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Content last modified 6/05/2009.

CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

July 10, 1974

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By the Staff
Board of Governors
of the Federal Reserve System

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DOMESTIC NONFINANCIAL SCENE

July 10, 1974

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SELECTED DOMESTIC NONFINANCIAL DATA
AVAILABLE SINCE PRECEDING GREENBOOK
(Seasonally adjusted)

	Latest Data			Per Cent Change From		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year Earlier
				(At Annual Rates)		
Civilian labor force	June	7/5/74	90.9	3.2	1.9	2.4
Unemployment rate	June	7/5/74	5.2	5.2 1/	5.1 1/	4.8 1/
Insured unemployment rate	May	6/28/74	3.3	3.3 1/	3.3 1/	2.7 1/
Nonfarm employment, payroll (mil.)	June	7/5/74	77.1	- .7	1.6	2.1
Manufacturing	June	7/5/74	19.9	-1.3	1.4	.3
Nonmanufacturing	June	7/5/74	57.2	- .5	1.7	2.7
Private nonfarm:						
Average weekly hours (hours)	June	7/5/74	36.8	36.8 1/	36.8 1/	37.1 1/
Hourly earnings ($)	June	7/5/75	4.17	4.14 1/	4.07 1/	3.87 1/
Manufacturing:						
Average weekly hours (hours)	June	7/5/74	40.1	40.3 1/	40.4 1/	40.6 1/
Unit labor cost (1967=100)	May	6/29/74	130.1	15.9	9.4	6.9
Consumer prices (1967=100)	May	6/21/74	145.5	12.7	10.9	10.7
Food	May	6/21/74	159.5	10.6	4.1	15.7
Commodities except food	May	6/21/74	134.6	15.3	15.1	9.6
Services 2/	May	6/21/74	149.4	12.2	9.9	8.6
Wholesale prices (1967=100)	May	6/13/74	154.4	15.5	14.6	16.4
Industrial commodities	May	6/13/74	150.1	32.8	34.6	20.1
Farm products & foods & feeds	May	6/13/74	166.4	-26.1	-27.3	8.1
Personal income ($ billion) 3/	May	6/20/74	1121.1	11.5	9.6	10.1
				(Not at Annual Rates)		
Mfrs. new orders dur. goods ($ bil.)	May	7/2/74	46.7	5.9	10.5	12.5
Capital goods industries:	May	7/2/74	14.0	4.1	3.9	18.4
Nondefense	May	7/2/74	11.9	- .1	4.4	18.7
Defense	May	7/2/74	2.1	36.7	1.1	16.7
Inventories to sales ratio:						
Manufacturing	May	7/2/74	1.62	1.62 1/	1.62 1/	1.59 1/
Ratio: Mfrs.' durable goods inventories to unfilled orders	May	7/2/74	.700	.714 1/	.721 1/	.786 1/
Retail sales, total ($ bil.)	May	7/9/74	44.6	.7	3.4	6.9
GAF	May	7/9/74	11.8	1.6	4.0	8.5
Auto sales, total (mil. units) 3/	June	7/5/74	9.2	.4	3.3	-23.0
Domestic models	June	7/5/74	8.0	1.5	8.4	-20.2
Foreign models	June	7/5/74	1.2	-2.8	-17.0	-34.0
Housing starts, private (thous.) 3/	May	6/19/74	1,450	-11.1	-24.6	-37.8
Leading indicators (1967=100)	May	6/29/74	173.3	.2	1.9	6.4

1/ Actual data. 2/ Not seasonally adjusted. 3/ At annual rate.

DOMESTIC NONFINANCIAL DEVELOPMENTS

The staff currently is estimating that real GNP changed little--or possibly edged down--in the second quarter. There are no present indications of an emergence of forces making for significant economic expansion. Meanwhile, the upward momentum of nonfarm prices continues very strong, and wage rates have been rising at an exceptionally rapid rate in recent months. Productivity in the private nonfarm economy apparently declined further in the second quarter.

In June, industrial production is estimated to have changed little, following two months of moderate increase. Auto assemblies were maintained at the May rate, and highly tentative data suggest that output of business equipment, steel, and some other major materials was relatively stable. For the second quarter as a whole, industrial output is estimated to have risen around 1/2 per cent from the first quarter.

Conditions in the labor market in June were about unchanged. The unemployment rate remained at 5.2 per cent, as the second consecutive increase in the civilian labor force was matched by a rise in total employment (household series). However, nonfarm payroll employment edged down, following two months of sizable increase. In manufacturing, both employment and the workweek were lower in June. For the second quarter as a whole, nonfarm payroll employment increased by about 400,000.

Consumer spending has remained sluggish. Weekly data suggest a slight decline in the dollar volume of retail sales in June, following a moderate increase in May. Unit sales of autos, however, edged up in June, with imports unchanged after several months of decline. For the second quarter as a whole, the increase in retail sales is estimated to have about matched the apparent rise in prices.

Both housing starts and residential building permits were down sharply in May, and for the quarter as a whole, starts probably were below the level of the two preceding quarters.

Manufacturers' new orders for durable goods rose sharply in May, as they had in April, with primary metals especially strong. Nondefense capital goods orders remained at the advanced April level. The limited data now available on business inventories indicate a large rise in book value in the second quarter. On a GNP basis--that is, after adjustment for the increased value of stocks because of higher prices--inventory investment apparently remained relatively low.

Wage rates increased at an exceptionally rapid rate in May and June. For the second quarter as a whole, the adjusted hourly earnings index for the nonfarm sector rose at an annual rate of about 9-1/2 per cent; in June, the index was about 8 per cent above a year earlier.

From mid-May to mid-June, prices of farm products declined for the fourth consecutive month. More recently, however, farm prices have been rising, particularly for meat animals. The wholesale price index for June is not yet available, but announced price increases for steel, chemicals, autos and other commodities indicate that industrial commodity prices probably advanced considerably further. In May, the consumer price index had risen 1.1 per cent, with increases widespread among commodities, including foods, and services. The consumer index was almost 11 per cent above a year earlier.

Outlook. Staff projections through mid-1975 incorporate the following monetary and fiscal policy assumptions. (1) Growth in M_1 is assumed to average an annual rate of about 5-1/4 per cent in the second half of 1974 and to be somewhat higher in the first half of 1975. This would imply that short-term interest rates by the end of the projection period would be somewhat above current advanced levels unless GNP growth is weaker than we are projecting. (2) An expanded public employment program is still assumed. (3) Other Federal expenditures are assumed to remain close to the budget for fiscal 1975.

Real GNP is now projected to change little in the third quarter and then to expand at a minimal pace to mid-1975. From the second quarter of 1975 to the second quarter of 1975, real growth is now projected to amount to less than 1 per cent, a slower rate than expected four weeks ago.

The further downscaling of real growth reflects a weaker housing outlook than appeared likely four weeks ago, a somewhat larger projected decline in net exports and continued sluggishness in real consumer purchases. Housing starts are now expected to remain at the reduced second quarter rate in the last two quarters of 1974 and to decline somewhat in the first half of 1975. These downward revisions reflect greater weakness in multifamily starts than had been anticipated, in part, because of increasing difficulties in construction financing. The housing projection does not, however, make allowance for any serious deterioration of savings inflows to thrift institutions attributable to the spread of new competitive market instruments.

Price prospects also appear bleaker than four weeks ago. The price increase for industrial products has been larger and more pervasive than anticipated, and increases for fuels, materials, and intermediate products are likely to be passed on through later production stages. Also important is the sharply accelerated pace of increase in wage rates; the emerging pattern of wage increases and the prospect of prices rising more rapidly has caused us to raise our projections with respect to compensation per manhour and unit labor costs. The increase in the GNP fixed-weight price index has been raised by an average of about 3/4 per cent over the next four quarters. In the fourth quarter of this year, this index is now projected to be rising at an annual rate of almost 8 per cent, and in the spring of next year at a 6 per cent rate.

With growth in real GNP now projected to average less than 1 per cent over the next four quarters, total employment is expected to change relatively little rather than increasing as had been anticipated four weeks ago. The unemployment rate is now projected to rise to about 6-1/2 per cent by mid-1975, even though growth in the civilian labor force is expected to be relatively slow.

STAFF GNP PROJECTIONS

	Changes in nominal GNP $ billion		Per cent change annual rate: Real GNP		Per cent change annual rate: Gross private product fixed weighted price index		Unemployment rate	
	6/12/74	7/10/74	6/12/74	7/10/74	6/12/74	7/10/74	6/12/74	7/10/74
1971 1/	78.3	78.3	3.2	3.2	4.6	4.6	5.9	5.9
1972 1/	99.7	99.7	6.1	6.1	3.2	3.2	5.6	5.6
1973 1/	133.9	133.9	5.9	5.9	6.1	6.1	4.9	4.9
1974 1/	107.2	103.2	- .6	- .8	9.6	9.7	5.5	5.4
1973: I 1/	43.3	43.3	8.7	8.7	7.0	7.0	5.0	5.0
II 1/	29.5	29.5	2.4	2.4	7.9	7.9	4.9	4.9
III 1/	32.5	32.5	3.4	3.4	7.0	7.0	4.7	4.7
IV 1/	33.0	33.0	1.6	1.6	8.6	8.6	4.7	4.7
1974: I 1/	14.7	14.7	-6.3	-6.3	13.5	13.5	5.2	5.2
II	27.8	23.1	- .5	- .8	9.4	9.0	5.2	5.1
III	29.5	29.2	1.3	.2	7.6	8.8	5.6	5.5
IV	33.9	32.5	2.2	1.3	7.1	7.8	5.9	5.8
1975: I	27.4	26.5	1.6	.8	6.0	6.7	6.1	6.2
II	25.0	24.5	1.6	.8	5.3	6.0	6.3	6.5
Change: 72-IV to 73-IV	138.3	138.3	4.0	4.0	7.8	7.8	- .6	- .6
73-IV to 74-IV	105.9	98.5	- .9	-1.5	9.4	9.8	1.2	1.1
74-II to 75-II	115.8	112.7	1.7	.8	6.5	7.3	1.1	1.4

1/ Actual.

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

	1974 Proj.	1974				1975	
			Projection				
		I	II	III	IV	I	II
Gross National Product	1392.3	1352.2	1375.3	1404.5	1437.0	1463.5	1488.0
Final purchases	1386.8	1346.7	1372.1	1398.0	1430.5	1457.0	1481.5
Private	1076.6	1048.9	1066.3	1083.8	1107.3	1126.5	1144.2
Excluding net exports	1076.2	1038.0	1065.1	1089.0	1112.8	1134.9	1154.5
Personal consumption expenditures	876.5	844.6	867.2	887.5	906.8	925.1	942.3
Durable goods	132.4	125.0	131.2	135.0	138.5	141.5	143.5
Nondurable goods	374.0	362.3	370.0	378.0	385.8	393.1	400.3
Services	370.1	357.3	366.0	374.5	382.5	390.5	398.5
Gross private domestic investment	205.2	198.9	201.1	208.1	212.5	216.3	218.7
Residential construction	49.2	49.3	49.4	49.1	49.1	49.1	47.9
Business fixed investment	150.5	144.1	148.5	152.5	156.9	160.7	164.3
Change in business inventories	5.4	5.5	3.2	6.5	6.5	6.5	6.5
Nonfarm	4.9	5.0	2.5	6.0	6.0	6.5	6.5
Net exports of goods and services 1/	.4	10.9 2/	1.2	-5.2	-5.4	-8.4	-10.3
Exports	134.2	130.4 2/	135.2	134.4	136.7	136.9	138.0
Imports	133.8	119.4	134.0	139.6	142.1	145.3	148.3
Gov't. purchases of goods and services	310.2	297.8	305.8	314.2	323.1	330.5	337.3
Federal	116.0	112.1	114.4	116.8	120.7	122.4	123.9
Defense	78.4	76.3	77.0	78.5	81.9	83.0	84.0
Other	37.6	35.8	37.4	38.3	38.8	39.4	39.9
State & local	194.2	185.7	191.4	197.4	202.4	208.1	213.4
Gross national product in constant (1958) dollars	830.7	831.0	829.4	829.9	832.6	834.3	836.0
GNP implicit deflator (1958 = 100)	167.6	162.7	165.8	169.2	172.6	175.4	178.0
Personal income	1135.7	1094.4	1121.5	1150.5	1176.2	1202.3	1227.2
Wage and salary disbursements	753.3	726.2	744.7	762.7	779.4	796.9	813.5
Disposable income	965.1	931.4	954.1	977.2	997.7	1019.3	1039.5
Personal saving	62.5	61.5	61.2	63.4	63.7	66.0	68.1
Saving rate (per cent)	6.5	6.6	6.4	6.5	6.4	6.5	6.6
Corporate profits & inventory val. adj.	114.0	112.9	110.9	113.7	118.5	117.0	115.5
Corporate profits before tax	144.3	144.0	146.7	143.0	143.5	136.5	132.5
Federal government receipts and expenditures, (N.I.A. basis)							
Receipts	294.5	285.6	292.2	296.9	303.2	307.3	311.4
Expenditures	298.5	282.3	294.4	304.6	312.5	319.1	325.1
Surplus or deficit (-)	-4.0	3.3	-2.2	-7.7	-9.3	-11.8	-13.7
High employment surplus or deficit (-)	3.0	2.4	.3	1.8	7.6	15.2	20.3
State and local government surplus or deficit (-), (N.I.A. basis)	3.7	4.6	4.5	3.1	2.9	1.3	.2
Total labor force (millions)	93.1	92.8	92.9	93.2	93.5	93.8	94.1
Armed forces "	2.3	2.3	2.3	2.2	2.2	2.2	2.2
Civilian labor force "	90.9	90.5	90.6	91.0	91.3	91.6	91.9
Unemployment rate (per cent)	5.4	5.2	5.1	5.5	5.8	6.2	6.5
Nonfarm payroll employment (millions)	77.0	76.7	77.1	77.1	77.1	77.1	77.2
Manufacturing	19.9	19.9	19.9	19.9	19.8	19.8	19.8
Industrial production (1967 = 100)	125.7	124.9	125.2	125.9	126.6	127.3	127.9
Capacity utilization, mfg. (per cent)	80.0	80.5	80.2	79.9	79.6	79.3	78.9
Major materials (per cent)	89.8	90.2	90.5	89.6	88.9	88.0	87.1
Housing starts, private (millions, A.R.)	1.54	1.63	1.51	1.50	1.50	1.45	1.40
Sales new autos (millions, A.R.)	9.22	9.04	9.20	9.25	9.40	9.50	9.50
Domestic models	7.90	7.49	7.95	8.00	8.15	8.25	8.25
Foreign models	1.33	1.55	1.25	1.25	1.25	1.25	1.25
1/ Net exports of g. & s. (Bal. of Paymts.)	1.0	11.6	1.8	-4.6	-4.8	-7.8	-9.7
Exports	135.2	131.5	136.3	135.5	137.8	138.0	139.1
Imports	134.2	119.9	134.5	140.1	142.6	145.8	148.8

2/ Includes effects of shipments of military equipment and supplies to Israel; for 1974-I these are now estimated at $.5 billion, annual rate, and considered as a sale, all from U.S. military stocks and thus reducing defense purchases by that amount.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1974 Proj.	1974				1975	
			Projection				
		I	II	III	IV	I	II
	Billions of Dollars						
Gross National Product	103.2	14.7	23.1	29.2	32.5	26.5	24.5
Inventory change	-2.6	-12.5	-2.3	3.3	.0	.0	.0
Final purchases	105.7	27.3	25.4	25.9	32.5	26.5	24.5
Private	72.6	15.1	17.4	17.5	23.6	19.1	17.7
Net exports	-5.4	-1.9	-9.7	-6.4	- .2	-3.0	-1.9
Excluding net exports	78.0	17.0	27.1	23.9	23.8	22.1	19.6
Personal consumption expenditures	72.5	19.4	22.6	20.2	19.4	18.3	17.2
Durable goods	1.6	- .6	6.2	3.7	3.6	3.0	2.0
Nondurable goods	38.1	12.7	7.7	8.0	7.8	7.3	7.2
Services	32.8	7.3	8.7	8.5	8.0	8.0	8.0
Residential fixed investment	-8.8	-4.7	.1	- .3	.0	.0	-1.2
Business fixed investment	14.3	2.3	4.4	4.0	4.4	3.8	3.6
Government	33.1	12.2	8.0	8.4	8.9	7.4	6.8
Federal	9.4	5.3	2.3	2.4	3.9	1.7	1.5
State and local	23.7	6.9	5.7	6.0	5.0	5.7	5.3
GNP in constant (1958) dollars	-6.7	-13.6	-1.6	.5	2.7	1.7	1.7
Final purchases	-4.1	-4.6	.7	-2.4	2.6	1.7	1.4
Private	-6.4	-7.3	.7	-2.7	3.2	2.3	1.2
	Per Cent Per Year 1/						
Gross National Product	8.0	4.5	7.0	8.8	9.6	7.6	6.9
Final purchases	8.3	8.5	7.8	7.8	9.6	7.6	6.9
Private	7.2	6.0	6.8	6.7	9.0	7.1	6.4
Personal consumption expenditures	9.0	9.7	11.1	9.7	9.0	8.3	7.6
Durable goods	1.2	-1.9	21.4	12.1	10.8	8.9	5.8
Nondurable goods	11.3	15.3	8.8	8.9	8.5	7.8	7.5
Services	9.7	8.6	10.1	9.6	8.8	8.6	8.4
Gross private domestic investment	1.5	-25.2	4.5	14.7	8.7	7.3	4.5
Residential structures	-15.2	-30.5	.8	-2.4	.0	.0	-9.4
Business fixed investment	10.5	6.6	12.8	11.2	12.1	10.0	9.3
Gov't. purchases of goods & services	11.9	18.2	11.2	11.4	11.8	9.5	8.5
Federal	8.8	21.4	8.5	8.7	14.0	5.8	5.0
Defense	6.1	19.3	3.7	8.0	18.5	5.5	4.9
Other	15.0	25.9	19.1	10.0	5.3	6.3	5.2
State and local	13.9	16.4	12.9	13.1	10.5	11.7	10.6
GNP in constant (1958) dollars	- .8	-6.3	- .8	.2	1.3	.8	.8
Final purchases	- .5	-2.2	.3	-1.1	1.3	.8	.7
Private	- .9	-4.2	.4	-1.6	1.9	1.4	.7
GNP implicit deflator	8.9	11.5 2/	7.9	8.5	8.1	6.7	6.0
Private GNP fixed weighted index 3/	9.7	13.5	9.0	8.8	7.8	6.7	6.0
Personal income	9.7	5.9	10.3	10.8	9.2	9.2	8.5
Wage and salary disbursements	8.9	5.1	10.6	10.0	9.1	9.3	8.6
Disposable income	9.4	6.1	10.1	10.0	8.7	8.9	8.2
Corporate profits before tax	14.3	63.2	7.7	-9.7	1.4	-18.1	-11.2
Federal government receipts and expenditures (N.I.A. basis)							
Receipts	11.1	17.5	9.6	6.6	8.8	5.5	5.4
Expenditures	13.1	20.2	18.3	14.6	10.8	8.7	7.7
Nonfarm payroll employment	1.9	.8	1.9	.0	.0	.0	.5
Manufacturing	.3	-2.9	.1	.0	-1.0	-1.0	.0
Industrial production	.0	-6.5	1.1	2.2	2.0	2.2	2.1
Housing starts, private	-24.5	11.6	-26.0	-2.6	.0	-12.7	-13.1
Sales new autos	-19.4	-35.3	7.2	13.1	6.6	4.3	.0
Domestic models	-18.3	-38.0	27.1	15.3	7.7	5.0	.0
Foreign models	-24.9	-19.8	-58.2	.0	.0	.0	.0

1/ Percentage rates are annual rates compounded quarterly.
2/ Excluding Federal pay increases rates of change are: 1974-I, 11.4 per cent; 1974-IV, 7.0 per cent; 1975-I, 6.0 per cent.
3/ Using expenditures in 1967 as weights.

Industrial production. Industrial production is tentatively estimated to have changed little in June. If this estimate holds, the second quarter average would be 0.4 per cent above the first quarter level.

Auto assemblies in June, which had been scheduled at an 8.1 million annual rate were reduced by a strike at Ford and output remained at the May level of 7.7 million units. Auto production schedules for the third quarter have been revised upward to an 8.7 million rate, reflecting a decision to produce a larger number of 1974 models in July.

Estimates of output in the business equipment area and in the electric power based sector of the total index based on production worker manhours were both about unchanged in June.

Production of raw steel and of the chemical, textile, and paper group apparently changed little.
(Note: The June production index will be ready for the Friday supplement.)

Retail sales. Our estimate of retail sales for June based on the weeks through June 29 suggests that sales were off about half a per cent from May with little strength evident in any major categories. More complete sample counts have raised earlier estimates of sales in April and May; April is now 0.9 per cent above March and May is 0.7 per cent above April.

RETAIL SALES (REVISED)
(Seasonally adjusted)

	--Millions of dollars--		Per cent change pervious month	
	April 1/	May 1/	April 1/	May 2/
Total sales	44283	44612	.9	.7
Durable	13941	14185	2.1	1.8
Auto	7644	7818	3.3	2.3
Furniture & appliance	2163	2203	-1.3	1.8
Nondurable	30342	30427	.4	.3
Food	9689	9744	1.0	.6
General merchandise	7438	7518	-1.4	1.1
Gasoline stations	3236	3314	2.6	2.4
Total, less auto and nonconsumption items	33879	34024	.5	.4
GAF	11611	11802	-2.3	1.6

1/ Final estimate.
2/ Preliminary estimate.

Unit sales of consumer durables. Sales of new domestic-type autos in June were at an 8.0 million unit annual rate, slightly above figures for April and May (revised upward because of changes in the seasonal factors) but a fifth below a year earlier. Small car sales were off 4 per cent from May, while large car sales were up by an equal percentage. Small cars accounted for 30 per cent of domestic-type sales in June, the same as a year earlier but well below the recent high of 39 per cent in January.

Preliminary estimates indicate that foreign car sales were at a 1.2 million unit rate in June, the same as in May but a third below last June. Imports accounted for 13 per cent of total auto sales, down from 16 per cent in June of last year.

Stocks of domestic-type new cars declined further in June to the equivalent of a 53 days supply, compared to a 57 days supply at the end of May. The stock/sales ratio in June of last year was at a 46 days supply.

Factory sales of major home appliances, TVs, and radios in the first three weeks of June remained at the May level but were 4 per cent below June of last year. Sales of color TVs and radios were up substantially from May.

SELECTED SALES OF CONSUMER DURABLES
Seasonally adjusted

	1973	1974			Per cent change from	
	June	April	May	June	Month ago	Year ago
	Annual rates, millions of units					
Auto sales, total	11.9r	9.2r	9.1r	9.2	1	-23
Foreign	1.8	1.3	1.2	1.2	0	-33
Domestic	10.1r	7.9r	7.9r	8.0	1	-20
Large	7.1r	5.3r	5.4r	5.6	4	-21
Small	3.0r	2.6r	2.5r	2.4	-4	-20
	Indexes, 1967=100					
Home goods factory						
Unit sales	160	145	154	154e	0	- 4
TVs 1/	173	149	165	170e	3	- 2
Radios 1/	79	75	115	170e	48	115
Major appliances	155	148	148	142e	-4	- 8

1/ Includes domestic and foreign label imports.
e/ Estimated on the basis of data through June 22.
r/ Revised.

<u>Michigan Survey Research Center survey of consumer attitudes</u>. The Michigan index of consumer sentiment--a composite of five questions on personal financial situations, business conditions, and whether it is a good time to buy household durables--indicated less pessimism in April and May than when the previous survey was taken in February, at the height of the energy crisis. However, attitudes were still somewhat less favorable than last fall and the index of these responses was notably lower than in past cyclical downturns.

The unusually low level of the index of consumer sentiment both before and after the energy crisis appears to be the result of intensified inflationary expectations and lack of confidence in government economics policies. For some time, those survey respondents who expected at least 10 per cent inflation and who think the government will be unsucessful in dealing with economic problems also have tended to have unfavorable attitudes toward personal financial situations and business conditions.

At present, however, a willingness to buy ahead of expected price increases may have loosened the relationship between the index of sentiment and outlays for household durables. In other downturns in consumer sentiment, large increases in pessimism about personal financial situations and business conditions were associated with marked deteriorations in the percentage of households who thought it was a good time to buy household durables. In contrast to earlier experience, the percentage of households who continue to think that it is a good time to buy large household durable has declined rather moderately over the last 18 months. In the April-May survey, more respondents still said that it was a "good time" to buy large household durables (39 per cent) than said it was a "bad time" (22 per cent). On the other hand, for over a year, consumers have not changed their opinions that market conditions for autos or homes are unfavorable because of high prices, high operating costs, and interest costs.

Manufacturers' orders and shipments. New orders for durable goods rose 5.9 per cent in May (p), following a 5.1 per cent increase in April. The gain in May was widespread with especially strong advances in primary metals, machinery and aircraft. Nondefense capital goods orders were virtually unchanged following a 5.5 per cent increase in April. In real terms, durable goods orders rose 3.6 per cent in May, but nondefense capital goods orders were off 2.2 per cent.

Shipments of durable goods were up 2.9 per cent in May and unfilled orders increased by 3.7 per cent.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
(Per cent changes)

	1973	1974	
	QIV from QIII 1/	QI from QIV 1/	May from April (p)
Durable goods, total	2.3	-1.6	5.9
Excluding defense	1.5	-1.9	4.8
Excluding primary metals and motor vehicles and parts	5.1	2.2	3.1
Primary metals	.3	-3.4	20.0
Motor vehicles and parts	-7.2	-17.1	2.4
Household durables	4.2	1.1	6.7
Nondefense capital goods	5.7	2.1	- .1
Defense capital goods	22.4	5.7	36.7
Construction and other durables	2.8	2.0	1.3
Durable goods total, in 1967$	.1	-5.7	3.6
Nondefense capital goods, in 1967$	4.1	.0	-2.2

1/ Changes between quarters are based on quarterly average levels.

Inventories. Book value of manufacturing and wholesale trade inventories increased at a $35 billion annual rate in May (p), following a $23 billion rise in April. The $28 billion annual rate of rise in manufacturing stocks in May occurred mainly in durable goods, particularly nonelectrical machinery, blast furnaces and steel mills and the non-auto components of transportation equipment. By stage of processing, the acceleration in rate of increase was mainly in materials and supplies. Wholesale trade inventories increased at an $8 billion rate following a $1 billion decline in April.

BUSINESS INVENTORIES
(Change at annual rates in seasonally adjusted book values, $ billions)

	1973		1974	
	QIII	QIV	QI	May (p)
Manufacturing and trade	21.1	36.5	36.9	n.a.
Manufacturing, total	12.4	19.0	22.5	27.9
Durable	9.8	12.8	14.3	17.2
Nondurable	2.6	6.3	8.2	10.7
Trade, total	8.7	17.5	14.4	n.a.
Wholesale	4.5	6.6	9.7	7.5
Retail	4.2	10.9	4.7	n.a.
Auto	1.2	4.4	- 2.5	n.a.

The manufacturing inventory-sales ratio was unchanged at 1.62 in May, while the wholesale trade ratio increased from 1.04 to 1.08. The ratio of inventories to unfilled orders at durable goods producers declined to .700 in May.

INVENTORY RATIOS

	1973		1974	
	Apr.	May	Apr.	May (p)
Inventories to sales:				
Manufacturing and trade	1.44	1.44	1.45	n.a.
Manufacturing, total	1.59	1.59	1.62	1.62
Durable	1.91	1.90	2.04	2.02
Nondurable	1.21	1.21	1.17	1.18
Trade, total	1.30	1.30	1.28	n.a.
Wholesale	1.13	1.15	1.04	1.08
Retail	1.42	1.41	1.47	n.a.
Inventories to unfilled orders:				
Durable manufacturing	.806	.786	.714	.700

<u>Cyclical indicators</u>. The Census composite index of leading indicators rose 0.2 per cent in May (p), following no change in April. The Boston FRB deflated leading index (with no trend adjustment) was off 1.3 per cent; the Census deflated coincident index rose for the third straight month.

CHANGES IN COMPOSITE CYCLICAL INDICATORS
(Per cent change from prior month)

	1973	1974				
	Dec.	Jan.	Feb.	Mar.	Apr.	May (p)
12 Leading, trend adjusted	-1.8	1.9	1.1	1.7	.0	.2
5 Coincident	- .2	- .4	.6	.7	.8	.5
5 Coincident, deflated	-1.1	-1.4	- .2	.1	.4	.2
6 Lagging	1.7	1.2	.3	2.1	2.3	1.0
	Leading indexes prior to trend adjustment					
Census undeflated	-2.1	1.5	.6	1.3	- .4	- .2
Boston FRB deflated	-3.5	.3	.2	.9	-1.1	-1.3

Of the eight leading series available for May, those increasing were the ratio of price to unit labor cost, initial claims for unemployment insurance (inverted), the average workweek in manufacturing, new orders for durable goods, and contracts and orders for plant and equipment. Industrial materials prices, common stock prices, and private building permits all declined.

Of the indicators currently available for June, the average workweek declined but common stock prices improved a bit.

Construction and real estate. Seasonally adjusted value of new construction put in place in June, at an annual rate of $135.7 billion, held at the May level. However, expenditures for private residential building approached a new low for this year and were almost a fifth below the peak in February 1973. Private nonresidential outlays remained little changed from their recent high in March, and outlays for public construction rose somewhat, but stayed below their April peak. For the second quarter as a whole, total outlays averaged only 1 per cent below the high reached in the third quarter of last year.

NEW CONSTRUCTION PUT IN PLACE
(Seasonally adjusted annual rates, in billions of dollars)

	1973	1974			Per cent change in June from	
	QII(r)	QI(r)	QII(p)	June 1/	May 1974	June 1973
Total - current dollars	134.4	134.7	135.7	135.7	--	--
Private	102.3	98.5	99.0	98.9	--	- 4
Residential	58.1	49.4	49.5	49.2	- 1	-15
Nonresidential	44.2	49.1	49.5	49.7	--	+10
Public	32.2	36.3	36.7	36.8	+ 2	+17
State and local	27.2	31.2	31.6	31.7	--	+21
Federal	4.9	5.1	5.0	5.1	+18	+ 5
Total - 1967 dollars	89.6	83.3	82.0	81.6	--	- 8

1/ Data for June 1974 are confidential Census Bureau extrapolations. In no case should public reference be made to them.
-- Means change less than 1 per cent.

Measured by the Census Bureau's composite index, construction costs in recent months have continued more than a tenth above year earlier levels. For the year 1973, such costs were up almost 9 per cent from 1972.

With private housing starts down sharply in May and residential building permits substantially reduced, it now appears that starts in the second quarter as a whole may have dropped below the reduced rate of the fourth quarter of 1973. As in the first quarter, the April-May average for single-family starts showed some improvement. However, starts of multifamily units dropped considerably further, owing to the still very large volume of units under construction and the adverse influence of increasingly higher costs for materials and construction loans. Moreover, difficulties currently being experienced by the REITs, which tend to specialize in interim financing for this sector, have also been an inhibiting factor.

Labor market. There was little overall change in labor market conditions during June. The unemployment rate remained at 5.2 per cent, seasonally adjusted, and nonfarm payroll employment changed relatively little. The factory workweek declined somewhat as overtime hours were curtailed.

The unemployment rate has been on a plateau a little above 5 per cent since the beginning of the year, following a rise from last October's low of 4.6 per cent. Unemployment among adult men and blue-collar workers dipped in May, but their jobless rates returned to previous levels in June, and unemployment among most other groups remained about unchanged.

SELECTED UNEMPLOYMENT RATES
(Per cent, seasonally adjusted)

	1973		1974		
	June	October	January	May	June
Total	4.8	4.6	5.2	5.2	5.2
Males 20+	3.2	3.0	3.4	3.4	3.5
Females 20+	4.9	4.4	5.2	5.1	5.1
Teenagers	14.0	14.0	15.6	15.8	15.6
White collar	2.9	2.6	3.2	3.2	3.1
Blue collar	5.3	5.1	6.0	5.7	6.2
Household heads	2.9	2.7	3.0	3.0	3.1
State insured	2.8	2.6	3.1	3.3	3.4

The civilian labor force and total employment rose by about a quarter of a million in June, following an even larger increase in May. The gains in the labor force were in sharp contrast to the sideways movement shown during the January-April period. Since January the adult female labor force has advanced at a rapid pace, but this increase has been partially offset by declines among teenagers and adult men.

A small decline in nonfarm payroll employment in June followed substantial gains in April and May. Manufacturing employment fell by 20,000, and the factory workweek shortened by 0.2 hours to 40.1 hours--a half hour less than a year ago. Construction employment fell again in June, in part due to increased strike activity, putting the total 150,000 below the February level. Employment in services and State and local government--two sectors which have generally been a source of employment strength throughout the recent period--again showed considerable gains in June. Since November 1973, nonfarm payroll employment has advanced at an annual rate of less than one million, compared with 2.7 million over the four quarters of 1973.

CHANGES IN PAYROLL EMPLOYMENT
(In thousands; seasonally adjusted)

	1972 QIV- 1973 QIV	Nov. 1973- June 1974	May 1974- June 1974
	--------Annual rate------		Monthly change
Total nonfarm	2,749	734	-48
Private	2,379	195	-50
Manufacturing	759	-303	-22
Durable	648	-189	+ 5
Nondurable	111	-115	-27
Construction	197	-171	-50
Trade	562	132	- 8
Services	603	453	55
Government	370	538	+ 2

Earnings. The average hourly earnings index for private nonfarm production workers has been rising at an accelerated pace in recent months. For the second quarter as a whole the nonfarm total was up at a 9.6 per cent annual rate. Large earnings increases have been occurring in most industries, with the fastest rates of rise in manufacturing, trade and services. In the construction industry, the earnings index has also been rising more rapidly, after a period of moderate increases when wages were under control of the Construction Industry Stabilization Committee.

HOURLY EARNINGS INDEX*
(Seasonally adjusted; per cent change, compound rates)

	Jan. 1972- Feb. 1973	Feb. 1973- Dec. 1973	Jan. 1974- June 1974	1974 QI- 1974 QII
Total private nonfarm	5.5	7.4	9.8	9.6
Manufacturing	5.3	7.0	11.0	11.2
Construction	5.5	7.4	10.4	8.5
Transportation & p.u.	9.5	6.9	5.1	4.3
Trade	4.7	7.5	10.1	10.0
Services	4.2	7.6	9.1	10.0

* Excludes effects of fluctuations in overtime premiums in manufacturing and of shifts of workers between industries.

<u>Collective bargaining.</u> A number of recent collective bargaining settlements have provided large wage increases. The longshoremen at North Atlantic seaports settled for a wage and fringe package estimated to cost more than 33 per cent over-the-life of the three year contract. Workers will receive a first year wage increase of nearly 15 per cent on October 1 and about 8-1/2 per cent in each of the next two contract years. Prior to the settlement, the longshoremen had received a 2.5 per cent pay raise on June 1 which restored the amount that had been disapproved by the Pay Board in May 1973. The new contract covers 25,000 workers and is expected to set the pattern for an additional 10,000 dock workers at the South Atlantic and Gulf Ports where contracts also expire September 30.

In other negotiations, the machinists and Northwest Airlines reached agreement on a 26 month pact which provides first year wage increases of about 7-1/2 per cent on top of a 3 per cent pay raise retroactive to September 1, 1973. Second year pay raises will average about 5 per cent. The cost-of-living formula was liberalized, but retains a cap--10 cents or about 1.3 per cent a year maximum in the second and third contract years. The new agreement, which covers 3,000 workers, is identical to the recent United Airlines settlement and is expected to be closely followed by TWA, National, Continental, and Allegheny where negotiations are continuing.

The men's clothing workers settled on a three year agreement which will give them pay raises of about 13 per cent in the first year and about 7 per cent in each of the remaining contract years as well as a cost-of-living escalator--the first in the clothing industry--which will pay out a maximum of 10 cents an hour or 2.4 per cent in the second and 15 cents or 3.3 per cent maximum in the third contract year.

Finally, the steel workers and seven other unions apparently reached agreement with Anaconda Company on a new three year contract. Although the terms have not yet been released, it is estimated that the pact is very similar to the basic steel settlement negotiated earlier in the spring. Bargaining is continuing with other major nonferrous metal companies, affecting a total of 115,000 workers.

<u>Recent wholesale price developments.</u> Price developments in recent weeks have been less encouraging than had been hoped. Prices of farm products declined from February to mid-June (a sizeable May-June drop will be reflected in the June WPI which will be released July 12 and reported in the Greenbook supplement, but in recent weeks prices of foodstuffs have risen appreciably. Spot prices for corn, wheat, and soybeans have all increased, reflecting uncertainty over crop yields and high export demand. Prices of steers and hogs--particularly the latter--have also moved up, although this could be a temporary development resulting in part from a hold-back on marketings of meat animals.

Spot prices of industrial materials have for the most part been firm except for such agriculturally-based raw materials as cotton, hides, and rubber. Prices of copper scrap and aluminum scrap in some areas nave dropped from peak spring (April-May) levels, but steel scrap prices have rebounded to levels approaching earlier highs in April. Recently, announcements have been made of further substantial price increases for steel mill products, lead, and fabricated aluminum products. Prices of chemicals also have been increased sharply.

In the finished goods category, announcements of higher prices for motor vehicles have been prominent.

<u>Consumer prices.</u> Consumer prices rose at a 13 per cent annual rate, seasonally adjusted, in May to a level nearly 11 per cent above a year earlier. Food prices advanced appreciably following their April decline. Increases in energy costs, although substantial, were well below the peak first-quarter rates, but prices of other nonfood items rose considerably faster than in earlier months this year.

CONSUMER PRICES
(Percentage changes, seasonally adjusted annual rates)1/

	Relative impor- tance Dec 1973	June 1973 to Sept 1973	Sept 1973 to Dec 1973	Dec 1973 to Mar 1974	March to April 1974	April to May 1974
All items	100.0	10.2	9.2	14.2	6.9	12.7
Food	24.8	26.7	11.0	19.4	-5.3	10.6
Commodities less food	38.6	3.6	7.6	16.0	12.8	15.3
Services 2/	36.5	7.4	9.4	9.2	7.3	12.2
Addendum						
All items less food and energy components 3/ 4/	68.8	5.6	5.5	8.6	7.9	13.9
Services less home finance 2/ 3/ 5/	29.9	4.8	7.2	10.2	8.4	12.6
Commodities less food, used cars, home purchases 3/	30.9	3.0	10.1	19.0	11.8	12.6

1/ Not compounded for one-month changes.
2/ Not seasonally adjusted.
3/ Confidential--not for publication.
4/ Excludes food, gasoline and motor oil, fuel oil and coal, and gas and electricity.
5/ Home financing costs excluded from services reflect property taxes and insurance rates--as well as mortgage costs--which in turn move with mortgage interest rates and house prices.

The rise in food prices in May--despite declines for meat, poultry and eggs--was in large part the result of a very sharp increase for fresh fruits and vegetables. In June retail meat prices continued to fall--according to USDA's chainstore sample data (preliminary, confidential). Recent advances in livestock prices may have an impact on subsequent months but are still expected to be temporary.

FARM-RETAIL SPREADS, 1974

	(Index, 1967=100)		Per cent change 1/	
	QI	QII 2/	QI	QII 2/
Market basket	142.6	154.8	19.6	24.2
Beef	177.7	174.7	25.8	17.5
Pork	150.9	164.7	42.2	36.6
Milk	133.2	138.7	17.1	21.2
White bread	130.3	149.2	19.5	31.4

Source: USDA
1/ From same quarter of 1973.
2/ April-May averages; May estimate preliminary, confidential.

The widening of farm-retail spreads has contributed very importantly to the increase in retail food prices over the last year. In the first quarter they were nearly 20 per cent, and in the second quarter about 24 per cent (preliminary, confidential), above their levels a year earlier. These estimated spreads--which reflect all nonfarm costs (wages, packaging, etc.) as well as profit margins of processing and distribution--accounted for about 55 per cent of the retail cost of USDA's market basket of foods of U.S. farm origin in the first and second quarters of 1973. Their increase thus contributed about half of the 22 per cent rise in the market basket between the first quarter of 1973 and the first quarter of 1974. Using second quarter data (preliminary, confidential) the estimate would be about 13 out of 16 per cent.

Energy prices rose substantially further in May, as in April, though much less than in the first quarter. The major impact on prices is now coming from other commodities and from services which have registered unusually large advances this year. In view of the recent pace of price rise for consumer finished goods at wholesale, a quick slowdown at retail appears unlikely. The April and May CPI increases were also boosted by a sharp climb in used car prices--of nearly 20 per cent in these two months following eight months of decline.

ENERGY PRICES AND THE CPI,1/ 1973
(Percentage changes, seasonally adjusted annual rates)2/

	Relative importance Dec 1973	Dec 1972 to Dec 1973	Sept 1973 to Dec 1973	Dec 1973 to March 1974	March to April 1974	April to May 1974
Gasoline and motor oil, fuel oil and coal	4.0	23.4	77.3	99.3	29.9	24.2
Gas and electricity	2.4	6.9	11.1	28.2	15.5r	17.9
All items less energy components	93.6	8.3	6.9	10.8	6.7	12.6

1/ Confidential--not for publication.
2/ Not compounded for one-month changes.

RECENT PRICE CHANGE, SELECTED COMPONENTS
(Per cent change, seasonally adjusted, not annual rates)

	Dec. 1972 to Dec. 1973 (12 months)	Dec. 1973 to May 1974 (5 months)
Nonfood commodities:		
Apparel	4.1	3.7
Other nondurables1/	3.6	5.4
Household durables	4.1	4.2
Services:		
Medical	5.8	4.2
Housekeeping and home maintenance	7.7	8.4

1/ Excluding fuels, alcohol and tobacco.

<u>Agriculture.</u> Production of red meat in June matched the record high level in May as increased beef output offset a decline in pork. Increased availability of meats was a major factor in the further reduction of average farm prices of 6 per cent during the month ending June 15. But prices have since turned sharply upward. On July 8, hog and steer prices were 55 and 25 per cent higher, respectively, than on June 15, while wheat, corn, and soybeans were about 15 per cent higher.

The advance in livestock prices mainly has reflected recent actions by Government and industry to increase demand. The Department of Agriculture will purchase more meat for the school lunch program and negotiations are under way to increase beef exports to Canada and to restrain imports from Australia and New Zealand. Also, retailers recently have promoted beef sales with specials and increased advertising. The higher price level may be sustained during summer months by shorter supplies of fed cattle.

Weather, on the other hand, has been the major factor in higher crop prices. Rains have caused grain and soybean crops to be planted later than usual and this may result in lower yields. Also, erosion and flooding have damaged some areas where planting was finished. Agricultural officials recently lowered the corn crop estimate from 6.7 to 6.4 billion bushels but the crop will likely be even smaller, though substantially exceeding last year's large harvest of 5.5 million bushels.

Winter wheat harvest from Texas northward through Nebraska is well along if not complete, but yields have been hurt by dry weather.

One well-known private analyst is now forecasting 12 per cent larger crop than last year as opposed to a 21 per cent larger crop that earlier had been predicted by agricultural officials.

The Department of Agriculture has raised its estimate of 1973 net farm income by $6 billion, to $32.2 billion. Crop receipts proved to be about $4 billion higher than previously estimated, primarily because sales of grain and soybeans stored from previous years had been underestimated. Receipts from livestock were also revised upward by about $1 billion, and the estimate of production expenses was lowered.

The Department's projection of net farm income for 1974 remains at $24 to $26 billion, but this now appears as a sharp drop from the 1973 level.

DOMESTIC FINANCIAL SITUATION

SELECTED DOMESTIC FINANCIAL DATA
(Dollar amounts in billions)

Indicator		Latest data Period	Latest data Level	Net change from Month ago	Net change from Three months ago	Net change from Year ago
Monetary and credit aggregates				SAAR (per cent)		
Total reserves		June	36.7	6.5	20.3	10.2
Reserves available (RPD's)		June	34.8	18.2	20.2	11.1
Money supply						
M1		June	280.8	6.9	6.7	5.8
M2		June	597.5	9.5	7.7	8.7
M3		June	930.9	7.8	6.6	7.9
Time and savings deposits (Less CDs)		June	316.6	11.5	8.5	11.5
CDs (dollar change in billions)		June	83.4	2.2	15.7	21.4
Savings flows (S&Ls + MSBs)		June	333.4	4.7	4.6	6.5
Bank credit (end of month)		June	678.7	7.8	11.5	12.1
Market yields and stock prices			Percentage or index points			
Federal funds	wk. endg.	7/3/74	13.55	2.10	3.62	3.34
Treasury bill (90 day)	"	7/3/74	7.45	-.58	-.96	-.24
Commercial paper (90-119 day)	"	7/3/74	11.95	1.25	2.50	3.39
New utility issue Aaa	"	7/5/74	--	--	--	--
Municipal bonds (Bond Buyer)	1 day	7/4/74	6.64	.63	.91	1.30
FNMA auction yield	(FHA/VA)	7/1/74	9.65	.11	.70	1.79
Dividends/price ratio (Common stocks)	wk. endg.	6/26/74	4.14	-.01	-.19	-1.05
NYSE index (12/31/65=50)	end of day	7/1/74	44.86	-1.95	-4.94	-9.31

Credit demands	Period	Net change or gross offerings: Current month 1974	Current month 1973	Year to date 1974	Year to date 1973
Business loans at commercial banks	June	1.8	1.4	18.4	19.0
Consumer instalment credit outstanding	May	1.3	2.0	4.6	9.4
Mortgage debt outst. (major holders)	April	5.3	5.3	16.1	16.5
Corporate bonds (public offerings)	April	1.7	.9	7.5	3.9
Municipal long-term bonds (gross offerings)	April	2.4	1.8	8.5	7.8
Federally sponsored Agcy. (net borrowing)	July	4.5e	3.7	2.0e	5.6
U.S. Treasury (net cash borrowing)	June	2.9	2.2	8.8	9.2
Total of above credits		19.9	17.3	65.9	71.4

e - Estimated

DOMESTIC FINANCIAL SITUATION

Total credit flows to businesses continued relatively large in June and early July. As money and credit markets came under increasing pressure after mid-month, and investor quality preference became more prevalent, market financing subsided and credit demands accelerated at large New York and Chicago banks.

Most recently, yields on CD's and commercial paper rose about 75 basis points as the Federal funds rate increased to around 13-1/2 per cent and short-term credit demands intensified. In the commercial paper market, spreads between prime and lower quality issues widened and rumors have developed about the solvency of some issuers. In early July some regional banks were said to be having difficulty placing their acceptances or to issue CD's, but at this writing the staff has been unable to confirm these reports. Treasury bills have not shared in the general upward movement in yields as foreign official, Federal Reserve, and private domestic demand remained large in the face of low and often short dealer positions.

In capital markets, yields on corporate and municipal bonds rose 30 to 50 basis points, and equity prices declined over 7 per cent--reaching levels last seen in 1970. Postponements, cancellations, and reductions of scheduled new issues were quite large in June, amounting to $575 million of corporate bonds (mostly public utilities), almost $250 million of stock, and $450 million of tax-exempt issues, Postponements and cancellations have continued into July. Rising interest costs were only one factor in these developments. Underwriters faced some difficulty in forming syndicates and many issuers have been forced to add more restrictive covenants to bond indentures (such as 10 year no call provisions). Some corporations chose to offer intermediate-term secutities as a way to tap a wider range of potential investors and to obtain lower interest costs, but many also shifted their financing to banks. In the tax-exempt market, offerings of short-term obligations rose very sharply as borrowers found themselves blocked by bond usury ceilings or sought to avoid locking themselves in at high interest cost.

Although relatively weak in late May and early June, business loan demands--particularly at New York City and Chicago banks--rose sharply from mid-June to early July. Takedowns of commitments are reported to reflect continued diversions of credit demands from borrowers unable to finance in the commercial paper market, and financing originally scheduled for the capital markets. With declining internal fund flows and reduced liquidity, many large borrowers are also reported to be drawing on their lines for the first time in years. In addition, foreign business loans in New York City and in San Francisco remained large in June.

The pick-up in business loans in New York and Chicago after mid-June was financed mainly in the CD and Euro-dollar market at rising rates. Foreign official and foreign commercial banks appeared to be large buyers of CD's, and, for the first time, the staff has reliable reports that Arab oil proceeds are being invested directly in CD's as well as Treasury issues. In April and May, foreign purchases of Treasury securities apparently had not reflected direct Arab investment.

Seasonally adjusted nonbank thrift deposit inflows rose in June from the depressed April-May level and the staff estimates that small denomination time deposits at commercial banks rose after two months of decline. However, available data for late June and early July indicate that relatively large outflows from the thrift institutions are occurring during the mid-year reinvestment period.

The average rate on mortgages in the primary market and secondary markets rose moderately in recent weeks to new highs, and FHA/VA ceiling rates were raised 1/4 percentage point to 9 per cent. New residential mortgage commitments at thrift institutions declined in May and probably in June as mortgage funds continued to be reported in short supply throughout the country.

Outlook. Federal financing demands--including those of the agencies--are expected to be large this summer. The Federal Financing Bank may offer its first issue of $1 to $1-1/2 billion this month and over the balance of the third quarter the Treasury and Federal Financing Bank combined are expected to raise another $4-1/2 to $5 billion. Sponsored agencies, mainly those supporting housing--whose issues are not purchased by the Federal Financing Bank--are also expected to need $6 billion this quarter.

The expanded Treasury offerings could be expected to raise bill and other Treasury yields. However, the market impact of these issues is likely to be blunted by foreign official purchases--either in the market or special issues--with an increasing share of the foreign demand from oil-exporting countries. If foreign buying is large, the supply of marketable Treasury issues available to the domestic public would contract further this summer, although the supply of agency offerings will expand. Such developments would tend to widen further the spread between Treasury and other securities yields.

About 45 per cent of projected corporate bond offerings in the current month are accounted for by the still uncertain $850 million offering of Citicorp and $200 million by Chase. These securities, with floating rates and "cash in" privileges each six months, are designed to attract small investors. As such they are likely to result in outflows from thrift institutions and commercial banks, as well as the Treasury bill market, rather than absorbing funds from traditional bond investors. Nevertheless, these issues have affected the scheduling of regular corporate bond issues, and if these two issues do not materialize, other more traditional issuers would likely accelerate their offerings to fill the void in the corporate calendar. Thus, under current money market conditions, bond yields would probably rise from current levels although postponements and cancellations of scheduled issues could continue.

Inflows of consumer time and savings deposits to banks and thrift institutions are likely to be under considerable restraint over the summer, as the pull of market yields continues to shift small savers to the securities markets. Marketing of Citicorp and Chase issues would, of course, increase fund outflows in July from these institutions. Even if these issues do not come to market, however, new residential mortgage commitments can be expected to decline further, mortgage availability to become even more restricted, and Federal agency support to the mortgage market even larger.

Business loan demands at banks are likely to continue to be sustained by takedowns of commitments by borrowers unable or unwilling to finance in money and capital markets. In the current financial environment, banks can be expected to tighten their lending terms further and to review their commitments policies, but to meet their existing commitments by borrowing mainly in the CD market and perhaps also the Euro-dollar market. Large prime banks may continue to attract time deposits from abroad, but less-than-prime banks could face some difficulty in placing CD's if financial market confidence deteriorates further.

Monetary aggregates. In June, rates of growth of M_1, M_2, and M_3 were more rapid than in May, but for the second quarter as a whole they were below first quarter rates. Part of the growth of M_1 in June--about 1-1/2 percentage points--was attributable to the temporary lodging of payments to oil-exporting countries in foreign official deposits at Federal Reserve Banks and commercial banks. M_2 accelerated to almost twice the rate of the previous month, reflecting both a sharp increase in inflows to banks of time and savings deposits other than large CD's and faster growth of M_1. Staff estimates suggest that the acceleration of the "other time" component of M_2 was due to a reversal of the two-month decline of small denomination deposits. As with M_2, the growth of M_3 reflected stronger inflows of consumer deposits at thrift institutions.

Loan growth moderated at banks in late May and early June; consequently, banks did not increase their outstanding CD's, and Euro-dollar borrowing and outstanding bank-related commercial paper declined over that period. But around the June tax date, as business loan demand picked up, Euro-dollar borrowings of banks began to expand once more, and CD's were issued in volume--particularly by the large New York City and Chicago banks. There are reports that regional banks have experienced difficulty in placing their CD's, but at this writing the staff has been unable to confirm the rumors. Through the month, foreign official institutions and foreign commercial banks purchased a sizeable volume of CD's. Despite the pick up after mid-month, the weakness in late May and early June resulted in a monthly average decline of non-deposit sources of funds in June, mostly associated

MONETARY AGGREGATES
(Seasonally adjusted changes)

	1973	1974				
	QIV	QI	QII	Apr.	May	June p
				Per cent at annual rates		
M_1 (Currency plus private demand deposits)	8.9	7.1	6.7	8.3	4.7	6.9
M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	11.0	9.9	7.7	8.2	5.3	9.5
M_3 (M_2 plus time and savings deposits at mutual savings banks and S&L's)	9.8	9.4	6.6	7.5	4.4	7.8
Adjusted bank credit proxy	3.3	8.5	21.0	31.6	16.8	13.6
Time and savings deposits at commercial banks						
a. Total	6.1	15.6	23.6	30.8	22.9	15.8
b. Other than large CD's	12.6	12.5	8.5	8.1	5.8	11.5
c. Other than all large time deposits 1/	11.0	12.7	-.2	-.4	-5.6	5.2
			(Billions of dollars)2/			
Memoranda:						
a. U.S. Government demand deposits	--	-.4	--	.8	-.7	-.1
b. Negotiable CD's	-1.3	1.6	5.2	7.7	5.8	2.2
c. Nondeposit sources of funds	--	.4	.5	1.0	1.1	-.5

1/ Staff estimates.
2/ Change in average levels month-to-month or average monthly change for the quarter, measured from last month in quarter to last month in quarter, not annualized.

with reduced Euro-dollar borrowing, and growth of CD's was considerably less on average than in April and May.

<u>Bank credit.</u> Total loans and investments at commercial banks in the month of June as a whole expanded considerably less than in the prior three months. Enlarged purchases of securities accompanied the deceleration of loan growth. Municipal bonds were added to bank portfolios during the month, with New York City banks being major purchasers of large local issues, and banks generally bought a substantial part of new Federal agency offerings (included in other securities) at mid-month.

The monthly bank credit statistics mask the sharp pick up in business loan expansion between mid-June and early July that offset weaker business loan expansion early in the month. Most of the strength in loans after mid-month occurred at large New York City and Chicago banks, and it appears that many of the borrowers were diverted not only from commercial paper but also from capital markets where a large volume of issues were postponed, cancelled, or reduced. The heavy borrowing at large banks took place against a backdrop of continued tightening in bank lending terms and commitments policy and continued large aggregate financing needs of both financial and nonfinancial corporations.

The composition of business borrowing at large banks in June was less concentrated in a few industries than in May when public utilities, construction companies, and oil companies accounted for almost all the loan growth. The business loan growth in June was broadly spread among public utilities, textile firms, metal fabricating

COMMERCIAL BANK CREDIT 1/
(Seasonally adjusted changes at annual percentage rates)

	1973	1974				
	QIV	QI	QII	Apr.	May	June
Total loans and investments 2/	6.3	15.9	11.5	16.0	10.2	7.8
U.S. Treasury securities	-25.5	25.8	6.4	10.7	--	8.5
Other securities	17.6	6.8	9.1	3.6	9.9	13.4
Total loans 2/	7.1	17.4	12.7	20.1	11.5	6.2
Business loans 2/	4.6	22.2	23.0	34.4	20.9	12.3
Real estate loans	15.9	12.2	12.2	11.9	13.7	10.7
Consumer loans	10.1	5.4	3.9	5.9	2.9	2.9
	(Average monthly change, billions of dollars)					
Memorandum:						
Loans to nonbank financial institutions	-.3	.8	.4	1.4	1.5	-1.5

1/ Last-Wednesday-of-month series except for June and December, which are adjusted to the last business day of the month.
2/ Includes outstanding amounts of loans reported as sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

firms, chemical and rubber companies, and trade concerns. Loans to foreign businesses were also substantial, particularly in San Francisco and New York.

Loans to nonbank financial institutions rose less than seasonally in June after showing substantial increases in April and May. The June decline, however, may be more apparent than real, since the seasonal factor anticipates a large shifting from the commercial paper market to bank loans as the holders' proceeds of maturing paper are used for mid-month tax payments. Many of the nonprime finance companies and REIT's were already out of the commercial paper market when June began, and the volume of outstanding directly-placed paper was unchanged in June. The seasonally adjusted decline in bank lending to nonbank financial institutions thus reflects developments in previous months.

COMMERCIAL PAPER
(Seasonally adjusted, billions of dollars)

	1974 Monthly or average monthly change 2/					Outstanding June 28, 1974 e/
	QI	QIIe	April	May	June e	
Total commercial 1/ paper outstanding	1.0	.4	--	1.1	--	45.8
Bank-related	.4	.3	.8	.3	-.1	7.0
Nonbank-related	.6	--	-.8	.8	--	38.8
Dealer-placed	.4	.1	-.2	.5	--	13.7
Directly-placed	.2	-.1	-.6	.3	--	25.1

1/ Seasonally adjusted figures are unavailable for bank-related paper. The unadjusted data for bank-related paper are combined with seasonally adjusted nonbank-related data to obtain the total for commercial paper outstanding.
2/ Changes shown are changes in levels end-of-month to end-of-month or average monthly change for the quarter, measured from end-of-month in quarter to end-of-month in quarter, not annualized.
e/ Estimated.

As noted earlier, the commercial paper market remains highly quality conscious, and commercial paper outstanding showed no growth in June. Dealer-placed paper by prime borrowers, however, had been quite strong until late in the month, at which time these borrowers apparently shifted bank to banks as the commercial paper rates rose relative to the lagging prime rate. Over the month as a whole, total short-term business credit expansion--as measured by the sum of business loans and dealer-placed commercial paper--moderated considerably to the lowest rate of growth of the year.

RATE SPREADS AND CHANGES IN BUSINESS LOANS AND COMMERCIAL PAPER
(Amounts in billions of dollars, seasonally adjusted monthly changes)

	Prime rate less 30-59 day commercial paper rate (per cent)	Business loans at all commercial banks 1/	Dealer placed commercial paper 2/	Total	Annual rate of change in total (per cent)
		Average monthly changes			
1973--QII	--	2.2	.1	2.3	18.1
QIII	--	2.1	.1	2.2	16.1
QIV	--	.6	1.1	1.7	12.3
1974--QI	--	2.9	.4	3.3	23.5
QII e/	--	3.2	.1	3.4	22.4
1973--July	-.90	3.3	-.1	3.2	24.2
Aug.	-.93	2.6	-.5	2.1	15.5
Sept.	-.40	.3	.8	1.1	8.0
Oct.	+.52	-.1	2.4	2.3	16.7
Nov.	+.38	1.2	1.0	2.2	15.7
Dec.	-.04	.7	-.1	.6	4.2
1974--Jan.	+.42	2.0	1.6	3.6	25.3
Feb.	+.85	1.2	1.7	2.9	20.0
Mar.	-.09	5.6	-2.1	3.5	23.7
Apr.	-.08	4.8	-.1	4.7	31.2
May	+.39	3.0	.5	3.5	22.7
June e/	+.38	1.8	--	1.8	12.1
Weekly Pattern:					
1974--May 5	-.30				
8	-.15				
15	+.13				
22	+.50				
29	+1.09				
June 5	+.95				
12	+.73				
19	+.28				
26	+.08				
July 3	-.23				

1/ Changes are based on last Wednesday-of-month data and are adjusted for outstanding amounts of loans sold to affiliates.
2/ Measured from end-of-month to end-of-month.
e/ Estimated.

<u>Nonbank financial intermediaries</u>. Deposit growth at S&Ls and MSBs during the second quarter is estimated to have been relatively weak, as in the summer of 1973. At both institutions deposit growth was stronger in June than during the first two months of the quarter. June experience at S&Ls showed moderate inflows partially offset by deposit losses in the last 10 days, followed by an estimated $2.7 billion in interest credited at the end of the month. Interest credited also bolstered MSB deposits in June, but these institutions had deposit losses (exclusive of interest) throughout the month. During the 3-grace days at the end of the month, a sample of large New York City MSBs had net deposit losses of $143 million--only moderately larger than in other recent years. However, more recent data for these New York City MSBs indicate they experienced heavy withdrawal pressures in early July. On just the first day of the month these large MSBs had a net loss of $75 million, as compared with a loss of $89 million during the first 5 business days of July a year ago. Losses during the first 5 days of July 1974 totaled $171 million.

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

	Mutual savings banks	Savings and loan associations	Both
1973 - QI	7.0	12.3	10.7
QII	7.1	11.4	10.1
QIII	1.3	4.9	3.8
QIV	5.1	9.3	8.1
1974 - QI	5.2	10.1	8.7
QII e/	1.0	5.5	4.0
April	- .1	4.8	3.3
May p/	.2	3.0	2.2
June e/	5.0	8.5	7.5

p/ Preliminary.
e/ Estimated on the basis of sample data.

The net increase in FHLB advances during June was approximately $800 million, about the same as in May. Over half of this increase was attributable to advances taken down under the 8-1/2 per cent special commitment program instituted last fall, leaving about $650 million of such commitments outstanding at the end of June. The remaining $400 million of regular advances and advances given out under other special programs in June were available only to those S&Ls that had reduced their liquidity to the 6 per cent level--a requirement imposed by all District FHLBanks in mid-May in order to allocate funds to those members who demonstrated need. In early July, the demand for advances continued strong and net advances accelerated to a pace of about $75 million per day.

Long-term securities markets. Corporate and municipal yields have risen about 60 basis points in the last four weeks, while the rise in long-term Governments has been substantially less. The market has been dominated by a preference for quality, and several utilities have been forced to take new tacks to obtain needed financing. Some have come to market with 10-year call protection and strict sinking fund requirements--provisions typically found only on industrial issues. Others have shortened the maturity of their issues to the 5 to 8 year range to take advantage of favorable yield spreads and, more importantly, to tap a market where there is currently substantial demand by individual investors. The yield spread between different rating categories has been widening, and investors have become increasingly wary of the verdicts rendered by rating agencies. In some cases, bonds with the same rating have differed in yield by as much as 80 basis points. Several poorly priced issues were recently freed from syndicate restrictions only one or two days after offering, and dealer positions in the corporate and Government markets are especially light.

Following a short rally in the beginning of June, stock prices fell sharply in the last three weeks of the month and early July. While the Dow-Jones Industrials fell about 8 per cent, other more broadly based indices fell by even greater amounts to levels last seen in 1970. The decline was led by bank stocks, as investors became increasingly concerned about the adequacy of bank capital, the quality of loans, especially to REITS, and particular incidents such as the problems of Franklin National and the closing of Bankhaus Herstatt in Cologne.

SELECTED LONG-TERM INTEREST RATES

	New Aaa utility bonds 1/	Recently offered Aaa utility bonds 1/	Long-term State and local bonds2/	U.S.Government bonds (10-year constant maturity)
1970 - High	9.43 (6/19)	9.20 (6/26)	7.12 (5/28)	8.06 (5/29)
Low	7.72 (12/11)	8.16 (12/18)	5.33 (12/10)	6.29 (12/18)
1971 - High	8.26 (7/30)	8.23 (1/1)	6.23 (6/24)	6.89 (7/20)
Low	7.02 (2/5)	7.17 (12/31)	4.97 (10/21)	5.87 (1/14)
1972 - High	7.60 (4/21)	7.49 (4/21)	5.54 (4/13)	6.58 (9/27)
Low	6.99 (11/24)	7.15 (12/1)	4.96 (12/7)	5.87 (1/14)
1973 - High	8.52 (8/10)	8.32 (8/10)	5.59 (8/3)	7.55 (8/10)
Low	7.29 (1/12)	7.28 (1/5)	4.99 (10/11)	6.42 (1/3)
1974 - High	9.50 (6/28)	9.78 (7/5)	6.64 (7/5)	7.66 (5/10)
Low	8.05 (2/6)	8.13 (1/4)	5.16 (2/7)	6.93 (2/15)
June 7	9.23	9.14	6.01	7.51
14	9.28	9.18	6.04	7.49
21	9.49	9.45	6.13	7.53
28	9.50	9.65	6.33	7.54
July 5	--	9.78p	6.64	7.65p

1/ FRB series.
2/ Bond Buyer.
p/ Preliminary.

The volume of corporate security offerings in June was substantially less than previously expected as the decline in bond and stock prices precipitated about $900 million of postponements, cancellations and reductions in size of several issues, mostly by utilities and financial institutions. Citing financial conditions, reduced demand for electricity, and other unfavorable factors, several utilities have recently announced reductions in planned capital expenditures.

Corporate financing in July is expected to be unseasonably heavy although the amount is particularly uncertain at this time. The postponement activity of late June has continued in July. The calendar includes over $1 billion of long-term issues by Citicorp and Chase Manhattan specifically designed to attract individual investors instead of the institutional buyers which normally dominate the bond market. The interest rate on the issues will change every six months, and will be one percentage point above the average of the 3-month Treasury bill rate in the first three bill auctions the month before the interest payment date. Also, the investor has the option, on each interest payment date, of redeeming the issues at par. If the issues are successful, other institutions may try this form of financing. On the other hand, if they are cancelled because of political or regulatory pressures, several other nonbank companies that are registered for traditional bond financing but do not have definite offering dates could jump in to fill some of the resulting void in the market. Given current and expected schedulings, the August volume of offerings will be slightly less than July, although still quite large for this month.

CORPORATE AND MUNICIPAL LONG-TERM SECURITY OFFERINGS
(Monthly or monthly averages, in millions of dollars)

	1973			1974		
	Year	QI	QII e/	June e/	July f/	Aug. f/
Corporate securities - Total	2,779	3,066	3,122	2,960	3,500	2,950
Public bonds	1,125	1,939	2,200	2,000	2,400	2,000
Privately placed bonds	725	534	467	500	400	400
Stock	929	593	455	460	700	550
State and local government securities	1,942	2,037	2,133	2,000	1,900	1,800

e/ Estimated.
f/ Forecast.

The volume of municipal offerings is expected to decline slightly in July and August. Several municipal governments have also recently postponed scheduled financial offerings citing unfavorable market conditions and, in some cases, statutory interest rate ceilings. Some units apparently have chosen to increase their issuance of short-term notes as a means of temporary financing. The volume of gross new issues of tax-exempt short-term notes rose substantially in June, and is expected to remain high in the near term.

Consumer credit. Total consumer credit outstanding rose \$19.7 billion in May, seasonally adjusted annual rate. Growth in April was at a rate of \$18.0 billion. While the gains during the first two months of the second quarter represent a substantial acceleration from the first quarter rate of \$8.2 billion, the rate continues below the \$24.1 billion of the second quarter of 1973.

Instalment debt rose at a \$15.1 billion seasonally adjusted annual rate in May compared with \$13.8 billion in April. The modest increase resulted from a larger advance in automobile credit and the second consecutive monthly record in home improvement loans. Growth in "other consumer goods" credit and personal loans remained at about the April rate.

Both extensions and repayments of instalment credit reached new highs in May. Extensions were at record levels for all categories of instalment credit except automobiles. Repayments, which had eased slightly in April after successive highs in each month of the first quarter, rebounded sharply in May.

CONSUMER INSTALMENT CREDIT

Period	Credit volume 1/			Finance rates 2/
	Net change in outstandings	Extensions	Repayments	New car loans
1973 - QI	23.7	162.4	138.4	11.87
QII	20.2	164.2	144.1	11.91
QIII	21.0	170.1	149.1	12.14
QIV	15.3	164.4	149.1	12.39
1974 - QI	8.8	164.3	155.5	12.34
April	13.8	170.1	156.3	12.28
May	15.1	176.0	160.9	12.36

1/ Billions of dollars, seasonally adjusted annual rates.
2/ Per cent per annum, on contracts purchased by major auto finance companies.

Although extensions of automobile credit are still running somewhat below the rate that prevailed throughout most of 1973, the decline in credit extensions this spring has not matched the decline in unit sales. The number of new car sales on credit as a proportion of total new car sales has been relatively stable, but average contract size has been increasing. This increase reflects the leveling in the proportion of small car sales, higher prices on all models, and rising finance rates. In May, the average amount financed on new car contracts purchased from retail dealers by finance companies reached $3,531, an increase of $50 from April and nearly $200 from December. Finance charges are adding to the burden in two ways--rates have turned up again after declining during the first quarter, and contract maturities are being extended. At finance companies, the weighted average maturity of new car contracts is 35.6 months with 6 per cent of all contracts having maturities in excess of 36 months. At commercial banks, more than 7 per cent of the contracts now have maturities over 36 months.

Short-term interest rates. At the time of the June FOMC meeting, most short-term interest rates had resumed their upward climb, after edging down somewhat in late May. Since that meeting, most private short-term rates have risen substantially further to new historical highs, while, in sharp contrast, Treasury bill rates have changed much less, with rates on shorter-term bills actually declining.

Much of the recent rise in private short-term rates has been the usual lagged response to movements in the Federal funds rate, which rose toward 12 per cent just prior to the June meeting and has moved considerably higher since. On most days recently, the daily effective Federal funds rate has been above 13 per cent, reaching a record high of 14.33 on July 1. An additional source of upward rate pressure has been the surge in short-term business credit demands, which have been bolstered recently by borrowers waiting for conditions to improve in the bond market. Moreover, money market pressures continue to be greatly aggravated by the strong investor preference for top quality instruments. There are widespread reports, for example, that less than prime nonfinancial borrowers, REITs, and some regional bank holding companies are encountering progressively greater difficulties in raising funds in the commercial paper market.

As a result of such pressures, record rate levels have been reached in the markets for commercial paper, CD's, and bankers acceptances--in the neighborhood of 12 per cent and above. Similarly, the prime rate has generally risen to 12 per cent, with a few banks moving further to 12-1/4 per cent.

In the Treasury bill market, most rates have increased relatively little if at all, thus leading to a further increase in rate spreads between bills and other money market instruments. The Desk bought over $1.2 billion (net) of bills for foreign central banks in June, including some investment of oil proceeds by a Mid-east country. Noncompetitive tenders in the weekly bill auctions have continued to be unusually large, and there was some reinvestment demand by holders of $4.5 billion of maturing June TABs, of which only about $.8 billion were turned in for taxes. Against this background of exceptionally strong demands, dealer bill holdings have decreased still further and have been in a net short position on most days since the last meeting. Indeed, the System has had some technical difficulties in supplying reserves recently, because of the shortage of bills available for purchase in the market.

Looking ahead, the Treasury is expected to come to the market in the near term with the first security offering of the Federal Financing Bank, amounting perhaps to $1.0 to $1.5 billion. Further, it currently appears that the Treasury may need to raise about $2.0 to $2.5 billion of new money in late July or early August, perhaps partly in the form of September TABs. Over the third quarter as a whole, the Treasury and the Financing Bank are expected to raise a total of about $5.0 billion of new money, about in line with past average third quarter borrowings of the Treasury and Budget Agencies combined. The calendar of borrowing by the sponsored agencies over the third quarter, however, has risen still further to an exceptionally large amount, averaging nearly $2.0 billion per month, so that the combined calendar of Federal and Federally sponsored borrowing appears to be fairly heavy.

It should be noted that the Treasury is reported to be negotiating with the oil producing countries about channeling a large share of their proceeds into Treasury issues. Such foreign purchases would, of course, considerably reduce the pressure that the expected Federal financing needs will place on the Treasury securities market.

SELECTED SHORT-TERM INTEREST RATES
(Per cent)

	1973	Daily rates 1974				
	Aug.-Sept. Highs	Feb. lows	June FOMC June 18	June 25	July 2	July 9
Treasury bills						
3-months	9.05	6.93	8.13	7.63	7.34	7.56
6-months	9.00	6.80	8.12	8.01	7.97	8.26
1-year	8.50	6.37	8.13	8.16	8.29	8.21
Commercial Paper						
1-month	10.38	8.13	11.38	11.50	12.00	12.13
90-119 days	10.50	7.75	11.25	11.50	12.00	12.13
4-6 months	10.50	7.50	11.00	11.25	11.75	11.88
Large negot. CD's 1/						
3-months	11.05	7.85	11.50	11.90	12.13	12.38
6-months	11.00	7.50	10.88	11.50	11.50	11.88
Federal agencies						
1-year	9.49	7.01	9.05	9.13	9.45	9.55(7/8)
Bank prime rate	10.00	8.75	11.50	11.50	11.75-12.00	12.00

	Statement week ended June 19	June 26	July 3	July 10 2/
Federal funds rate (weekly average)	11.85	11.97	13.55	13.54

1/ Highest quoted new issues.
2/ Average for first six days of the week.

Mortgage market. Mortgage markets tightened somewhat further during June and early July. While the increases were moderate and irregular, interest rates on new commitments for home mortgages reached new highs in both the primary and secondary mortgage markets, and non-rate loan terms continued to become more restrictive. Seasonally adjusted new commitments for mortgages at savings and loan associations, which had declined substantially in May after seven consecutive months of recovery from last September's low, apparently dropped further in June as S&L's continued to report funds in short supply in virtually all of the 12 FHLBank districts.

Average contract interest rates on new commitments for 80 per cent conventional home loans at selected savings and loans tended higher through July 5 to a level of 9.14 per cent. This was above prevailing usury ceilings in 16 states and the District of Columbia. Moreover, mortgage investment generally has remained relatively unattractive to diversified lenders as yields on new issues of high-grade utility bonds have held above yields on home mortgages in most areas of the country, even before allowance for the higher servicing costs associated with mortgages. Non-rate loan terms offered on home mortgage commitments also tightened further in June. Even so, about two-thirds of S&L's were still offering 90-per cent 25-year financing to eligible borrowers; this compared with a low of about one-half of the S&L's in this category last September.

CONVENTIONAL HOME MORTGAGES
AT 120 S&L's

	Average going rate on 80% loans (per cent)	Basis point change from month or week earlier	Spread[1/] (basis points)	Number of Federal Home Loan Bank districts with funds in short supply
1973 - High	8.85 (9/28)	--	107 (9/12)	12 (Aug.-Sept.)
Low	7.43 (1/26, 2/2, 2/9)	--	- 12 (8/8)	0 (Jan.-Mar.)
1974				
Jan.	8.52	- 4	27	4
Feb.	8.42	-10	32	0
Mar.	8.41	- 1	-23	0
Apr.	8.73	+32	-25	6
May	9.03	+30	- 6	12
June 7	9.06	+ 3	-17	11
14	9.11	+ 5	-17	12
21	9.07	- 4	-42	12
28	9.10	+ 3	-40	11
July 5	9.14	± 4	n.a.	12

1/ Average mortgage return before deducting servicing costs minus average yield on new issues of Aaa utility bonds paying interest semi-annually and with 5-year call protection. Mortgage yields shown may be converted to equivalents of semi-annual interest investments by adding 16 basis points to the gross yields between 8.59 and 8.85 per cent, and 17 basis points to yields above this level.

Offerings in the July 1 FNMA auction of commitments to purchase FHA/VA home mortgages increased substantially from the volume posted in the June auctions, reflecting renewed expectations among mortgage bankers that mortgage prices may fall further in the near future. At the same time, the average yield on accepted bids rose by 11 basis points to a new high after leveling off in the first half of June.

FNMA AUCTION RESULTS
HOME MORTGAGE COMMITMENTS

	Government-Underwritten			Conventional		
	Amount (in millions of dollars)		Yield to FNMA	Amount (in millions of dollars)		Yield to FNMA
	Offered	Accepted		Offered	Accepted	
1973 - High	551 (9/3)	289 (9/3)	9.37 (9/17)	171 (8/20)	88 (4/16)	9.68 (9/17)
Low	25 (10/15, 11/26)	17 (10/15)	7.69 (1/8)	9 (10/1)	7 (10/1)	7.84 (1/2)
1974 - Jan. 14	40	36	8.71	49	35	8.77
Feb. 11	50	49	8.53	48	48	8.69
25	58	42	8.43	49	39	8.50
Mar. 11	351	285	8.44	74	50	8.47
25	1,154	333	8.62	126	34	8.64
Apr. 8	1,061	267	8.95	164	63	9.00
22	334	169	9.18	80	41	9.21
May 6	256	111	9.34	74	30	9.44
20	218	83	9.48	41	24	9.63
June 3	85	72	9.54	26	21	9.70
17	39	32	9.54	22	11	9.69
July 1	272	103	9.65	40	24	9.76

NOTE: Average secondary market yields are gross before deduction of the fee of 38 basis points paid for mortgage servicing. They reflect the average accepted bid yield for home mortgages assuming a prepayment period of 12 years for 30-year loans, without special adjustment for FNMA commitment fees and FNMA stock purchase and holding requirements. Mortgage amounts offered by bidders relate to total bids received. The maximum size of competitive offers was $3 million in all but the March 25 and April 8 auctions when the maximum was suspended.

Activity under the subsidy programs announced by the Administration in May generally has remained strong. Through July 5, the FHLMC had already issued $2.1 billion in commitments under the program to purchase up to $3 billion of 8-3/4 per cent conventional new-home mortgages. Furthermore, applications to the FHLBanks for the new subsidized advances have been exceeding the $500 million per month pace scheduled for the rest of the year. Some support is also being generated by the GNMA Tandem Plan, although in June GNMA issued commitments to purchase below-market-rate mortgages on fewer than 13,000 units--and, altogether, commitments for only about 100,000 units have been issued since the first phase of the program began in late January.[1/] One reason mentioned by the trade for this relative sluggishness is that the low contract rate on the mortgages involved in the program at a time of rising market interest rates tends to make the cost of warehousing prohibitive for mortgage originators, despite the potential appeal of such mortgages to home buyers and builders.

With 8-3/4 per cent FHA/VA mortgages selling at discounts of more than 5 points, the maximum contract interest rate on Government-underwritten mortgages was raised one-quarter percentage point by administrative action to a record level of 9 per cent, effective July 8. This was the third such rise since mid-April. Rates specified for mortgages under GNMA's Tandem Plan, however, remain unchanged.

1/ The January 22 plan provides for GNMA purchase of 200,000 new-unit FHA/VA mortgages which must bear a contract interest rate of 7-3/4 per cent. The supplemental plan announced May 10 provides for purchase of an additional 100,000 mortgages with contract rates of 8 per cent.

Federal finance. The budgetary outlook for fiscal 1975 is quite tentative at this time because of pending Congressional action regarding both expenditure and tax programs. As yet, action has not been completed on any of the major appropriations bills. Considerable debate is expected on the "Oil and Gas Energy Tax Act of 1974". Although this measure has been approved by the Ways and Means Committee, floor procedures regarding amendments have not yet been fully determined (staff projections assume enactment). Recently, the Ways and Means Committee rescheduled the target date for completion of its report on tax reform legislation from June 30 to July 20. The Congress has passed the "Congressional Budget and Impoundment Control Act of 1974" that would affect budgets beginning in fiscal year 1976. It is uncertain, however, whether the President will sign the bill because of its anti-impoundment provisions.

While there has been no official change in the Administration's budget forecast, the President has stated that an anti-inflation spending cut of $5 billion has been targeted for the current fiscal year. However, little information has been provided on where reductions might take place, and this target could be difficult to achieve given the level of commitments implied by existing legislation and court rulings on impoundment. On the tax side, Secretary Simon reported that the Treasury is currently studying the possibility of a "balanced tax package" that would provide incentives for business investment and give tax relief to low-income individuals; he indicated that some offsetting revenue might be obtained from changing the tax treatment of capital gains in a way which would "unlock" investors.

Because of these various uncertainties, the staff has not changed its $304 billion outlays projection for the new fiscal year. The receipts estimate, however, has been lowered by $1.1 billion to a level of $294.9 billion in response to revised income assumptions and a lower estimated effective corporate tax rate. These projections result in a $9.1 billion deficit for fiscal 1975. For the preceding fiscal year, preliminary data suggests a deficit of $3.0 billion, reflecting receipts of $264.5 billion and outlays of $267.5 billion.

On July 1st, the Treasury released a report stating that it would seek legislation permitting it to invest its tax and loan account balances in interest-bearing instruments, and directly compensate banks for the services they render. In the interim, the Treasury said it would reduce the level of these balances, and experiment with placing funds in thirty-day time deposits. No legislation is required as long as the funds are kept in the form of deposits. (A summary of this report will be presented in an Appendix to the Greenbook Supplement.) On June 30, the President signed the bill raising the debt ceiling to $495 billion through March 31. Originally, the Administration had requested a $505 billion ceiling through June 30, 1975.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	June[e]	July	Aug.	Sept.
Total net borrowing	-3.4	4.5	.7	.9
Weekly and monthly bills	1.6	.8	.8	--
Tax bills	--	2.0	--	-2.0
Coupon issues, net	--	--	--	--
As yet unspecified new borrowing	--	1.0	--	2.5
Special foreign series	-1.0	-.8	-.8	--
Budget agency transactions with the public	.2	--	--	--
Net Federal Financing Bank transactions with the public	--	1.5	.7	.4
Debt repayment	-4.2	--	--	--
Plus: Other net financial sources a/	-1.4 b/	.9 b/	-1.5	--
Plus: Budget surplus or deficit (-)	7.6	-6.3	-2.6	4.0
Equals: Change in cash balance	2.8 c/	-.9	-3.4	4.9
Memoranda: Level of cash balance, end of period	9.2 c/	8.3	4.9	9.8
Derivation of budget surplus or deficit:				
Budget receipts	30.9	20.3	24.0	28.6
Budget outlays	23.3	26.6	26.6	24.6
Maturing coupon issues held by public	--	--	4.4	1.9
Net borrowing by government-sponsored agencies	2.9	2.9	1.1	2.0

e--estimated.
a/ Checks outstanding less checks paid and other accrual items.
b/ Reflects assumption of $1.2 billion in deferred receipts from auction of offshore oil leases.
c/ Actual.

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

	Fiscal 1974 e/		Fiscal 1975 e/		Calendar Years		F.R.B. Staff Estimates: Calendar Quarters				Half-Yr.
	Adm. Est.	F.R.	Adm. Est.	F.R.	1973	1974	1974				1975
	5-30-74	Board	5-30-74	Board	Actual	FRB e/	I*	II	III	IV	Jan-June
Federal Budget							Unadjusted data				
Surplus/deficit	-3.5	-3.0	-11.4	-9.1	-7.9	-8.6	-7.1	10.3	-4.9	-6.9	2.7
Receipts	266.0	264.5	294.0	294.9	250.4	280.1	60.5	79.8	72.9	66.9	155.1
Outlays	269.5	267.5	305.4	304.0	258.3	288.8	67.6	69.6	77.8	73.8	152.4
Means of financing:											
Net borrowing from the public	n.a.	3.4	n.a.	n.e.	7.9	10.4	3.4	-5.9	6.1	6.8	n.e.
Decrease in cash operating balance	n.a.	3.4	n.a.	n.e.	.7	2.6	2.0	-.8	-.6	2.0	n.e.
Other 1/	n.a.	-3.9	n.a.	n.e.	-.7	-4.4	1.7	-3.6	-.6	-1.9	n.e.
Cash operating balance, end of period	n.a.	9.2	n.a.	n.e.	10.4	7.8	8.4	9.2	9.8	7.8	n.e.
Memo 2/: Sales of financial assets to the public 3/	n.a.	1.5	n.a.	n.e.	3.6	1.4	.1	.5	.4	.4	n.e.
Borrowing from the public: 4/											
Budget agency	1.7	1.2)	n.a.)	n.e.	-.1)	5.0	.4	.2)	2.6	1.8	n.e.
Federal Financing Bank	--	--)	)		--)		--	--)			
Treasury borrowing, net	n.a.	2.3	n.a.	n.e.	8.1	5.3	2.9	-6.1	3.5	5.0	n.e.
Sponsored agency borrowing 5/	13.6	15.2	n.a.	n.e.	16.3	15.8	--	5.9	6.0	3.8	n.e.
National Income Sector							Seasonally adjusted annual rates				
Surplus/deficit	-.6	-.2	-12.8	-11.3	.9	-4.0	3.3	-2.2	-7.7	-9.3	-12.8
Receipts	278.2	278.7 6/	304.3	304.1 6/	265.0	294.5	285.6	292.2	296.9	303.2	309.4
Expenditures	278.8	278.9 7/	317.1	315.4	264.0	298.5	282.3	294.4	304.6	312.5	322.1
High Employment surplus/deficit (NIA basis) 8/	n.a.	.4	n.a.	11.2	-1.3	3.0	2.4	.3	1.8	7.6	17.8

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

Footnotes continued

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

2/ The sum of sponsored and budget agency debt issues, financial asset sales, and borrowing by the Federal Financing Bank does not necessarily reflect the volume of debt absorbed by the public, since both the sponsored and budget agencies acquire a portion of these issues. Most of the market activities of budget agencies are expected to be handled by the Federal Financing Bank in fiscal year 1975.

3/ Includes net sales of loans held by the Government National Mortgage Assn., Federal Housing Adm., and Veterans,Adm. Receipts from these sales are netted against Federal Budget Outlays shown above.

4/ Budget agencies such as U.S. Postal Service, Export-Import Bank, and Tennessee Valley Authority, borrow directly from the public or from the Federal Financing Bank. The Federal Financing Bank in turn borrows from the public or from the Treasury. To avoid double counting only net borrowing from the public is shown in the table.

5/ 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.

6/ Quarterly averages exceed fiscal year total by $1.7 billion for fiscal 1974 and $.6 billion for fiscal 1975 due to spreading of wage base effect over calendar year.

7/ Fiscal year exceeds quarterly average by $.9 billion due to seasonal adjustment.

8/ Estimated by F.R. Board Staff.

INTERNATIONAL DEVELOPMENTS

CONFIDENTIAL (FR)

7/10/74

III -- T - 1

U.S. Balance of Payments
(In millions of dollars; seasonally adjusted)

	1973			1974		
	YEAR	3Q	4Q	1Q	APRIL*	MAY*
Goods and services, net 1/	4,543	1,683	2,934	2,902		
Trade balance 2/	623	602	1,343	101	-140	-993
Exports 2/	70,252	18,143	20,211	22,299	8,150	7,487
Imports 2/	-69,629	-17,541	-18,868	-22,198	8,290	8,480
Service balance	3,918	1,081	1,591	2,801		
Remittances and pensions	-1,943	-412	-717	-396		
Govt. grants & capital, net	-3,472	-883	-1,309	-1,183		
U.S. private capital (- = outflow)	-14,101	-1,629	-4,728	-7,391		
Direct investment abroad	-4,872	-710	-1,374	-220		
Foreign securities	-807	-209	-525	-647	-183	-66
Bank-reported claims -- liquid	-1,103	-456	-472	-2,248	474	-1,491
" " " other	-4,773	421	-1,571	-2,983	-1,990	-1,570
Nonbank-reported claims -- liquid	-841	-65	-21	-412	98	
" " " other	-1,704	-610	-765	-881		
Foreign capital (excl. reserve trans.)	12,444	3,571	5,689	6,822		
Direct investment in U.S.	2,537	886	712	1,127		
U.S. corporate stocks	2,758	871	486	376	16	-19
New U.S. direct investment issues	1,223	197	368	25		
Other U.S. securities (excl. U.S. Treas.)	70	106	-184	296		
Liquid liabilities to:	4,436	837	4,113	4,573	166	2,579
Commercial banks abroad	2,978	699	3,229	4,589	45	2,209
Of which liab. to branches 3/	(309)	(119)	(212)	(3,381)	(-1,958)	(1,755)
Other private foreign	1,082	188	500	577	245	116
Intl. & regional organizations	376	-50	384	-593	-124	254
Other nonliquid liabilities	1,420	675	194	426		
Liab. to foreign official reserve agencies	5,095	-1,930	-2,646	-834	1,636	796
U.S. monetary reserves (increase, -)	209	-13	-15	-210	-63	-219
Gold stock	--	--	--	--	--	--
Special drawing rights	9	--	--	--	--	3
IMF gold tranche	-33	-13	-15	-209	-63	-165
Convertible currencies	233	--	(*)	-1	--	-57
Errors and omissions	-2,776	-387	792	290		
BALANCE (deficit -)						
Official settlements, S.A.		1,943	2,661	1,044		
" " , N.S.A.	-5,304	939	2,982	1,488	-1,573	-577
Net liquidity, S.A.		-1,627	-959	-869		
" " , N.S.A.	-7,796	611	-179	-48	-2,311	
Liquidity, S.A. 4/		1,106	-1,452	-3,529		
" , N.S.A.	-9,740	131	-520	-2,850	-1,739	-3,156
Basic balance, S.A.		1,917	-498	2,065		
" " , N.S.A.	-744	-250	1,237	2,453		

* 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/ Not seasonally adjusted.
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.

INTERNATIONAL DEVELOPMENTS

Summary and outlook. The dollar has appreciated by about 1/2 per cent on a weighted average basis over the past month, to a level about 2-1/2 per cent above its mid-May low. This improvement has occurred despite a probable further deterioration in the trade balance (already in deficit at an annual rate of $6.8 billion in April-May combined), and while net private capital flows are still probably tending to move outward.

Data for bank-reported claims on foreigners showed a jump of about $3 billion in May (about equally divided between U.S. commercial banks and agencies and branches of foreign banks) and weekly data for member banks show some further rise in June. Banks' liabilities to foreign commercial banks were also rising, but by lesser amounts. Foreign dealings in U.S. corporate stocks appear to have turned negative in May, and a pickup since then seems unlikely. Finally, some of the inflows of capital in the first quarter associated with the activities of the major petroleum companies were probably reversed during the second quarter to meet payments of taxes and royalties to oil-producing countries.

In terms of the official settlements balance the United States had a deficit of about $2 billion in June, and probably over $4 billion (not seasonally adjusted) for the second quarter as a whole. However, this does not reflect to any great extent a buildup of dollar holdings as a result of official intervention in exchange markets to support the dollar against other major currencies; reserves of the major industrial countries as a group changed very little in June, and rose only about $1/2 billion during the second quarter. The main increase in official dollar holdings in the United States was by other countries -- and partial data indicate that most of the gain was by oil producers. Thus, the placement of funds by these countries has provided considerable support for the U.S. dollar in recent months. Apart from this feature, the strength of the dollar in exchange markets probably reflects the generalized effects on market attitudes of high and rising interest rates in the United States.

The near-term outlook for economic activity in other industrial countries (with the exception of Canada) is for continued slow growth in internal demand, and in some countries for a further slowing in the rates of growth. In Japan, France and Italy, policy actions aim at achieving such a slowdown; in other countries the effects of past restrictive actions, combined with an erosion in the growth of real incomes, are acting to depress economic activity. Disruptions of banking markets may also dampen activity. In most countries, exports are looked to as a major support to economic activity rates, but such expectations cannot materialize if internal demand remains sluggish in most industrial countries. However, with inflation rates remaining in the two-digit range almost everywhere, except in Germany, Austria and the Netherlands, policy concerns continue to focus primarily on reducing inflationary pressures.

The outlook for the U.S. balance of payments has not changed materially; the balance on goods and services is expected to worsen considerably over the year ahead, with over-all balance and the strength of the dollar depending largely on the extent to which oil-producing countries place funds in U.S. capital markets, as well as on the net flow of private capital between the U.S. and other countries.

Foreign exchange markets. The weighted average exchange value of the dollar has increased by 1/2 per cent from its level of four weeks ago, and currently stands 6 per cent above its value of last October and 6 per cent below its high of late January.

The dominant feature of exchange markets during the past month has been the sharp drop in trading activity following the June 26 foreign exchange related failure of the Herstatt Bank in Germany. Uncertainty created by the Herstatt failure caused an immediate drop in the volume of trading on the New York and European foreign exchange markets to below half of its normal level. Although trading activity has increased somewhat so far in July, it remains well below normal.

The mark-dollar exchange rate experienced conflicting pressures over the past month. The strong upward movement of U.S. interest rates during the period and the Bundesbank's move to provide increased re-discount assistance to the German banking system put upward exchange rate pressure on the dollar relative to the mark. Pressure in the opposite direction was generated by the swing into substantial deficit of the May U.S. trade balance and the further increase in the May German trade surplus to 4.9 billion marks. On balance, the dollar has shown a net gain of 1-1/2 per cent against the mark since mid-June, moving up by smaller amounts against the other snake currencies and the Swiss franc. During the last two weeks of June the Bundesbank made intervention sales of $130 million and the System purchased marks in the New York market and made swap repayments totaling $106 million equivalent.

The dollar has depreciated by 1-1/2 per cent against the French franc and lira over the past month. The rise in the franc was stimulated by a tightening of the French money market and the announcement of a $5 billion export agreement with Iran. The increased demand for the lira followed the announcement of stringent anti-inflation measures by the Italian government. The central banks of France and Italy both made intervention purchases totaling about $200 million in the last two weeks of June. The Italian intervention purchases partially balance intervention sales by the Bank of Italy totaling $500 million earlier in June.

In other intervention activity, the Swiss National Bank made substantial swap dollar purchases to provide quarter-end liquidity to the Swiss banking system while the Bank of England engaged in sales of dollars on a swap basis in order to reduce excess liquidity in the British money market. The Bank of Canada made small net sales of dollars during the period to moderate an easing of the Canadian dollar rate.

The gold price dropped sharply from a high of $160 on June 14 to a low of $129 on July 4, then made an equally sharp recovery to a current level above $140.

<u>Euro-dollar market</u>. Euro-dollar interest rates, along with U.S. interest rates, have risen to record highs in recent weeks. In the week ended July 10 the overnight deposit rate averaged 13-7/16 per cent, up 2-1/4 percentage points from four weeks earlier. Three-month Euro-dollar deposit rates averaged 13-13/16 per cent in the week ended July 10, also an increase of 2-1/4 percentage points in four weeks.

U.S. banks' liabilities to their foreign branches, after declining sharply in the first half of June, turned up, rising by nearly $1 billion in the two weeks to July 5 to a level of $3.6 billion.

Apart from the influence of U.S. interest rate movements, and continued strong loan demand in the Euro-markets, one additional factor putting upward pressure on Euro-dollar rates in recent weeks has reportedly been an increase in the "risk" premium demanded by investors in that market, particularly arising from the Franklin National and Herstatt troubles, and in general from the widespread talk about the Euro-markets lacking a lender of last resort, etc. Presumably it is this increased risk premium which accounts for the wide differential (1-3/4 per cent, or so) which has opened up between U.S. CD rates and three-month Euro-dollar deposits.

A wider differential between Euro-dollar loan rates and U.S. bank loan rates has also developed in recent weeks as can be seen in Table 2.

This reflects both a wider differential on deposit rates <u>and</u> a wider spread between deposit and loan rates in the Euro-market, the latter emerging as the lending banks themselves have perceived greater

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

Average for month or week ending Wednesday	(1) Over-night Euro-$	(2) Federal Funds	(3) Differ-ential (1)-(2)(*)	(4) 3-month Euro-$ Deposit	(5) 60-89 day CD rate	(6) Differ-ential (4)-(5)(*)
1974-Apr.	9.73	10.47	-0.74 (0.11)	10.48	10.05	0.43 (0.47)
May	10.94	11.32	-0.38 (0.57)	11.70	10.88	0.82 (0.89)
June	11.40	11.75	-0.35 (0.64)	12.04	11.08	0.96 (1.04)
1974-June 5	11.24	11.44	-0.20 (0.78)	11.86	10.75	1.11 (1.21)
12	11.13	11.60	-0.47 (0.50)	11.50	10.75	0.75 (0.81)
19	11.43	11.85	-0.42 (0.57)	11.90	11.13	0.77 (0.84)
26	11.67	11.96	-0.29 (0.72)	12.68	11.50	1.18 (1.28)
July 3	12.43	13.55	-1.12 (-0.04)	13.41	11.63	1.78 (1.93)
10 p/	13.42	13.55	-0.13 (1.04)	13.80	11.63	2.17 (2.36)

*/ Differentials in parentheses are adjusted for the cost of required reserves.
p/ Preliminary

SELECTED EURO-DOLLAR AND U.S. COSTS FOR PRIME BORROWERS
(1974; Friday dates)

	June 14	June 21	June 28	July 5
1) 3-mo. Euro-$ loan a/	12.56	12.94	14.13	14.50
2) 90-119 day com'l. paper b/	11.38	11.50	12.13	12.13
3) U.S. bank loan:				
a) predominant prime rate	11.50	11.50	11.75	12.00
b) with 15% comp. bal's. c/	13.53	13.53	13.82	14.12
c) with 20% comp. bal's. c/	14.38	14.38	14.69	15.00
Differentials:				
(1) - (2)	1.18	1.44	2.00	2.37
(1) - (3a)	1.06	1.44	2.38	2.50
(1) - (3b)	-0.97	-0.59	0.31	0.38
(1) - (3c)	-1.82	-1.44	-0.56	-0.56

a/ 3/4 per cent over deposit bid rate in June.
b/ offer rate *plus* 1/8 per cent.
c/ prime rate adjusted for compensating balances.

risks, perhaps related to problems of maturity structure of their assets and liabilities and/or perhaps to growing concern over the creditworthiness of borrowers.

Arrangements for publicized medium-term Euro-currency loans came to $2.1 billion in June, according to preliminary World Bank estimates, off from the revised level of $2.8 billion in May. For the second quarter, publicized arrangements averaged $2.6 billion per month, down sharply from the $4.6 billion monthly average for the first quarter. In June, loans of $100 million or more were arranged by the Royal Dutch Shell group ($400 million), Mexicana de Cobre S.A., ($300 million), the Bank of Greece ($200 million), the Government of Brazil ($150 million), the Gabonese Railways ($150 million), the Central Bank of the Philippines ($150 million), the Government of Argentina ($100 million), and the Xerox Corporation ($100 million).

U.S. balance of payments. Over-all indicators of the U.S. international position showed mixed movements in June. The dollar appreciated slightly, on average, against the major foreign currencies, following a steady depreciation since January. However, based on very preliminary data it appears that the official settlements balance was in substantial deficit in June -- over $2 billion (not seasonally adjusted, not at annual rate). For the second quarter this balance is estimated to have been in deficit by around $4-1/2 billion (seasonally adjusted, not at annual rate). This compares with surpluses of $1 billion in the first quarter and $2-3/4 billion in the fourth quarter of 1973.

U.S. liabilities to official institutions of the major oil-exporting countries rose by about $1 billion in the first quarter and probably by more than $2 billion in the second.

There is very little information available on the components of the balance of payments for the second quarter, but information which is available for April-May indicates that the deterioration in the official settlements balance stems, at least in part, from a large trade deficit and a further increase in bank-reported net capital outflows. For April and May combined the trade deficit was over $1 billion (seasonally adjusted, not at annual rate), compared with a small surplus in the first quarter; the deterioration reflects a sharp rise in the price of imported oil. Bank-reported capital flows for April-May show a net outflow of $1-3/4 billion (not seasonally adjusted, not at annual rate), compared with about $3/4 billion for the entire first quarter. Bank-reported claims on foreigners in April and May combined increased by $4-1/2 billion, with almost $3 billion reported by U.S. commercial banks and the remainder by U.S. agencies and branches of foreign banks. For the same period liquid liabilities to private foreigners increased $2-3/4 billion, of which $1/2 billion was reported by U.S. agencies and branches of foreign banks.

Private securities transactions resulted in a small net outflow in April and May together, compared to a small net inflow in the first quarter. Foreigners sold, net, a small amount of U.S. stocks in May and reduced their net purchases of bonds. U.S. purchases of new foreign bond issues also dropped in May; issues by countries previously affected by the Interest Equalization Tax continued to be small.

Complete information on the U.S. balance of payments for the first quarter of this year indicates that much of the change from the fourth quarter resulted from petroleum-related transactions. The removal of controls on capital flows, both by the United States and foreign countries, was also a significant element. The total balance on goods and services in the first quarter was essentially unchanged from the fourth quarter, holding at the large surplus of $2.9 billion (seasonally adjusted, not at an annual rate). However, the first quarter results were affected favorably by a steep and probably temporary rise in the reported foreign earnings of U.S. oil companies. The trade balance showed an equal and offsetting decline.

The basic balance (sum of current account and long-term capital transactions) was in surplus by over $2 billion in the first quarter compared with a deficit of $1/2 billion in the fourth quarter of 1973. This shift reflected a substantial decline in U.S. direct investments abroad and a rise in foreign direct investments in the United States. The favorable changes in these accounts are also probably temporary, reflecting delays by U.S. oil companies in payments to their foreign affiliates as well as an inflow representing unpaid dividends to Saudi Arabia on its share of petroleum earnings. To an extent, which will not be known for some time, these transactions that strengthened the international accounts in the first quarter will be unwound in the second and subsequent quarters.

U.S. merchandise trade. In May, the U.S. trade balance deteriorated sharply, registering a deficit of $11.9 billion at an annual rate (balance-of-payments basis) as exports declined by 8 percent, while imports rose by more than 2 percent. For April-May combined the trade balance was in deficit by $6.8 billion at an annual rate, as compared to a small surplus in the first quarter. The dominant factor in the worsening of the trade balance between the first quarter and April-May was the more than $9 billion increase in fuel imports. There was also a dip in agricultural exports. The trade balance, excluding agricultural exports and fuel imports, would have shown a more than $3 billion improvement (at an annual rate) in April-May.

U.S. MERCHANDISE TRADE, BALANCE OF PAYMENTS BASIS
(billions of dollars, seasonally adjusted annual rates)

	Current dollars				Constant (1967) dollars			
	1973		1974		1973		1974	
	3Q	4Q	1Q	Apr.-May	3Q	4Q	1Q	Apr.-May
EXPORTS	72.6	80.8	89.2	93.8	51.5	53.7	54.8	56.1
Agric.	19.0	21.2	23.6	22.6	10.2	10.4	10.4	9.8
Nonagric.	53.5	59.7	65.6	71.2	41.3	43.6	44.7	47.0
IMPORTS	70.2	75.5	88.8	100.6	46.1	45.6	46.1	46.4
Fuels	9.0	11.5	20.5	29.9	6.4	6.2	5.2	5.9
Nonfuels	61.2	63.9	68.3	70.7	39.8	39.4	41.0	39.4
TOTAL BALANCE	+2.4	+5.4	+0.4	-6.8	+5.4	+8.1	+8.7	+9.8
BALANCE excl. fuel imp. & agr. exp.	-7.7	-4.2	-2.7	+0.5	+1.5	+4.2	+3.7	+7.6

By country, the U.S. trade balance with the less-developed petroleum supplying countries deteriorated sharply, even though U.S. exports to those countries rose appreciably. The trade balance with other developing countries improved slightly or remained steady, as the increase in exports and imports was evenly matched. However, the U.S. trade balance with the developed countries declined in April-May; sharp increases in imports from Germany and Japan combined with a flattening out in exports to both of those countries were responsible for most of that decline.

U.S. exports for April-May were at an annual rate of $93.8 billion (balance of payments basis), 5 percent above their first quarter level. The increase resulted entirely from larger shipments of non-agricultural products; exports of agricultural goods declined by nearly $1 billion from the record first quarter rate.

The decline in the value of agricultural exports -- the first decline since the second quarter of 1972 -- stemmed from a drop in volume, particularly wheat, while the export unit value showed a small increase. However, in May, export prices of many commodities such as wheat, corn, rice, and soybeans levelled off or declined. With the increased supply of agricultural goods in world markets, U.S. agricultural export prices may decline further in coming months.

The value of U.S. exports of nonagricultural goods increased in April-May in all major categories, except civilian aircraft. Increased shipments of both machinery and industrial supplies accounted for most of the gain. While the increase in the value of machinery exports was in volume, the advance in the value of industrial supplies was largely the effect of higher prices. With the weakening in world demand for industrial supplies, as evidenced by recent declines in prices of metals in commodity markets, the rate of increase in prices of materials exports may slacken. On the other hand, foreign orders for U.S. durable equipment (excluding aircraft) continued to rise in April-May suggesting continued strength in such exports.

U.S. imports for April-May were at annual rate of $100.6 billion (balance of payments basis), an increase of nearly $12 billion from the first quarter rate. The 45 percent jump in the value of fuel imports in April-May was responsible for most of the gain in the value of total imports. The average price of oil imports was $11.61 per barrel in April-May compared with $9.10 in the first quarter. With the lifting of the oil embargo in late March, the volume of oil imports averaged more than 6.5 million barrels a day in April-May, as compared with an average of 5.9 million barrels per day in the first three months of the year, and it is expected that the volume of oil imports will average about 7 million barrels a day during the rest of the year.

The somewhat higher value of nonfuel imports in April-May resulted entirely from higher prices; volumes declined. Decreases in the volume of food imports (particularly coffee, cocoa, and meat) and automotive vehicles from Canada were responsible for most of the decline in volume. With the continued sluggishness in U.S. activity, the volume of imports of industrial supplies has remained virtually flat. In addition, the April-May volume of imports of consumer goods (excluding cars and food) rose only slightly above the first quarter level. So far this year, the monthly volume of consumer goods imports has continued below the average monthly levels of 1972 and 1973, probably reflecting in large part the effect of the exchange rate realignments begun in 1971.

In contrast, the volume of imports of foreign-type cars in April-May continued to increase -- more than 20 percent above the already high first quarter rate. In every month this year, imports have been far in excess of U.S. sales, and some foreign car suppliers have announced plans to cut back their deliveries to the United States in order to reduce the current high stock-sale ratio.

<u>Economic activity in major foreign industrial countries</u>. At the recent meeting of the OECD's Economic Policy Committee in Paris, it was clear that the main policy concern of the industrial countries was the need to bring the rapid rise in the level of prices under control. The consensus was that the series of restrictive policy measures taken in most countries over recent months has been appropriate. However, opinions varied as to whether actions taken so far would be sufficient to achieve the desired moderation in price increases, whether further restriction would be necessary, and at what point relaxation of these measures would be appropriate. Most authorities are facing the same policy dilemma: will restrictive actions create a downturn leading to possible "stag-" or "slump-flation," or are inflationary pressures still so tenacious that, despite the downward risks, continued or additional restriction is necessary? A further consideration is that restrictive policy measures are being taken simultaneously in many countries and could, therefore, have a cumulative effect on economic activity.

The authorities' present concern with the need for restriction represents a change from early this year when the major concern for many countries was the possibility of a world recession in the wake of the oil crisis. This fear receded when countries came out of the oil-embargo period with a somewhat smaller decline in economic activity, but with much more rapid price increases, than had been expected. This situation led almost all governments to tighten monetary policies, and in most cases also to tighten fiscal policies. Consumer prices in all of the industrial countries, with the exception of Austria, Germany, and the Netherlands, are now rising at year-over-year rates of from 10 to over 20 per cent, and there is little hope that these rates of increase will decline significantly before the end of the year. Inflationary pressures are also being aggravated as wage earners attempt to protect their real earnings by demanding large catch-up wage settlements. Although excess demand is not a general problem any longer, most authorities are relying on traditional demand management instruments in their attempts to control inflation. Except in a few countries, such as Austria, where price and wage controls have worked fairly well, it appears that most policy makers have become disenchanted with the use of these auxiliary policy instruments; thus, they are now willing to accept the risks of depressing demand levels more than they might otherwise think desirable.

In all of the major industrial countries except Canada, a slowdown in rates of growth of real GNP began in the third or fourth quarter of 1973. (See table.) Given the further slowdown -- or actual decline -- in the growth of real GNP in the first quarter of this year and the cumulation of recent restrictive policy measures, the official projections for 1974 over 1973 shown in the table would appear to be at the upper range of what seems feasible. First, most

ACTUAL GROWTH RATES OF REAL GNP, 1959-1973,
AND OFFICIAL FORECASTS, 1974
(percentage changes)

	Average	From previous year		From same quarter preceding year			
	1959-60 to 1970-71	1973	1974 forecasts a/	73-QII	73-QIII	73-QIV	74-QI
France b/	5.8	6.1	5	6.9	6.2	5.7	4.4
Germany	4.9	5.3	2	6.4	5.6	3.6	1.5
Italy c/	5.5	5.9	4 d/				
United Kingdom b/	2.9	5.6	-1-1/4	5.3	5.8	3.2	-3.1
Japan	11.1	10.5	-1-1/2	12.2	9.2	5.9	-3.6
Canada	4.9	6.8	5	5.7	6.7	6.8	5.4
United States	3.9	5.9	-3/4	6.2	5.6	4.0	0.2

a/ National sources and OECD Secretariat; for United States, FRB forecast.
b/ GDP.
c/ Quarterly GNP data not available.
d/ Estimate predates recent stabilization measures.

of the country projections assume a relatively fast expansion of exports; if this expansion is less than expected, total activity could be significantly lower than predicted. Second, the outlook is based on a general expectation of relatively strong private investment demand. The capacity shortages which became evident last year are expected to motivate businesses to increase their investment plans regardless of any short-term sluggishness of demand. However, because of weak capital market conditions, it may be difficult for some companies to realize their investment intentions. And third, since inflation rates have cut into real purchasing power in most countries, forecasts of some increase in consumption expenditures are predicated upon falls in savings rates, which may not be as significant as expected.

A major danger in underestimating the downward risks inherent in the current situation is that, if activity rates begin to fall off much more rapidly than currently expected and if liquidity squeezes produce a relatively large number of business failures, governments may be forced to take expansionary action on a larger scale than would be consistent with the aim of avoiding renewed inflationary pressures. Thus, the acceptance of the considerable downside risk does not necessarily rule out the risk of continued inflation.

The United Kingdom provides a good example of the policy dilemma facing the governments of the major industrial countries.

After a very sharp upward spurt from mid-1972 through early 1973, economic activity remained flat, although at a high level through the rest of 1973. The growth of real GDP in 1973 over 1972 was a record 5.6 per cent, as compared to a longer run average rate of just under 3 per cent. Because of the disruptions associated with the miners' strike and the oil crisis, there was a large drop in real GDP in the first quarter of 1974, but not as great a decrease as had been originally expected. Measures announced in mid-December to restrict demand have been maintained and were reinforced at the end of March by the 1974/75 Budget. However, in view of the likely cumulative effects of these measures, the authorities now are considering some easing of policy, despite the fact that consumer prices are rising at a year-over-year rate of about 16 per cent.

Private consumption expenditure has been weak, and expected slow or negative growth of real incomes, combined with the possibility that consumers may want to rebuild their savings after a first quarter rundown, suggests that it may remain so. Private investment also is not likely to show much strength, because of uncertainties about current proposals regarding government participation in industry and also because of financing problems. As in other countries, tight monetary conditions have led to a considerable fall in residential construction.

There are indications that there has been some shift of resources into export industries, which is essential for the achievement of the government's second major policy goal, the improvement of the external balance. But the achievement of that goal, like the fight against inflation, is likely to be a slow process, and external pressures are not likely to be significantly relieved until the pumping of North Sea oil in substantial volume begins.

In France, real GDP in the six months ending in March 1974 rose at a seasonally adjusted annual rate of about 6 per cent, the economy's potential rate. However, since the beginning of 1974 growth has slowed, and for the year as a whole the French authorities expect real output to grow at a rate of about 5 per cent. The recently announced anti-inflation program aims at slowing growth in all sectors of internal demand, in part because supply bottlenecks continue to exist in various industrial sectors. The stated goals of the plan are first, to bring the rate of inflation, as measured by the CPI, down from an average monthly increase of 1.4 per cent during the first five months of 1974 to 0.5 per cent by mid-1975; and second, to reduce the present monthly trade deficits, which averaged about Ff. 2 billion per month during the first four months of 1974, by one-half by mid-1975 and eliminate them by end-1975. Since unemployment is already high by French standards, the authorities hope that a strong demand for French exports will offset the decrease in domestic demand and consequently, that output will not be affected.

The growth in government spending, consumption expenditure and residential construction should weaken considerably this year compared with 1973. At present, investment is forecast to increase by 5 per cent in volume this year. However, this estimate seems optimistic because of tight financial conditions. In addition, the latest government measures will undoubtedly limit borrowing possibilities further, and the imposition of an 18 per cent surtax on 1973 corporate taxes will put an additional burden on industry. In this respect, the government's austerity program seems to focus more on balance of payments aims than on eliminating capacity shortages in various sectors.

In Germany, the positive overall rate of growth in the first quarter of 1974 obscures a fall in internal demand which was more than offset by a large increase in the external surplus, with the volume of imports decreasing and that of exports rising strongly. With the slowing of the overall growth rate, the inflation rate has slowed to about 7 per cent, as measured by the year-over-year rate of increase in the CPI, still high by German standards. The government's policy is still aimed primarily at moderating the inflation rate, and in particular, at forestalling a further upward push on the price level because of wage increases. The spring negotiations yielded wage increases of about 13-15 per cent, well above the government's 9 per cent guideline, and with current policies it is hoped to bring the rate of increase below these figures in negotiations later this year.

Because there was little excess demand as early as the middle of last year, the government began to ease up on its restrictive fiscal policy towards the end of the year. The 11 per cent investment tax imposed on private investment in May 1973 was lifted in December, government budget ceilings were relaxed, and the 10 per cent surtax on middle- and high-income groups was allowed to expire as of July 1, 1974. (Revenue from that source amounted to 1.6 billion DM in 1973.) Under current legislative proposals, tax reform will add 12 billion DM to disposable income at the beginning of next year. Monetary policy has been eased slightly in the past few weeks.

Official forecasts expect an increase in real GNP of about 2 per cent in 1974 over 1973, mainly because of continued strength of the external sector, but with the rate of internal growth rising through the year. If internal demand fails to rise, the government has indicated its willingness to take stronger expansionary measures. The authorities are clearly concerned about the current structure of demand with its heavy emphasis on exports, but expects that as capacity constraints ease in other countries, the enormous trade surpluses will recede, and the pattern of growth will shift towards greater dependence on domestic demand factors.

In Italy, an alarmingly accelerating rate of inflation, with year-over-year rates of increase of about 15 per cent for the CPI and 45 per cent for the WPI, coupled with intolerably large balance of payments deficits, has forced the government to impose severely restrictive measures. Last year, the Italian authorities had hopes of returning the economy to a steady growth path after years of crippling social strife. In particular, it was hoped that an upsurge in private investment demand would provide the basis for further increases in output. But the current situation has necessarily changed these policy goals.

Limits on credit extension and the import deposit scheme have produced a liquidity squeeze which is becoming increasingly severe. Short-term interest rates have risen sharply; the prime rate rose from 9.5 per cent early this year to 15.5 per cent in June. The government is now reenforcing these measures with a fiscal package that includes increases in taxes and charges by public utilities and limits on the growth of government expenditure. The situation is sufficiently critical to have enabled the precarious government coalition to obtain a favorable vote of confidence for this stabilization program. The aim of the program is to slow down internal demand markedly by the end of this year.

So far this year, the unemployment rate has continued to fall and in April was 2.6 per cent compared to 3.0 per cent in the fourth quarter of 1973; also, the labor force participation rate has increased.

Industrial production, excluding the automobile sector, probably remained stable during the first five months of this year. However, the large fall in demand for automobiles produced a decline in the overall index.

With the shift in policy, the outlook for this year has changed markedly. Before the introduction of the stabilization program, real GNP was expected to grow by about 4 per cent in 1974 over 1973, partly because of large increases in private investment and buoyant private consumption. Now, both of these sectors are likely to provide only a minor source of strength and it is hoped that most of the slack will be taken up by export demand, although the authorities are worried that demand conditions in other countries may be such as to make this difficult.

Under the impact of the energy crisis and the restrictive monetary and fiscal policies pursued by the <u>Japanese</u> authorities, output has generally declined since late last year. Real GNP in the first quarter declined by 5 per cent (over 20 per cent at an annual rate) from the fourth quarter level, largely because of a 5-1/2 per cent fall in real personal consumption expenditures. The rapid upsurge of inflation in Japan, with year-over-year rates of increase of consumer prices now over 20 per cent, cut heavily into real incomes and caused consumers to curtail their purchases. The large -- even by Japanese standards -- wage increases negotiated this spring are likely to stimulate consumption expenditure over the next few months, but on balance, no substantial contribution to growth is expected from this source.

The Japanese authorities are trying to achieve the dual policy objectives of moderating inflation and bringing about a very substantial improvement in the external balance. There appears to be some progress toward achieving both goals. Price increases have moderated somewhat, although they still remain high and consumer prices may accelerate again in coming months because of planned increases in transportation and communication rates, as well as in rice prices. On the external side, exports have been increasing rapidly in recent months, outpacing the rise in imports. Consequently, the trade deficit has been cut down from $1-1/4 billion in the first quarter of this year to a quarterly rate of under $1/2 billion in April/May.

Despite the progress that is being made towards the government's stated policy goals, the authorities have repeatedly declared that tight policies will continue to be pursued until at least late this year, because of a general fear that inflationary expectations could easily be rekindled. Thus, government estimates put the change in GNP in 1974 over 1973 at minus 1-1/2 per cent.

In contrast to the situation in some of the other countries, internal demand in Canada is quite strong. Even if Canadian exports do not contribute to growth because of the slowdown in U.S. demand, real GNP for 1974 as a whole still is expected to increase at a rate of about 5 per cent, approximately equal to potential. Although as elsewhere, consumer spending may weaken and tighter credit conditions may discourage investment, the world commodity boom and the energy crisis have served to stimulate economic activity in Canada.

With year-over-year rates of increase in the CPI now about 11 per cent, there is a great deal of concern in Canada about inflation, but policies have been less restrictive than in other countries. Monetary policy has been tightened considerably since the early part of 1973 in order to stem inflation, but official statements have emphasized that monetary policy will continue to accommodate the growth of output and employment.

The Canadian authorities have chosen to fight inflation by trying to expand capacity and increase productivity rather than by deflating demand. However, the Canadian opposition parties did advocate the use of wage and price controls when they voted against the government's budget. The pre-election budget represented a more or less neutral policy stance, and Prime Minister Trudeau had pledged to reintroduce the same budget proposals if elected. Thus, given Trudeau's victory in the July 8 election, the general strategy for dealing with inflation will probably remain the same.