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Content last modified 6/05/2009.

CONFIDENTIAL (FR)

INTERIM REPORT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

November 25, 1967

SELECTED ECONOMIC AND FINANCIAL DEVELOPMENTS

The Domestic Economy

The gross national product rose at an annual rate of $16 billion in the third quarter to a level of $791.2 billion, about $1 billion higher than the preliminary Commerce estimates carried in the last Greenbook. Final sales were reduced $1.2 billion because of lowered estimates for consumer expenditures and defense outlays. Inventory investment, on the other hand, was revised upward by $2.3 billion to show accumulation at the rate of $3.8 billion as compared with $0.5 billion in the second quarter.

The saving rate remained at about 7 per cent of disposable income. Revisions in consumer expenditures--which lowered purchases of goods and raised outlays for services--resulted in a net downward revision in total consumer outlays of half a billion dollars--to a level of $495.3 billion.

Defense spending rose by only $700 million, annual rate, in the third quarter, or about half the increase estimated earlier. However, the fourth quarter increase in defense outlays is expected to be larger than the third, even aside from the expected pay-raise.

Revisions in expenditures for fixed business investment, residential construction, and net exports were minor.

There was no revision in the GNP deflator, which rose at an annual rate of 3.8 per cent from the second to the third quarter.

REVISED THIRD QUARTER GROSS NATIONAL PRODUCT ESTIMATES
(Billions of dollars seasonally adjusted annual rates)

	Preliminary Commerce Estimates[1/]	Revised Commerce Estimates	Changes
Gross National Product	790.1	791.2	1.1
Final Sales	788.6	787.4	-1.2
Private	609.7	609.2	-0.5
Personal Consumption Expenditures	495.8	495.3	-0.5
Durable Goods	73.0	72.7	-0.3
Nondurable Goods	219.0	218.5	-0.5
Services	203.8	204.1	0.3
Gross Private Domestic Investment	109.8	112.2	2.4
Residential Construction	25.4	25.6	0.2
Business Fixed Investment	82.9	82.8	-0.1
Change in Business Inventory	1.5	3.8	2.3
Nonfarm	1.1	3.4	2.3
Net Exports	5.6	5.4	-0.2
Gov't. Purchases of Goods & Services	178.9	178.2	-0.7
Federal	91.4	90.9	-0.5
Defense	73.9	73.3	-0.6
Other	17.5	17.6	0.1
State & local	87.6	87.4	-0.2
GNP (constant - 1958 - $)	671.6	672.0	0.4
GNP Implicit Deflator (1958 = 100)	117.7	117.7	0.0
Savings Rate (per cent)	6.9	7.0	0.1
Federal Government Surplus or Deficit	-13.5	-13.1	0.4

Source: United States Department of Commerce.
1/ Estimates carried in the November 8th Greenbook.

It is estimated that the November industrial production index will increase at least one full point from the preliminary October figure of 156.2 per cent, reflecting principally the resumption of production after termination of strikes. If this increase is realized, the November index still would be 2 points or so below the December 1966 peak.

The October decline of one-half point was due primarily to a work stoppage in the nonelectrical machinery industry and a 5 per cent decline in crude oil production, as output changes in most other industries were small and about offsetting. In early November, crude oil output stabilized at the October level and the work stoppages at Ford and Caterpillar have been settled. The estimated November increase in production of autos, trucks, and parts will amount to about .7 of one point of the total production index, about one-half of the earlier loss from the Ford strike. If output in the nonelectrical machinery industry recovers to the September level, it will add .3 of one point to the November index. In addition, steel ingot production rose 3 per cent in early November and is likely to raise the total index slightly. Other available weekly production data do not suggest either output declines or increase for the products they represent.

New orders received by manufacturers of durable goods fell 3.0 per cent in October. This was the second consecutive decline and the third in the last four months. Most of the decline can be attributed to the Ford strike. Motor vehicle orders and shipments were down 16 per cent after falling 18 per cent the previous month. When the motor

vehicle industry is excluded, durable goods orders in October were still down 0.8 per cent. Declines were recorded for iron and steel, nonferrous metals, and machinery and equipment. Aircraft and fabricated metal products were the only industries in which orders increased.

Unfilled orders edged up 0.5 per cent in October continuing the rise that resumed in May. Nearly all the increase in the latest month came in the aircraft industry.

NEW ORDERS
(Billion of dollars, seasonally adjusted)

Industry	June	July	August	September	October
Durable goods	24.3	23.7	23.7	23.2	22.5
Per cent change	1.7	-2.3	0.0	-2.3	-3.0
Durable goods, excluding transportation equipment	16.9	17.0	17.8	17.3	17.0
Per cent change	1.7	0.4	4.5	-2.5	-1.8

Business inventory accumulation in August was revised sharply upward, to total nearly $800 million, and then in September it dropped back to $150 million. The book value increase now reported for the third quarter was at a seasonally adjusted annual rate of $4.8 billion, compared with $0.3 billion in the second quarter and with the $18.8 billion peak reached in the fourth quarter 1966. The spurt in total business inventory accumulation in the third quarter came mainly in the auto sector but all other manufacturing and trade industries combined also showed some pick-up in the rate of accumulation.

The total business stock-sales ratio, which had declined moderately in the spring, edged up between June and September--to 1.56 compared with averages of 1.48 in 1966 and 1.46-1.47 in 1964 and 1965.

Private housing starts, which were revised downward moderately for September, rose in October to an annual rate of 1.5 million. The rate was somewhat higher than projected and virtually matched the fourth quarter of 1965 average. Even if there is some decline in November and December--as seems possible on technical grounds--the fourth quarter average will be up significantly from the 1.4 million in the third quarter.

Multifamily starts again dominated the increase in October, more than doubling the unusually low rate reached a year earlier and the highest since mid-1964. Building permits also rose further in October, with the rise greater for multifamily starts than for single family units. All regions showed some rise.

PRIVATE HOUSING STARTS AND PERMITS

	October 1967 (Thousands of units)1/	Per cent change from	
		September 1967	October 1967
Starts	1,496	+ 5	+ 77
1-family	914	+ 1	+ 53
2-or-more family	582	+12	+135
Northeast	265	-11	+114
North Central	399	+30	+ 78
South	552	- 1	+ 54
West	280	+ 5	+101
Permits	1,202	+ 4	+ 67
1-family	655	+ 3	+ 51
2-or-more family	547	+ 5	+ 92

1/ Seasonally adjusted annual rates; preliminary.

Personal income, at $636 billion (annual rate) in October, was up by only $1-1/2 billion over the month, the smallest monthly increase since last April. The slackening of personal income growth in both September and October reflected very largely the impact on manufacturing output and payrolls of strikes which affected autos, machinery and metals; manufacturing payrolls were off by $1/2 billion in October.

More rapid growth in wage and salary disbursements, and in personal income, may be anticipated in November and over the next several months. The settlement of several major strikes--with the attendant recovery of hours of work and employment in the high wage auto, metals and machinery industries--along with the impact of the large wage settlements in autos, should have the effect of raising earnings significantly in the manufacturing sector.

Wholesale prices of industrial commodities, which increased at an annual rate of 3 per cent from mid-July to mid-September, showed a similar large increase from mid-September to mid-October. After mid-October, announcements of price increases diminished considerably, and the over-all price advance for industrial commodities may have slowed. (The BLS preliminary estimate for mid-November and the final October figures are to be released November 29.)

Main features of the October rise in the BLS industrial commodity average included: (1) an increase of more than 2 per cent in prices of autos and trucks, with the introduction of new models; (2) a pronounced rise in inorganic chemicals, as a result of which the index

for the chemicals group increased moderately following 4 months of decline; and (3) a decline in prices of lumber and plywood and gasoline-- in part owing to seasonal influences.

Following devaluation of the pound, prices of basic commodities in the United Kingdom rose by about the amount of the devaluation. Little effect of the British devaluation on U.S. prices has been evident as yet, although some farm commodities tended to weaken further with prospects of reduced exports to the U.K.

The Domestic Financial Situation

As measured by the bank credit proxy (adjusted to include Euro-dollar borrowing), growth in member bank credit over the first three weeks of November was somewhat less than the average pace of September and October, and for the month as a whole, is expected to be at about a 10 per cent annual rate. Euro-dollar borrowing expanded by about $300 million over the first three weeks of the month--bringing the level of such borrowing to a new high, and rose about $210 million further at New York banks in the statement week just past.

At weekly reporting banks, credit growth was reflected mainly in increased holdings of investments, allowing for the usual seasonal changes. These banks made smaller than usual reductions in their holdings of Treasury issues over the early weeks of the month and participated heavily in the attractive November cash refunding-- acquiring for their own account relatively large amounts of both the 15-month and 7-year note. Acquisitions of other securities also were

substantial. Business loan growth remained moderate, as has been the case since early fall, while miscellaneous security loans and loans to finance companies continued to show strength.

Time and savings deposit inflows--on a daily average basis--have continued at their recent reduced pace, and for the month such deposits are likely to expand at an annual rate of 12 per cent, about the same as the September-October rate. Fragmentary data suggest that the recent Treasury note offerings at 5-3/4 per cent did result in some diversion of individual's savings flows from banks to market instruments. Negotiable CD's accounted for a substantial part of the recent over-all growth in time deposits. In contrast to their net decline in the September-October period, large CD's expanded by about $500 million over the first three weeks of November, probably reflecting efforts of banks to prepare for large December maturities.

Offering rates showed little change over this period, and it is likely that these sales were in relatively short maturities since maturities of longer than 4 or 5 months had already become noncompetitive at the 5-1/2 per cent ceiling before the recent rise in the discount rate. After the discount rate increase, not only did most large banks raise their prime lending rate to 6 per cent from 5-1/2 per cent but they also increased their offering rates on shorter maturity CD's. On November 22, most of the large reporting banks were paying the 5-1/2 per cent ceiling on maturities of 90-days and over, and a few banks were offering 5-1/2 per cent on shorter maturities. In the statement week in

which CD rates were raised, New York City banks added $140 million to their outstandings while Chicago banks lost $60 million of CD's.

The money stock is expected to grow at about a 7.5 per cent rate in November.

Unsettled market conditions over the past two weeks have resulted in the postponement of numerous corporate bond issues. Last week, U.S. Steel postponed its $225 million offering and Tenneco halved its $200 million issue; and in the current week all of the $165 million scheduled straight debt offerings have been postponed. Because of these cut-backs and the failure of additional new issues to be added to the November calendar, the volume of corporate bonds likely to be offered in the corporate public market this month is now probably no more than $700 million. This is only a little over half what some market participants were previously expecting, and the lowest monthly volume this year. The expected supply of new corporate issues in December is still uncertain but it could approximate $900 million, below most other months this year.

The total volume of municipal bond offerings expected in November has also been revised downward, but by a much smaller amount than in the corporate market. Although recent municipal postponements have numbered nearly as many as in the corporate market, their aggregate volume amounts to only about $100 million; thus the November estimate for municipals still totals about $1.2 billion--continuing the record billion dollar a month pace that has persisted most of this year.

Moreover, the municipal bond calendar for December is expected to total $1.3 billion. In both November and December municipal volume has been augmented substantially by industrial revenue issues, with $375 million offered in November and $350 million or more tentatively scheduled for December.

CORPORATE AND MUNICIPAL BOND OFFERINGS
(Millions of dollars)

	Corporate public bond offerings		Municipal bond offerings	
	1966	1967	1966	1967
October	499	1,350e	759	950e
November	569	700e	976	1,200e
December	980	900e	940	1,300e

KEY INTEREST RATES

	1966 High	1967 Nov. 13	1967 Nov. 17	1967 Nov. 24
Short-Term Rates				
3-months				
Treasury bills (bid)	5.59 (9/21)	4.62	4.67	4.91*
Bankers' acceptances	5.75 (10/25)	4.88	4.88	5.13
Federal agencies	5.76 (9/21)	5.15	5.05	5.20*
Finance paper	5.88 (12/31)	5.13	5.13	5.25
CD's (prime NYC)				
Highest quoted new issues	5.50 (12/31)	5.25	5.25	5.50*
Secondary market	5.90 (9/21)	5.30	5.30	5.60*
6-months				
Treasury bills (bid)	5.98 (9/19)	5.10	5.13	5.48*
Bankers' acceptances	6.00 (9/23)	5.13	5.13	5.38
Commercial paper	6.00 (12/31)	5.13	5.13	5.50
Federal agencies	6.04 (9/21)	5.50*	5.40	5.45
CD's (prime NYC)				
Highest quoted new issue	5.50 (12/31)	5.38	5.38	5.50*
Secondary market	6.30 (9/28)	5.55	5.60	6.00*
1-year				
Treasury bills	5.94 (9/21)	5.29	5.27	5.56*
Prime municipals	4.25 (9/21)	3.45	3.40	3.75*
Intermediate and Long-Term				
Treasury coupon issues				
5-years	5.89 (8/29)	5.91*	5.72	5.77
20-years	5.12 (8/29)	5.80*	5.70	5.70
Corporate				
Seasoned Aaa	5.53 (9/8)	6.03	6.13*	6.10
Baa	6.20 (12/23)	6.70	6.76	6.79*
New Issue Aaa				
With call protection	5.98 (9/2)	6.37	6.53*	--
Without call protection	6.10 (12/2)	--	6.68*	--
Municipal				
Bond Buyer Index	4.24 (9/2)	4.31	4.33	4.37*
Moody's Aaa	4.04 (8/26)	3.97	3.98	4.03*
FHA home mortgages				
30-years	6.81 (Nov.)	6.63 (Sept.)	--	6.65* (Oct.)

* 1967 highs.

Rates on home mortgages were raised in a few metropolitan areas soon after the System's recent discount increase, according to informal reports. Earlier in the month, upward pressures on mortgage rates had continued to intensify, judging from the additional rise in bond yields and the further slight increase in the already advanced level of offerings of Government underwritten mortgages to FNMA for purchase under its secondary market operations.

In October, yields on FHA mortgages sold in the secondary market edged slightly higher, as average discounts again exceeded 5 points. Contract interest rates on conventional first mortgages (FHA series) remained unchanged on both new and existing houses, partly reflecting the continued availability of funds to savings and loan associations during a period of seasonal easing in loan demands.

During October, as in a number of earlier months this year, secondary market yields on FHA mortgages--the most sensitive of the mortgage yield series--increased less than average returns on new issues of high-grade corporate bonds. As a result, the gross yield spread favoring home mortgages, which has remained unusually low since mid-year, narrowed sharply further, as the table shows.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary Market: Conventional loans		Secondary Market: FHA-insured loans			
	Level (Per cent)	Change (Basis points)	Level (Per cent)	Change (Basis points)	Discount (points)	Yield Spread (Basis points)
1966						
November	6.70	0	6.81	n.a.	6.8	109
December	6.65	- 5	6.77	- 4	6.5	103
1967						
January	6.60	- 5	6.62	-15	5.3	124
February	6.50	-10	6.46	-16	4.0	126
March	6.45	- 5	6.35	-11	3.0	104
April	6.40	- 5	6.29	- 6	2.5	90
May	6.45	5	6.44	15	3.8	78
June	6.50	5	6.51	7	4.4	72
July	6.50	0	6.53	2	4.6	75
August	6.55	5	6.60	7	5.2	71
September	6.55	0	6.63	3	5.4	75
October	6.55	0	6.65	2	5.6	53

NOTE: FHA series; interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points; secondary market yields and discounts are for certain 6 per cent, FHA-insured Sec. 203 loans. Gross yield spread is FHA yield minus average yield on new issues of high grade corporate bonds.

More complete (but still preliminary) data now available on savings flows to depositary-type thrift institutions confirm earlier indications of a further moderation of inflows in October. While inflows to both S&L's and savings banks were substantially improved over a year ago, as the table shows, the performance for both institutions falls short of previous Octobers--particularly at the S&L's. In addition, savings deposit data for the first half of November at New York City's 15 largest savings banks, show a $3.5 million or 10 per cent

FLOWS TO DEPOSITARY-TYPE THRIFT INSTITUTIONS
(Millions of dollars)

Date	S&L's		Savings Banks	
	October	Year to date	October	Year to date
1963	$811	$8,538	$195	$2,452
1964	756	8,058	233	3,267
1965	582	5,934	170	2,706
1966	-56	1,279	131	1,643
1967	486	8,284	190	4,116

After declining 6.6 per cent from late September to November 8, stock prices--as measured by Standard and Poor's composite index--have since advanced on balance, although the path of this advance has been quite irregular. Prices broke sharply after announcement of the British devaluation, but then quickly recovered. Trading has been unusually active, averaging 10 million shares per day since November 8; and at its most recent level of 93.65, Standard and Poor's index has erased about 2/5 of its late September to early November decline.

International Developments

Devaluations. The devaluation of sterling by 14.3 per cent on November 18, 1967, has been followed by devaluations in relatively few other countries. All devaluing countries together accounted in 1966 for only 14 per cent of world trade and 11-1/2 per cent of U. S. trade, as will be seen from the table below, with Britain alone accounting for 8-1/2 and 6-1/2 per cent, respectively. Among the countries that devalued, Denmark and Hong Kong devalued considerably less than Britain did, while New Zealand devalued more.

FOREIGN TRADE OF DEVALUING COUNTRIES, 1966

Country	(Per cent devaluation)	Per cent of world trade			Per cent of U. S. trade		
		Exports	Imports	Total	U. S. exports	U. S. imports	U. S. Total
United Kingdom	(14.3)	8.1	8.7	8.4	5.7	7.0	6.3
Denmark	(7.9)	1.4	1.6	1.5	0.6	0.8	0.7
Spain	(14.3)	0.7	1.9	1.3	1.7	0.6	1.2
Hong Kong	(5.7)	0.7	0.9	0.8	0.8	1.6	1.2
New Zealand	(20.0)	0.6	0.6	0.6	0.4	0.7	0.5
Ireland	(14.3)	0.4	0.5	0.5	0.3	0.4	0.3
Israel	(14.3)	0.3	0.4	0.4	0.7	0.3	0.5
Others 1/		0.3	0.5	0.4	0.7	0.5	0.6
Total		12.4	15.0	13.8	10.9	11.9	11.4

1/ Bermuda, Cyprus, Fiji, Gambia, Guyana, Jamaica, Malawi, Malta, and Nepal. Of these, all except Fiji devalued by 14.3 per cent.

All the Group of Ten countries other than Britain announced promptly that their parities would not be changed. A large number of sterling area countries--including all the major ones except Ireland

and New Zealand--have also retained their previous parities in terms of gold and U. S. dollars. Thus, the devaluation of the pound has been fairly effectively localized and treated as a necessary adjustment to help correct a fundamental disequilibrium in the U. K. balance of payments. Regular IMF procedures were followed, and a high degree of international coordination was attained.

U. K. program. At the same time that it devalued the pound, the U. K. government announced a broad series of measures to reduce domestic demand, and thus to limit domestic wage and price increases and facilitate the massive shift of resources into export and import-competing industries that will be required if there is to be a substantial improvement in the U. K. balance of payments. These measures are intended to open the way to an eventual improvement in the balance of payments of about £ 500 million a year; this would bring the "basic" balance--on current and long-term capital transactions--from a deficit estimated at about $550 million (£ 200 million) in 1967 to a surplus of over $700 million (now equivalent to about £ 300 million). For comparison, it may be noted that the largest "basic" surplus recorded since the early 1950's was that of $420 million (£ 151 million) in 1958.

Britain also announced that it was seeking an IMF standby of $1.4 billion and had obtained additional assistance of about $1-1/2 billion from other central banks in order to tide sterling over any further period of market uncertainty while the new measures were taking effect.

The new measures taken include the following:

(1) A rise in the Bank of England's discount rate from 6-1/2 to 8 per cent, the highest level since the outbreak of World War I.

(2) A request to banks in the United Kingdom to avoid any increase until further notice in the level of outstanding advances to the private sector.

(3) An increase in minimum downpayments on installment purchases of automobiles from 25 to 33-1/3 per cent, and a reduction in the maximum repayment period from 36 to 27 months. This reverses most, but not all, of the easing announced in June and August; before June, the minimum downpayment was 40 per cent and the maximum repayment period was 24 months.

(4) A reduction in central government spending in the fiscal year beginning April 1, 1968, by about £ 400 million from planned levels.

(a) Defense spending will be cut £ 100 million;

(b) Selective Employment Tax refunds and premium payments to manufacturers will be reduced £ 100 million;

(c) Capital spending in nationalized industries will be cut £ 100 million;

(d) Export rebates, amounting to £ 100 million a year, will be terminated.

(5) An increase in the corporate income tax in the fiscal year beginning April 1, 1968, from 40 to 42.5 per cent, to yield nearly £ 100 million additional.

(6) The Government will continue its current price and incomes policy, under which wage and price increases can be delayed by as much as seven months.

The new measures of domestic restraint are expected to make aggregate domestic demand in Britain about £500 million a year smaller than it would otherwise have been, and the Government foresees a further "deflationary effect" amounting to about £350 million as a result of the rise in domestic prices of imported commodities following the devaluation.

An IMF mission has found that the U.K. program is satisfactory. It is expected that the Group of Ten countries, meeting in Paris next Wednesday, November 29, will approve a further activation of the General Arrangements to Borrow (GAB), and that the IMF will soon thereafter agree to the requested standby credit of $1.4 billion.

U.S. balance of payments. If the sterling devaluation and associated U.K. measures are successful, they will have some adverse effects on the U.S. balance of payments, as well as on the payments positions of surplus countries. These effects might ordinarily be considered moderate, but now they will add to what is already a very large U.S. payments deficit.

Through the end of October, the accumulated deficit on the liquidity basis was $2.7 billion before seasonal adjustment,

and it would have been about $3.9 billion unadjusted in the absence of special official transactions, as shown in the table on the next page. In the first two weeks of November, prior to the devaluation of sterling, there was an additional unadjusted liquidity deficit of about $250 million. In the past several years, the final six weeks of the year have not usually shown large unadjusted deficits, and have sometimes shown a surplus. However, the outcome this year may obviously be influenced by the devaluation. The liquidity deficit would not be affected by shifts of existing _foreign_ liquid dollar holdings from private to official accounts; but it would be inflated by any surge in outflows of _U.S._ capital. All in all, it seems likely that the published liquidity deficit for the year 1967 as a whole will be at least twice as large as last year's $1.4 billion. Apart from special transactions, this year's liquidity deficit may approach $4 billion, compared with $2.9 billion last year.

The situation as measured on the official reserve transactions basis is less certain, since it will be greatly affected during the remaining weeks of the year by factors influencing U.S. banks to maintain or change the amount of their liabilities to their foreign branches. These liabilities reached a record high of $4.8 billion on November 22, and their sharp increases during most of the period since May served to hold down the official settlements deficit, and in fact to generate a seasonally adjusted surplus in

Measures of the U.S. Balance of Payments, 1966-67
(In millions of dollars)

	Year 1966	1967 Q-1	Q-2	Q-3	Oct.	Jan.-Oct.
Liquidity balance: (NSA)	-1,357	-241	-224	-1,208	-1,021p	-2,694p
(SA)	-1,357	-530	-560	-670	n.a.	n.a.
Selected special transactions 1/	1,585	374	757	209	-168p	1,172p
Liquidity balance before special transactions:						
(NSA)	-2,942	-615	-981	-1,417	-853p	-3,866p
(SA)	-2,942	-904	-1,317	-879	n.a.	n.a.
Balance on official reserve transactions basis: (NSA)	225	-1,282	-691	2	-300e	-2,270e
(SA)	225	-1,813	-830	462	n.a.	n.a.
Selected special transactions 1/	409	9	82	4	-294	-199
Balance on official reserve transactions basis before special transactions:						
(NSA)	-184	-1,291	-773	-2	0e	-2,070e
(SA)	-184	-1,822	-912	458	n.a.	n.a.

p Preliminary. e Estimated. n.a. Not available.

1/ Special transactions affecting liquidity deficit are primarily investments by foreign official and international institutions in nonliquid assets in the United States, including U.K. official transactions in securities, and advance repayments of debt to the United States. Of these, advance debt payments and U.K. official shifts between nonliquid securities and liquid assets affect the official reserve transactions balance.

the third quarter. Nevertheless, for the year through October, there was a cumulative deficit on the official reserve transactions basis of roughly $2-1/4 billion before seasonal adjustment. (Special transactions have had only small net effects on this balance this year.) And it is possible that there will be a very large deficit on this basis during the remainder of the year. A rise in yields on sterling assets, general uneasiness among foreigners about holding dollar assets, plus the usual year-end window-dressing demands in Europe, may put heavy upward pressures on Euro-dollar rates and cause U.S. banks to allow a large running-off of Euro-dollar deposits.

Projections of the U.S. balance of payments in 1968 made in October were for a liquidity deficit before special transactions of well over $3 billion, or about the same order of magnitude as this year. Since special transactions may be more difficult to arrange, the published deficit would have been expected to show an increase from this year.

These projections need to be reassessed in the light of the devaluation of sterling and a few other currencies. A fuller analysis will be presented in the next Green Book. But it appears that the adverse net effect on the U.S. trade balance of a successful U.K. shift into payments surplus, with attendant price changes, might be of the order of $300 million, and that the adverse trade effect of other devaluations might be about $50 million. There would also be

small adverse effects on net U.S. income from service transactions and on movements of U.S. private capital. And, as earlier noted, the adverse effects on the official settlements balance via movements of foreign private liquid funds could be very large.

Short-term capital flows. Indirect evidence -- from central banks' net daily acquisitions of dollar reserves and spot exchange market quotations -- suggests that a considerable reflow into sterling occurred in the week after the devaluation. However, to Friday, November 24, the reflow was apparently only about half the size of the (extremely large) outflow from November 1 to November 17. Large amounts of forward contracts are still outstanding; at maturity these presumably will cause net reserve losses for the Bank of England to the extent that the profits that will be realized are kept in dollars or other non-sterling currencies.

The dollar was strong against Continental European currencies early in the week, suggesting some movement from those currencies through the dollar to sterling; later the movement was reversed, and great strength developed in the exchange rates for most major Continental currencies. Movements of funds in that direction were associated with speculation on gold price changes, not in the sense that such conversions had anything to do with the financing of gold purchases, but rather that the idea is widely accepted that strength of gold on free markets equals weakness of the dollar.

Euro-dollar market. Interest rates in the Euro-dollar market changed only narrowly during October and the first part of November, but rose sharply on Tuesday, November 21. (The London banks were closed on Monday.) With further advances later in the week, the 3-month rate on Friday, November 24, stood at 6-3/4 per cent, up a full percentage point from a week earlier. Call money, at 5-1/8 per cent, and 1-month deposits, at 5-3/4 per cent, were each up by about 3/4 of a percentage point, and there were similar advances in the rates on 6- and 12-month maturities. These changes were primarily a reaction to the devaluation weekend discount rate increases -- from 6-1/2 to 8 per cent in Britain, from 5 to 6 per cent in Canada, and from 4 to 4-1/2 per cent in the United States -- and to associated changes in other interest rates.

Liabilities of New York banks to their branches abroad were somewhat lower in the first part of the week after devaluation than on corresponding days a week earlier. This development appeared consistent with evidence pointing to capital flows into sterling. Because of disturbance of the intra-weekly variations by the Thanksgiving Day holiday, the sharp increase in liabilities to branches that occurred on Wednesday, November 22, is of doubtful significance.

Gold. Demand in the London gold market was heavy on Tuesday and increased to unparalleled levels as the week went on. If the Pool follows the usual practice of settling early in the

following month, the Treasury gold stock figure on Wednesday, November 29, will remain unaffected.

U.S. holdings of "free" gold, i.e. of gold in excess of that required to be held against Federal Reserve notes, amounted to $2.7 billion at the end of October. Settlement for the U.S. share of losses by the Pool in the London market through November 24 will reduce this by several hundred million dollars. During the past week there has been only one small foreign official purchase of gold from the United States, $8 million by the central bank of Surinam. It is, of course, possible that some central banks have been buying gold in the London market.

EEC countries' reserves. During the first ten months of 1967, the Common Market countries' net official reserves and related assets increased by $1.2 billion. With the addition of net foreign assets of the commercial banks in these countries, the aggregate net asset gain produced by surpluses on current account and nonbank capital account was about $2 billion. Reserve gains in November through the 24th were around $900 million.