Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optical character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Content last modified 6/05/2009.

CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

March 4, 1970

TABLE OF CONTENTS

TABLE OF CONTENTS

SUMMARY AND OUTLOOK

Outlook for economic activity

Key indicators of economic activity continue bearish. The composite of leading indicators was down--and sharply--for the fourth successive month in January. New orders for durable goods dropped considerably following three months of moderate declines, and backlogs were also reduced in most industries and market groups. Both initial claims and insured unemployment rose in January and again in February. Retail sales remain generally weak, although unit auto sales were strong in late February.

Given these and other incoming statistics, our expectations of further slowing in current dollar GNP and of a moderate decline in real GNP this quarter are apparently being confirmed. Much of the weakness stems from a sharp reduction in the growth of final demands, reflecting a drop in auto and other consumer goods sales, curtailed housing activity, and declining defense expenditures. Inventory investment probably is also declining in the current quarter as producers endeavor to adjust output to sluggish sales.

Growth of GNP in current dollars is expected to pick up only moderately in the second quarter. There are prospects for a somewhat faster rise in consumer expenditures this spring in response to the boost to disposable income resulting from a large increase in Social Security benefits beginning in April and retroactive to the first of the year. Federal defense expenditures, however, are scheduled to decline substantially in the second quarter as the size of the armed forces and spending for military equipment are further curtailed. The recent decline in housing starts, with a further drop in prospect, seems certain to result in substantial further reductions in residential construction expenditures over the first half of the year. Inventory investment is expected to fall further in the second quarter as incentives for inventory building weaken further.

Spending for business fixed investment remains the major expansive force in the first half of the year. Recent private surveys indicate that business has increased its capital spending plans for 1970 since late last fall. It is difficult to evaluate these surveys, however, as they appear inconsistent with the decline over recent months in orders for machinery and equipment and the leveling off of output of business equipment. Moreover, a recent NICB report showed some decline in fourth quarter capital appropriations of large manufacturers, although the backlog of unspent appropriations remained very high. More definitive information on capital spending plans for 1970 will become available with release of the Commerce-SEC survey in the next several days. Meanwhile, we have not changed out projections of business fixed investment from the recent chart show pattern.

Outlook for resource use and prices

Pressure on manpower and industrial resources has continued to lessen and further easing is anticipated. Industrial production is expected to be down for the first quarter as a whole, although the index apparently will show little net change in February because of the return of strikers to work early in the month at G.E. With capacity continuing to grow, the utilization rate in manufacturing is estimated to be down to 80 per cent this quarter and is projected to continue to edge lower until late in the year.

Manufacturing employment is expected to decline in February, exclusive of G.E., and for some months after that while total nonfarm employment is estimated to change little on balance. State insured unemployment rose further in February from the relatively high level reached in mid-January, suggesting that the unemployment rate also may have risen from the 3.9 per cent of January. Further increases in the unemployment rate may be expected in the months ahead as the labor force continues to grow and productivity increases.

Wage demands will continue strong in view of the continued erosion of money wages by rapid advances in living costs and labor efforts to achieve higher living standards. Many more workers are covered by expiring major contracts this year than last, and settlements are expected to be sizable. But with production easing, demands for labor are projected to be less urgent and to result in shorter average workweeks and less overtime at premium rates; this in turn will be reflected in some slowing of the increase in average hourly earnings.

We continue to project a slowing in the pace of price increases over the course of this year. One hopeful development was the moderation in February of the increase in wholesale prices of industrial commodities and their much less widespread nature than earlier. While one month can hardly establish or confirm a trend, it can offer some basis for hope. So far as consumer prices are concerned, a significant slowing will be heavily dependent on the course of prices of foods and services. Prospects of moderation are more hopeful for the former than the latter.

Prospective financial developments

The combination of increased Regulation Q rate ceilings and sharply reduced yields on market securities appears to be easing pressures on the supply of funds available to banks. Deposit attrition for the banking system as a whole seems to be halting. And for the next two months a resumption of net deposit growth is projected, assuming Treasury bill yields range a little below current levels. While there may be a little growth in private demand deposits (and the money supply), this improvement in deposit flows is likely to be centered, as in recent weeks, in consumer-type time and savings deposits at banks outside major money centers and in accounts of foreign official institutions at large banks. Some small net pick-up in large domestic CD's also seems likely, but major banks should continue to find it advantageous to issue bank-related commercial paper as well.

With respect to the demand for bank funds, there are scattered reports of some lessening of pressure for loans from businesses. With many firms continuing under severe liquidity strain, however, over-all business demands for bank credit still appear to be substantial. Factors likely to maintain business loan demands in the period ahead include large March-April Federal income tax payments, the deepening profits squeeze, and the continuing need to finance capital spending programs already in train. On the other hand, if staff estimates of reduced inventory accumulation in the second quarter are confirmed by events, needs for business inventory financing might slacken relative to their recent pace. Also, the very large calendar of near-term corporate financing in capital markets probably will be reflected to some extent in repayment of bank debt.

In other sectors of bank lending, demands for consumer instalment loans, which recently have weakened substantially, are likely to remain sluggish. There could be some further expansion of security loans, particularly if the day-to-day cost of borrowing from banks to position speculative security inventories should decline further. And banks have recently increased their own takings of market securities to some extent, chiefly at institutions outside the money centers.

Securities markets. Any major effort by banks to step up their investments would, of course, tend to be reflected in further declines of security yields, particularly in the market for municipals.

But the extent of relief now in prospect for banks seems unlikely to permit any large volume of security acquisitions. Moreover, the sharpness of the recent decline in municipal security yields has reflected in large part dealer positioning of new issues in anticipation of some pick-up in bank investment. And the volume of pent-up State and local government financing that could be triggered by further yield declines is huge.

In markets for fully-taxable securities, the prospective calendar of new offerings is also heavy. Capital market financing scheduled by business corporations for March and April is already at a record level for the period, and borrowing by FNMA and the FHLB is scheduled to continue at or somewhat above its recent active pace. Taken by itself, the unusually large forward calendar of corporate, agency, and municipal security offerings can be expected to act as a substantial brake against further near-term declines in note and bond yields. But the outlook for yields will also continue to depend importantly on the degree to which signs of business easing cumulate and the extent to which the degree of monetary restraint is lessened. Moreover, the U.S. Treasury, although still expected to raise possibly $2 - $2.5 billion of new money over the next few weeks, including additions to regular Treasury bill offerings, will become a large net repayer of debt during the second quarter of the year.

Mortgage markets. Despite the recent general easing of security market yields, upward pressures on mortgage interest rates and continued restrictions on the availability of mortgage funds seem likely over the near-term. Improvement of savings inflows to thrift institutions should remain relatively slow unless there are appreciable further declines in short-term interest rates, and much of any initial improvement in flows may well be allocated to a rebuilding of liquidity. Thus, some further near-term reduction in new mortgage commitments seems likely at a time when demands for such credit are normally expanding seasonally.

Balance of payments outlook

The scanty information presently available on U.S. external transactions in December, January and February is on the whole consistent with the projections of the over-all balance of payments given to the Committee in February, though the trend in merchandise trade is in doubt. There are likely to be large deficits in the current quarter and half-year on both the liquidity basis and the official settlements basis. Important factors in the change from the surpluses of the fourth quarter are the virtual cessation of repatriations of funds out of German marks and probably some partial reversal of the end of year inflows stimulated by OFDI controls.

U.S. foreign trade statistics for January are at least as discouraging as the December figures were encouraging. In view of the problems of seasonal adjustment of the monthly data, attention should be focused on moving averages rather than single months. Even with moving averages, the picture is one of virtual lack of growth in merchandise exports over the past six months together with a leveling off of merchandise imports. Unless some improvement becomes observable in the next month or two, some downward revision of our 1970 net exports projection will be called for.

Euro-dollar interest rates have remained fairly stable during the past month despite declines in U.S. money market rates. It is therefore not surprising that liabilities of U.S. banks to their foreign branches have tended to decline, though a large part of the decline apparently represents a shift of foreign official dollar holdings into CD's. Last week liabilities to branches were lower than at any time since mid-July 1969 except for the end-of-October and end-of-December temporary dips. Failure of Euro-dollar interest rates to continue their January decline--which was primarily seasonal--reflects the tight money market conditions in most major European countries. A review of these conditions given in Part IV below indicates that the likelihood is slight of any significant easing abroad in bank credit availability during the next few months. This means that declines in Euro-dollar rates are likely to continue lagging behind any further declines in U.S. rates.

March 3, 1970

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1969 Oct.	1969 Nov.	1969 Dec.	1970 Jan.	Per Cent Change* From 1 mo. ago	Per Cent Change* From 3 mos. ago	Per Cent Change* From Year ago
Civilian labor force (mil.)	81.5	81.4	81.6	82.2	0.8	0.8	3.1
Unemployment rate (%)	3.8	3.5	3.5	3.9	--	--	[3.4] 4/
Insured unempl. rate (%)	2.2	2.3	2.3	2.5	--	--	[2.1] 4/
Nonfarm employment, payroll (mil.)	70.7	70.6	70.7	70.6	0.0	0.0	2.1
Manufacturing	20.2	20.0	20.0	20.0	0.0	-0.7	0.1
Nonmanufacturing	50.5	50.6	50.6	50.6	0.0	0.3	2.9
Industrial production (57-59=100)	173.1	171.4	171.1	169.9	-0.7	-1.8	0.5
Final products, total	170.9	168.3	168.0	167.3	-0.4	-2.1	-0.5
Consumer goods	161.2	160.4	160.1	160.1	0.0	-0.7	-0.6
Business equipment	200.9	194.1	193.3	191.4	-1.0	-4.7	0.0
Materials	175.4	174.5	174.1	172.5	-0.9	-1.7	1.7
Capacity util. rate, mfg.	82.7	81.5	81.0	79.9	--	--	[84.1] 4/
Wholesale prices (57-59=100) 1/	114.0	114.7	115.1	116.0 5/	0.8	1.8	4.8
Industrial commodities (FR)	112.8	113.1	113.5	114.0	0.4	1.1	3.7
Sensitive materials (FR)	113.5	114.2	114.9	116.0	1.0	2.2	3.2
Farm products, foods & feeds	114.3	115.7	116.4	118.2 6/	1.5	3.4	7.7
Consumer prices (57-59=100) 1/	129.8	130.5	131.3	131.8	0.4	1.5	6.2
Food	127.2	128.1	129.9	130.7	0.6	2.8	7.1
Commodities except food	119.8	120.2	120.3	120.1	-0.2	0.3	4.4
Services	146.5	147.2	148.3	149.6	0.9	2.1	7.6
Hourly earnings, pvt. nonfarm ($)	3.10	3.12	3.14	3.14	0.0	1.3	6.8
Hourly earnings, mfg. ($)	3.25	3.26	3.27	3.28	0.3	0.9	5.5
Weekly earnings, mfg. ($)	131.34	131.70	132.83	132.26	-0.4	0.7	4.4
Net spend. weekly earnings, mfg. (3 dependents 57-59 $) 1/	87.50	87.07	87.85	86.66	-1.4	-1.0	-1.1
Personal income ($ bil.) 2/	763.7	767.6	770.6	773.0	0.3	1.2	7.6
Retail sales, total ($ bil.)	29.6	29.5	29.4	29.1	-1.0	-1.6	0.6
Autos (million units) 2/	8.4	8.3	7.7	6.8	-11.3	-18.8	-16.4
GAAF ($ bil.) 3/	8.1	8.0	8.0	8.2	1.5	1.0	6.7
12 leaders, composite (1963=100)	153.2	152.2	152.1	149.3	-1.8	-2.5	0.5
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/	1,392	1,295	1,252	1,166	-6.9	-16.2	-37.9
Factory workweek (hours)	40.5	40.5	40.6	40.2	-1.0	-0.7	-1.0
Unempl. claims, initial (thous.)	198	210	212	235	-18.6 7/	-10.8 7/	-23.0 7/
New orders, dur. goods, ($ bil.)	31.8	31.2	30.3	28.7	-5.2	-9.7	-3.2
Machinery & equipment	6.5	6.7	6.5	6.4	-1.7	-1.1	2.8
Common stock prices (41-43=10)	95.52	96.21	91.11	90.31 8/	-0.9	-5.5	-11.5

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates. 3/ Gen'l. mercandise, apparel, and furniture and appliances. 4/ Actual figures. 5/ February prel., 116.3. 6/ February prel., 118.5. 7/ Sign reversed. 8/ February figure, 87.16.

SELECTED DOMESTIC FINANCIAL DATA

	1969 QII	1969 QIII	1969 QIV	1970 Jan.	1970 Feb.	1970 Week ended Feb. 25
	Averages					
Interest rates, per cent						
Federal funds	8.33	8.98	8.94	8.98	8.98	8.41
3-mo. Treasury bills	6.20	7.02	7.36	7.87	7.13	6.84
3-mo. Federal agencies	6.80	7.63	7.92	8.27	7.75	7.34
3-mo. Euro-dollars	9.69	10.89	10.48	9.96	9.37	9.28
3-mo. finance co. paper	6.72	7.74	7.89	8.15	8.01	7.89
4-6 mo. commercial paper	7.54	8.49	8.63	8.78	8.55	8.50
Bond buyer municipals	5.43	6.00	6.40	6.68	6.36	6.16
Aaa corporate-new issues	7.32	7.75	8.32	8.46	8.30	8.20
20-year Treasury bonds	6.14	6.34	6.71	6.92	6.67	6.60
FHA mortgages, 30-year	8.17	8.38	8.53	n.a.	n.a.	n.a.

	1969 QII	1969 QIII	1969 QIV	1970 Jan.	1970 Feb.
	Change During Period				
Change in monetary aggregates (SAAR, per cent)					
Total reserves	1.2	-9.3	1.4	3.0	-14.7
Nonborrowed reserves	-4.7	-4.8	-0.1	7.0	-19.2
Credit proxy	-2.2	-9.4	0.1	-4.2	-8.4
Credit proxy + nondep. funds	n.a.	-4.0	2.1	-3.1	-6.3
Money supply	4.5	--	1.2	9.6	-10.7
Time and savings deposits	-3.0	-13.3	--	-12.4	--
Deposits at S&L's and MSB's	3.9	2.1	1.2	-5.0	n.a.
Bank credit, end-of-month	6.1	-0.8	2.1	-7.5	4.5e
Treasury securities	-8.4	-11.4	-21.2	-44.0	-7.2e
Other securities	0.6	-7.2	--	6.8	--
Total loans	10.9	3.1	7.2	-3.9	7.8e
Business	10.8	5.1	5.0	-9.2	4.6e

	1969 QII	1969 QIII	1969 QIV	1969 Dec.	1970 Jan.
Commercial paper (SA change, $ mil.)	3,683	3,552	2,973	935	1,307
Bank related (NSA change, $ mil.)	n.a.	1,254	1,713	130	1,221

	1968 Year	1969 Year	1969 Jan.	1969 Feb.	1970 Jan.	1970 Feb.
New security issues (NSA, $ mil.)						
Total corp. issues	21,965	27,192	2,075	2,045	2,400e	1,900e
Public offerings	15,314	21,290	1,440	1,649	2,100e	1,600e
State and local government bond offerings	16,574	11,881	1,262	987	1,300e	1,200e
Fed. sponsored agency debt (change)	+ 3,354	+ 9,292	+ 322	+ 269	+ 467	+1,182
Fed. gov't. debt (change)	15,300	-2,258	1,626	-1,887	- 194	- 100

n.a. - Not available. e - Estimated. p - Preliminary.
SAAR - Seasonally adjusted annual rate. NSA - Not seasonally adjusted.

U.S. BALANCE OF PAYMENTS
In millions of dollars; seasonally adjusted

	1968	1 9 6 9				1970
	Year	Year^p	II	III^p	IV^p	Jan.^p*
Goods and services, net 1/	2,516		306	745		
Trade balance 2/	626	674	0	337	438	40
Exports 2/	33,598	36,484	9,599	9,580	9,827	3,270
Imports 2/	-32,972	-35,810	-9,599	-9,243	-9,389	-3,230
Service balance	1,890		306	408		
Remittances and pensions	-1,159		-287	-307		
Govt. grants & capital, net	-3,955		-1,155	-1,052		
U.S. private capital	-5,157		-2,002	-1,321		
Direct investment	-3,025		-1,057	-1,095		
Foreign securities	-1,266	-1,378	-427	-562	-66	
Banking claims	269	-528	-501	217	-326	431
Other	-1,134		-17	119		
Foreign capital	9,277		4,525	3,558		
Official foreign, nonliquid	2,282		-278	-592		
Official foreign, liquid	-3,099	-525	-570	2,132	-954	666
Foreign commercial banks, liquid	3,382	9,252	4,802	1,274	215	101
New direct investment issues 3/	2,129		150	216		
U.S. corporate stocks	2,084	1,515	127	169	468	-46
Other	2,499		294	359		
U.S. monetary reserves (increase -)	-880	-1,254	-299	-686	-221	-432
Gold stock	1,173	-967	-317	-11	-695	-23
Special drawing rights	--	--	--	--	--	4/ -899
IMF gold tranche	-870	-1,034	-228	-233	-542	3
Convertible currencies	-1,183	747	246	-442	1,016	487
Errors and omissions	-642		-1,088	-937		
BALANCES, (deficit -)						
Official settlements balance, S.A.			1,236	-926	1,323	
" " " , N.S.A. 5/	1,638	2,777	1,202	-1,046	910	391
Liquidity balance, S.A.			-3,871	-2,581	1,137	
" " , N.S.A.	168	-6,985	-3,812	-2,949	1,051	-413
Adjusted over-all balance, S.A.			-3,566	-2,200	1,108	
" " " , N.S.A. 6/	-1,744	-6,475	-3,514	-2,576	1,045	290
Financed by:						
Liab. to comm. banks (decrease -)	3,382	9,252	4,716	1,530	-135	101
Official settlements 7/	-1,638	-2,777	-1,202	1,046	-910	-391

* Only exports and imports are seasonally adjusted.
1/ Equals "net exports" in the GNP, except for latest revisions.
2/ Balance of payments basis which differs a little from Census basis.
3/ New issues sold abroad by U.S. direct investors.
4/ Includes initial allocation of SDR ($867 million) plus purchases during January.
5/ Differs from liquidity balance by counting as receipts (+) increase in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increases in certain nonliquid liabilities to foreign official institutions.
6/ Represents the net result of all international transactions of the U.S. other than changes in reserve assets, in all liabilities to foreign monetary authorities and in liabilities to commercial banks abroad (including U.S. bank branches) reported by banks in the U.S.
7/ Minus sign indicates decrease in net liabilities.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. There has been little in the recent economic picture to suggest any significant change in the outlook presented in the Chart Show last month. Demands have weakened further in key sectors about as expected, and downward production adjustments have continued, with increased reports of layoffs and shorter workweeks.

Revised GNP data confirm that growth of the economy halted last quarter, with real GNP declining by half a per cent, annual rate. Cessation of growth was the cumulative result of the continued sluggishness in consumer outlays, weakness in residential construction, curtailed spending for defense and a slowing in inventory accumulation. These same tendencies appear likely to continue to dominate economic activity over the next several months, and in real terms, we expect a decline in GNP this quarter of about 1-1/2 per cent, annual rate, and no growth in the second quarter.

PROJECTED CHANGES IN GNP AND RELATED ITEMS, 1970

	First quarter		Second quarter	
	February proj.	Current proj.	February proj.	Current proj.
GNP ($ billion)	6.9	6.8	9.0	8.5
Final sales ($ billion)	9.2	8.5	11.5	11.0
Real GNP (per cent)	-1.3	-1.3	-0.2	-0.5
GNP deflator (per cent)	4.2	4.2	4.0	4.0

With virtually every sector of final demand declining or showing less strength, we anticipate that growth of final sales in the current quarter will be $4 billion less than in the fourth quarter. An expected pickup in personal consumption expenditures in the second quarter could boost the increase in final sales to about $11 billion. But a further reduction in the rate of inventory accumulation still seems in prospect as high stock levels are brought closer into line with sales, particularly in durable goods. The sharp further cuts scheduled in defense outlays also may induce lower inventory investment in defense industries. On the other hand, the return to production at G.E. after the strike may moderate the decline in accumulation somewhat this quarter.

Weakness in consumer demands, which has been an important element in the slackening of over-all growth during the past half year, continues very much in evidence. Retail sales declined in January for the third month in a row, and figures for the first three weeks suggest that February sales will be down by another one per cent or more. Unit domestic auto sales for the first quarter now appear likely to average one tenth below the fourth quarter, despite the pickup in late February.

As a result of the general weakness in durables, we have reduced our projection of the increase in consumer expenditures for the first quarter by about $1 billion, with outlays for consumer durables now expected to be down by $2-1/2 billion from the fourth quarter.

We are assuming that a sharp increase in disposable income in the second quarter--reflecting largely the payment of Social Security benefits retroactive to the beginning of the year--will stimulate some rebound in consumer demand. But the newest Census buying expectations survey (taken in January) does not suggest any substantial improvement in total consumer outlays during the first half--in fact, consumers report plans for reduced spending for appliances and furniture--although some recovery in auto purchases is also indicated. Therefore, we have moderately reduced our earlier estimate of the second quarter consumption rise, raising the increase in the personal saving rate somewhat further. The saving rate, at 7.1 per cent, would be the highest since the spring of 1968.

Residential construction also weakened further in January, and there were strong signs of further declines on the way. Private housing starts dropped by 7 per cent to an annual rate of 1.17 million, about in line with our projection for the first quarter. Building permits in January dropped precipitously by nearly a fourth to 950,000, annual rate, the lowest since February 1967. Commitments for new residential construction by banks and other mortgage lending institutions were also down sharply early in the year. Although FNMA and FHLB assistance should continue to moderate the decline in activity somewhat, it appears increasingly likely that starts will drop further in the months ahead. For now, we are holding with our earlier estimate of about one million units, annual rate, in the second quarter, although a sharper drop is not out of the question. Assuming the one million rate, dollar outlays for residential structures are likely to decline about $5-1/2 billion (annual rate) from the fourth to the second quarter.

Business capital spending remains the only sector of the economy continuing to show signs of significant expansiveness. Recent private surveys indicate that businessmen are now planning somewhat higher outlays for 1970 than they had reported in the late fall of last year, though a better indication of current plans will be provided by the Commerce-SEC survey, soon to be released. On the other hand, new orders for machinery and equipment have edged down in the past few months, and new appropriations may be topping out: NICB reported a 5 per cent decline in its fourth quarter survey of large manufacturers, although the backlog remains very large. With sales continuing to weaken, and corporate profits apparently declining, we continue to believe that there will be little if any further increase in capital spending after midyear.

We are still anticipating a resumption of growth of real GNP after midyear. Construction activity is likely to begin to recover, following an assumed easing during the spring in monetary restraint. In addition, gains in aggregate final sales are expected to strengthen after the first quarter, reflecting mainly improved consumer goods sales. This should help to improve stock-sales ratios, and to encourage resumption of a somewhat higher rate of inventory investment after midyear. We anticipate that the recovery in real growth will be modest, however, with expansion in real GNP rising to an annual rate of only about 2-1/2 per cent in the fourth quarter.

Some moderate easing of price pressures should be evident during the coming months, largely as a result of less urgent demands and an increased reluctance of markets to accept price increases. Moreover, some abatement of cost pressures should begin to be evident as well by the second half of the year. Given these expectations, we are projecting a slowing in the rise of the price deflator to 4 per cent in the second quarter and to about 3-1/2 per cent by yearend.

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

	1968	1969	1970 Proj.	1969 II	1969 III	1969 IV	1970 Projected I	1970 Projected II	1970 Projected III	1970 Projected IV
Gross National Product	865.7	932.1	975.7	924.8	942.8	952.2	959.0	967.5	980.7	995.7
Final sales	858.4	924.1	971.2	917.9	932.0	944.5	953.0	964.0	976.7	991.1
Private	658.1	709.5	750.5	705.0	715.0	726.2	734.4	744.6	755.4	767.4
Excluding net exports	655.6	707.4	746.8	703.4	712.3	723.5	730.4	740.3	752.5	763.8
Personal consumption expenditures	536.6	576.0	612.2	572.8	579.8	589.5	596.5	607.3	618.2	626.7
Durable goods	83.3	89.8	89.0	90.6	89.8	90.4	87.7	88.2	89.5	90.5
Nondurable goods	230.6	243.6	260.0	242.1	245.1	248.7	253.3	258.3	262.9	265.4
Services	222.8	242.6	263.2	240.1	244.9	250.3	255.5	260.8	265.8	270.8
Gross private domestic investment	126.3	139.4	139.1	137.4	143.3	141.8	139.9	136.5	138.3	141.7
Residential construction	30.2	32.2	27.6	32.7	31.4	31.6	28.9	26.0	26.3	29.1
Business fixed investment	88.8	99.2	107.0	97.8	101.1	102.5	105.0	107.0	108.0	108.0
Change in business inventories	7.3	8.0	4.5	6.9	10.7	7.7	6.0	3.5	4.0	4.6
Nonfarm	7.4	7.8	4.5	6.7	10.3	7.4	6.0	3.5	4.0	4.6
Net exports of goods and services	2.5	2.1	3.7	1.6	2.7	2.7	4.0	4.3	2.9	3.6
Gov't. purchases of goods & services	200.3	214.6	220.8	212.9	217.0	218.3	218.6	219.4	221.3	223.7
Federal	99.5	101.9	97.5	100.6	103.2	102.3	99.8	97.9	96.6	95.5
Defense	78.0	79.2	74.2	78.5	80.3	79.2	77.3	74.9	73.1	71.6
Other	21.5	22.7	23.2	22.1	22.9	23.1	22.5	23.0	23.5	23.9
State & local	100.7	112.7	123.3	112.3	113.8	116.0	118.8	121.5	124.7	128.2
Gross national product in constant (1958) dollars	707.6	727.5	729.5	726.7	730.6	729.8	727.3	726.5	729.7	734.4
GNP implicit deflator (1958 = 100)	122.3	128.1	133.8	127.3	129.0	130.5	131.9	133.2	134.4	135.6
Personal income	687.9	747.2	794.2	740.5	756.5	767.4	776.3	792.3	799.0	809.3
Wages and salaries	465.0	509.9	540.5	504.3	516.9	525.0	531.0	536.3	543.1	551.5
Disposable income	590.0	629.7	675.8	622.0	639.0	647.5	658.3	671.9	682.6	690.3
Personal saving	38.4	37.6	46.7	33.3	43.1	41.7	44.9	48.0	47.5	46.5
Saving rate (per cent)	6.5	6.0	6.9	5.3	6.7	6.4	6.8	7.1	7.0	6.7
Corporate profits before tax	91.1	94.0	85.3	95.4	92.5	92.5*	87.5	85.0	84.0	84.5
Federal government receipts and expenditures (N.I.A. basis)										
Receipts	176.3	201.6	196.8	202.8	201.3	203.7*	197.4	198.7	194.2	196.7
Expenditures	181.5	192.0	201.1	189.3	193.6	196.7	197.4	205.2	201.0	200.9
Surplus or deficit (-)	-5.2	9.6	-4.3	13.5	7.7	7.0*	0.0	-6.5	-6.8	-4.2
Total labor force (millions)	82.3	84.2	85.6	83.9	84.6	85.0	85.2	85.3	85.7	86.1
Armed forces "	3.5	3.4	3.2	3.5	3.5	3.5	3.4	3.2	3.1	3.1
Civilian labor force "	78.7	80.7	82.4	80.4	81.0	81.5	81.8	82.1	82.6	83.1
Unemployment rate (per cent)	3.6	3.5	4.7	3.5	3.6	3.6	4.2	4.6	4.9	5.1
Nonfarm payroll employment (millions)	67.9	70.1	70.8	70.0	70.4	70.6	70.7	70.6	70.6	71.2
Manufacturing	19.8	20.1	19.7	20.1	20.2	20.1	20.0	19.7	19.5	19.7
Industrial production (1957-59=100)	165.5	172.8	169.9	172.6	174.3	171.9	169.8	168.5	169.7	171.7
Capacity utilization, manufacturing (per cent)	84.6	83.7	78.1	84.5	84.2	81.7	79.5	78.0	77.6	77.4
Housing starts, private (millions A.R.)	1.51	1.46	1.15	1.51	1.43	1.31	1.12	1.03	1.15	1.30
Sales new domestic autos (millions, A.R.)	8.62	8.46	7.64	8.54	8.45	8.13	7.20	7.60	7.75	8.00

* Implied in Commerce estimate for 1969.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1968	1969	1970 Proj.	1969 II	1969 III	1969 IV	1970 Projected I	1970 Projected II	1970 Projected III	1970 Projected IV
	-----	-----	-----	-----In Billions of Dollars-----	-----	-----	-----	-----	-----	-----
Gross National Product	72.2	66.4	43.6	16.1	18.0	9.4	6.8	8.5	13.2	15.0
Inventory change	-0.1	0.7	-3.5	0.3	3.8	-3.0	-1.7	-2.5	0.5	0.6
Final sales	72.2	65.7	47.1	15.8	14.1	12.5	8.5	11.0	12.7	14.4
Private	52.0	51.4	41.0	12.9	10.0	11.2	8.2	10.2	10.8	12.0
Excluding net exports	54.7	51.8	39.4	12.8	8.9	11.2	6.9	9.9	12.2	11.3
Net exports	-2.7	-0.4	1.6	0.1	1.1	0.0	1.3	0.3	-1.4	0.7
Government	20.2	14.3	6.2	2.9	4.1	1.3	0.3	0.8	1.9	2.4
GNP in constant (1958) dollars	33.0	19.9	1.8	3.6	3.9	-0.8	-2.5	-0.8	3.2	4.7
Final sales	33.3	19.6	5.1	3.5	0.6	1.8	-1.0	1.4	2.7	4.2
Private	24.9	18.3	8.6	3.9	1.4	2.8	0.0	3.0	3.2	4.0
	-----	-----	-----	-----In Per Cent Per Year-----	-----	-----	-----	-----	-----	-----
Gross National Product	9.1	7.7	4.7	7.1	7.8	4.0	2.9	3.5	5.5	6.1
Final sales	9.2	7.7	5.1	7.0	6.1	5.4	3.6	4.6	5.3	5.9
Private	8.5	7.8	5.8	7.5	5.7	6.3	4.5	5.6	5.8	6.4
Personal consumption expenditures	9.0	7.3	6.3	7.7	4.9	6.7	4.7	7.2	7.2	5.5
Durable goods	14.1	7.8	-0.9	10.0	-3.5	2.7	-11.9	2.3	5.9	4.5
Nondurable goods	7.2	5.6	6.7	5.9	5.0	5.9	7.4	7.9	7.1	3.8
Services	9.1	8.9	8.5	8.7	8.0	8.8	8.3	8.3	7.7	7.5
Gross private domestic investment	8.9	10.4	-0.2	6.5	17.2	-4.2	-5.4	-9.7	5.3	9.8
Residential construction	20.8	6.6	-14.3	-7.2	-15.9	2.5	-34.2	-40.1	4.6	42.6
Business fixed investment	6.1	11.7	7.9	10.5	13.5	5.5	9.8	7.6	3.7	0.0
Gov't. purchases of goods & services	11.2	7.1	2.9	5.5	7.7	2.4	0.5	1.5	3.5	4.3
Federal	9.7	2.4	-4.3	-3.9	10.3	-3.5	-9.8	-7.6	-5.3	-4.6
Defense	7.7	1.5	-6.3	-2.5	9.2	-5.5	-9.6	-12.4	-9.6	-8.2
Other	16.8	5.6	2.2	-8.9	14.5	3.5	-10.4	8.9	8.7	6.8
State & local	12.8	11.9	9.4	14.0	5.3	7.7	9.7	9.1	10.5	11.2
GNP in constant (1958) dollars	4.9	2.8	0.2	2.0	2.1	-0.4	-1.3	-0.5	1.7	2.6
Final sales	5.0	2.8	0.7	2.0	0.3	1.0	-0.6	0.8	1.5	2.3
Private	4.7	3.3	1.5	2.8	1.0	2.0	0.0	2.1	2.2	2.8
GNP implicit deflator *	4.0	4.7	4.4	5.1	5.6 1/	4.5	4.2	4.0	3.7	3.5
Personal income	9.3	8.6	6.3	8.9	8.6	5.8	4.6	8.2	3.4	5.2
Wages and salaries	9.8	9.7	6.0	8.9	10.0	6.3	4.6	4.0	5.1	6.2
Disposable income	8.0	6.7	7.3	7.7	10.9	5.3	6.7	8.3	6.4	4.5
Corporate profits before tax	13.4	3.2	-9.3	0.4	-12.2	0.0	-21.6	-11.4	-4.7	2.4
Federal government receipts and expenditures (N.I.A. basis)										
Receipts	16.7	14.4	-2.4	8.5	-3.0	4.8	-12.4	2.6	-9.1	5.1
Expenditures	10.8	5.8	4.7	1.7	9.1	6.4	1.4	15.8	-8.2	-0.2
Nonfarm payroll employment	3.0	3.4	1.0	3.3	2.0	1.5	0.6	-0.6	0.0	3.4
Manufacturing	2.1	1.8	-2.0	1.6	1.8	-3.4	2.0	-6.0	-4.1	4.1
Industrial production	4.7	4.4	-1.7	5.6	3.9	-5.5	-4.9	-3.1	2.8	4.7
Housing starts, private	16.7	-2.9	-21.2	-48.3	-21.5	-33.8	-57.3	-35.6	48.8	52.2
Sales new domestic autos	14.0	-1.9	-9.8	8.4	-4.2	-15.1	-45.7	22.2	7.9	12.9

* Based on deflators calculated to three decimals.

1/ Excluding Federal pay increase 4.3 per cent.

<u>Industrial production</u>. Industrial production is tentatively estimated to have changed little in February from the preliminary January index of 169.9 per cent of the 1957-59 average. The rise in output because of the settlement of the G.E. strike in early February is expected to offset further production declines in some other industries.

Auto assemblies were reduced further in February to a seasonally adjusted annual rate of 6.5 million units from 6.8 million units in January. Preliminary production schedules for March are at a 6.9 million unit rate. Among other consumer goods, output of television sets rose in February from the low January level and production of electrical appliances increased from the earlier strike reduced level.

Output of business equipment is estimated to have recovered partially in February because of the strike settlement. Truck production, however, declined further as sales dropped sharply in January and were 10 per cent below a year earlier. New strikes in the electrical equipment industry and at International Harvester also will dampen somewhat the February recovery in business equipment. Output of raw steel, the only other major industry for which February data are available, was down about 2 per cent.

The decline in industrial production from the July 1969 peak to January 1970 has amounted to only 2.7 per cent, of which about .7 per cent is directly attributable to the G.E. strike. The largest downward readjustments in output have been in consumer durable goods and durable goods materials and half of the decline in these two sectors is attributable to the 30 per cent curtailment in auto production. If unit sales

INDUSTRIAL PRODUCTION IN JANUARY 1970

	Per cent changes January 1970 from	
	Month ago	July 1969*
Total index	- .7	- 2.7
Final products	- .4	- 3.2
Consumer goods	0	- 2.6
Durable	- .9	-12.0
Nondurable	.3	.8
Equipment	-1.2	- 4.2
Business	-1.0	- 2.8
Defense	-1.8	- 9.5
Materials	- .9	- 2.3
Durable	-1.6	- 4.3
Nondurable	- .3	- .5

* High for total index.

of new domestic autos level off at about or moderately below the 7.9 million unit rate of February, some increase in auto assemblies might occur in the second quarter. With output of television sets and appliances curtailed 25 per cent since mid-1969, factory stocks declined almost 15 per cent from September to the end of January. Unless retail sales of these goods decline appreciably further, output readjustments in these lines may also be about completed.

Production of business equipment rose at an annual rate of 8 per cent from July to October 1969, when the total index was easing off, but then declined 5 per cent (20 per cent annual rate) through January largely because of the G.E. strike. At present the major apparent weaknesses in this sector are in farm machinery and trucks. Demand is increasing for telephone and electrical utility equipment and has not diminished for manufacturing equipment. Output of defense equipment, however, is expected to decline further in the months ahead.

Output of metal goods materials declined 4 per cent from July to January, mainly because consumption was curtailed in the production of consumer metal goods. If the readjustments in production of consumer durable goods are largely over and if output of business equipment is maintained, any further cutbacks in durable materials may well be small. Under such circumstances, large additional declines in the industrial production index in coming months would be quite unlikely.

Retail sales. Data for the first three weeks of February suggest that sales for the month as a whole may have been about 1 per cent below January. In real terms, February apparently was the ninth month in which sales were below year-earlier levels.

Total durable goods sales in February are tentatively estimated to have been lower than in January, with furniture and appliances, lumber, building material, and hardware weakening to about the same extent. Sales of nondurable goods apparently increased slightly, with all important types of stores up.

PERCENTAGE CHANGE IN RETAIL SALES FROM PREVIOUS QUARTER OR MONTH

	1969			1970
	II	III	IV	December to January
Total - all stores	1.2	- .5	.9	-1.0
Durables	.6	-3.2	.6	-4.7
Durables, ex. autos	1.4	-5.8	.1	- .4
Nondurables	1.5	.7	1.1	.7
Food group	- .2	1.2	1.5	.5
General merchandise	5.0	2.1	.4	3.2
Total, real*	- .3	-1.8	- .4	-1.1

* Deflated by all commodity CPI.

Unit sales of new domestic autos, which had been weak in the first 20 days of February, advanced sharply in the last 10 days bringing the total for the month to a seasonally adjusted annual rate of 7.9 million units--one-sixth above the January total of 6.8 million. It is difficult to appraise the significance of this recent upsurge for the months immediately ahead. Newspaper accounts suggested that it was largely attributable to the introduction of two new GM models and the widespread resort in the industry to dealer incentive contests.

January Census buying expectations. The January survey of buying expectations showed conflicting movements, with indications of a further decline in purchases of homes, appliances and furniture, but an improvement in new car sales in the next six months.

The index of expected purchases of houses (either new or used), which had been generally low since the end of 1968, drifted lower in January. In addition, the number of major appliances likely to be gought by households dropped sharply and the per cent of households planning major expenditures on furniture and carpets was also down. However, plans for increased expenditures on home improvements rose somewhat.

The mean probability of a family expecting to receive a substantial income increase within 12 months was at a record high for the three years this survey has been conducted in its present form. While all income groups below $10,000 showed some increase, a large proportion of this improvement in income expectations was among households with incomes under $3,000 which probably reflects anticipated higher Social Security payments due in April.

The index of expected auto purchases, seasonally adjusted, was 104.7 in January--higher than in any quarter of 1969 and all but the third quarter of 1968. But since the higher level of automobile buying plans appears to be associated with a surprising rebound in income anticipations of persons in the $5 ,000 to $7,499 category, there is more doubt than usual about the significance of the increase in car purchase plans.

CONSUMER BUYING EXPECTATIONS - SELECTED RESULTS
BY QUARTERS

	1969				1970
	Jan.	Apr.	July	Oct.	Jan.
INDEXES OF EXPECTED 6-MONTH UNIT PURCHASES (Seasonally adjusted. Jan. and Apr. 1967 = 100)					
New cars	99.4	103.3	104.0	100.8	104.7
Houses	89.3	99.3	93.0	94.1	94.1
EXPECTATIONS TO BUY FURNITURE, APPLIANCES, AND HOME IMPROVEMENTS WITHIN 12 MONTHS					
Number of major appliances reported Likely to be bought per 100 households	27.9	25.8	26.2	28.6	25.5
Per cent of households reporting probable major expenditures on--					
Furniture and carpets	25.2	26.9	25.3	28.0	25.2
Home improvements	8.1	9.5	8.5	7.7	8.4
MEAN PROBABILITIES OF RECEIVING SUBSTANTIAL INCOME INCREASES WITHIN 12 MONTHS (Average number of chances in 100)					
All households	16.5	18.1	18.6	17.6	20.1

Cyclical indicators. The preliminary leading indicator composite declined 1.8 per cent in January and was 2.7 per cent below its September high. The coincident composite declined for the second month and the lagging composite rose slightly.

COMPOSITE CYCLICAL INDICATORS
1963 = 100

		12 Leading indicators 1/	5 Coincident indicators	6 Lagging indicators
1969:	September	153.5	172.2	196.0
	October	153.2	173.1	198.9
	November	152.2	173.4	198.4
	December	152.1	173.2	201.1
1970:	January (prel.)	149.3	171.6	201.8

1/ Trend adjusted.

Three of the eight components of the leading composite were still rising in January: contracts and orders for plant and equipment (reflecting a further rise in commercial and industrial building contracts), industrial materials prices, and the ratio of price to unit labor cost in manufacturing.

Among the coincident indicator components, the three production and employment indicators were down, but personal income was up; total manufacturing and trade sales were not available for inclusion in the preliminary composite.

The latest month's drop in the preliminary leading composite was relatively steep. The current four-month decline of 2.7 per cent is comparable to declines which have preceded or accompanied recessions; however, the leading index has also shown declines of about this magnitude that were followed by relatively mild adjustments.

<u>Orders and shipments</u>. New orders for durable manufactured goods dropped 5 per cent in January. The aerospace and electrical machinery industries accounted for more than half of the total decline, with both defense and capital equipment orders down sharply. Orders for consumer durables and construction materials continued to decline. The only increase was in the iron and steel group, where hedging against February price increases may have raised January orders.

There was some upward revision in the November and December figures, but the January level of new orders was 10 per cent below the September peak, 7-1/2 per cent below the fourth-quarter average, and the lowest since September 1968.

NEW ORDERS FOR DURABLE GOODS
Per cent changes

	January 1970 from December 1969
Total durable goods	- 5.2
Primary metals	.7
Iron and steel	3.9
Other primary metals	- 1.7
Motor vehicles and parts	- 4.7
Household durable goods	- 5.2
Defense products	- 11.4
Capital equipment	- 9.8
All other durable goods	- 2.5

Durable goods shipments and backlogs also decreased in January. Shipments and orders rose slightly at nondurable goods manufacturers.

The decline in durable goods backlogs was significant in amount and widespread among industry and market groups; there was a particularly sharp decline at iron and steel plants. The exception was electrical machinery, where the strike probably kept backlogs from being worked off.

Inventories. Inventory growth at manufacturers slowed in January, as the book value of nondurable stocks declined. Durable stock additions continued at about the December pace.

Trade inventory data for January are not yet available, but information on unit new car production, sales, and stocks suggests that auto dealer's stocks may have declined further.

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

	1969		1970
	Q IV average	December	January
Manufacturing and trade, total	12.7	11.1	n.a.
Manufacturing, total	6.8	5.9	3.1
Durable	6.1	5.7	5.2
Nondurable	0.7	0.2	- 2.1
Trade, total	5.9	5.2	n.a.
Wholesale	1.8	1.6	n.a.
Retail	4.1	3.6	n.a.
Automotive	0.6	- 3.1	n.a.

Durable goods manufacturing inventory-sales and inventory-backlog ratios continued to climb in January, and were above the levels of January 1967, when a substantial slowdown in inventory accumulation was underway.

INVENTORY RATIOS

	1966 December	1967 January	1969 December	1970 January
Inventories to sales:				
Manufacturing and trade, total	1.56	1.57	1.59	n.a.
Manufacturing, total	1.72	1.76	1.73	1.74
Durable	2.00	2.06	2.10	2.13
Nondurable	1.37	1.40	1.29	1.28
Inventories to unfilled orders, durable manufacturing	.639	.653	.733	.749

Construction and real estate. Total outlays for new construction put in place, which were revised somewhat for January, edged off further in February and, at a seasonally adjusted annual rate of $88.0 billion, were 5 per cent below the peak reached last April. While the year-to-year decline in current dollars amounted to only 4 per cent, it came to nearly 10 per cent after allowance for cost increases as measured by the Census Bureau.

Within the private sector, expenditures for residential construction, which lag starts, continued to move steadily downward and in February were nearly a fifth under the high achieved in April of 1969. Outlays for private nonresidential structures, although still above a year-earlier, remained moderately below the peak established last September.

Public construction outlays--already down sharply from their April 1969 high--changed little in February as expenditures by State and local governments held at their reduced January rate. Some further decline in such expenditures is indicated for the period ahead, as discussed in Appendix B on the results of our recent survey of State and local borrowing realizations in the fourth quarter of last year.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	February 1970 ($ billions)1/	Per cent change from January 1970	Per cent change from February 1970
Total	88.0	-1	- 4
Private	60.9	-1	- 3
Residential	27.7	-3	-12
Nonresidential	33.2	--	+ 7
Public	27.1	--	- 8
Federal	3.3	+4	- 5
State and local	23.8	--	- 9

1/ Seasonally adjusted annual rates; preliminary. Data for the most recent month, February, are confidential Census Bureau extrapolations. In no case should public reference be made to them.

Seasonally adjusted private housing starts continued downward in January to an annual rate of 1.17 million units, the lowest since April 1967. As in most other recent months, the decline was most pronounced for multifamily units, which--unlike single-family starts--had been at a near-peak in January of 1969 and had actually achieved a record total for 1969 as a whole. Regionally, starts in the Northeast and North Central states--already close to their 1966 lows--turned upward sharply, although not by enough to offset further reductions in the South and West.

The magnitude of the January drop in residential building permits was unprecedented, although the preliminary figures may have overstated the actual decline. (For December, for example, the rate initially reported was revised upward by 5 per cent.) These and related mortgage market indications continue to point to persistence of the decline in starts over the period immediately ahead. Thus, even if starts held at or near a 1.15 million seasonally adjusted annual rate in February, the first quarter average seems unlikely to be much over a 1.1 million unit rate. This would compare with a 1.31 million rate in the fourth quarter of 1969 and would be the lowest for any quarter in the past three years.

PRIVATE HOUSING STARTS AND PERMITS

	January 1970 (Thousands of units) 1/	Per cent change from	
		December 1969	January 1969
Starts	1,166	- 7	-38
1-family	695	- 3	-35
2-or-more-family	471	-12	-42
Northeast	171	+20	-46
North Central	315	+23	-44
South	467	-18	-39
West	213	-26	-15
Permits	952	-23	-32
1-family	457	-28	-32
2-or-more-family	495	-19	-32

1/ Seasonally adjusted annual rates; preliminary.

Underscoring the pressure of demands on available residential space this winter, rental vacancy rates moved downward further during the fourth quarter of 1969. The national average--at 4.7 per cent--was the lowest for any quarter in the history of the series, which began in 1956. Vacancy rates for home-owner properties available for sale--a less sensitive series--also remained exceptionally low by most earlier standards.

RESIDENTIAL VACANCY RATES
(Per cent)

	Average for fourth quarter of:					
	1956	1965	1966	1967	1968	1969
Rental units, U.S.	5.3	7.7	7.0	5.6	4.9	4.7
Northeast	2.8	5.1	4.9	3.9	3.1	2.2
North Central	5.1	6.6	5.8	5.1	4.7	5.6
South	7.3	8.4	7.6	6.4	6.2	6.4
West	6.9	11.7	10.9	7.4	6.1	4.7
Home-owner units,U.S.	0.8	1.4	1.2	1.2	1.1	1.0

Anticipated spending for plant and equipment. Two private surveys have recently reported upward revisions in businessmen's 1970 plans for investment in new plant and equipment. Preliminary Rinfret-Boston results indicate current plans for a 14 per cent increase over 1969; the same survey reported a planned increase of 8 per cent last September. Edie now shows a 10 per cent rise as opposed to 7 per cent in September. In December OBE-SEC reported plans for a 9 per cent gain. (Another OBE-SEC report is expected about March 6.) The Rinfret-Boston and Edie surveys are meant to be comparable with the Commerce-SEC survey although they are smaller in size and differ somewhat in sample and detail. The Edie survey has been in operation longer and has been slightly more accurate in the two years for which direct comparisons are available. In the past, neither of these surveys has been especially accurate in magnitude of change--both have an average absolute error of 5 percentage points--compared with an average absolute error of 2 points for the Commerce-SEC surveys.

The two surveys differ considerably in the pattern of recent changes. In both surveys there were upward revisions from their fall results in most industries--in the Rinfret-Boston survey most of the net upward revision is in the nonmanufacturing sector (which is a very weak part of their sample) while in the Edie survey changes are concentrated in manufacturing, especially in durable goods. Primary iron and steel, motor vehicles, other transportation equipment, and rubber show downward revisions in both surveys. Especially large upward revisions are reported for utilities, communication-commercial and other, railroads, and machinery.

ANTICIPATED EXPENDITURES FOR NEW PLANT AND EQUIPMENT
Per cent change 1969-1970

	1969	McGraw-Hill	Commerce-SEC	Rinfret-Boston		Edie	
	actual	11/69	12/69	10/69	3/70	10/69	2/70
All business	11	8	9	8	14	7	10
Manufacturing	12	9	7	7	8	4	9
Durable	13	7	4	3	7	4	10
Nondurable	11	11	11	11	9	4	8
Nonmanufacturing	11	8	11	9	19	8	11

The latest NICB survey indicates that new appropriations for capital spending by the 1,000 largest manufacturing companies declined 5 per cent in the fourth quarter of 1969 after rising slightly in the third quarter. Sizable percentage reductions were reported for the nonferrous metals, motor vehicles, chemicals, and rubber industries, with iron and steel showing somewhat less of a decline. Substantial increases in appropriations by producers of fabricated metals, food and beverages, and petroleum products helped cushion the over-all decline.

Despite the fourth quarter decline in newly approved appropriations, the manufacturing capital spending outlook for 1970 remains relatively strong. Backlogs of unspent appropriations were at a record level at the end of the year and were sufficient to maintain recent rates of expenditures through the summer. A rate of expenditures by these manufacturing companies throughout 1970 at the 1969 third and fourth quarter average rate would itself result in outlays 4.7 per cent above those in 1969, compared with a 12 per cent increase in 1969.

Labor market. State unemployment insurance claims continued to increase through mid-February and the unemployment rate seems likely to rise further. The number of workers drawing unemployment pay in mid-February was 28 per cent above a year earlier, while initial claims were up 43 per cent over the year. To a large extent, the higher levels reflect the effects of sharply reduced demand for autos; more indefinite layoffs have occurred, a number of assembly plants have been temporarily closed in recent weeks and some supply and service firms have been forced to reduce production and employment. Layoffs also have increased in other sectors of manufacturing (largely defense-related activities such as ordnance and aircraft).

Recent increases in unemployment have occurred mainly among male blue-collar workers last employed in manufacturing or construction. Manufacturing separations exceeded hirings by a significant margin in

January, suggesting a further decline in manufacturing employment in February. However, the impact on employment of these layoffs may be temporarily offset by the return to work of G.E. strikers.

STATE INSURED UNEMPLOYMENT
(Weekly average, in thousands, seasonally adjusted)

	Initial claims	Insured unemployment
1969:		
October	198	1,152
November	210	1,195
December	212	1,214
1970:		
January	235	1,308
February*	265	1,355

* Estimates based on data for first two weeks of the month.

The recent rise of insured unemployment--which began from a very low level--has been about as rapid as during the 1960-1961 recession and the level of insured unemployment now appears likely to average 1.36 million (seasonally adjusted) in February, the highest since early 1965. Claims have increased sharply in several large industrial states (such as Michigan and Indiana) but there were also increases in most other states.

Labor costs. Unit labor costs increased by 6.4 per cent in the private nonfarm economy from 1968 to 1969--just short of the record increases of 1951 and 1956. In contrast to the latter increases, which followed several years of relatively stable unit labor costs, the 1969 rise extended a pronounced uptrend which began in 1966.

The small increase of output per manhour in 1969, in conjunction with the large rise in compensation per manhour, gave rise to the sharp increase in unit labor costs. In the fourth quarter, however, output per manhour increased, reflecting reductions in average hours and selective employment cuts. Such employment adjustments continued in a number of industries in January.

PRIVATE NONFARM ECONOMY
(Per cent)

	Increase from a year earlier		Increase from prior quarter (annual rate)
	1968	1969	IV 1969
Output per manhour	3.3	0.4	1.9
Compensation per manhour	7.4	6.8	7.5
Unit labor costs	3.9	6.4	5.5

The rate of increase of unit labor costs eased slightly in the fourth quarter and some further improvement in labor costs would be likely if productivity gains accelerated this year. However, substantial and sustainable improvement in the labor cost picture would also require a reduction in the size of wage and benefit increases. As of now, it appears unlikely that union and nonunion wage demands will be reduced; in fact, pre-bargaining position statements by Teamster and United Auto Worker union officials incorporate or imply very large wage demands. Such large increases are likely to be strongly opposed by employers who are now faced with weaker product demand, rising costs, and falling profits.

<u>Industrial relations</u>. Westinghouse and 80,000 union members reached agreement on a 40-month contract patterned after the G.E. pact. Wages are to be increased 8 per cent the first year (including a 3-cent immediate cost-of-living adjustment), 4 per cent the second year, and 3 per cent the third year. The average increase in wages and benefits, including likely cost-of-living adjustments, is estimated at slightly more than 7 per cent per year--less than the 8 per cent median increase in major contract settlements in 1969.

Negotiations between 48,000 members of four shopcraft unions and the railroads were resumed March 2, just as a court issued an injunction against selective or "whipsaw" strikes by the unions. However, possibility of a nationwide rail strike remains although the President has requested new legislation immediately to forestall this strike.

A three-year agreement reached in January by 80,000 garment workers with the women's dress industry provided for a 10 per cent first-year wage increase. Contracts affecting another 90,000 womens' garment workers expire at the end of May.

Wholesale prices. The rise in industrial prices slowed in February, according to early estimates, and the rise in prices of agricultural products was less rapid than in recent months. The industrial commodity index rose at an annual rate of about 2 per cent between mid-January and mid-February, the smallest rise since last summer when lumber and plywood prices were dropping precipitously. Moreover, price increases in February were less widespread than in recent months, and announcements of increases since the February pricing date have been similar to the February experience.

WHOLESALE PRICES
(Percentage changes at annual rates)

Commodity Group	Dec. 1968 to June 1969	June to Sept. 1969	Sept. to Dec. 1969	Dec. to Jan 1970	Jan. to Feb. 1970
All commodities	6.1	1.5	5.4	8.8	3.1
Industrial commodities	3.6	3.6	4.6	5.4	2.1
Farm products, and processed foods and feeds	13.0	- 4.0	7.4	18.0	3.0

Note: These percentage changes may differ from those derived from figures published by the BLS owing to differences in rounding procedures.

The Federal Reserve sensitive commodity index declined slightly in February according to preliminary estimates, reflecting stability in non-ferrous metals--which have been the fastest-moving component in industrial prices for some time--and a further decline in lumber and plywood prices. BLS sensitive crude material prices have risen about 2 per cent between mid-December and mid-February, but the rise is largely attributable to one item--iron and steel scrap prices, which may have reached their peak.

Supplies of most non-ferrous metals are improving. Aluminum supplies are adequate, while downward pressures on tin, lead, and zinc prices may be developing. (Planned sales of lead from the government stockpile have been cancelled, according to reports, owing to an expected plunge in prices if leaded gasoline is banned).

The steel industry continued in the pricing spotlight in February as a policy of not raising prices on rolled-steel products more than once in a twelve-month period was adopted by the industry. Price increases on about two-thirds of steel industry shipments have already been announced, and further price increases are considered likely. Nevertheless, the new policy, along with lower demand for steel products, seems to promise that steel price increases will be much less than last year when there were two major rounds of increases and continuous advances in between.

Despite signs of lessening pressure on metal prices, metals and metal products were mainly responsible for the rise in industrial commodities in February as increases were posted for steel mill products, iron and steel scrap, metal containers, and other metal products. The rise in prices of machinery, which accelerated in late

1969, showed some signs of easing, but this may have been partly seasonal. Fuels, agricultural chemicals, and paper products also increased while some textiles, leather and gasoline were lower. Although lumber prices exhibited contra-seasonal weakness, prices of other major building materials continued to rise sharply.

Meat prices declined in February, but prices of livestock--which were 15 per cent above a year earlier in January--rose further. Production of red meat in January was 4 per cent below last January, although beef production was up slightly. A decline in prices of eggs, chickens, vegetables, and sugar helped the food price picture.

Consumer prices. Consumer prices rose at a seasonally adjusted annual rate of over 7 per cent in January, about the same as in the preceding 2 months. Much of the January increase derived from an exceptionally sharp rise in service prices. However, food prices also continued to rise, and the decline in nonfood commodities was less than seasonal.

The sharp rise in service prices in January is attributable largely to transportation, especially the New York City transit fare increase, and higher automobile registration fees and insurance costs. The December increase was also very large; for 1969 as a whole there was a sharp acceleration in this category. Mortgage interest rates have been rising relatively slowly in the last few months. The rise in permitted interest rates on FHA and VA mortgages is being spread over several months in the series to allow for take-downs of previous commitments at lower rates. (A reduction in points will not affect the BLS series since it is assumed they are paid by the seller).

The rise in food prices in January was less sharp than in the preceding two months. Meat prices rose, seasonally adjusted, as did eggs, poultry, and milk, but fresh vegetables dropped. Although the advance in food prices may be moderating, a further rise is indicated for February by a preliminary run of BLS data.

Among nonfood commodities, new car prices declined less than seasonally. However, the usual clearance sales in January produced a seasonal decline in apparel prices, which last year increased almost without interruption. House prices, a component of durable goods, climbed fairly sharply.

CONSUMER PRICES*
(Percentage changes, seasonally adjusted, annual rates)

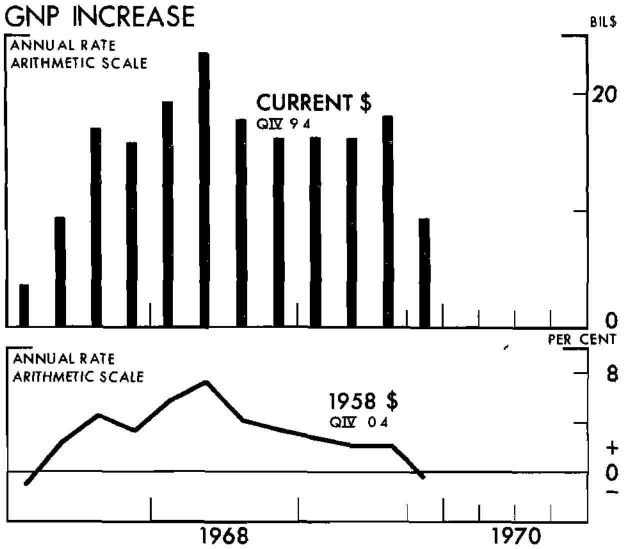
	Dec. 1968 to June 1969	June to Sept. 1969	Sept. to Dec. 1969	Nov. to Dec 1969	Dec 1969 to Jan 1970
All items	6.3	5.0	6.5	7.4	7.3
Durable commodities1/	5.5	1.8	5.0	4.2	3.2
New cars	2.2	0	4.3	5.8	5.8
Nondurable commodities	5.6	4.2	7.3	9.5	3.8
Food	6.3	5.4	10.1	14.9	4.6
Apparel	5.4	4.4	5.6	0.9	0
Services	7.5	7.5	6.3	9.0	10.5
Medical care	9.5	7.3	1.4	7.0	6.9
Rent	3.1	4.0	4.3	5.0	3.0
Transportation	8.0	4.8	12.2	21.4	36.4
Mortgage interest rates	15.3	9.8	4.1	2.6	2.6
Addendum:					
Nonfood commodities	5.0	2.4	5.1	5.0	3.0
Durable products2/	4.1	1.5	1.8	3.3	3.3
Services less home finance3/	5.7	5.8	5.3	7.9	10.1

1/ Includes home purchase as well as new and used cars and household durables.
2/ Excludes home purchase and used cars.
3/ Excludes mortgage interest, property taxes and insurance.
* Seasonal adjustment factors have been furnished by the BLS on a confidential basis. Services are not adjusted since seasonality is very slight.

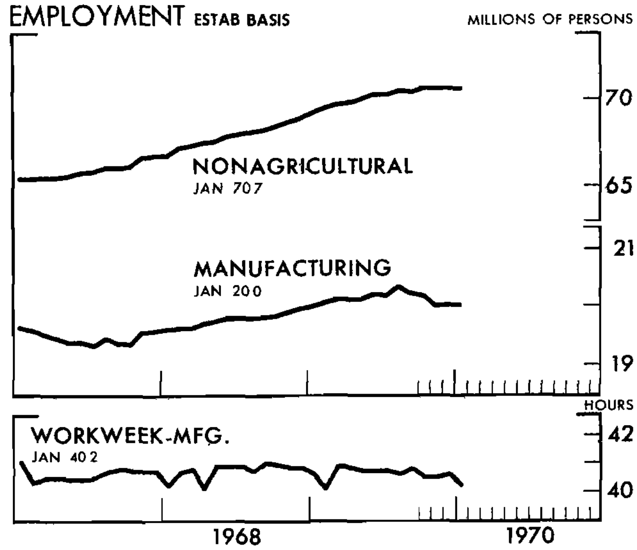
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

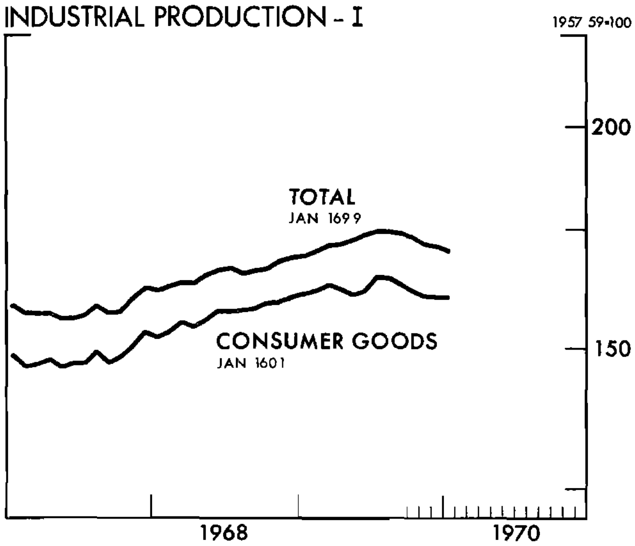
GNP INCREASE



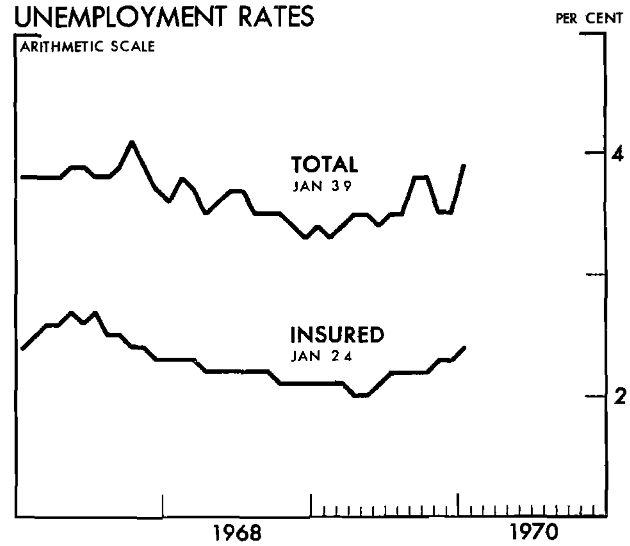
EMPLOYMENT ESTAB BASIS



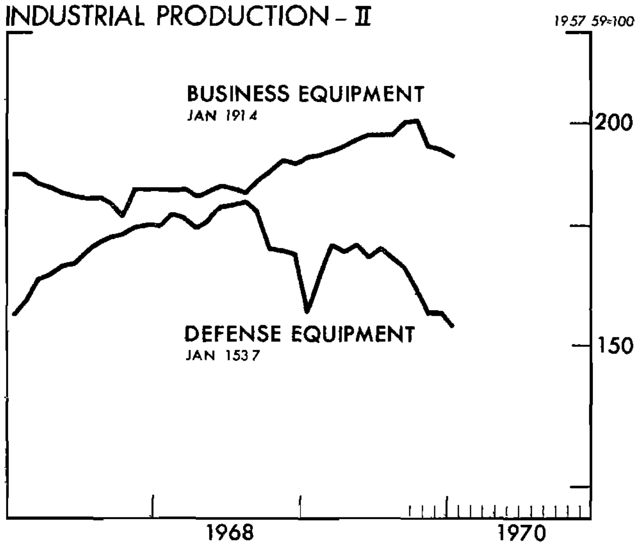
INDUSTRIAL PRODUCTION - I



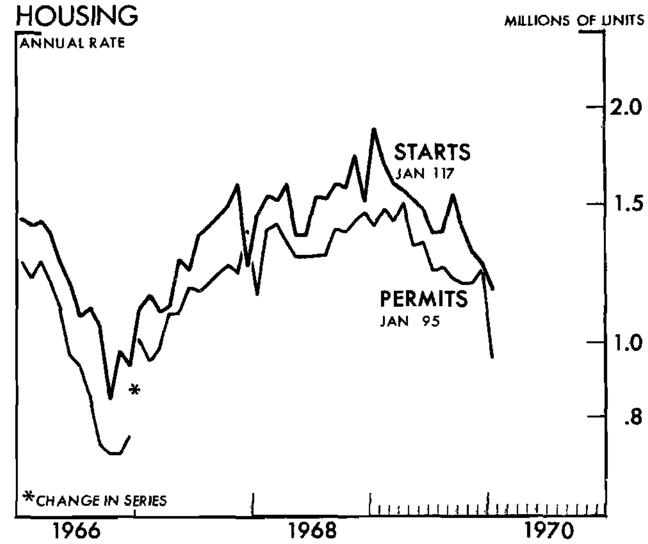
UNEMPLOYMENT RATES



INDUSTRIAL PRODUCTION - II

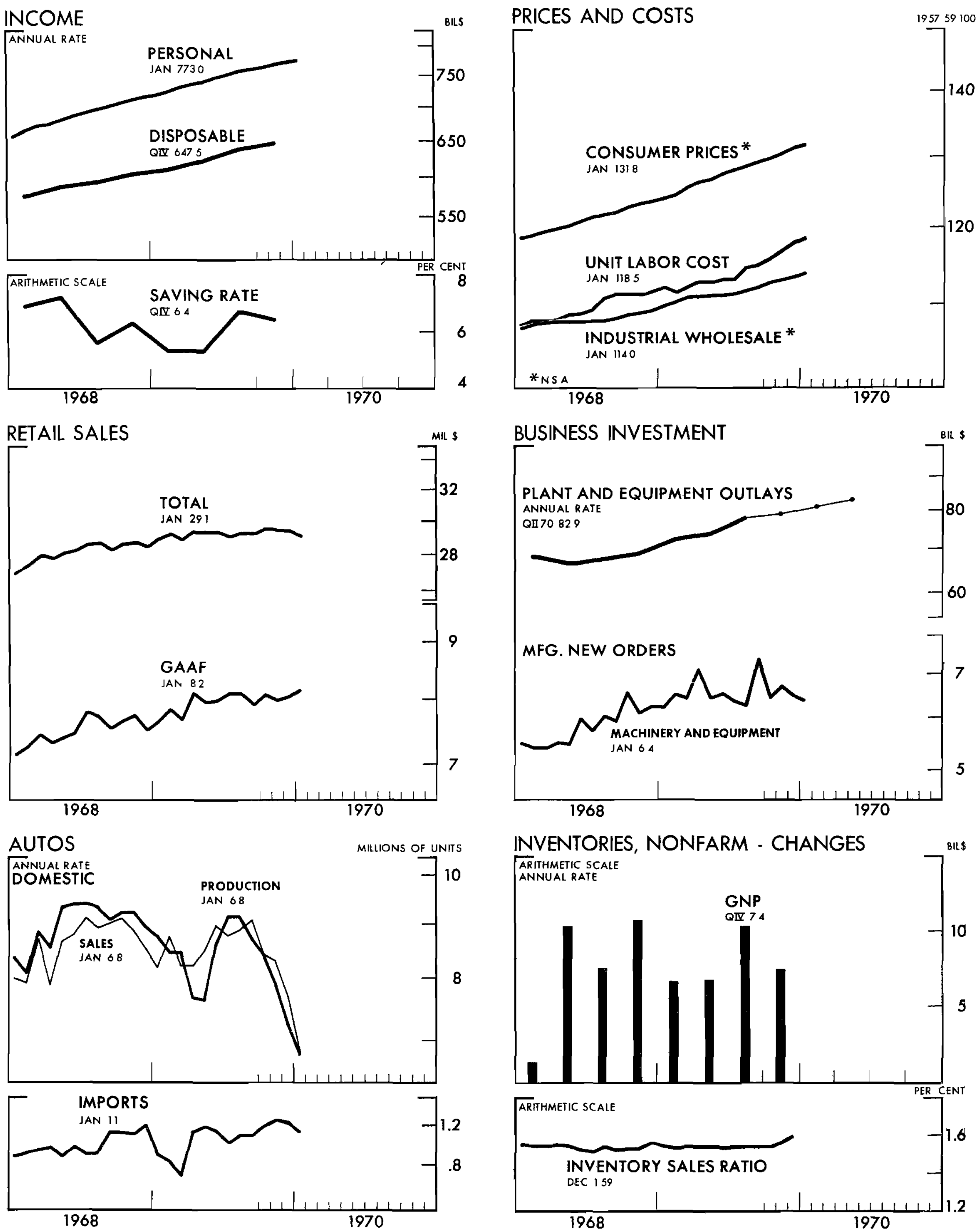


HOUSING



ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Bank credit. Commercial bank credit, adjusted to include loans sold to affiliates, rose substantially in February, following a small decline in January and little net growth over the second half of 1969. The February rise in bank credit resulted from a rapid rate of increase in bank loans that was only partially offset by moderate liquidation of security holdings.

COMMERCIAL BANK CREDIT, INCLUDING LOAN SALES 1/
(Seasonally adjusted percentage change, at annual rates)

	1969		1970	
	1st Half	2nd Half	January	February 2/
Total loans & investments 3/	5.1	1.5	- 1.5	6.0
U.S. Gov't. securities	-17.2	-16.0	-44.0	-7.2
Other securities	1.4	- 3.6	6.8	0.0
Total loans 3/	11.5	6.4	4.7	9.8
Business loans 4/	16.1	7.1	12.3	8.9

1/ Last Wednesday of the month series.
2/ Preliminary estimates. Loan sales are through February 18.
3/ Includes outright sales of loans by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
4/ Includes outright sales of business loans by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

The February pick-up in loan expansion reflected in large part a sizable increase in security loans--in contrast to sharp reductions in these loans during the prior two months--as dealers built up inventories of securities, apparently in anticipation of lower interest rates. Business loans, adjusted to include business loans sold to affiliates, also registered a substantial increase, although less than that in January, which followed a quite low December increase. Other major types of loans continued to expand at close to the moderate pace of recent months.

The rate of growth in adjusted business loans since year-end has been greater than during the second half of 1969, but it is still well below the rapid rate that prevailed in the first half of last year. Recent increases, although fairly widely distributed geographically, have been concentrated in a relatively few industry categories, particularly machinery, transportation equipment, other fabricated metals, chemicals, and retail trade--in the latter case possibly reflecting the financing of involuntary inventory accumulation.

Bank portfolio liquidity declined further in February. Banks continued to reduce their holdings of U.S. Government securities--mainly Treasury bills--but at a rate sharply below that in January, when outflows of time and savings deposits were large. Banks kept their holdings of other securities unchanged, after having acquired some of these securities, on balance, in the previous few months. But current bank holdings of such securities are still about $900 million below those at midyear 1969, when sizable bank liquidation of these securities began.

Monetary aggregates. Daily average deposits of member banks declined more rapidly in February than in January, reflecting a large reduction in private demand deposits. Time and savings deposits at all commercial banks remained unchanged in February, as did U.S. Government deposits. The additional funds obtained by banks from nondeposit sources continued to offset only a small part of total deposit outflows.

MONETARY AGGREGATES
(Seasonally adjusted percentage changes, at annual rates) 1/

	1969		1970	
	1st Half	2nd Half	January	Feburary 2/
Member bank deposits	-3.5	-4.6	- 4.2	- 8.4
Member bank deposits plus nondeposit sources	n.a.	-1.1	- 3.1	- 6.3
Commercial bank time and savings deposits	-4.0	-6.7	-12.4	0.0
Money stock	4.3	.6	9.6	-10.7

1/ Based on monthly average of daily figures for deposits and monthly average of weekly figures for nondeposit funds.
2/ Preliminary estimates.

At all commercial banks, the February decline in private demand deposits more than offset the increase in January, with the result that these deposits have remained essentially unchanged, on balance, since February of last year. Even with continued growth in currency in the hands of the public, the money stock in February declined nearly to the level prevailing in November of last year.

The cessation of outflows of time and savings deposits in February--following a sharp decline in January--apparently resulted in part from the increase in Regulation Q ceilings in January and from the fall in yields on money market instruments in recent weeks. About midmonth sizable inflows began to take place, offsetting earlier outflows. However, much of these inflows were from foreign official sources, and may have represented transfers of funds previously borrowed through foreign branches.

TREASURY BILL YIELDS AND CD CEILINGS
(Daily averages for statement week ending February 25, in per cent)

	Term to Maturity			
	1 month	3 months	6 months	1 year
Treasury bills, investment yields	6.84	7.06	7.38	7.39
CD ceilings	6.25	6.75	7.00	7.50

Seasonally unadjusted data for weekly reporting banks points up these influences. Attrition of domestically held CD's (IPC) certainly slowed in February, as did the outflow of consumer-type deposits. But CD's held by "others" and "all other time" deposits rose sharply, the former reflecting mostly the inflow of foreign official funds. Country banks also experienced substantial inflows of time and savings deposits in February, the first since the spring of last year.

NET CHANGE IN TIME AND SAVINGS DEPOSITS
(Millions of dollars, not seasonally adjusted)

	Dec. 31-Jan. 28 1/			Jan. 28-Feb. 18 1/		
	1968	1969	1970	1968	1969	1970
Weekly Reporting Banks						
Total time and savings	1,257	-2,073	-1,761	506	-732	251
Consumer-type	440	- 166	-1,312	453	348	-110
CD's	826	-1,789	- 451	174	-905	162
IPC	578	-1,252	- 433	-237	-693	- 79
Other	248	- 537	- 18	411	-212	242
All other time	- 9	- 118	2	-121	-175	199
Country banks						
Total time and savings	801	284	- 224	708	550	361

1/ Dates are for 1970, comparable dates used for other years.

Banks continued to reduce their borrowing in the Euro-dollar market during the first three weeks in February--by about $530 million--while affiliates of banks issued an additional $425 million in commercial paper. However, on a monthly average basis, the level of funds raised from nondeposit sources in February is estimated to have been about $500 million greater than the average level in January.

Nonbank depositary intermediaries. Following extraordinarily large outflows during January, the thrift institutions in early February had modest, smaller than seasonal, inflows. According to a FHLBB sample survey for the first ten days of February, savings and loan associations in most areas other than the West Coast received small net deposit inflows, and the sensitive New York City mutual savings banks also showed a minor net gain. For the whole month of January, more complete data confirm the earlier estimates of massive withdrawals from both groups of intermediaries.

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

	Mutual Savings Banks	Savings and Loan Associations	Both
1969 - Q I	6.1	6.0	6.0
Q II	4.3	3.7	3.9
Q III	2.0	2.1	2.1
Q IV	2.7	0.4	1.2
1969 - November*	4.9	2.4	3.2
December*	2.3	0.4	1.0
1970 - January *	-1.9	-6.6	-5.0
Memo: December & January	0.2	-3.1	-2.0

* Monthly patterns may not be significant because of seasonal adjustment problems.

Savings and loan associations have continued to reduce their mortgage commitments, and in the first three weeks of February they borrowed an additional $150 million from the Federal Home Loan Banks--in a period when net repayments usually occur. These advances have become an increasingly less profitable source of funds to borrowing associations. Interest rates on the nearly $10 billion of FHLB advances outstanding now range from 7-1/2 per cent to 7-5/8 per cent, compared with the approximately 8-1/2 per cent nationwide average gross interest rate on conventional new home mortgage loans. Moreover, the sizable early March FHLB financing, part of which will replace maturing paper, will probably serve to increase the costs of these advances since the interest rates S&Ls must pay on <u>all</u> outstanding advances very with the FHLB's own average cost of money.[1/]

Life Insurance companies. After some abatement during the fourth quarter of 1969, the net increase in policy loans from life insurance companies rebounded sharply in January, perhaps in association with the reported large activity on the part of individuals in recent corporate bond offerings. If the usual seasonal patterns hold true, policy loan claims against life insurance funds will be extraordinarly large during the next few months, as policyholders in the past have typically used this source of funds for their income tax payments.

1/ The FHLBB is now considering ways to subsidize the cost to associations of these advances. The yields on its most recent financing on February 11 were 8.45 per cent on a $650 million, 16-month issue and 8.35 per cent on a $350 million, 3-year issue.

NET INCREASE IN POLICY LOANS
AT 15 LIFE INSURANCE COMPANIES*
(million of dollars)

	Monthly Average			
	Q III	Q IV	January	
1965	30	27	36	(1966)
1966	111	104	70	(1967)
1967	43	45	57	(1968)
1968	73	56	81	(1969)
1969	181	140	167	(1970)

* These companies account for nearly 65 per cent of policy loans held by all life insurance companies.

With this outlook for future fund flows, life insurance companies sharply reduced their already-modest new commitment volume. In January, for the first time since at least 1964, the volume of new commitments made to acquire corporate direct placements was less than $100 million. Although no data on new mortgage commitmenrs made during January are presently available, it is likely that these too have followed a pattern similar to that of direct placements commitments; during the fourth quarter of 1969 new mortgage commitments had already been reduced by nearly half from the third quarter volume.

CORPORATE DIRECT PLACEMENT COMMITMENTS
MADE BY LIFE INSURANCE COMPANIES*
(Millions of dollars)

	Monthly Average			
	Q III	Q IV	January	
1965	426	502	380	(1966)
1966	360	175	235	(1967)
1967	424	495	214	(1968)
1968	287	360	224	(1969)
1969	202	197	69p/	(1970)

* Sample of companies representing about two-thirds of industry assets.

p/ preliminary.

Mortgage market. Secondary market yields on FHA and VA home loans in FNMA's auction of its forward purchase commitments declined very little in February from the record level reached shortly after the contract rate on these loans was adjusted upward in early January. With returns on high-grade corporate bonds dropping sharply, yield spreads favoring investment in Federally underwritten home mortgages have recently regained much of the ground lost during the past year. Even so, field reports from FNMA suggest that investor interest in this type of mortgage has as yet shown only slight improvement.

FNMA AUCTION

	Amount of total offers		Implicit private market yield on 6-month commitments
	Received	Accepted	
	(Millions of Dollars)		(Per cent)
Highs for Weekly Auction			
1968	$232(6/3)	$ 89(7/1)	7.71(6/10)
1969	410(6/16)	152(9/8)	8.87(12/29)
1970			
Weekly Auction			
January 5	$705	123	9.19
12	638	151	9.36
Bi-Weekly Auction			
January 26	$581	298	9.29
February 9	497	295	9.28
24	438	280	9.25

Note: Average secondary market yield after allowance for commitment fee and required purchase and holding of FNMA stock, assuming prepayment period of 15 years for 30-year Government-underwritten mortgages. Yields shown are gross, before deduction of 50 basis point fee paid by investors to servicers. The first auction date was May 6, 1968.

In the primary market, the average interest rate on conventional home mortgages rose in January along with yields on FHA and VA loans. Below-market usury ceilings continued to inhibit an upward movement in interest rates on conventional mortgages in such areas as the Middle Atlantic states. In that region, the average slipped further behind the more competitive levels attained in the West, where higher usury limits have not yet become an important market restriction.

AVERAGE RATES ON CONVENTIONAL HOME MORTGAGES

	U.S. (Per Cent)	Middle Atlantic (Per cent)	West (Per cent)	West Minus Middle Atlantic (Basis Points)
1969				
Low (Jan.)	7.55	7.45	7.85	40
High (Dec.)	8.35	7.65	9.05	140
October	8.30	7.65	9.00	135
November	8.35	7.65	9.00	135
December	8.35	7.65	9.05	140
1970				
January	8.55	7.65	9.40	175

Note: FHA series. Interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points. The FHA Middle Atlantic region includes New Jersey, Pennsylvania, Delaware, District of Columbia, Maryland, and Virginia.

While average loan-to-value ratios and average maturities on conventional home mortgages made in January remained well below earlier peaks, prices of homes being financed continued quite high, probably reflecting in part a further rationing-out by lenders of higher-risk borrowers generally in the market for lower-priced homes. As a result, the amount of first-mortgage credit extended per transaction continued unusually large.

Despite continued support in near-record volume from FNMA, the total net flow of funds into mortgages of all types declined further in January. Net acquisitions of residential and nonresidential loans by savings and loan associations reached the lowest seasonally adjusted rate since the spring of 1967. Further declines in S&L lending are in prospect, judging from the dwindling backlog of outstanding S&L mortgage commitments, which reached the lowest point in more than two years. Commercial banks, now the second largest private lender in the depressed mortgage market, also continued to acquire mortgages at a sharply reduced pace.

Corporate securities and municipal bond markets. A basic shift in expectations, produced by the cumulating evidence of a slowing economy and by rumors of--and hopes for--an easier monetary policy, resulted in a spirited rally in both corporate and municipal bond markets in February. The expected easing in monetary restraint contributed to some improvement in stock prices, too, even though there were still sustantial market uncertainties about the future of business activity and profits. The sensitivity of all long-term financial markets to expectational shifts with respect to the policy outlook was demonstrated by the rapid, sharp response to remarks by public officials and the announcements of cuts in the prime rate by some small banks.

STOCK PRICES AND BOND YIELDS

		Stock Prices 1/		Bond Yields	
		NYSE	AMEX	New Corporate Aaa2/	Long-term State and local bonds 3/
1969					
Low		49.31(7/29)	25.02(7/29)	6.90(1/10)	4.82(12/24)
High		59.32(5/14)	32.91(1/3)	8.85(12/5)	6.90(12/19)
1970					
Week of:					
Jan.	23	49.93	26.31	8.32	6.67
	30	47.54	25.46	8.60	6.78
Feb.	6	48.24	25.56	8.63	6.54
	13	48.49	25.61	8.40	6.42
	20	49.20	25.63	8.32	6.32
	27	50.10	25.80	8.20	6.16

1/ Prices as of the day shown. NYSE is New York Stock Exchange. AMEX is American Stock Exchange.

2/ With call protection (includes some issues with 10-year call protection.)

3/ Bond Buyer (mixed qualities.)

In the public corporate bond market, yields declined about 40 basis points during February. Underwriters, encouraged by sustained demand for new bonds and notes by individual investors, a noticeable pickup in institutional demand, and their own light inventory positions, continued to raise prices even as the volume of new offerings picked up substantially in the latter half of the month. This pricing was generally ahead of the market, with dealers indicating willingness to absorb inventory in expectation of still higher bond prices, in spite of the large forthcoming volume.

In the stock market, the general decline in prices since late 1969 has proved to be expansive to issuers of equities. Esso, for example, will be able to raise only $387 million in its February-March rights offerings instead of the $450 to $475 million originally planned. But, despite the greater cost of equity financing, the current and projected volume of stock offerings has remained unusually large as many large corporations make efforts to improve their debt-to-equity ratios. In addition, the number of small offerings of stock, while less than in 1969, has remained quite large.

Despite the sustained volume of stock offerings, total corporate security financing volume declined sharply in February. Public bond offerings fell to $1.0 billion because of the cancellation or postponement of about $250 million of convertibles, resulting from uncertainty in the stock market. In addition, staff estimates of private placements have been revised downward substantially on the basis of recently released SEC data. Indeed, the continued evidence of a decline in commitments by life insureance companies suggests that future takedowns of private placements will remain relatively low.

CORPORATE SECURITY OFFERINGS 1/
(Monthly or monthly averages
in millions of dollars)

	Public Offerings		Private Placements		Stocks		Total	
	1969	1970	1969	1970	1969	1970	1969	1970
Year	1,060	--	492	--	709	--	2,261	--
Q I	866	1,417e	513	330e	674	683e	2,073	2,433e
January	980	1,550e	636	300e	460	550e	2,075	2,400e
February	842	1,000e	395	300e	807	600e	2,045	1,900e
March	935	1,700e	509	400e	755	900e	2,098	3,000e

1/ Data are gross proceeds.

e/ Data estimated.

On the other hand, public bond issues in March are expected to increase sharply. Recent announcements of new offerings have raised the estimated volume to $1.7 billion, and March offerings could move even higher--if no congestion develops--because of the continued build-up in the demand for long-term financing by large industrial corporations. Looking even further ahead, the forward calendar through June is building rapidly, with a number of industrial and financial firms added in recent weeks. Large corporations are also becoming increasingly evident in the future stock issue calendar and, with the giant Esso stock issue, the staff estimates that total corporate financing in March will rise to a record $3.0 billion.

Yields on tax-exempts, which had risen sharply in the last two weeks of January, fell steadily throughout February, evenn though the volume of new long-term municipal bonds remained relatively large. Underwriters report that shorter-term issues have been supported by bank purchases, particularly by banks outside New York, as well as by a considerable volume of individual buying. Interest in the longer maturities has been mainly from dealers, who are said to be willing holders, a reflection of their optimism about future monetary ease and declining rates.

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

	1969	1970
Year	990	--
Q I	927	1,237e
Q II	1,216	--
Q III	821	--
Q IV	994	--
January	1,262	1,311e
February	987	1,200e
March	538	1,200e

e/ Estimated.

Visible supply in the municipal market is still large and if yields continue to decline, volume may begin to pick up noticeably as previously postponed issues reenter the market.1/ At this time the staff estimates that total long-term State and local borrowing in March will be about $1.2 billion.

1/ Appendix B discusses the volume of postponed tax-exempt issues in the fourth quarter of 1969, as estimated by the Board's experimental survey of State and local borrowing anticipations and realizations.

Government securities market. The shift in market expectations indicated above sustained the rally in the U.S. Government securities market through the end of February. As a result, yields on coupon issues declined by around 30 basis points for long-term issues to as much as 70 basis points on shorter maturities; bill rates moved sharply lower, with yields generally down by around 55 to 75 basis points. The 3- and 6-month bills most recently were quoted around 6.80 to 6.90 per cent on a discount basis, while the 1-year bill was bid at 6.70 per cent.

WEEKLY AVERAGE MARKET YIELDS ON U.S. GOVERNMENT AND AGENCY SECURITIES 1/
(Per cent)

	Nov.-Dec. 1969 Highs	Week ending Feb. 10	Feb. 24	Mar. 3
Bills				
1-month	7.54	7.29	6.76	6.55
3-month	8.08	7.44	6.81	6.88
6-month	8.09	7.48	7.00	6.88
1-year	7.86	7.27	6.90	6.69
Coupons				
3-year	8.51	7.99	7.69	7.35
5-year	8.33	8.12	7.60	7.39
7-year	7.77	7.71	7.37	7.17
10-year	8.05	7.38	7.12	6.96
20-year	7.14	6.75	6.61	6.57
Agencies				
6-month	8.70	8.43	7.86	7.68
1-year	8.76	8.54	8.14	7.96
3-year	8.55	8.44	8.23	8.09
5-year	8.47	8.30	8.13	8.05

1/ Latest dates of high or low rates in parentheses and refer to single dates.

The Treasury's February refunding operation was more successful than expected at the time of its announcement, with an attrition rate of only 13 per cent on the $5.6 billion of publicly held maturing issues. Moreover, reflecting the shift in interest rate expectations, public subscriptions to the 7-year, 8 per cent note totaled $1.4 billion. As indicated by data on dealers' positions in coupon issues in the 1-5 year and over-5 year categories, the professional portion of the market participated actively in the refunding, taking $905 million of the issues. Since the books were closed early in February, holdings have shown only moderate declines, indicating a general willingness to position both these and other securities, despite a level of dealer loan rates at the banks that has continued higher than the yields on dealer inventories.

The level of financing costs for dealers has had little influence on the bill market in recent weeks, in part because the market has continued to be characterized by considerable shortages of bills, particularly in the less-than-92-day category. Also, the reserve supplying operations of the Desk through repurchase agreements have served to finance a large portion of the dealers' bill positions at a 6 per cent cost, and the market has been expecting capital gains on existing holdings. Recent Treasury additions of $100 million to the weekly 6-month bill auctions and of $200 million to the monthly 12-month bill auction and an offering of $1.75 billion of April tax bills, however, have relieved the market shortages of bills in some degree, and in early March bill rates were backing up somewhat.

The Treasury recently made an administrative decision to issue Treasury bills in minimum denominations of $10,000 thus eliminating the $1.000 and $5,000 bills. The Federal Home Loan Banks and FNMA took similar actions. Purchases of Treasury bills in the two smallest denominations accounted for about 1 to 2 per cent of total bill sales in recent months, and thus made up only a minor fraction of the noncompetitive tenders. In January and February, when noncompetitive tenders were very large, an estimated $400 million of bills was purchases in the smaller than $10,000 denominations.

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

	February 2	February 9	February 16	March 2
Treasury securities				
Total	2.821	2,886	2,575	3,334
Treasury bills (totals)	2,188	1,889	1,729	2,436
Due in 92 days or less	95	102	18	459
93 days or over	2,093	1,787	1,711	1,976
Treasury notes and bonds (total)	633	997	847	898
Due within 1 year	718	84	78	225
1-5 years	4	498	392	313
over 5 years	- 88	415	376	361
Agency securities				
Total	543	458	547	739
Due within 1 year	298	228	202	312
over 1 year	244	229	345	427

Four new Federal Agency issues were offered in February, raising a total of $1,334 million in new money. This compares with six offerings by Agencies in January for a total of $1,439 million in new money. Reflecting improvement in securities markets, the February issues were priced at successively wider margins below similar January issues, with the FNMA offering on February 26 priced around 60 basis points under the late January issue. Yields on outstanding Agency securities moved lower in line with declines in the Treasury market.

NEW ISSUE ACTIVITY BY
FEDERAL AGENCIES IN FEBRUARY
(In millions of dollars)

Date	Agency	Rate	Maturity and Amounts: less than one year	1-3	over 3-5 Years	Of Which New Money:
Feb. 5	FLB	8.50		300		94
		8.38			220	
11	FHLB	8.45		650		350
		8.35		350		
18	FICB	8.10	332			90
		8.15		203		
26	FNMA	8.12		500		800
		9.10			300	
Total			332	2,003	520	1,334

<u>Other short-term credit markets</u>. Interest rates on most private short-term securities have declined considerably from turn-of-the-year peaks, but the February decline was smaller than that of January. Offered yields on all maturities of bankers' acceptances are 8.13 per cent, down from a year-end peak of 9.00 per cent. End-of-February commercial paper yields, at 8.38 per cent on 3-month maturities and 8.25 per cent on 6-month maturities, are down around a full percentages point from year-end and 1/8--1/4 of a per cent from the end of January. The yield on 1-month finance company paper, however, edged up slightly during February--to 8.38 per cent, and most of the supply of finance company paper is apparently concentrated in the short maturities.

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

	1969 Highs[1/]	January 30	February 13	February 27
1-Month				
Finance paper	9.00 (12/31)	8.25	8.38	8.38
Banker' acceptances	9.00 (12/31)	8.50	8.25	8.13
Treasury bill	7.50 (12/31)	7.70	7.20	6.60
3-Month				
Commercial paper	9.25 (12/31)	8.50	8.63	8.38
Finance paper	8.50 (7/18)	8.13	8.25	8.00
Bankers' acceptances	9.00 (12/31)	8.50	8.25	8.13
Treasury bill	8.12 (12/30)	7.88	7.10	6.90
6-Month				
Commercial paper	9.25 (12/31)	8.50	8.50	8.25
Finance paper	8.38 (11/21)	8.00	8.00	7.75
Bankers' acceptances	9.00 (12/31)	8.50	8.25	8.13
Treasury bill	8.10 (12/30)	7.86	7.15	7.00
12-Month				
Prime municipals[2/]	6.25 (12/12)	5.40	4.90	4.50
Treasury bill	7.75 (11/21)	7.64	7.05	6.66

1/ Dates of highs in parentheses; latest date used if high occurred on more than one date.
2/ Bond yield basis.
Source: Salomon Brothers & Hutzler's Bond Market Roundup.

Note: Directly placed finance company and bank-related commercial paper rose sharply in January, by $1.5 billion on a seasonally adjusted basis. This was the main factor raising total commercial paper outstanding to $34.5 billion, (seasonally adjusted). Bank-related paper in January posted its largest monthly increase to date, rising by $1.2 billion (seasonally unadjusted) and accounting for 44 per cent of the rise in all commercial and finance company paper outstanding. Through mid-February bank-related paper continued to rise, but at a somewhat reduced pace; on February 18, bank-related paper totaled $5.9 billion.

COMMERCIAL AND FINANCE COMPANY PAPER AND BANKERS' ACCEPTANCES OUTSTANDING
(End-of-month data--in millions of dollars)

	1969		1970	
	November	December	January	February 1/
Total commercial and finance paper 2/	32,286	33,221	34,528	n.a.
Placed through dealers	12,109	12,677	12,464	n.a.
Placed directly	20,177	20,544	22,064	n.a.
Note: Bank-related paper 3/ (seas. unadj.)	4,079	4,209	5,430	5,852
Bankers' acceptances	5,212	5,451	5,288	n.a.

1/ Bank-related paper as of February 18, 1970.
2/ Data for commercial and finance paper are seasonally adjusted, in contrast to similar data published in the Bulletin that are seasonally unadjusted.
3/ Bank-related paper is included in directly-placed, dealer-placed and total commercial paper.

Federal finance. The Board Staff continues to project a fiscal 1970 surplus of about $2.0 billion on a NIA basis and a small deficit of $.9 billion on a unified budget basis. Federal outlays in February turned out somewhat lower than projected in the last Greenbook and the Administration's intention to hold current fiscal year outlays to $197.9 billion seems attainable. Moreover, the recent Senate vote to reduce appropriations for education below the level approved by the House suggests that near-term outlays for HEW may not greatly exceed the level requested by the Administration.

The end-of-February cash balance at the Treasury ($6.6 billion) was $1.2 billion higher than projected in the last Greenbook, partly because of the lower than anticipated outlays in February, mentioned above. The Board Staff now estimates an end of March cash balance of $5.7 billion, which includes funds from the Treasury's recent sale of new April tax bills in the amount of $1.75 billion, payable on March 3, and also the increase in the size of the regularly scheduled weekly and monthly bill issues, amounting to $100 million and $200 million, respectively.

These increments to the regular bill issues are assumed to be continued beyond the month of March. The Staff now estimates that the Treasury will need to raise only about $1.5 to $2.0 billion of additional new money in early April prior to the inflow of April tax receipts.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	Feb.	March	April
Borrowing operations			
New cash raised			
Unspecified new borrowing	--	--	1.7
Weekly and monthly bills	.1	.8	.7
Tax bills	--	1.8	--
Coupon issues	--	--	--
Other (agency, debt repayment, etc.)	-.2	-1.9	-4.9
Total net borrowing from public	-.1	.7	-2.5
Plus: Other net financial sources a/	-.3	1.3	-1.1
Plus: Budget surplus or deficit (-)	.6	-2.9	5.3
Equals: Change in cash balance	+.2 b/	- .9	1.7
Memoranda: Level of cash balance end of period	6.6 b/	5.7	7.4
Derivation of budget surplus or deficit			
Budget receipts	15.3	14.0	23.2
Budget outlays	14.7	16.9	17.9

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

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

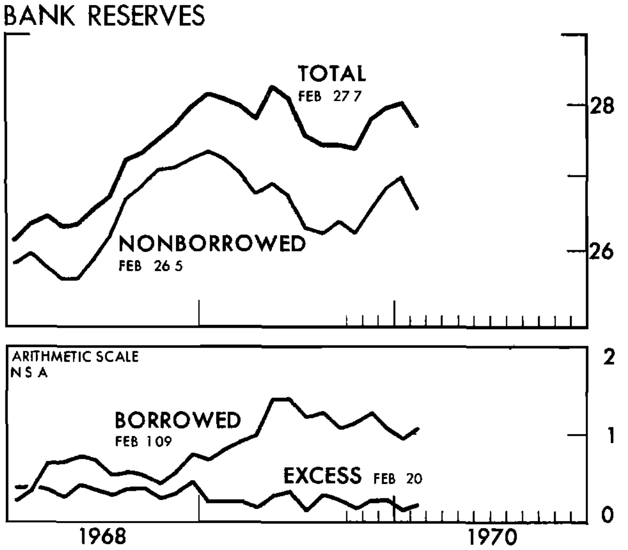
	Fiscal 1970 e/		Fiscal 1971 e/	Calendar Years		Calendar Quarters				
	Jan. Budget	F.R. Board	January Budget	1969	1970 1/	1969 IV	1970 1/ I	II	III	IV
Federal Budget										
(Quarterly data, unadjusted)										
Surplus/deficit	1.5	-.9	1.3	5.3	-3.4	-5.7	-2.4	9.6	-2.3	-8.3
Receipts	199.4	197.0	202.1	195.6	195.1	42.9	45.6	60.6	47.2	41.7
Outlays	197.9	197.9	200.8	190.3	198.5	48.5	48.0	51.0	49.5	50.0
Means of financing:										
Net borrowing from the public	-2.6	1.6 2/	-1.2	-4.1	3.1	5.1	.4	-7.1	1.7	8.1
Decrease in cash operating balance		-1.3		- .6	-.3	1.3	-.4	-5.1	.6	1.0
Other 3/	n.a.	.6	n.a.	- .7	.6	-.8	2.4	-1.0	--	-.8
Cash operating balance, end of period		7.2		5.3	5.6	5.3	5.7	7.2	6.6	5.6
National Income Sector										
(Seasonally adjusted annual rate)	3.6	2.1	1.6	9.6	-4.4	7.0	0.0	-6.5	-6.8	-4.2
Surplus/deficit	201.7	200.3	205.4	201.6	196.8	203.7	197.4	198.7	194.2	196.7
Receipts	198.1	198.2	203.8	192.0	201.1	196.7	197.4	205.2	201.0	200.9
Expenditures										
High employment budget surplus/deficit 1/	n.a.	6.8	n.a.	9.6	5.5	10.1	6.4	3.0	4.3	8.3

e--Projected.
n.a.--Not available.
1/ Estimated by Federal Reserve Board Staff.
2/ Excludes effect of reclassification of $1.6 billion of CCC certificates of interest from Budget transactions to borrowing from the public.
3/ Includes such items as deposit fund accounts and clearing accounts.

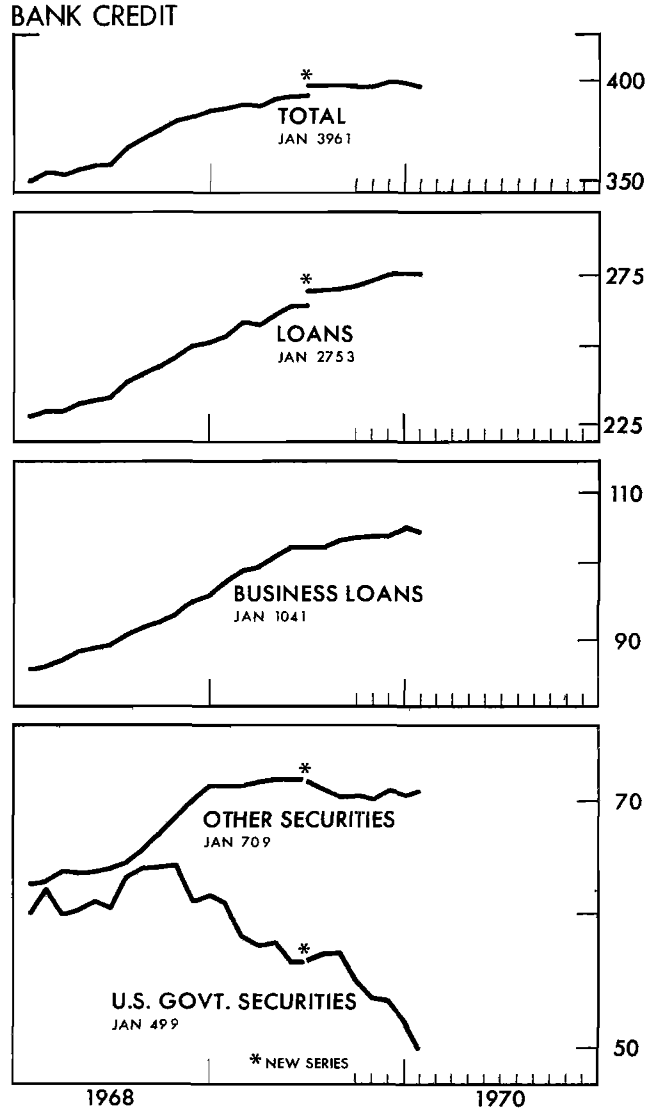
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

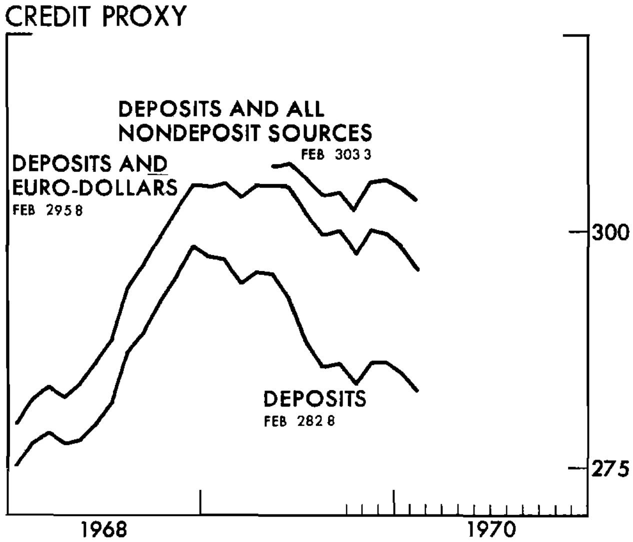
BANK RESERVES



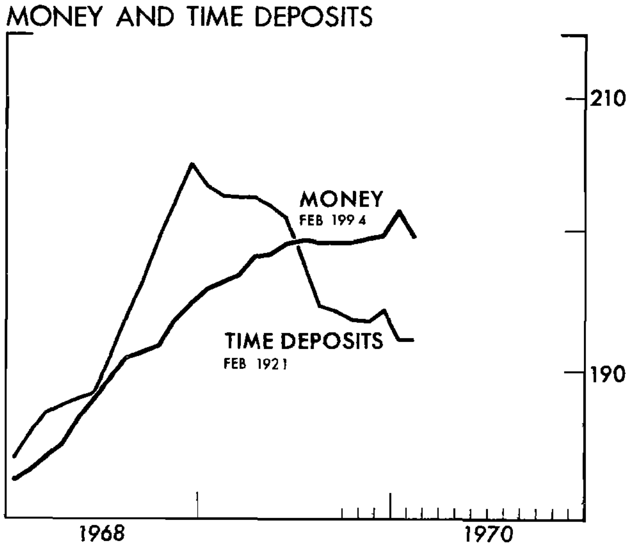
BANK CREDIT



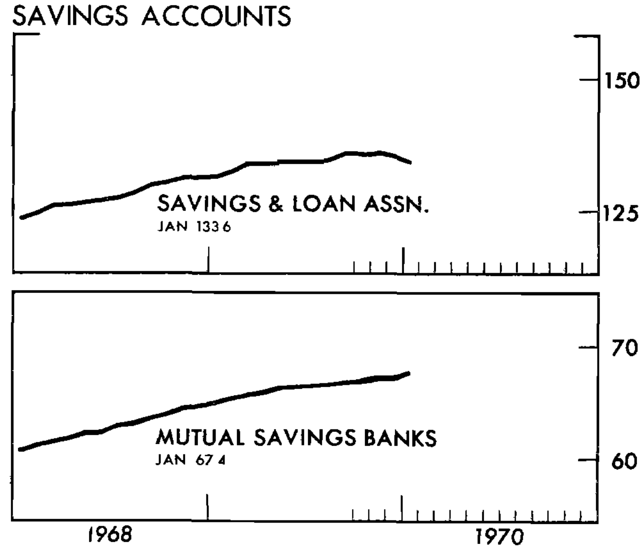
CREDIT PROXY



MONEY AND TIME DEPOSITS

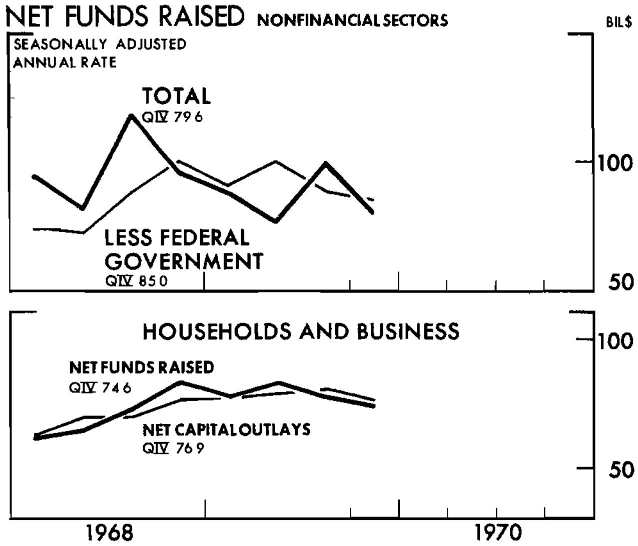


SAVINGS ACCOUNTS

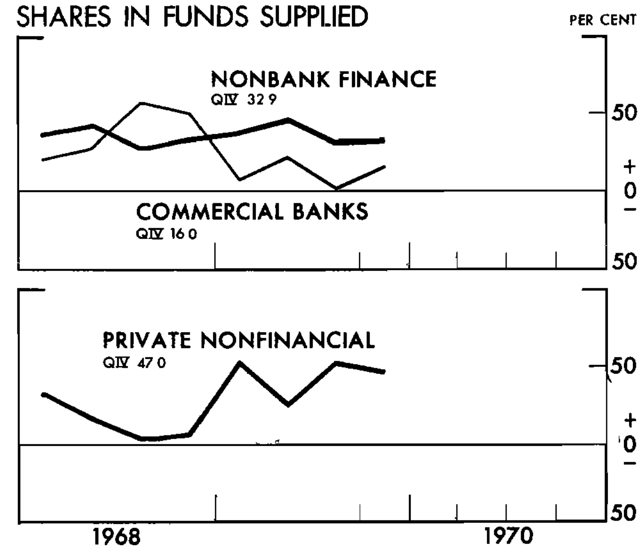


FINANCIAL DEVELOPMENTS - UNITED STATES

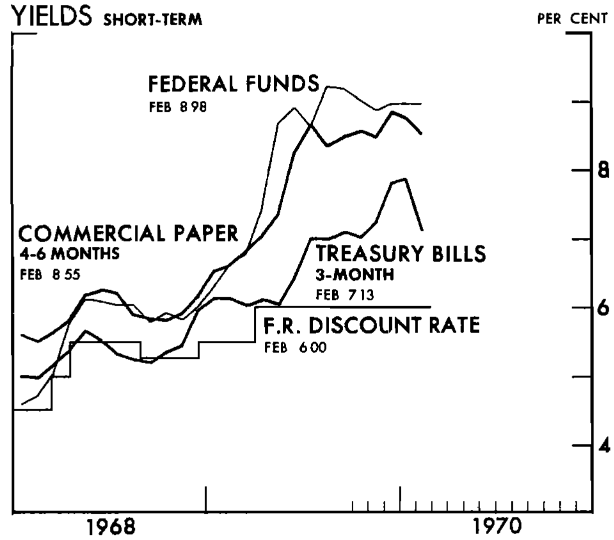
NET FUNDS RAISED NONFINANCIAL SECTORS



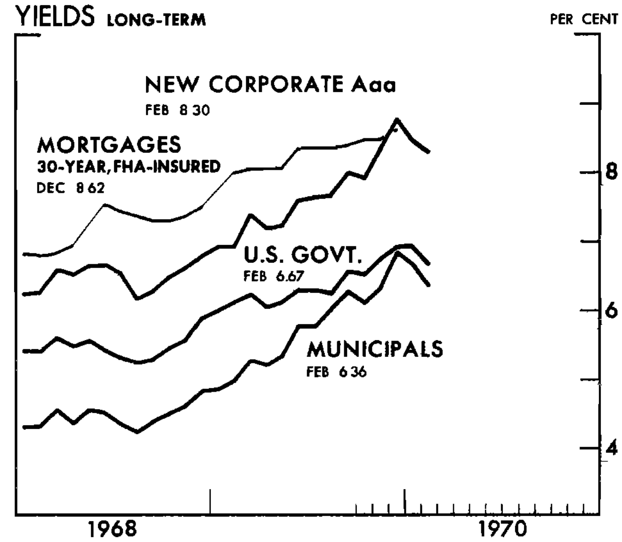
SHARES IN FUNDS SUPPLIED



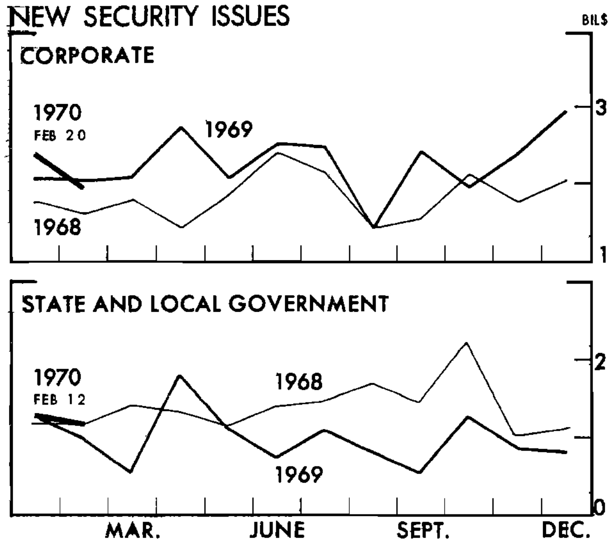
YIELDS SHORT-TERM



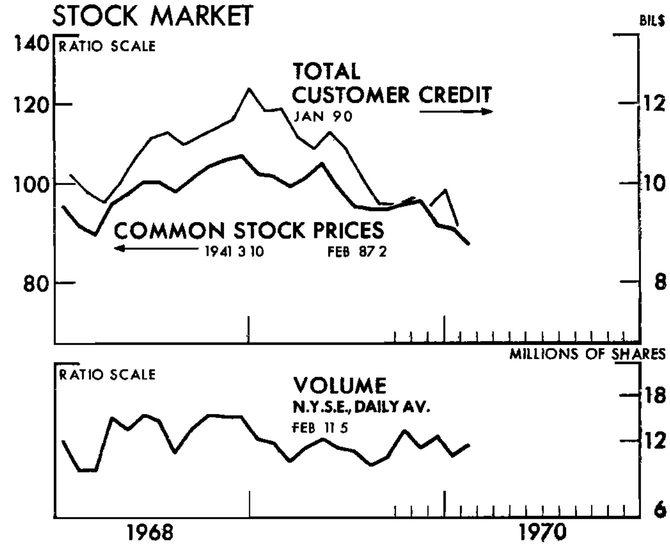
YIELDS LONG-TERM



NEW SECURITY ISSUES



STOCK MARKET



THE ECONOMIC PICTURE IN DETAIL

International Developments

U.S. balance of payments. Such information as is now available for the balance of payments in the early weeks of the year is not reassuring, though repercussions from the favorable inflows at the end of 1969 were probably responsible for a large part of the recorded deficit.

In January the liquidity deficit, seasonally adjusted, was \$1.5 billion (not including the initial allocation of \$867 million of SDR's). Of this, about \$0.5 billion reflected the liquidation of medium-term U.S. Treasury notes issued to Germany under the military offset agreement, and there was also a reduction of \$125 million in other officially held nonliquid claims on the U.S. It seems likely that a large part of the remaining deficit occurred in the first week of the year as U.S. corporations and others returned to their foreign affiliates, or to the Euro-dollar market, some of the funds brought to the U.S. just prior to the end of the year. A favorable element in the January results was a reduction of \$431 million in claims on foreigners reported by U.S. banks. This was comparable to the inflow in January 1969, but larger than the seasonal inflow in earlier years.

Transactions in securities with foreigners resulted in a minor net outflow for the month. U.S. investors bought a modest amount of foreign bonds, but sold (net) a nearly equal amount of foreign corporate stocks. Meanwhile, foreign investors were net purchasers of U.S. bonds, but swung over in January to net selling of U.S. corporate stocks. This liquidation was the first since last July. Although the outflow of U.S. funds to purchase foreign securities was quite low in January -- and in fact has been relatively small since last September -- this favorable shift was smaller than the drop in receipts from the inflow of foreign capital to purchase securities of U.S. corporations.

The trade surplus in January narrowed to an annual rate of only $500 million. As discussed below, although the data for a single month can be misleading, the change from the preceding months casts doubt on the trend toward an improved trade balance that had been suggested by the earlier data.

For February, the weekly payments indicators through the 25th add up to a sizable liquidity deficit -- about $800 million -- though this includes a guess that there was a large deficit in the February part of the week ended February 4. There were no major "special" transactions in the period. If the monthly data confirm a deficit of that size it would be even higher than last year's record for the month.

On the <u>official settlements</u> basis there was a January deficit of $0.5 billion (excluding here also the initial allocation of SDR's). This deficit will be substantially larger in February, as liabilities of U.S. banks to private foreigners are drawn down. Part of this decline represents reduced borrowing by U.S. banks via their foreign branches -- though the extent of the reduction in the use of foreign funds is exaggerated by the movement of foreign official holdings out of the Euro-dollar market into CD's at U S. banks. However, there has also been some reduction in liabilities to private foreigners other than branches, probably reflecting higher interest rates in some foreign national money markets.

U.S. foreign trade. In January the export surplus fell abruptly from the sizable December level as imports expanded sharply while exports advanced only moderately.[1/] Though too much significance should not be attached to this change, since month-to-month fluctuations in foreign trade movements are not unusual, it does cast doubt on the extent of our underlying trade strength.

An examination of trade movements since mid-1969, after smoothing out monthly aberrations, indicates that the export surplus has shown little growth during the period. For the three months ending January, the export surplus was $1.4 billion at an annual rate (balance of payments basis), slightly lower than in the preceding three months of August-October. Both exports and imports have apparently stabilized since mid-1969. The levelling off of imports was expected as the pace of domestic economic activity slowed; increases in imports of foodstuffs have been balanced by declines in other categories of imports. However,

1/ The January trade figures are still very preliminary because of the provisional seasonal adjustment factors used in that month. Whether the change that will probably be made in these factors will improve or worsen our January trade surplus cannot be estimated at this time.

there has been an unexpected sluggishness in U.S. exports despite the dynamic growth in world trade.

Exports in November-January were at an annual rate of $39.1 billion, virtually unchanged from the rate in August-October. Shipments of agricultural products continued to drift downward from the October peak, mainly the result of a sharp drop in shipments of tobacco. Exports of nonagricultural commodities were only slightly greater in November-January than in the preceding three months. Although there were no deliveries of the new Boeing 747 to foreign customers through January, sales of other types of commercial planes were very strong, increasing by nearly 30 per cent between the two periods. Exports of steel, coal and chemicals expanded further. However, these advances were just about offset by a decline in exports of crude industrial materials, miscellaneous manufactured articles -- largely scientific instruments -- and lower deliveries of automobiles and parts to Canada. Exports of machinery remained weak; the expected upturn in exports of these products has not yet materialized.

The expansion in exports from August-October to November-January was limited to shipments to the Common Market countries and to the developing countries of Asia and Africa; exports to all other areas were lower.

Preliminary data indicate that world trade (excluding shipments to the United States) expanded at a record rate of nearly 15 per cent from 1968 to 1969. U.S. exports, however, increased at about 9 per cent and our share in world exports fell by nearly one percentage point, equivalent to about $2 billion at current levels of world trade. Even more pronounced was the sharp drop in our position in the fourth quarter when world trade rose very sharply -- by over 10 per cent -- from the third quarter, while U.S. exports (including military commodities) increased by about 1 per cent. A prime factor in the expansion in world trade in 1969 was the acceleration in trade among the Common Market countries. Among other countries, Japan's exports still grew rapidly, but at a slower rate than in 1968, while the increase in exports of the United Kingdom was the highest in the 1960's.

Imports in November-January combined were $37.7 billion at an annual rate (balance of payments basis), marginally higher than the rate in August-October. An accelerated rise in import prices and a strong rise in the volume of foodstuffs were important factors in sustaining the current value of imports at a high level. In the first three quarters of 1969, the total unit-value indexes of imports had shown a quarter-to-quarter rise of less than 1 per cent. From the third to the fourth quarter, the index rose by 3.5 per cent, with the rise spread across all major commodity categories.

Food was the only major category of imports that increased in November-January, rising by 12 per cent as both volume and prices increased. Despite strong price increases, the value of other categories -- machinery, automobiles and other consumer goods, semiprocessed industrial materials -- all declined. The decreases ranged from about 1/2 of one per cent for apparel, footwear and miscellaneous manufactured consumer items to about 6 per cent for machinery (including electrical appliances).

Foreign exchange markets. Foreign exchange activity during February centered mostly on sterling and the Italian lira. Demand for sterling was strong throughout the month. The Italian lira, on the other hand, continued under substantial selling pressure. Late in the month stronger demand for the Canadian dollar pushed the exchange rate to its upper limit and the Bank of Canada purchased about $150 million in the market. Tight liquidity conditions in Swiss financial markets caused Swiss banks to repatriate funds from abroad during most of February; the Swiss franc rate rose to or close to its upper limit on several occasions and the Swiss National Bank purchased about $140 million in the market.

Very strong demand for sterling pushed the pound exchange rate to a new two-year high of $2.408 during February, at the same time allowing the Bank of England to purchase almost $900 million in the market -- more than double its January market purchases. At times heavy bursts of demand for sterling were triggered by special factors such as the announcement at mid-month of a £39 million trade surplus for January, the sixth consecutive month of trade surpluses. A generally growing bullishness over sterling was evident throughout the month. In early March the announcement of a reserve increase of

$65 million in February triggered further heavy demand for sterling, and the Bank of England purchased $450 million in the first three trading days of the month.

The Bank of England made substantial debt repayments during February. Its monthly reserve release included announcement that it had repaid $150 million to the IMF and $75 million to the BIS and associated central banks under the First Sterling Balances Arrangement. It repaid substantial additional debt, including the final $350 million outstanding on its swap drawings with the System and $40 million of guaranteed sterling held by the System and an equal amount held by the U.S. Treasury -- at the same time financing part of these repayments by borrowing $250 million on a short-term basis from the BIS. During the first two months of 1970, the Bank of England made debt repayments (including repayments to the IMF) totaling $1.6 billion.

The Italian lira continued under heavy selling pressure during February, when the Bank of Italy lost an estimated $570 million in exchange market support of the lira rate. (During January it had sold $400 million in exchange markets.) A massive capital outflow -- being generated largely by political uncertainties in Italy -- together with a seasonally adverse current account appear to be the major factors behind the selling pressure on the lira. Italian authorities took several measures during the month to moderate the pressure on the lira, including restrictions on the scope for adverse shifts in leads and lags on trade payments, and administrative moves designed to tighten surveillance of lira banknote conversions and short-term lending by Italian commercial banks.

Euro-dollar market. Euro-dollar rates changed little, on balance, over the past four weeks. A slight easing of rates in mid-February was followed by some firming during the week ended March 4.

SELECTED EURO-DOLLAR AND U.S. MONEY MARKET RATES
(weekly average of daily figures)

Average for week ending Wednesday	(1) Call Euro-$ Deposit	(2) Federal Funds	(3) =(1)-(2) Differ-ential	(4) 3-month Euro-$ Deposit	(5) 3-month Treasury Bill	(6) =(4)-(5) Differ-ential
Jan. 28	8.62	9.04	-0.42	9.52	7.89	1.63
Feb. 4	9.06	9.21	-0.15	9.49	7.77	1.72
11	9.07	9.18	-0.11	9.47	7.36	2.11
18	9.03	9.39	-0.36	9.31	6.83	2.48
25	9.22	8.41	0.81	9.27	6.84	2.43
Mar. 4	9.30	8.34^{p}	0.96^{p}	9.36	6.84^{p}	2.52^{p}

Liabilities to foreign branches of U.S. banks declined by $466 million in the four weeks ended February 25, but a substantial part of the decline apparently represented a shift of foreign official funds from foreign branches to CD's at the head offices of U.S. banks, with little net effect on conditions in the Euro-dollar market.

While U.S. banks were decreasing their demands on the Euro-dollar market, German banks were increasing their's. Partial data indicate that German banks decreased their net foreign asset position by $330 million in the first three weeks of February, virtually all of which was accounted for by an increase in foreign liabilities.

On the supply side, very large intervention gains by the Bank of England during February probably reflected some shifting of funds out of the Euro-dollar market into sterling. The effects of British reserve gains on the supply of funds to the Euro-dollar market may have been largely offset, however, by large Italian reserve losses, part of which probably augmented the supply of Euro-dollar funds.

Monetary policy in major industrial nations. During 1969 monetary policy was progressively tightened in all major industrial nations. Some countries may find it necessary to tighten their restraint further if demand pressures remain strong.

Inflationary pressures were the paramount reason for monetary tightening in Germany, Canada, Japan, Belgium, the Netherlands and Switzerland. In France the external deficit was also a factor, and in the United Kingdom the need to restore external balance has been the prime reason for applying monetary brakes. The large Italian capital outflow in 1969 induced a shift in policy toward moderate restraint in the final months of last year. Until the mark revaluation, German monetary policy was mainly aimed at offsetting large current account surpluses with capital outflows and at reversing short-term inflows. In France, Belgium, and some Scandinavian countries very high Euro-dollar rates may have led monetary authorities--in order to protect reserves--to allow domestic interest rates to rise to a level higher than demand management considerations warranted.

In Germany, Italy and Japan, a significant degree of monetary restraint was not reached until late 1969 or even early this year, and the effectiveness of restraint cannot yet be ascertained. In both the United Kingdom and France, the marked tightening of monetary policy late in 1968 contributed to improvement in the external balance.

Interest rate levels in the United States are an important influence on interest rates in the Euro-dollar market and in financial markets within other industrial nations. But demand pressures in all of these nations and concern over reserve levels in some of them strongly imply that an easing of monetary policy in this country would not be followed promptly by similar action abroad.

In Germany, monetary policy became progressively more restrictive during the first three quarters of 1969, but the impact on domestic liquidity was slight, mainly because of speculative capital inflows before the revaluation of the German mark in October. Following the lead of other major central banks, the Bundesbank raised its discount rate from 3 to 6 per cent in three steps between April and September. Reserve requirements of the commercial banks were increased by about 20 per cent during the same period. On several occasions last year, the central bank expressed concern over the growing signs of economic overheating, but found it difficult to achieve significant monetary tightening. It was considered desirable to offset the continued large surplus on goods and services--$2.6 billion for January through September--with long-term capital outflows. Such flows were facilitated by keeping German interest rates lower than rates elsewhere. This did not, however, prevent the inflow of speculative funds.

SELECTED GERMAN MONETARY INDICATORS

	1969							1970	
	Q-1	Q-2	Q-3	Sept.	Oct.	Nov.	Dec.	Jan.	Feb.
3-month interbank loan rate[a]	4.0	4.7	6.4	7.0	7.4	7.7	8.8	9.5	9.5
Banks' "free liquid reserves" as per cent of total deposits[b]	11	13	12	12	11	8	7[c]	6	n.a.

a/ Average of weekly averages.
b/ End of period. "Free liquid reserves" includes excess reserves, short-term money market paper, advances against securities and unused rediscount quotas.
c/ FRB staff estimate.

The revaluation of the mark was followed by massive capital outflows through December which put sharp pressure on bank liquidity, and led to a dramatic rise in German interest rates, as shown in the table. To keep the rise in German interest rates from being too abrupt, the Bundesbank lowered reserve requirements by 10 per cent in November and by an additional 10 per cent only for the month of December.

In early December the Bundesbank raised its "Lombard" rate for short-term advances against commercial paper from 7.5 to 9.0 per cent. This was done to discourage banks from borrowing against commercial paper in order to lend in the Euro-dollar market as well as to encourage the banks to draw on their foreign assets to meet domestic lending requirements. The Bundesbank discount rate was not raised, but expansion of rediscounts was limited by the existing quotas for each bank.

Short-term interest rates in Germany are now at post-war highs and covered interest differentials--which moved substantially in favor of Euro-dollars late in 1969--are now virtually eliminated as the forward premium on the mark narrowed sharply. In these circumstances, the net foreign position of German banks has swung from a net creditor to a net debtor vis-à-vis non-residents. But the squeeze on liquidity continues, as the January seasonal easing in the money markets did not materialize, and the termination of the seasonal reduction in reserve requirements for December added pressure.

While some observers fear that too much fiscal and monetary tightening may result in a recession--as it did in 1966-67--there is a wide measure of agreement that the boom is still strong and that recent price increases have been excessive. Consumer prices in January were 3.5 per cent higher than a year earlier. The excess demand on the labor market--vacancies in December were 670 thousand--and the degree of utilization of capacity are the highest on record. There is strong sentiment in the Bundesbank for further monetary tightening on domestic grounds.

In France both fiscal and monetary policies became very expansionary after the May 1968 disturbances. But the huge basic balance of payments deficit--$2.4 billion in the second hald of 1968--forced a reversal of these policies during and after the November 1968 crisis.

SELECTED FRENCH MONETARY INDICATORS

	1967	1968				1969			
	Q-4	Q-1	Q-2	Q-3	Q-4	Q-1	Q-2	Q-3	Q-4
Annual rates of change (per cent) from preceding period:									
Money supply (M1), s.a.	+ 1	- 1	+16	+13	+ 6	+ 5	0	+ 4	+ 2*
Domestic credit, n.s.a.	+20	- 6	+35	+19	+17	+ 6	+19	+ 6	+ 4*
Call money rate	4.6	4.9	5.5	6.2	8.2	8.7	8.9	9.2	9.8

* October and November only.

In the spring of 1969 the political crisis that culminated in the de Gaulle resignation foreclosed the intensification of fiscal restraint. The rapidly overheating French economy had to be contained by monetary restraint only. Bank credit expansion slowed and money supply, which had been expanding at an annual rate of 10 per cent in the second half of 1968, rose by only 3 per cent (at an annual rate) in the first half of 1969. The tightening was reinforced in June by restrictions on installment purchases and by an increase from 6 to 7 per cent in the discount rate.

The large current account deficit and the continuing overheating of the economy, both reflecting in part lack of confidence in the franc on the part of Frenchmen, led to the decision on August 8 to devalue the franc by 11.1 per cent. In early September a series of restraint measures was announced including the elimination of the budget deficit for 1970. Monetary measures included an extension of the very restrictive short-term credit expansion ceiling until June 1970, the placing of moderately restrictive ceilings on medium- and long-term credit expansion, and a drastic tightening of installment purchase terms. In October 1969 the Bank of France again raised its discount rate--to the historically high level of 8 per cent.

Monetary and fiscal restraints are beginning to show results in France. Consumer demand is slackening, (the savings ratio moved markedly up during the autumn) and--following the revaluation of the German mark--confidence in the stability of the franc appears to be returning. The improvement in the external balance has been substantial--the trade account, seasonally adjusted for the period November 1969 through January 1970, was virtually in balance. Since devaluation French official reserves have increased by nearly $1.5 billion, chiefly because of a shift in leads and lags back toward normal.

The expansionary impact of reserve gains on French monetary conditions has not been offset thus far by the authorities and has resulted in a slight easing of the squeeze on liquidity. However, the economy is still operating very close to capacity--unfilled vacancies, equal to about one-half of one per cent of the French labor force, remained unchanged from November through January. The improvement in the trade balance is precarious, and prices continue to increase in excess of the official target of 4 per cent for 1970. Hence we can expect continued monetary restraint in France, at least through the first half of 1970.

In <u>Britain</u>, monetary policy was tightened from November 1968 through mid-1969 in support of the government's over-all restraint program. The principal monetary moves included a directive in November 1968 to the clearing banks to reduce loans outstanding by 2 per cent, an increase in Bank Rate to 8 per cent in February 1969, net sales of long-term government securities by the Bank of England in spite of the continuing fall in bond prices to an all-time low in June, and adoption of a target for domestic credit expansion (DCE) in June.

DOMESTIC CREDIT EXPANSION IN THE UNITED KINGDOM
(£ millions, n.s.a.)

	1967		1968				1969		
	Q-3	Q-4	Q-1	Q-2	Q-3	Q-4	Q-1	Q-2	Q-3
Change during period	+805	+886	+90	+915	+71	+822	-628	-72	+85

Note: DCE equals, broadly, the increase in bank deposits and currency in circulation plus the official settlements balance-of-payments deficit (or minus the surplus).

The stipulated reduction in bank lending has, in fact, not been accomplished, but the slight rise which has taken place is considered acceptable by the authorities in view of the severe liquidity squeeze on private business and the success in meeting the target for DCE.

DCE is broadly comparable to the Federal Reserve's credit proxy except that it is adjusted for changes in official gold and foreign exchange reserves. This latter adjustment is particularly important in the United Kingdom, given its open economy.

The British authorities are aiming at a DCE goal of not more than £400 million in the fiscal year ending March 31. In the preceding fiscal year, DCE had grown by £1,180 million. Thus far, the DCE goal has been met with a wide margin to spare. The public sector surplus, limited credit expansion to the private sector, and the balance of payments surplus all combined to restrict DCE expansion in the period April 1 to September 30--latest available information--to only £13 million.

British reserves have registered substantial gains since early last autumn and the Bank of England has offset only a part of these gains by government bond sales, thus permitting some easing of the liquidity squeeze which reaches a seasonal peak during the first-quarter tax collection period.

Although the GNP growth rate in the fourth quarter of 1969 appears to have been negligible, growth during 1970 is expected to accelerate to about a 3 per cent annual rate. Weekly wage rates rose by 5.5 per cent from the fourth quarter of 1968 to the fourth quarter of 1969 and the rate of increase will certainly be even faster this year, providing considerable stimulus to aggregate demand. The expected strong export performance will also contribute to the strength of demand.

It is not likely that monetary policy will be significantly eased soon. Bank Rate may be lowered from its present level of 8 per cent--chiefly to encourage investment--but, as long as credit expansion is regulated mainly by administratively imposed ceilings, such a move would not represent a major step away from tight money.

During the past 10 months, monetary policy in Italy has undergone a substantial modification because of the changing outlook for both the balance of payments and the domestic economy. Interest rates have advanced considerably in response to moves by the Bank of Italy, the attraction of high yields in external markets, and--more recently--probably some expectations of further moves to tighten credit.

In the spring and summer of 1969, Bank of Italy actions resulted in a rise of 1-1/4 percentage point in the commercial banks' prime lending rate, and the legal maximum rate on interbank deposits rose from 3-2/3 to 5 per cent. In addition, the Bank allowed the composite yield on all bonds other than Treasury bonds to rise from about 6.5 per cent in May to 7-1/4 per cent in December, and further increases have been recorded in recent weeks. In January and February, two large borrowings by public sector lending agencies were sold to yield 7.9 per cent. A previous offering by one of them in June 1969 yielded only 6.6 per cent. In recent days the interbank loan rate, pegged to the Treasury bill rate, advanced further to 6.5 per cent.

The Bank of Italy began to slow down the expansion of the monetary base in the last quarter of 1969. The progressively stronger application of monetary brakes has reflected growing concern over the balance of payments, which registered a $1.4 billion deficit last year because of rapidly rising net outflows of private capital. In addition, the rise in aggregate demand is currently excessive because very large wage increases were granted late last year after a wave of strikes. This year, wage rates in the metal, engineering, chemical and construction industries will be about 17 per cent higher than in 1969 (inclusive of projected automatic cost-of-living increases). For the economy as a whole, wage increases this year will be somewhat less than this, but unit labor costs will increase sharply. Treasury Minister Colombo has publicly projected that the GNP deflator will increase from an estimated 3.4 per cent in 1969 to 6 per cent or more in 1970.

Capital outflows will probably decline in 1970 because of higher Italian interest rates and increased borrowing abroad by public sector entities, but the decline may be entirely offset by an expected deterioration in what has been a persistently large current account surplus. Given these prospects for the domestic economy and the balance of payments, it appears likely that monetary restraint will not be eased in coming months.

The Swiss authorities became concerned with growing signs of economic overheating that appeared during the summer of 1969. Accordingly, at the end of July the Swiss National Bank obtained an agreement from the commercial banks to limit their loan expansion during the year ending July 31, 1970 to an average of about 10 per cent. The action was reinforced by a rise in the discount rate of 3/4 of a percentage point in mid-September.

The revaluation of the German mark has strong inflationary implications for Switzerland and the Swiss National Bank has felt it necessary to further limit bank loan expansion. A new agreement, recently negotiated, restricts credit expansion during the period February through July to 85 per cent of the original target. This move has been backed by anti-inflationary fiscal measures.

Yields on government bonds rose by a full percentage point during 1969. The call money rate has risen sharply since mid-January, indicating increasingly tight credit conditions.

In Belgium, monetary policy, characterized by very flexible use of discount rate changes, became progressively more restrictive during 1969. Credit expansion was limited by administratively imposed ceilings last May in an effort to prevent overheating of the economy and to minimize losses of international reserves that might occur because of higher interest rates outside Belgium.

These policies were very effective insofar as the external balance is concerned, and Belgium recorded a large balance of payments surplus last year. However, demand pressures intensified during 1969 and Belgian officials expect them to remain excessively strong this year. The latest projections show no slowing of domestic demand in 1970 and--as in 1969--a rise in the GNP deflator of about 4 per cent. This outlook suggests a continuation of the present degree of monetary restraint at least for the next several months.

Inflationary pressures in the Netherlands intensified during 1969. Consumer prices, in part because of the introduction of value-added taxes last year, rose so rapidly in the first quarter that the authorities imposed a price freeze in April and did not lift it until mid-September.

Monetary policy became progressively more restrictive and the Netherlands Bank increased its discount rate from 5-1/2 to 6 per cent in August. Short-term credit expansion was placed under ceilings by agreement between the central bank and commercial banks. Long-term credit expansion is to be limited to the extent that any increase in assets is to be balanced by an increase in long-term liabilities.

Inflationary pressures in the Dutch economy remain strong and the present restrictive monetary stance is likely to be continued.

In Japan, monetary policy moved toward restraint last September, the first time in the post-war period such a move has been made with the balance of payments in surplus.

The Bank of Japan raised its discount rate from 5.84 to 6.25 per cent and increased reserve requirements for demand deposits of large city banks from 1.0 to 1.5 per cent. At the same time, reserve requirements for other financial institutions were raised. The Bank of Japan also moderately tightened its "position guidance" policy, under which, in monthly conferences with large commercial banks, central bank lending quotas for each bank are adjusted so as to restrain aggregate commercial bank credit expansion. The Bank is hoping to restrict year-over-year bank credit expansion in the first quarter of this year to 5 per cent--a fairly severe restraint.

A further indication of monetary tightening was the announcement on February 4 that in March-April interest rates on new issues of public and corporate bonds would be increased by about 1/2 percentage point, rates on long-term bank loans by 30 basis points, and rates on one-year time deposits by 1/4 percentage point--for the first time in nine years--from 5.5 to 5.75 per cent. All these rates are customarily regulated by the authorities in an informal manner.

The tightening of Japanese monetary policy was prompted by increasing signs of economic overheating, fed by a rapid rate of credit expansion and export growth. There are as yet few signs that demand pressures are relaxing. Industrial production in December rose 2.per cent and was 18.5 per cent higher than a year earlier. Consumer prices in January jumped 1.4 per cent over the December level. Manufacturing wages last December were 14.4 per cent higher than a year earlier. Seasonally adjusted bank credit expansion began to show some signs of slackening in December and interest rates rose fairly sharply, indicating the increasing tightness of credit. Further advances interest rates are likely. Should the pace of economic expansion not slow down, the Central Bank is likely to intensify credit restraint.

In Canada, monetary policy became very restrictive before the middle of 1969. The monetary squeeze has resulted in sharp increases in interest rates.

GROWTH OF CANADIAN MONETARY AGGREGATES
(annual rates, per cent)

	Dec. 68 to June 69	June 69 to Dec. 69	Oct. 69 to Jan. 70
M1 (currency plus demand deposits)	7.9	0.9	-4.2
M2 (currency + all Can.$ bank deposits)	7.2	0.3	3.1
Bank assets	8.4	1.9	6.9

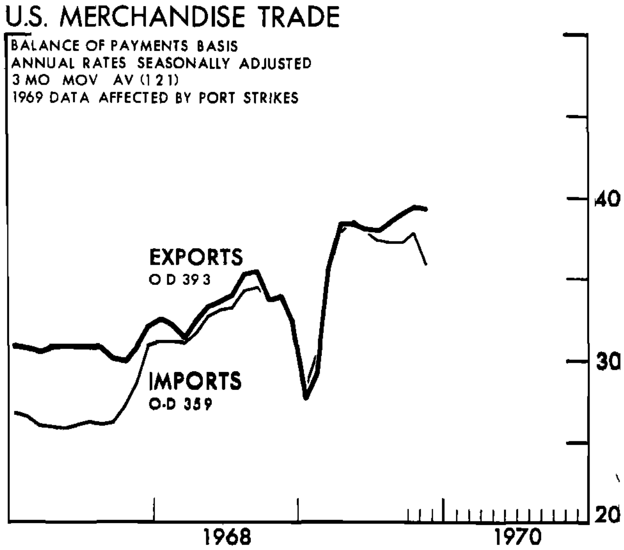
A number of large-scale labor disputes in the second and third quarters of 1969 distorted the Canadian GNP statistics and made it difficult to judge the effects of monetary restraint on aggregate demand. Real GNP is estimated to have grown at an annual rate of only 1.1 per cent in the second half of 1969, as compared with 5.8 per cent in the first half. However, consumer prices at the end of the year were still rising at about a 5 per cent annual rate.

The pull of higher interest rates in the U.S. and Euro-dollar markets undoubtedly had some effect on Canadian interest rate levels. Canadian banks increased their net external asset position in foreign currencies by nearly $500 million during 1969. The dominant concern of the monetary authorities continues to be domestic inflation, and there is less concern over a possible recession than may be the case in the United States. In these circumstances, if monetary conditions in the United States ease, Canadian interest rates will follow U.S. interest rates only partially and with some lag.

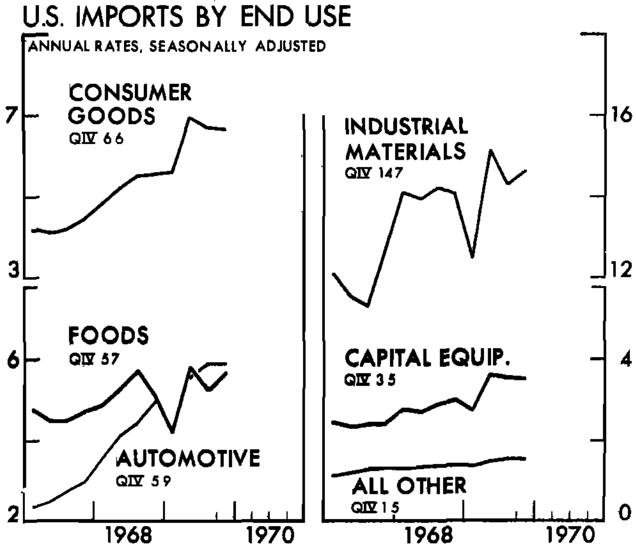
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

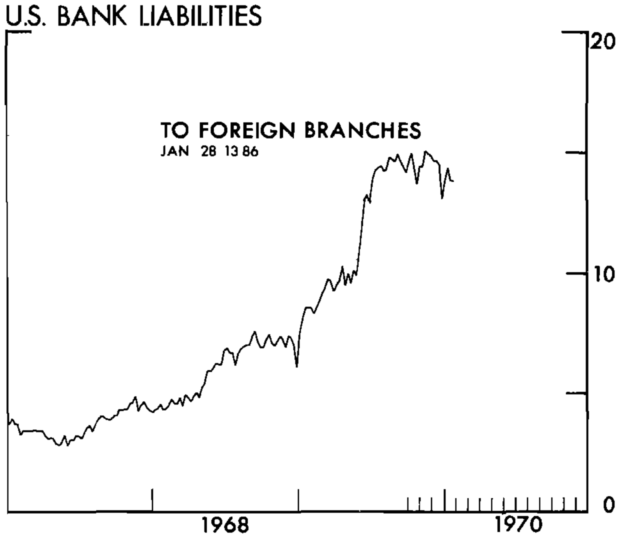
U.S. MERCHANDISE TRADE



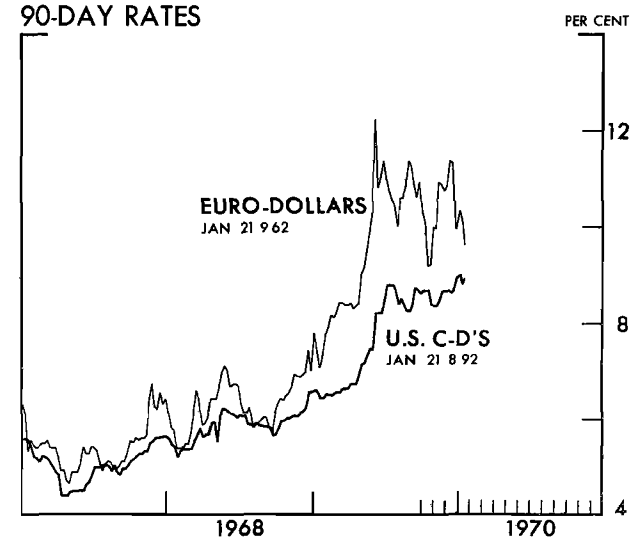
U.S. IMPORTS BY END USE



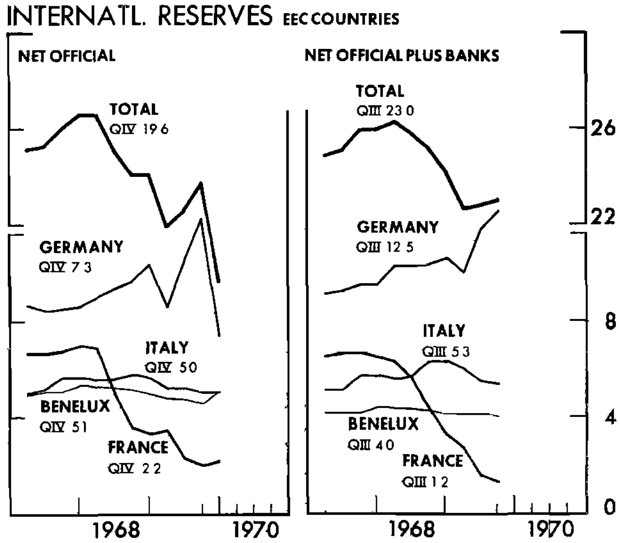
U.S. BANK LIABILITIES



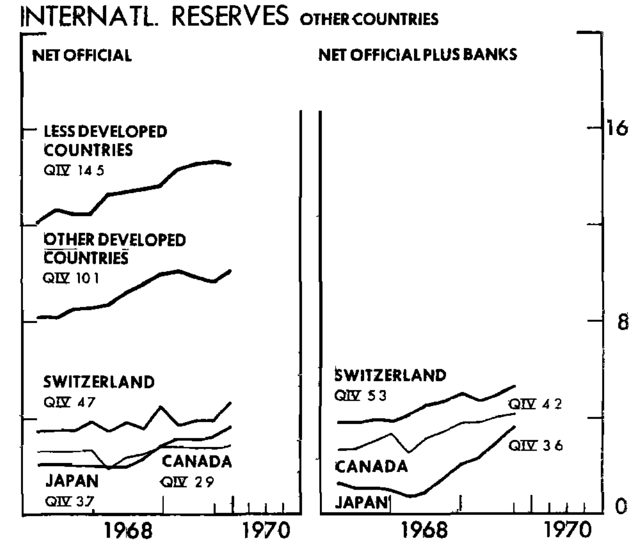
90-DAY RATES



INTERNATL. RESERVES EEC COUNTRIES



INTERNATL. RESERVES OTHER COUNTRIES



APPENDIX A: MORTGAGE-BACKED SECURITIES GUARANTEED BY THE GOVERNMENT NATIONAL MORTGAGE ASSOCIATION*

As part of the Housing Act of 1968, in which the Government National Mortgage Association was spun off from the old Federal National Mortgage Association, GNMA was authorized to guarantee the payment of principal and interest on securities sold by approved issuers and backed by pools of Government-underwritten mortgages. The final regulations for the pass-through security program were established in mid-November and following approval by the Treasury, preliminary regulations for a second-type of GNMA security, a mortgage-backed bond, will soon be released.

Since the introduction of the pass-through arrangement in November, GNMA has received only $26.9 million in applications to form mortgage pools. The first sale of a pass-through -- a private placement -- did not occur until mid-February. In view of the limited demand for the pass-through and some undesirable features which are discussed below, the staff feels that the pass-through arrangement will continue to be relatively unattractive to the investment community. However, the bond-type security should have substantially more investor appeal.

The mortgage-backed securities are designed to enable mortgages to compete more effectively with alternative capital market instruments in general and particularly to encourage pension funds -- and other non-mortgage investors -- to shift a part of their resources into the mortgage market. Although pass-through securities can take one of three forms, all applications received by GNMA have been for the "fully modified" version, in which holders receive specified installments of principal and a fixed rate of interest on the outstanding principal balance, whether these are collected or not. In all three types of pass-through, prepayments of principal are passed on as they are collected. GNMA guarantees the timely payment of principal and interest in accordance with the terms set forth in the security instrument.

The favorable characteristics of this type of security, from the standpoint of the investor, centers on its reduction of the problem of servicing a mortgage. By participating in the pool, the investor is freed from the time and effort involved in servicing individual loans in his own mortgage portfolio. Some of the additional work associated with

---

* Prepared by Fred Taylor, Economist, Capital Markets Section, Division of Research and Statistics.

the investment in individual mortgages, such as property inspection and processing of foreclosures, is also eliminated. Furthermore, the GNMA guarantee assures the security holder that the mortgages involved will be properly serviced and that if any mortgage is found to be defective, the issuer will make the adjustments to the pool which GNMA requires.

Despite these favorable characteristics, there are a number of other features that may limit the effectiveness and appeal of the current program. One of the basic objectives of the guarantee program was to provide an instrument, backed by a pool of Government-underwritten mortgages, that included many of the characteristics appealing to bond investors. In a number of ways, the pass-through fails to accomplish this. In the first place, in the pass-through, as in the case of any mortgage, the principal is repaid monthly as long as the mortgages remain outstanding, unlike most bonds which are repaid at maturity. Secondly, lacking call protection, the investor has no guarantee that his expected yield will be forthcoming for at least a minimum period of time. Prepayments are still possible under the pass-through arrangement and these could present problems for investors in terms of anticipating flows and in scheduling future investments. The problems associated with prepayments could become particularly acute in periods of declining interest rates. Finally, it is possible that the pass-through may be truly competitive, on a yield basis, only during periods when rates are generally falling. This possibility reflects the fact that mortgage interest rates normally move in lagged response to other long-term rates and historically have been less sensitive than other capital market rates. This could be overcome to an extent, however, if the issuer sells the security at a discount.

To date only one GNMA-backed security issue, for $2.0 million, has actually been sold. The securities were sold to three state pension funds, all of which normally hold part of their assets directly in Government-underwritten mortgages. Judging from an informal interview with the investor, the purchase of the pass-throughs were only a substitute for direct mortgage investment.

In addition to the pass-through security, GNMA is expected to announe, within the next few weeks, proposed regulations governing a bond-type mortgage-backed security. The staff expects that bond issues will have to be in a minimum size of $200 million -- a limit designed to restrict the use of this instrument to FNMA and the FHL Banks. because of the risks assumed by GNMA. As currently envisioned, the mortgage-backed bond will have a fixed maturity and feature some call protection. In addition, the bond may be offered publicly at a competitive rate. By eliminating the practice of passing on prepayments as collected, the bond-type security should solve some of the difficulties associated with the pass-through. In order to compensate for the prepayments that do occur, however, the issuer may have to overcollateralize considerably.

Although the regulations covering the GNMA guaranteed bond may not appear in final form for at least 30 days, the staff expects investors to exhibit considerably more interest in the bond than in the pass-through arrangement.

APPENDIX B: SURVEY OF STATE AND LOCAL GOVERNMENT BORROWING REALIZATIONS FOURTH QUARTER, 1969*

The experimental survey of State and local government borrowing realizations for the fourth quarter of 1969 suggests that high interest rates induced at least a $2.25 billion shortfall in long-term borrowing. Such shortfalls are equivalent to 80 per cent of the $2.75 billion in State and local long-term borrowing actually accomplished last quarter.1/ As a consequence of these shortfalls, capital outlay cutbacks are estimated to range between $1.1 and $1.3 billion, or about 15 per cent of the estimated fourth quarter total of $8 billion of State and local capital expenditures. Essentially all these delays and abandonments of capital construction occurred in areas with some form of legal rate ceilings. Analysis of borrowing expectations of units in the sample indicates that State and local governments would like to be borrowing at approximately a $20 billion gross annual rate during the first half of 1970, as compared to less than $12 billion in all of 1969.

Borrowing Shortfalls

Table 1 displays a breakdown by type of governmental unit of the long-term borrowing accomplished and of the shortfalls induced by high interest rates. Only those shortfalls attributable to high borrowing costs are discussed below. Approximately $1.4 billion in additional shortfalls stemmed from other factors, some of which may have been partly related to the level of interest rates. Thus, the estimates for interest rate effects on borrowing--and on spending--may be understated.

1/ Long-term bond sales for the fourth quarter of 1969 amounted to $2.90 billion, while the estimates for total borrowing, based on the survey sample, are $2.75 billion. Evidently the blown-up survey results reported herein captured only 95.1 per cent of the borrowing actually accomplished. No attempt has yet been made to correct for this discrepancy. Of the 625 units included in the quarterly survey, all but 4 responded, for a response rate of 99.5 per cent.

* Prepared by John E. Petersen, Economist, Capital Markets Section, currently on leave to the Urban Institute.

Table 1

LONG-TERM BORROWING AND SHORTFALLS[1/]
INDUCED BY HIGH INTEREST RATES
4th Quarter 1969, Millions of Dollars

Type of unit	(1) Actual Borrowing	(2) Shortfalls induced by high interest rates[1/]	(2)/(1) Ratio
State[2/]	$1,235	$ 572	.46
County	122	209	1.71
City & town	739	475	.64
Special District	147	203	1.38
School District	510	785	1.54
Total	$2,754	$2,242	.81

1/ Includes postponements, abandonments and reductions in issues.
2/ Includes State authorities and colleges.

High interest rates in the fourth quarter of 1969 displaced $2.25 billion in desired long-term borrowing,[2/] 30 per cent greater than the displacements for similar reasons in the third quarter of 1969.

2/ The total amount of the long-term borrowing shortage where high interest rates were at least a contributing factor was $2.5 billion. When multiple reasons for bond postponements or reductions were given, the amount of the shortfall was distributed proportionately among them. The same procedure was used in allocating spending impacts among reasons.

The $2.25 billion figure for bond postponements in the fourth quarter contrasts sharply with the $600 million increase in cumulative displacements as reported by the Bond Buyer. The latter source carries a strong downward bias because it counts only those issue that have advertised for bid and counts issues only as of the date they were originally postponed.

As in the third quarter, all types of State and local units sharply reduced their planned borrowing, with counties and school districts faring worst. For three types of local units--counties, special districts, and school districts--the amount of interest-rate displaced borrowing greatly exceeded the amount of borrowing actually accomplished.

Effects on Capital Spending

As shown in Table 2, the estimated impact of borrowing shortfalls induced by interest rates amounted to \$1.1 to \$1.3 billion in reductions of capital spending below planned levels.3/

Table 2

CAPITAL SPENDING AND CONTRACT AWARD CUTBACKS
INDUCED BY HIGH INTEREST RATES
4th Quarter, 1969

Type of unit	Contract and spending cutbacks 1/ (Millions of dollars)	Ratio of cutbacks to borrowing shortfalls (Per cent) 2/
State	\$ 131 to 331	24 to 58
County	25 to 62	12 to 30
City & town	168 to 171	35 to 36
Special District	71 to 75	35 to 37
School District	676 to 683	87 to 88
Total	\$1,070 to 1,318	48 to 59

1/ Upper limit of range is given by addition of proxy amounts of spending reduction where units indicated spending cutbacks but failed to give a dollar estimate.
2/ Long-term borrowing shortfalls induced by high interests are given in Table 1.

3/ The expenditure impacts have been estimated in terms of a range because 17 of the units reporting capital spending impacts did not estimate the amount of the reduction. In such cases, the borrowing shortfall has been used as a proxy for the spending reduction. Thus, the reduction amounts explicitly given by units form the bottom of the range whereas addition of the proxied amounts gives the upper limit.

Such spending reductions are evidently heaviest for school districts, providing further evidence to the proposition that the smaller units have the greatest difficulty in finding alternative forms of financing projects in periods of restrictive credit. For these units, nearly ninety per cent of the dollar volume of long-term borrowing shortfalls have given rise to construction cutbacks.

The ratio of aggregate spending reductions to total borrowing shortfalls attributed to the high cost of borrowing is approximately 53 per cent. This is more than ten percentage points higher than the 40 per cent ratio found in the third quarter of 1969 and 2-1/2 times the ratio found in the System's survey of State and local borrowing in 1966.

The bulk of these spending reductions are net additions to the $600 to $750 million in spending delays reported by the third quarter survey. Only about $200 million of the $1.1 to $1.3 billion figure represent continuation of spending hold-ups first reported in the third quarter. Hence, it appears that high interest rates in the second half of 1969 (no data are available for the first half) set off about $1.6 to $1.8 billion in capital spending delays and reductions.

Because of lags inherent in the construction process, the full impact of these reductions on capital outlays will take time to work themselves out. But on an annual rate basis, they suggest a $3.0 to $3.6 shortfall of State and local capital spending below intended levels. Preliminary State and local construction statistics for the fourth quarter of 1969 do indeed show an actual downturn in seasonally adjusted expenditures amounting to approximately $1.0 billion on an annual rate basis. Even though some relaxation in the bond markets this spring may allow resumption of many postponed projects, it seems unlikely that State and local construction expenditures will increase significantly on balance throughout 1970. A contributing factor of unmeasured magnitude is the voluntary postponement of Federally-aided capital expenditures by State officials in response to the President's request of last August.

State-by-State Experience

As might be expected, the extent of bond postponements induced by adverse market conditions varied greatly among the states. Those ten states with no rate ceilings (or suspended ceilings) in force during the fourth quarter;[4] accounted for 26 per cent of all borrowing cutbacks associated with high interest rate. But, virtually none of these borrowing shortfalls resulted in construction cutbacks. Apparently, interest-rate induced postponement of borrowings in these states only occurred if other financing means were available. Of course, this

4/ Connecticut, Idaho, Indiana, Maine, Massachusetts, New Hampshire, North Carolina, New Jersey, New York, and Wyoming.

means that essentially all of the reductions in capital outlays at the State and local level, that were associated with high borrowing costs, occurred in those areas with some form of legal rate ceiling.

Those states with the largest volume of construction delays or abandonments were Pennsylvania, ($111 million), California ($100 million), and Texas ($72 million). In several states the amount of borrowing postponed due to high interest rates was several times the volume actually accomplished: Michigan, 6 times; Maryland, 5; Oklahoma, 10; Kansas, 25. Although regional tabulations have not yet been completed, it is clear that the New England states have been most successful in avoiding spending cuts as a result of long-term borrowing shortfalls. None of these states carries interest rate ceilings, and most of them typically make much heavier use of short-term borrowing than states in other regions of the country.

Alternative Means of Financing

Approximately $800 million in long-term shortfalls attributed to high interest rates did not lead to spending cutbacks. As depicted in Table 3, short-term borrowing supplied over half the alternative funds used to finance expenditure plans. Liquid asset reductions, which were of relatively little importance in the third quarter, supplied 22 per cent of the alternative funds used in the fourth quarter. The increased importance of this source may reflect the fact that local tax collections are relatively heaviest in the fourth quarter of the year when, typically, 35 per cent of the year's revenues are collected. Of greatly decreased importance in sheltering expenditure plans from capital market difficulties was the "no immediate need for funds" category. With prolonged stringency, relatively few units have been borrowing well in advance of cash needs. The erosión of these buffers, discussed in the Greenbook Appendix of October 1969, accounts for much of the growing severity of the bond financing shortages upon spending plans.

Table 3

ALTERNATIVE MEANS OF FINANCING
SHORTFALLS DUE TO HIGH INTEREST RATES
3rd Quarter, 1969

Means	Millions of dollars	Per cent of total
Short-term borrowing	$ 437	55
Reductions in liquid assets	175	22
Reductions in current expenditures	4	1
No immediate need	71	9
Governmental loans	79	10
Other means	31	4
Total	$ 798	100

Revisions of Borrowing Expectations

The amount of long-term borrowing anticipated by respondents should be interpreted as a desired amount that could be brought to market if conditions permitted. Obviously, factors other than high interest rates are going to reduce actual borrowing below planned levels. Only time--and staff experience with the panel of government respondents--will develop patterns of systematic biases in expectations and thus permit a better approximation of more firm intentions.

As a first approximation, however, it appears that governments envisage a $20 billion annual rate of borrowing for the first half of 1970. These plans probably carry some downward bias due to the fact that about half the planned amount represents intentions that have not been updated since June 30 of last year.

APPENDIX C: SEASONAL ADJUSTMENT OF CONSUMER PRICE INDEXES*

Although seasonally adjusted percentage changes in consumer prices from month to month and quarter to quarter have been released from time to time, most of the seasonally adjusted indexes themselves have not been published or made available because of technical problems in obtaining accurate seasonal factors. However, BLS has made available for our analytical use on a confidential basis recently revised seasonal factors for 1969 and 1970. Factors for major commodity groups are shown in the table. Seasonality in service prices is negligible.

*Prepared by Mary W. Smelker, Senior Economist, Business Conditions Section, Division of Research and Statistics.

CONSUMER PRICE INDEX

	Unadjusted CPI index 1957-59 = 100	Seasonally adjusted CPI 1/ 1957-59 = 100	Seasonal factors 1/					
			All items	Nondurable commodities	Food	Apparel	Durable commodities	New cars
1969								
January	124.1	124.3	99.8	99.8	99.9	99.3	99.9	100.7
February	124.6	124.8	99.8	99.8	99.8	99.4	99.8	100.4
March	125.6	125.7	99.9	99.9	99.7	99.8	99.8	100.3
April	126.4	126.4	100.0	99.9	99.7	99.9	100.1	100.0
May	126.8	126.9	99.9	99.8	99.6	100.3	100.0	99.7
June	127.6	127.6	100.0	100.0	100.1	100.1	100.1	99.4
July	128.2	128.1	100.1	100.2	100.7	99.5	100.1	99.2
August	128.7	128.6	100.1	100.3	100.8	99.2	99.9	98.4
September	129.3	129.2	100.1	100.3	100.3	100.3	99.6	97.2
October	129.8	129.7	100.1	100.2	100.1	100.7	100.2	101.4
November	130.5	130.5	100.0	99.9	99.6	100.8	100.5	102.0
December	131.3	131.3	100.0	100.0	99.7	100.6	100.1	101.4
1970								
January	131.8	132.1						

1/ Not for publication, confidential.