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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

October 13, 1971

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International Developments IV

SUMMARY AND OUTLOOK

Nonfinancial

Economic data relating to the period following mid-August announcement of the new economic program suggest that, on balance, activity was gaining momentum at the end of the quarter and increases in average prices and wages had moderated significantly. For the third quarter as a whole, however, real GNP is still estimated to have increased at about a 2 per cent annual rate, well below the second-quarter increase.

In September the labor market firmed; nonfarm payroll employment increased sharply, fairly large gains were reported in most manufacturing industries, and the unemployment rate edged down to 6.0 per cent following increases in the two previous months. However, the average work week in manufacturing industries declined further. The industrial production index is estimated to have risen somewhat in September, reflecting in part recovery in steel production, and increased business equipment and consumer goods output.

Sales of domestic-type automobiles continued strong in late September and for the month as a whole were about 12 per cent above the August rate, apparently reflecting the expected cut in the excise tax and possible price increases after mid-November. Sales of imports, which rose to record levels in August, fell back last month, apparently due to a shortage of supplies resulting from the West Coast dock strike.

Most chain and department stores reported strong sales in September, and total retail sales are estimated to have increased by 0.6 per cent during the month.

New orders for durable goods advanced in August in all categories except defense and primary metals; excluding these groups orders were an impressive 5 per cent above the second-quarter average. New orders exceeded shipments in August for the first month in some time.

The wholesale price index, seasonally adjusted, fell appreciably between August and September. Although most of the decline reflected a reduction in prices of farm and food products, prices of industrial commodities also moved lower for the first time since mid-1964. Average hourly earnings for the private nonfarm economy, seasonally adjusted, levelled off in September. In manufacturing, trade and services, the year-over-year increases in hourly earnings were well below those of other recent months.

Outlook. Real GNP is now projected to rise at an annual rate of about 7 per cent in the fourth quarter, a somewhat faster pace than previously anticipated. The projection has been raised because of the apparent recent strengthening of consumer spending, a shift in the assumed date of the military pay increase from January 1 to mid-November, and the enhanced probability that the tax benefits enacted by Congress will be effective earlier and will be larger than the Administration recommended. The GNP deflator should increase less than during the third quarter, although some flurry of price increases seems probable after mid-November.

In the first half of next year real GNP is projected to rise at an average rate of about 7.5 per cent. Because of the large expected increase in final sales, and in particular the anticipated need of the auto industry to replenish depleted stocks, inventory investment is expected to increase appreciably. Business fixed investment should also begin to move up as real growth accelerates and businesses begin to take increasing advantage of the investment tax credit. Consumer spending is likely to be strengthened further by rising disposable income, reflecting increases in employment and hours of work, and--if the House tax bill becomes law--substantially larger tax refunds in the first half of next year than previously had been anticipated. The new programs are also expected to result in a shift from deficit to surplus in net exports of goods and services.

We have assumed that the President's program will keep price increases in the private sectors in the range of 2.5 - 3.0 per cent. The gains in real GNP we have projected in the first half of next year should result in both large gains in productivity and a substantial increase in employment. However, we also expect a sizable increase in the labor force. On balance, the unemployment rate is projected to decline to 5.5 per cent in the second quarter of 1972.

Financial

Recent Developments. Since the last Committee meeting, interest rates in both short- and long-term markets have declined roughly 1/8 to 1/4 of 1 percentage point, and most market rates are now at their lowest level since the President's mid-August speech. Most of the decline occurred before the announcement of the Administration's post-freeze plan in early October as market participants apparently had discounted the market impact of the program. In addition, slackened growth in key monetary aggregates along with declines in the Federal funds rate had generated market expectations of an easier monetary policy.

Growth in total loans and investments at commercial banks slowed during September from the rapid August rate. Business loan growth was sharply reduced from the month earlier when demands had been bolstered by developments in foreign exchange markets. But real estate and consumer loans continued to expand briskly, and banks added appreciably to their holdings of municipal securities.

Banks financed their September credit growth mainly by selling negotiable CD's. Consumer-type time and savings deposits at commercial banks rose at about the same moderate rate as in August. On the other hand, net inflows of deposits at nonbank thrift institutions accelerated. This faster deposit growth, together with Government mortgage support programs appears to have stabilized yields on home mortgages in September.

Outlook. If economic activity accelerates as projected during the fourth quarter, credit demands in short-term markets are likely to expand further in light of consumer and business financing needs. Also, sizeable Treasury and Federal agency demands are in prospect, although their cash needs are expected to be only $2-1/2 billion larger than seasonal--and less than a year ago--assuming no appreciable drain on Treasury cash from reductions in official foreign accounts. Part of their demands will fall on commercial banks who may rely to a considerable extent on CD sales for funds, given the outlook for only modest growth in other sources.

Upward rate tendencies in short-term markets, which usually occur anyway in the fourth quarter, could develop in this environment, with possible feedback effect on long-term rates. On the other hand, upward rate pressures could be offset by continuing favorable public assessment of the post-freeze program. Moreover, long-term interest rates will be under reduced pressure because credit demands in such markets probably will be smaller than earlier this year. Corporate bond offerings are expected to taper off in association with further improvements in internal funds generation. State and local government bond issues might also recede following the flotation of some previously postponed issues in September.

Mortgage rates might ease with the seasonal decline in mortgage credit demands, given continuing strong Government support programs, especially through FNMA and GNMA, and ample cash flows of funds at thrift institutions. The volume of financial saving is expected to remain large despite some pick-up in consumer spending, and developments in securities markets do not suggest any appreciable, further shift in fund flows away from financial institutions.

Balance of payments

The U. S. foreign trade position in August was again heavily in deficit, and it is expected that September results will prove to have been similar. Three kinds of factors were responsible for the $4 billion annual rate of trade deficit in April-August. Some part of the adverse balance resulted from underlying factors of deterioration in the U. S. trade position, including not only U. S. competitive difficulties with manufactured products but also structural elements such as the growing requirement for petroleum imports. Some part was due to cyclical weakness in aggregate demand in Japan and other foreign countries. A third part was due to temporary factors, such as anticipation of the East Coast port strike which began this month. In the current (fourth) quarter, a more favorable position with respect to the last of these categories should bring some narrowing of the trade deficit, as will the effects of the temporary import surcharge. Further improvement as a result of exchange rate changes and the U. S. wage and price control programs may become visible next year, if not sooner.

Cyclical factors here and abroad may work against the expected improvement in the foreign trade balance next year, keeping the gains less than they might otherwise be. While some acceleration in aggregate demand may occur in Britain, Japan, and Canada, helping U. S. exports, such developments might not outweigh the effects of rising U. S. activity and income on U. S. imports. Meanwhile, in continental Western Europe a period of generally slow real GNP growth may be setting in, bringing some further easing of supply positions in Europe. Whereas the slowdown in growth that started in the spring of 1970 eased demand-supply conditions at first mainly for steel and other industrial materials, this year such effects are being felt in markets for machinery and equipment.

Under present conditions of controlled floating of exchange rates, statistics of the over-all U. S. balance of payments position are of limited significance. The September official settlements deficit was about $1-1/2 billion. Apparently there were still some sizable short-term capital outflows in September, though not on the August scale. No big reflows of speculative funds have been evident--though a sharp drop has occurred in Euro-dollar interest rates.

The continuing tendency for the United States to have a deficit in the underlying payments position can be met with four sorts of reactions, with varying results for reserves and exchange rates.

There may be further appreciations of some foreign currencies, with temporary shifts of private funds balancing the accounts until other adjustments occur. Or some countries may choose to acquire additional official dollar reserves, even though the dollars are inconvertible and of uncertain future value in foreign currency terms. Or there may be a further proliferation of measures to restrict capital inflows taken by foreign countries trying to avoid either of the first two courses. Lastly, there continues to be a danger that foreign dissatisfaction with the present situation, accentuated by unhappiness about the U. S. surcharge and the discriminatory feature of the investment tax credit, may bring retaliation in such forms as export subsidies.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1971				Per Cent Change* From		
	June	July	Aug.	Sept.	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	83.1	83.8	84.3	84.6	0.3	1.8	2.0
Unemployment rate (%)	5.6	5.8	6.1	6.0	--	--	5.4 4/
Insured unempl. rate (%) 5/	4.4	4.0	4.2	n.a.	--	--	3.7 4/
Nonfarm employment, payroll (mil.)	70.7	70.5	70.6	70.9	0.4	0.3	0.5
Manufacturing	18.6	18.5	18.5	18.6	0.7	0.0	-3.3
Nonmanufacturing	52.0	52.0	52.1	52.3	0.3	0.4	2.0
Industrial production (1967=100) 5/	107.0	106.0	105.1	n.a.	-0.8	-1.8	-2.2
Final products, total	104.3	104.3	104.1	n.a.	-0.2	0.2	-0.8
Consumer goods	115.9	115.8	115.5	n.a.	-0.3	-0.2	3.5
Business equipment	95.0	95.4	95.0	n.a.	-0.4	0.6	-6.6
Materials	108.7	105.8	104.2	n.a.	-1.5	-4.3	-4.7
Capacity util. rate, mfg.	74.7	74.0	72.8	72.6	--	--	77.0 4/
Wholesale prices (1967=100) 1/	114.3	114.6	114.9	114.5	-0.3	0.2	3.2
Industrial commodities (FR) 5/	113.7	114.3	114.9	n.a.	0.5	1.3	4.5
Sensitive materials (FR) 5/	113.6	115.1	116.4	n.a.	1.1	2.7	2.9
Farm products, foods & feeds	115.4	115.0	114.6	113.0	-1.4	-2.1	0.4
Consumer prices (1967=100) 1/ 5/	121.5	121.8	122.2	n.a.	0.3	1.2	4.5
Food	119.2	119.8	120.0	n.a.	0.2	1.5	3.5
Commodities except food	117.1	117.0	117.3	n.a.	0.3	0.6	4.2
Services	128.2	128.8	129.4	n.a.	0.5	1.5	5.5
Hourly earnings, pvt. nonfarm ($)	3.42	3.43	3.46	3.45	-0.3	0.9	5.8
Hourly earnings, mfg. ($)	3.57	3.58	3.59	3.60	0.3	0.8	5.3
Weekly earnings, mfg. ($)	142.55	143.09	142.40	142.22	-0.1	-0.2	6.0
Net spend. weekly earnings, mfg. (3 dependents 1967 $) 1/ 5/	102.45	101.27	101.17	n.a.	-0.1	-0.6	1.8
Personal income ($ bil.) 2/ 5/	807.1	859.2	868.0	n.a.	1.0	2.1	7.3
Retail sales, total ($ bil.)	33.3	33.0	33.6	33.8	0.6	1.4	9.4
Autos (million units) 2/	8.2	8.4	8.4	9.5	12.1	15.7	38.2
GAAF ($ bil.) 3/	9.3	9.0	9.1	9.0	-0.6	-2.3	9.8
12 leaders, composite (1967=100) 5/	125.0	127.1	125.9	n.a.	-0.9	0.6	9.3
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/ 5/	2,000	2,215	2,228	n.a.	0.6	12.8	56.4
Factory workweek (hours)	40.0	40.0	39.8	39.6	-0.5	-1.0	0.8
Unempl. claims, initial (thous.) 5/	307	275	333	n.a.	-21.3 6/	-9.6 6/	-11.8 6/
New orders, dur. goods, ($ bil.) 5/	30.7	31.7	31.5	n.a.	-0.7	2.9	5.9
Capital equipment	8.2	7.5	8.1	n.a.	7.8	2.8	7.6
Common stock prices (41-43=10)	99.72	99.00	97.24	99.40	2.2	-0.3	20.4

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l. merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ Percent calculated to August 1971. 6/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	Averages					
	1970	1971				Week ended
	QIV	QI	QII	QIII	Sept.	Oct. 6
Interest rates, per cent						
Federal funds	5.57	3.86	4.56	5.47	5.55	5.32
3-mo. Treasury bills	5.35	3.76	4.26	5.01	4.69	4.54
3-mo. Federal agencies	5.50	3.78	4.43	5.29	5.11	5.01
3-mo. Euro-dollars	7.46	5.50	6.72	7.77	8.34	7.30
3-mo. finance co. paper	6.12	4.48	4.74	5.52	5.44	5.44
4-6 mo. commercial paper	6.28	4.57	5.05	5.74	5.75	5.75
Bond buyer municipals	5.93	5.25	5.74	5.75	5.37	5.24
Aaa corporate-new issues	8.26	7.33	7.83	7.68	7.44	7.53
20-year Treasury bonds	6.57	6.00	6.24	6.24	6.05	5.96
FHA mortgages, 30-year	8.76	--	7.67	n.a.	n.a.	--

	1970	1971			
	QIV	QI	QII	QIII	Sept.
Change in monetary aggregates (SAAR, per cent)					
Total reserves	6.6	11.0	6.6	11.3	18.5
Nonborrowed reserves	9.4	11.0	5.3	11.7 e	32.3 e
Credit proxy	15.1	17.0	9.6	9.6 e	8.0 e
Credit proxy + nondep. funds	8.3	10.9	6.5	9.0	8.5
Money supply	3.4	8.9	11.3	3.0	-3.7
Time and savings deposits	21.8	27.3	13.5	11.0	14.9
Deposits at S&L's and MSB's	11.6	23.3	17.3	n.a.	n.a.
Bank credit, end-of-month 1/	8.6	12.2	9.1	9.8	9.7
Treasury securities	6.2	19.8	9.8	-14.0	-17.5
Other securities	36.5	27.9	17.0	9.9	17.2
Total loans 1/	1.4	6.3	6.6	14.7	12.4
Business 1/	-4.9	2.5	4.6	16.5	8.1

	1970	1971			
	QIV	QI	QII	QIII	Sept.
Change in commercial paper ($ millions)					
Total (SA)	-760	-2,581	-874	n.a.	n.a.
Bank-related (NSA)	-2,269	-657	41	133	74

	1969	1970			1971	
	QIII	H-2	QIII	Sept.	QIII	Sept.
New security issues (NSA, $ millions)						
Total corp. issues	6,332	20,499	8,560	2,518	11,034 e	4,120 e
Public offerings	4,984	16,830	7,646	3,129	9,247 e	3,370 e
State and local government bond offerings	2,464	10,327	4,465	1,758	5,499 e	1,700 e
Fed. sponsored agency debt (change)	2,697	3,057	1,593	339	1,722 e	434 e
Fed. govt. debt (change)	4,741	16,259	7,368	2,718	9,580 e	-1,500 e

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.
Note: ** Bank credit data revised beginning in January to reflect adjustments to June 30, 1971 Call Report Benchmarks.

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

	1971 p/				
	I	II	June*	July*	Aug.*
Goods and services, net 1/	1,147	-22			
Trade balance 2/	269	-1,040	-424	-360	-320
Exports 2/	11,030	10,716	3,594	3,435	3,635
Imports 2/	-10,761	-11,756	-4,018	-3,795	-3,955
Service balance	878	1,018			
Remittances and pensions	-342	-357			
Govt. grants & capital, net	-1,026	-1,094			
U.S. private capital (- = outflow)	-2,230	-1,967			
Direct investment abroad	-1,370	-1,315			
Foreign securities	-353	-396	-150	-70	-174
Bank-reported claims -- liquid	-72	38	437	-77	-272
" " " other	-53	-317	139	113	-1,372
Nonbank-reported claims -- liquid	-225	66	76	-13	n.a.
" " " -- other	-157	-43			
Foreign capital (excl. reserve trans.)	-2,241	-110			
Direct investment in U.S.	92	-24			
U.S. corporate stocks	78	1	-11	-4	79
New U.S. direct investment issues	317	264			
Other U.S. securities (excl. U.S. Treas.)	164	-59			
Liquid liabilities to:	-2,693	-59	1,025	-422	-1,025
Commercial banks abroad	-3,042	-85	1,134	-437	-1,040
Other private foreign	78	-148	-86	-66	-91
Intl. & regional institutions	271	174	-23	81	106
Nonliquid liab. to banks and others	-199	-233			
Foreign official reserve claims	4,856	5,047	-1,515	2,250	7,607
Liquid	5,067	5,216	-1,455	2,309	7,710
Other	-211	-169	-60	-59	-103
U.S. monetary reserves (increase, -)	862	838	307	221	1,155
Gold stock	109	456	61	54	244
Special drawing rights 3/	125	196	--	100	50
IMF gold tranche	255	252	250	-5	859
Convertible currencies	373	-66	-4	72	2
Errors and omissions	-1,026	-2,335			
BALANCES (deficit -) 3/					
Official settlements, S.A.	-5,718	-5,885			
" " N.S.A.	-5,440	-6,444	1,208	-2,471	-8,762
Net Liquidity, S.A.	-2,728	-5,930			
" " , N.S.A.	-2,604	-6,572	-330	-1,959	n.a.
Adjusted liquidity, S.A. 4/	-3,025	-5,826			
" " , N.S.A.	-2,927	-6,548	183	-2,049	-7,737

* Monthly, 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/ Excludes allocation of $717 million of SDRs on 1/1/71.
4/ Measured by changes in U.S. monetary reserves, all liabilities to foreign official reserve agencies and liquid liabilities to commercial banks and other foreigners.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. Our current estimate of GNP for the third quarter is little changed from the projection of four weeks ago. A rise of $15 billion, annual rate, is now indicated, $1 billion less than last time. In real terms, economic activity is now estimated to have risen at an annual rate of about 1.7 per cent, with the GNP deflator up about 4 per cent, annual rate. (The official OBE estimate for the third quarter should be available by the end of the week.)

Our previous estimate of inventory investment in the third quarter has been reduced $1 billion to $2.7 billion; manufacturers continued to liquidate inventories in August. Sales of domestic-type autos rose sharply in September, while production was about unchanged. Our earlier estimate of net exports of goods and services has been revised down by $1 billion to a minus $2.0 billion because of further deterioration in foreign trade in July and August. State and local government expenditures have been pared by $.5 billion because their construction outlays have failed to expand as anticipated. But largely offsetting these downward revisions are upward revisions in outlays for residential construction and personal consumption.

The current projection of GNP and its components for the final quarter of this year and the first two quarters of next year is based on the assumptions underlying our previous projection with these

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

	Third Quarter		Fourth Quarter	
	Proj. of 9/15/71	Current	Proj. of 9/15/71	Current
	--------Billions of dollars------------			
GNP	16.0	15.0	22.8	25.5
Final sales	17.9	18.0	21.1	23.7
Personal consumption	10.9	11.6	14.4	14.9
Residential construction	1.3	2.2	1.4	1.1
Business fixed investment	1.0	1.0	- .2	.0
Net exports	- .5	-1.5	.0	1.0
Federal purchases	1.8	1.8	2.5	3.7
State & local purchases	3.5	3.0	3.0	3.0
Inventory change	-1.9	-3.0	1.7	1.8
	-----------Per cent Per Year-----------			
Real GNP	2.1	1.7	6.4	7.1
GNP deflator	4.1	3.9	2.2	2.5 1/

1/ Excluding $1.2 billion, annual rate, of voluntary army pay increase, 2.1 per cent per year.

modifications:

--the effective date of the military pay increase associated with the volunteer army is shifted to November 15th in line with the recently enacted legislation and with the end of Phase I of the price-wage freeze.

--the provisions of the House-passed Revenue Act of 1971, which contains some modifications, have been substituted for the Administration-proposed version. These provisions are discussed in the financial section of the Greenbook.

Advancing the starting date of the military pay increase associated with the volunteer army to November 15 would raise the increase previously projected for the fourth quarter for Federal government defense spending, and personal income, by $1.2 billion, annual rate. The increase in defense purchases and personal income in the first quarter of next year would also be $1.2 billion when the balance of the pay increase becomes effective. Thus, the first quarter increase is $1.2 billion smaller than projected previously.

The additional liberalizations in Federal personal income tax liabilities passed by the House, retroactive to the beginning of this year, would also result in sizable increases in disposable personal income in the current and next two quarters. These increases in income are expected to induce somewhat larger gains in consumption expenditures than we had previously projected in each of the three quarters involved.

We have held to our assumption that business fixed investment through mid-1972 would be mainly influenced by actual and prospective capacity utilization rates. Therefore, we have not changed our projected figures for the period despite the reduction in our tax credit benefit assumption.

Besides the revisions in Federal defense outlays and personal consumption expenditures in the fourth quarter of this year and the first two quarters of next year because of changes in the underlying assumptions, we have modified slightly the pattern of residential construction outlays and business inventory investment as indicated in the text tables.

GNP AND RELATED ITEMS, 1972
(Changes in seasonally adjusted totals at annual rates)

	First Quarter		Second Quarter	
	Proj. of 9/15/71	Current	Proj. of 9/15/71	Current
	---------Billions of dollars------------			
GNP	30.5	31.0	25.4	27.0
Final sales	28.3	27.8	20.6	22.2
Personal consumption	16.7	17.2	13.4	15.3
Residential construction	1.4	1.8	.7	.4
Business fixed investment	1.7	1.5	2.5	2.5
Net exports	1.5	1.5	1.5	1.5
Federal purchases	3.0	1.8	- .5	- .5
State & local purchases	4.0	4.0	3.0	3.0
Inventory change	2.2	3.2	4.8	4.8
	-----------Per Cent Per Year-----------			
Real GNP	7.3	7.9	7.5	7.1
GNP deflator	3.9	3.5 1/	1.6	2.5

1/ Excluding remaining $1.2 billion, annual rate, voluntary army pay increase, 3.1 per cent, per year.

The effect of these modifications is to strengthen the substantial expansion previously indicated for these three quarters. The annual rate of real change through mid-1972 now averages 7-1/4 per cent per year with a price rise assumed to be in a range of about 2-1/2 to 3 per cent per year.

The stronger economic picture now projected seems likely to result in slightly larger gains in employment, and also in the labor force. We continue to anticipate an acceleration in output per manhour

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October 13, 1971

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

	1970	1971 Proj.	1971 I	1971 II	1971 III (Projection)	1971 IV (Projection)	1972 I (Projection)	1972 II (Projection)
Gross National Product	974.1	1051.4	1020.8	1043.1	1058.1	1083.6	1114.6	1141.6
Final purchases	971.3	1047.4	1017.6	1037.4	1055.4	1079.1	1106.9	1129.1
Private	751.9	813.6	789.4	807.2	820.4	837.4	859.4	879.1
Excluding net exports	748.3	813.4	785.2	807.7	822.4	838.4	858.9	877.1
Personal consumption expenditures	615.8	666.4	644.6	660.9	672.5	687.4	704.6	719.9
Durable goods	88.6	102.2	97.6	100.8	103.5	107.0	110.9	114.0
Nondurable goods	264.7	281.2	272.0	279.8	283.0	290.0	298.0	304.7
Services	262.5	283.0	275.0	280.4	286.0	290.4	295.7	301.2
Gross private domestic investment	135.3	151.1	143.8	152.4	152.6	155.5	162.0	169.7
Residential construction	30.4	40.3	36.4	39.7	41.9	43.0	44.8	45.2
Business fixed investment	102.1	106.8	104.3	107.0	108.0	108.0	109.5	112.0
Change in business inventories	2.8	4.0	3.2	5.7	2.7	4.5	7.7	12.5
Nonfarm	2.5	3.6	3.0	5.2	2.0	4.0	7.5	12.5
Net exports of goods and services	3.6	0.2	4.2	-0.5	-2.0	-1.0	0.5	2.0
Exports	62.9	66.5	66.1	66.4	66.9	66.5	71.0	72.7
Imports	59.3	66.3	61.9	66.9	68.9	67.5	70.5	70.7
Gov't. purchases of goods & services	219.4	233.8	228.2	230.2	235.0	241.7	247.5	250.0
Federal	97.2	97.8	96.7	95.7	97.5	101.2	103.0	102.5
Defense	75.4	72.3	73.0	71.8	71.5	72.7	73.5	73.5
Other	21.9	25.5	23.7	23.9	26.0	28.5	29.5	29.0
State & local	122.2	136.0	131.5	134.5	137.5	140.5	144.5	147.5
Gross national product in constant (1958) dollars	720.0	741.1	729.7	738.4	741.6	754.7	769.6	783.3
GNP implicit deflator (1958 = 100)	135.3	141.9	139.9	141.3	142.7	143.6	144.8	145.7
Personal income	803.6	859.2	834.3	854.8	866.5	881.0	901.0	918.0
Wage and salary disbursements	541.4	576.5	562.3	572.4	580.2	590.9	605.2	617.2
Disposable income	687.8	744.0	721.6	740.8	750.2	764.1	784.0	799.3
Personal saving	54.1	58.6	58.4	60.9	58.5	57.2	59.5	59.2
Saving rate (per cent)	7.9	7.9	8.1	8.2	7.8	7.5	7.6	7.4
Corporate profits before tax	75.4	82.9	79.1	83.3	82.5	86.5	93.5	99.5
Corp. cash flow, net of div. (domestic)	69.8	81.2	77.2	81.2	81.3	85.1	90.9	96.2
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	191.5	199.5	195.6	198.3	200.9	203.3	208.3	213.4
Expenditures	205.1	222.3	213.2	220.9	224.5	230.4	237.0	238.9
Surplus or deficit (-)	-13.6	-22.7	-17.5	-22.6	-23.6	-27.1	-28.7	-25.5
High employment surplus or deficit (-)	0.9	0.9	2.9	1.1	3.4	-3.8	-7.2	4.9
Total labor force (millions)	85.9	86.9	86.5	86.5	87.0	87.6	87.9	88.2
Armed forces "	3.2	2.8	3.0	2.8	2.8	2.7	2.6	2.5
Civilian labor force "	82.7	84.1	83.6	83.7	84.2	84.9	85.3	85.7
Unemployment rate (per cent)	4.9	6.0	5.9	6.0	6.0	5.9	5.7	5.5
Nonfarm payroll employment (millions)	70.6	70.7	70.4	70.7	70.6	71.2	71.8	72.4
Manufacturing	19.4	18.6	18.7	18.6	18.5	18.7	18.9	19.1
Industrial production (1967 = 100)	106.7	106.5	105.5	106.7	105.6	108.0	110.8	113.6
Capacity utilization, manufacturing (per cent)	78.1	74.2	74.5	74.9	73.2	74.1	75.2	76.3
Housing starts, private (millions A.R.)	1.43	2.04	1.81	1.96	2.18	2.20	2.20	2.15
Sales new autos (millions, A.R.)								
Domestic models	7.12	8.71	8.39	8.29	8.76	9.40	9.40	9.40
Foreign models	1.23	1.53	1.50	1.53	1.59	1.50	1.40	1.30

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.	1971 I	1971 II	1971 III (Projection)	1971 IV (Projection)	1972 I (Projection)	1972 II (Projection)
	Billions Of Dollars							
Gross National Product	45.0	77.3	32.4	22.3	15.0	25.5	31.0	27.0
Inventory change	-4.6	1.2	-0.5	2.5	-3.0	1.8	3.2	4.8
Final purchases	49.6	76.1	32.9	19.8	18.0	23.7	27.8	22.2
Private	39.9	61.7	28.4	17.8	13.2	17.0	22.0	19.7
Excluding net exports	38.3	65.1	26.9	22.4	14.7	16.0	20.5	18.2
Net exports	1.6	-3.4	1.5	-4.7	-1.5	1.0	1.5	1.5
Government	9.7	14.4	4.5	2.0	4.8	6.7	5.8	2.5
GNP in constant (1958) dollars	-4.7	21.1	13.8	8.7	3.2	13.1	14.9	13.7
Final purchases	-0.5	19.9	14.3	6.4	5.6	11.7	12.2	10.1
Private	5.7	20.6	15.0	6.9	3.6	9.8	11.0	10.1
	In Per Cent Per Year							
Gross National Product	4.8	7.9	13.8 1/	9.0 1/	5.8	9.6	11.4	9.7
Final purchases	5.4	7.8	13.4	7.8	6.9	9.0	10.3	8.0
Private	5.6	8.2	14.9	9.0	6.5	8.3	10.5	9.2
Personal consumption expenditures	6.2	8.2	12.7	10.1	7.0	8.9	10.0	8.7
Durable goods	-1.4	15.3	59.8	13.1	10.7	13.5	14.6	11.2
Nondurable goods	6.9	6.2	1.6	11.5	4.6	9.9	11.0	9.0
Services	8.4	7.8	9.1	7.9	8.0	6.2	7.3	7.4
Gross private domestic investment	-1.8	11.7	18.9	23.9	0.5	7.6	16.7	19.0
Residential construction	-4.4	32.6	43.9	36.3	22.2	10.5	16.7	3.6
Business fixed investment	3.5	4.6	13.9	10.4	3.7	0.0	5.6	9.1
Gov't. purchases of goods & services	4.6	6.6	8.0	3.5	8.3	11.4	9.6	4.0
Federal	-2.0	0.6	3.3	-4.1	7.5	15.2	7.1	-1.9
Defense	-3.8	-4.1	-1.1	-6.6	-1.7	6.7	4.4	0.0
Other	5.8	16.4	17.6	3.4	35.1	38.5	14.0	-6.8
State & local	10.5	11.3	11.3	9.1	8.9	8.7	11.4	8.3
GNP in constant (1958) dollars	-0.6	2.9	8.0 1/	4.8 1/	1.7	7.1	7.9	7.1
Final purchases	-0.1	2.8	8.0	3.5	3.1	6.4	6.5	5.3
Private	1.0	3.6	10.4	4.7	2.4	6.5	7.2	6.5
GNP implicit deflator	5.5	4.8	5.3 1/	4.0 1/	3.9	2.5 3/	3.5 4/	2.5
Private GNP fixed weight price index 2/	4.8	4.9	5.6 1/	5.0 1/	4.3	2.4	3.3	2.9
Personal income	7.1	6.9	8.6	9.8	5.5	6.7	9.1	7.5
Wage and salary disbursements	6.2	6.5	11.0	7.2	5.5	7.4	9.7	7.9
Disposable income	8.5	8.2	11.5	10.6	5.1	7.4	10.4	7.8
Corporate profits before tax	-10.5	9.5	41.9	21.2	-8.6	24.5	32.4	25.7
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	-2.7	4.2	13.3	5.5	5.2	4.8	9.8	9.8
Expenditures	8.2	8.4	6.5	14.4	6.5	10.5	11.5	3.2
Nonfarm payroll employment	0.5	0.1	1.8	1.3	-0.2	3.4	3.4	3.3
Manufacturing	-4.0	-4.1	0.4	-0.6	-2.4	4.3	4.3	4.2
Industrial production	-3.6	-0.2	7.3	4.7	-4.2	9.1	10.3	10.1
Housing starts, private	-2.3	42.2	8.1	32.7	44.6	3.5	0.0	-9.3
Sales new autos								
Domestic models	-15.9	22.3	216.1	-4.7	22.7	29.3	0.0	0.0
Foreign models	16.0	24.4	60.2	8.3	16.2	-22.6	-26.7	-28.6

1/ At compound rates.

2/ Using expenditures in 1967 as weights.

3/ Excluding first $1.2 billion, annual rate, of voluntary army pay increase, 2.1 per cent, per year.

4/ Excluding remaining $1.2 billion, annual rate, of voluntary army pay increase, 3.1 per cent, per year.

in the first half of next year. On balance, we project that the unemployment rate will decline to around 5-1/2 per cent by the second quarter.

Industrial production. The industrial production index is expected to rise about 0.5 per cent in September from the reduced level of 105.2 for August. The third quarter average is estimated to be 1 per cent lower than the second quarter and 5-1/2 per cent below the peak quarter in the autumn of 1969.

In addition to a partial recovery in steel production in September, it is likely that output of both consumer goods and business equipment rose somewhat, while defense equipment fell off further. Auto assemblies have remained at the 8.5 million rate prevailing in recent months, after allowing for the new model seasonal changeovers. October auto output schedules continue at that level as the industry regards present fourth quarter schedules as already high. Production of appliances and TV sets has been reduced since mid-year as factory and distributors' stocks have increased considerably since last spring, while output of consumer non-durable goods has risen further.

In early October steel production has leveled off following a sharp rise in September from a level of operations that has been reduced by 10 per cent from the preliminary August estimates. The leveling off in steel rolling mill operations and a 3 per cent decline in raw steel output in the first week of October has reflected, first, the earlier replenishment of steel mill shipping stock and, second, little recovery so far in demands from major steel consuming industries--although their rate of inventory liquidation must be quite high. Some industry sources have pushed back their expectations of a renewed volume of steel buying and mill operations from the fourth quarter to the early part of 1972.

Capacity utilization. The Federal Reserve series for manufacturing capacity and capacity utilization have been revised in line with the revised industrial production index. The revisions resulted in raising moderately the levels of capacity utilization since 1966, with the largest revision of around three percentage points upward in the period from the second quarter of 1967 to the first quarter of 1969. In the first half of 1971, the revised capacity utilization rate has been raised about 1.5 percentage points above the old level.

The increases in the total manufacturing series were largely the result of the fact that the revised production index grew more rapidly during this period than the unrevised index. While the revision increased the level of manufacturing capacity utilization in recent years, it left quarterly patterns virtually unchanged. After peaking at 91 per cent in the second and third quarters of 1966, the rates have declined from 87 per cent in the third quarter of 1969 to an estimated 73 per cent in the third quarter of 1971.

MANUFACTURING CAPACITY UTILIZATION
(1967 production=100)

Year	QI	QII	QIII	QIV	Annual average
		(Per cent)			
1964	84.2	85.4	86.0	86.3	85.5
1965	88.3	88.5	89.3	89.7	89.0
1966	91.4	92.3	92.3	91.6	91.9
1967	88.9	87.7	87.3	87.7	87.9
1968	87.9	88.1	87.6	87.2	87.7
1969	87.7	87.1	86.9	84.3	86.5
1970	80.6	79.6	78.0	74.0	78.1
1971	74.5	74.9	73.2 e		

e - estimated.

Retail sales. Advance data suggest that the stronger sales pace which became evident in early spring was sustained in September, with sales rising 0.6 per cent from August and 9.4 per cent from a year earlier. As was generally true in earlier months, most of the additional push was from sales of the automotive group which increased 4.4 per cent from August. Sales of durable goods as a whole increased 2.4 per cent, as higher auto sales were offset to some extent by lower sales of furniture and appliances. Nondurable goods sales were vitually unchanged, as a marginal gain in general merchandise sales failed to offset declines in most other nondurable sales.

The retail sales series will be revised shortly to reflect new seasonal factors. As a result, the second month sample count for August which is usually available at this time has not yet been released.

Unit auto sales and stocks. Sales of new domestic-type autos were maintained at the stepped-up pace noted since the announcement of the President's economic programs. Sales reached a 9.5 million unit rate for the month of September, up 12 per cent from August and 38 per cent from a year earlier, which was affected by general economic conditions and the consumer belief that GM cars were not available because of the strike. Stocks of new domestic-type cars at the end of September were placed at a 52-day supply down 16 per cent from last month and 22 per cent from last year.

Due to the earlier and more rapid production change-over for the model year and to the pre-introduction sales of the new models, seasonal factors for sales of domestic type autos have been changed back to mid August.

SALES OF DOMESTIC TYPE AUTOS
(Seasonally adjusted, annual rates, in millions)

1971		New series	Old series
August	1st 10 days	8.09	8.09
	2nd 10 days	8.52	7.72
	3rd 10 days	8.61	9.45
	month	8.47	8.47
September	1st 10 days	9.03	10.05
	2nd 10 days	9.10	10.14
	3rd 10 days	9.62	10.71
	month	9.47	10.60

September sales of foreign cars fell to an annual rate of 1.3 million units, down 26 per cent from last month's record high but still 14 per cent above last year, primarily the result of the prolonged West Coast dock strike which depleted inventories. The import share of the US auto market was less than 15 per cent in September, below the 22 per cent in August and the 16 per cent of last September. In addition to the effects of the West Coast dock strike, the smaller share reflected a seasonal movement wherein the share of domestic-type sales usually increase in September when new models are introduced.

DISTRIBUTION OF U. S. AUTO SALES
(In per cent 1/)

	1970	1971		
	September	July	August	September
Total	100.0	100.0	100.0	100.0
Domestic				
Total	84.5	81.9	78.1	85.5
Large	64.9	61.1	57.1	65.6
Small 2/	19.6	20.8	21.1	19.9
Imports				
Total	15.5	18.1	21.9	14.5
Low priced	12.6	15.6	18.6	12.2

1/ Based on not seasonally adjusted data.
2/ Compacts and subcompacts.

The Michigan and Conference Board Surveys of Consumer Demand. No significant change in consumer attitudes and purchase plans occured in the regularly repeated questions in the September Michigan Survey Research Center (SRC) survey and the August Conference Board survey. However, special questions added to the SRC survey indicated that respondents were overwhelmingly in favor of the freeze and that the continued pessimism recorded in the standard questions was closely correlated with uncertainty about the likely success of the Government in controlling both unemployment and inflation. Nonetheless, the SRC survey does suggest more favorable evaluations of buying conditions for durable goods, particularly autos, and both independent surveys indicate a high demand for homes.

The SRC index of consumer sentiment was little changed in September at 82.4 (Feb. 1966=100), compared with 81.6 in May and up only modestly from an historical low of 75.4 in May 1970. The slight increase in the index, which is composed of four questions on expected and present business and financial conditions and a fifth question on market conditions for durable goods, was attributable to more favorable evaluations of the prices of household durables--particularly autos. This improvement was largely offset by some deterioration in respondents' appraisal of their present personal financial situations and continued concern about future personal income and business conditions.

Additional special questions in the SRC survey disclosed that respondents were still more concerned about unemployment than inflation and that slightly more respondents thought the Administration would be unsuccessful than successful in attacking these dual problems. In the short term, nonetheless, households expect price stability with fully 54 per cent of the respondents' answering that the freeze would be extended in its present form after the initial 90 day period and the favorable evaluations of market conditions for cars largely associated with prices are "low and good buys available" rather than the response favored in the previous survey--"prices are likely to go higher."

The Conference Board survey taken in August, after the price-wage freeze, reported buying plans for new autos unchanged from May and a year earlier and lower purchase plans for major appliances, both compared with the last survey and a year earlier. Income expectations fell back to their January level and other attitudinal questions on present and expected business and employment conditions were about what they were in the previous two or three surveys.

Cyclical indicators. The preliminary Census composite leading indicator declined 1 per cent in August, after a July increase of 1.7 per cent. The decline resulted from decreases in the manufacturing workweek, new orders for durable goods, common stock prices, the ratio of price to unit labor cost, and housing permits, and an increase in initial claims for unemployment insurance (which is treated inversely in the composite index). To some extent this decline reflected the post-contract rundown of steel stockpiles, but in a similar month--August 1968--the leading composite rose. The improvement in common stock prices which followed the announcement of the new economic policy was not sufficient to raise the August monthly average above July, but it will be reflected in the September composite. Leading series increasing in August were contracts and orders for plant and equipment and industrial materials prices; the latter increased further in September. (Most of the raw industrial materials such as metal scrap which make up this materials price index are still below their May 1970 levels, and the freeze allows them to rise to those levels.)

COMPOSITE CYCLICAL INDICATORS
(1967=100)

		12 Leading Trend Adjusted	5 Coincident	6 Lagging
1971:	April	124.1	123.1	123.6
	May	125.2	124.0	123.0
	June	125.0	126.1 (H)	124.1
	July	127.1 (H)	124.5	124.3
	August (prel.)	125.9	124.2	126.9 (H)

(H) Current high value.

The coincident composite declined 0.3 per cent in August and is 1.5 per cent below its June high.

The preliminary lagging composite rose 2.1 per cent and was 3 per cent above its May low.

Manufacturers' orders and shipments. New orders for durable goods declined 0.7 per cent in August, according to preliminary data, after rising 3.4 per cent in July. The decline was all in defense products and primary metals; excluding those groups, orders rose 4 per cent in August and were 5 per cent above the second-quarter average.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
(Seasonally adjusted monthly averages)

	1971 Q I	Q II	July (rev.)	August (prel.)	Change, August from July
	--------Billions of dollars--------				--Per Cent--
Durable goods, total	31.4	30.5	31.7	31.5	- .7
Excluding defense & primary metals	24.1	24.2	24.4	25.3	3.9
Primary metals	5.3	4.7	4.4	4.1	- 8.4
Iron & steel	2.7	2.1	2.0	1.6	-21.0
Motor vehicles & parts	4.9	4.7	5.0	5.1	2.2
Household durables	2.3	2.4	2.4	2.4	1.0
Defense products	2.0	1.6	2.9	2.1	-27.6
Capital equipment	7.8	7.9	7.5	8.1	7.8
All other durables	9.0	9.2	9.5	9.7	2.4

NOTE: Detail may not add to total because of rounding.

The decline in iron and steel orders was quite similar in amount to the post-labor-contract decline in August 1968, but this year steel shipments dropped more sharply than in 1968 and fell below the volume of incoming orders, and steel order backlogs rose. In August 1968 order backlogs were still declining. The deep cut in shipments, along with some other evidence such as steel production and inventory data, suggests that as of the end of August there has been a deeper, faster rundown of steel stocks than in 1968, but the fact that new orders declined no further than in 1968 and unfilled orders rose instead of declining may be indications of somewhat earlier reordering than might otherwise have been expected.

Orders for motor vehicles and parts, household durables, and capital equipment improved in August, though orders for capital equipment are still below their June high. The August increase in "other durables" was mainly in the "other fabricated metals" group which is a heavy supplier to the auto industry.

Shipments of durable goods declined 2 per cent in August, as the sharp drop in steel shipments outweighed a 3 per cent increase elsewhere; there were increases for all other major categories. The backlog of unfilled orders rose at most major groups, including (as already noted) iron and steel.

<u>Inventories</u>. Book value of business inventories rose at an $8.1 billion annual rate in August, double the July rate and somewhat higher than in the first half of 1971. The runoff of steel inventories in August, reflected in declines in related areas of both manufacturing and wholesale trade, was more than offset by a high rate of stockbuilding at retail auto dealers and an accelerated rate of increase in other areas. (In September, new domestic auto sales exceeded production and unit stocks declined.)

The business inventory-sales ratio rose slightly in August, but this was mainly a result of the sharp drop in steel shipments. Elsewhere, ratios changed little, and many were well below year-earlier levels.

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

	Q I	Q II	1971 July (rev.)	August (prel.)
Manufacturing and trade, total	6.8	6.2	3.7	8.1
Manufacturing, total	.1	.1	-4.1	- .2
Durable	- .3	-1.0	-1.6	- .7
Materials *	.9	1.3	-1.2	-1.5
End products	-1.2	-2.3	- .4	.8
Nondurable	.4	1.2	-2.5	.5
Trade, total	6.7	6.0	7.8	8.3
Wholesale	.7	2.2	6.4	.1
Motor vehicles	.7	.3	2.4	.6
Metals excl. scrap	.3	.4	1.1	-1.7
Retail	6.0	3.9	1.4	8.2
Durable	4.4	2.7	.8	6.9
Automotive	5.0	2.8	.6	7.6
Nonautomotive	- .6	- .1	.2	- .8
Nondurable	1.6	1.1	.6	1.4

NOTE: Detail may not add to totals because of rounding.
* Including finished and in-process stocks of primary metals manufacturers.

Both the book value data for total materials stocks at durable goods manufacturers and tonnage data on inventories of steel mill shapes indicate that while this year's steel stockpile relative to steel requirements was larger than in 1968, the rundown of the stockpile has been more rapid than in the previous steel contract year.

Compared with shipments of durable goods other than materials ("end products"), durable manufacturers' stocks of both materials and end products appear in better shape than in the last steel rundown. Compared with unfilled orders, stocks are still very high, but the ratios have at least leveled off.

INVENTORY RATIOS

	1968		1970		1971	
	July	August	July	August	July (rev.)	August (prel.)
Inventories to sales						
Manufacturing and trade, total	1.53	1.57	1.59	1.59	1.54	1.55
Manufacturing, total	1.71	1.80	1.79	1.79	1.72	1.75
Durable	1.99	2.18	2.14	2.13	2.03	2.07
Nondurable	1.36	1.36	1.37	1.37	1.35	1.36
Trade, total	1.34	1.33	1.37	1.38	1.35	1.35
Wholesale	1.21	1.20	1.23	1.23	1.23	1.23
Retail	1.42	1.42	1.46	1.48	1.44	1.44
Durable	1.96	1.96	2.08	2.12	1.98	1.97
Automotive	1.52	1.52	1.73	1.82	1.66	1.69
Nonautomotive durables	2.62	2.59	2.57	2.53	2.47	2.42
Nondurable	1.15	1.16	1.19	1.19	1.18	1.18
Inventories to unfilled orders						
Durable goods manufacturing	.715	.716	.806	.816	.867	.863

Construction and real estate. Seasonally adjusted outlays for new construction, which were revised upward by 2 per cent to a new high for August, expanded further in September to almost the $110 billion mark. Benefiting from the unprecedented 2.2 million unit rate of housing starts in July and August, expenditures for residential construction continued to dominate the over-all advance, at a rate more than 60 per cent above the low in July of 1970.

Outlays for private nonresidential construction apparently edged higher in September and about matched the previous record rate established last April. While expenditures for public construction also tended upward in September, the rise was limited to federally owned projects, and the combined public construction rate remained moderately below the recent peak reached in the first quarter of the year.

Construction costs apparently changed little in September, based on tentative Census Bureau indications. However, on a year-to-year basis, the increase amounted to 9 per cent. This was about the same as the exceptional average annual increase in such costs during 1970 and accounted for nearly half the year-to-year rise in total current dollar outlays in September.

Underscoring the strength of housing demands this past summer, sales of existing homes in August--the latest month for which data are available--continued about a fifth above the rising level a year earlier, according to the National Association of Real Estate Boards. The median price of such homes showed little change at a level of $25,300 or 8 per cent above a year earlier. This compared with an average year-over-year increase of 6 per cent in 1970 as a whole, when mortgage terms were less favorable and the mix of effective demands was relatively more concentrated in smaller and less expensive types of units.

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
1971 - IQ	101.3	70.7	35.4	35.3	30.6
IIQ (r)	105.2	75.7	40.0	35.7	29.5
IIIQ (p)	107.5	78.3	42.2	36.1	29.2
1971					
July (r)	105.9	76.8	40.8	36.0	29.1
August (r)	107.3	78.2	42.0	36.1	29.1
September (p) 1/	109.3	80.1	43.8	36.3	29.3
	Per cent change in August from a year earlier				
In current dollars	+20	+28	+52	+7	+3
In 1957-59 dollars	+11	+17	+41	-6	-4

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

Labor market. There appears to have been some strengthening recently in the labor market. Seasonally adjusted nonfarm payroll employment rose 300,000 over the month after showing little change during the summer. Reflecting these employment gains, the unemployment rate edged down 0.1 percentage point in September to 6.0 per cent, seasonally adjusted, even though the labor force expanded appreciably.

Payroll employment. After declining steadily since May, employment rose sharply in manufacturing in September, with gains widespread, particularly in both electrical and non-electrical machinery and fabricated metals industries. All of the increase took place among production workers. Increases in employment were also reported in most nonmanufacturing industries. The number of employees on nonfarm payrolls has increased by 360,000 from a year ago, but is still little changed from May 1971 levels. Most of the year-to-year increase in employment has been in trade, services and State and local government; partially offsetting this gain was a decline of over 600,000 in factory employment.

While employment was expanding last month, average hours worked in manufacturing fell for the second month to 39.6 hours, seasonally adjusted, the lowest level this year. Declines in weekly hours were widespread with the largest decline in the auto industry.

NONFARM PAYROLL EMPLOYMENT, SEPTEMBER 1971
(Seasonally adjusted, in thousands)

	Change from:		
	September 1970*	May 1971	August 1971
Total	359	86	301
Government	364	50	46
Private	-5	36	255
Manufacturing	-638	-99	130
Production Workers	-459	-55	134
Nonmanufacturing	633	135	125

* Not seasonally adjusted.

Unemployment and labor force. The unemployment rates for adult men and teenagers were unchanged in September and about the same as in May. The rate for adult women, however, declined during the month reflecting a large increase in their employment. The unemployment rate for Negroes and other races, which has been fluctuating widely during the year, rose 0.7 percentage points to 10.5 per cent while the rate for whites declined, returning the nonwhite-to-white unemployment ratio closer to its longer run ratio of two to one. Except for June and July, where seasonal factors were difficult to interpret, total unemployment has shown little change throughout most of the year.

SELECTED UNEMPLOYMENT RATES
(Per cent, seasonally adjusted)

	1970	1971			
	September	Jan.	May	August	September
Total	5.4	6.0	6.2	6.1	6.0
Men aged:					
20 to 24 years	10.1	10.4	10.8	10.5	10.5
25 and over	3.0	3.5	3.6	3.6	3.6
Women, aged 20 and over	5.0	5.7	6.0	5.8	5.6
Teenagers	16.5	17.6	17.3	17.0	17.1
White	5.0	5.9	5.7	5.6	5.4
Negro and other races	8.8	9.5	10.5	9.8	10.5

The strengthening in the demand for labor is apparently stimulating growth of the civilian labor force. During the second quarter of 1971, the civilian labor force averaged only about 1.1 million higher than a year ago, well below the large increases of 1969 and early 1970.

Since July, however, labor force growth has picked up, with a substantial proportion occurring among adult men. The increase in labor force has been associated with a rise in total employment while unemployment has shown little change.

CIVILIAN LABOR FORCE
(Change from a year earlier, in thousands)1/

	Total	Men 20 years and over	Women 20 years and over	Both sexes, 16 to 19 years
1970 II Q	2,070	935	829	306
III Q	1,720	761	774	185
IV Q	1,772	836	780	156
1971 I Q	1,443	664	613	168
II Q	1,073	590	348	135
III Q	1,453	744	451	258
September	1,588	741	767	80

1/ Monthly and quarterly changes in the labor force tend to be erratic and may not show a clear cut pattern. Thus, analysis of labor force growth is frequently based on year-to-year changes which are more likely to reveal underlying trends.

Wages. Average hourly earnings of production and nonsupervisory workers on private nonfarm payrolls appear to have levelled off in the month following the wage-price freeze. The average unadjusted increase from August to September is usually sizable because young people who tend to be concentrated in low paying jobs are returning to school. The 3-cent increase in September was smaller than usual and, after seasonal adjustment, hourly earnings declined one-cent to $3.45 in the private sector. Compared with a year earlier, the increase was 5.8 per cent, a somewhat smaller gain than in either July or August. In most industries, average hourly earnings in September advanced more moderately from a year earlier than in the first half of the year.

AVERAGE HOURLY EARNINGS OF PRODUCTION AND NONSUPERVISORY WORKERS
(Per cent change from a year earlier)

		1971				
	1970	Q I	Q II	July	August	September
Total private nonfarm	5.9	6.4	6.7	6.2	6.2	5.8
Manufacturing	5.3	6.5	6.4	5.9	5.6	5.3
Mining	6.4	5.9	6.2	6.0	7.0	6.4
Contract construction	9.6	9.0	9.4	8.8	8.1	8.9
Transportation and public utilities	5.8	8.6	8.7	9.3	9.0	8.9
Trade	5.9	5.9	6.2	5.9	5.9	5.5
Services	7.7	7.7	7.2	6.4	6.4	5.6

Industrial relations. Bituminous coal miners and East Coast longshoremen went on strike when their contracts expired before a new agreement was negotiated. With no immediate prospect of an end to the

West Coast dock strike which has been in effect since July 1, the President set in motion procedures under the Taft-Hartley Act to enjoin the strike for an 80-day "cooling-off" period. Both the West Coast and Chicago dock workers--the latter represented by the Grain Elevator Operators union--returned to work on October 8 and 9 following issuance of temporary restraining orders.

In the West Coast negotiations, the longshoremen's union was unable to obtain agreement to extend its jurisdiction to include the loading and unloading of containers within 50-miles of the pier --work usually done by the teamsters union. Other demands include a 40-hour workweek guarantee for regular members, improved pensions and a wage increase. The Pacific Maritime Association has reportedly offered a 34.7 per cent wage increase over a three year contract, or about 10.5 per cent compounded annually. The East Coast longshoremen have stated that they consider the offer by the Pacific Maritime Association to be a floor under their wage demand. The immediate cause of the East Coast strike was the New York Shipping Association's refusal to continue to guarantee 2,080 hours of work annually after expiration of the old contract unless the union made certain concessions which would reduce the employment costs and remedy the alleged union abuses. There appears to have been little negotiation, so far, on new contracts covering 45,000 workers at Atlantic and Gulf ports.

In negotiations between the bituminous coal operators and the 80,000 member union, the miners are reportedly seeking a 35 per cent wage increase over a 3 year contract, an increase from 40 to 80 cents a ton in the employer's payment to the pension fund. The railroads and 90,000 members of shopcraft unions have reached agreement on a new 30-month contract retroactive to the first of the year which is reported to provide a wage increase of about 10.5 per cent a year.

Consumer prices. Consumer prices rose in August at a seasonally adjusted annual rate of 5.2 per cent which reflects, in the main, price changes before the August freeze. While nonfood commodity prices showed an accelerated increase, largely attributable to the sharp rise for gasoline, food and service prices rose at rates similar to those in July. The indexes for September and subsequent months, although expected to show substantially smaller increases than in August, are likely to be only partial indicators of the effects of the freeze.

CONSUMER PRICES
(Percentage changes, seasonally adjusted annual rates)

	June 1970 to Dec. 1970	Dec. 1970 to Mar. 1971	Mar. 1971 to June 1971	June 1971 to July 1971	July 1971 to Aug. 1971
All items	4.9	2.8	5.3	2.4	5.2
Food	.9	6.0	6.3	1.0	1.0
Commodities less food	5.2	1.0	4.9	1.0	6.3
Services 1/	7.0	3.2	5.2	5.8	5.7
Addendum:					
Services less home finance 1/2/	6.9	8.5	6.3	5.9	4.8

1/ Not seasonally adjusted
2/ Confidential

The increase for nonfood commodities in August reflects a one-month jump of 3.7 per cent to a level slightly above the January high. Apparel and new car prices dropped somewhat more than seasonally, the latter after three months of not following the usual downward movement. Recent increases in service prices excluding home financing costs have been smaller than in 1970 and the early months of this year.

NON-FOOD COMMODITY PRICES
(Percentage changes, seasonally adjusted annual rates)

	June 1970 to Dec. 1970	Dec. 1970 to Mar. 1971	Mar. 1971 to June 1971	June 1971 to July 1971	July 1971 to Aug. 1971
Commodities less food 1/	5.2	1.0	4.9	1.0	6.3
Apparel	4.3	1.0	4.4	.0	-1.0
Gasoline 2/	4.0	-5.8	-3.4	-8.8	53.8
New cars	11.6	4.7	3.2	4.3	-1.0
Used cars 2/	1.7	-9.5	30.3	-6.1	-10.1

1/ Includes items not listed
2/ Not seasonally adjusted

Impact of the price freeze on the CPI. To aid in analysis of post-freeze price developments, BLS will attempt to evaluate the effect on the September index of such factors as exempted items, including imports and taxes, and price comparisons which reflect in whole or in part price changes before August. This is not expected to result in a definitive estimate of the effect of the freeze on consumer prices.

Even if all frozen prices are unchanged there is a major source of possible increases in the September and, to a lesser extent the October, index deriving from the three-month rotation schedule for pricing most non-food items outside the five largest cities. The September index will include price changes since June, and the October index since July, for the cities regularly priced in these months. Other components, such as rent and property taxes, are priced less frequently or, in the case of used cars and houses, are represented by three-month moving averages.

Food is priced monthly in all cities but usually during the first week of the month, so that the September index will reflect price changes since early in August, before the freeze. Items exempted from the freeze--including fresh fruits and vegetables, eggs, mortgage rates and property taxes--represent nearly 10 per cent of the CPI market basket. (The mortgage cost component of the CPI, however, also reflects changes in house prices, which are not exempt). According to BLS estimates, tax changes (including sales taxes) accounted for about one-tenth of the .3 per cent (unadjusted) increase in the August CPI. Increases in prices of imported finished goods affect the CPI to the extent they are priced, but they may well be under-represented.

Seasonal adjustment factors in September and October may offset much of the upward trend in other prices (outside the scope of the above BLS evaluation). The factor for new cars is 4.5 index points higher in October than in September, while that for apparel commodities increases 1.2 index points in September and .5 index points in October. Unless permitted seasonal price increases are of this order of magnitude, these seasonally adjusted components could show an important decline and the effect on the index could be substantial. In addition, the annual adjustment in the medical services index (presumably downwards) usually occurs in October.

Removal of the auto excise tax is expected to have a significant impact on the CPI, as indicated by the BLS estimate for the refund of taxes on one American make of automobiles, in advance of Congressional approval, to purchasers of new cars after August 15. This accounted for about one-third of the .8 per cent (unadjusted) price decline in the August index for new cars.

The net effect of all these factors is difficult to evaluate; however, assuming that food prices decline about seasonally, as anticipated, there could be a net decline in the seasonally-adjusted index in September or October. This seems more likely if the removal of the excise tax coincides with the period of normal seasonal rise for autos.

<u>Wholesale prices</u>. The wholesale price index declined between August and September at a seasonally-adjusted annual rate of 4.7 per cent--the first decline since November 1970 and the largest monthly decline since October 1966. The BLS reported that two-thirds of the decline in the overall WPI (unadjusted) was accounted for by price decreases for raw agricultural products and some imported commodities which are not covered by the President's stabilization program. A large drop in prices of farm and food products was mainly responsible for the decline in the WPI. Prices of industrial commodities were also lower, however, declining at an annual rate of 0.9 per cent, in large part as a result of reduced prices for passenger cars and trucks. This was the first seasonally-adjusted decline in the industrial commodities index since mid-1964.

WHOLESALE PRICES
(Percentage changes, seasonally adjusted annual rates)

	June 70 to Dec. 70	Dec. 70 to Mar. 71	Mar. 71 to June 71	June 71 to Sept. 71	Aug. 71 to Sept. 71
All commodities	2.2	5.4	4.7	2.1	-4.7
Farm and food[1/]	- .4	11.3	3.2	-5.5	-19.0
Industrial commodities	3.4	2.9	5.3	4.7	- .9
Crude materials[2/]	.8	2.4	7.1	1.3	2.0
Int. materials[2/]	1.8	4.0	6.9	6.8	.0
Finished goods[2/]	5.4	2.8	1.9	2.4	-1.1
Producer	6.0	3.9	2.8	2.8	-1.0
Consumer	5.1	2.2	1.5	2.1	-1.1

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

Seven of the thirteen groups in the industrial commodities index were unchanged on a seasonally-unadjusted basis in September. A further breakdown of changes in prices of industrial commodities shows that the number of increases in the prices of 231 industrial product classes in the September index were markedly less than in September 1970 and more recent periods.

WHOLESALE PRICES
Monthly changes in 231 Industrial Product Classes

	1970	1971			
		Average monthly changes			
	Sept.1/	Jan-Mar	Apr-June	July-Aug.	Sept.
Increases	101	124	111	113	51
Decreases	42	40	40	33	62
No changes	85	67	79	85	118

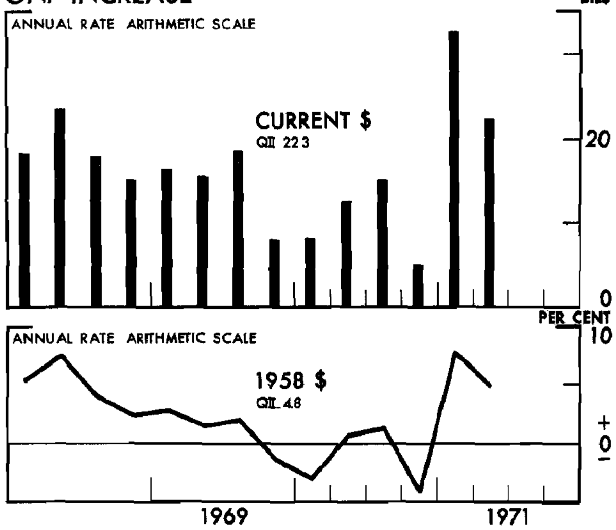
1/ 228 product classes.

Price changes for industrial materials and finished goods, by stage of processing, show that prices of crude materials rose, owing largely to higher prices for iron and steel scrap and wastepaper, which were permitted to rise under the President's stabilization program because their prices increased from levels below their legal ceilings established as of May 25, 1970. Prices of intermediate materials were unchanged, however. The decline in prices of producer finished goods was mainly the result of decreases for machinery and equipment. Consumer nonfood finished goods rose from August to September as consumer nondurables increased at an annual rate of 1.1 per cent with increases for men's suits and coats, miscellaneous rubber products, and paper bags more than offsetting declines for cotton broadwoven goods, tires and tubes, and cotton textile housefurnishings. Consumer durables declined at an annual rate of 7.3 per cent, however, largely because of a decrease in prices of automobiles.

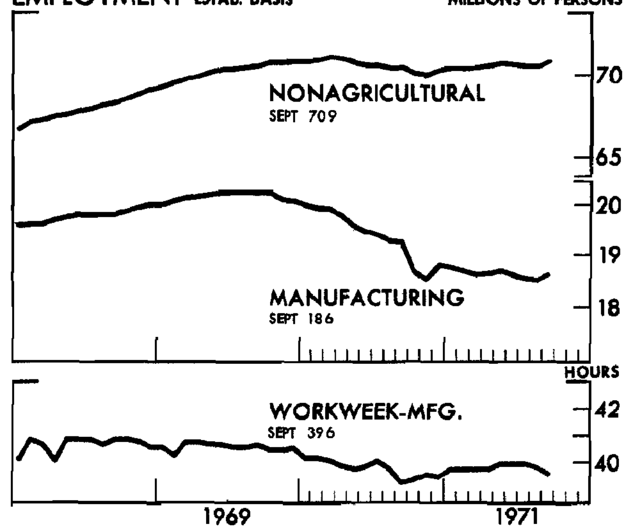
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

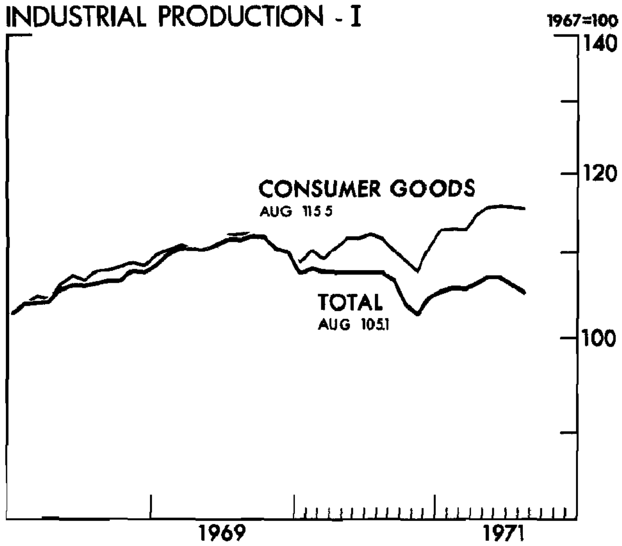
GNP INCREASE



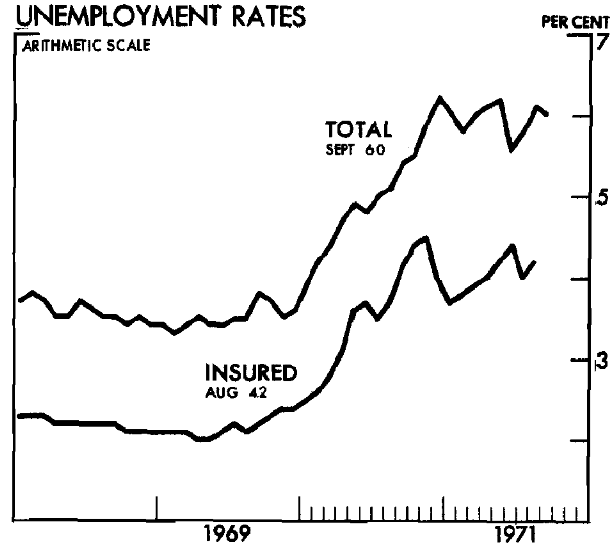
EMPLOYMENT ESTAB. BASIS



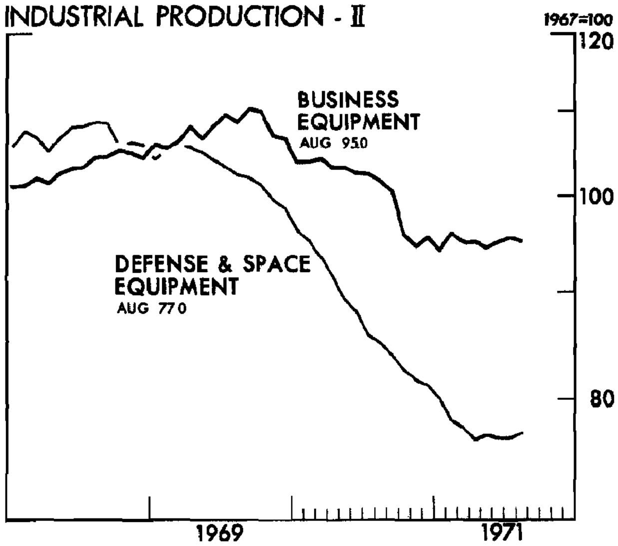
INDUSTRIAL PRODUCTION - I



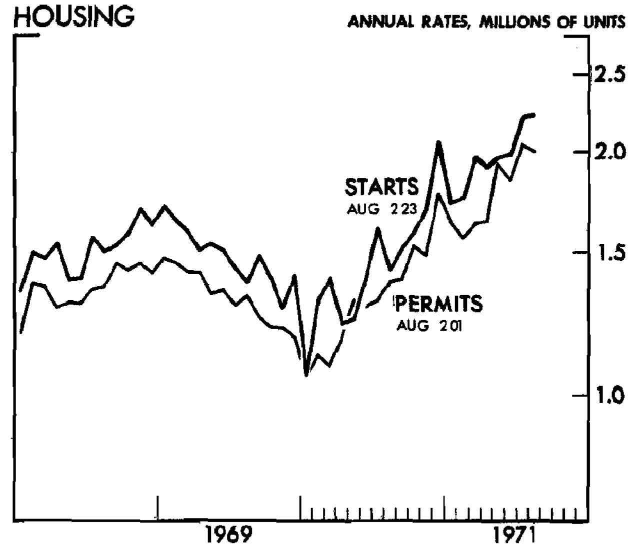
UNEMPLOYMENT RATES



INDUSTRIAL PRODUCTION - II



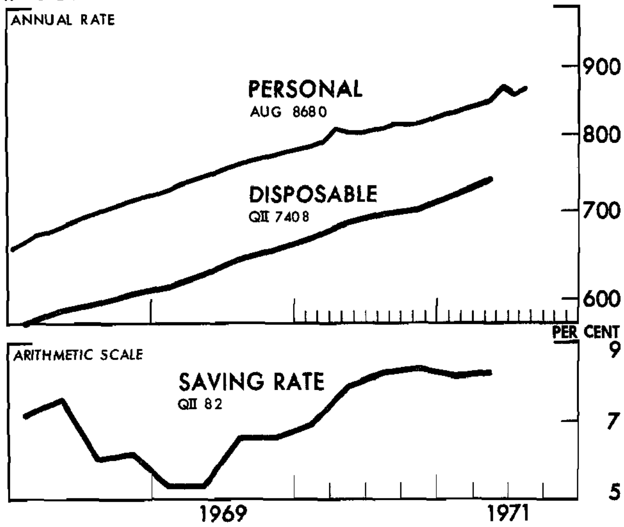
HOUSING



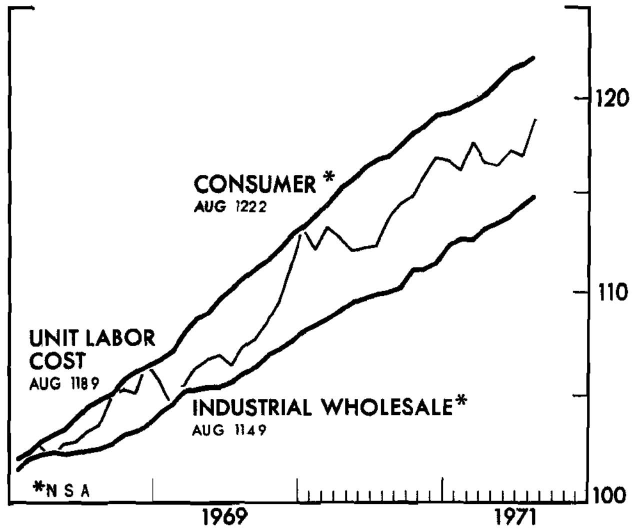
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

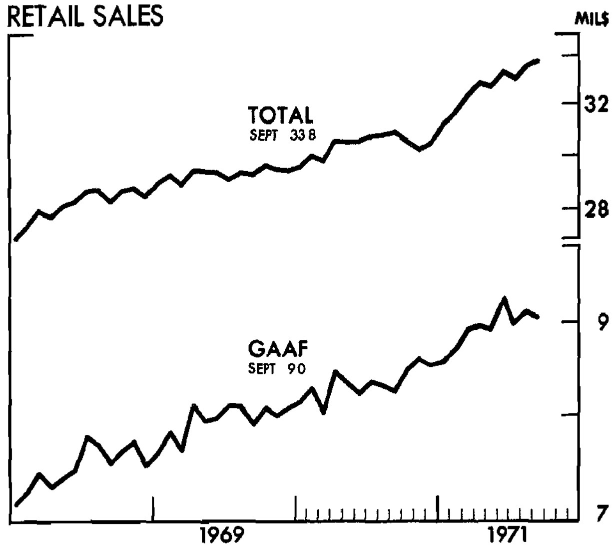
INCOME



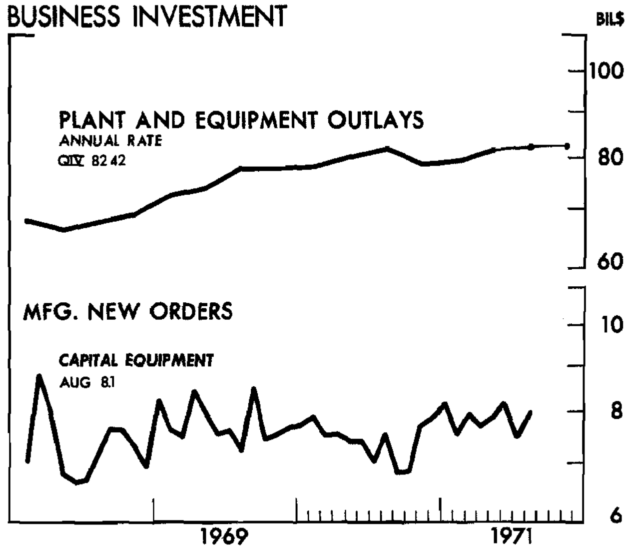
PRICES AND COSTS



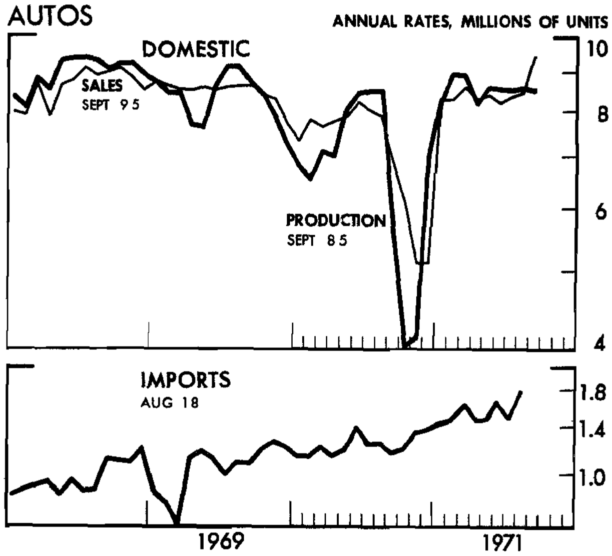
RETAIL SALES



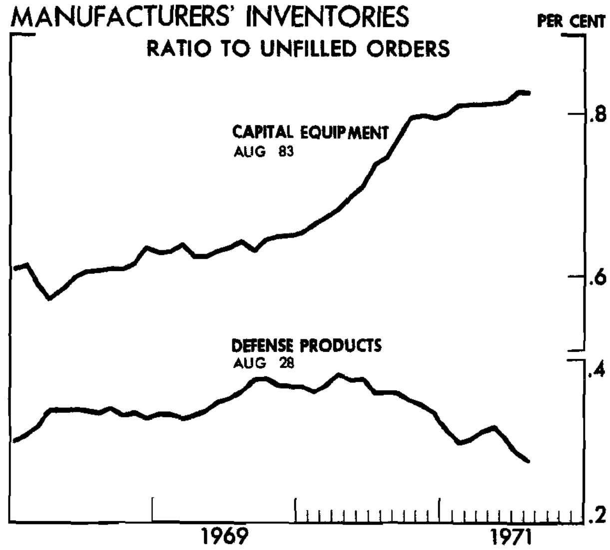
BUSINESS INVESTMENT



AUTOS



MANUFACTURERS' INVENTORIES



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Monetary Aggregates. Preliminary data indicate that the narrow money stock (M_1) actually declined during September at about a 3.5 per cent annual rate, lagging behind earlier projections for the second consecutive month. Combined with the unexpectedly slow growth rate for August, this brings the rate of increase for the third quarter as a whole to only 3 per cent, far below the second quarter rate of over 11 per cent.

MONETARY AGGREGATES
(Seasonally adjusted changes)

	1970	1971				
	QIV	QI	QII	QIII	Aug.	Sept.
		Annual Percentage Rates				
1. M_1 (Currency plus private demand deposits)	3.4	8.9	11.3	3.0p	2.6	-3.7p
2. M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	9.2	17.8	12.6	4.3p	4.8	1.1p
3. M_3 (M_2 plus savings deposits at mutual savings banks and S&L's)	9.7	19.0	14.8	7.3p	7.2	4.5p
4. Adjusted bank credit proxy	8.3	10.9	6.5	9.0p	10.3	8.5p
5. Other aggregates						
a) Total time and savings deposits	21.8	27.3	13.5	11.0p	6.5	14.9p
b) Time and savings deposits other than large CD's	15.4	27.2	13.7	5.7p	6.4	6.3p
		Billions of Dollars				
c) Negotiable CD's (SA)	1.4	0.6	0.2	1.3p	0.2	2.0p

With the exception of the first week in September, the weakness in the money stock persisted throughout the month. The reasons for the continued sluggishness are not clear, particularly since the huge flow of private dollar balances abroad, which probably contributed to the slowing in August, dropped off very sharply during September. Among the possible explanations are the effects of interest rate increases earlier in the year on desired cash balances. The evidence on past responses to interest rate increases suggests, however, that the present slackening is considerably greater than would have seemed likely. Perhaps what is occuring is in the nature of a correction from the higher-than-expected monthly growth rates in the spring and early summer.

The broadly defined money stock (M_2) also behaved sluggishly in September, with preliminary data indicating an annual growth rate of 1 per cent for the month. The decline from the August rate of about 5 per cent was due entirely to the M_1 component as time and savings deposits other than large negotiable CD's expanded at about the same moderate pace as in August and over the third quarter as a whole.

The adjusted credit proxy grew at a slightly slower rate during September than in August, but the slowdown was much less pronounced than in the other aggregates and the growth rate for the third quarter somewhat exceeded that for the second. Large negotiable CD's outstanding increased sharply in September, more than offsetting the decline in demand deposits.

The growth in CD's amounted to $2.0 billion on a seasonally adjusted basis, the largest rise since December 1970, and probably reflected the widened yield differential between these instruments and

Treasury bills brought about by increased CD offering rates early in the month. At the end of the month, the plentiful supply of CD money prompted some banks, particularly in New York City where inflows were strongest at that time, to lower their offering rates on such instruments, especially the shorter maturities. Over the month as a whole, CD growth was relatively strongest at banks outside New York. In addition to the CD growth, there was a small increase in Euro-dollar borrowing by U. S. banks, probably arising from a slight increase in the cost differential in favor of overnight Euro-dollars as compared with Federal funds.

Bank Credit. End-of-month commercial bank credit expanded at a seasonally adjusted annual rate of almost 10 per cent during September, somewhat below the rate for August and about the same as the average for the third quarter. As in earlier months of the quarter, a rise in total loans accounted for the largest share of this increase. Banks did acquire sizeable amounts of municipal securities (primarily short-term) and some Federal agency debt as well during the month, following a small drop in holdings of such issues during August, but these latter increases were offset to a considerable degree by a continued decline, for the third consecutive month, in holdings of U. S. Government obligations.

Business loan growth dropped off during September from the extremely rapid pace of August. This drop lends further credence to the view that a large part of the August bulge in business loans stemmed from foreign exchange developments during the period. Moreover, there is some evidence--by no means firm--that suggests that the moderate

COMMERCIAL BANK CREDIT ADJUSTED FOR LOANS
SOLD TO AFFILIATES 1/
(Seasonally adjusted changes)

	1970 2nd half	1971 half	QI	QII	QIII	Aug.	Sept.
			Annual Percentage Rates				
Total loans & investments 2/	11.4	10.8	12.2	9.1	9.8	13.4	9.7
U. S. Treasury securities	16.3	15.0	19.8	9.8	-14.0	-3.9	-17.5
Other securities	29.3	22.8	27.9	17.0	9.9	-3.7	17.2
Total loans 2/	5.6	6.5	6.3	6.6	14.7	22.5	12.4
Business loans 2/	-1.6	3.6	2.5	4.6	16.5	29.1	8.1
Real estate loans	4.8	11.7	10.0	13.0	14.2	14.1	13.9
Consumer loans	4.9	5.6	4.8	6.3	12.5	14.0	13.8
			Billions of Dollars				
Security loans	3.4	-1.8	-0.3	-1.5	2.0	1.1	1.1
Loans to nonbank financial institutions	1.0	1.4	0.9	0.5	-0.6	0.1	-0.7

Note: Changes in commercial bank credit are based on data revised to reflect adjustments to June 30, 1971, Call Report benchmarks.
1/ Last-Wednesday-of-month series.
2/ Includes outstanding amounts of loans reported sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

increase in business loans during September includes some borrowing attributable to foreign exchange considerations. Even after taking account of these factors, however, it would still appear that domestic business loan demand during the third quarter as a whole probably picked up at least slightly over the second quarter.

With business loans showing modest growth in September, the remainder of the rise in total loans was spread over a number of loan categories. Real estate loans continued to expand rapidly for the fourth month in succession, reflecting the high level of activity in both new and existing properties. Loans against securities showed an increase of over $1 billion after seasonal adjustment for the second month in a row, as dealers in municipal and corporate securities expanded their inventories. Finally, consumer loans, which were revised sharply upward for August, apparently showed another very large increase in September, probably reflecting in part the upsurge in new car sales. It also has been suggested, however, that customer financing of automobile purchases may be shifting from finance companies to banks due both to lower rates and to the willingness of at least some banks to extend the maturity of auto loans to 42 months. This observation also is consistent with the seasonally adjusted decline during September in bank loans to nonbank financial institutions; however, this decline probably resulted primarily from a shift by nonbank finance companies from bank loans to less expensive short-term borrowing in the open market.

Nonbank depositary institutions. Deposit outflows from nonbank thrift institutions during the grace day portion of the September-October dividend reinvestment period were unusually small, a reflection no doubt of the generally lower yields available from alternative uses of funds such as short-term market securities.

During the whole month of September, deposit inflows to nonbank thrift institutions were sustained at about the pace of July and August combined. During the third quarter as a whole, deposit growth moderated further from the very high rate of the first quarter this year; by any other standard, however, nonbank institutions' deposit growth has remained strong, especially at savings and loan associations.

DEPOSIT FLOWS EXCLUDING INTEREST CREDITED DURING THE THREE DAY END-OF-SEPTEMBER GRACE PERIOD
(Millions of dollars, not seasonally adjusted)

	Savings and Loan Associations	15 Largest New York City Savings Banks*	
		Net	Net After Passbook Loans
1966	-353	-171	-73
1967	-166	-154	-58
1968	+44	-167	-62
1969	-425	-271	-135
1970	-220	-143	-72
1971	-101	-112*	-74*

* Beginning with the 1971 survey, the reporting panel for this series was expanded from the 15 to the 17 largest New York City savings banks.

Mutual savings banks in July and August, for the first time this year, acquired a substantially larger volume of mortgages than of corporate securities. This shift in favor of mortgages probably reflects the lag in takedowns from the expanded mortgage commitment activity that accompanied large savings inflows earlier in the year. While awaiting delivery of completed mortgages, corporate bonds were, of course, readily available as an outlet for funds in addition to those allocations that would have been made anyway on the basis of yield considerations.

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	10.5	12.1	11.6
1971 - QI	17.7	26.0	23.3
QII	15.0	18.4	17.3
QIII p/	7.5	14.7	12.4
1971 - July*	8.8	19.2	15.9
August* p/	6.6	9.3	8.4
September* p/	6.9	15.1	12.5
August and September p/	6.8	12.3	10.5

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

Savings and loan associations in August made a moderate further downward adjustment in their still-ample liquid asset position. While cash flows from mortgage repayments, including refinancing, remained very large during August, S&Ls augmented them somewhat by borrowing about $150 million from the FHLB in September, about the same as they had in August.

Mortgage market. As of early October, yields on Government underwritten home mortgages were continuing to edge down in the secondary market, judging from FNMA's auction results. Average yields on 3-month forward purchase commitments in the October 4 auction were 1 basis point below their level two weeks earlier, and 22 basis points below the year's high posted several weeks before the President's mid-August speech. (September data for rates on conventional home mortgages in the more sluggish primary market may be available in time for the Greenbook Supplement; during August, such rates showed little change.)

FNMA PURCHASE AUCTIONS

	Amount of total offers		3-month commitments	
	Received	Accepted	Discount	Private market yield
	(Millions of dollars)		(Points)	(Per cent)
1971 - High	1,168 (5/10)	314 (4/26)	8.5 (7/26)	8.07 (7/26)
July 26	686	183	8.5	8.07
Aug. 25	635	154	7.8	7.97
Sept. 7	445	189	7.1	7.88
20	438	193	6.9	7.86
Oct. 4	365	195	6.9	7.85

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 38 basis points. Beginning September 7, auctions are only for mortgages too large for GNMA discount subsidy.

Beginning July 26 auction are only for 3-month commitments; during the third quarter, not seasonally adjusted flows of credit to the mortgage market continued to expand for the sixth consecutive quarter, but less sharply than in the spring. Net increases for each major type-of-property component--except farm--reached record highs, judging from tentative estimates. On residential mortgages, net growth in outstanding credit attained a seasonally adjusted annual rate of as much as $42 billion, far above the $20 billion low posted early last year. Federal credit agencies, which accelerated their net acquisitions considerably, and savings and loan associations together apparently accounted for about three-fourths of the total residential debt expansion. The more diversified commercial banks and mutual savings banks also appear to have stepped up their net takings. Life insurance companies, in contrast disinvested in this sector for the third consecutive quarter, as they placed fewer funds in new residential mortgages than were repaid on their $42 billion portfolio.

Given the exceptionally strong momentum in mortgage lending activity and the development of concern about savings flow prospects, nonbank thrift institutions apparently became more cautious about their commitment policies in July and August. For New York State savings banks and all savings and loan associations, the combined seasonally adjusted volume of mortgage commitments outstanding changed little in August, at a level more than twice the low reached in early 1970.

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., Apr.)
August	6.8	2.0	8.8
1971			
March	10.1	2.5	12.6
April	11.1	2.8	13.8
May	12.2	3.1	15.4
June	13.0	3.1	16.1
July	13.2	3.1	16.4
August	13.3	3.1	16.4

1/ Based on data, including loans in process, from Federal Home Loan Bank Board and Savings Banks Association of New York State. Detail may not add to total because of rounding.

Consumer credit. Consumer instalment credit outstanding increased at a $9.9 billion seasonally adjusted annual rate in August, continuing the step-ups in the rate of credit growth that have occurred since last year's fourth quarter when outstandings actually declined. Instalment credit expanded at an annual rate of $2.7 billion in the first quarter of 1971, $6.7 billion in the second quarter, and a near-record $9.5 billion in the first 2 months of the third quarter. The marked gains in new car deliveries and the improved rate of chain store sales during September suggest another month of substantial credit use.

Both extensions and repayments of automobile credit and non-automotive consumer goods credit were at new highs in August; these

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

	Total	Automobile	Other consumer goods	Personal loans	Home repair and modernization
1970 - QI	4.0	.0	2.4	1.7	.0
QII	4.6	.2	2.3	1.9	.1
QIII	4.1	- .6	2.4	2.1	.1
QIV	-1.5	-4.4	1.8	1.1	.0
1971 - QI	2.7	.4	.6	1.7	.1
QII	6.7	2.3	1.3	2.3	.3
July-Aug.	9.5	3.1	2.4	3.7	.3

increases boosted total extensions and repayments above their earlier peaks reached in late spring. Automobile credit was extended at a $36 billion annual rate in August, up more than 9 per cent from the $33 billion rate in the first half of 1971, and more than 35 per cent above the strike-affected fourth quarter of 1970; the August increase occurred mainly at commercial banks. While the number of new and used cars financed has risen about in line with unit sales, there has been a substantial increase in the size of the average contract. During the July-August period seasonally adjusted new car contracts averaged more than $3,350 compared with less than $3,100 in the fourth quarter of 1970; used car contracts have risen to $1,850 from about $1,700.

The trend of extensions for nonautomotive consumer goods and services continues to be dominated by the major growth sectors--mobile homes and bank credit cards. As of mid-1971, mobile home financing constituted almost one-half of the nonautomotive consumer goods credit outstanding at commercial banks. (Beginning next month the Consumer

Credit Section will begin regular publication of monthly estimates of bank lending in the mobile home sector.)

Corporate and municipal securities markets. After a period of rising long-term interest rates in the latter half of September, when the market absorbed a heavy volume of bonds, yields on both corporate and municipal bonds began to fall again. By October 8 the new issue Aaa corporate index was only 10 basis points above the level prevailing at the time of the last Committee meeting, and the improvement in secondary market yields was even more marked. Tax-exempt bond yields were close to their 1971 low.

In the last four weeks, NYSE, AMEX and NASDAQ price indices have shown little fluctuation with relatively low trading volume in each of their respective markets. Up to October 11, stock prices have exhibited no definite pattern in their reaction to announcements concerning the post-freeze program.

Public offerings of corporate bonds amounted to $2 billion in September, somewhat below previous estimates because of postponements as rates rose late in the month. On the basis of present schedulings, the staff expects the October and November calendars to average about $1.75 billion, appreciably below the average volume for the first three-quarters of the year. Underwriters report that, on the whole, prospective bond issuers are not in immediate need of funds, since the borrowers who were pressed had already issued bonds or stock earlier this year. In addition, general uncertainty about the effects on bond markets of the Administration's program to cope with inflation and about the strength of the economic recovery seems to be a factor in the tapering of the forward calendar.

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 (6/9)	7.12 (5/28)
1971			
Low		6.76 (1/29)	5.00 (3/18)
High		8.23 (5/21)	6.23 (6/24)
Week of:			
August	13	7.97	6.03
September	3	7.38	5.39
	10	7.21	5.36
	17	7.56	5.38
	24	7.60	5.48
October	1	7.53	5.24
	8	7.30	5.17

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

New equity offerings remain at a high level, despite recent sluggishness in the stock market. The sharp fluctuation in projected volume from October to November reflects the timing pattern of utility offerings. Stock issues by power companies accounted for about 38 per cent of total stock volume during the first half of 1971, and irregularities in issue patterns by the investor-owned utilities have an important impact on the total volume in any given month. Takedowns of private placements are apparently also continuing at a high level. However, the expected drop in public bond offerings from the first-half levels suggests a significant decline in total corporate securities offerings during the fourth quarter.

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

	Bonds			
	Public	Private	Stocks	Total
1970 - Year	2,099	403	713	3,245
Through September	1,951	384	665	3,001
1971 - Through September	2,183	562	1,134	3,879
QI	2,790	505	768	4,063
QII	2,182	586	1,128	3,896
QIII e/	1,577	596	1,505	3,678
September e/	2,000	750	1,370	4,120
October e/	1,800	550	700	3,050
November e/	1,700	550	1,200	3,450

e/ Estimated.

Offerings of long-term tax-exempt bonds amounted to $2 billion in September; but this total included two issues of over $250 million each, and there appears to be a slight reduction in the forward municipal bond calendar, as in the corporate sector. Commercial bank acquisitions of State and local bonds have picked up again in the last few weeks, and some casualty companies have also increased their purchases recently.

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

	Long-term	Net Short-term
1970 - Year	1,514	393
Through September	1,367	350
1971 - Through September	2,060	431
QI	2,229	540
QII	2,017	421
QIII e/	1,950	332
September e/	2,050	428
October e/	1,700	300
November e/	1,700	n.a.

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

<u>Government securities market.</u> Yields on Treasury notes and bonds, as well as Treasury bill rates, have declined on balance since the last meeting of the Committee. Over the three weeks ending October 8, yield reductions in the coupon sector ranged from 10 to about 30 basis points, while bill rates moved 25 to 50 basis points lower. The key 3-month bill was recently bid at about 4.50 per cent, compared with 4.78 per cent on September 21. The market reacted mildly to the announcement of Phase II as many participants continued to adopt a wait-and-see attitude with regard to the specific details of the plan.

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

	1971		Weekly average for week ending				
	Daily highs 1/	Daily lows 1/	Aug 13	Sept 21	Sept 28	Oct 5	Oct 12
Bills							
1-month	5.33 (7/19)	2.07 (3/12)	5.17	4.60	4.57	4.41	4.28
3-month	5.53 (7/19)	3.22 (3/11)	5.25	4.78	4.73	4.55	4.52
6-month	5.84 (7/27)	3.35 (3/11)	5.67	5.01	5.03	4.85	4.68
1-year	6.01 (7/28)	3.45 (3/11)	5.92	5.20	5.22	5.07	4.93
Coupons							
3-year	6.91 (7/28)	4.27 (3/22)	6.81	5.90	5.92	5.78	5.71
5-year	7.03 (8/10)	4.74 (3/22)	6.94	6.15	6.19	6.07	6.03
7-year	7.11 (8/10)	5.15 (3/23)	7.03	6.22	6.24	6.11	6.04
10-year	6.95 (8/28)	5.38 (3/23)	6.82	6.15	6.16	6.01	5.94
20-year	6.56 (6/15)	5.69 (3/23)	6.41	6.07	6.08	5.97	5.94
Agencies							
6-month	6.20 (7/23)	3.67 (3/16)	6.08	5.45	5.46	5.35	5.20
1-year	6.56 (7/28)	3.93 (3/16)	6.53	5.83	5.82	5.73	5.62
3-year	7.33 (8/12)	4/70 (3/24)	7.33	6.36	6.35	6.28	6.20
5-year	7.45 (8/13)	5.12 (3/23)	7.44	6.63	6.63	6.56	6.46

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

Aside from the general improvement in all markets resulting from growing hopes as to the strength of the President's post-freeze program of wage-price restraint, the firmness in the Treasury market over the last few weeks also reflected factors more directly connected with monetary policy: namely, the expectations effects arising out of the continued slowing in growth of the money aggregates and the emergence of somewhat easier money market conditions. The last of these, through the resultant reduction in day-to-day dealer financing costs, was especially important for the bill market where recurrent rumors of an increase in supplies through a tax bill financing and a drop-off in foreign official demand for bills might have otherwise tended to hold rates up. In the coupon sector, the decline in yields was also derived in part from the encouraging reception accorded the large weekly offerings of corporate and tax-exempt issues. The Treasury's announcement of an auction on October 15 of $2.0 billion 5-7/8 per cent, 3-1/4-year note was well received by the market and caused little change in prices.

Dealer positions in Treasury issues have also reflected the general improvement in the market. Positions in Treasury bills have changed relatively little, fluctuating around $2.25 billion, indicating fairly easy sales of dealers' weekly bill awards at the declining yields and no particular pressure from the dealers at current financing costs to pare down the general level of their bill holdings. Coupon positions have tended to rise slightly recently on continued expectations of falling interest rates and as the market has begun focusing on the forthcoming November refunding and the possibility that an advance refunding may be included in the financing.

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

	Aug. 13	September Daily Average	Sept. 20	Sept. 27	Oct. 4	Oct. 8
Treasury securities						
Total	2,381	3,855	3,411	3,668	3,313	3,601
Treasury bills (total)	1,823	2,768	2,309	2,603	2,117	2,204
Due in 92 days or less	968	1,189	1,017	860	988	1,073
93 days or over	855	1,579	1,292	1,643	1,129	1,131
Treasury notes and bonds (Total)	558	1,087	1,102	1,066	1,196	1,397
Due within 1-year	185	320	352	375	459	654
1-5 years	315	354	301	328	314	334
over 5 years	59	413	448	362	423	409
Agency securities						
Total	599	930	967	937	906	857
Due within 1-year	281	472	498	506	401	323
Over 1-year	318	458	469	431	505	534

Shortly after the last Committee meeting, it was announced that the System would be undertaking outright operations in Federal agency securities as part of regular open market operations. Prices of agency issues immediately adjusted higher but then retreated quickly to the levels prevailing prior to the announcement. Actual Desk purchases of agency issues took place on two days: on September 23, $61 million were purchased in maturities of less than two years and on September 30, $35 million were purchased of which $26 million were in over-5-year maturities. These operations have had hardly any effect on prices in the agency market; and in fact spreads over comparable maturities of direct Treasury have widened slightly over the entire period from late September.

There were three new issues in the agency market in late September and early October. All were accorded good receptions and subsequently traded at premiums. The details of the issues are summarized in the following table.

NEW FEDERAL AGENCY OFFERINGS

Date	Agency	Amounts (millions of $)	Maturity	Yield	New Money (millions of $)
Sept. 28	TVA	200	119-day	5.13 1/	10
Sept. 28	FNMA	600	3-yr, 5-mo	6.35	400
		300	7-yr, 2-mo	6.75	
Oct. 7	FLB	326	2-yr, 9-mo	5.85	180
		300	6-yr	6.85	

1/ Average discount

Other short-term credit markets. Preliminary estimates for September show seasonally adjusted commercial and finance paper outstanding at $30.6 billion, an increase of $1.2 billion for the month. Directly-placed finance company paper rose $1.0 billion seasonally adjusted, accounting for the greater part of this expansion. (So large a rise is probably due to the inappropriateness of the usual seasonal factor in the face of the earlier model changeover in automobiles.)

Over the third quarter, directly-placed paper rose only about $200 million a month, on average. The moderate quarterly increase in finance paper outstanding at a time when car sales were rising apparently reflects the continuing shift of retail auto loans into commercial banks.

In the week ending October 6, most private short-term interest rates moved down from the plateau on which they have been since early September, after having declined following the announcement of wage-price controls on August 15. Most of the recent declines were small, but they ranged in the longer maturities up to 37 basis points.

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

	1970		1971				Net change
	Highs	Lows	Aug. 11	Sept. 8	Sept. 22	Oct. 6	Aug. 11 - Oct. 6
1-month							
Commercial paper	9.25	5.50	5.75	5.63	5.63	5.50	-25
Finance paper	9.00	5.00	5.50	5.25	5.38	5.13	-37
Bankers' acceptances	9.00	5.50	5.75	5.75	5.75	5.50	-25
Certificates of Deposit--new issue 1/	7.75	5.00	5.50	5.25	6.38	5.25	-25
Treasury bill	7.84	4.58	5.17	4.49	4.57	4.34	-83
3-month							
Commercial paper	9.25	6.00	6.00	5.88	5.88	5.75	-25
Financial paper	8.25	5.50	5.50	5.38	5.38	5.38	-12
Bankers' acceptances	9.00	5.50	5.88	5.88	5.88	5.63	-25
Certificates of Deposit--new issue 1/	6.75	5.50	5.75	5.50	5.63	5.50	-25
Treasury bill	7.93	4.74	5.22	4.60	4.77	4.54	-68
6-month							
Bankers' acceptances	9.00	5.50	6.00	6.00	5.88	5.63	-37
Treasury bill	7.99	4.78	5.67	4.89	5.06	4.72	-95
12-month							
Certificates of Deposit--new issue 1/	7.50	5.50	6.25	5.75	5.75	5.75	-50
Treasury bill	7.62	4.74	5.91	5.15	5.30	5.02	-89
Prime municipal notes	5.80	2.95	3.60	3.00	3.10	2.85	-75

1/ Investment yield basis. Highs for certificates of deposit are ceilings affective 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)

1971	July	August	September
Total commercial and finance paper 1/	29,397	29,342	30,585 e/
Bank related 2/	1,808	1,792	1,865 p/
Nonbank related 3/	27,589	27,550	28,720 e/
Placed through dealers	11,459	11,236	11,451 e/
Placed directly	16,130	16,314	17,269 e/
		Net change	
Total commercial and financial paper 1/	- 683	- 55	+ 1,243 e/
Bank related 2/	+ 75	- 16	+ 73 p/
Nonbank related 3/	- 758	- 39	+ 1,170 e/
Placed through dealers	- 118	- 223	+ 215 e/
Placed directly	- 640	+ 184	+ 955 e/

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

Federal finance. The tax bill recently passed in the House would reduce total Federal revenues by about $8 billion in calendar 1972, approximately $1/2 billion less than the amount proposed in the President's new economic program. However, the House bill provides a smaller tax reduction for corporations and a larger reduction for individuals, as can be seen by comparing columns (2) and (3) of Table I. While the Senate has not yet acted on the tax bill, it is also expected to be more receptive to reductions in individual taxes. In view of this Congressional sentiment, the staff projections now incorporate the House-passed amendments to the Administration tax proposals.

Table 1

STAFF ESTIMATE OF THE INITIAL IMPACT ON FEDERAL RECEIPTS OF HOUSE-PASSED TAX BILL COMBINED WITH PRIOR LEGISLATION
(billions of dollars, NIA accounts)

	Calendar 1972		
	(1) House Bill Alone	(2) House Bill and Previous Tax Legislation	(3) President's Program and Previous Tax Legislation 1/
Personal tax receipts	-4.0	-6.8	-5.5
Corporate profit tax accruals	-1.5	-1.5	-3.8
Indirect business taxes	-2.6	-2.6	-2.2
Social insurance taxes	--	+3.0	+3.0
Total	-8.1	-7.9	-8.5

1/ Import surcharge not included.

The House initiated an increase retroactive to January 1971 in the personal exemption, from $650 to $675, together with a retroactive increase in low income allowances. While these measures reduce 1971 liabilities by $1.4 billion, only a fraction of this will be reflected in lower withholding during 1971. This lower withholding is slated to start in mid-November, but will probably be further delayed by the Senate. Hence, to provide for the retroactive reduction in liabilities prior to mid-November, Table 1 allows for a one-time increase in refunds (of about $1.0 billion) that will affect the budget largely in the Spring of 1972.

In addition to passing the Administration's proposals to advance to January 1972 the increase in the personal exemption and general standard deduction previously legislated to start in 1973, the House adopted a low income allowance--raising the minimum standard deduction to $1,300.

Turning to corporate tax liabilities, the House approved a straight 7 per cent investment tax credit, which reduces calendar 1972 corporate liabilities by $2.9 billion. The Administration had recommended a 10 per cent investment tax credit (later declining to 5 per cent) that would reduce 1972 liabilities by about $3.8 billion. In addition, the House bill would increase corporate tax liabilities by about $1.4 billion in calendar 1972 by modifying the accelerated depreciation rules recently adopted by the Administration. Thus, on net, the House-bill would reduce calendar 1972 corporate tax liabilities by about $1.5 billion, compared to the $3.8 billion reduction proposed in the new economic program. The House bill also provides a larger reduction in indirect business taxes because the elimination of the auto excise tax is extended to small trucks.

As previously assumed in the staff projection, Congress has now upheld the six-month postponement of the Federal pay raise recommended by the President. While Congress has not acted on most of the other expenditure cuts included in the new program, mere failure to act can have the recommended effect because, to a large extent, the proposed cuts are to be achieved by postponing new programs, especially revenue sharing and welfare reform. There has been little change in the staff estimate of Federal expenditures since the mid-September Greenbook. The estimate of fiscal year outlays for national defense has been raised by about $.3 billion because the staff now assumes that the military pay raise will become effective in mid-November, at the end of the freeze period, rather than in January.

These recent developments have not greatly changed the near-term budget outlook. Although the House tax bill affects the composition of receipts, the staff estimate of total receipts, on a unified budget basis, for fiscal 1972 has not been changed since the last Greenbook and the projected deficit remains $27.5 billion. On a NIA basis, the projected deficit in the first half of calendar 1972 has declined slightly, with the decrease in personal tax receipts attributable to the House tax bill offset by increased corporate taxes and the effect of increased income assumptions. The high employment budget projections also show a large shift toward fiscal stimulus in the first half of 1972 than shown in the last Greenbook. However, this does not include any allowance for the House action in changing the composition of projected receipts, which may have some additional stimulative effects in the short-run because of the greater emphasis on personal income tax cuts.

With the Treasury cash balance higher than projected at the end of September, net cash borrowing in the fourth quarter is now projected to be smaller, amounting to slightly more than $7 billion. While this is less than the exceptionally large $9 billion borrowed in the same period of the previous year, as much as a third of that year's borrowing was financed by foreign purchases of Treasury securities.

The Treasury has announced that it will borrow $2.0 billion in mid-October by auctioning a note that matures in February 1975. In addition, staff projections assume that the Treasury will resume $.2 billion additions to the regular weekly bill auction and that outstanding Euro-dollar certificates will be retired as they mature. There are market expectations of a possible advance refunding as well as additional cash borrowing at the time of the November quarterly refinancing.

Table 1
FEDERAL BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS 1/
(In billions of dollars)

	Fiscal Year 1971*	Calendar Year 1971 F.R. Board	Fiscal Year 1972e/ Adm. Estimate 2/	Fiscal Year 1972e/ F.R. Board	F. R. Board Staff estimates, Calendar Quarters, 1971 II*	1971 III	1971 IV	1972 I	1972 II
Federal Budget									
(Quarterly data, unadjusted)									
Surplus/deficit	-23.2	-26.3	-27.5	-27.6	1.6	-8.2	-11.6	-11.2	3.4
Receipts	188.3	193.1	204.5	202.9	56.7	48.8	43.5	48.2	62.4
Outlays	211.6	219.4	232.0	230.5	55.1	57.0	55.1	59.4	59.0
Means of financing:									
Net borrowing from the public	19.4	20.0	n.a.	24.9	1.6	9.6	7.2	9.6	-1.5
Decrease in cash operating balance	-.8	3.1	n.a.	2.2	-4.3	-1.2	5.0	-.1	-1.5
Other 3/	4.5	3.2	n.a.	.5	1.1	- .2	-.6	1.7	- .4
Cash operating balance, end of period	8.8	5.0	n.a.	6.6	8.8	10.0	5.0	5.1	6.6
Memo: Net agency borrowing 4/	1.1	1.2	n.a.	n.e.	- .9	1.7	1.5	n.e.	n.e.
National Income Sector									
(Seasonally adjusted annual rate)									
Surplus/deficit	-19.0	-22.7	n.a.	-26.2	-22.6	-23.6	-27.1	-28.7	-25.5
Receipts	193.6	199.5	n.a.	206.5	198.3	200.9	203.3	208.3	213.4
Expenditures	212.7	222.3	n.a.	232.7	220.9	224.5	230.4	237.0	238.9
High employment surplus/deficit (NIA basis) 5/	1.4	.9	n.a.	- 3.1	1.1	3.4	-3.8	-7.2	-4.9

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

1/ Reflects effects of House amendments to Treasury's newly-approved "asset depreciation range" guidelines, which are effective as of the beginning of 1971.

2/ In testimony before the House Ways & Means Committee on Sept. 8, 1971, Secretary Connally disclosed the current Administration budget deficit estimate of $27.0--28.0 billion and the updated outlays estimate of $232.0 billion. These figures would imply a receipts estimate ranging from $204.0--205.0 billion.

Footnotes continued

FEDERAL BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS[1/]
(In billions of dollars)

3/ Includes such items as deposit fund accounts and clearing accounts.
4/ 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.
5/ Estimated by F.R. Board staff.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

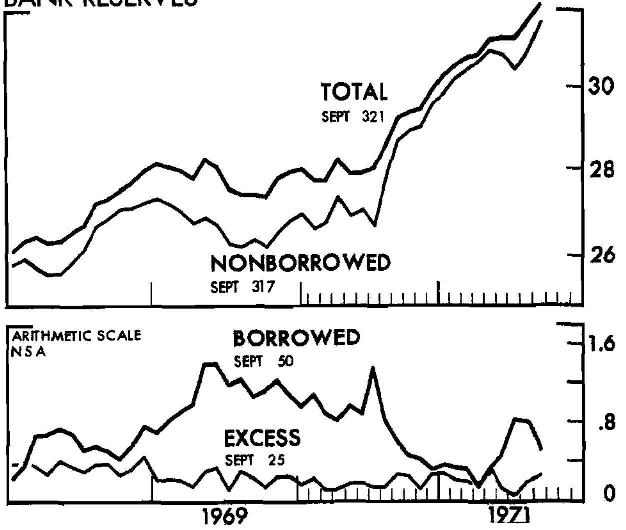
	Sept.	Oct.	Nov.
Total net borrowing	-1.5	1.4	3.2
Weekly and monthly bills	.8	.4	.8
Tax bills	-1.8	--	--
Coupon issues	1.2	--	--
As yet unspecified new borrowing	--	2.0	3.0
Other (debt repayments, etc.)	-1.7	-1.0	- .6
Plus: Other net financial sources a/	.9	1.0	- .9
Plus: Budget surplus or deficit (-)	1.1	-6.6	-4.1
Equals: Change in cash balance	.5 b/	-4.2	-1.8
Memoranda: Level of cash balance, end of period	10.0 b/	5.8	4.0
Derivation of budget surplus or deficit:			
Budget receipts	19.9	12.9	14.7
Budget outlays	18.8	19.5	18.8
Maturing coupon issues held by public	--	--	3.7
Net agency borrowing	.4	.7	.8

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

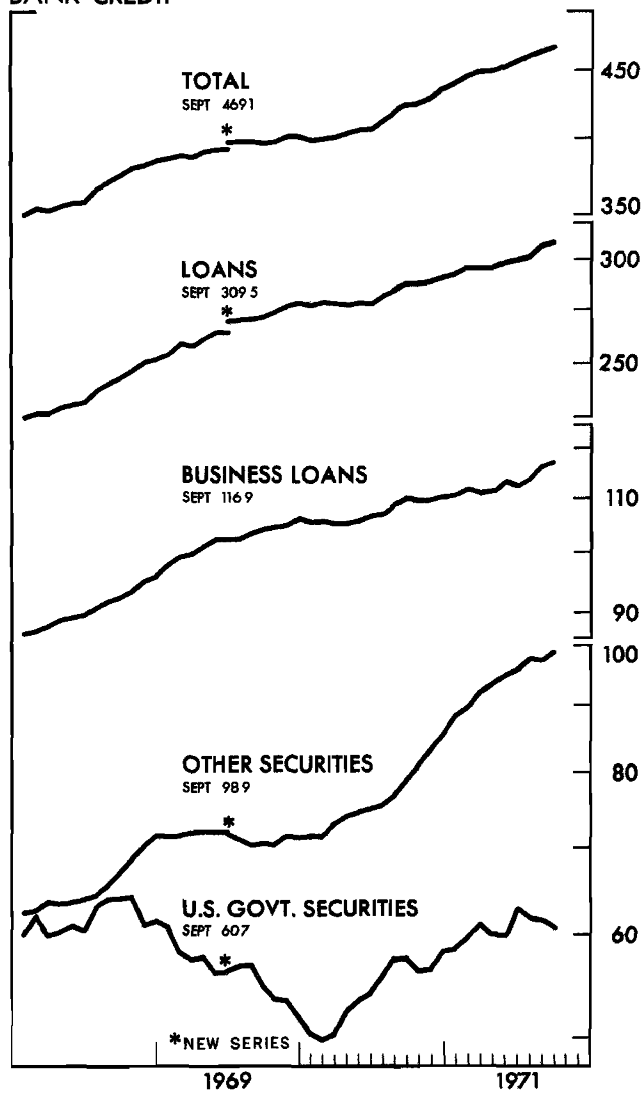
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

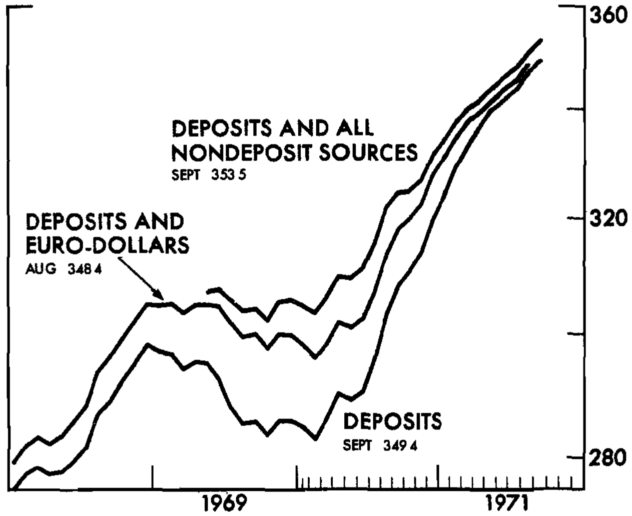
BANK RESERVES



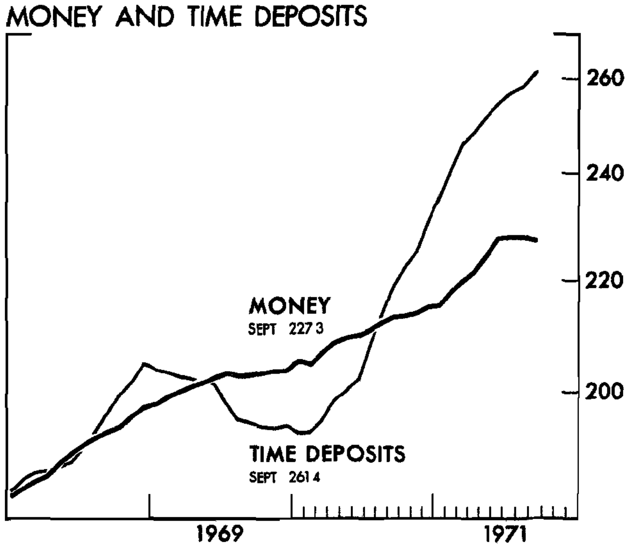
BANK CREDIT



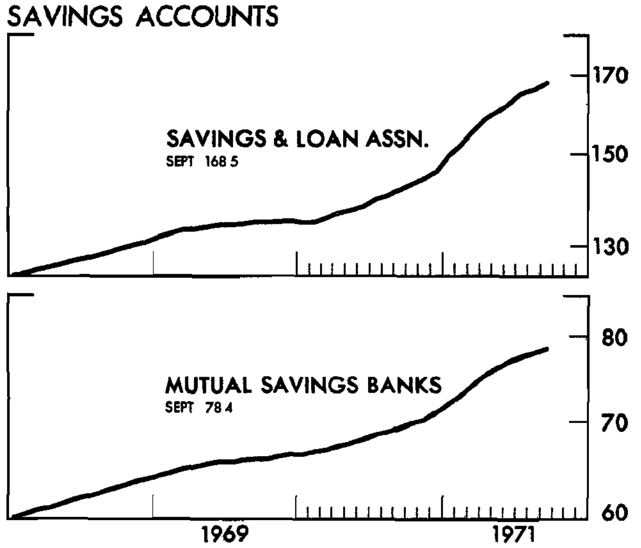
CREDIT PROXY



MONEY AND TIME DEPOSITS

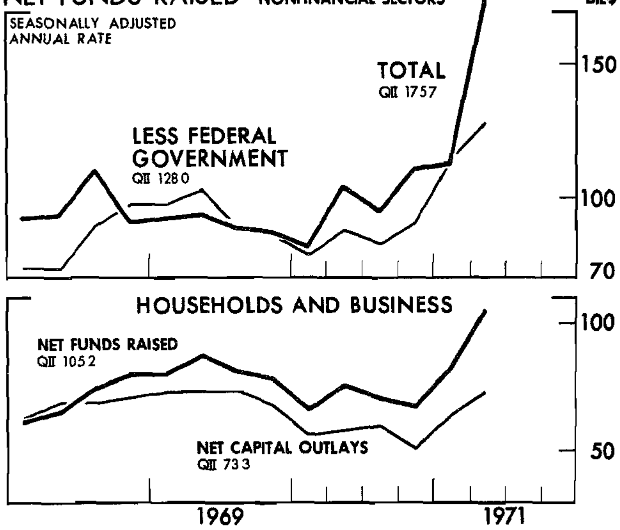


SAVINGS ACCOUNTS

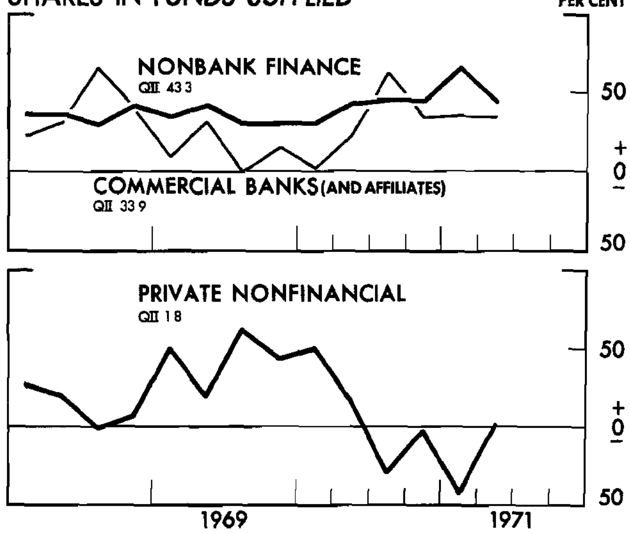


FINANCIAL DEVELOPMENTS - UNITED STATES

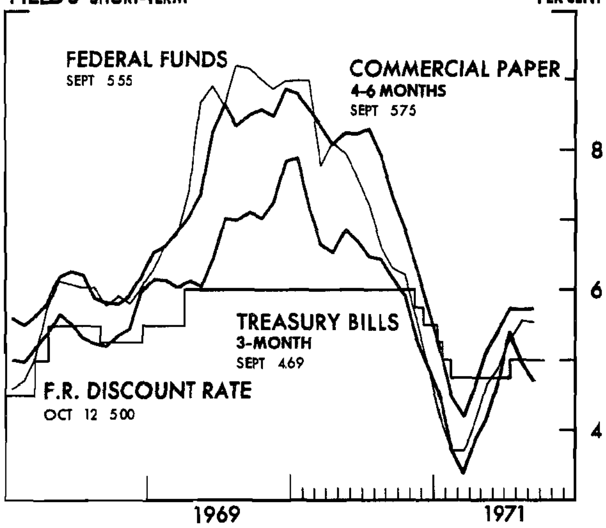
NET FUNDS RAISED NONFINANCIAL SECTORS



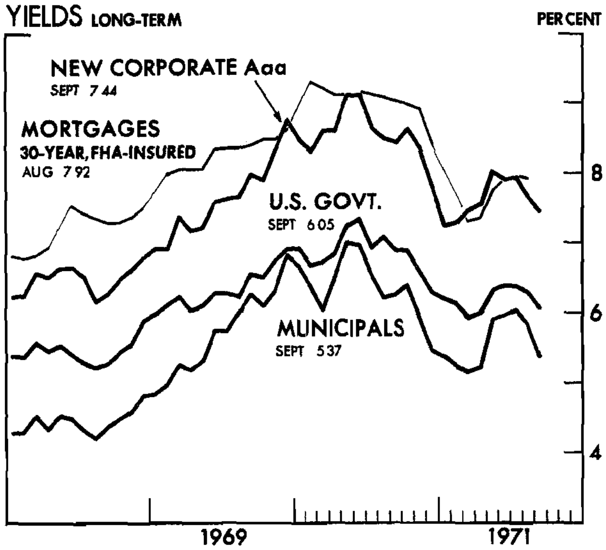
SHARES IN FUNDS SUPPLIED



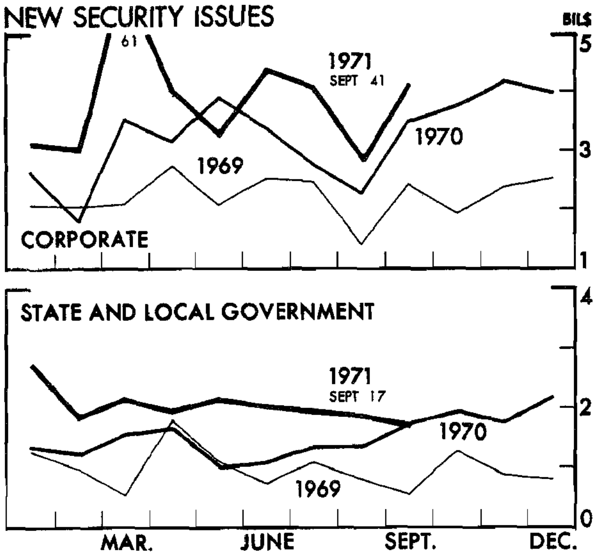
YIELDS SHORT-TERM



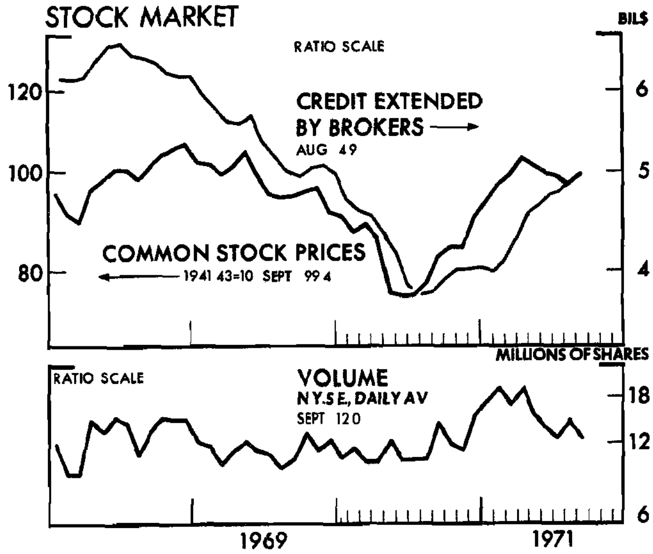
YIELDS LONG-TERM



NEW SECURITY ISSUES



STOCK MARKET



THE ECONOMIC PICTURE IN DETAIL

International Developments

Foreign exchange markets. Major foreign currencies firmed sharply ahead of the annual IMF meetings in late September, the rise being fueled by press reports of specific revaluation percentages (well above market rates at the time) purportedly being suggested by the IMF. Since that run-up, most currencies have shown little further change, with the exception of the Japanese yen which has continued to appreciate. Appreciations and depreciations -- as of September 15 and 30 and October 12 -- of major currencies from their pars, both against the dollar and against a weighted average of all currencies, are shown in the table below.

Table 1

PER CENT APPRECIATIONS OR DEPRECIATIONS (-) FROM PAR VALUES
OF MAJOR FOREIGN CURRENCIES

	Against U.S. dollar			Against all currencies
	Sept. 15	Sept. 30	Oct. 12	Oct. 12
U.S. dollar	--	--	--	-3.3
Sterling	3.0	3.6	3.8	.6
Canadian dollar	6.6	7.2	7.5	4.2
DM	8.7	10.4	10.1	6.7
Swiss franc	9.8	10.6	10.2	6.8
Guilder	5.7	7.6	7.8	4.4
French franc	0.8	0.5	0.4	-2.9
Belgian franc	4.3	6.5	7.0	3.4
Lira	1.9	2.1	2.1	-1.3
Yen	6.7	7.7	9.0	5.3

Note: Calculations are based on offer rates in the New York market on September 15 and 30 and October 12, 1971 and par values in effect on May 1, 1970. For weighted average appreciations (column 4), weights are shares of each country in 1970 world trade. Shares are calculated as the sum of each country's exports and imports (f.o.b.) divided by two times world exports. Currencies other than the ten are assumed, as a group, to have neither appreciated nor depreciated against the U.S. dollar.

Forward premiums for most of the major foreign currencies have declined in the past two weeks or so, apparently reflecting a shift in market expectations about the likely appreciation of spot rates for these currencies in the near future. Three-month forward premiums (per cent per annum) for these currencies are shown in Table 2.

Table 2

THREE-MONTH FORWARD PREMIUMS (PER CENT PER ANNUM)
FOR MAJOR FOREIGN CURRENCIES AS OF SEPT. 30 AND OCT. 12, 1971

	Sept. 30	Oct. 12		Sept. 30	Oct. 12
Sterling	2.0	1.9	French franc	6.6	3.1
Canadian $	0.8	0.4	Belgian franc	2.7	0.9
DM	1.2	1.1	Lira	1.2	3.4
Swiss franc	6.6	5.5	Yen	n.a.	11.7
Guilder	1.9	1.1			

Volume in most markets has returned to more or less normal levels for commercial transactions, but noncommercial business (interest arbitrage, speculative, and other) remains at a low level.

Demand for sterling, both commercial and speculative, and possibly interest arbitrage, has been strong since late September, and the Bank of England has been intervening heavily in the market. It may have purchased as much as $500 million so far in October. (Britain's published reserves for September showed an increase of just over $200 million). On October 6, the Bank of England extended the list of British money market instruments ineligible for purchase by non-residents.

There are some indications that the Bank of Japan may have been intervening less heavily in October than in September, but we are unable to confirm this at present. Japan's published reserves increased by around $800 million in September.

The German Federal Bank has purchased $0.7 billion forward and about $180 million spot since September 21. Prior to that it had not been intervening to limit the appreciation of the DM.

The Bank of France has sold some $0.5 billion since September 15, as the French franc eased well away from its upper limit. Compliance by French exporters and importers with exchange control regulations (instituted in August) has apparently led to some reversal of leads and lags, and the Bank of France indicated that it is now seeing some unwinding of speculative forward positions in francs taken up in July.

In system operations, the FRBNY purchased $37 million equivalent of Belgian francs in the New York market, and utilized these balances to repay a $35 million equivalent swap drawing on the Belgian National Bank, incurring a $1.9 million loss on that drawing. Outstanding Belgian franc drawings now total $600 million equivalent (at the exchange rate in effect when the drawing was made). The System's purchases of francs -- which were undertaken at the request of the National Bank of Belgium -- apparently were the chief cause of an appreciation of the franc by about 3/4 per cent in the week ended October 8.

Euro-dollar market. Euro-dollar rates, which had been firm during September, eased very sharply during the first few days of October as shown in the table below.

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) Differ-ential	(4) 3-month Euro-$ Deposit 1/	(5) 60-89 day CD rate (Adj.) 3/	(6) (4)-(5) Differ-ential
1971						
Jan.-Mar.	4.68	3.87	0.81	5.52	4.41	1.11
Apr.-June	6.15	4.56	1.59	6.70	4.95	1.75
July	5.39	5.28	0.11	6.47	5.81	0.66
Aug.	12.20	5.57	6.63	8.16	5.72	2.44
Sept.	5.10	5.55	-0.45	8.34	5.70	2.64
Sept. 1	28.48	5.59	22.89	9.16	5.59	3.57
8	5.17	5.73	-0.56	8.76	5.62	3.14
15r	5.84	5.59r	0.25r	8.09	5.79r	2.30r
22	4.97	5.46	-0.49	8.21	5.76	2.45
29	5.18	5.43	-0.25	8.21	5.74	2.47
Oct. 6	4.94	5.33	-0.39	7.30	5.66	1.64
13p	5.36	5.25	0.11	6.76	5.66	1.10

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.

The fall in rates might reflect market participants' increased willingness to acquire dollar claims, and a weakening in demand for dollar loans for conversion into foreign currencies, as the market assigned a lower probability to large exchange rate changes following the IMF meetings at the end of September. Forward exchange rates for most major foreign currencies eased in October; coupled with easier money market conditions in some European centers, this may have led to some arbitrage into Euro-dollars, contributing to the fall in rates.

Wire service reports have alleged that the primary source of funds to the market has been the Bank for International Settlements, and have surmised that central banks are supplying the market through the BIS. However, the Bank of Japan and the Bank of France have denied that they have supplied the market, and we are not aware that any G-10 country has determined to break the earlier agreement against making Euro-dollar placements. Other central banks could be supplying the market, but we cannot verify this.

Overnight Euro-dollars have remained competitive with overnight funds available in the Federal funds market, and U.S. banks increased their liabilities to branches by $575 million from September 15 through October 6, more than offsetting a run-off of $500 million of special Euro-dollar issues on September 28. The Treasury allowed an additional $500 million of such issues to run-off on October 12, bringing the amount outstanding to $1/2 billion. The final $1/2 billion issue will mature on October 26.

On September 22 the National Bank of Belgium announced a cut in their discount rate by 1/2 per cent to 5-1/2 per cent and on September 14 the Netherlands Bank cut its discount rate by 1/2 per cent to 5 per cent. The Bundesbank announced a cut in its discount rate from 5 to 4-1/2 per cent on October 13.

U.S. balance of payments. There are very few clues in the data that have become available since August 15 to the underlying condition of the U.S. balance of payments. As noted in the following section, the merchandise trade deficit in the April-August period was exaggerated by temporary influences -- though even with allowance for such elements the trade deficit was substantial -- and since then the opening of West Coast ports and the closing of East Coast and some Gulf ports have compounded the confusion. Added to this are the uncertain effects of exchange rate changes and the import surcharge -- which should, of course, be tending to reduce the trade deficit during the fourth quarter.

In August the official settlements over-all deficit (not seasonally adjusted) was some $8.8 billion, compared to $2.5 billion in July. Of the factors known at this time, the trade deficit was about the same in each of the months, and transactions in foreign and U.S. securities were not significantly different. Lending reported by banks in the United States was far larger in August than the month before, reaching a net outflow of $1,650 million (not seasonally adjusted) compared to a small net inflow in July. Of the August outflow, about $450 million was accounted for by U.S. branches and agencies of foreign banks, $1.2 billion was by U.S. banks and chargeable to VFCR ceilings, and $50 million was outflows for customer accounts or of types not covered by the VFCR.

In September, there was still a large official settlements deficit -- perhaps $1-1/2 billion. Most of this accrued to a few countries whose central banks were buying dollars to prevent their exchange rates from rising faster. In a few cases -- notably Germany -- the central bank also operated in the forward market, buying dollars forward to lessen the spot inflow. In most countries measures were in operation to either force capital inflows into a separate market or to make such inflows difficult by restricting the assets that could be purchased or eliminating interest payments on foreign deposits. Some countries in easing monetary policy have intended to minimize capital inflows as well as to stimulate domestic activity.

There is scarcely any evidence yet that the market is convinced that any of the major currencies involved has reached its maximum likely appreciation against the dollar, though lower Euro-dollar rates suggest some easing of speculative demand. Positions are not likely to be unwound on a large scale until new parities are established, or until the pattern of "floating" rates looks more settled. However, once the market believes that only minor further upward movements can be expected, there could be a rush to shift back into dollars, or to repay high-cost Euro-dollar debt incurred in establishing speculative positions.

Apart from the prospect of a reflow of speculative funds, the near-term outlook for the U.S. balance of payments is not promising. Any tendency for economic conditions in other industrial countries to slacken further would have a greater adverse effect on the trade balance than any immediate results of the exchange rate changes that might occur. Certainly, the rate changes that have occurred since May are not likely to be very significant, since they amount to a dollar devaluation of only 3-4 per cent against all other currencies, though the import surcharge could have a substantial effect if it is operating into next year. Very important over the longer run will be the degree of success of the program to restrain wage and price increased in the United States.

Uncertainties about the exchange rates that might finally be established abroad may cause some delay in corporate capital flows as investors reassess their plans for the location of additional capacity abroad. However, the latest Commerce survey shows that expansion of investment abroad is still high on the agenda of U.S. industry. Over-all projections for foreign plant and equipment expenditures are for a rise of 12 per cent in 1971, followed by a further increase of 10 per cent in 1972. For Western Europe, these percentages are 9 and 14, respectively. It would probably take very large revaluations abroad to slow this trend; in the case of Japan, any relaxation of restrictions on inflows would probably result in a major inflow from the United States even if the rate for the yen were to rise sharply.

U.S. foreign trade. The U.S. trade balance in August showed another large deficit, for the fifth consecutive month. For the two months July-August the deficit was at an annual rate of $4.1 billion (balance of payments basis), about equal to the very high deficit rate of the second quarter, as both exports and imports fell by about the same amount. For the first 8 months of this year the trade balance was a deficit of $2-1/2 billion at an annual rate. In the corresponding period of 1970, the balance was a $2-3/4 billion surplus.

Trade movements this year have been beset by special or temporary factors making it difficult to determine our basic trade position. A rough adjustment for such factors indicates that our trade balance in July-August would still have been in deficit but at a rate of between $2-1/2 and $3 billion -- about two-thirds or three-fourths of the actual rate.

Ordinarily the West Coast dock strike (which began in early July) might have been expected to affect imports more than exports, but a considerable amount of inbound cargo, particularly cars from Japan, was apparently diverted to other ports so that it is estimated that the effect of the strike on the trade balance was not very great. (In early October the West Coast strike was ended for at least 80 days by a Taft-Hartley injunction).

In the third quarter there was a greater acceleration in imports than in exports through East and Gulf Coast ports, to beat a dock strike at these ports on October 1, which did begin on that date. Thus, on balance, port strike developments tended to worsen the trade account through September. In the fourth quarter, with

East Coast ports closed, both imports and exports may be sharply reduced -- imports probably more than exports. The import surcharge and the still relatively small exchange rate changes may also begin to damp down imports in the current quarter.

However, other factors which have been adversely affecting our trade balance are still present. These include: (1) a less favorable cyclical position than was present last year, resulting in an easing of supply conditions in Europe and Japan; and (2) the market penetration by foreign products in the past six years when domestic costs and prices were rising steeply. Exports in the first eight months of this year were only 3 per cent greater in value than exports in the corresponding period of 1970, even after rough adjustment for the effects of U.S. strikes. The entire gain in exports this year has been in agricultural commodities and commercial aircraft (in the early part of the year) and through higher deliveries of automotive equipment to Canada. Exports of machinery have slowed and there has been a sharp decline in non-agricultural industrial materials -- particularly copper and aluminum -- reflecting the slowdown in foreign economic activity (see p. IV-13). There has been a further slippage in the U.S. share of world exports of manufactured goods to about 17-1/2 per cent, about 1 percentage point below our share in the second quarter of last year.

In contrast, imports in the first 8 months of this year (also adjusted for strike effects) were about 12 per cent greater than in the like period of 1970. Nearly 40 per cent of the increase was in cars. The increasing popularity of compact and sub-compact cars -- which dominate the types produced in Canada -- account for the upsurge in car imports from that source. In 1970, sales of European and Japanese cars totaled about 1.3 million units, about 15 per cent of total car sales in the United States. In August of this year sales were up to an annual rate of more than 1.85 million units, equivalent to over 18 per cent of an enlarged domestic car market. Sales of Japanese cars have nearly doubled in the first 9 months of this year compared to the corresponding period of 1970. Imports of foreign cars were also boosted by the additional inventories needed to support the expansion in sales.

Imports of several categories of industrial materials, not affected by domestic strikes, also increased this year. The heavy inflow of crude petroleum which began in May reflects the decline in tanker rates, increased quotas and higher prices resulting from the new tax arrangements made by U.S. oil companies with foreign countries last spring. Imports of lumber this year have continued the uptrend that begin in mid-1970 as domestic housing starts boomed. Imports of chemicals, which were relatively flat throughout 1970, have also been increasingly large in each quarter of this year.

As a result of the slow rate of expansion in exports and the continuing growth in imports, our trade balance with most major areas, particularly Western Europe and Japan, has deteriorated this year.

In the first half of this year our trade deficit with Japan was at an annual rate of $3 billion compared with a $1-1/4 billion deficit in all of 1970. (This rate of deficit was reduced in July-August as imports from Japan fell more than exports as a result of the West Coast strike.) Our traditional trade surplus with Western Europe ($2.9 billion in 1970) virtually disappeared in the second quarter of this year and then turned into a deficit in July-August as exports to these countries leveled off while imports picked up sharply.

Cyclical developments in major industrial countries. In many European countries economic expansion has slowed down significantly in recent months. In contrast to the temporary flattening of economic activity around mid-1970, which resulted from inventory adjustments and supply constraints, the current slowing of activity reflects weaker demand conditions for plant and equipment. In Japan, growth has remained very slow throughout the period since mid-1970. In Canada, there appears to have been some recovery from the 1970 recession during the first half of 1971.

Almost everywhere the mainsprings of such growth as did occur this spring and summer were consumer spending and exports. Japanese and Canadian exports rose very rapidly, while in Britain they were the one strong sector; in France, exports were also an important factor in economic expansion.

The *de facto* exchange rate changes that have occurred so far and the temporary U.S. measures, if these should persist for some time, will affect activity most in Japan, Germany and Canada, but there will also be a significant, albeit smaller, impact on Belgium, the Netherlands and Sweden. The United Kingdom will probably be affected relatively little. In France and Italy, where the impact of the U.S. measures is slight, the exchange rate changes of other countries even benefit the trade balance and stimulate the domestic economy. The same is true on balance for British and Canadian exports. Final exchange rate realignment and the removal of the U.S. import surcharge obviously will alter the pattern of effects among countries, but are not likely to change the above assessment by much.

The outlook for the remainder of this year and for early 1972 is for accelerating activity in the United Kingdom -- where the Government took expansionary actions in July -- and continued very slow growth in Germany and Japan. Activity in Canada will tend to run parallel with that of the U.S. economy. In the other industrial countries of Europe there is, on the average, likely to be moderate expansion with considerable variations from country to country.

The above assessments can be substantially altered by changes in or reversals of the present policy stances. Stimulative policies are now being pursued in Britain, Japan and Canada. Germany is still putting emphasis on controlling inflationary tendencies, but has a large countercyclical contingency budget and the discount rate was reduced on October 13. Maintenance of a high level of activity in Germany would help to sustain growth elsewhere in Europe.

In general, neither present cyclical indicators nor expected policy stances point to a serious and pervasive recession in Europe. On the other hand, a period of very slow growth in Germany and some other countries is now indicated and this tendency may be reinforced by the prospective adjustments in trade balances.

In Germany, the moderation in pace of activity which had been apparent during most of 1970 and which reflected inventory adjustments and supply difficulties, was interrupted around the turn of the year. Since the spring, the slower growth has become more clearly defined and results from a weakening of demand for investment goods. Real GNP, after a relatively large rise in the first quarter of the year, probably was flat in the second quarter. Taking the two quarters together, the underlying growth trend moderated from about a 4 per cent annual rate during 1970 to about a 2-1/2 per cent annual rate. Industrial production eased off a little from April through August mainly because of some decline in the output of machinery, reflecting slackening demand. Both domestic and export new orders have stabilized this year and may have begun to turn down during the summer. In real terms, both new orders and deliveries in German manufacturing have declined. But demand for housing construction and consumer goods, and also government demand for goods and services, are continuing to rise.

With the slower economic pace, overtime is being curtailed and hourly earnings in industry are rising much less rapidly than they did in 1970. In addition, newly concluded labor contracts show more moderate increases than in the past. Consequently, the rise in unit labor costs has moderated. However, the rise in industrial wholesale prices has moderated only slightly if at all; between March-April and July-August they rose at an annual rate of 4 per cent. Thus, profit margins are no longer under pressure from labor costs. Consumer prices have continued to rise at a 5 per cent annual rate.

The foreign trade balance through August has not shown a clear reaction to the diminution of demand pressures and the appreciation of the German mark since May. Since March, the trade balance has increased not only in dollars, but also in German marks. Exports regained their high winter level and imports stabilized. As import unit values have fallen, the volume of imports has continued to rise, especially imports of industrial materials and semi-finished goods, which reflects the fact that the German economy still operates at a high level of activity.

The German government continues to place its main policy emphasis on controlling the remaining inflationary tendencies. Market factors -- including the absence of reserve accruals by the Bundesbank -- had been tightening monetary conditions, and on October 13 the Bundesbank moved to at least offset these tendencies. The discount rate was cut by 1/2 of a percentage point to 4-1/2 per cent, the Lombard rate by a full percentage point to 5-1/2 per cent and reserve requirements were also reduced. The government has proposed a "stability-minded" budget for 1972 with expenditures rising by about the same amount as nominal GNP -- around 8.4 per cent. But there may be more give in the budget than the published figures imply. In addition, the "contingency" budget to be used in the event of an undesirable weakening in economic activity is very large.

In the United Kingdom, real GNP in the first half of 1971 was 1 per cent below the level in the second half of 1970. But the reflationary impact of the April budget, bolstered by a further package of expansionary measures in July, should insure that GNP increases at an annual rate of about 4 to 4-1/2 per cent (in real terms) at least through mid-1972. However, even at this relatively high rate of growth, unemployment -- which in September reached a total of almost 900,000, exceedingly high by British standards -- is unlikely to decline significantly during the next year.

During the first quarter this year, GNP declined sharply, largely due to strikes. Total output then rose in the second quarter but not enough to reach the level in the fourth quarter last year. The weakest component of GNP in the first half was fixed capital investment, which declined by about 2 per cent in real terms from the second half of 1970. There was a particularly steep decrease of about 7 per cent in investment in manufacturing. Real personal consumption expenditures were virtually unchanged between the two periods. The only major GNP category to show strength during the first half was exports of goods and services, which increased by about 2.7 per cent in real terms.

The government sought to stimulate the economy early last spring when, in the budget which began April 1, it announced cuts in both business and personal taxation and increases in social insurance payments. However, the disappointingly small increase in output in the second quarter prompted the government to take additional expansionary action in July. The principal measures included substantial reductions in indirect taxes and the removal of restrictions on installment buying. In addition, regulations governing depreciation allowances were liberalized and expenditures on public works projects in areas of high unemployment were raised.

The July measures were aimed primarily at stimulating personal consumption expenditures, which are expected to rise by about 6 per cent, in real terms, from first half 1971 to first half 1972. A substantial rise in the volume of retail sales -- which account for about half of total personal consumption expenditures -- in both July and August suggest that the July measures have had an immediate stimulative impact.

The recovery should also be aided by exports of goods and services, projected to grow by about 4 per cent, in real terms, in the same period, despite the post-August 15 developments. Private nonresidential investment will remain the weakest element in the economy; surveys of businessmen's intentions indicate a decline continuing through 1972. However, if Parliament on October 28 votes its approval -- as expected -- of Britain's entry into the EEC, investment plans may be revised upward. Rapid recovery in consumer spending should have the same effect.

The government's stepped up efforts to stimulate economic growth have apparently been accompanied by a change in its attitude toward prices and incomes policy, which before July had been limited almost solely to encouraging resistance by employers to wage demands considered excessive, even at the expense of long and costly strikes. In July, however, the government endorsed the Confederation of British

Industry's campaign to win the agreement of British business to halt price increases, or restrict them to 5 per cent where "unavoidable," in the year ending July 31. The CBI's program has apparently gained a wide measure of support from business and, if accompanied by cooperation from labor unions in the form of more moderate wage demands, could make a significant contribution to easing Britain's still severe price and wage inflation.

The French government projects 1971 real GNP to be 6 per cent above 1970, about the same increase as from 1969 to 1970. But unemployment rose sharply in the latter half of 1970 and has not fallen significantly this year. Consumer prices have been rising steadily at a rate of about 6 per cent. In contrast to 1970, when investment led the expansion, consumption has been the mainspring of growth in 1971. Exports have continued to grow rapidly.

The policy stance in France has been slightly on the expansionary side this year. Fiscal policy was more or less neutral, but monetary policy was expansionary despite the announced tightening last May when the Bank of France's discount rate was raised by a quarter point to underscore official concern about inflation. In the first 7 months of this year, money supply (M_2), seasonally adjusted, grew at a 16 per cent annual rate, a sharp rise from the 10 per cent rate of the same period a year earlier.

The 1972 budget is expected to be in balance and is considered by the government as neutral in its economic effects. Shifts within the budget, however, emphasize increased public investment spending and the impact of the budget next year should be slightly stimulative. Finance Minister Giscard d'Estaing announced during a recent budget speech that he would not hesitate to reflate the economy next year should it show signs of flagging. But the reflationary instruments to be used differ from past practice. The government will resort to changes in value-added tax rates instead of releasing funds from special public works accounts, whose spending impact on the economy is considered to be too slow.

The announcement of the intended 1972 policy stance suggests that the authorities are opting for a continuation of a high growth rate -- 5.5 per cent in real terms in 1972 -- and that they are thus prepared to tolerate a fairly high rate of price increases. This choice indicates that social peace remains the major concern of the French government. Unemployment in France is still high and industrial production in the second quarter was seriously disrupted by strikes. There are few signs of resistance by employers (including the public and nationalized sectors) to sizable wage demands, and hourly wage rates this year have been growing at an annual rate of more than 10 per cent, as was the case in 1970.

In an attempt to slow down inflation and perhaps moderate wage demands, the Government recently signed an agreement with the Patronat (Employers' Association). The agreement, similar to the British one, limits price increases of most goods to 1.5 per cent in the period September 15, 1971, to March 15, 1972; at the retail level existing profit margins are expected to be maintained.

In Italy, real GNP probably did not increase in the first half of 1971, when declines in industrial production apparently offset increases in output in agriculture and services. Industrial production (excluding construction) fell a further 3-1/2 per cent in each of the months July and August, but the August drop may be overstated by a faulty seasonal adjustment.

Production has continued to be plagued by strikes and absenteeism, but by last spring an insufficiency of aggregate demand had become the main impediment to expansion. Plant and equipment spending, which levelled off after mid-1970, has declined this year. Enterprises' ability to invest was reduced in 1970 when profits were squeezed, primarily because of very large wage increases but also in reflection of low output levels. This year, the incentive to invest has been eroded by the persistently high level of unused plant capacity. Residential construction has continued to contract, largely in further reaction to the artificially contrived housing boom in 1968-69. The growth of private consumption has been very moderate, partly because job uncertainties have lowered the propensity to consume.

Monetary policy has been expansionary for about a year. In June, the government increased interest subsidies to stimulate residential construction, and took steps to speed up investment by local authorities. In July, a package of fiscal measures was adopted.

Social security contributions were reduced for small- and medium-sized firms and for all firms in the South, and interest subsidies and investment funds were increased for many sectors. These measures were expected to have most of their impact in the second half of 1971, when they might add about 1-1/2 per cent to the GNP. However, incentives for investment when so much idle plant capacity exists may not prove very stimulating. The government's annual Forecasting and Programming Report on September 30 avoided any projection of the national accounts.

In the Netherlands, real GNP is expected to increase by 5 per cent from 1970 to 1971, not much less than from 1969 to 1970. The economy has continued to be influenced both by excess demand and cost-push inflation but by the end of summer an easing of the labor market suggest that demand pressures have begun to abate.

Through mid-1971 private investment remained at very high levels, but a decline (in real terms) is forecast for next year. High wage increases have kept consumption demand rising steadily. Government expenditures have been more expansionary than intended largely because of pay increases. Big capital inflows from abroad before August 15 served to frustrate the nominally tight monetary policy. With the capital inflows no longer occurring, policy restraint can now be more effective. And, given the underlying trends, real GNP is expected to grow in 1972 at less than a full capacity rate of around 3 per cent. Cost inflation is expected to continue.

The Belgian economy, like others, has undergone a slackening of business activity. Plant and equipment expenditures in industry, which rose sharply in 1970, have apparently been rising much more slowly since last winter. Consumer buying has also been markedly weaker. In the first half of this year, depressed consumer buying was mainly a reaction to the speeding up of purchases of consumer goods late last year in anticipation of higher prices resulting from the introduction of the value-added tax on January 1, 1971. More recently, consumption has also been affected by the reduced buoyancy in other sectors. Exports declined early in 1971, and in May-June were only one per cent above the fourth quarter of 1970, compared with an 11 per cent gain during last year. Some observers believe that the decline reflected an acceleration of export shipments late in 1970 caused by erroneous expectations that tax changes effective last January 1 would make Belgian exports less competitive.

The Belgian discount rate was reduced by 1/2 of a percentage point in March and again in September, when ceilings on bank credit were abolished as well. Fiscal policy has been expansionary this year in reflection of higher public investment outlays.

In Sweden, a sharp tightening of fiscal and monetary policies in the autumn of 1970 has resulted in a levelling off in industrial activity. A price and wage freeze introduced in October 1970 is still partially in force. Retail prices had been rising at an annual rate of 7 per cent in the first three quarters of 1970 but were stable in the first 7 months of 1971.

The reduced level of aggregate demand and pessimistic business expectations affected investment spending this year. Real GNP in 1971 is likely to average less than 3 per cent above 1970, compared with the 4.5 per cent growth from 1969 to 1970. Unemployment, rarely a problem in Sweden, grew significantly in 1971 and the authorities responded by relaxing monetary restraints and applying several minor fiscal stimulants. However, the most important reflationary tool has been the release of funds from the Counter-cyclical Investment Funds where enterprises deposit part of their profits in boom years in order to gain tax advantages.

In Japan, industrial activity has moved irregularly in recent months to a level only slightly higher than a year earlier. In July-August the index was 3.3 per cent higher than in the same period in 1970, but moved little from preceding months.

Growth of real GNP has been very slow since mid-1970. From the third quarter of 1970 to the second quarter of this year, real GNP rose at an annual rate of only about 2-1/2 per cent. For the fiscal year which began this April, the government estimated in September that real GNP will be about 4 to 5 per cent greater than a year earlier. This implies about a 5 per cent rate of growth on into early 1972 and is a substantially slower rate than the 10 per cent increase from mid-1969 to mid-1970.

The sluggishness in the economy has resulted mainly from weak demand for machinery and equipment. New orders for machinery (excluding ships) were down 20 per cent in the second quarter from the first quarter level. The total level of orders was sustained by increased demand from the utilities sector.

The U.S. measures of August 15 produced a psychological shock in Japan. Stock prices declined sharply as did new export contracts. Consequently, many firms are now sharply reducing their investment plans. Since Japan's economic growth has been heavily dependent on investment and a rapid rate of increase in exports, the growth of real GNP over the next few quarters is likely to continue to be low.

Late in September the government announced five emergency measures to assist small- and medium-sized exporters adversely influenced by the U.S. import surcharge. These measures include special loans from public financial corporations, special Bank of Japan credit facilities of up to $300 million to finance export bills, liberalization of insurance facilities, and special tax concessions.

But the major offsets to the adverse impact of the U.S. import surcharge and the appreciation of the yen, focus heavily on increased fiscal stimulus from accelerated expenditures and a reduction in personal income taxes. The budget has already been boosted twice by supplementary budgets, and a third supplementary budget is currently being proposed.

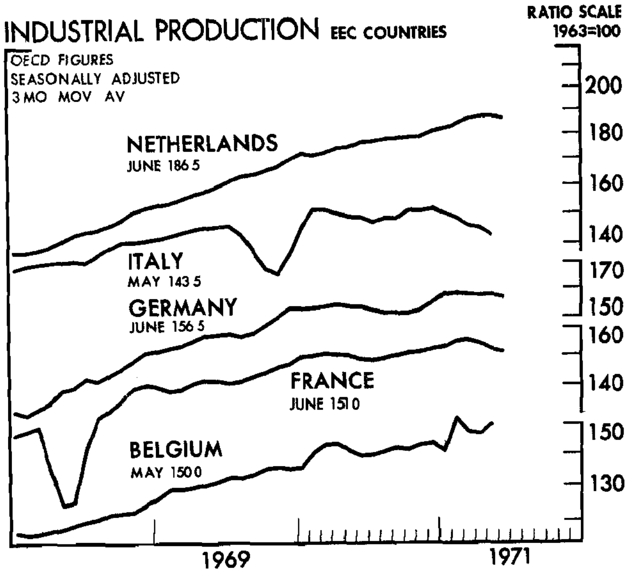
The Bank of Japan is pursuing an easy money policy and newspapers reported in mid-September that a possible fifth reduction in the Bank's basic discount rate, now 5-1/4 per cent, is being studied.

If this cut were made the interest rate paid on time and savings deposits might also have to be reduced, since the present spread is very narrow. Such an action would present some legislative problems.

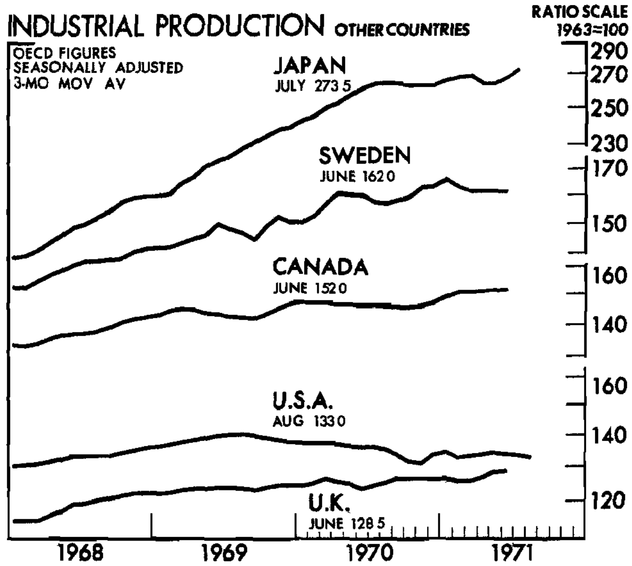
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

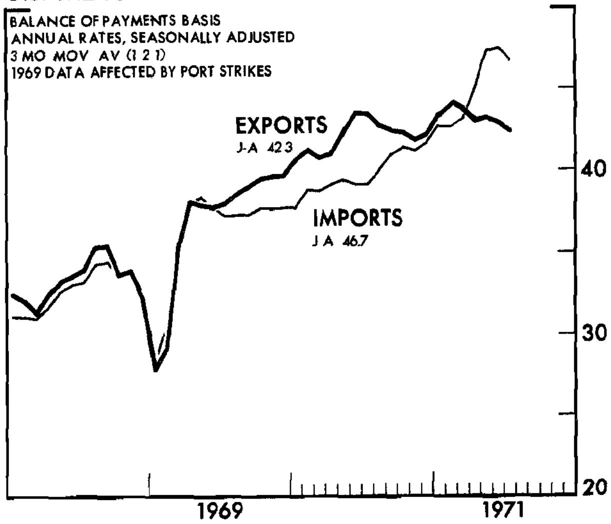
INDUSTRIAL PRODUCTION EEC COUNTRIES



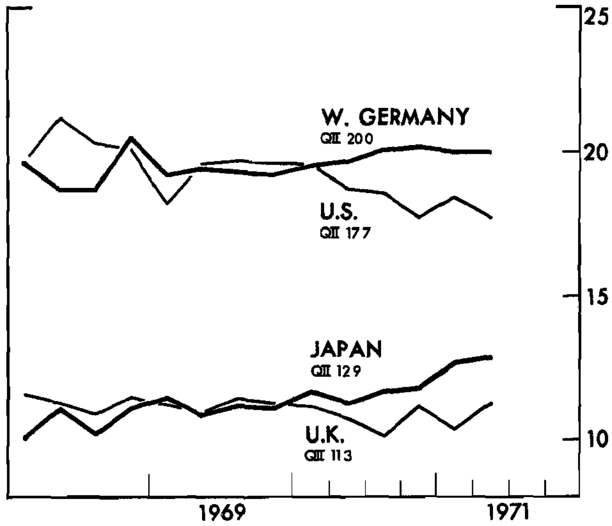
INDUSTRIAL PRODUCTION OTHER COUNTRIES



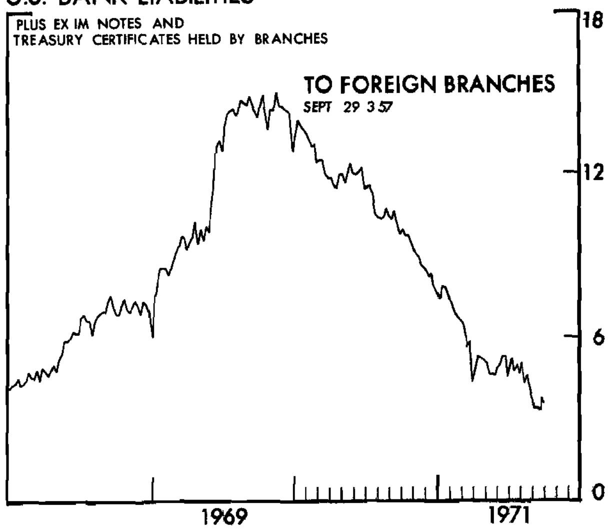
U.S. MERCHANDISE TRADE



SHARE OF MANUFACTURES EXPORTS



U.S. BANK LIABILITIES



90-DAY RATES