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Part I

CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

Summary and Outlook

Prepared for the
Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

November 13, 1974

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SUMMARY AND OUTLOOK

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Summary and Outlook

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. The decline in overall economic activity appears to be accelerating and becoming more widespread. Retail sales are sluggish and auto sales are down sharply. Industrial output appears to be declining significantly from the third quarter level; residential construction is likely to reach new lows in the current quarter and there are signs that business capital spending in real terms has passed its peak. The labor market has weakened further, with unemployment moving upward from already advanced levels. The bituminous coal strike will depress activity this quarter if it lasts for more than two weeks, as seems likely.

Prices are still advancing at a rapid rate, although perhaps a little less rapidly than in the third quarter. Wage rates and unit labor costs continue to rise sharply.

In October, industrial production is estimated to have declined more than 1/2 per cent, after changing little since May. Auto assemblies temporarily were up somewhat last month, but there were declines in other consumer durables, construction materials, and a wide range of other durable and nondurable materials. Steel output, however, remained high, as buying in anticipation of the coal strike continued. Output of business equipment was maintained at about the advanced level reached in June. In the current month, assemblies of autos and trucks are being cut materially, and public announcements indicate downward adjustments in output and employment in autos and numerous other industries.

In October, the unemployment rate rose to 6.0 per cent--from 5.8 per cent in September. Nonfarm payroll employment changed little, as a sizable decline in goods-producing industries was about offset by a rise in service activities. More recently, layoffs have accelerated in the automobile and other industries and initial claims for unemployment compensation benefits have risen further.

In consumer markets, demands for new domestic-type autos have been exceptionally weak--with unit sales in October at only a 6.4 million annual rate, down one-fifth from September. By the end of October, unit auto stocks had risen to a record level for the period. Sales of imports--which were still selling at 1974 prices--strengthened somewhat. Apart from autos, retail sales rose moderately in October, although sales of furniture and appliances weakened further. Housing starts in September remained at the depressed 1.1 million annual rate of August.

It now appears that business fixed investment in real terms may be heading down. In real terms, new orders for nondefense capital equipment have declined appreciably in the past two months, and in September the backlog of orders in real terms fell for the first time in two years. The recent McGraw-Hill Survey indicated a planned increase of 12 per cent in business plant and equipment spending for 1975--in line with other recent private surveys, but also found that businesses expect prices of such equipment to rise by 12 per cent. Moreover, McGraw-Hill reported a widespread downscaling of earlier plans. Further curtailments are likely as recessionary forces cumulate.

A continued sharp rise in unit labor costs is maintaining strong upward pressures on prices. In the third quarter, productivity in the private nonfarm sector declined again, while the rise in compensation per manhour accelerated. In October, the adjusted hourly earnings index was up more than 9 per cent from a year earlier.

Prices continue under strong upward pressure, but there is evidence of abatement for some commodities. In September, the rise in wholesale industrial prices--while still large--was less than half the extremely rapid rate of the preceding eight months. Prices received by farmers rose in October, following a September decline. At the retail level, further sizable increases in food prices are widely expected. The consumer price index rose 1.1 per cent in September, about the same as the average July-August rate, and was 12 per cent above a year earlier.

Outlook. The monetary and fiscal assumptions underlying the current staff projection are essentially the same as those of five weeks ago. The staff has not incorporated Administration recommendations for a 5 per cent surtax and a liberalized investment tax credit because the likelihood of their early passage seemed remote. (1) Growth in M_1 is assumed to be at an average annual rate of about 5-3/4 per cent through calendar 1975. Both short-term and long-term interest rates are assumed to remain near current levels, or to drift lower, through the first half of 1975--reflecting, in part, the modest pace of expansion in nominal GNP. (2) A considerably expanded public employment program, larger than recommended by the Administration, is assumed to be phased in beginning during the Spring of 1975. (3) The special unemployment program recommended by the Administration, which increases coverage and extends duration is also assumed. (4) Federal expenditures in fiscal 1975 are projected at just under $300 billion on a unified budget basis. (5) An increase in social security benefits of almost $5 billion, effective July 1, 1975, will result from the automatic cost of living adjustments provided by existing legislation, (6) An increase in corporate taxes for oil companies, amounting to almost $2 billion in fiscal 1975, also is assumed.

The staff projection for the current quarter now shows real GNP declining by over 5 per cent, annual rate, a much sharper drop than previously projected. A special influence this quarter is the four week coal strike, assumed by the staff, which significantly depresses inventory investment in the coal and steel industries.

The further decline now projected in real GNP for the first half of 1975 is less than that for the current quarter, partly because some restocking of depleted coal and steel stocks following the coal strike settlement should tend to hold up inventory investment in the first quarter. The underlying adjustment in the current and the following two quarters is deeper than projected a month ago. Consumer buying is likely to be inhibited by further sizable price increases, declining real disposable income, and increased caution resulting from the anticipated rise in unemployment. Residential construction, however, may begin turning up in the Spring, reflecting an increased volume of inflows to thrift institutions, the help provided by new Federal programs, and an expected downdrift in mortgage interest rates. Real business fixed investment, on the other hand, is expected to edge down over the course of the year, and some outright liquidation of inventories is projected by mid-year.

An end to the downward inventory adjustment is expected in the second half of 1975, contributing to a moderate upturn in real GNP. The resumption of real growth is also predicated on a recovery in housing, a small advance in real consumer purchases, and continued expansion in State and local expenditures.

On the basis of recent trends, prices are expected to rise a little faster this quarter than anticipated last time. For 1975, however, projected price increases are virtually the same as 5 weeks ago, with the fixed-weighted GNP price index expected to slow throughout the year to a 7 per cent rate by year-end.

The civilian labor force has increased at a relatively rapid pace over the past 12 months. But in view of the sluggish economy projected for next year, labor force growth is expected to slow considerably in 1975. The staff has raised its projected unemployment rate for the fourth quarter of this year to 6.4 per cent; moreover, the rate is projected to move up--despite a large and growing public service employment program--to around 7-3/4 per cent by the fourth quarter of 1975.

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 (per cent)	
	10/9/74	11/13/74	10/9/74	11/13/74	10/9/74	11/13/74	10/9/74	11/13/74
1971 1/	77.8	77.8	3.3	3.3	4.3	4.3	5.9	5.9
1972 1/	103.1	103.1	6.2	6.2	3.3	3.3	5.6	5.6
1973 1/	136.9	136.9	5.9	5.9	6.3	6.3	4.9	4.9
1974	101.9	101.8	-1.8	-2.0	11.5	11.7	5.5	5.6
1975	98.0	97.7	-1.6	-2.2	9.7	10.2	7.1	7.4
1973: I 1/	44.2	44.2	9.5	9.5	7.4	7.4	5.0	5.0
II 1/	29.0	29.0	2.2	2.2	8.1	8.1	4.9	4.9
III 1/	31.0	31.0	1.6	1.6	8.4	8.4	4.7	4.7
IV 1/	35.1	35.1	2.3	2.3	9.1	9.1	4.7	4.7
1974: I 1/	14.8	14.8	-7.0	-7.0	14.1	14.1	5.2	5.2
II 1/	25.0	25.0	-1.6	-1.6 1/	12.3	12.3 1/	5.1	5.1
III	26.2	27.8	-2.0	-2.9 1/	13.5	14.0 1/	5.5	5.5
IV	24.5	20.9	-2.9	-5.5	11.1	12.7	6.1	6.4
1975: I	19.0	21.0	-2.7	-2.5	9.5	9.7	6.6	6.8
II	23.0	21.0	-1.0	-1.9	8.0	8.3	7.0	7.2
III	30.0	32.0	1.0	1.5	7.5	7.6	7.3	7.6
IV	36.0	36.5	2.1	2.4	7.0	7.0	7.5	7.8
Change:								
72-IV to 73-IV	139.3	139.3	3.9	3.9	8.3	8.3	- .6	- .6
73-IV to 74-IV	90.5	88.5	-3.5	-4.3	12.7	13.3	1.4	1.7
74-II to 75-II	92.7	90.7	-2.2	-3.2	10.5	11.1	1.9	2.1
74-IV to 75-IV	108.0	110.5	- .2	- .1	8.0	8.1	1.4	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.	1975 Proj.	1974 III	1974 IV	1975 Projection I	II	III	IV
Gross National Product	1396.7	1494.4	1411.6	1432.5	1453.5	1474.5	1506.5	1543.0
Final purchases	1386.1	1493.4	1405.8	1426.5	1450.5	1475.5	1506.5	1541.0
Private	1078.7	1158.9	1094.6	1108.7	1126.8	1145.9	1168.8	1193.9
Excluding net exports	1078.5	1164.4	1098.7	1113.5	1131.7	1150.8	1174.4	1200.5
Personal consumption expenditures	881.4	955.8	899.9	915.8	930.8	945.5	963.5	983.2
Durable goods	130.0	130.9	136.0	130.5	129.5	128.5	131.0	134.5
Nondurable goods	381.8	415.5	388.1	398.8	405.3	411.7	418.6	426.2
Services	369.7	409.4	375.9	386.5	396.0	405.3	413.9	422.5
Gross private domestic investment	207.7	209.6	204.6	203.7	203.9	204.3	210.9	219.3
Residential construction	46.3	43.4	46.3	41.7	40.4	41.3	44.2	47.5
Business fixed investment	150.8	165.3	152.5	156.0	160.5	164.0	166.7	169.8
Change in business inventories	10.6	1.0	5.8	6.0	3.0	-1.0	.0	2.0
Nonfarm	7.9	1.0	3.1	5.0	3.0	.0	.0	1.0
Net exports of goods and services 1/	.2	-5.5	-4.1	-4.8	-4.9	-4.9	-5.6	-6.6
Exports	140.2	153.5	143.9	147.3	149.2	151.6	154.7	158.3
Imports	140.0	159.0	148.0	152.1	154.1	156.5	160.3	164.9
Gov't. purchases of goods and services	307.4	334.5	311.2	317.8	323.7	329.6	337.7	347.1
Federal	115.1	122.3	116.4	118.3	119.4	120.4	122.5	126.7
Defense	77.7	82.4	78.8	79.7	80.5	80.9	82.5	85.5
Other	37.4	39.9	37.7	38.6	38.9	39.5	40.0	41.2
State & local	192.3	212.3	194.8	199.5	204.3	209.2	215.2	220.4
Gross national product in constant (1958) dollars	822.1	804.2	821.1	809.5	804.4	800.5	803.5	808.3
GNP implicit deflator (1958 = 100)	170.0	185.8	171.9	177.0	180.7	184.2	187.5	190.9
Personal income	1151.0	1250.4	1165.9	1191.0	1212.2	1234.7	1264.5	1290.3
Wage and salary disbursements	753.0	814.5	762.6	776.4	790.5	805.0	821.8	840.7
Disposable income	979.9	1060.9	990.8	1011.5	1028.9	1047.5	1072.9	1094.3
Personal saving	72.4	78.0	64.6	69.1	71.3	74.9	82.1	83.5
Saving rate (per cent)	7.4	7.4	6.5	6.8	6.9	7.2	7.7	7.6
Corporate profits & inventory val. adj.	104.1	95.3	104.8	98.4	93.3	90.5	95.3	102.0
Corporate profits before tax	147.3	131.5	160.0	147.0	135.5	128.0	130.5	132.0
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	295.0	314.3	306.2	304.1	308.2	310.2	316.4	322.3
Expenditures	295.6	327.1	301.9	307.9	314.1	320.2	333.1	341.1
Surplus or deficit (-)	-.6	-12.9	4.3	-3.8	-5.9	-10.0	-16.7	-18.8
High employment surplus or deficit (-)	-.8	22.1	-2.4	5.9	15.9	23.6	22.4	26.6
State and local government surplus or deficit (-), (N.I.A. basis)	2.7	-.2	2.5	2.8	1.1	-.1	-.7	-1.1
Total labor force (millions)	93.4	95.2	93.6	94.4	94.8	95.1	95.3	95.4
Armed forces "	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Civilian labor force "	91.2	93.0	91.4	92.2	92.6	92.9	93.1	93.2
Unemployment rate (per cent)	5.6	7.4	5.5	6.4	6.8	7.2	7.6	7.8
Nonfarm payroll employment (millions)	77.0	77.0	77.2	77.1	77.2	77.1	76.9	76.8
Manufacturing	19.8	18.9	19.9	19.5	19.2	18.9	18.7	18.6
Industrial production (1967 = 100)	124.6	121.1	125.4	122.6	121.6	120.4	120.7	121.5
Capacity utilization, mfg. (per cent)	79.2	74.3	79.3	77.0	75.6	74.2	73.7	73.5
Major materials (per cent)	89.2	81.6	88.3	85.5	83.2	81.5	81.0	80.8
Housing starts, private (millions, A.R.)	1.38	1.33	1.19	1.15	1.15	1.25	1.40	1.50
Sales new autos (millions, A.R.)	9.19	8.75	10.03	8.50	8.50	8.50	8.75	9.25
Domestic models	7.68	7.25	8.48	6.80	7.00	7.00	7.25	7.75
Foreign models	1.51	1.50	1.55	1.70	1.50	1.50	1.50	1.50
1/ Net exports of g. & s. (Bal. of Paymts.)	1.0 2/	-4.8 2/	-3.2 2/	-3.9 2/	-4.0	-4.0	-5.0	-6.0
Exports	141.2 2/	153.6 2/	144 2 2/	147.6 2/	149.5	151.9	154.7	158.3
Imports	140.1	158.4	147.4	151.5	153.5	155.9	159.7	164.3

2/ Includes shipments of military equipment and supplies to Israel amounting to $.3 billion, annual rate, not included in GNP figures.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1974 Proj.	1975 Proj.	1974 III	1974 IV	1975 Projected I	1975 Projected II	1975 Projected III	1975 Projected IV
	Billions of Dollars							
Gross National Product	101.8	97.7	27.8	20.9	21.0	21.0	32.0	36.5
Inventory change	-4.8	-9.6	-7.7	.2	-3.0	-4.0	1.0	2.0
Final purchases	106.5	107.3	35.5	20.7	24.0	25.0	31.0	34.5
Private	75.5	80.2	28.7	14.1	18.1	19.1	22.9	25.1
Net exports	-3.7	-5.7	-2.6	- .7	- .1	.0	- .7	-1.0
Excluding net exports	79.2	85.9	31.3	14.8	18.2	19.1	23.6	26.1
Personal consumption expenditures	76.2	74.4	30.8	15.9	15.0	14.7	18.0	19.7
Durable goods	- .3	.9	6.5	-5.5	-1.0	-1.0	2.5	3.5
Nondurable goods	43.8	33.7	12.3	10.7	6.5	6.4	6.9	7.6
Services	32.8	39.7	12.1	10.6	9.5	9.3	8.6	8.6
Residential fixed investment	-10.9	-2.9	-2.5	-4.6	4.5	3.5	2.7	3.1
Business fixed investment	14.0	14.5	3.1	3.5	-3.0	-4.0	1.0	2.0
Government	31.0	27.1	6.8	6.6	5.9	5.9	8.1	9.4
Federal	8.5	7.2	2.1	1.9	1.1	1.0	2.1	4.2
State and local	22.5	20.0	4.7	4.7	4.8	4.9	6.0	5.2
GNP in constant (1958) dollars	-17.2	-17.9	-6.0	-11.6	-5.1	-3.9	3.0	4.8
Final purchases	-12.8	-12.2	-1.1	-12.0	-3.4	-1.6	2.6	3.5
Private	-13.7	-11.5	- .7	-10.8	-2.8	-2.2	1.6	3.1
	Per Cent Per Year 1/							
Gross National Product	7.9	7.0	8.3	6.1	6.0	5.9	9.0	10.0
Final purchases	8.3	7.7	10.8	6.0	6.9	7.1	8.7	9.5
Private	7.5	7.4	11.2	5.3	6.7	7.0	8.2	8.9
Personal consumption expenditures	9.5	8.4	14.9	7.3	6.7	6.5	7.8	8.4
Durable goods	- .2	.7	21.6	-15.2	-3.0	-3.1	8.0	11.1
Nondurable goods	13.0	8.8	13.7	11.5	6.7	6.5	6.9	7.5
Services	9.7	10.7	14.0	11.8	10.2	9.7	8.8	8.6
Gross private domestic investment	- .8	.9	-12.9	-1.7	.4	.8	13.6	16.9
Residential structures	-19.1	-6.3	-19.0	-34.2	-11.9	9.2	31.2	33.4
Business fixed investment	10.2	9.6	8.6	9.5	12.0	9.0	6.7	7.6
Gov't. purchases of goods & services	11.2	8.8	9.2	8.8	7.6	7.5	10.2	11.6
Federal	8.0	6.3	7.6	6.7	3.8	3.4	7.2	14.4
Defense	4.4	6.0	12.0	4.6	4.1	2.0	8.1	15.4
Other	16.1	6.7	.0	9.9	3.1	6.3	5.2	12.6
State and local	13.3	10.4	10.3	10.0	10.0	9.9	12.0	10.0
GNP in constant (1958) dollars	-2.0	-2.2	-2.9	-5.5	-2.5	-1.9	1.5	2.4
Final purchases	-1.5	-1.5	- .5	-5.8	-1.7	- .8	1.3	1.7
Private	-2.0	-1.7	- .4	-6.4	-1.7	-1.3	1.0	1.9
GNP implicit deflator	10.1	9.3	11.5	12.3 2/	8.7 2/	8.0	7.3	7.5 2/
Private GNP fixed weighted index 3/	11.7	10.2	14.0	12.7	9.7	8.3	7.6	7.0
Personal income	9.1	8.6	11.5	8.9	7.3	7.6	10.0	8.4
Wage and salary disbursements	8.9	8.2	9.7	7.4	7.5	7.5	8.6	9.5
Disposable income	8.4	8.3	10.4	8.6	7.1	7.4	10.1	8.2
Corporate profits before tax	20.0	-10.7	54.6	-28.7	-27.8	-20.4	8.0	4.7
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.1	6.5	23.8	-2.7	5.5	2.6	8.2	7.7
Expenditures	11.9	10.7	14.9	8.2	8.3	8.0	17.1	10.0
Nonfarm payroll employment	1.9	.0	.8	- .6	.5	- .5	-1.0	- .5
Manufacturing	- .1	-4.5	-1.3	-7.8	-6.0	-6.1	-4.2	-2.1
Industrial production	- .8	-2.8	- .1	-8.7	-3.2	-3.8	1.0	2.6
Housing starts, private	-32.3	-3.6	-66.5	-13.1	.0	39.6	57.4	31.8
Sales new autos	-19.7	-4.8	41.4	-48.5	.0	.0	12.3	24.9
Domestic models	-20.6	-5.6	29.4	-58.6	12.3	.0	15.1	30.6
Foreign models	-14.6	- .7	138.3	43.6	-39.4	.0	.0	.0

1/ Percentage rates are annual rates compounded quarterly.
2/ Excluding Federal pay increases rates of change are: 1974-IV, 11.6 per cent; 1975-I, 8.5 per cent; and 1975-IV, 6.8 per cent.
3/ Using expenditures in 1967 as weights.

DOMESTIC FINANCIAL SITUATION

<u>Summary</u>. Since the mid-October FOMC meeting, private short-term market rates of interest have declined ½ to 3/4 of a percentage point, extending the reduction in such rates, which began in August, to around 3 percentage points. Treasury bill rates have also declined, on balance, despite large recent and prospective additions to the bill supply.

The commercial bank prime rate has declined by as much as one to one and a quarter percentage points at some banks since mid-October, but the total decline since August is less than half of the decline in CD and commercial paper rates. In addition to the typical lag in adjustment of this rate to market rates, banks appear to have been reluctant to lower the prime rate because of their desire to limit loan expansion. In response to the high cost of bank credit, prime customers in the last two months have shifted their short-term credit demands increasingly to the commercial paper market. Banks, in turn, have had less need to raise funds in money markets and their outstanding Euro-dollar and CD borrowings, combined, have declined $2.8 billion since late September.

The increase in the total of nonfinancial business short-term credit--business loans plus commercial paper--has moderated to a 13.5 per cent rate in the three months ending October. In part, this is attributable to the weakening of economic activity, but there was also a substant hift to capital market financing by nonfinancial businesses last month. Finance companies have also recently stepped up their long-term financing which, in combination with lower consumer credit demands and tighter consumer loan policies, has reduced short-term credit demands of these institutions most recently.

In October, total corporate bond offerings were the second largest on record and projections for November suggest a sustained large volume of new issues. But despite the large increase in supply, corporate bond rates have declined about a percentage point since mid-October as both individuals and institutions, believing that interest rates have peaked and monetary policy will continue to ease, stepped up their purchases. Tax-exempt bond yields rose somewhat, however, as increased offerings came at a time when institutional investors able to utilize tax-exemption, especially banks, were not active buyers.

The general easing in credit conditions extended to the mortgage market. From early October to early November, home mortgage rates declined about 20 basis points in the primary market and about 40 basis points in the secondary market, and construction loan rates, with most such rates tied to the prime rate, declined more sharply. The improvement in the tone of the mortgage market has reflected the decline in market interest rates and the resultant improvement of deposit flows at the thrift institutions associated with the decline in short-term market rates. S&L's, for example, received net new money in October for the first time since June and MSB outflows moderated; commercial banks also benefited from higher consumer-type deposit inflows in October.

Outlook. Total credit expansion is expected to moderate over the winter, although corporate bond offerings are likely to remain relatively large. Consumer credit growth should remain quite low as consumer purchases--particularly of durables--stay depressed, loan repayments increase, and lenders evaluate the credit-worthiness of borrowers more catiously. Mortgage debt expansion is also expected to slacken further, with outstanding mortgage commitments at low levels and lenders likely to use most of their improved deposit inflows to rebuild their liquidity and repay high-cost debt before stepping up new commitment activity appreciably. Housing agencies are likely to reduce their net borrowing demands in credit markets as thrift institution inflows pick up to rates of 5 to 6 per cent in the fourth quarter; indeed, only the special subsidized programs already in train for housing are likely to lead to any borrowing at all by such agencies. Treasury cash borrowing of around $4 billion over the balance of the year--mainly in the bill market--is about seasonal.

Short-term credit demands by nonfinancial businesses are unlikely to accelerate and may moderate further as economic activity remains sluggish and capital market borrowing continues relatively large. The distribution of short-term credit flows as between banks and the paper market will continue to depend on rate relationships, but rate spreads favoring market financing are now so large that even a continuation of weekly quarter point reductions in the prime rate will keep bank credit relatively expensive until late in the year. The expected moderate growth in business, consumer, and real estate loans at banks is expected to be financed mainly from inflows of consumer-type time and savings deposits, and thus there should be little pressure on banks to borrow heavily in the CD and Euro-dollar markets.

The forward calendar of bond market financing suggests that corporations--particularly public utilities and manufacturers--will continue to sell large volumes of debt in capital markets in the months ahead. Such borrowing reflects not only the widening gap between rising nominal capital outlays and lower internal funds generation, but also corporate efforts to restructure balance sheets and rebuild depleted liquidity.

Financial market participants apparently are expecting monetary policy to ease further, and to some extent the current level of market interest rates has already discounted additional declines in the Federal funds rate. Thus, if the funds rate does not decline further, there may be some tendency for yields to back-up in the very short-run--especially in bond markets. But, over the winter, the economic outlook, and the credit demands associated with it, suggest that interest rates will continue to trend downward--more gradually if policy does not ease further, more rapidly if it does.

INTERNATIONAL DEVELOPMENTS

Summary and Outlook. The dollar has declined further in the foreign exchange markets in the past five weeks, dropping about 3/4 per cent on a weighted average basis in that period and 2 per cent since early September. An important factor in the recent weakening probably was the decline in U.S. interest rates relative to rates in most other countries. Gains against the dollar were especially noteworthy for the Swiss franc (4-1/2 per cent in the past five weeks), the German mark (2 per cent) and the Dutch guilder (1-1/2 per cent).

Data for U.S. banks' liabilities to banks abroad and other private foreigners show a reduction of about $900 million in September -- after a buildup of $13 billion in the first eight months of the year, and partial data for recent weeks show substantial further declines. The increase in OPEC official funds held in the United States was about $1-1/4 billion in September and probably also a like amount in October. There have been substantial drawdowns on loans by OPEC to other countries, and U.S. exports to these countries have risen sharply.

Trading in securities with foreigners was relatively inactive in September, with foreigners still holding back from investing in U.S. markets and sales of foreign issues here mainly confined to Canadian bonds.

Data on recent transactions connected with direct investments are not available, but it is likely that since mid year income receipts have been much reduced and net capital outflows considerably higher. Data for merchandise trade in October are also not yet available, but the deficit probably rose from the reduced September rate.

In spite of the relative easing of interest rates here, there was a dramatic turnaround in foreign lending by U.S. commercial banks (apart from lending by U.S. affiliates of foreign banks) after July; they reduced their claims on foreigners by about $1/2 billion in August and had only slight changes in September; weekly data show further declines in October. Thus, commercial banks have recently been trimming both their claims on and liabilities to foreigners.

Incoming data for economic activity in other industrial countries indicate a severe slowdown in the second half of 1974, and projections based on present policies suggest that recovery in 1975 would be tentative and delayed to the latter part of the year. Rates of inflation remain high and prospects for cooling off depend on upcoming wage negotiations and the course of food prices.

There are indications that in some countries, notably in Germany where the process began some time ago, policy is shifting gradually toward limiting the extent of prospective declines in economic activity. Nevertheless, unless movement toward easing becomes more aggressive the slowdown in demand abroad may be sufficient to reduce U.S. exports below their presently projected level. To the extent easing abroad brings reductions in foreign interest rates there will be some relief from the present inducement for outflows of interest-restrictive funds from the United States.