FEDERAL RESERVE BANK OF NEW YORK

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Contents

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The Business Situation

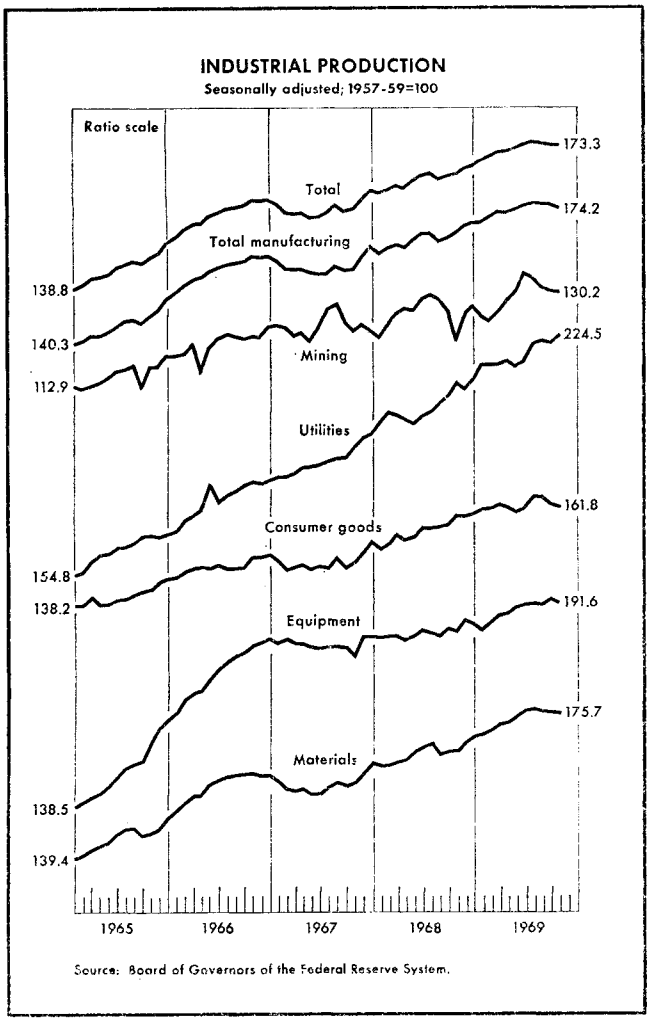
The business statistics indicate that some further slowing of the economy's rate of growth is under way, but on a longer view expansionary forces seem still dominant. The consumer appears to have become cautious about the economic outlook: retail buying has been sluggish for some time now, and recent surveys of spending plans have found further evidence of consumer restraint. Inventories at retail have risen relative to sales, and production of consumer goods—particularly of automobiles—appears to be in the process of adjustment. Partly for this reason, industrial production has declined moderately over the past three months, but strikes have also played a part in reducing output. At the same time, home-building activity remains under pressure from tight conditions in the mortgage market, although the readings on new housing starts over the past few months suggest that the rate of decline may have slowed as demand for new homes and apartments has become even more intense. On the stronger side, businessmen's plant and equipment spending plans indicate that capital outlays are likely to continue rising at a fast clip—a finding that is supported both by new survey evidence and the recent strong performance of new orders for durable goods. Moreover, looking further ahead, the expiration next year of the surtax on personal income and corporate profits will add stimulus to the economy, as will the prospective large increase in social security benefits. Meanwhile, price and cost pressures are as severe as ever, and expectations of continuing inflation appear to remain an overriding element in much economic decision making, including collective wage bargaining.

PRODUCTION AND CONSTRUCTION

The volume of industrial output declined in October for the third consecutive month. The Federal Reserve Board's index of industrial production fell 0.4 percent in October to a seasonally adjusted level of 173.3 percent of the 1957-59 average (see chart). In the decade of the sixties, output has fallen three months in a row only twice—during the mini-recession in 1967 and in the 1960 recession. The August-October decline amounted to only 0.7 percent, however, much milder than the downward movement in either 1960 or 1967. Furthermore, the recent drop has been partially the result of strikes.

Consumer goods production in October was off ½ percent from September and more than 1½ percent from July. Scattered strikes in the automobile industry contributed to this decline, but auto production schedules for the fourth quarter—originally set below 1968 actual levels—have been cut back further. On a unit basis, output of new cars fell from a seasonally adjusted annual rate of 8.7 million in September to 8.4 million in October, and in November were off an additional 10½ percent to 7.5 million units. Production of other consumer goods also eased in October. After rising in September, output of business equipment remained strong despite the General Electric strike. The overall materials index was about unchanged, and the iron and steel component was also steady at the September level. Following a very strong first half, iron and steel output has moved down from its June peak. Industry spokesmen, however, continue to predict strength through the end of the year, and data on steel ingot production indicate that output rose slightly in November.

Total construction activity continues at a high level, with private nonresidential building providing much of the strength. Residential construction spending moved higher in September and October, after declining steadily in the preceding four months. However, home building remains under pressure from very tight mortgage market conditions. During the third quarter, private nonfarm housing starts averaged 1.4 million units at an annual rate, down from 1.7 million in the first quarter, and the starts rate fell further in October to 1.3 million units. Moreover, steady declines in the number of building permits issued by local authorities suggest continued weakness in home building over the near term. Permits volume has trended



down each month since April, and in October the number of permits issued was the lowest since early 1967.

INVENTORIES, ORDERS, AND CAPITAL SPENDING

Total business inventories[1] rose $1.0 billion in September from an upward revised August level, with retail and manufacturing inventories each increasing $480 million. For the retail sector, this was the fourth successive month of large accumulation averaging $445 million per month. Both durable and nondurable retail stores built up their stocks in September, with virtually all the increase at durables stores due to higher inventories held by auto dealers. Since retail sales have been sluggish overall, the large inventory accumulation recently has been reflected in an appreciably higher inventory-sales ratio than was the case earlier in the year. At the manufacturing level, on the other hand, a substantial jump in shipments in September, particularly of durable goods, caused the inventory-sales ratio to fall despite the rapid increase of inventories. As a result, the ratio for all businesses was about unchanged in September and remained well within the range prevailing over the past year or two. The October data for manufacturing indicate that inventory building in the sector was again very large, but shipments also gained and the inventory-sales ratio rose only slightly.

New orders received by manufacturers of durable goods continued strong through October. During the third quarter, incoming orders averaged $31.2 billion per month, up $1.2 billion from the April-June period. In September, volume advanced sharply to a record $32.1 billion as machinery and equipment buying surged. As was to be expected, new durables orders dropped a bit in October following the strong September performance, but at $31.8 billion they remained above the third-quarter average.

Business capital spending plans for 1970 point to further substantial growth, but also suggest that price inflation may absorb much of the planned increase in outlays. The fall survey by McGraw-Hill found that businessmen plan to spend 8 percent more on plant and equipment in 1970 than in 1969. Furthermore, a very recent survey conducted by the Department of Commerce and the Securities and Exchange Commission presents an even stronger picture. The Commerce-SEC study found that businessmen plan a 13½ percent spending increase (at an annual rate) between the fourth quarter of this year and the second quarter of 1970. In the McGraw-Hill survey, however, businessmen reported that they expect prices of plant and equipment to rise 7 percent in 1970, which implies that purchases in real terms would be up considerably less than dollar spending. It should be noted in assessing the plant and equipment outlook that plans for next year are still somewhat indefinite for many businesses, and that substantial revision could occur before orders are placed and construction contracts signed. However, the several surveys conducted consecutively over the past few months clearly indicate that businessmen have been upping their estimates of 1970 spending as the year draws closer. Growing fears of sharply higher capital goods prices, giving rise to a "buy

[1]The Department of Commerce has revised upward its third-quarter estimate of gross national product (GNP) by $0.5 billion to $942.8 billion. The estimate for inventory accumulation was raised from $9.4 billion to $10.7 billion, and consumption expenditures were revised downward from $581.6 billion to $579.8 billion.

now" or "build now" attitude, may have played a role in this upgrading.

On the other hand, if internal funds for financing capital programs continue under pressure from declining profits, the extremely tight conditions now prevailing in the financial markets may take on a more critical role in influencing capital spending decisions. In this connection, after-tax corporate profits turned in a second consecutive decline in the third quarter to a seasonally adjusted annual rate of $50.0 billion, the lowest level in a year.

EMPLOYMENT, PERSONAL INCOME AND RETAIL SALES

In the labor market, signs of a slight easing have remained numerous, even though the unemployment rate fell back sharply in November after several months of increase. From June to November, nonagricultural payroll employment rose only 64,000 per month, compared with the exceptionally large average gains of 238,000 in the first half of the year. While the services and trade sectors registered sizable increases in jobs, construction payrolls in November remained at June levels and manufacturing payrolls were below June levels. Sluggishness in manufacturing was further evidenced in October and November by a large seasonally adjusted decline of 0.3 hour in the average workweek of factory workers. Data from the household survey of employment and the labor force also point to some letup in the very tight conditions in the labor market that have prevailed over the last year. The labor force increased by fully 1 million persons from June to October on a seasonally adjusted basis, a rate about half again faster than that of the first half of the year. During the same period there was a 0.4 million increase in the number of unemployed, bringing the total count of unemployed to 3.2 million. Thus, in October, 3.9 percent of the labor force was unemployed, down 0.1 percentage point from September but still significantly higher than the 3.4 percent averaged in the first half of this year. The sharp November decline in the aggregate rate to 3½ percent resulted largely from a fall in the labor force, as employment increased only moderately. The movement was centered in the adult women category, where the unemployment rate fell 0.5 percentage point to 3.5 percent, equaling the low for the year. The rate for adult men also dropped to 2.2 percent from 2.4 percent but still far exceeded the previous low of 1.8 percent set last December.

Personal income moved up slowly in October, increasing by only $2.4 billion, the smallest monthly rise in over a year. Despite an upward revision in the September estimate, the September and October gains in wages and salaries were substantially smaller than those earlier this year. Had it not been for the midyear Federal pay increase, the July change would also have been quite modest. October's small $1.6 billion rise in wages and salaries reflected, in part, the decline in the average workweek in manufacturing.

Consumer demand continues to show little buoyancy. In October, according to the revised estimate, retail sales increased to a new record level of $29.6 billion but were still only about ½ percent above the previous peak reached last April. Moreover, the 4½ percent dollar gain in retail sales since last December has probably been associated with unchanged volume in real terms, since consumer goods prices have risen at about the same pace. Weakness is particularly apparent in the durables sales figures, which are below the levels of early this year. Sales of domestically produced new automobiles rose to an annual rate of 9 million units in September, but then fell back in October and November to less than 8½ million units, in line with the slow pace of the months prior to September. Sales of other consumer durables have edged down further since July, when there was a large drop.

WAGES AND PRICES

The price situation remains critical. Steep advances continue at wholesale and consumer levels, and wage pressures appear to be intensifying at a time when productivity growth is lagging.

During the third quarter, labor compensation per manhour in manufacturing rose at a seasonally adjusted annual rate of 6.3 percent, well in excess of the 1½ percent annual rate of productivity increase in the quarter. These widely divergent trends resulted in a 5 percent growth in the labor cost per unit of output, on an annual rate basis, compared with 3 percent in the second quarter. Moreover, negotiated wage settlements point to mounting cost pressures. In the first nine months of 1969 the median negotiated settlement provided for a 7.4 percent per year gain in wages and fringe benefits over the life of the contract. This is well above the median increase of 6.0 percent per year negotiated in 1968 and more than twice as great as the median provided by 1965 contracts. Negotiated settlements were larger in nonmanufacturing than in manufacturing, with construction workers receiving particularly sizable boosts in wages. The labor contracts of recent years typically have provided for bigger pay raises in the first year of the contract than later, and this trend appears to be continuing. Thus, while the average annual increase in wages (excluding fringe benefits) under agree-

ments signed this year is 6.6 percent over the life of the contract, the median increase in the first year is a full 8.0 percent. Cost-of-living escalator clauses may, of course, add to the scheduled raises beyond the first year of many contracts.

Wholesale prices of industrial commodities continue under severe pressure. The index of industrial goods prices advanced at a sharp 6.4 percent annual rate in October. A particularly steep price increase in transportation equipment resulted from the higher prices on 1970-model cars, which took effect that month. In November, industrial prices moved up further at a 4.2 percent annual rate, according to the revised estimate. Thus, the average annual rate of rise during the first two months of the fourth quarter was 5.3 percent, compared with a 3½ percent annual rate in the third quarter.

Consumer prices continue to climb at excessively high rates, although there has been some slight moderation since the first half of the year. From June through October, the average annual rate of increase of the consumer price index was 5.2 percent, compared with 6.3 percent in the first six months of 1969. In October, prices rose at an annual rate of 4.6 percent as food prices fell for the first time in eight months, a largely seasonal phenomenon. Excluding the food component, prices moved up at a 7.4 percent rate. A major factor in the October rise was the price increase on domestically produced 1970-model cars.

PERSPECTIVE '69

Each January this Bank publishes *Perspective,* a brief, informative review of the performance of the economy during the preceding year. This booklet is a layman's guide to the economic highlights of the year. A more comprehensive treatment is presented in our *Annual Report,* available in March.

Perspective '69 will be available without charge from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, N.Y. 10045. (A copy will be mailed with the January 1970 issue of the *Monthly Review.*)

The Money and Bond Markets in November

The rapid drop in prices of intermediate- and long-term securities, which began in the latter part of October following a rally earlier that month, carried market yields in many sectors to new highs during November (see Chart I). Vietnam and inflation continued to dominate market attention, and in large measure the sharp price declines during the month were fueled by discouragement over the absence of apparent progress in either area. In addition, market participants increasingly came to feel that fiscal restraint was lessening and that the prospect of any near-term relaxation of monetary restraint was remote. Borrowing demands continued to be very heavy, and the response of institutional investors to new offerings was often indifferent. Even at progressively higher offering yields, which reached as much as 60 basis points above those at the beginning of the month, many corporate flotations could not be fully placed. When unsold portions were released from underwriting syndicates to trade in the secondary market, their yields soared further. New offerings of tax-exempt issues also moved slowly despite record-high interest rates, and a considerable volume of flotations was again held off the market because of statutory rate ceilings.

Yields on most Treasury bills also climbed sharply higher to new record levels in November, with many increases ranging from 40 to 50 basis points. The bulk of the advances took place after midmonth, when auctions of bills on three successive business days—November 21, 24, and 25—taxed the capacity of the market. Upward bill rate pressures also resulted from large demands for new short-term funds by Federal agencies and tax-exempt borrowers and from sales of Treasury bills by foreign holders. Only in the short end of the bill market did strong demand place a damper on the rate advances. Prices of intermediate- and long-term Government securities dropped sharply, and yield increases of from 20 to 30 basis points were not uncommon. In the process, long-term bond yields registered new record highs, although yields on higher coupon intermediate-term issues failed to reach the early-October peaks.

Bank reserve positions continued to be hard pressed during November, and member bank borrowings remained sizable. Federal funds traded above 9 percent until late in the period, rates on three-month Euro-dollars climbed sharply around midmonth, and other short-term rates were as much as ½ percentage point higher at the end of November.

BANK RESERVES AND THE MONEY MARKET

Nationwide bank reserve availability remained relatively unchanged on balance during November. Member banks' net borrowed reserves averaged around $1 billion and their average borrowings at the discount window were $1.2 billion, both about the same as in October. Federal funds traded generally at 9 percent or above until the last week of the month, when the effective rate averaged below 8½ percent. Operating factors absorbed member bank reserves in each of the statement weeks ended in November (see Table I). The amount absorbed—over $2 billion—was considerably greater than usually occurs in November, partly because foreign central banks made large repayments of previous drawings under the Federal Reserve swap network. As an offset to the reserve absorption by market forces, the Federal Reserve injected reserves through open market operations, primarily by outright purchases of Treasury securities.

Money center banks, particularly those in New York City, experienced large deposit outflows early in the month, and in the week ended on November 12 the net basic reserve deficit of the forty-six major banks soared to $5.3 billion (see Chart II), the highest level of 1969. The combination of this swing and the aggregate reserve absorption by market forces placed heavy strains on the Federal funds market, where rates averaged 9¼ percent for the first two weeks of the month. That the rate did not push higher was due in part to recourse by the large banks to borrowings from Federal Reserve Banks. During the week of November 12, average borrowings for the forty-six banks reached $646 million (see Table II), the highest volume since the beginning of the year.

The large banks were slow to recoup their deposit losses

after midmonth, and until the week of November 26 the Federal funds rate generally held steady around 9¼ percent. During that week, reserve deficits were pared considerably and, with a relatively small net shift in reserves caused by market factors, Federal funds rates eased a bit to a 7 to 9 percent range.

Most short-term money market rates moved higher over the month. Although ninety-day finance company paper remained around 7¾ percent, bankers' acceptances and prime four- to six-month dealer-offered commercial paper each rose ½ point. The three-month Euro-dollar rate was steady at 10 percent until midmonth, then jumped to around 11 percent for most of the balance of the period. In part, demands for Euro-dollar funds were spurred by the prospect of closer regulation of member banks' use of the commercial paper market.[1] At the end of October the volume of bank-related commercial paper outstanding approximated $3.6 billion, up over $1 billion during the month and $2.4 billion higher than in June.

Monetary aggregates moved up in November. According to preliminary data, the narrow money supply expanded at about a 5 percent annual rate after several months of little change, and total member bank deposits subject to reserve requirements (adjusted to include Euro-dollar liabilities) advanced 11 percent.

THE GOVERNMENT SECURITIES MARKET

Rates on most Treasury bills recorded their sharpest rises of the year in November and, in the process, swept to new all-time high levels. The advances reflected the spreading belief that monetary policy would have to remain restrictive for a protracted period before inflationary pressures would recede. Heavy Treasury and agency financing and bill sales by foreign holders also contributed to pressures in the short-term markets. Only in the very short bill maturities, where strong demand was in evidence, did rates fall. Over the month as a whole, one-month bill rates fell 35 basis points to 6.65 percent, while rates on three-month and one-year bills climbed 52 and 47 basis points, respectively, to 7.51 percent and 7.50 percent.

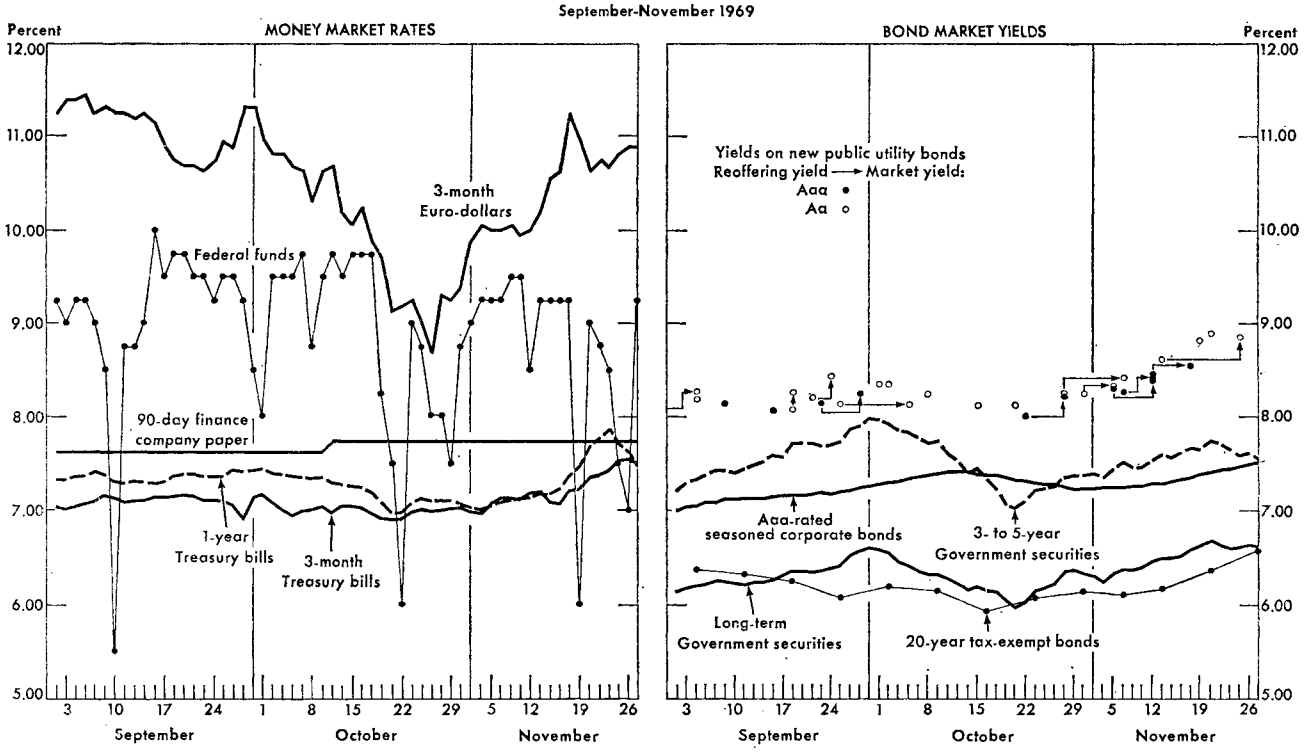
Most of the upward rate movement in bills came after midmonth, when the concentration of bill auctions on three successive business days, November 21, 24, and 25, contributed to an abrupt upsurge. Early on Monday, November 17, the Treasury announced that it would auction an additional $2.5 billion of April and June tax anticipation bills (TAB's) on November 21. The announcement immediately pushed longer bill rates higher and, in the regular weekly auction held later on Monday, the average rate of discount on the six-month bill reached a record 7.518 percent, 8 basis points higher than the week before (see Table III). In the TAB auction four days later the $1 billion of the April maturity commanded an average rate of 7.815 percent, and the rate on the $1.5 billion of the June maturity averaged 7.975 percent—53 and 77 basis points higher than the rates that had been set for the same maturities at two auctions during October. These were the highest auction rates ever recorded for new TAB issues.

In the span of the four business days from November 20 through November 25—which encompassed the offering of the TAB's and the regular weekly and monthly bill auctions—rates on issues maturing in three months or more soared as much as 25 to 35 basis points. These pressures pushed the new-issue rates to new highs in the auctions on November 24 and 25. On November 24 the auction rates for the new three- and six-month issues averaged 7.476 percent and 8.027 percent, respectively, up 34 and 51 basis points from the previous week's auction. The 8.027 percent rate was the highest ever set on any maturity in a Treasury bill auction. Then, on November 25, the new nine- and twelve-month bills were auctioned at average rates of 7.778 percent and 7.592 percent, respectively, 53 and 47 basis points higher than a month earlier. At the higher rates, considerable investor and dealer interest materialized in the longer maturing bills. At the close of the month the bid rate on the new six-month bills was 7.81 percent, down 22 basis points from the November 24 auction rate.

Yields on intermediate- and long-term Treasury coupon issues also forged higher in November—in many cases to record highs. The pressures generated by the large volume of Federal agency and corporate new-issue flotations were an important contributing factor. In addition, disappointment over the President's November 3 speech, which was interpreted in the market to mean that no new developments in Vietnam were in the offing, prompted dealers to lighten positions. Yields rose 20 to 35 basis points in light

[1] On October 29 the Board of Governors of the Federal Reserve System announced that it had determined that commercial paper and similar obligations issued by subsidiaries of member banks were, under the provisions of Regulations Q and D, subject to interest-rate limitations and reserve requirements to the same extent as obligations issued directly by member banks. The Board subsequently announced measures for the accommodation of an orderly adjustment by member banks to that determination. In another action on October 29, the Board announced that it was considering amending the provisions of Regulation Q to apply to funds received by member banks from the sale of commercial paper or similar obligations by either the parent holding company or a collateral affiliate of a member bank in a holding company system.

Chart I
SELECTED INTEREST RATES
September-November 1969



Note: Data are shown for business days only.

MONEY MARKET RATES QUOTED: Bid rates for three-month Euro-dollars in London; offering rates for directly placed finance company paper; the effective rate on Federal funds (the rate most representative of the transactions executed); closing bid rates (quoted in terms of rate of discount) on newest outstanding three-month and one-year Treasury bills.

BOND MARKET YIELDS QUOTED: Yields on new Aaa- and Aa-rated public utility bonds (arrows point from underwriting syndicate reoffering yield on a given issue to market yield on the same issue immediately after it has been released from syndicate restrictions); daily averages of yields on seasoned Aaa-rated corporate bonds; daily averages of yields on long-term Government securities (bonds due or callable in ten years or more) and on Government securities due in three to five years, computed on the basis of closing bid prices; Thursday averages of yields on twenty seasoned twenty-year tax-exempt bonds (carrying Moody's ratings of Aaa, Aa, A, and Baa).

Sources: Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System, Moody's Investors Service, and The Weekly Bond Buyer.

trading, with the 4¼ percent bond of 1987-92 reaching a record 6.86 percent during the month. Although the rise in rates in the intermediate-term sector was somewhat sharper than that of long-term, deep-discount bonds, yields on the high-coupon notes failed to reach the peaks registered in late September and early October, and yields on most intermediate-term issues moved lower during the last few days of November.

OTHER SECURITIES MARKETS

Yields on new corporate securities moved sharply upward almost without pause during November, leaving a wake of unsuccessful underwriting ventures as evidence of increasing congestion in the market. The continued manifestations of the strength of inflation cast a pall over market sentiment, and the fact that the President's November 3 address failed to contain encouraging news about immediate peace prospects was an additional disappointment.

The heavy volume of financing demands and the unwieldy positions of dealers and underwriters discouraged any rush by institutional investors to initiate new commitments. Utility offerings, which have tended to glut the market of late, were again under especially heavy pressure. The feature of the early part of the month was a $125 million offering on November 12 by South Central Bell Telephone Company. The issue carried an 8½ percent coupon and yielded investors 8.45 percent, 20 basis points

above the previous record high for a Bell System offering set in September. Initial investor interest was light, however, and when the unsold portion was released from syndicate price restrictions on November 18, the yield soared as high as 8.67 percent in early secondary market trading.

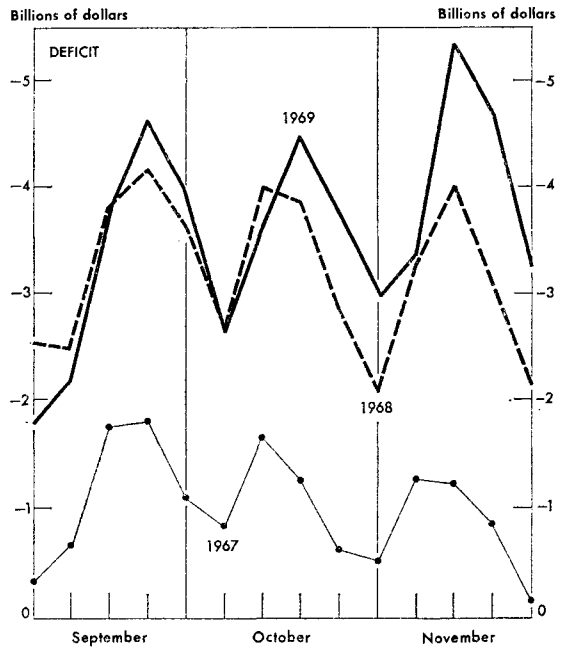
Only when new-issue yields approached the 9 percent level did investor interest quicken, but even then receptions were mixed. Two finance subsidiaries of large retail firms each offered $50 million of A-rated debentures at 9 percent, and sales were brisk. In contrast, on November 19 a very weak reception was accorded another utility, Pacific Gas and Electric Company, which offered $80 million of 9 percent mortgage bonds to yield 8.81 percent, a new record for Aa-rated issues. The next day, however, a quick sellout greeted the $50 million issue of Boston Edison Company, offered with a 9 percent coupon to yield 8.90 percent to investors. While much of the interest was reported to be from individuals, some institutional support again emerged. Although this response contributed to some added sales of the Pacific Gas and Electric offering, when the issue was finally released from pricing restrictions after the month end, the yield jumped 23 basis points. The generally unreceptive condition of the market, to which a succession of syndicate terminations testified, prompted Commonwealth Edison to defer a $100 million bond offering, which had been scheduled for November 25. At the month end, demand pressures remained very strong and the beginning of a seasonal slackening in the volume of scheduled offerings afforded little relief to the market. In the last week of November the four-week visible supply of forthcoming corporate financings approximated $1.3 billion.

Federal agency financings continued to be sizable, and new offerings provided an upward thrust to rates in both short- and long-term markets. The highlight of the month was a $1.1 billion financing on November 13 by the Federal Home Loan Banks. The issue, which raised $600 million in new funds, consisted of an 8⅜ percent ten-month note, an 8.20 percent 2¼-year bond, and an 8 percent five-year bond. The offering encountered investor resistance, in part because of the overhang of other imminent agency flotations, and at the close of the period bid-price discounts were $^{6}/_{32}$, $^{4}/_{32}$, and $^{16}/_{32}$, respectively.

In the tax-exempt market, statutory interest-rate ceilings, which have restricted new offerings throughout much of the year, again curtailed activity. A large volume of new issues carried short maturities as a means of tapping a less congested sector, where financing was less costly and rate ceilings less constraining. Indeed, some issues were sold at rates lower than earlier in the fall. In contrast, long-term bonds with serial maturities encountered investor resistance which resulted in higher costs and, in some cases, cancellations or postponements.

On November 6, for the second consecutive occasion, a 6 percent interest-rate ceiling impeded the flotation of tax-exempt Federally guaranteed housing bonds through the Federal Housing Assistance Administration. Only about $33 million of an offering totaling $139 million was awarded to bidders, and the issue cost averaged 5.996 percent—a record. However, short-term Federally guaranteed notes issued under the auspices of the Department of Housing and Urban Development (HUD) fared considerably better than the longer term housing bonds. On November 12, local renewal agencies marketed almost $330 million of project notes having an average maturity of about 9½ months at an average interest rate of 5.49 percent. This cost was about 10 basis points lower than that in an October financing. HUD announced that no placement fees had been paid, although such an option is open in the event borrowing costs exceed the 6 percent interest-rate ceiling generally applicable on these notes. In another financing on November 18, local public housing authorities sold almost $300 million of project notes

Chart II
BASIC RESERVE POSITION OF MAJOR MONEY MARKET BANKS



Note: Calculation of the basic reserve position is illustrated in Table II.

Table I

FACTORS TENDING TO INCREASE OR DECREASE MEMBER BANK RESERVES, NOVEMBER 1969

In millions of dollars; (+) denotes increase (—) decrease in excess reserves

Factors	Changes in daily averages—week ended on				Net changes
	Nov. 5	Nov. 12	Nov. 19	Nov. 26	
"Market" factors					
Member bank required reserves	— 273	+ 23	— 480	+ 358	— 372
Operating transactions (subtotal)	— 729	— 266	— 294	— 722	— 2,011
Federal Reserve float	— 198	+ 104	+ 597	— 197	+ 306
Treasury operations*	— 174	— 34	+ 94	+ 67	— 47
Gold and foreign account	— 19	— 1	— 10	+ 25	— 5
Currency outside banks	— 52	— 333	— 557	— 191	—1,133
Other Federal Reserve accounts (net)†	— 283	— 4	— 419	— 424	—1,130
Total "market" factors	—1,002	— 243	— 774	— 364	—2,383
Direct Federal Reserve credit transactions					
Open market operations (subtotal)	+1,075	+ 381	+ 735	+ 169	+2,360
Outright holdings:					
Government securities	+ 788	+ 585	+ 815	+ 164	+2,352
Bankers' acceptances	+ 1	+ 1	+ 1	+ 5	+ 8
Repurchase agreements:					
Government securities	+ 261	— 194	— 67	—	—
Bankers' acceptances	+ 7	— 3	— 4	—	—
Federal agency obligations	+ 18	— 8	— 10	—	—
Member bank borrowings	+ 144	— 83	— 172	+ 135	+ 24
Other loans, discounts, and advances	—	—	—	—	—
Total	+1,219	+ 298	+ 563	+ 304	+2,384
Excess reserves	+ 217	+ 55	— 211	— 60	+ 1
	Daily average levels				
Member bank:					
Total reserves, including vault cash	27,662	27,698	27,965	27,547	27,717‡
Required reserves	27,365	27,342	27,822	27,464	27,498‡
Excess reserves	297	354	143	83	219‡
Borrowings	1,327	1,244	1,072	1,207	1,212‡
Free, or net borrowed (—), reserves	—1,030	— 890	— 929	—1,124	— 993‡
Nonborrowed reserves	26,335	26,452	26,893	26,340	26,505‡
Net carry-over, excess or deficit (—)§	52	181	211	108	138‡
	Changes in Wednesday levels				
System Account holdings of Government securities maturing in:					
Less than one year	+1,471	+ 43	+1,647	— 95	+3,066
More than one year	—	—	—1,141	—	—1,141
Total	+1,471	+ 43	+ 506	— 95	+1,925

Note: Because of rounding, figures do not necessarily add to totals.

* Includes changes in Treasury currency and cash.

† Includes assets denominated in foreign currencies.

‡ Average for four weeks ended on November 26.

§ Not reflected in data above.

Table II

RESERVE POSITIONS OF MAJOR RESERVE CITY BANKS NOVEMBER 1969

In millions of dollars

Factors affecting basic reserve positions	Daily averages—week ended on				Average of four weeks ended on Nov. 26
	Nov. 5	Nov. 12	Nov. 19	Nov. 26	
Eight banks in New York City					
Reserve excess or deficiency (—)*	96	79	35	7	54
Less borrowings from Reserve Banks	121	350	—	8	120
Less net interbank Federal funds purchases or sales (—)	199	1,583	1,396	568	937
Gross purchases	1,731	2,200	2,519	1,752	2,051
Gross sales	1,532	617	1,124	1,184	1,114
Equals net basic reserve surplus or deficit (—)	— 224	—1,854	—1,361	— 569	—1,002
Net loans to Government securities dealers	670	614	528	503	579
Net carry-over, excess or deficit (—)†	— 3	70	60	22	37
Thirty-eight banks outside New York City					
Reserve excess or deficiency (—)*	53	57	— 39	— 31	10
Less borrowings from Reserve Banks	425	296	389	438	387
Less net interbank Federal funds purchases or sales (—)	2,780	3,213	2,753	2,196	2,736
Gross purchases	4,346	5,164	4,820	4,130	4,615
Gross sales	1,566	1,951	2,067	1,935	1,880
Equals net basic reserve surplus or deficit (—)	—3,152	—3,452	—3,181	—2,665	—3,113
Net loans to Government securities dealers	178	138	161	216	173
Net carry-over, excess or deficit (—)†	— 6	43	37	14	22

Note: Because of rounding, figures do not necessarily add to totals.

* Reserves held after all adjustments applicable to the reporting period less required reserves.

† Not reflected in data above.

Table III

AVERAGE ISSUING RATES* AT REGULAR TREASURY BILL AUCTIONS

In percent

Maturities	Weekly auction dates—November 1969			
	Nov. 3	Nov. 10	Nov. 17	Nov. 24
Three-month	6.998	7.157	7.141	7.476
Six-month	7.281	7.435	7.518	8.027
	Monthly auction dates—September-November 1969			
	Sept. 23	Oct. 28	Nov. 25	
Nine-month	7.357	7.244	7.778	
One-year	7.350	7.127	7.592	

* Interest rates on bills are quoted in terms of a 360-day year, with the discounts from par as the return on the face amount of the bills payable at maturity. Bond yield equivalents, related to the amount actually invested, would be slightly higher.

with an average maturity of 6½ months at an average rate of 5.36 percent. This cost was almost 50 basis points below that in October.

Not only did interest-rate ceilings block some flotations, but one recently raised ceiling proved barely high enough to allow a sale. The instance in question involved the Pennsylvania State Public School Building Authority, which in October had its ceiling raised from 6 percent to 7 percent. An offering of $53 million by the Authority was awarded at a net interest cost of 6.996 percent and was moderately well received by investors at yields ranging from 5.60 percent in 1972 to 7 percent in 2008.

The Blue List of dealer-advertised inventories advanced in November from the already sizable levels of October. At midmonth a new record 1969 high of $632 million was registered, and inventories were usually above $550 million throughout the period. Moreover, the four-week visible supply of forthcoming new financings generally exceeded $900 million until late in the month. Both furnished clear evidence of the congestion of the tax-exempt sector—a condition also reflected by *The Weekly Bond Buyer's* index of twenty municipal bond yields, which closed November at 6.58 percent, up 45 basis points over the month.

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Recent Economic Policy in Industrial Countries Abroad

The two most serious economic policy problems confronting industrial countries over the past year or so have been large international payments imbalances and accelerating inflationary trends. Major steps taken this year to resolve these difficulties have included the French devaluation in August, the German revaluation in October, and a gradual swing to monetary and fiscal restraint in all the major countries. While it is too soon to judge the ultimate results of these measures, exchange markets have recently been more orderly. The pattern of international payments has also benefited from a British swing into surplus after a period of heavy payments deficits. This welcome change stems in part from the 1967 sterling devaluation and a subsequent policy of increasingly severe economic restraint. On the other hand, the massive balance-of-payments deficit of the United States continues to be a major concern.

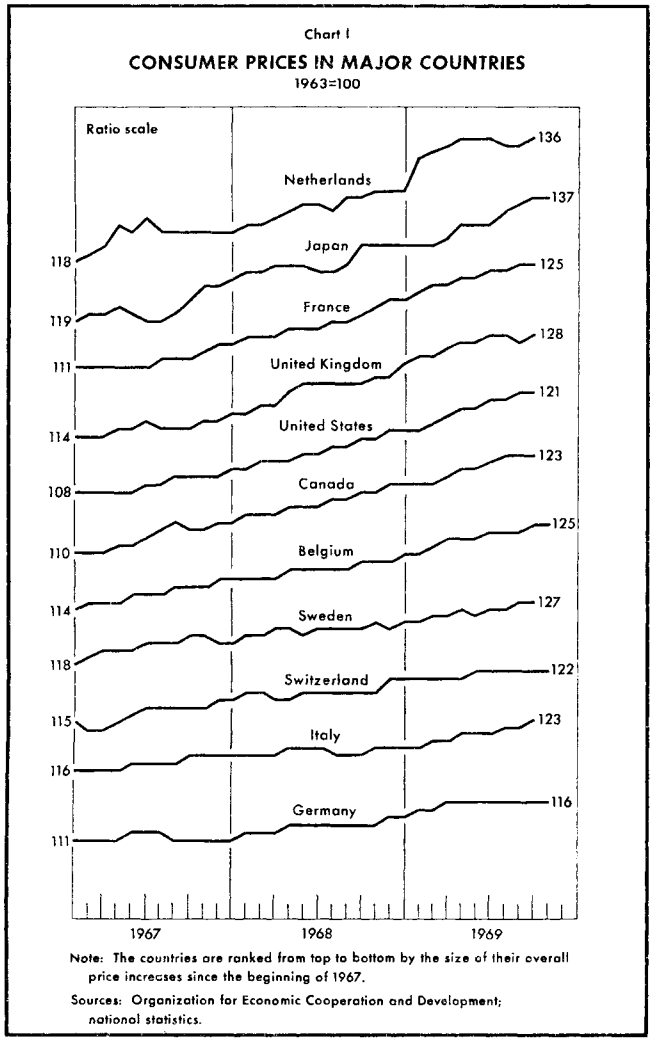
The external payments imbalances which the recent currency readjustments were designed to reduce have, of course, been rooted in the inevitable differences in economic conditions among the major industrial nations and in the varying priorities they have assigned to domestic policy objectives. In November 1968, when payments disequilibria were large and currency speculation intense, the strength of the mark reflected Germany's successful pursuit of price stability in the face of more inflationary conditions elsewhere. In France, on the other hand, massive labor disturbances in the spring of 1968 had resulted in large wage increases and other expansionary measures. Strong inflationary pressures in the United States were being reflected in current-account balance-of-payments deterioration, and rising consumer demand in Britain was slowing the realization of gains from that country's 1967 devaluation. (The trends in consumer prices and in the current-account balance of payments of the major countries are shown in Charts I and II.)

Following the Bonn conference of November 1968, all industrial countries took some measures to reduce payments imbalances. France and Germany adjusted their taxes to produce the effect of a small devaluation and revaluation, respectively, and the United Kingdom added a temporary boost to the import price effects of the 1967 sterling devaluation by requiring interest-free deposits on imports of manufactures. Further, while all countries turned toward economic restraint late in 1968 and in 1969, those where inflationary pressures had been strongest—notably the United States, Canada, France, and the United Kingdom—applied especially severe fiscal and monetary restraints. However, most countries found their monetary policy complicated by flows of funds through the Euro-dollar market. On the one hand, intensified monetary restraint in the United States caused large American banks to draw heavily on Euro-dollars as a source of funds to lend in the United States. On the other hand, there were intermittent but heavy speculative flows into German marks and out of French francs and other currencies. Both flows tended to raise Euro-dollar rates to levels higher than believed desirable in any national credit market. Countries losing funds acted to protect their domestic financial conditions and their foreign exchange reserves by direct control of international capital flows. Germany, by contrast, confronted with unwelcome capital inflows, took steps to discourage or rechannel them or, failing that, to offset their inflationary impact.

The recent French and German parity adjustments will, of course, contribute more substantially than the earlier measures could to reducing current-account balance-of-payments disequilibrium of those countries and of their trading partners. The adjustments have also reversed the disturbing speculative capital flows caused by anticipation of these moves. However, the accelerating pace of inflation in many countries during 1969 continues to retard international payments adjustment. Hence, most countries are maintaining or strengthening their policies of economic restraint.

GERMANY

At the time of the November 1968 currency crisis, German economic policy faced a dilemma. There was a need, on the one hand, for domestic restraint to contain incipient inflationary pressures and, on the other,



for ease to encourage capital outflows that would offset Germany's very large and persistent current-account surplus. It was widely assumed that this dilemma, arising from Germany's understandable reluctance to accept the degree of inflation prevalent in other countries, would be resolved by a mark revaluation. At that time, Germany was rounding out a year of industrial growth unequaled since 1951—an expansion spurred by rapidly rising exports (especially to the United States) and by the aftereffects of expansionary monetary and fiscal measures undertaken in 1967 to overcome the 1966-67 slump. As output pressed against capital and labor resources, price and wage increases did accelerate but remained less rapid than in most other countries, and the current-account surplus widened. The January 1968 switch from a turnover to a value-added tax system may also have contributed to this increased surplus. The change had little effect on export prices but gave rise to substantially increased border taxes on imports. Official efforts to offset the current-account surplus by encouraging foreign bond flotations were frustrated by offsetting short-term capital inflows arising from both cautionary leads and lags in current payments and outright currency speculation.

Although the German government decided against a full-fledged revaluation in 1968, it did reduce for a limited period of time the export rebates and border taxes associated with the value-added tax. The authorities hoped this *de facto* revaluation of about 3 percent for merchandise trade would significantly reduce the current-account surplus. But, since this process clearly required time, it remained necessary to balance the growing need for domestic restraint against the continuing need for large capital outflows. A moderate shift toward fiscal restraint served both domestic restraint and balance-of-payments purposes. The deferral and subsequent cancellation of about 2 percent of Federal expenditures that had been planned for 1969, an acceleration of corporate tax payments, and rising tax yields served to swing the cash accounts of the Federal and provincial governments (with whom tax receipts are shared) from deficit to surplus. These changes tended to reduce domestic demand for goods and services and, at the same time, made more room for foreign borrowing in German capital markets. The authorities also allowed domestic money and capital markets to be tightened by the unwinding of speculative mark positions and by a record volume of mark-denominated foreign bond issues early in 1969, and supplemented these influences in February by discontinuing open market support for long-term government bonds. By this past April, however, the rate of foreign bond issues had become so heavy that the semiofficial West German Capital Committee announced a temporary suspension of foreign issues and plans for slowing the future pace of such borrowing.

At about the same time, monetary policy was further complicated by another wave of massive short-term capital inflows spurred by doubts regarding the effectiveness of Germany's border tax adjustments in reducing its current-account surplus and reports that mark revaluation was under official consideration. As in November, the German Federal Bank attempted to discourage and deflect these inflows, but with indifferent success. Requirements that 100 percent reserves be held against increases in foreign-owned bank deposits tended to shift speculative inflows to nonbank channels. Providing German banks with forward cover at favorable rates encouraged bank place-

ments abroad but may also have facilitated further capital inflows. (These swaps were sometimes suspended as in May.) Firm official rejection of the revaluation idea temporarily ended capital inflows in May, but the flows were only partially reversed in subsequent months. To reduce the inflationary impact of short-term capital inflows, the central bank raised deposit reserve requirements at banks and other financial institutions in June and again in August, and reduced rediscount quotas in July. It also raised the official discount rate—to 4 percent (from 3 percent) in April, then to 5 percent in June, and to 6 percent in September. As a result, the wide gap between short-term interest rates in Germany and those prevailing in other money markets in 1968 and early 1969 was reduced to small proportions (except *vis-à-vis* Euro-dollar rates). However, the differential between yields on mark-denominated and dollar-denominated Euro-bonds was little changed.

Despite these moves toward monetary restraint, bank liquidity continued ample, and money and credit tended to grow about as rapidly as the year before. As the strain on economic resources intensified, price and wage increases accelerated. Thus it seemed increasingly unlikely that Germany would regain the desired control over domestic monetary and price developments until the external value of the mark had been officially readjusted, or until internal inflation had eliminated the necessity for such a readjustment. In September, it was decided to allow the mark to "float" until after the establishment of a new government. Then, on October 26, the mark was officially revalued by 9.3 percent. As the outflow of speculative funds gathered momentum thereafter, the German Federal Bank reduced reserve requirements in November, and again in December, to steady the German financial markets. Very recently the central bank also raised sharply, from 7½ percent to 9 percent, its rate for loans against government securities and requested banks to exercise restraint in lending at home and abroad as well as to repatriate maturing foreign placements. To protect German farmers from lower price imports, a border tax, now 8½ percent, has been applied to agricultural imports since the mark rate was temporarily floated. This arrangement is expected to be superseded soon by a subsidy for German farmers to which the European Economic Community (EEC) would contribute.

FRANCE

At the end of 1968, France found itself headed for the inflationary end of the international price spectrum after several years on middle ground. The proximate cause was the Grenelle wage agreement, aimed at restoring industrial peace after the crippling student and labor disturbances of May and June. This agreement resulted in a 16 percent increase in wage rates during 1968. Faced with such a dramatic wage explosion, the official strategy for the period through November 1968 was to apply strong fiscal and monetary stimulus to push the economy toward fuller utilization of plant and labor resources than had prevailed early in the year. Improved price surveillance, temporary import quotas, export subsidies, and exchange controls (briefly) were employed to minimize transitional strains. It was hoped that the productivity gains resulting from rapid economic expansion would largely offset the rise in wages, thus preserving the real value of wage concessions and at the same time protecting France's trade position. The authorities expected to have taken up most of the slack in the economy by the end of 1968, at which time withdrawal of policy stimulus and protection was to result in a self-sustained and slower rate of expansion.

At the time of the Bonn conference, the effects of France's expansionary policy were beginning to emerge. Bank credits were about 25 percent higher than a year earlier, and industrial output was up 13 percent. Moreover, labor productivity in manufacturing was 15 percent higher than a year earlier, nearly sufficient to offset the 16 percent wage increases granted for 1968. However, the close to 5 percent rise in consumer and export prices during 1968 placed France in the forefront of inflationary countries, and the trade account was deteriorating as imports spurted ahead of exports. Then, just as France was completing the initial expansionary phase of her original program, the early November speculative rush into German marks, exacerbated by fears regarding the political and economic outlook for France, made serious inroads on France's international reserves.

Following the Bonn conference, the French government decided against a devaluation. However, tax changes were made which had a total effect on trade equivalent to a roughly 2 percent devaluation, and foreign exchange controls on capital transactions and travel were reimposed in tighter form. In addition, the authorities moved strongly toward monetary and fiscal restraint. Minimum reserve requirements and liquidity ratios were raised, discount quotas were reduced, and credit ceilings were imposed which, in effect, limited short-term bank credit to the private sector to temporary accommodation of seasonal needs. Also, the official discount rate was raised from 5 percent to 6 percent. Fiscal policy was adjusted by reducing subsidies to the nationalized gas, electric, and railroad industries and by increases in the value-added tax. In the hope that private investment would be maintained

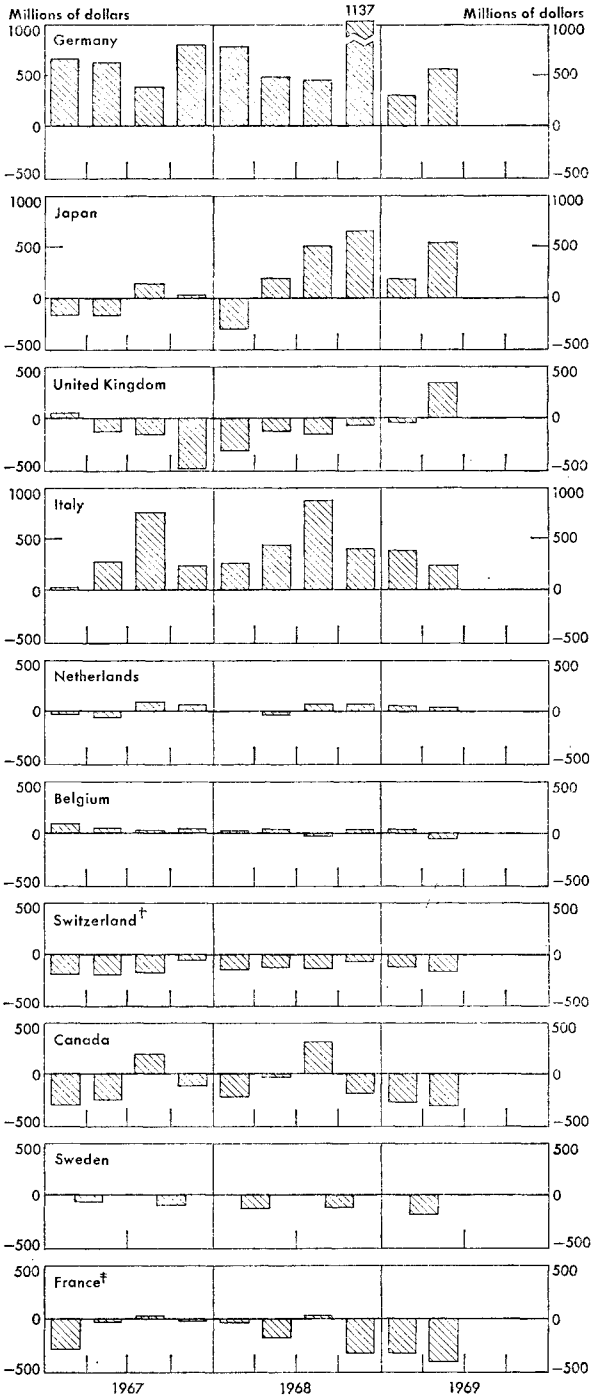
despite the reduced rate of economic expansion, investment incentives were left intact.

During the first seven months of 1969, the French economy failed to respond to fiscal and monetary restraint as quickly as it had earlier to expansionary policies. Bank credit rose almost as rapidly as in 1968, partly because bank financing of the government—and others exempt from the credit ceilings—was heavier than anticipated, but the credit ceilings themselves were also breached. Further, the investment tax incentive had proved unexpectedly potent. Although initial labor-management discussions in March regarding a second nationwide wage adjustment had proved inconclusive, labor shortages were forcing locally negotiated wage increases running close to a 10 percent annual rate. Moreover, retail sales—especially of durable goods—continued to rise. Given these expansionary developments, imports continued upward and the trade deficit widened somewhat. In May, therefore, the authorities initiated a new series of restraint measures by tightening consumer credit regulations. In June, all bank credit ceilings were extended and the official discount rate was increased from 6 percent to 7 percent. In July, the government established a countercyclical investment fund which, in effect, postponed part of its expenditures until such time as the economy required a fiscal stimulus.

Early in August, following Mr. Pompidou's election as president, the new government devalued the franc by 11.1 percent. A month later it outlined the major features of its overall economic strategy. It intensified restraint on consumption by further tightening instalment credit restrictions for a five-month period and by offering new tax incentives to purchasers of life insurance and long-term fixed-interest securities. Previously revised bank credit ceilings were reinforced by tying the banks' important rediscount privilege to ceiling compliance. In October the official discount rate was raised to 8 percent. Although the brunt of the restrictive burden was borne by monetary policy, the government also impounded more public investment authorizations in the countercyclical fund, and—departing from previous policy—moved to dampen private investment by terminating the special tax incentive three months early in September. But devaluation was the keystone of the overall strategy. It was adopted in the hope that it would permit the shift of resources, required to produce external balance, to be made with less sacrifice of economic growth and, hence, with less ultimate damage to the French standard of living than would otherwise be the case. Although contributing to attainment of general balance-of-payments equilibrium, the French devaluation did upset the EEC policy of common agricultural prices, which were fixed in terms of a common unit of account.

Chart II

CURRENT-ACCOUNT BALANCE OF PAYMENTS OF MAJOR INDUSTRIAL COUNTRIES*



*Except for France and Switzerland.
†Trade account only; imports CIF, exports FOB.
‡Trade account only; imports FOB, exports FOB.

Source: National statistics.

To avoid undue stimulation to French agriculture and heavier subsidy costs for its EEC partners, France was exempt from the uniform price requirement for twenty-eight months and was required to tax exports and subsidize imports in order to offset the difference between French and other EEC agricultural prices.

UNITED KINGDOM

By the end of 1968, a full year after the 14.3 percent sterling devaluation, the hoped-for balance-of-payments surplus had not yet appeared. Prior to devaluation the United Kingdom had suffered chronic payments deficits, partly as the result of a poor price and productivity record relative to her major competitors, especially Germany. This tendency had forced Britain to choose between a slow rate of growth, in the interests of external balance, and the payments deficits which attended strong economic growth. The government had expected that devaluation would resolve the dilemma and permit modest economic growth to coexist with a developing balance-of-payments surplus, needed to repay indebtedness incurred to finance previous deficits. The strategy, which was expected to produce a surplus by the second half of 1968, was outlined in the March budget presentation. The plan called for a maximum 4 percent growth in gross domestic product (GDP) from the second half of 1967 to the second half of 1968 and for a resource shift from consumption to exports and investment. Restrictive fiscal, monetary, and incomes policies were undertaken to reinforce devaluation by cutting back consumption. While the GDP target was achieved in 1968, the external basic balance was still slightly in deficit at the year-end. A major difficulty had been that domestic consumption had increased by 1 percent, rather than declining by 2 percent as planned, and had pulled in extra imports. In retrospect, the authorities recognized that sizable monetary expansion, despite ceilings on certain bank loans, had facilitated the breaching of the incomes policy and assisted consumer resistance to fiscal restraint.

In the light of the 1968 experience, a modified strategy was worked out between November 1968 and April 1969, when objectives for the year were set out in the budget message. Between the second halves of 1968 and 1969, real GDP growth was to be no more than 2.6 percent, real public and private consumption (taken together) were to be roughly unchanged, and the increase in investment was to be pulled back to less than 3 percent. Real imports were to be held level and, with rising exports, a current-account balance-of-payments surplus was expected to emerge in the second half of 1969. Measures to implement the new strategy took effect in the November-April period. To curb consumer expenditures, consumer credit regulations were tightened and purchase taxes on alcohol, gasoline, tobacco, and a broad range of durable goods were increased by 10 percent in November 1968. The April budget also raised the "selective employment tax" (which hits the consumers' services sector hardest). To reduce domestic investment incentives, special tax concessions were allowed to lapse in December 1968, and the new budget included an increase in corporate taxes. Attacking imports directly, a six-month interest-free deposit with the government, equal to 50 percent of the value of their imports, was required of importers of manufactures beginning in December 1968; the interest to be thus forfeited probably added 1 to 2 percent to the cost of imports.

More generally, the government aims—by means of fiscal, debt management, and monetary policy—to limit "domestic credit expansion" to no more than $960 million equivalent in the financial year ending in March 1970, compared with the $2.8 billion increase in the preceding year. This total includes credit extended to public and private borrowers by the domestic banking sector and foreign lending to the public sector (including public corporations). Fiscal policy—based on relatively stable expenditures and a rise in tax rates and tax yields—is designed to permit a sizable reduction of government debt, including that held by banks. Tax exemptions have been granted on capital gains from the sale of government bonds, with the intent of encouraging government debt ownership by nonbank investors. As for monetary policy, bank credit ceilings have been set in order to reduce loans to the private sector, and the buildup of import deposits in early 1969 absorbed substantial liquidity. (The deposit requirement has recently been renewed until the end of 1970 but at the reduced rat eof 40 percent of import value). The official discount rate has been maintained at 8 percent since February.

On the basis of fairly complete information about the first half of 1969, and preliminary indications for the second half, it appears that the British economy is, in the main, holding to the course plotted. "Domestic credit expansion" is running well below the intended limit, with a sharper than planned reduction in government borrowing more than offsetting continued breaching of credit ceilings. Consumption and investment are probably close to planned levels, and output is rising modestly. The tendency of exports to hold their own in rapidly expanding world markets (in contrast to many years of declining shares before devaluation), and the stability of imports in 1969, helped to swing the basic balance of payments to a $686 million surplus in the second and third quarters of 1969,

taken together. This is close to the $720 million balance-of-payments surplus originally hoped for in the year ending in March 1970. At present, therefore, the United Kingdom appears to be achieving modest growth and a balance-of-payments surplus.

ITALY

Despite Italy's expansionary monetary and fiscal policies and strongly rising exports in 1968, domestic demand and imports continued sluggish through much of that year and price increases remained moderate. Although the current-account surplus had increased, political uncertainties stimulated a capital outflow so large that the financing of domestic investment may have suffered. Furthermore, uneven regional growth and continued unemployment were contributing to growing social unrest. In view of all of these factors, Italy's economic policy remained predominantly expansionary well into 1969. Considerable reliance has been placed on increases in government expenditures which have recently been directed largely to raising old-age pensions and the wages of government workers. The Bank of Italy continued to encourage domestic credit expansion but, at the same time, took steps to force repatriation of bank funds and discourage capital outflows. In March, commercial banks were requested to bring their net foreign position into balance by the end of June, while their participation in international bond consortia was temporarily suspended. The purchase of foreign mutual fund shares was restricted. To reduce the differential between domestic and foreign interest rates, the Bank of Italy withdrew support from the treasury bill market.

During the early months of 1969, domestic consumption responded strongly to expansionary policies, price and wage increases accelerated, and there was some reduction in Italy's current-account surplus. In view of developing inflationary pressures and continued heavy capital outflow, the Bank of Italy in July raised from 3½ percent to 5 percent its official penalty discount rate for banks whose average rediscounting during the preceding six months exceeded 5 percent of their minimum reserve requirements. On August 14 the basic discount rate for banks not subject to this penalty was raised from 3½ percent to 4 percent, the first change since June 1958.

OTHER EUROPEAN COUNTRIES

During 1968, strongly rising demand in the larger industrial countries had been rapidly transmitted to the smaller industrial countries of Europe—the Netherlands, Belgium, Sweden, and Switzerland. By the end of the year, plant capacity was becoming strained, labor shortages were emerging, and price and wage increases were accelerating. As restrictive monetary policies initiated in the larger countries late in 1968 began to affect the money markets of the smaller industrial countries, they also moved toward monetary restraint. Thus, official discount rates were gradually shifted upward, but the timing and the size of the rate changes were, of course, influenced by differing domestic considerations. The National Bank of Belgium made an upward discount rate adjustment in December 1968 and again in March, May, July, and September 1969 for a total increase of 3¾ percentage points to 7½ percent. The Netherlands Bank raised its discount rate in December, April, and August 1969 for a total of 1½ percentage points to 6 percent. Sweden, whose business cycle lagged somewhat behind that of other countries, moved in February and July to raise its discount rate 2 percentage points to 7 percent. In Switzerland, the authorities permitted the interest rate on three-month commercial bank deposits to move upward by 1 percentage point to 5 percent in the first six months of this year, but did not adjust the official discount rate until September, when it was increased by ¾ percentage point to 3¾ percent. (This was the first change in the official discount rate since the ½ percentage point reduction in July 1967.)

Since none of the monetary authorities of these smaller European countries were prepared to accept a level of interest rates as high as that in the Euro-dollar market, measures were taken to pull back short-term capital previously placed in that market. In April, the Belgian central bank requested commercial banks to cut nearly in half by the end of June important components of their foreign exchange position. In August, the central bank abandoned its preferential discount rate for certain export paper and tightened foreign exchange regulations. Also, the Netherlands Bank, in July, obtained a voluntary agreement from commercial banks that they would cut back their foreign exchange position during the second half of the year. In Sweden, capital flows were already subject to exchange controls, but these controls were applied more strictly in 1969 than earlier.

Introducing an element of credit rationing, the monetary authorities also established a ceiling on the permissible expansion of bank credits to the private sector. The Netherlands Bank obtained agreements from the commercial and agricultural credit banks which limited their 1969 short-term credit expansion to 10 percent. The National Bank of Belgium imposed ceilings on both the rediscount privileges it extends to commercial banks and the permissible volume of commercial bank loans outstanding. Swe-

den's Riksbank in July recommended a cutback in most bank credit. The Swiss National Bank had hoped for parliamentary approval of a proposed law which would have given the bank added powers, including the right to set mandatory credit ceilings. After the proposal was rejected in June, the central bank developed the customary "gentleman's agreement" limitation on bank credit.

In most cases, fiscal policy has also moved moderately in the direction of restraint. The general approach has been to limit the increase in expenditures, rather than to make any major changes in tax rates. However, the Netherlands and Sweden, as previously planned, switched from a turnover to a value-added tax, which the EEC countries and some other European countries are in the process of adopting. In the inflationary atmosphere which existed in the Netherlands when the tax change was launched, the tax was often simply added to the sales price. This helped produce a 6 percent increase in consumer prices during the first four months of 1969, which in turn necessitated sizable compensatory wage increases. To arrest the inflationary spiral, the Netherlands authorities imposed a comprehensive price freeze from April to September. In view of the Dutch experience, Belgium and Italy have announced plans to postpone their planned changeover to a value-added tax until inflationary pressures in their countries have abated.

Economic developments in the smaller industrial countries of Europe reflect both the timing and the character of the restraint measures adopted. Belgium, Switzerland, and Sweden continue to experience lower than average increases in consumer prices, while Dutch prices, after an initial increase, were stabilized by the freeze. The current-account balance of payments of Sweden, Switzerland, and Belgium deteriorated somewhat in the first part of 1969, but the Netherlands current account improved.

JAPAN

The 1968 rate of industrial growth in Japan, had, as usual, exceeded that of any other industrial country, and wages in manufacturing also rose faster than in most countries. In the export and capital goods industries, these increases were apparently covered by productivity gains so that prices remained stable; but, in the less dynamic consumer goods industries, wage increases produced a substantial rise in the cost of living. Because of rising exports to the United States, Southeast Asia, and the Middle East, and long-standing import restraints, the current account had improved strongly. In view of this generally favorable situation, Japan made no substantial change in fiscal policy in 1969 and continued until late in the year the moderately expansionary monetary policy to which she had turned in September 1968. Since the current account continued strong, the authorities sought to offset this by stimulating capital outflows. The Bank of Japan, in April, issued a "yen shift" guideline to the banks, encouraging them to reduce liabilities to foreigners and to assume the financing of foreign trade previously financed abroad. The ensuing yen shift, which exceeded $700 million in the second quarter of the year, temporarily reduced official reserves.

By the summer of this year, signs of domestic strain and inflationary pressures began to emerge, and on September 1 the Bank of Japan moved toward restraint, raising the discount rate from 5.84 percent to 6.25 percent. The development of domestic inflationary pressures, without any accompanying current-account deterioration yet apparent, is a novel experience for Japan. The persistence of the payments surplus has stimulated considerable discussions as to whether any change in trade or domestic development policy, or further promotion of capital exports, is required in the interests of external equilibrium or whether further reserve accumulation would be desirable.

CANADA

The Canadian economy had moved ahead very briskly in 1968, stimulated by rising exports to the United States and by a construction boom. Monetary policy had been easy since midyear and, although the government had planned to eliminate its fiscal deficit, rising prices and unexpected difficulties in cutting back expenditures frustrated that intention. Both price and wage increases quickened disturbingly. In 1969, therefore, both fiscal and monetary policy moved toward restraint. The government's cash budget swung into surplus, owing to firm expenditure control and to higher tax yields and tax rates. Deferral of capital cost allowances provided a tax disincentive to commercial construction. On the side of monetary policy, the Bank of Canada followed international interest-rate trends quite closely, raising the official discount rate from 6 percent to 6½ percent in December 1968, to 7 percent in March 1969, to 7½ percent in June, and to 8 percent in July. However, it proved possible to hold Canadian interest rates somewhat below Euro-dollar levels. In part this was because guidelines for banks, other financial institutions, and nonfinancial corporations limited investment in Europe. (These guidelines were originally established in 1968 to prevent an outflow of capital from the United States through Canada to third countries.) In July, the

central bank created a further barrier to capital outflow by imposing a freeze on "swapped deposits",[1] which had financed substantial capital outflows to the United States and Europe. As the result of fiscal and monetary restraint, the growth of bank credit, which had been very strong in the winter and spring, tapered off at midyear. However, inflationary tendencies have not abated. A wave of strikes, especially severe in the mining and metal industries, held back industrial growth. Strike settlements in October and November, which resulted in large wage and price increases, threatened a further inflationary surge. A Prices and Incomes Commission, established in the summer to study the inflation problem, has proposed a system of voluntary restraint for both wages and prices. This idea has met with considerable resistance, especially from the labor unions.

[1]A "swapped deposit" is a United States dollar-denominated time deposit accompanied by a United States dollar-Canadian dollar swap which leaves the depositor with Canadian dollars at the end of the term.