up 17 per cent, and oil, up 59 per cent. Cotton exports are up a third from a year ago, reflecting smaller export availabilities in competing countries, smaller mill stocks in major exporting countries, and slightly higher consumption. However, tight supplies of the short staples wanted by foreign mills for blending with synthetic fibers are limiting expansion of our exports.

CONSUMER PRICE INDEXES

(Percentage changes at seasonally adjusted annual rates

	Four-quarter change to:			One-quarter change to:				
				1970				1971
	QIV 1968	QIV 1969	QIV 1970	Q I	QII	QIII	QIV	Q I
All items:								
PCE 1/	4.2	4.7	4.5	5.0	4.4	3.9	4.9	5.2
CPI-modified 2/	4.3	4.8	4.6	6.1	4.6	3.6	4.9	5.1
CPI	4.7	5.8	5.6	6.8	6.0	4.4	5.4	3.8
Durable goods:								
PCE 1/	2.9	2.5	3.5	2.5	1.5	3.8	6.4	7.1
CPI-modified 2/	3.0	2.7	3.7	2.8	2.1	3.9	6.2	6.6
CPI	2.8	4.2	5.4	3.7	5.6	5.5	6.9	3.9
Nondurable goods:								
PCE 1/	4.3	5.1	3.5	4.9	3.7	2.4	2.9	2.9
CPI	4.4	5.3	3.7	5.9	4.0	2.1	3.2	2.5
Services:								
PCE 1/	4.5	5.0	6.0	5.9	6.2	5.6	6.4	7.1
CPI-modified 2/	4.5	5.4	6.5	7.3	6.2	6.1	6.6	7.8
CPI	6.0	7.3	8.2	9.7	9.1	6.8	7.4	5.3

1/ Fixed-weighted price indexes, with fourth quarter of 1965 weights, for personal consumption expenditures and its components; estimates for periods after QII 1970 not for publication.

2/ FRB estimate, not for publication, based on confidential BLS indexes for durable goods excluding used cars and home purchase and for services excluding home financing costs. Reweighted, with used car weights assigned to new cars, and home financing to rent.

Note: CPI changes are based on quarterly averages.

of lumber and plywood earlier this year (after a protracted decline) accounted for about 70 per cent of the increase in the FRB index in the January-April period, although hides and skins posted the largest increase: textiles and nonferrous metals also were important in the rise in this period. Copper scrap, hides, and burlap were of major importance in the rise in the BLS series.

COMPARISON OF CHANGES IN INDEXES OF PRICES
OF SENSITIVE INDUSTRIAL MATERIALS
(Percentage change, January to April 1971)

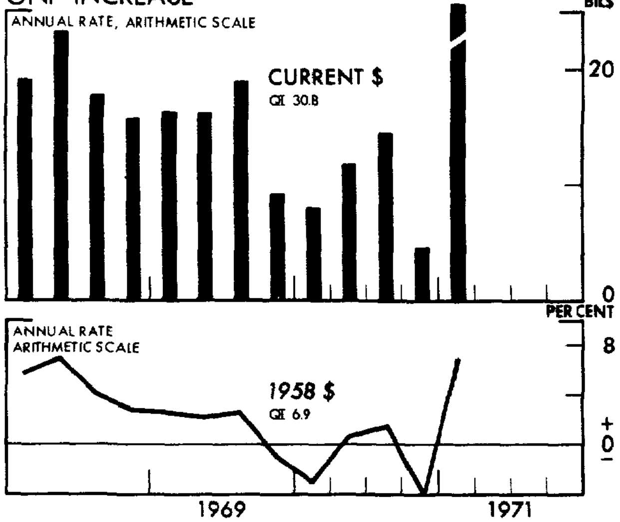
Sensitive industrial materials (FRB)	4.0
Lumber and plywood	14.9
Nonferrous metals	0.7
Textile and fibers	1.6
Hides and skins	22.4
Iron and steel scrap	-10.7
Raw industrials (BLS)	5.2
Copper scrap	24.2
Hides	18.9
Burlap	18.8
Steel scrap	-11.8
Wood tops	- 7.8

The FRB index is not yet available for May, but the BLS index (based on prices of Tuesdays of the weeks in which the 13th fall, declined more than 2 per cent from mid-April to mid-May as the price of copper scrap dropped sharply; prices of hides and burlap also declined, reversing the increases of the January-April period; and the price of wool tops was reduced further. Additional increases in prices of cotton, zinc, rubber and steel scrap largely offset the drop in the other prices.

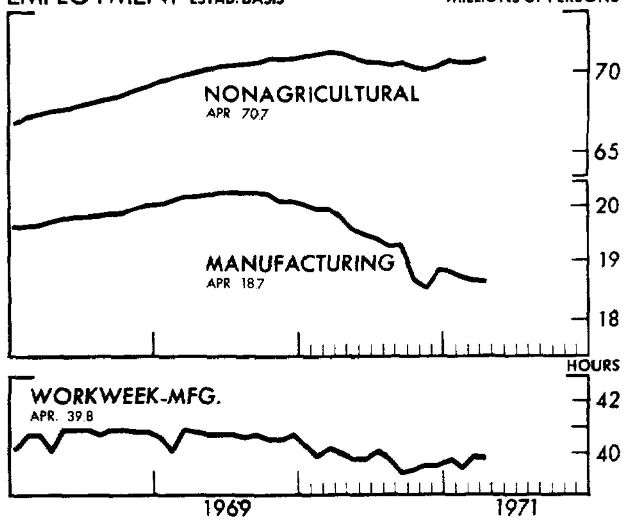
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

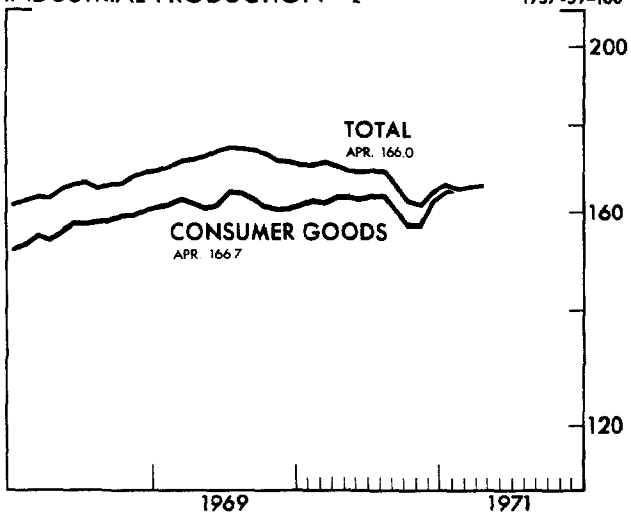
GNP INCREASE



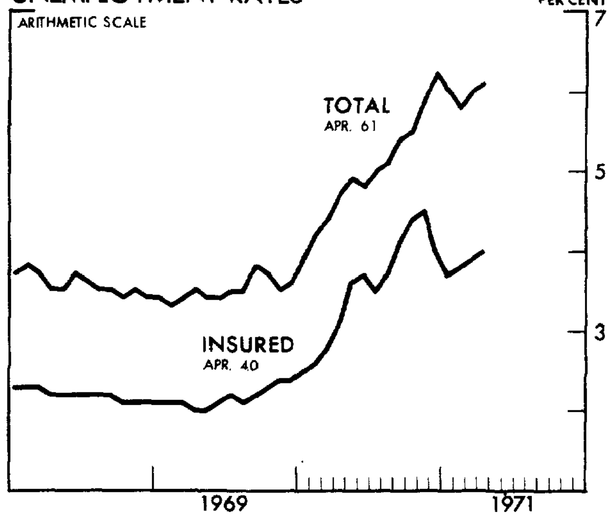
EMPLOYMENT ESTAB. BASIS



INDUSTRIAL PRODUCTION - I



UNEMPLOYMENT RATES



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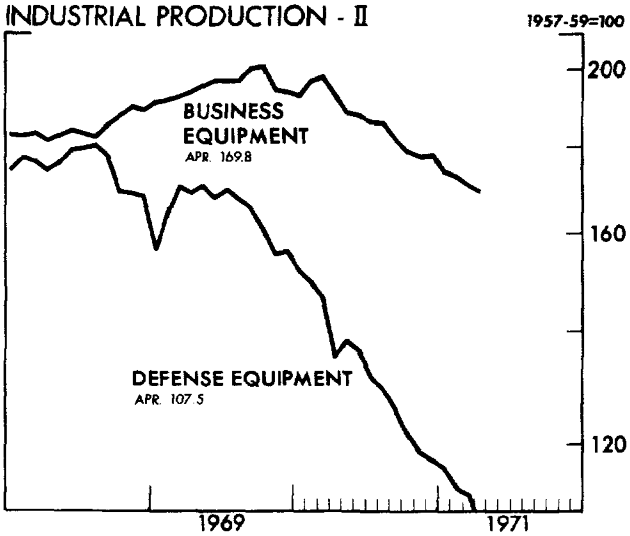
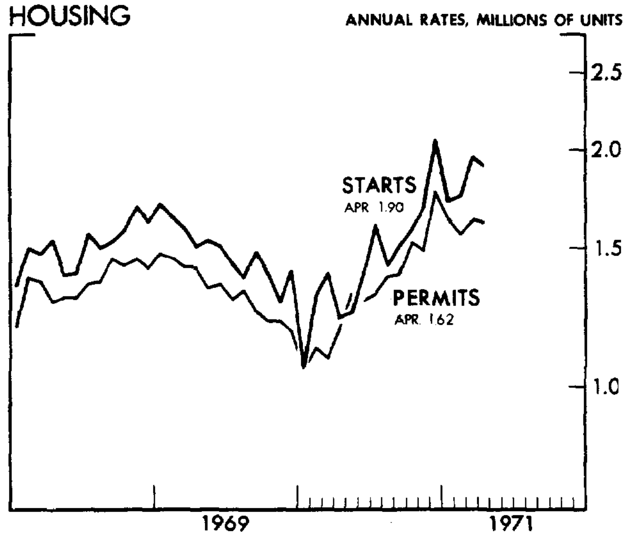
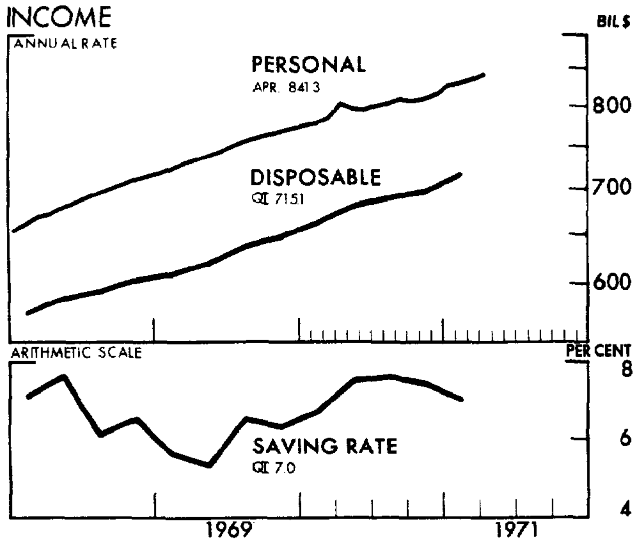


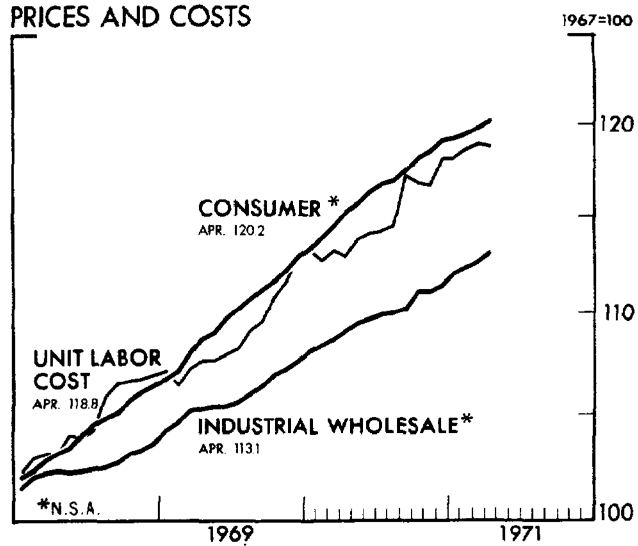
HOUSING

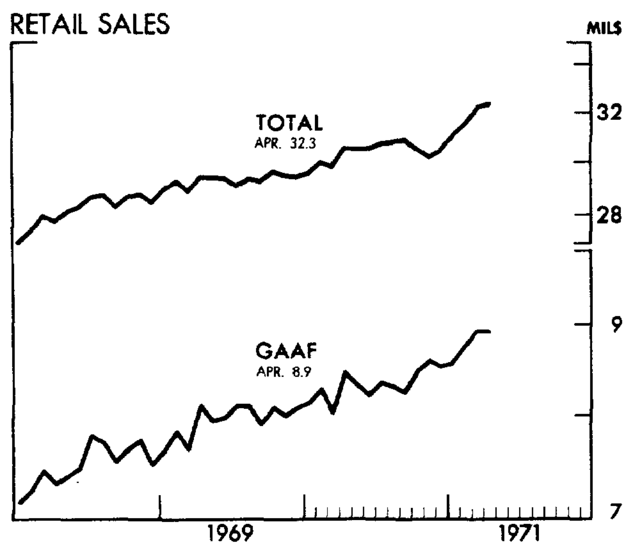


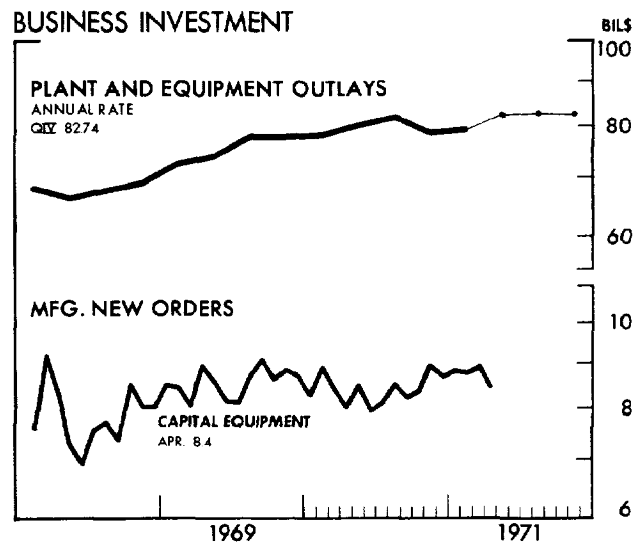
ECONOMIC DEVELOPMENTS - UNITED STATES

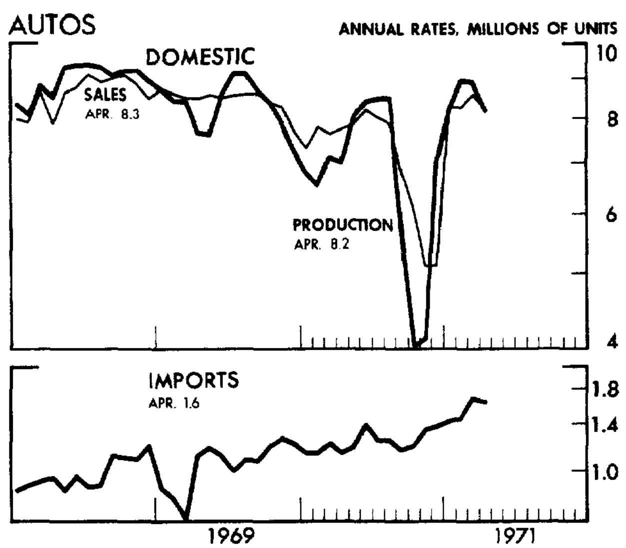
SEASONALLY ADJUSTED, RATIO SCALE

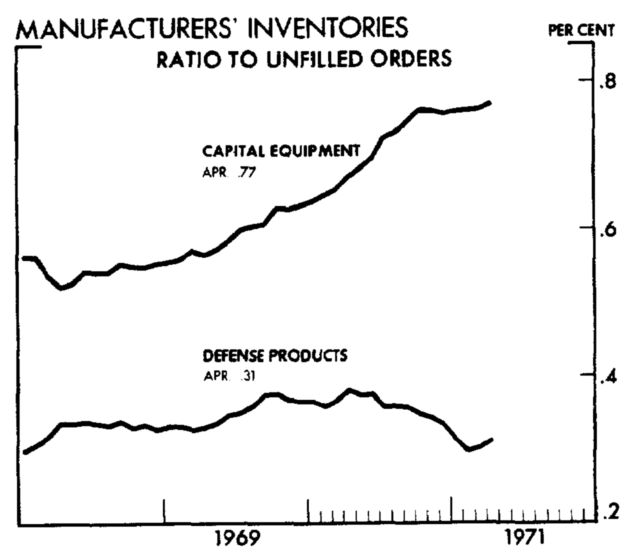












THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Monetary aggregates. The monetary aggregates are estimated to have risen substantially further in May. M_1 (currency plus private demand deposits) is estimated to have increased at an annual rate of 14 per cent, above the pace in April and the first quarter. Growth in M_2 (M_1 plus commercial bank time and savings deposits other than large CD's), also at about a 14 per cent annual rate, was only slightly higher in May with much of the pickup in the growth rate of M_1 offset by a slowing in the rate of growth of the time and savings deposit component. The May advance in M_2 was well below the growth rate during the first quarter, when inflows of time and savings deposits were much stronger.

While May inflows of time and savings deposits other than large CD's were down somewhat from April and significantly below those recorded in the first quarter, they remained quite large by historical standards. All classes of banks continued to receive large time and savings deposit inflows. Commercial bank sales of CD's increased in May, about offsetting the April decline in these deposits. Sales to foreign official institutions accounted for a large part of CD expansion, but IPC customers also were buyers toward month end, possibly in response to the rise in CD offering rates that took place over the month.

The adjusted bank credit proxy increased at a somewhat faster rate in May, reflecting mainly the stronger growth of private demand deposits and large CD's. In addition, while Euro-dollar liabilities continued to decline in May, they did so at a slower rate than in other recent months when foreign branch purchases of special Ex-Im and Treasury certificates biased the liability data downward. Borrowing by bank affiliates in the commercial paper market, measured on a daily average basis for the month, will be somewhat higher in May than in April--though the rise in these liabilities actually occurred in the latter half of April. On a week to week basis, commercial paper indebtedness has been moving down since late April.

MONETARY AGGERGATES
(Seasonally adjusted, annual rates of change, in per cent)

	1970	1971			
	QIV	QI	March	April	May e
1. M_1 (currency plus private demand deposits)	3.4	8.9	11.6	9.8	14.0
2. M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	9.2	17.8	18.9	12.6	13.5
3. M_3 (M_2 plus savings deposits at mutual savings banks and S & L's)	9.7	19.0	19.8	16.1	n.a.
4. Adjusted bank credit proxy	8.3	10.9	8.9	5.3	7.5
5. Commercial bank time and savings deposits	21.8	27.3	25.9	10.7	14.0
a. large CD's	79.4	27.9	19.2	-21.3	21.2
b. other time and savings	15.4	27.2	27.0	14.8	13.0
6. Savings deposits at mutual savings banks and S & L's	11.5	23.3	24.9	21.7	n.a.

e - estimated.

Bank credit. Commercial bank credit, adjusted for loan transfers between banks and their affiliates, increased at an annual rate of 12.0 per cent in May, according to preliminary estimates. This rise in the end of the month bank credit series followed a slight reduction in April but was roughly in line with the rate of increase in the first quarter. Growth in loans accounted for a major share of the May expansion, but security investments also increased further. Holdings of U.S. Treasury securities rose moderately, primarily reflecting bank participations in the Treasury sale of strip bills; payment was made on May 25 by crediting tax and loan accounts. Other security holdings also rose substantially further in May, but the increase fell well short of the gains during preceding months of the year.

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

	1970	1971		
	QIV	QI	April	May e
Total loans & investments 2/	6.1	13.8	- .5	12.0
U.S. Government securities	2.8	22.1	-25.5	8.0
Other securities	34.5	30.4	22.2	14.1
Total loans	-1.0	7.3	-2.4	12.1
Business loans 3/	-9.2	2.5	1.1	17.2

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.
e - Partially estimated.

The sharp rise in loans in May was led by exceptionally large increases in business loans and loans to nonbank financial institutions. A further rapid increase was also posted for real estate loans, while modest gains were recorded in other major loan categories.

The sharp May upturn in business loans in part reflects seasonal adjustment problems. Borrowing around the mid-April and mid-March tax dates was considerably lighter than in earlier years, and thus it seems likely that loan repayments were also well below normal in May. As a result, the use of seasonal adjustment factors reflecting borrowing patterns of earlier years probably resulted in an overstatement of the strength of the May loan increase. For the April-May period combined, the expansion in business loans was at an annual rate of 9 per cent, but since the first of the year--which may represent a better averaging out of the seasonal adjustment problems--business loans have expanded at about a 5 per cent annual rate. Wholesalers and retailers and machinery producers were responsible for much of the May strengthening in loan growth.

A marked increase in loans to nonbank financial institutions in May may also be attributable in part to a seasonal adjustment problem. But this also reflects heavy borrowing by mortgage brokers to finance warehousing of mortgages. Sales finance companies also apparently increased their bank borrowing.

Some pickup in loans to businesses and nonbank financial institutions was, of course, to be expected in May in view of the improvement in business activity. In addition, the competitive position of banks vis-a-vis the commercial paper market has improved in recent weeks with the increase in commercial paper rates. Finally, bank lending policies appear to have become more aggressive recently. In a survey conducted on April 30, a large proportion of the reporting banks indicated that their loan commitment policies had eased further since early in the year. (A full review of this survey will be provided in the Supplement.)

With the further rise of CD rates in May, the spread between these rates and the prime lending rate of banks has narrowed appreciably. Since last fall CD rates have been below their ceilings, and the prime rate has usually been 100-150 basis points above the 3 month CD rate. But currently, the spread is only 50 basis points. The one year CD rate is presently at the prime rate, rather than 75-100 basis points below it. These interest rate relations suggest that banks may raise the prime rate, if recent strength in loan demand continues.

Nonbank thrift institutions. Despite the rise in yields on market securities, deposit inflows to the thrift institutions continued unusually large in April, and apparently in May--though data for May are still incomplete. Total flows available to S&L's in April were augmented by a further increase in repayments on outstanding mortgages, to a record annual rate. Essentially all of this total April cash flow was used to acquire mortgages and repay advances; liquid asset holdings were virtually unchanged. Comparable information for savings banks is not yet available.

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

	Mutual Savings Banks	Savings and Loan Associations	Both
1970 - QI	2.7	2.3	2.5
QII	6.4	7.2	7.0
QIII	6.9	10.6	9.3
QIV	10.2	12.1	11.5
1971 - QI (p)	17.7	25.9	23.3
March* (p)	21.2	26.6	24.9
April* (p)	18.6	23.2	21.7

(p) Preliminary.
* Monthly patterns may not be significant because of difficulties with seasonal adjustment.

During April and May, savings and loan associations repaid about one-third of the $6.6 billion of maturing subsidized term advances originally made during the Spring of 1970. Most of the Home Loan banks have offered varied incentives for S&L's to convert these subsidized loans to new advances in order to maintain mortgage credit flows. The recent rise in market yields and the high level of commitments and mortgage closings has apparently led S&L's to be receptive to the FHLB incentives. Approximately $2.0 billion of the maturing term advances have been converted to new advances maturing in one year or more, and $2.3 billion to advances maturing in less than one year.

Mortgage market. The continued large inflows of funds to thrift institutions have been accompanied by ready availability of mortgage credit, although yields have increased as market interest rates have risen. At S&L's during April, seasonally adjusted new and outstanding mortgage commitments as well as mortgage closings reached new highs. Bolstered by heavy demands for credit to finance market transactions as well as to refinance older loans, S&L mortgage commitments outstanding by the end of April were more than double their April 1970 volume. At the more diversified New York State savings banks, mortgage commitment backlogs also rose further in April, but remained below the highs established in 1964-65 when the yield spread favoring home mortgages over corporate bonds was quite attractive.

MORTGAGE COMMITMENTS OUTSTANDING AT THRIFT INSTITUTIONS 1/
(Billions of dollars, seasonally adjusted)

Date	S&L's	N.Y. State Savings Banks	Both Thrift Institutions
1970 - High	8.1 (Dec.)	2.6 (Jan.)	10.1 (Dec.)
Low	5.2 (Mar.)	1.8 (Oct., Nov.)	7.7 (Mar.)
April	5.4	2.3	7.7
1971			
January	8.3	2.1	10.4
February	8.9	2.3	11.2
March	10.1	2.5	12.6
April	11.1	2.8	13.8

1/ Based on data, including loans in process, from Federal Home Loan Bank Board and Savings Banks Association of New York State.

The average contract interest rate on conventional new-home mortgages in the primary market declined much less in April than in earlier months of 1971. Two regions, in fact, posted small rate increases, and the unusually narrow rate spread that had prevailed in March between the Northeast and the West widened. During May, there were reports of scattered increases in these rates, reflecting recent shifts in borrower and investor expectations.

INTEREST RATES ON CONVENTIONAL HOME MORTGAGES
(In per cent)

Date	United States	Selected Regions		
		Northeast	West	West minus Northeast (basis points)
1970 - High	8.60	8.30	9.40	110
1971 - January	7.95	7.80	8.05	25
February	7.75	7.50	7.90	40
March	7.60	7.45	7.60	15
April	7.55	7.35	7.65	30

NOTE: FHA series, rounded to nearest 5 basis points, for first mortgages to finance purchases of new homes.

In the particularly sensitive secondary market, returns to lenders on Government-underwritten mortgages, which had begun to move upward early in April in FNMA's forward commitment purchase auctions, reached new 1971 highs in the May 24 auction. On 6-month commitments, yields rose to 7.97 per cent, 29 basis points above the May 10 level and 54 basis points above the early March low.[1/] Discounts associated with such commitments increased to a restrictive level of nearly 8 points, heightening trade expectations that the current 7 per cent ceiling on FHA and VA mortgage interest rates would be raised by administrative action.

FNMA PURCHASE AUCTIONS

	Amount of total offers			6-month commitments	
	Received	Accepted	Per cent accepted	Discount	Private market yield
	(Millions of dollars)			(Points)	(Per cent)
Bi-weekly					
1970 - High	581 (1/26)	298 (1/26)	94 (9/21)	6.3 (6/28)	9.33 (6/29)
1971 - High	1,168 (5/12)	312 (4/26)	80 (1/25)	7.8 (5/24)	7.97 (5/24)
Mar. 1	186	52	28	3.6	7.43
15	194	74	38	3.7	7.45
29	122	67	55	3.7	7.44
Apr. 12	127	54	43	3.7	7.45
26	687	314	46	4.4	7.54
May 10	1,168	237	20	5.6	7.68
24*	794	152	19	7.8	7.97

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. Implicit yields shown are gross, before deduction of fee paid by investors to servicers of 50 basis points prior to August 10, 1970, auction, and 38 basis points thereafter.

*Dollar limits were announced in advance by FNMA on the total offers it would accept, and on the total competitive offers that any one bidder could make.

1/ Auction yields generally vary inversely with the amount of offers accepted by FNMA. Between the May 10 and May 24 auctions, however, only a minor part of the increase in 6-month commitment yields apparently reflected the reduced amount of offers that FNMA accepted in the May 24 auction.

The recent rise in secondary market yields indicated in FNMA's purchase auctions has been accompanied by record offerings from mortgage companies anxious to obtain long-term financing commitments once it became evident that interest rates had reversed their earlier downtrend. In the expectation that mortgage prices would continue to rise, many mortgage companies had agreed earlier to finance homebuilders, and had been holding loans in warehouse, but without obtaining take-out commitments from any permanent lenders. Field reports indicate that these take-outs have become difficult to obtain elsewhere than from FNMA, in view of uncertainties about future interest rate developments.

To limit demands on its resources and to spread these resources among more market participants, FNMA announced in advance of its May 24 auction that it would reinstate ceilings in effect last year on the amount of total and individual offers that it would accept. Since then, FNMA has tightened these ceilings and has indicated that it would resume weekly auctions for the first time in 1971. Results of the initial weekly auction of June 2 will be included in the Greenbook Supplement.

During the first quarter, the quality of home mortgage debt outstanding showed no significant change, according to the Mortgage Bankers Association series which is heavily weighted with FHA and VA loans. The average delinquency rate declined normally for the time of the year, as a seasonal improvement in short-term delinquencies was partly offset by some increase in longer-term delinquencies. The over-all delinquency rate was the highest for any first quarter in the history of the series, which began in 1954. The advanced rate partly reflected an increase volume of outstanding delinquent-prone mortgages under FHA's section 235 program, which provides interest-rate subsidies for lower-income homeowners. Meanwhile, foreclosure rates increased to .40 per cent, the highest first-quarter level since 1964.

DELINQUENCY AND FORECLOSURE RATES ON HOME MORTGAGES
(per cent)

	First quarter averages		First quarter					
	1954-61	1962-71	1966	1967	1968	1969	1970	1971
Delinquent	2.28	2.95	3.02	3.04	2.84	2.77	2.96	3.21
In foreclosure	n.a.	.35	.38	.38	.32	.26	.31	.40

NOTE: Mortgage Bankers Association Survey based on several million mortgages on 1-to-4-family properties held or serviced by approximately 400 member respondents, largely involving FHA and VA loans.

Corporate and municipal securities markets. Yields on corporate and municipal bonds continued to climb throughout most of May, reaching levels 100 to 150 basis points above the lows set earlier this year. Borrowers and lenders remained cautious, reflecting concern about the international situation, the sustained rise in short-term rates, the ambiguities shown by various domestic economic indicators, the continued signs of upward pressure on costs and prices, and the future course of monetary policy. These same concerns also exerted a depressing influence on the stock market. As shown in the accompanying table, stock prices fell over the month on a declining volume of transactions.

BOND YIELDS
(per cent)

	New Aaa Corporate Bonds 1/	Long-term State and Local Bonds 2/
1970		
Low	7.68 (12/18)	5.33 (12/10)
High	9.30 (6/18)	7.12 (5/28)
1971		
Low	6.76 (1/29)	5.00 (3/18)
High	8.23 (5/21)	5.96 (5/20)
Week of:		
April 23	7.54	5.48
30	7.81	5.69
May 7	7.88	5.84
14	7.93	5.96
21	8.23	5.96
28	8.06	5.86

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

STOCK PRICES[1/]

	NYSE	AMEX	Dow Jones	NASDAQ OTC2/
1970				
Low	37.69 (5/26)	19.36 (5/27)	631.16 (5/26)	n.a.
High	52.36 (1/5)	27.02 (1/8)	842.00 (12/29)	n.a.
1971				
Low	49.73 (1/4)	22.72 (1/4)	830.57 (1/4)	99.68 (5/22
High	57.76 (4/28)	26.68 (4/28)	950.82 (4/28)	112.46 (4/29)
April 23	57.32	26.51	947.79	110.65
30	57.27	26.47	941.75	112.30
May 7	56.67	26.24	936.97	110.69
14	56.35	26.15	936.06	110.74
21	55.59	25.86	921.87	108.25
28	54.69	25.71	907.81	108.25
Per cent decline from late April high to May 28	-4.6	-3.0	-4.2	-3.6

1/ Prices as of the day shown.
2/ The NASDAQ OTC Composite Index is a new over-the-counter stock index computed from all issues listed on the new NASDAQ automated quotation system for OTC securities. (There are approximately 2100 securities listed at present.) The Index assigns a base value of 100 to market prices as of February 5, 1971, the last trading day before the institution of the NASDAQ system.

In the bond markets, some issuers postponed scheduled offerings and investors retired to the sidelines, making purchases hesitantly and frequently waiting for syndicate terminations to bring them higher yields. When high-grade corporate bonds sold at yields over 8 per cent and tax-exempt rates approached the 6 per cent level, however, buyer interest began to pick up and rates started to move downward in the final days of May.

As in April, the upward movement of corporate rates in May retarded the flow of new corporate bonds to the market. With the calendar lightened by about $750 million of postponements, the May volume of public bond offerings remained below the record first-quarter level. With corporate financial positions now permitting more flexible schedulings than earlier this year, the recent uptrend of long-term bond yields has not precipitated a rush of issuers to market, as occurred after the February rise in rates. Underwriters report that there are still a large number of firms planning long-term debt issues, but some prospective borrowers do not need the money immediately and may be delaying their financing in anticipation of lower rates this summer. Thus, the staff estimates that the June public bond volume will be about $2.5 billion, up less than seasonally from May.

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

	Bonds			
	Public	Private	Stocks	Total
1969 - Year	1,061	468	700	2,229
1970 - Year	2,099	403	713	3,245
1971 - QI	2,790	505	769	4,063
QII e/	2,287	550	1,033	3,870
April e/	2,160	450	1,300	3,910
May e/	2,200	500	900	3,600
June e/	2,500	700	900	4,100

e/ Estimated.

Although second-quarter public bond volume will not match the record first-quarter financing, issue volume in other sectors of the long-term securities markets may well be larger than in any quarter of the last two years. Available evidence from life insurance companies suggests that takedowns of private placements in the second quarter will exceed the first-quarter average. New equity issues have continued at a brisk pace in spite of the recent downdrift in stock prices, and the staff now estimates that volume for both May and June will be close to $1 billion. Underwriters report a continuing trend toward more stock issues by utilities; and, of course, the July total will be ballooned by the closing of the subscription period for the $1.4 billion issue of convertible preferred stock by AT&T.

The sustained large volume of offerings by State and local governments and the reduced rate of acquisitions by commercial banks in late April and May depressed the tax-exempt market, and yields reached new highs for this year in mid-May. However, fire and casualty company purchases have remained high, bank buying picked up again in recent weeks, and the market appears to have stabilized. Several large negotiated issues helped raise May volume to $2.2 billion. The staff estimates that the June total will probably be around $2 billion, bringing sales of long-term municipal bonds for the second quarter to about $6.1 billion, over 90 per cent of the total quarterly sales anticipated by State and local units according to the latest FRB-Census survey of State and local long-term bond anticipations. 1/

1/ An analysis of State and local borrowing plans and realizations for the first quarter, and anticipations for the second quarter, based on the FRB-Census survey, will be in an appendix to the Supplement.

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

	Long-term	Net Short-term
1969 - Year	991	294
1970 - Year	1,515	383
1971 - QI	2,230	554e
QII e/	2,017	n.a.
April e/	1,888	750
May e/	2,200	576
June e/	2,000	n.a.

e/ Estimated.
Note: Long-term offerings are gross. Short-term offerings are Federal Reserve Board estimates of net sales.

Net short-term municipal security sales remained unusually high in April and May. Large tax-anticipation issues--particularly by units in the Northeast, which have had problems in financing current operating expenditures--are responsible for much of this growth. Short-term rates did not rise so steeply as long-term rates over May, however, since the municipal note market has benefitted from the apparent desire of buyers to shorten the maturity structure of their holdings.

Government securities market. Interest rates on U.S. Government securities rose sharply in the period between the last Committee meeting and the Chairman's May 19 testimony. Since then, however, Treasury yields have tended downward, particularly on longer-term issues. For the whole period since the last meeting, yields on notes and bonds have risen on balance by about 20 basis points, and yields on bills 30 to 50 basis points. These rate movements have reflected the same background influences described above in connection with the corporate and municipal bond markets.

MARKET YIELDS ON U. S. GOVERNMENT AND AGENCY SECURITIES
(Per cent)

	1971		Weekly average for week ending			
	Daily highs 1/	Daily lows 1/	May 11	May 18	May 25	June 1
Bills						
1-month	4.83 (1/6)	3.07 (3/12)	3.75	3.99	4.30	4.27
3-month	4.89 (1/4)	3.22 (3/11)	3.84	4.17	4.40	4.36
6-month	4.94 (1/4)	3.35 (3/11)	4.17	4.39	4.49	4.51
1-year	4.83 (5/24)	3.45 (3/11)	4.48	4.75	4.76	4.74
Coupons						
3-year	6.28 (5/18)	4.27 (3/22)	5.88	6.11	6.03	5.87
5-year	6.60 (5/18)	4.74 (3/22)	6.18	6.41	6.38	6.21
7-year	6.71 (5/18)	5.15 (3/23)	6.29	6.54	6.54	6.38
10-year	6.65 (5/18)	5.38 (3/23)	6.25	6.51	6.51	6.37
20-year	6.49 (5/18)	5.69 (3/23)	6.27	6.41	6.36	6.26
Agencies						
6-month	5.31 (5/24)	3.67 (3/16)	4.77	4.99	5.27	5.18
1-year	5.82 (5/24)	3.93 (3/16)	5.43	5.63	5.78	5.68
3-year	6.67 (5/19)	4.70 (3/24)	6.34	6.44	6.58	6.45
5-year	6.83 (5/19)	5.12 (3/23)	6.62	6.70	6.76	6.68

1/ Latest dates of high and low rates in parenthesis.

In the market for Treasury coupon issues earlier upward rate pressures had been intensified by selling on the part of speculative holders seeking to capture capital gains while the upturn of interest rates was still in an early stage. Since May 19, however, pressure to liquidate speculative positions seems to have dissipated. The virtual absence of any build-up of trading positions in the Treasury's May re-financing contributed to this improvement, and dealers holdings of all coupon issues have been substantially reduced over recent weeks to rather moderate proportions. The System helped to reduce the overhang of speculative positions by purchasing some $130 million of coupon issues during the early weeks of May when yields were still rising.

Yields on Treasury bills have shown less tendency to decline since May 19. This has reflected the combination of some further firming in money market costs and an end-of-month concentration of bill auctions. The latter included a $1.6 billion strip offering of short bills for cash, as well as the usual monthly and weekly operations. Dealers came through these auctions with bill positions of only moderate size, after allowance for the usual month-end build-up.

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

	April Daily average	May 10	May 17	May 24	June 1
Treasury securities					
Total	4,869	2,682	2,029	2,093	3,334
Treasury bills (total)	3,534	1,584	1,307	1,506	3,751
Due in 92 days or less	982	341	367	683	521
93 days or over	2,552	1,244	940	823	2,230
Treasury notes and bonds (Total)	1,336	1,098	723	587	584
Due within 1-year	483	330	193	236	237
1-5 years	416	348	189	102	138
over 5 years	437	420	341	248	209
Agency securities					
Total	1,125	820	790	744	925
Due within 1-year	570	345	346	415	442
Over 1-year	555	475	444	330	483

New issue activity in the Federal agency market continued to be relatively light in May, but the trend toward somewhat longer maturities is still in evidence with FNMA including a $250 million 5-year maturity in their latest offering. New agency issues have raised only a modest $47 million of net/new funds in May as FHLB has repaid debt on balance. Nonetheless, with interest rates in competing financial markets rising, the upward movement in agency market yields which began in mid-March was sustained. Since May 10, these yields have risen further by 10 to 48 basis points with the largest increases occurring in maturities of one year and under.

Other short-term credit markets. Short-term rates have continued their general upward movement over the past five weeks, with the increases ranging from 11 to 75 basis points. The largest advances were in commercial and finance company paper rates; 3-month commercial paper is now at 5-1/2 per cent, and thus is as high as the prime rate for the first time since October 1970. These rate increases have occurred despite continued limited use of the short-term open market by borrowers.

Commercial and finance company paper outstanding (seasonally adjusted) increased only $209 million for April, following a $1.6 billion decline in March. Dealer paper declined $432 million, the third consecutive monthly decline, while directly-placed paper outstanding, on the other hand, rose $539 million. The rise in directly-placed paper was primarily in auto finance company paper outstanding, reflecting auto sales contests held early in April. The most recent data available for May suggest this increase was temporary.

Bank-related paper outstanding increased $102 million over the month. This is the first monthly increase since July 1970 and the advance reflects financing by banks of their nonbank subsidiaries.

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

	1970		1971			Net Change
	Highs	Lows	April 28	May 12	May 26	April 28 May 26
1-month						
Commercial paper	9.25	5.50	4.50	4.75	5.13	+.63
Finance paper	9.00	5.00	4.13	4.50	4.74	+.62
Bankers' acceptances	9.00	5.50	4.88	5.13	5.25	+.37
Certificates of deposit--new issue 1/	7.75	5.00	4.38	4.50	4.75	+.37
Treasury bill	7.84	4.58	3.86	3.80	4.33	+.47
3-month						
Commercial paper	9.25	6.00	5.00	4.88	5.50	+.50
Finance paper	8.25	5.50	4.25	4.50	5.00	+.75
Bankers' acceptances	9.00	5.50	5.00	5.13	5.38	+.38
Certificates of deposit--new issue 1/	6.75	5.50	4.63	4.75	5.00	+.37
Treasury bill	7.93	4.74	4.04	3.94	4.40	+.36
6-month						
Bankers' acceptances	9.00	5.50	5.00	5.13	5.38	+.38
Treasury bill	7.99	4.78	4.32	4.22	4.43	+.11
12-month						
Certificates of deposit--new issue 1/	7.50	5.50	5.13	5.25	5.50	+.37
Treasury bill	7.62	4.74	4.54	4.54	4.68	+.14
Prime municipal notes	5.80	2.95	2.85	3.20	3.30	+.45

1/ Investment yield basis. Highs for certificates of deposit are ceilings effective as of January 21, 1970.

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.

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

	February	March	April
Total commercial and finance paper 1/	32,574	30,954	31,163
Bank related 2/	1,901	1,692	1,794
Nonbank related 3/	30,673	29,262	29,369
Placed through dealers	13,758	12,880	12,448
Placed directly	16,915	16,382	16,921
Total commercial and finance paper 1/	- 409	-1,620	209
Bank related 2/	- 129	- 209	102
Nonbank related 3/	- 280	-1,411	107
Placed through dealers	- 1	- 878	- 432
Placed directly	- 279	- 533	539

1/ Combines seasonally adjusted nonbank-related paper and seasonally unadjusted bank-related paper.

2/

2/ Seasonally unadjusted.

3/ Seasonally adjusted.

Federal finance. The staff continues to project a Federal deficit in the unified budget of about $21 billion for the current fiscal year. However, recent experience suggests that both receipts and outlays may be below the levels projected in the preceding Greenbook. The expected shortfall in outlays is reflected in several categories of expenditures and lending, while the shortfall in receipts is in personal income tax payments on current 1971 liabilities. Not only did the final April figure on such payments come in below earlier estimates, preliminary data for May also appear to have been on the low side.

Since the preceding Greenbook, the staff has also lowered Federal expenditure estimates for fiscal 1972, by about $2.0 billion. Of course, the fiscal 1972 outcome is still highly uncertain because Congress has not completed action on a number of important bills. But if the current trend continues, the net effect of Congressional action may be to lower outlays below previous staff estimates. For example, it now appears likely that the $5.0 billion general revenue sharing program proposed by the Administration will not be enacted in time to affect outlays in fiscal year 1972. Furthermore, the present version of Congressman Mills' $10 billion welfare reform and social security bill (HR-1), which was expected to offset the loss of general revenue sharing, would not take effect until the start of fiscal 1973. Additional areas of uncertainty include the specifics of a bill involving a pay raise for the military (to move toward an all volunteer army); the threatened Presidential veto of legislation providing for an acceleration of public works program; and increases in social security taxes included in Congressman Mills' welfare bill.

The revisions in the budget estimates since the preceding Greenbook reduce the high employment surplus in calendar 1971 slightly, since spending on an NIA basis--in contrast to the unified budget measurement--has been running slightly stronger than recently estimated. Thus, the near balance in the high employment budget experienced in 1970 is still expected to persist this year.

The Treasury cash balance at the end of May was about $6.9 billion. This is $3.5 billion above the level projected a month ago, partly because the international currency crisis brought in a large amount of money--nearly $3 billion in May--through the issuance of special Treasury certificates to foreign central banks, and partly because the Treasury borrowed $1.6 billion sooner than had been expected--in the form of a short-term bill strip.

The timing and amount of future Treasury market borrowing operations will be significantly affected by what happens to the special issues held by foreign central banks. The present staff projection assumes that these holdings will remain about unchanged on balance over the next two months. On this basis, the Treasury may require a total of about $5.5 billion of new cash from now until late July with the next borrowing probably to be announced in late June. This amount of late June-July borrowing would be roughly similar in magnitude to Treasury borrowing a year ago, but somewhat larger than in some other recent years.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	May	June	July
Total net borrowing	2.5	-2.5	5.5
Weekly and monthly bills	1.6	--	--
Tax bills	--	-2.5	--
Coupon issues	-1.7	--	--
As yet unspecified new borrowing		--	5.5
Other (debt repayments, etc.)	2.6 a/	--	--
Plus: Other net financial sources b/	-.9	-1.9	.1
Plus: Budget surplus or deficit (-)	-3.6	4.0	-7.5
Equals: Change in cash balance	-2.0 c/	-.4	-1.9
Memoranda: Level of cash balance, end of period	6.9 c/	6.5	4.6
Derivation of budget surplus or deficit:			
Budget receipts	13.7	22.6	13.5
Budget outlays	17.3	18.6	21.0
Maturing coupon issues held by public	5.8 d/	--	--
Net agency borrowing	-.4	.3	.5

a/ Includes about $2.8 billion in sales of Treasury securities to foreign central banks.
b/ Checks issued less checks paid and other accrual items.
c/ Actual
d/ The May refunding fell short of its goal by $1.8 billion.

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

	Fiscal 1971e/		Fiscal 1972e/		Calendar Years		F.R. Board Staff estimates				
							Calendar Quarters				
	Jan. Budget	F.R. Board	Jan. Budget	F.R. Board	1970 Actual	1971e/	1970 IV*	1971 I*	II	III	IV
Federal Budget											
(Quarterly data, unadjusted)											
Surplus/deficit	-18.6	-21.0	-11.6	-21.5	-11.4	-26.6	-8.9	-8.2	3.6	-10.6	-11.4
Receipts	194.2	189.0	217.6	211.0	190.5	194.8	41.1	44.1	57.3	49.2	44.2
Outlays	212.8	210.0	229.2	232.5	201.9	221.3	49.9	52.2	53.7	59.8	55.6
Means of financing:											
Net borrowing from the public	17.6	17.6	10.6	20.5	11.8	24.0	8.9	1.6	-.3	10.8	11.9
Decrease in cash operating balance	n.a.	1.5	n.a.	--	-2.8	.5	.7	3.6	-2.0	-1.4	.3
Other 1/	n.a.	1.9	n.a.	1.0	2.4	2.0	-.7	2.9	-1.3	1.2	-.8
Cash operating balance, end of period	n.a.	6.5	n.a.	6.5	8.1	7.6	8.1	4.5	6.5	7.9	7.6
Memo: Net agency borrowing 2/	n.a.	1.7	n.a.	n.e.	8.2	n.e.	1.5	-1.0	- .3	1.2	n.e.
National Income Sector											
(Seasonally adjusted annual rate)											
Surplus/deficit	-15.0	-15.2	-4.2	n.e.	-11.1	-15.1	-18.1	-13.3	-17.5	-17.2	-12.2
Receipts	200.0	198.2	225.9	n.e.	195.2	208.5	191.7	200.8	205.3	209.8	217.9
Expenditures	215.0	213.4	230.1	233.7	206.3	223.6	209.9	214.2	222.8	227.3	229.9
High employment surplus/deficit (NIA basis) 3/	n.a.	-.2	n.a.	1.5	-.8	.3	1.3	1.3	-1.8	-1.0	2.6

*Actual e--projected n.e.--not estimated n.a.--not available

1/ Includes such items as deposit fund accounts and clearing accounts.

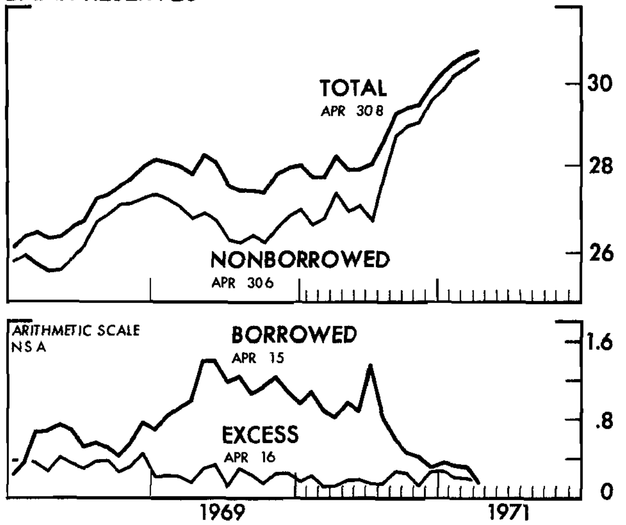
2/ Federally-sponsored credit agencies, i.e., Federal Home Loan Banks, Federal National Mortgage Assn., Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.

3/ Estimated by Federal Reserve Board Staff. The level of the estimated series shown here differs considerably from the estimates by the Council of Economic Advisers. Continues to show effect of accelerated depreciation recently proposed by the Treasury.

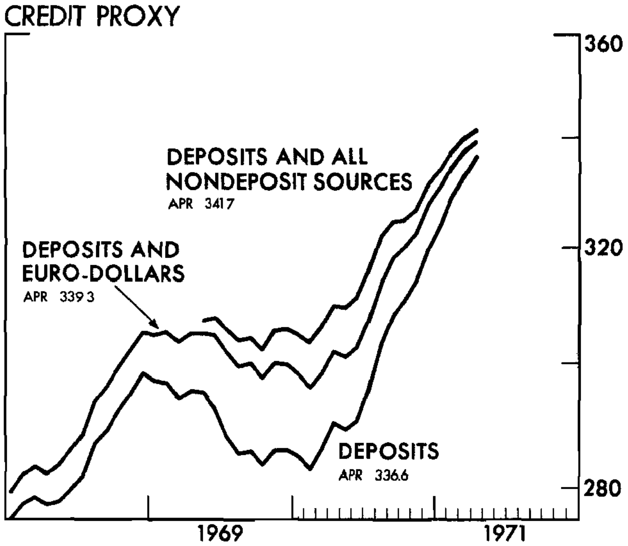
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

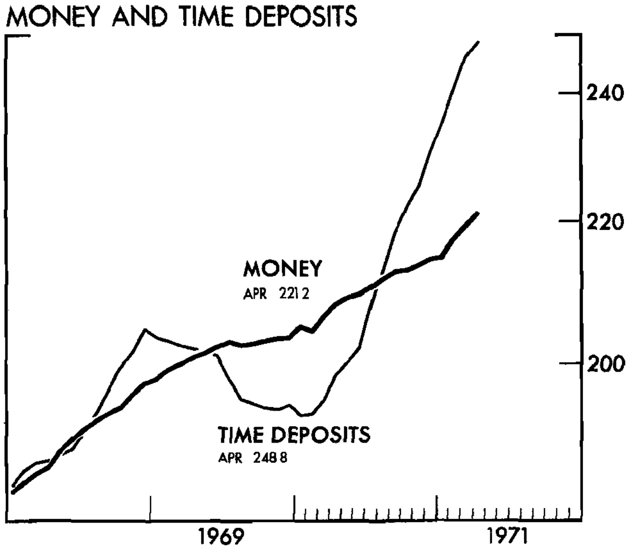
BANK RESERVES



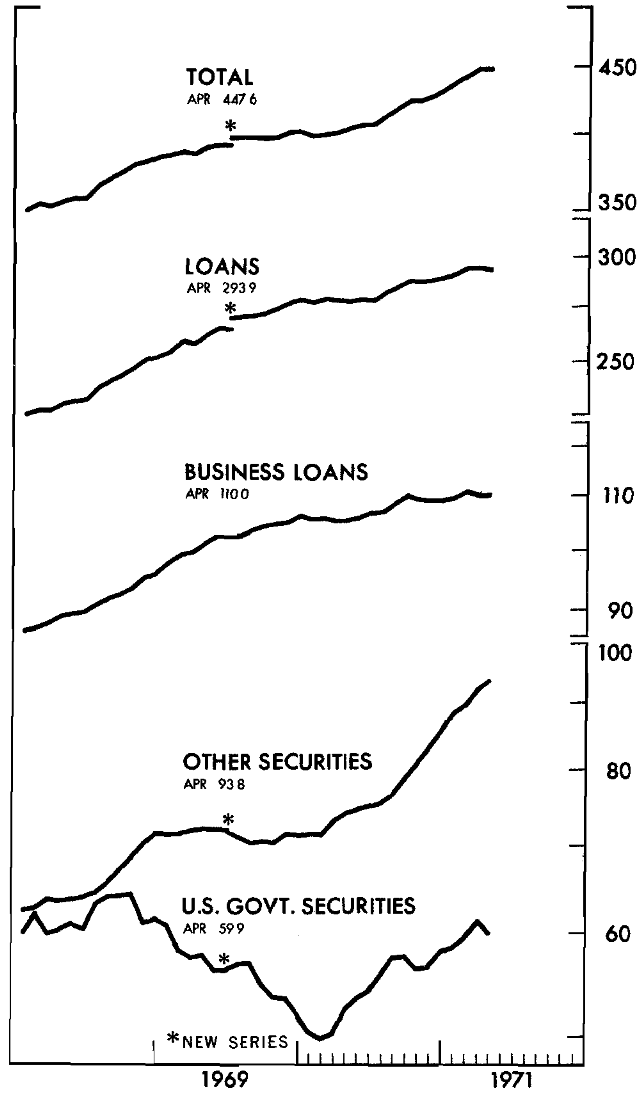
CREDIT PROXY



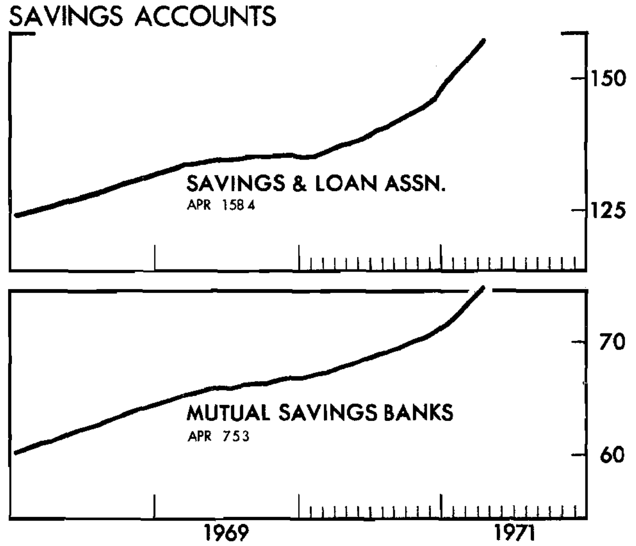
MONEY AND TIME DEPOSITS



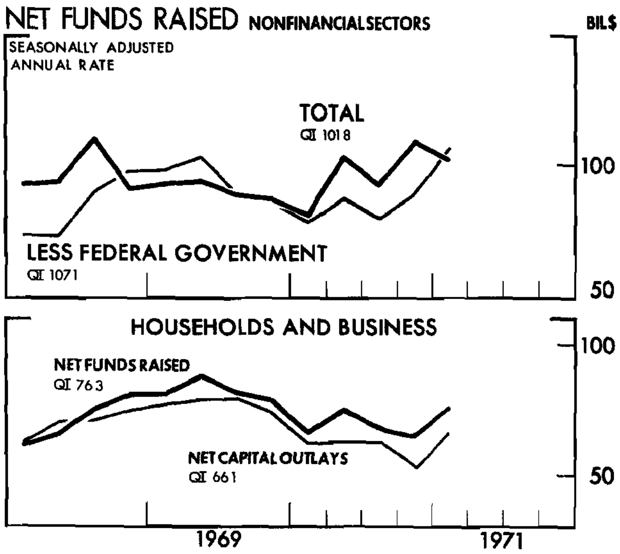
BANK CREDIT

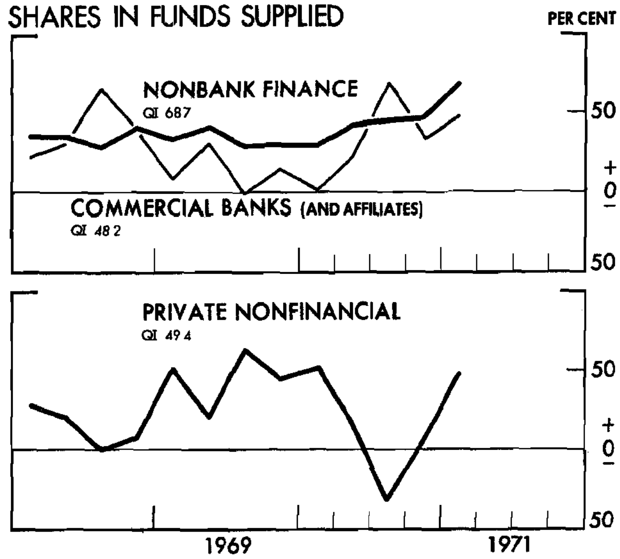


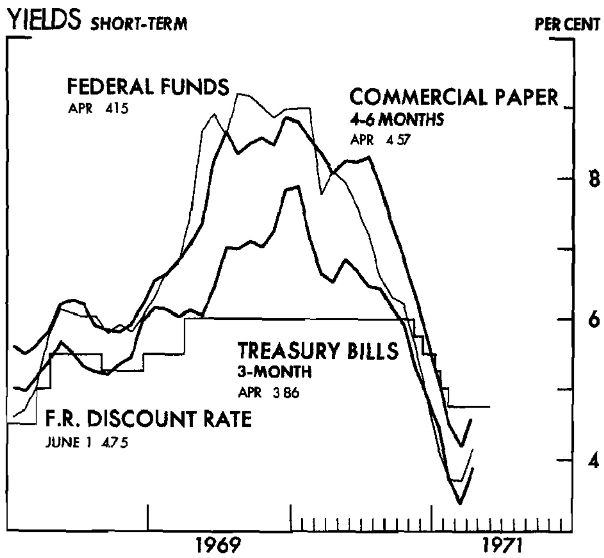
SAVINGS ACCOUNTS

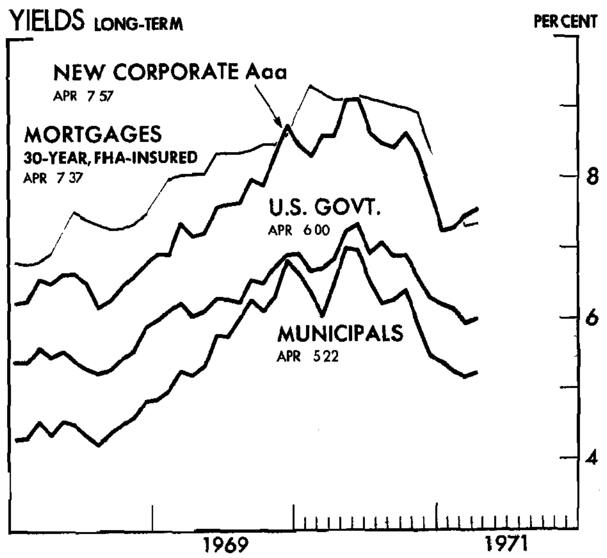


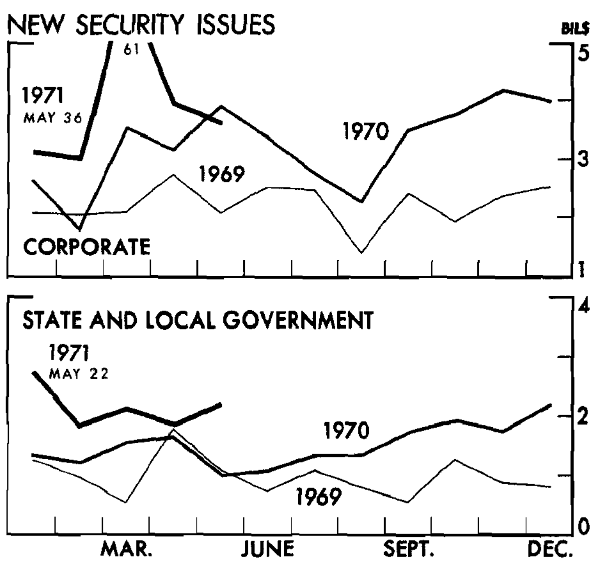
FINANCIAL DEVELOPMENTS - UNITED STATES

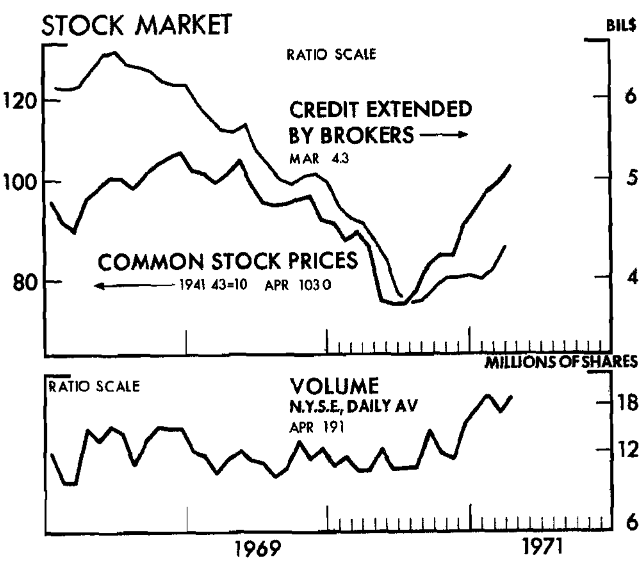












THE ECONOMIC PICTURE IN DETAIL

International Developments

U.S. balance of payments. The principal feature of the balance of payments in late April and early May was, of course, the enormous official settlements deficit resulting from the culmination of speculation on the revaluation of the German mark and other European currencies. Since the week ending May 12, when the weekly deficit peaked at $4.3 billion, there has been an interval of relative calm. But weekly deficits in the two weeks ended May 26 still averaged $300 million, indicating that any profit-taking by American speculators was more than offset by new outflows -- perhaps to take advantage of higher interest rates abroad or to hedge against a yen revaluation. There is also the possibility that developments in the current and long-term capital account are unfavorable. The following table summarizes the course of over-all balances so far this year.

MEASURES OF OVER-ALL DEFICIT
(billions of dollars, N.S.A.)

	Year 1970	1971 1Q	1971 Mar.	1971 Apr.	1971 May 1-12	1971 May 13-26
Official settlements basis 1/	11.1	5.4	2.7	2.5	5.0	.6
Liquidity basis 1/	4.8	2.9	1.5	2.2	4.7	.6
Special transactions affecting:						
Official settlements basis	.4	--	--	.1	--	--
Liquidity basis	.1	-.2	-.1	--	--	--

1/ Before special transactions and allocations of SDR.

Data available now explain only a small part of the worsening in the deficit since the beginning of the year; the main factor was undoubtedly an outflow of liquid capital partly as advances to foreign affiliates (early reports suggest a record first quarter outflow of perhaps $1-3/4 billion) and partly through channels that escape the normal reporting procedures. While interest rate differentials were an important influence, the pace of outflows related to exchange rate uncertainties rose sharply by April. (A survey is being made of major banks to obtain some background information on purchases of foreign exchange at the height of the speculation in early May).

A major adverse development in U.S. transactions in April was a shift in the trade balance from surpluses averaging $100 million per month in the first quarter to a deficit of nearly $300 million. On the other hand, the reduction of liabilities to foreign branches (including Treasury borrowings) was much less in April than before. Other known changes in capital account transactions through April were relatively minor. Foreign dealings in U.S. corporate stocks may have yielded a small net inflow in April, after small net liquidations in February and March. U.S. purchases of foreign securities remained relatively low -- the only notable feature was a rise in purchases of Japanese equities, bringing net purchases of such equities for the year to about $100 million. The April outflow in connection with bank-reported claims on foreigners was moderate, but banks contributed to the large deficit in the week of May 12 when they increased their loans and balances abroad by over $500 million. The rise in balances was quickly reversed but loans to foreign banks rose further after May 12.

Financing of the official settlements deficit this year -- about $13-1/2 billion through May 26 -- has been effected very largely through a huge increase in liabilities to foreign official reserve holders. U.S. reserve assets have declined by about $1.4 billion, including $503 million of gold (of which $290 million was used by foreign countries for payment to the IMF), $330 million of SDR, $311 million of foreign currencies, and a $259 million reduction in the U.S. reserve position with the IMF. Reserve gains of the EEC countries for the year through May 26 totaled about $7 billion, of which Germany accounted for about $5 billion. These countries' reserves have changed only slightly since the first week of May, when the German mark and the guilder were allowed to float. The net reserve gain for the United Kingdom has probably considerably exceeded $2 billion, and the gain for Japan was about $2 billion. Since May 7, Japan has been the only country with major reserve increases.

U.S. foreign trade. The trade balance in April showed a sizable import balance, as exports declined sharply and imports rose steeply. For January-April, the trade balance was zero on the balance of payments basis, down from the $.8 billion annual rate surplus for the last four months of 1970.

The weakening in our trade position this year stems mainly from the strong rise in imports. Much of this strength in imports has been in non-food consumer goods, as well as in foodstuffs.

Exports rose more than imports in the first three months largely because of exceptionally heavy shipments of agricultural commodities throughout the quarter and deliveries of a large number of jumbo jets in March. In April, exports fell as shipments of these goods declined sharply. There were also decreases in exports of other goods in April -- particularly of machinery. However, machinery exports are expected to pick up if there is a sustained resumption of growth in foreign industrial activity.

In January-April, the trade balance with all major industrial areas was worse than in the last four months of 1970. Imports from Canada and Western Europe were up more than U.S. exports to those areas. In trade with Japan, the worsening reflected both declining exports and increasing imports.

U.S. TRADE BY MAJOR WORLD AREAS 1/
(billions of dollars, seasonally adjusted annual rate)

	Sept.-Dec. 1970			Jan.-April 1971		
	Exports	Imports	Balance	Exports	Imports	Balance
World	41.9	41.2	.8	43.5	43.5	--
Canada	8.7	10.9	-2.2	9.8	12.2	-2.4
Western Europe	14.1	11.7	2.2	14.3	12.4	1.9
U.K.	2.5	2.2	0.3	2.7	2.4	0.3
EEC	8.3	6.9	1.4	8.2	7.6	0.6
Japan	4.8	6.3	-1.6	4.1	7.1	-3.0
Rest of World	14.5	12.3	2.2	15.2	11.7	3.5

1/ Estimated balance of payments basis.

Exports, for the period January-April were $43.5 billion, at an annual rate (balance of payments basis), almost 11 per cent higher at an annual rate than in the last four months of 1970. This rate of increase is slightly less than the year-to-year change from 1969 to 1970, when allowance is made for the 1969 dock strike.

In the first four months of this year, increases in shipments of agricultural commodities and of transport equipment (especially commercial aircraft) were partially offset by declines in exports of industrial materials. The rise in exports of automobiles and parts to Canada was associated with the recovery from the GM strike. Exports of machinery were essentially unchanged.

The increase in agricultural exports resulted mainly from larger shipments of soybeans, cotton, and tobacco; exports of grains declined markedly.

Based on unit-value data for the first quarter, almost all of the increase in the value of total exports in January-April can be attributed to higher export prices, particularly in autos and machinery. In contrast, about one-third of the total rise in the value of exports from 1969 to 1970 was accounted for by price increases.

Imports in January-April were also at an annual rate of $43.5 billion (balance of payments basis), 17 per cent higher at an annual rate than in the last four months of 1970. The year-to-year increase from 1969 to 1970 was 10 per cent. About a third of the increase in the value of imports in January-April over the preceding four months represents higher prices, whereas price rises accounted for two-thirds of the increase from 1969 to 1970.

The rise in imports was spread over a broad range of commodities, with significant increases occurring in foods (coffee and sugar), machinery, automotive equipment, and a wide variety of consumer goods. Imports of industrial materials remained roughly unchanged -- declines in imports of petroleum products and copper offset hedge-buying of steel and aluminum in anticipation of possible strikes this year.

The strong showing of automotive imports reflects both the post-strike recovery of Canadian auto production and the continued strength of Japanese and Western European car sales in the United States. Imports of other consumer goods (clothing, footwear, television sets, radios, furniture) continued their upward climb despite little growth in domestic expenditures on such goods.

Foreign exchange markets. Since May 10, when the foreign exchange markets began trading with the Swiss franc and Austrian schilling revalued (by 7.07 and 5.05 per cent, respectively) and the German mark and Dutch guilder floating as an official "interim" policy, the major foreign central banks in the aggregate have made only moderate net additions to their reserves through exchange market intervention. While there has been a fairly large flow of funds out of the Swiss franc since its revaluation, the German mark and Dutch guilder have remained in a range of about 2-1/2 to 4-3/4 per cent and 1-1/2 to 2-3/4 per cent above their respective par values, and neither the Bundesbank nor the Netherlands Bank has intervened in the exchange market. The Swiss reserve losses in the exchange market and a moderate amount of net sales of dollars by the Bank of England since the first week of May have been more than offset by dollar purchases by the National Bank of Belgium and the Bank of Japan.

Shortly after the decision was made to float the mark the Bonn government announced certain measures designed to encourage a reduction in the demand for marks. Interest payments to non-residents on new and maturing DM deposits were prohibited, and non-residents may not purchase short-term German securities, or long-term securities under repurchases agreements, unless a special exemption is obtained from the central bank.

Despite these measures, and the announced intention of German authorities to see the mark exchange rate eventually return to its current par value, the mark advanced fairly steadily in the first two weeks after it was allowed to float. The mark reached a high of about 28.63 U.S. cents (or 4.8 per cent above par) on May 19, apparently in response to rumors that the Bundesbank would very soon enter the market buying marks (selling dollars) at an exchange rate about 5.2 per cent above the mark's par value. But by the last week of May, with no such action having been taken, and Euro-dollar rates sharply higher, the mark declined steadily and on June 1 was quoted at about 28.03 cents, or 2.6 per cent above par. On June 2 the Bundesbank offered to buy marks at 28.03 cents, but the market immediately firmed to about 28.20 cents (or 3.2 per cent above par) and the Bundesbank did not intervene.

During the first two weeks of June the Bundesbank will be receiving about $1/2 billion from the market as its forward mark sales contracts of early March mature; a further $2.1 billion of forward contracts will mature in July. These receipts of dollars (deliveries of marks) by the Bundesbank will add substantially to reserves in the German banking system; in order to absorb some of these additions to domestic liquidity the Bundesbank on June 2 announced an across the board increase in required reserve ratios applying to all classes of German banks' liabilities.

The Dutch guilder exchange rate has more or less passively followed the German mark since the two were floated. The guilder reached its peak level of about 28.4 U.S. cents, about 2.8 per cent above par, at the same time that the mark reached its high; the guilder has since eased to about 1.8 per cent above par. Conditions in the guilder market for the forseeable future will probably continue to be largely determined by developments in the market for German marks. About one half of the Netherlands Bank's $340 million reserve gain in the first week of May has been offset by deliveries of dollars on maturing forward contracts with Dutch banks -- arising from swaps done with these banks three months earlier.

The Swiss franc -- which now has slightly wider upper and lower limits of about 1.85 per cent on either side of par -- traded at less that 1/2 per cent below its par value in the first few days following the revaluation, firmed to a level moderately above par in the third week of May, but has since eased to about 24.40 cents -- compared to its new par value of 24.485. The Swiss National Bank, which purchased about $700 million in the first week of May, has since made net sales of dollars (spot and on a swap basis) totaling about $670 million. Of this amount, $250 million was sold to Swiss banks on a three-month swap basis. By prior agreement the Swiss banks placed these funds on deposit with the BIS, which in turn deposited the funds in the U.S. CD market. At the same time the BNS requested the Federal Reserve to draw $250 million on the swap facility, providing an exchange rate guarantee for that amount of Swiss reserves. The purpose of these transactions was to accomplish a reduction in Swiss official reserves, and Swiss franc liquidity in the Swiss banking system, but in a way that would indirectly channel funds to the United States rather than to other central banks.

On May 11 the National Bank of Belgium resumed dealings in the exchange market with no change in the franc's parity, but at the same time introduced a modification in its existing "dual" exchange rate system -- channeling all capital account transactions through the free (floating) Belgian franc market. (See p. IV - 21).

Since May 11 the free market franc rate has been in a range of about 1/2 to 1 per cent above the official rate; until the last few days of May the official market rate remained at its upper limit and the central bank purchased about $130 million.

In late April and the first week of May the French franc advanced to its upper limit and the Bank of France purchased about $1/4 billion. The exchange rate then declined for a week or so then advanced following the Bank of France's decision to raise both the bank rate and the rate on secured advances and to raise reserve requirements on French banks' domestic and foreign deposit liabilities; but in the last few days of May and the first two days of June the French franc, with other European currencies, declined as Euro-dollar rates rose rapidly.

Sterling, the Canadian dollar and the Italian lira remained largely on the sidelines during and after the early May exchange market crisis, but eased with the recent advances in Euro-dollar rates. The Bank of England has sold, net, about $50 million since the first week of May. The Canadian dollar moved from a high of 99.4 U.S. cents in the first week of May to as low as 98.7 cents on June 2; The Bank of Canada did a small amount of business on both sides of the market during the month. The Italian lira nearly reached its upper limit in the first week of May, when the Bank of Italy purchased $30 million, but has declined fairly steadily since and the Bank of Italy has sold a small amount of dollars.

The Japanese yen remained at its upper limit throughout the month reflecting both speculative positioning in yen and a seasonally strong basic payments balance. For the month as a whole the Bank of Japan purchased over $1 billion, of which about $0.4 billion was purchased in the first week. Japanese authorities have repeatedly rejected the possibility of a revaluation and have taken certain steps to dampen the demand for yen. On May 7 the central bank discount rate was reduced by 1/4 per cent, to 5-1/2 per cent; more recently the Japanese authorities "temporarily" prohibited non-resident purchases of Japanese stocks, bonds, and mutual funds not listed on the exchanges; no prohibition was applied to listed securities in order to avoid a violation of OECD agreements on capital controls.

The large increases in central banks' dollar holdings in early May have prompted numerous transactions on the System swap line and foreign central bank purchases of reserve assets from U.S. holdings. During May the U.S. Treasury sold a total of $367 million of gold, $85 million to the National Bank of Belgium and $282 million to the Bank of France, the latter in connection with a French repayment to the IMF. The Swiss National Bank has recently requested the purchase of $100 million of gold, but final arrangements on the sale have not been completed. The Treasury also sold $55 million of SDR's to the Belgians and $150 million in SDR's to the Dutch in May.

During May the System drew a total of $95 million equivalent on the Belgium swap line and repaid a total of $55 million equivalent on that line using Belgian franc balances acquired as a result of the U.S. Treasury SDR sales to Belgium. System drawings on the $500 million Belgian line now stand at $490 million equivalent. In addition a special $100 million swap line was established between the U.S. Treasury and the National Bank of Belgium during the month, on which the Treasury has drawn the full amount.

Immediately following the floating of the Dutch guilder the System fully repaid its $250 million equivalent obligation on the Dutch swap line using guilder balances purchased from the Netherlands Bank, at the guilder's official upper limit. The clearing up of this swap line was the result of a standing agreement by participants in the swap arrangements to repay all balances if the creditor's currency is revalued or floated. This transaction, in combination with nearly $350 million of reserve gains in the first week of May left the Netherlands Bank with substantial uncovered dollar holdings. So far the only move made by the Dutch to reduce these holdings has been the SDR purchase mentioned above.

Gold prices advanced from around $39.50 in early May to nearly $42.00 at mid-month but have since declined to about $40.75.

Euro-dollar market. Euro-dollar market conditions in May were dominated by developments in the foreign exchange markets. Euro-dollar rates rose very rapidly in the first week of the month as market participants either liquidated Euro-dollar holdings or sought to increase their borrowings from the Euro-dollar market in the course of shifting funds into German marks and other continental currencies. In the next two weeks Euro-dollar rates declined on balance, but remained well above late April levels, primarily because of the lack of any substantial reflow of funds from the major foreign currencies. Then in the last week of May and first two days of June Euro-dollar rates rose markedly; rates in most maturities reached levels above those of the first week of May. The recent sharp advances in Euro-dollar rates have been attributed, primarily, to needs to acquire dollars to deliver to the Bundesbank as the latter's $1/2 billion of forward DM sales contracts made in early March mature in the first two weeks of June. (See Foreign Exchange Markets, p. IV - 8).

Call Euro-dollar deposits were not quoted throughout most of May and meaningful quotes remain difficult to obtain. (As a result the overnight Euro-dollar rate has been substituted for the call rate in the interest rate comparison table below). Overnight Euro-dollars were quoted at 10 to 12 per cent for a few days in early May, declined to around 5-1/4 per cent near mid-month, but reached extraordinarily high levels on the last day of May and averaged over

8 per cent in the first two days of June. Three-month deposits advanced from around 6 per cent in late April to as high as 7-5/8 per cent in the first week of May; after falling to about 7 per cent near mid-month the three-month rate increased to nearly 8 per cent as of June 2.

These Euro-dollar rate developments brought the excess of Euro-dollar rates over the cost of domestic sources of funds to U.S. banks to very high levels in early May and again in late May and early June (See Table), and substantially raised the incentive for U.S. investors to place funds in Euro-dollar deposits.

SELECTED EURO-DOLLAR AND U.S. MONEY MARKET RATES

Average for month or week ending Wednesday	(1) Over-Night Euro-$ 1/	(2) Federal Funds 2/	(3)= (1)-(2) Differential	(4) 3-month Euro-$ Deposit 1/	(5) 60-89 day CD rate (Adj.) 3/	(6) (4)-(5) Differential
1971						
January	5.13	4.14	0.99	5.92	5.10	0.82
February	4.38	3.72	0.66	5.54	4.34	1.20
March	4.43	3.76	0.67	5.11	3.79	1.32
April	4.82	4.15	0.67	5.92	4.41	1.51
May 5	5.63	4.41	1.22	6.41	4.87	1.54
12	9.86	4.59	5.27	7.36	4.87	2.49
19	5.29	4.55	0.74	7.06	5.00	2.06
26	5.81	4.68	1.13	6.86	5.13	1.73
June 2	15.93	4.83p	11.10p	7.70	5.13p	2.57p

1/ All Euro-dollar rates are noon bid rates in the London market; overnight rate adjusted for certain technical factors to reflect the effective cost of funds to U.S. banks.

2/ Effective rate.

3/ Offer rate (median, as of Wednesday) on large denomination CD's by prime banks in New York City; CD rates are adjusted for the cost of required reserves.

p/ Preliminary.

Despite the adverse development in cost differentials there was no marked acceleration in Euro-dollar repayments by U.S. banks between late April and the end of May. Gross liabilities of U.S. banks to their foreign branches declined about $0.6 billion, to $1.7 billion, from April 28 to May 26. (These liabilities increased slightly from April 30 to May 26 owing to a nearly $1 billion decline on the last day of April that was largely reversed in the first few days of May.) From May 26 to 31 partial data show little net change in these liabilities.

In the four week Euro-dollar reserve requirement computation period ended May 12, U.S. banks' Euro-dollar liabilities and foreign branch holdings of special Ex-Im and Treasury securities averaged $475 million less than in the prior computation period; the preceeding period-to-period decline had been about $3/4 billion.

<u>Some implications for industrial countries of recent exchange rate developments</u>. The key to an understanding of recent foreign exchange developments certainly lies in what has happened in the German economy. Although economic indicators still give an ambiguous picture of the strength of aggregate demand in that country, it seems quite clear that prices and wages there will continue to increase at higher than desired rates for some time.

So long as the Bundesbank was constrained to support the mark rate within a relatively narrow band around 3.66 marks per dollar, and was unwilling or unable to impose controls on capital inflows, attempts to pursue a more restrictive, anti-inflationary monetary policy tended to be partially frustrated by inflows of interest-sensitive funds. This dilemma was highlighted by the series of reports and official statements -- now well known -- that led to sharply increased speculative pressures on the mark.

Speculation also spread to other currencies, including those of Austria, Switzerland, and the Netherlands. As seen in the table, these three countries obtain a particularly large proportion of their total imports from Germany. Thus, in the absence of exchange rate action of their own, an appreciation of the mark would tend to have a significant direct impact on their domestic price levels, in addition to the indirect inflationary effects of any increase in their trade and balance-of-payments surpluses (or decrease in their deficits).

Consequently, when the German authorities decided to allow the mark rate to rise, Austria, Switzerland, and the Netherlands -- each with its own concern about inflation -- also felt obliged to raise the dollar value of their currencies (Austria and Switzerland), or to allow it to float (the Netherlands). The Belgians, however, adapted their dual-exchange rate system so as to channel capital inflows into the free market where the National Bank of Belgium does not have to intervene.

The problem of inflation -- not a balance-of-payments disequilibrium, per se -- was what caused exchange rate actions to be considered at this time. (When it became known that such action was being considered, capital inflows forced the decision.) Thus,

IMPORT SHARES IN SELECTED INDUSTRIAL COUNTRIES, 1970
(Per cent of total imports in receiving country)

Importing Country	Supplying Country					
	Germany	Netherlands	Switzerland	Austria	Other	Total
Germany	--	12	3	2	83	100
Netherlands	27	--	1	1	71	100
Switzerland	30	3	--	4	63	100
Austria	41	3	7	--	49	100
United Kingdom	6	5	2	1	86	100
France	22	6	3	a/	69	100
Italy	20	4	2	2	72	100
Belgium	23	15	1	a/	61	100
Japan	3	1	1	a/	95	100
United States	8	1	1	a/	90	100

a/ Less than 0.5 per cent.

in trying to evaluate the implications of all the various measures that have been adopted in the past month, it is necessary to consider the extent to which they enable anti-inflationary policy in Europe to be more effective or more palatable than it would otherwise have been.

In Germany, it is likely that some of the constraints on monetary policy will be removed, and some time may be bought to allow the deflationary impact of fiscal actions to be felt, although the Bonn Government's reluctance to use fiscal policy actively still persists. In the other revaluing countries, however, it is not clear that the exchange rate developments will make it significantly easier to combat inflation than if the Germans had not allowed the mark to float.

Policy options in Germany prior to the floating of the mark had become quite limited. Essentially, the Germans could shift more of the burden from monetary to fiscal policy, or they could try to isolate the domestic financial markets from international flows of funds. Increased reliance on fiscal policy had been rejected earlier, and by early May the effects of fiscal actions would take far too long to work themselves out to be of any help against the strong speculative pressures. The idea of attempting to set up an effective system of exchange controls appears to have been ruled out on grounds of social philosophy, leaving exchange rate action as the only means of achieving an isolation of domestic from international financial markets. Thus, the mark was allowed to float.

In order to support the government's stabilization efforts, and to complement the presumably more effective monetary policy, several fiscal measures were also announced (on May 9). These measures appear to be little more than a moderate tightening of the expenditure ceilings announced in March by former Finance Minister Moeller. As a counterpart to the expenditure ceilings, a reduction -- amounting to about DM 2.3 billion -- in the government's right to borrow was approved on May 21, largely as a means of enforcing the expenditure ceilings at the state and local levels. The total package represents a cut-back on the order of only about 1 per cent of the total public sector budget.

The appreciation of the German mark, assuming it persists, should have some direct impact on the underlying German balance of payments, and thus on the domestic economy, in addition to the implications cited above. In particular, the invisibles account will show a larger deficit, as it did following the 1969 revaluation. The surplus on current account in 1971 may be slightly lower than previously expected (the current balance was $666 million in 1970), but the bulk of any effect probably will not be felt until 1972.

The Netherlands was compelled, following the German move, to let the guilder rate rise. Had the rate remained unchanged, large speculative flows would probably have been directed from the mark to the guilder, creating serious problems for the Dutch monetary authorities. In addition, a revalued mark -- reflected in higher prices of German imports -- would have added significantly to already severe domestic cost inflation, since almost 30 per cent of total Dutch imports come from Germany. Finally, given the tight labor market situation in the Netherlands, the pull of labor to Germany would have been unwelcome.

Increased deficits on both trade account (from \$350 million in 1969 to \$650 million 1970) and current account (from \$4 million to \$480 million) normally would have precluded such a decision. However, about one-third of Dutch exports go to Germany, thereby mitigating the adverse effects of an appreciated mark on the Dutch trade balance. Also, a large portion of Dutch agricultural trade may remain unaffected because of arrangements made within the framework of the Common Market agricultural policy.

The Swiss revaluation was decided upon largely for domestic reasons. Inflationary pressures have caused consumer prices in Switzerland to rise nearly 7 per cent in the past year. With about 30 per cent of Swiss imports originating in Germany, failure to appreciate the exchange rate of the franc would have aggravated that problem.

Unlike the Netherlands case, however, the Swiss revaluation was justifiable on balance-of-payments grounds as well. Although the current account is believed to have been about in balance last year, there was a large capital inflow, partly because Swiss interest rates, which had been low relative to others, held fairly level while

Euro-dollar and other rates declined. The Swiss National Bank's net foreign assets rose $880 million in the 12 months through last April.

The Austrian decision to revalue the schilling was clearly a reaction to the German and Swiss actions. The main objective was to safeguard price stability. An additional consideration was the possibility of intensified labor migration to Germany at a time of acute labor shortage in Austria.

Given Austria's close trade relationships with Germany and Switzerland, the impact of all the parity changes on Austria's trade balance (which is showing a significant deficit) should be small. Moreover, measures to encourage exports have been announced.

The Belgian government announced on May 9 that it would amend the regulations pertaining to Belgium's dual-exchange market system. The new regulations provide that current transactions, excluding unilateral transfers and certain tourism items, are to be settled in the official market -- where the National Bank must intervene when the rate reaches its allowed upper or lower limit -- and that all other transactions, including all capital flows, are to pass through the free market. If there is no official intervention in the free market, the movement of the rate would prevent any net capital inflow or outflow, assuming that the regulations can be enforced so that the two markets are in fact completely separated.

While the new exchange market regulations will protect the Belgian economy from net capital inflows, speculative or otherwise, they will not serve to reduce the large Belgian current account surplus. In 1970, this surplus amounted to $750 million, and another large current account surplus was expected this year, even before the recent realignment of exchange rates.

The failure of Belgium to revalue or float the franc seems to have several explanations. The authorities there probably share in some degree the French view that present external surpluses of European countries are caused by disequilibrium on the part of the United States which this country ought to correct by its own actions. Secondly, Belgian officials are very cautious about any action that might weaken their balance of payments. Thirdly, inflation in Belgium in the past year has been less severe than in a number of other industrial countries, so that the inflationary consequences of maintaining the official exchange rate while others revalue may be less acutely felt.

France, Italy, and the United Kingdom took no exchange rate actions. France has had large balance-of-payments surpluses since late 1969, and is currently experiencing high rates of price and wage inflation. Nevertheless, the French chose not to revalue the franc, perhaps because the French feel it is up to the United States, not the Europeans, to take actions to correct international payments imbalances, but also because the French external accounts may not remain as strong as they now appear. This would be the case if, as we suspect, much of the 1970-71 surplus -- all of which was on capital account -- has been due to a reflow of capital that fled France prior to the devaluation.

On May 13, the Bank of France tightened its policy, by raising its discount rate (from 6-1/2 to 6-3/4 per cent) and its reserve requirements. It is unlikely that these actions will significantly help to reduce domestic inflationary pressures, especially in view of the reduced importance of rediscounting and the relatively free access of banks to reserve funds supplied by the Bank of France through the so-called money market. But at any rate monetary policy in France, unlike that in Germany, would be somewhat protected by exchange controls from inflows of funds from abroad if an effort were really made to check credit expansion.

Italy also has been having a balance-of-payments surplus. But Italy's external position could deteriorate sharply if labor unrest intensified, or if the government and central bank decided to ease their policy stance, as now seems quite possible.

Since about 30 per cent of trade in both France and Italy is with the revaluing countries, the latest exchange rate developments will have an impact on price levels and external balances in both countries, assuming that Germany and the Netherlands do in fact revalue their currencies or let them float above the earlier range for any length of time. Presumably, this impact is considered tolerable.

The United Kingdom is in a position different from the other countries. Specifically, resolution of the exchange "crisis" by currency appreciations can yield only positive net results for Britain, in terms of both its balance of payments and its domestic economy.

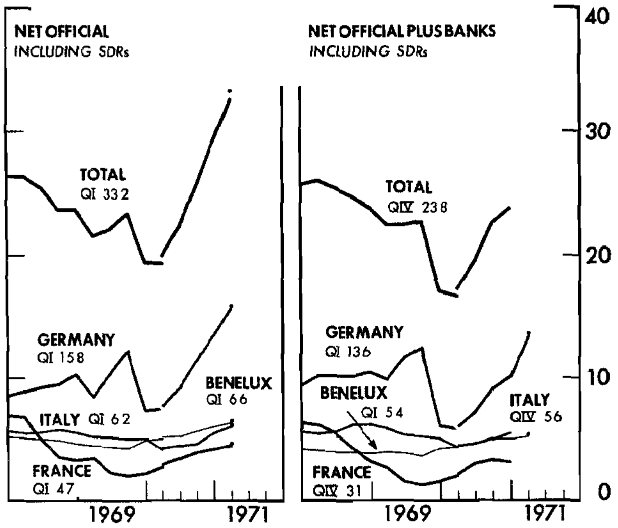
The favorable effect of appreciation by the other currencies on Britain's balance of payments may be of significant magnitude. A large part of the gain would derive from increased exports to third countries. In the first four months of 1970, Britain appears to have been running a current account surplus at an annual rate of about $1.3 billion, but with wage costs and prices rising at rates higher than elsewhere, the relative devaluation of the pound may help to prevent a serious deterioration in Britain's balance of payments from emerging as early as otherwise might have happened. Moreover, there is considerable spare capacity at present (unemployment is exceptionally high, and industrial output is depressed), so that stimulus provided by increased exports is welcome, and may not have significant inflationary implications. Finally, since imports from the revaluing countries account for a relatively small proportion of total British imports, the direct effect on British prices will be correspondingly small.

<u>Japanese</u> exports would tend to benefit from a permanent revaluation of the German mark, primarily because that would tend to improve Japan's competitive position in third markets. Further pressures for a revaluation of the yen have thus developed.

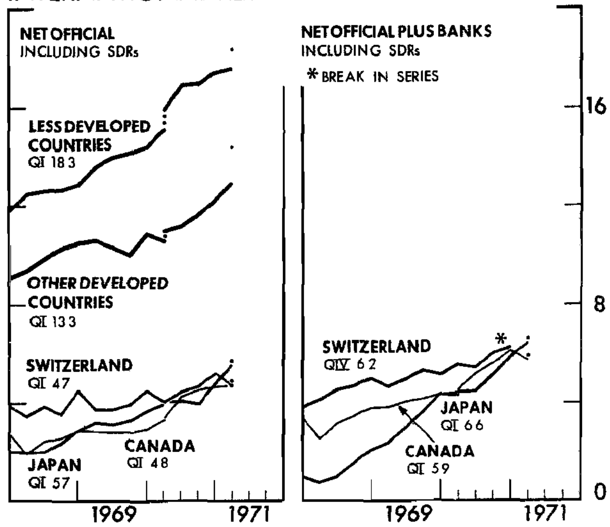
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

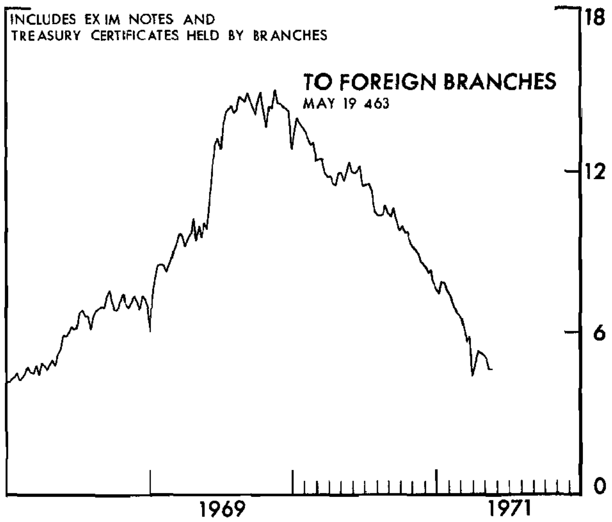
INTERNATIONAL RESERVES EEC COUNTRIES



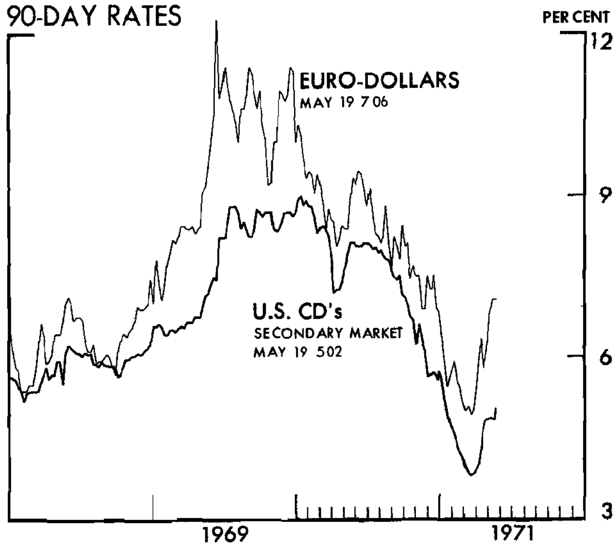
INTERNATIONAL RESERVES OTHER COUNTRIES



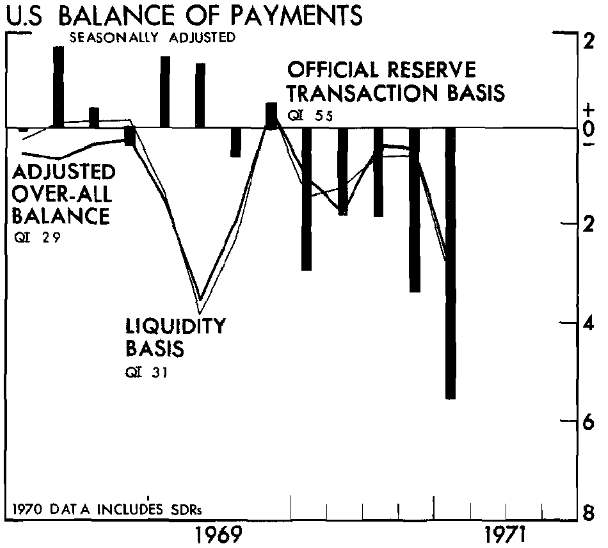
U.S. BANK LIABILITIES



90-DAY RATES



U.S. BALANCE OF PAYMENTS



U.S. MERCHANDISE TRADE