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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

September 9, 1970

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SUMMARY AND OUTLOOK

Nonfinancial

Data becoming available since the preceding Greenbook continue consistent with the staff projection of a modest rise in real GNP in the third quarter and some abatement of upward price pressures.

With output of business and defense equipment apparently down further and output of consumer goods continuing to edge up, total industrial production is now estimated to have declined somewhat in August, following an increase in July. The index has been in a very narrow--one-half of one percentage point--range for the four months May-August. Retail sales are tentatively estimated to have declined one-half to one per cent in August, on the basis of weekly figures, although the July-August average still appears to be somewhat above the second quarter level. Unit sales of new domestic autos were at an annual rate of close to 8.5 million units in August, for the third consecutive month. A July increase in new orders was mostly attributable to defense orders, an erratic series, but capital equipment orders increased somewhat and were at about the reduced second quarter average. Meanwhile housing starts increased sharply in July, following a sizable increase in June. And the composite index of 12 leading indicators rose in July for the second consecutive month.

The labor market eased slightly further in August, as employment rate edged up to 5.1 per cent, nonfarm employment declined, and the average workweek in manufacturing was also off. Major contracts in the auto industry expire at midnight September 14, and the UAW strike targets are GM and/or Chrysler.

Recent price developments offer additional evidence that inflationary pressures are abating. On a seasonally adjusted basis, average wholesale prices declined from mid-July to mid-August, as the sharp July rise in prices of farm products was more than reversed, while the rise in industrial commodities slowed further. Prices of sensitive industrial materials declined again. Reports of the corn blight have raised questions about prospective supplies and prices of both corn and related products, but we expect that the effect on food prices will be relatively small at least until early next year.

The rise in consumer prices has also slowed perceptibly in recent months, with food prices and a leveling off of mortgage interest rates important contributing factors. But prices of services generally have continued to rise sharply and prices of 1971 model autos also will rise considerably.

Outlook. Real GNP is expected to increase at a modest pace in the current quarter and more rapidly next quarter. In the first two quarters of 1971, real GNP is projected to increase at an average rate of 3-1/4 per cent, with growth projected to be a little faster in the second quarter. With manpower and capital resources continuing ample relative to demands, the increase in the GNP deflator is expected to slow to an annual rate of 3 per cent next spring.

As compared with our last projection, the current outlook is for greater strength in residential construction, a little less weakness in plant and equipment spending, and a somewhat larger decline in defense outlays. Housing starts are now projected to rise to an annual rate of about 1-3/4 million units in the second quarter of next year, assuming continued relatively sizable inflows of funds into depositary institutions. With housing starts generally on a higher track, residential construction has been raised correspondingly.

The expected decline in business fixed investment is somewhat smaller than in the preceding projection. We have made some allowance for the tendency of new orders for capital equipment to level off most recently, for the leveling off of new manufacturing capital appropriations in the second quarter and the possibility of a rise this quarter, and for the modest reduction from earlier plans reported in the August Commerce-SEC survey.

We note again that our projections assume no lengthy auto strike. Any extended strike, particularly against GM, would lower fourth quarter output and income, consumer spending and inventories from present projections--and tend to raise these categories in the first quarter of 1971.

Financial

In August, as investor attitudes changed, both short- and long-term market interest rates declined on balance, stock prices and volume rose, and finance companies were able to increase their outstanding commercial paper for the first time since May. These changes in financial markets accompanied the more rapid growth of bank credit and the monetary aggregates, easing of money market conditions, and announcement of the cut in reserve requirements. In early September, however, the financial markets became somewhat less buoyant in the face of a mounting forward volume of new security issues and the somewhat tauter money market conditions that developed in spite of sizable System reserve supplying operations.

Prospective credit demands over the fall appear to be quite large. Despite the expected decline in capital outlays and some improvement in the availability of internal funds, the forward calendar of new corporate security offerings remains historically high and underwriters report a significant volume of new and rescheduled issues in process. State and local governments are also beginning to step up their pace of offerings, and the most recent FRB-Census survey indicates that these units plan to expand their borrowing in coming months. Treasury net borrowing in the fourth quarter is expected to be around $7-1/2 billion, larger than in the previous two years. Moreover, FHLB and FNMA net new money demands in the final four months of the year are projected by these agencies to total about $3.0 billion, although, given the apparent improvement in mortgage credit flows, such large demands may not materialize.

Current and prospective financial patterns suggest that even large total credit demands might be accommodated at declining yields in coming months. Bank credit growth is expected to remain large as time deposit expansion continues sizable, though tapering off from the recent exceptional pace. The projected deposit growth suggests that banks will not only be able to continue to absorb Treasury and tax-exempt obligations, but also soon could become more willing lenders to businesses, and perhaps to the mortgage market. Indeed, present and prospective interest rate relationships and continued deposit growth could set the stage for a cut in the prime rate in the next few weeks. In the event of such a reduction in the prime rate, there could be a significant drop in both short- and long-term market yields, as investor expectations shift and possibly as some businesses shift borrowing from the open market to banks.

Residential mortgage markets are reflecting the impact of accelerated savings inflows to nonbank thrift institutions. With inflows expected to remain large--although below the July pace--and with the liquidity of thrift institutions already largely restored, increased aggressiveness in forward mortgage commitment policies is likely, particularly with the backstop of a lenient FHLB advance policy. FNMA and the FHLB continue to plan for maintenance of a high pace of their own activities, supplemented--under new congressional authority granted to the FHLB--by the initiation before the end of the year of some conventional mortgage purchases in the secondary market.

Balance of payments

In July-August the over-all payments deficit on the liquidity basis (before special transactions) was at a rate less than half of the second quarter's $2.2 billion, quarterly rate. Partly the change reflected improvement in the trade balance. Through July at least, the general trend in exports was still one of rapid expansion, reflecting strong demand abroad, as had been the case since the beginning of this year. Particularly notable has been the strength in shipments of machinery, while sales of industrial materials have leveled off. U. S. imports had bulged in May, but in July they were again no larger in value than during the early months of the year.

A major part of the over-all improvement in the payments balance after midyear occurred in private capital flows. Recently available data show that direct investment outflows in the first and second quarters were much in excess of the quarterly average implied in the OFDI program for 1970; probably the pace of these outflows has been reduced in recent months. Bank credit reflows after midyear were another factor, and still another was the resumption, which started in June, of foreigners' net purchases of U. S. equity securities on a moderate scale.

Prospective developments in the U. S. economy and in Europe, Japan and Canada are such as to suggest the maintenance on into next year of a considerable surplus in U. S. merchandise trade. The net inflow of foreign buying in the stock market is also likely to continue. The OFDI controls should prove helpful during the remainder of 1970 in discouraging direct investment outflows.

Despite the improvement in July-August, the liquidity deficit has continued sizable. With repayments by U. S. banks of liabilities to their foreign branches also large in July, the official settlements deficit for the past two months exceeded its second-quarter level (over $2 billion quarterly). Hope that the official settlements deficit may be smaller in the rest of the year depends a good deal on faith in the restraint on U. S. banks' Euro-dollar repayments set up by the prospect of automatic reductions of reserve-free bases. The effectiveness of this restraint is likely to diminish if banks become convinced that there is little likelihood of a renewed squeeze on their liquidity positions over the coming year or two.

Foreign central bank reserve gains were extraordinarily large in the first half of 1970. In the second quarter, gains by other industrial countries much exceeded those explainable by U.S. international transactions; one significant cause of this difference in the second quarter was a growth of official reserve holdings in the form of dollar balances with institutions outside the United States. Even if foreign reserve gains during the remainder of the year are no larger than the U.S. official settlements deficit, the growth of official dollar reserves in 1970 will be much larger than was contemplated as an annual average for the first three-year period of SDR allocations.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1970 May	1970 June	1970 July	1970 August	Per Cent Change* From 1 mo. ago	Per Cent Change* From 3 mos. ago	Per Cent Change* From Year ago
Civilian labor force (mil.)	82.6	82.1	82.8	82.7	-0.2	0.1	2.1
Unemployment rate (%)	5.0	4.7	5.0	5.1	--	--	[3.5] 4/
Insured unempl. rate (%)	3.6	3.7	3.6	n.a.	--	--	[2.2] 4/
Nonfarm employment, payroll (mil.)	70.9	70.6	70.6	70.5	-0.1	-0.4	0.1
Manufacturing	19.6	19.5	19.4	19.3	-0.4	-1.2	-4.5
Nonmanufacturing	51.3	51.1	51.2	51.2	0.0	-0.1	1.9
Industrial production (57-59=100) 5/	169.1	168.8	169.2	n.a.	0.2	-0.6	-3.1
Final products, total	167.8	167.1	167.2	n.a.	0.1	-0.8	-3.2
Consumer goods	163.3	162.6	163.3	n.a.	0.4	0.1	-0.7
Business equipment	188.7	188.3	186.9	n.a.	-0.7	-3.2	-5.1
Materials	170.8	170.7	171.5	n.a.	0.5	-0.2	-2.8
Capacity util. rate, mfg.	77.8	77.3	77.2	n.a.	--	--	[84.6] 4/
Wholesale prices (57-59=100) 1/	116.8	117.0	117.7	117.2	-0.4	0.3	3.4
Industrial commodities (FR) 5/	115.5	115.7	115.9	n.a.	0.2	0.7	4.0
Sensitive materials (FR)	116.9	115.9	114.7	114.5	-0.2	-2.1	1.8
Farm products, foods & feeds	117.0	117.5	119.3	117.0	-1.9	0.0	2.1
Consumer prices (57-59=100) 1/ 5/	134.6	135.2	135.7	n.a.	0.4	1.3	5.9
Food	132.4	132.7	133.4	n.a.	0.5	1.1	5.3
Commodities except food	122.3	122.8	122.9	n.a.	0.1	1.1	4.1
Services	154.1	155.0	155.8	n.a.	0.5	1.6	8.2
Hourly earnings, pvt. nonfarm ($)	3.20	3.21	3.23	3.25	0.6	1.7	5.9
Hourly earnings, mfg. ($)	3.34	3.36	3.38	3.40	0.5	1.9	5.0
Weekly earnings, mfg. ($)	132.93	133.73	135.82	135.14	-0.5	1.7	3.2
Net spend. weekly earnings, mfg. (3 dependents 57-59 $) 1/ 5/	85.64	86.12	85.21	n.a.	-1.1	-0.2	-1.5
Personal income ($ bil.) 2/ 5/	799.7	798.2	801.8	n.a.	0.5	-0.5	6.5
Retail sales, total ($ bil.) 5/	30.5	30.5	30.7	n.a.	0.7	0.7	5.7
Autos (million units) 2/	7.8	8.6	8.5	n.a.	-1.4	14.0	-3.2
GAAF ($ bil.) 3/	8.3	8.2	8.4	n.a.	1.8	-1.1	3.2
12 leaders, composite (1963=100) 5/	114.0	114.3	116.1	n.a.	1.6	0.7	-1.3
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/ 5/	1,242	1,375	1,585	n.a.	15.3	29.5	10.9
Factory workweek (hours)	39.8	39.8	40.1	39.9	-0.5	0.3	-1.7
Unempl. claims, initial (thous.) 5/	314	312	270	n.a.	13.3 6/	17.2 6/	-26.0 6/
New orders, dur. goods, ($ bil.) 5/	29.5	29.7	30.7	n.a.	3.3	7.4	-1.1
Machinery & equipment	6.2	6.4	6.5	n.a.	1.7	7.0	1.9
Common stock prices (41-43=10)	76.06	75.59	75.72	77.73	2.7	2.2	-17.5

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l. merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ Per cent calculated to June 1970. 6/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	Averages 1969	Averages 1970				1970 Week ended
	QIV	QI	QII	July	Aug.	Aug. 26
Interest rates, per cent						
Federal funds	8.94	8.56	7.88	7.21	6.61	6.34
3-mo. Treasury bills	7.36	7.21	6.67	6.45	6.41	6.28
3-mo. Federal agencies	7.92	7.72	7.09	6.68	6.87	6.71
3-mo. Euro-dollars	10.48	9.26	8.87	8.76	8.19	8.15
3-mo. finance co. paper	7.89	7.94	7.41	7.64	7.48	7.43
4-6 mo. commercial paper	8.63	8.55	8.16	8.29	7.90	7.90
Bond buyer municipals	6.40	6.35	6.81	6.53	6.20	6.16
Aaa corporate-new issues	8.32	8.45	8.94	8.63	8.52	8.40
20-year Treasury bonds	6.71	6.78	7.14	6.92	7.08	7.09
FHA mortgages, 30-year	8.53	9.25	9.12	9.11	n.a.	n.a.

	1969	1970			
	QIV	QI	QII	July	Aug.
Change in monetary aggregates (SAAR, per cent)					
Total reserves	1.4	- 2.9	2.6	6.0	23.0
Nonborrowed reserves	- 0.1	- 0.4	4.1	16.1	48.5
Credit proxy	0.1	0.6	6.0	22.7	29.6
Credit proxy + nondep. funds	2.0	0.5	6.5	18.1	23.9
Money supply	1.2	3.8	4.2	4.1	11.2
Time and savings deposits	--	0.4	13.8	35.2	27.7
Deposits at S&L's and MSB's	1.4	1.9	7.1	12.3	n.a.
Bank credit, end-of-month	4.8	- 0.4	4.2	16.6	16.4
Treasury securities	-20.5	-12.3	30.2	31.1	36.8
Other securities	4.5	9.5	9.9	8.0	20.7
Total loans	10.0	- 0.7	- 2.0	16.1	10.7
Business	7.7	- 4.5	1.5	4.6	19.3

	1969	1970			
	QIV	QI	QII	July	Aug.
Change, in millions of dollars					
Commercial paper (SA)	3,151	3,185	2,091	-2,033	n.a.
Bank related (NSA)	1,614	2,224	1,035	217	- 512

	1968	1969			1970	
	Year	Year	QII	Aug.	QII	Aug.
New security issues (NSA, $ mil.)						
Total corp. issues	21,965	26,744	7,354	1,427	10,272e	2,600e
Public offerings	15,314	21,131	5,679	1,167	8,963e	2,200e
State and local government bond offerings	16,574	11,881	3,648	808	3,711	1,275e
Fed. sponsored agency debt (change)	3,354	9,292	2,411	947	1,233	504e
Fed. gov't. debt (change)	15,300	-2,557	-12,527	679	-6,396	2,794e

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

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

	1969 r/ Year	1970 p I	II	MAY*	JUNE*	JULY*
Goods and services, net 1/	1,950	851	1,119			
Trade balance 2/	638	518	847	239	423	421
Exports 2/	36,473	10,241	10,714	3,588	3,710	3,640
Imports 2/	-35,835	-9,723	-9,867	-3,349	-3,287	-3,219
Service balance	1,312	333	272			
Remittances and pensions	-1,191	-328	-359			
Govt. grant & capital, net	-3,828	-855	-785			
U.S. private capital	-5,374	-1,686	-1,813			
Direct investment	-3,070	-1,411	-1,363			
Foreign securities	-1,494	-133	64	61	41	-144
Banking claims	-541	147	-459	-280	-123	345
Other	-269	-289	-55			
Foreign capital	12,345	1,679	1,547			
Official foreign, liquid	-525	3,044	450	378	502	1,292
Official reserve holders, nonliquid	-996	-422	506	128	288	-71
Other official foreign, nonliquid	259	-38	-182			
Foreign commercial banks, liquid	9,225	-1,916	-118	-343	-739	-1,134
New direct investment issues 3/	1,029	155	308			
U.S. corporate stocks	1,565	-85	-128	-200	64	54
Other	1,788	941	711			
U.S. monetary reserves (inc.-)	-1,187	481	1,022	754	-163	263
Gold stock	-967	-44	14	2	11	-45
Special drawing rights	--	-53	-37	1	-32	-4
IMF gold tranche	-1,034	-253	227	150	10	-104
Convertible currencies	814	831	818	601	-152	416
Errors and omissions	-2,715	-142	-729			
BALANCES (deficit -) 4/						
Official settlements, S.A.		-3,103	-1,978			
" " , N.S.A.	2,708	-2,829	-2,061	-1,260	-627	-1,484
Liquidity, S.A.		-1,598	-1,420			
" , N.S.A.	-7,012	-1,496	-1,411	-751	280	-339
Adjusted over-all, S.A		-1,187	-1,860			
" " , N.S.A.	-6,517	-1,093	-1,858	-917	112	-350
Financed by: 5/						
Liab. to comm. banks	9,225	-1,736	-203	-343	-739	-1,134
Official settlements	-2,708	2,829	2,061	1,260	627	1,484

* 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/ Excludes initial allocation of SDRs on January 1, 1970; total $867 million, quarterly S.A., $217 million.
5/ Minus sign indicates decrease in net liabilities. Data not seasonally adjusted.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product. Economic data for the past several weeks indicate the likelihood of a modest improvement in the rate of growth of activity this quarter. The decline in industrial production seems to have about halted in the past several months, and the recent rough stability of hours of work and unemployment claims suggest that the period of large layoffs may be at, or close to, an end. New orders for durable goods have been edging up in the past few months, and there has been a strong recovery in housing starts and residential construction activity. Although consumer demand for goods appears not to have been fully maintained in August, we still anticipate a larger increase in GNP this quarter than last. In current dollar terms, a rise of $14 billion is anticipated, as compared to an $11-1/2 billion increase in the second quarter. Assuming a slight further moderation in the rise of the deflator, this means an increase in real GNP of over 1-1/2 per cent as compared with 0.6 per cent in the second quarter.

Economic activity this quarter is being strengthened by a resurgence of residential construction activity. We have revised up our projection of such outlays, as a result both of the recent sharp rise in housing starts and the surprisingly large flow of consumer-type time and savings deposits at both banks and nonbank intermediaries. Residential starts are now projected to rise to about a 1.5 million annual rate this quarter, an increase of 200,000 units, annual rate, from last quarter, and outlays are expected to rise by $1.6 billion, instead of by the $0.5 billion we had formerly projected. (See Appendix A.)

CHANGES IN GNP AND RELATED ITEMS, 1970
(Seasonally adjusted, annual rates)

	Third Quarter		Fourth Quarter	
	Projection of 8/12/70	Current Projection	Projection of 8/12/70	Current Projection
	--------------Billions of dollars--------------			
GNP	13.5	13.9	15.2	15.0
Final sales	13.8	13.9	14.8	15.0
Personal consumption	11.5	10.6	10.8	11.0
Residential construction	.5	1.6	2.7	2.7
Business fixed investment	-.5	-.5	-1.0	-.5
Net exports	.6	.6	.3	.3
Federal purchases	-.6	-.7	-1.0	-1.5
State and local purchases	2.3	2.3	3.0	3.0
Inventory change	-.3	-.1	.4	0
	--------------Per cent--------------			
Real GNP	1.6	1.7	2.7	2.5
GNP deflator	4.0	4.0	3.5	3.6

On the other hand, growth of consumer spending this quarter now appears likely to fall about $1 billion short of our projection in the preceding Greenbook. Based on weekly data, August retail sales were apparently from one half to one per cent below the upward revised July level, with weakness particularly evident at durable goods stores, department, and apparel stores. The dollar volume of auto sales fell somewhat below the July level, although unit sales of domestically produced cars were virtually unchanged at close to an 8-1/2 million annual rate.

Despite the dip in August, we still expect a sizable gain of about $10-1/2 billion in consumer outlays for the quarter as a whole, with demand sustained in part by removal of the tax surcharge at midyear and by a lagged response to the large increase in disposable income last quarter, which raised the saving rate to an abnormally high level.

Projections of other major demand sectors for the third quarter remain virtually unchanged--a larger increase in State and local outlays than in the second quarter, but little further change in the rate of inventory accumulation; we continue to expect business fixed investment spending to begin to edge down slightly this quarter, despite business plant and equipment spending plans which call for some increase in the third quarter.

Assuming no auto strike, real growth is expected to increase somewhat further in the fourth quarter to about a 2-1/2 per cent annual rate, about as we had been projecting earlier. The composition of the fourth quarter increase has been changed slightly, however. The recent firmness in new orders figures and the August Commerce-SEC survey results suggest that capital expenditures may hold up a bit better than we had expected. We now project a fourth quarter decline of about $0.5 billion, rather the $1.0 billion decline formerly projected. The projected decline in these expenditures in the first half of 1970 is revised to $1 billion a quarter from $1-1/2 billion.

On the other hand, it is now anticipated that Congressional appropriations are likely to curtail defense outlays somewhat more than formerly expected for the remainder of fiscal 1971, and such purchases are now expected to drop by about half a billion dollars more than projected earlier in the fourth quarter. On balance, these various changes should be about offsetting, and GNP is expected to rise by about $15 billion.

In the event of an auto strike, particularly a protracted one against GM, the gain in fourth quarter GNP could be cut significantly. The impact of this cut would be largely on inventories but consumer durable goods purchases would also be affected as production and income are cut back. However, much of this loss of output would likely be made up in the first quarter.

CHANGES IN GNP AND RELATED ITEMS, 1971
(Seasonally adjusted, annual rates)

	First Quarter		Second Quarter	
	Projection of 8/12/70	Current Projection	Projection of 8/12/70	Current Projection
	Billions of dollars			
GNP	18.2	17.5	16.0	17.1
Final sales	17.9	17.0	14.5	16.1
Personal consumption	11.0	11.2	11.0	11.5
Residential construction	2.4	2.0	1.1	1.4
Business fixed investment	-1.5	-1.0	-1.5	-1.0
Net exports	.6	.6	.1	.1
Federal purchases	1.9	.7	.0	.3
State and local purchases	3.5	3.5	3.8	3.8
Inventory change	.3	.5	1.5	1.0
	Per cent			
Real GNP	3.2	2.8	3.3	3.7
GNP deflator	4.1 1/	4.2 1/	3.0	3.0

1/ Excluding effects of Federal pay increase, 3.2 per cent per year.

Our projections call for a further rise in real GNP in the first half of 1971, despite the lower amounts now projected for defense spending. Continued recovery is anticipated for residential construction activity, and easier financial markets should permit more rapid expansion of State and local outlays; with support for consumer demand provided by a Federal pay raise, and some expansion in inventory investment, we expect GNP to increase by over $17 billion a quarter, or an average 3-1/4 per cent annual rate in real terms. Growth would still remain below potential, suggesting a further small rise in unemployment and some continued easing of pressure on prices.

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September 9, 1970

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.)

	1969	1970 Proj.	1970 I	1970 II	1970 III Projected	1970 IV Projected	1971 I Projected	1971 II Projected
Gross National Product	931.4	978.9	959.5	971.1	985.0	1000.0	1017.5	1034.6
Final purchases	922.9	976.3	957.9	968.1	982.0	997.0	1014.0	1030.1
Private	710.7	756.4	738.3	749.7	762.0	775.5	788.3	800.3
Excluding net exports	708.8	752.0	734.8	745.6	757.3	770.5	782.7	794.6
Personal consumption expenditures	577.5	619.6	603.1	614.4	625.0	636.0	647.2	658.7
Durable goods	90.0	92.4	89.1	91.9	93.5	95.0	96.2	97.2
Nondurable goods	245.8	264.7	258.8	262.6	266.5	271.0	275.5	280.5
Services	241.6	262.5	255.2	259.9	265.0	270.0	275.5	281.0
Gross private domestic investment	139.8	135.1	133.2	134.3	135.3	137.5	139.0	140.4
Residential construction	32.0	30.1	29.1	28.4	30.0	32.7	34.7	36.1
Business fixed investment	99.3	102.4	102.6	102.8	102.3	101.8	100.8	99.8
Change in business inventories	8.5	2.7	1.6	3.1	3.0	3.0	3.5	4.5
Nonfarm	8.0	2.4	0.9	2.6	3.0	3.0	3.5	4.5
Net exports of goods and services	1.9	4.3	3.5	4.1	4.7	5.0	5.6	5.7
Gov't. purchases of goods & services	212.2	219.9	219.6	218.4	220.0	221.5	225.7	229.8
Federal	101.3	99.6	102.3	99.7	99.0	97.5	98.2	98.5
Defense	78.8	76.1	79.3	76.8	75.5	73.0	72.8	72.0
Other	22.6	23.5	23.0	22.9	23.5	24.5	25.4	26.5
State & local	110.8	120.3	117.4	118.7	121.0	124.0	127.5	131.3
Gross national product in constant (1958) dollars	727.1	727.2	723.8	724.9	727.9	732.4	737.5	744.4
GNP implicit deflator (1958 = 100)	128.1	134.6	132.6	134.0	135.3	136.5	138.0	139.0
Personal income	748.9	803.7	782.3	801.3	809.5	821.5	835.0	848.6
Wages and salaries	509.0	543.0	531.9	539.5	546.5	554.0	564.5	572.8
Disposable income	631.6	686.4	665.3	683.6	693.5	703.3	713.5	724.5
Personal saving	37.6	49.0	44.8	51.5	50.7	49.0	47.7	46.9
Saving rate (per cent)	6.0	7.1	6.7	7.5	7.3	7.0	6.7	6.5
Corporate profits before tax	91.2	82.7	82.6	82.3	82.5	83.5	82.5	84.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	200.6	196.2	195.9	196.6	194.7	197.4	204.7	207 9
Expenditures	191.3	206.9	197.7	210.9	209.0	210.0	215.0	218.0
Surplus or deficit (-)	9.3	-10.7	-1.7	-14.3	-14.3	-12.6	-10.3	-10.1
High employment surplus or deficit (-)	4.5	-1.6	2.9	-5.4	-4.3	0.3	8.0	8.1
Total labor force (millions)	84.2	86.0	85.8	85.7	86.0	86.4	86.8	87.3
Armed forces "	3.5	3.2	3.3	3.2	3.1	3.1	3.0	3.0
Civilian labor force "	80.7	82.8	82.4	82.5	82.9	83.3	83.8	84.3
Unemployment rate (per cent)	3.5	4.8	4.1	4.8	5.1	5.3	5.5	5.6
Nonfarm payroll employment (millions)	70.3	70.9	71.1	70.9	70.7	71.0	71.3	71.8
Manufacturing	20.2	19.6	20.0	19.6	19.4	19.5	19.5	19.6
Industrial production (1957-59=100)	172.8	170.3	170.7	169.3	170.0	171.0	172.2	174.0
Capacity utilization, manufacturing (per cent)	83.7	78.0	79.8	77.9	77.3	76.8	76.6	76.6
Housing starts, private (millions A.R.)	1.47	1.39	1.25	1.28	1.49	1.53	1.65	1.75
Sales new domestic autos (millions, A.R.)	8.46	8.08	7.35	7.95	8.50	8.50	8.65	8.75

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1969	1970 Proj.	1970 I	1970 II	1970 III	1970 IV (Projected)	1971 I (Projected)	1971 II (Projected)
	----------	----------	----------	Billions of Dollars	----------	----------	----------	----------
Gross National Product	66.4	47.5	7.8	11.6	13.9	15.0	17.5	17.1
Inventory change	0.9	-5.8	-5.6	1.5	-0.1	0.0	0.5	1.0
Final purchases	65.5	53.4	13.4	10.2	13.9	15.0	17.0	16.1
Private	53.5	45.7	10.1	11.4	12.3	13.5	12.8	12.0
Excluding net exports	54.1	43.2	9.2	10 8	11.7	13.2	12.2	11.9
Net exports	-0.6	2.4	0.9	0.6	0.6	0.3	0.6	0.1
Government	12.0	7.7	3 3	-1.2	1.6	1.5	4.2	4.1
GNP in constant (1958) dollars	19.9	0.1	-5.4	1.1	3.0	4.5	5.1	6.9
Final purchases	19.6	4.8	-0.5	-0.5	3.2	4.5	4.7	5.9
Private	20.1	11.8	1.1	3 3	4.5	5.7	5.3	5.1
	----------	----------	----------	In Per Cent Per Year	----------	----------	----------	----------
Gross National Product	7.7	5.1	3.3	4.8	5.7	6.1	7.0	6.7
Final purchases	7.6	5.8	5.7	4.3	5.7	6.1	6.8	6.4
Private	8.1	6.4	5.5	6.2	6.6	7.1	6.6	6.1
Personal consumption expenditures	7.8	7.3	7.1	7.5	6.9	7.0	7.0	7.1
Durable goods	7.1	2.7	-7.5	12.6	7.0	6.4	5.1	4.2
Nondurable goods	6.8	7.7	10.8	5.9	5.9	6.8	6.6	7.3
Services	9.0	8.7	8.6	7.4	7.8	7.5	8.1	8 0
Gross private domestic investment	10.5	-3.4	-20.0	3.3	3.0	6.5	4.4	4.0
Residential construction	5 6	-5.9	-17 1	-9.6	22.5	36.0	24.5	16.1
Business fixed investment	12.0	3.1	0.0	0.8	-1.9	-2.0	-3.9	-4.0
Gov't. purchases of goods & services	6.0	3.6	6.1	-2.2	2.9	2.7	7.6	7.3
Federal	1.8	-1.7	0.8	-10.2	-2.8	-6.1	2.9	1.2
Defense	1.0	-3.3	2.5	-12.6	-6.8	-13.2	-1.1	-4.4
Other	5.1	4.0	-5.2	-1.7	10.5	17.0	14.7	17.3
State & local	10.0	8.6	11.2	4.4	7.8	9.9	11.3	11.9
GNP in constant (1958) dollars	2.8	0.0	-3.0	0 6	1.7	2.5	2.8	3.7
Final purchases	2.8	0.7	-0.4	-0.3	1.8	2.5	2.6	3.2
Private	3.6	2.1	0 8	2 3	3.1	3.9	3.6	3.4
GNP implicit deflator	4.7	5.1	6 4 1/	4.3	4.0	3.6	4.2 2/	3.0
Personal income	8.7	7.3	6.1	9.7	4.1	5.9	6.6	6.5
Wages and salaries	9.5	6.7	5 0	5.7	5.2	5.5	7.6	5 9
Disposable income	6.8	8.7	9 0	11.0	5.8	5.7	5.8	6.2
Corporate profits before tax	2.8	-9.3	-26.7	-1.5	1.0	4.8	-4.8	9.7
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	14.4	-2.2	-12.1	1 4	-3.9	5.5	14.8	6.3
Expenditures	5.3	8.2	3.7	26 7	-3.6	1.9	9.5	5.6
Nonfarm payroll employment	3.5	0.9	1.7	-1.1	-1.1	1.7	1.7	2.8
Manufacturing	2 0	-3.0	-2.0	-8.0	-4.1	2.1	0.0	2.1
Industrial production	4.4	-1.4	-2.8	-3.3	-1.7	2.4	2.8	4.2
Housing starts, private	-2.7	-5.3	-31.0	8.9	65.6	11.5	30.5	24.2
Sales new domestic autos	-1.9	-4.6	-38.1	32.3	27.8	0.0	7.1	4.6

1/ Excluding effects of Federal pay increase, 5.5 per cent per year.

2/ Excluding effects of Federal pay increase, 3.3 per cent per year.

Industrial production. The available physical product data (still very sketchy at this time) and the manhours data indicate some decline in industrial production in August. Output of business and defense equipment was apparently down further and on balance production of materials probably declined. Output of consumer goods, mainly of nondurables, is estimated to have edged up.

Auto assemblies in August, at a seasonally adjusted annual rate of about 8.5 million units after allowance for the model change-over period, were unchanged from July. Production schedules for September, excluding a strike, are set at the August rate. Output of television rose further in August and was up 35 per cent from the 1970 low, but was still about one-fifth below the early 1969 level. However, production of household appliances declined from the record July volume. Output of furniture, following a year of decline, leveled off in July and increased in August. Although retail sales continue sluggish, the readjustment in inventories and output of consumer durable goods in the manufacturing sector seems to be over.

The August manhours data indicate further declines in almost all business equipment lines. Production of trucks, however, was close to record levels.

Among materials, production of raw steel eased off in August and available data suggest declines in output of paper and textile products, and possibly construction materials. Production of chemicals and rubber changed little, while output of crude oil increased.

In 1967 the United Auto Workers went on strike against Ford on September 7 and settled on October 25. There were also small, short-lived strikes against the other auto manufacturers. The strike came during the recovery from the 1967 mini-recession and, despite secondary effects on other industries, the total index excluding only motor vehicles and parts continued to rise, except for the first month of the strike. If there is a strike this month, the effect on the total index will depend on several factors; whether the strike is against General Motors or Chrysler or both, the length of the strike, and, of course, underlying strength or weakness in the rest of the industrial sector.

INDUSTRIAL PRODUCTION
AND THE 1967 AUTO STRIKE

	Aug.	Sept.	Oct.	Nov.	Dec.
Total index (1957-59=100)	158.3	156.8	157.2	159.8	162.1
Motor vehicles & parts	158.0	129.4	128.6	141.4	166.9
Total, excluding motor vehicles and parts	158.3	158.1	158.6	160.7	161.9

Unit auto sales. Sales of new domestic autos in August were at a seasonally adjusted annual rate of 8.4 million units, down slightly from a month ago and 5 per cent below a year earlier. Unit sales in the three months June-August were at an 8.5 million unit rate, up 14 per cent from the first 5 months of 1970 and down 4 per cent from a year earlier.

Dealers' stocks of new domestic autos at the end of July (the latest data available) represented 52 days' supply, compared with 53 days a year earlier.

Consumer credit. Consumer instalment credit outstanding increased at a seasonally adjusted annual rate of $5.3 billion in July--about the same rate as in June. Increases in personal loans and home repair loans during July equaled those of the preceding month; a decline in auto credit outstanding was offset by a rise in nonautomotive consumer goods paper.

There were sizable sales of both auto and other consumer goods instalment paper by finance companies to commercial banks in July, in part because of dislocations in the commercial paper market. Even after adjustment for such transfers, both extensions and repayments of instalment credit reached new records in July, on a seasonally adjusted basis. Extensions of auto credit, which had decreased slightly in June despite a substantial advance in unit sales of new cars, rose to their highest volume this year but they were still below the high levels of late 1968-early 1969. Personal loan extensions exceeded their previous high reached last August, but nonautomotive consumer goods lending was somewhat below the May 1970 peak.

CONSUMER INSTALMENT CREDIT EXTENSIONS
(Billions of dollars, seasonally adjusted annual rates)

	Total	Automobile	Other Consumer Goods	Personal Loans
1969 - QI	100.7	32.4	31.5	34.4
QII	104.4	33.0	33.6	35.2
QIII	103.5	32.0	33.3	35.9
QIV	102.5	31.9	33.5	35.1
1970 - QI	102.2	30.0	35.5	34.6
QII	104.7	31.0	35.8	35.7
July	108.8	32.2	37.5	36.8

Cyclical indicators. In July, the preliminary leading indicator composite rose 1.6 per cent, the second month of rise in a row; the June composite, originally reported as unchanged, now shows a small increase. At past cyclical upturns, this series has led the turn in general activity by 2 to 9 months, with 2-month leads in the last two recessions. The coincident composite was unchanged in July and the lagging composite declined slightly.

COMPOSITE CYCLICAL INDICATORS
(1967 = 100 1/)

	12 Leading, trend adjusted	5 Coincident	6 Lagging
1969 - December	117.8	122.2 (H)	132.3 (H)
1970 - January	115.9	121.7	131.8
February	116.7	121.9	131.2
March	115.0	122.0	130.7
April	115.3	122.0	130.8
May	114.0	121.2	131.0
June	114.3	121.4	131.1
July (prel.)	116.1	121.4	130.9

1/ The base year for these indexes has been changed from 1963 to 1967.
(H) Current high value.

The increase in the leading composite resulted from a sharp drop in initial claims for unemployment insurance and from increases in the manufacturing workweek, new orders for durable goods, contracts and orders for plant and equipment, common stock prices, and the ratio of price to unit labor costs. There were declines in July in housing permits and industrial materials prices.

In August according to preliminary data, common stock prices rose, materials prices and the workweek declined, and a rise in unemployment initial claims will also have a downward effect on the composite index.

Michigan Survey of Consumer Demand. The August survey of consumer demand suggests little imminent change in the present restrained rate of consumer durable goods purchases. While the index of consumer sentiment increased to 77.1 (February 1966 = 100) from 75.4 in May--the first rise after five declines--the change was not significant, according to the Survey Research Center. Moreover, most components of the index did not improve. In the past, small changes in the index have usually been meaningful only when all components moved in the same direction.

Date of survey	INDEX OF CONSUMER SENTIMENT ALL FAMILIES (February 1966 = 100)	PERCENTAGE OF FAMILIES INDICATING A "GOOD TIME TO BUY"	
		Large household goods	Cars
1969-February	95.1	51	44
May-June	91.6	52	41
Aug.-Sept.	86.4	43	35
Oct.-Nov.	79.7	37	28
1970-February	78.1	39	35
April-May	75.4	37	35
August	77.1	34	29

There was, however, a slight increase in the percentage of families planning to purchase a new car compared with a year earlier, and a specific question on expected price trends for new cars indicated some anticipation of improved price trends--presumably because of the new compacts. Nonetheless, an unusually large percentage of families reported it was a bad time to buy cars; opinions about whether it is a good time to buy large household goods also declined to a low level. A growing number of families (now about 70 per cent) thought it would be a hardship to make larger instalment payments. Expectations of higher unemployment, although less than in the April survey, were still at a high level.

INTENTIONS TO BUY CARS DURING NEXT 12 MONTHS
(Percentage of family units)

August	All Cars	New Cars	Used Cars
1966	18.6	10.7	8.0
1967	15.7	8.8	6.9
1968	17.4	10.7	6.7
1969	18.1	9.5	8.6
1970	15.7	10.1	5.6

A decrease in inflationary expectations was evident in the survey, however, and this finding is suggestive of a future upturn in consumer durable expenditures, if incomes are maintained. Consumers indicated the change in their inflationary attitudes both in response to a direct question on the size of likely price increases and in another question comparing expected price changes with prices in the past year. During earlier post-World War II inflations, the Survey Research Center found that consumers attempted to save more of their income for necessities rather than buy in anticipation of price rises.

Inventories. Book value of manufacturers' inventories rose at a $9.2 billion annual rate in July, according to preliminary data, after declining at a $2.2 billion rate in June. Both the July increase and the June decline were entirely at durable goods plants, with non-durable manufacturers' inventories showing small, partly offsetting changes.

Inventory increases were widespread among producers of capital equipment, construction materials, autos, and other consumer durable goods; both dollar and unit data indicate a marked increase in factory stocks of household durables. Defense stocks increased little. Nearly half the durables increase was in finished goods, but both materials and in-process stocks also rose.

CHANGE IN BOOK VALUE OF MANUFACTURERS' INVENTORIES
(Billions of dollars, seasonally adjusted annual rate)

	1970			
	I	II	June	July p/
Manufacturing, total	4.0	3.3	-2.2	9.2
Durable	2.8	.4	-2.8	9.8
Nondurable	1.2	2.9	.7	-.6

Durable goods shipments rose more than inventories, and the inventory-shipments ratio declined for the third month in a row. This ratio has been dropping in a manner similar to that in the early stages of cyclical recoveries. Further cyclical decline in this ratio would most likely be the result of small inventory increases accompanied by somewhat greater increases in sales, if the pattern of 1961 and 1967 is followed.

The inventory-backlog ratio, on the other hand, continued its rapid rise, and is at an all-time high for the 17-year history of the series. Inventories rose relative to backlogs for all major market groupings except defense products; a jump in defense backlogs reduced the defense inventory-backlog ratio, which remains quite high, however.

DURABLE GOODS MANUFACTURING INVENTORY RATIOS
Selected recovery periods

Year and month	Inventories to sales 1/	Inventories to unfilled orders
1961-February 2/	2.22	.744
March	2.18	.743
April	2.12	.733
May	2.07	.730
1967-May 2/	2.12	.681
June	2.10	.673
July	2.12	.674
August	2.10	.678
1970-April 2/	2.18	.781
May	2.16	.789
June	2.12	.794
July	2.11	.807

1/ Two-month moving average, recorded in second month.
2/ Month of high in inventory sales-ratio.

<u>Manufacturers' new orders</u>. New orders for durable goods rose $1 billion, or 3.3 per cent in July, according to the preliminary report--revised down from the 6 per cent increase reported in the advance release. The rise reflected a sharp jump in orders for defense products, while nondefense orders, on balance, declined slightly. The defense series showed a similar large increase in July of last year; still, in July and the preceding two months of this year defense orders averaged 20 per cent above year-ago levels. These recent increases are not necessarily inconsistent, as yet, with the anticipated scaling down of defense expenditures. A six-month average--probably more appropriate for this extremely irregular series--yields a 4 per cent decline in defense orders from a year ago.

Capital equipment orders increased somewhat from the June level but were no higher than the reduced second-quarter average. Orders for construction materials declined after two months at advanced levels. Orders for primary metals other than iron and steel were also down, while iron and steel orders were unchanged. Orders for household durables declined and remained below a year ago, while motor vehicle orders rose.

VALUE OF MANUFACTURERS' NEW ORDERS
(Seasonally adjusted, averages of monthly data, millions of dollars)

	1970		
	QII	June	July
Manufacturing, total	54.5	55.6	56.6
Durable	29.2	29.7	30.7
Nondurable	25.3	25.9	25.9
Selected groups:			
Home goods and apparel	4.6	4.9	4.7
Household durables	2.0	2.1	2.0
Defense products	1.7	1.7	3.0
Capital equipment	8.1	7.9	8.1
Producers' capital goods industries*	6.2	6.4	6.5
Autos and related equipment	4.5	4.7	4.8
Construction materials	4.5	4.6	4.3
Primary metals	4.8	4.9	4.7
Iron and steel	2.2	2.2	2.2

* Formerly titled 'machinery and equipment industries".

Durable goods shipments exceeded new orders and the backlog declined--although by only $300 million, considerably less than the $900 million average monthly decline in the first half of the year. The defense products backlog rose, but this increase was more than offset by declines in unfilled orders for capital equipment, construction materials, nonferrous metals, and household durables.

Construction and real estate. Outlays for new construction put in place, were revised down for July to show continuation of the downtrend since February. In August, however, they advanced 2 per cent to a seasonally adjusted annual rate of $89.5 billion. While the August rate was unchanged compared with a year earlier, in real terms it was lower by 5 per cent.

With housing starts up sharply in recent months, current dollar outlays for private residential construction increased appreciably and accounted for nearly all of the rise in total construction in August. Outlays for private nonresidential construction were unchanged at a level only 4 per cent below the peak reached last February and--like residential outlays--were at least as high as in August of 1969. Within the public construction sector, there was a sizable recovery in expenditures for Federally-owned projects, but it was from a considerably reduced July rate; altogether, the combined public subtotal increased only slightly as outlays in the large State and local sector apparently remained at about the low established last April.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	August 1970 ($ Billions) 1/	Per cent change from July 1970	Per cent change from August 1969
Total	89.5	+ 2	--
Private	62.6	+ 2	--
Residential	29.3	+ 5	--
Nonresidential	33.3	--	--
Public	26.9	+ 1	-2
Federal	3.2	+11	-5
State and local	23.6	--	-2

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

The upsurge in private housing starts in July, which followed a 7 per cent rise in June, carried the seasonally adjusted annual rate to nearly 1.6 million units, the highest in more than a year. However, all of the July rise was in multifamily starts, which soared two-fifths from their reduced earlier rate, a remarkable shift even for that volatile group. Moreover, while all regions shared in the month-to-month advance, one region--the Northeast--showed by far the major gain.

Given the recent decline in building permits for multifamily units, as shown in the table, and other factors, indications are that total starts may have turned downward again in August. Still, if as seems likely under present mortgage market conditions, total starts hold at or above a 1.4 million rate through September, the third quarter average would approach a 1.5 million annual rate. This would mark a substantial advance from the 1.27 million rate averaged in the first half of the year when starts showed little quarter-to-quarter change.

PRIVATE HOUSING STARTS AND PERMITS

	July 1970 (Thousands of units)1/	Per cent change from	
		June 1970	July 1969
Starts2/	1,585	+15	+11
1-family	827	--	+ 3
2-or more-family	758	+39	+21
Northeast	260	+49	+55
North Central	323	+ 7	+ 6
South	655	+11	+12
West	347	+12	- 7
Permits	1,265	- 3	+ 3
1-family	630	+ 3	+11
2- or more-family	635	- 8	- 3

1/ Seasonally adjusted annual rates; preliminary.
2/ Apart from starts, mobile home shipments for domestic use in July were at a seasonally adjusted annual rate of 432,000, 5 per cent above a year earlier.

While resistance to higher costs and to the advanced level of interest rates apparently has continued, residential vacancy rates have remained exceptionally low. In the second quarter, for example, rental vacancy rates were unchanged from the first quarter and were the lowest for any second quarter since 1957, at an over-all average of only 5.0 per cent of rental units available and fit for use. Regionally, only in the North Central states were such rates above their already reduced year earlier level. Vacancy rates for home-owner properties, a much less sensitive series than that for rental units, edged down to 0.9 per cent from the first to the second quarter of the year. This compared with a second quarter high of 1.4 per cent in 1966 and some other earlier years and with a low of 0.8 per cent in the first and third quarters of 1957.

RENTAL VACANCY RATES
(Per cent)

	Average for second quarter of:					
	1957	1965	1967	1968	1969	1970
All Regions	4.9	7.5	6.3	5.7	5.1	5.0
Northeast	3.0	4.8	4.2	3.5	2.9	2.7
North Central	4.4	6.6	5.4	4.8	4.8	5.6
South	5.8	7.7	7.5	7.2	6.4	6.4
West	7.5	12.0	8.6	7.6	6.4	5.4

Manufacturers' new capital appropriations. An NICB survey of the 1,000 largest manufacturing firms indicates that new appropriations for capital spending declined only 1 per cent in the second quarter, after falling 13 per cent in the first quarter and 2 per cent in the fourth quarter of 1969. Both durable and nondurable manufacturing industries showed about the same magnitude of decline in the second quarter.

Given the usual lag of about three quarters between the time when funds are appropriated and when they are spent, the appropriations data for the second quarter would seem to indicate further reductions in manufacturing outlays at least through early 1971. Further support to this position is the fact that backlogs of unspent funds have been dropping in recent quarters suggesting that some firms may be nearing completion of projects without authorizing new ones.

The NICB also indicated that their respondents expect third quarter appropriations to total somewhat more than in the second quarter. (These expectations have sometimes differed rather markedly from actual appropriations, in direction of change as well as in magnitude.) If these expectations are realized it could mean that manufacturers' plant and equipment spending might begin to rise sometime next spring.

Anticipated spending for new plant and equipment. According to the August Commerce-SEC survey, businessmen, as expected, have scaled down their 1970 capital spending plans somewhat further from those reported in the May survey. The increase in anticipated 1970 outlays is now 3 percentage points below that reported in the February survey. Current plans now indicate an increase in total outlays of 6.6 per cent over 1969 as opposed to the 7.8 per cent rise planned in May.

PLANNED EXPENDITURES FOR NEW PLANT AND EQUIPMENT, 1970
(Comparison of successive Commerce-SEC surveys)

	(Billions of dollars)				Per cent change from 1969		
	1969	1970					
	Actual	Feb. Survey	May Survey	August Survey	Feb. Survey	May Survey	August Survey
Total	75.56	82.94	81.45	80.52	9.8	7.8	6.6
Manufacturing	31.68	34.60	32.85	32.05	9.2	3.7	1.2
Durable goods	15.96	17.50	16.44	15.88	9.7	3.0	-.5
Nondurable goods	15.72	17.10	16.42	16.16	8.8	4.5	2.8
Nonmanufacturing	43.88	48.34	48.60	48.47	10.2	10.8	10.5

Actual spending in the second quarter rose $2.0 billion, only $0.4 billion less than expected at the time of the May survey. For the remainder of 1970 businessmen now anticipate an increase of $0.8 billion in the third quarter instead of their earlier anticipated $2.6 billion gain. But, they now expect a rise of $1.2 billion in the fourth quarter rather than the slight decline anticipated in the May survey. Past experience suggests, however, that additional shortfalls of actual spending from planned outlays are likely to occur.

QUARTERLY PATTERN OF ANTICIPATED EXPENDITURES
FOR NEW PLANT AND EQUIPMENT, 1970
(Billions of dollars, seasonally adjusted annual rates)

	1969				1970			
	I	II	III	IV	I	II	III	IV
	(actual)						anticipated	
Total	72.52	73.94	77.84	77.84	78.22	80.22	81.05	82.24
Manufacturing	29.99	31.16	33.05	32.39	32.44	34.43	31.21	32.15
Durable	15.47	15.98	16.53	15.88	16.40	16.32	15.38	15.53
Nondurable	14.52	15.18	16.52	16.50	16.05	16.11	15.84	16.62
Nonmanufacturing	42.53	42.78	44.80	45.46	45.78	47.79	49.84	50.09

Second quarter spending by manufacturers of durable goods was essentially unchanged from the preceding quarter as reductions in primary metals and nonautomotive transportation equipment were offset by sharp increases in the machinery and auto equipment industries. However, for the third quarter most of these industries plan cuts from their second quarter spending, and with few exceptions still further reductions are planned for the fourth quarter.

Nondurable manufacturing investment in the second quarter was only slightly above that of the first as increases in spending by producers of petroleum and chemicals cancelled reductions in most other industries. Reductions in plans of petroleum, paper, and rubber manufacturers are expected to result in a decline in third quarter spending. But some recovery is anticipated in the fourth quarter with most industries now planning increased expenditures.

In the second quarter, nonmanufacturing industries--especially communications and public utilities--accounted for all of the gain in overall fixed investment spending. Spending by air transportation and electric utility companies is expected to surge in the third quarter and taper off in the fourth. At the same time communication and commercial firms currently anticipate only a slight change in the second half from the second quarter level.

Labor market. The labor market eased slightly further in August. The unemployment rate edged up to 5.1 per cent from 5.0 per cent in July, with the entire rise among teenagers. At the same time, nonfarm payroll employment dropped about 90,000 reflecting a further decline in the goods-producing industries. Employment reductions in August were smaller than the average during the March-July period, but there were no signs of strengthened labor demand in any sector. With the exception of State and local governments, no industry group has shown appreciable employment growth since March, while large employment declines have continued in manufacturing and construction.

NONFARM PAYROLL EMPLOYMENT, 1969-70
(Seasonally adjusted, in thousands)

	Nov. 1969-March 1970	March-July 1970	July-August 1970
	(Average monthly change)		
Total	112	-155	- 92
Government	49	21	23
Private	64	-176	-115
Mining	1	- 2	3
Construction	2	- 42	- 39
Manufacturing	-35	-133	- 73
Transportation	10	9	- 15
Trade	34	- 11	- 8
Services & finance	52	3	17

Average weekly hours of production and nonsupervisory workers on private payrolls were unchanged in August after rising slightly in June and July. In the more volatile manufacturing sector, the workweek declined in August to 39.9 hours after rising in July to 40.1 hours (revised upward). Both the July and August changes were centered in auto parts supplier firms and for the most part probably reflected the timing of the auto model changeover. Over the past four months, the workweek of factory workers has averaged a little less than 40 hours. This was the shortest workweek for an extended period since 1961, but it appears that average working hours have about leveled off, after moving irregularily lower in the last half of 1969 and early 1970.

Unemployment. Teenage unemployment rose further in August to a rate of nearly 16 per cent, while rates for adults continued near their July levels. Jobless rates for all groups were sharply higher than a year earlier.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1969		1970		
	August	November	February	May	August
Total	3.5	3.5	4.2	5.0	5.1
Men aged:					
20 to 24 years	4.5	5.3	6.9	7.7	8.5
25 and over	1.7	1.7	2.2	2.9	3.0
Women, aged 20 and over	3.8	3.6	4.1	5.1	4.8
Teenagers	12.3	11.8	13.4	14.3	15.9
White-collar	2.2	2.1	2.3	2.8	2.7
Blue-collar	3.8	4.2	5.0	6.2	7.0
Insured unemployed	2.2	2.3	2.6	3.6	3.7*

*Estimated monthly average.

The rise of total unemployment has slowed markedly in the last three months, partly as a response to fewer layoffs. But the slowing also has been associated with a leveling off of the civilian labor force, which was no higher in August than in March. Some workers--especially youngsters--apparently became discouraged by slack in labor markets and did not enter the work force in their usual numbers this spring and summer.

Hourly earnings. Despite large wage increases negotiated in recent collective bargaining settlements and deferred increases provided in earlier collective bargaining agreements, advances in average hourly earnings of production and nonsupervisory workers on private payrolls have been somewhat smaller this year than last year. Moderation has occurred in trade, finance, services and manufacturing. The slowing in manufacturing is primarily attributable to much less overtime and to lower employment in high-wage industries. Hourly earnings increases have been larger than last year in construction, and more recently in trucking, reflecting the effect of large wage settlements in those industries.

AVERAGE HOURLY EARNINGS OF PRODUCTION
AND NONSUPERVISORY WORKERS
(Per cent change from a year earlier)

	1968	1969	1970		
			QI	QII	QIII*
Total private	6.3	6.7	6.4	6.0	5.9
Manufacturing	6.4	6.0	5.8	5.7	5.3
Durables	6.3	6.3	5.4	6.0	5.6
Nondurables	6.6	6.2	6.3	5.9	5.8
Mining	5.0	7.5	6.8	6.4	6.7
Contract construction	7.3	8.4	10.0	8.7	9.4
Transportation and public utilities	5.6	6.1	5.4	5.3	6.0
Trade	7.1	6.7	6.8	6.3	5.9
Finance	6.6	6.2	5.2	4.8	4.8
Services	6.1	8.2	8.6	7.7	7.2

* July-August average.

Industrial relations. Contract negotiations between the auto industry and 650,000 members of the United Auto Workers are now approaching the September 14th expiration date of the present contract.

As of this writing, the U.A.W. has not specified its full range of economic demands but has insisted on a return to an unlimited cost-of-living escalator clause. The 1967 contract is estimated to have provided workers with an average annual increase of about 6 per cent (including fringe benefits). The membership expects their leadership to obtain a larger package this year, especially in light of the big increases granted in recent construction and trucking industry agreements. Wage bargaining is further complicated this year by an ambiguous clause in the 1967 contract; it provides that cost-of-living increases "lost" under the limitations imposed in the 1967 contract (amounting to 26 cents) are to be made available at the end of the contract period. Some auto workers apparently feel that the 26 cents should be added to the current hourly rate (an average of $3.84), while the industry negotiators argue that is should be considered part of the first-year wage raise.

With the industry and union so far apart, and workers very militant on the wage issue, it is hard to visualize a strike-free settlement. At present, the U.A.W. has indicated that the strike target will be General Motors and/or Chrysler. Ford, which was struck in 1967, has been excluded.

<u>Wholesale prices.</u> Wholesale prices declined at a seasonally adjusted annual rate of 1 per cent from July to August (July 14 to August 11) as a result of a drop in prices of farm and food products and a slower increase in prices of industrial commodities. The decline in the overall index was the first since April 1967.

The wholesale price indexes for July and August illustrate the saw-tooth movement of prices of farm and food products and the marked effect that it can have on monthly changes in the overall WPI. Lower prices for hogs, cattle, eggs, meat, and fresh and dried fruits and vegetables were the main reasons for the August decline in prices of farm and food products.

WHOLESALE PRICES
(Seasonally adjusted percentage changes at annual rates)

	June 1969 to Dec 1969	Dec 1969 to June 1970	June 1970 to July 1970	July 1970 to August 1970
All commodities	4.2	2.5	6.0	- 1.0
Farm products, and processed foods and feeds	5.4	- 1.9	16.0	- 5.1
Farm products	5.9	- 5.5	17.5	-28.1
Processed foods and feeds	4.7	1.0	13.6	4.8
Industrial commodities	4.1	3.9	3.2	2.0
Fuels & related products & power	2.1	4.7	3.3	7.7
Lumber & wood products	-11.3	- 3.8	- 6.0	6.0
Pulp, paper & allied products	2.2	4.9	3.2	- 2.1
Metals & metal products	10.0	8.6	- .9	- 1.9
Addendum:				
Sensitive industrial materials (not seasonally adjusted)	4.6	1.7	-12.4	- 2.1

Industrial prices rose at an annual rate of 2.0 per cent in August, significantly less than in July and in the first half of 1970. Increases for fuels and power contributed most to the August rise in prices of industrial commodities, but increases were also reported for machinery and equipment, softwood lumber and plywood, and some chemicals. Declines occurred for paper products, leather, passenger cars, cigarettes, and man-made fiber textiles.

The slower rate of increase in prices of industrial commodities in the July-August period is encouraging, but for a variety of reasons, it is not necessarily a precursor of as low or lower rates of increase in the remaining months of this year. According to advance announcements, prices of new-model passenger cars and trucks will be up more this fall than last. In addition, declines in June and July in prices of lumber and wood products were reversed in August, and these prices could continue to rise if projections of higher housing starts are realized. The decline in prices of nonferrous metals may slacken as stocks are reduced and, in turn, act to brake any slowing in the rate of increase in the index of industrial commodities.

Consumer prices. The increase in consumer prices was at a seasonally adjusted annual rate of 3.4 per cent in July, significantly below the rise in June and well below the 6 per cent advance in the first five months of the year. Food prices increased only about 1 per cent while the rise in non-food commodities slowed to a 2 per cent rate.

The slowing in the rise of non-food commodities reflects a number of mixed trends. Much of the improvement derives from a July decrease in used car prices, which had risen very rapidly in the April-June quarter. Other consumer durable goods have also been rising less rapidly, despite an upturn in prices of new cars in July. The favorable trend may be temporarily reversed in October and November, however, when 1971 model cars make their appearance at higher prices.

With respect to nondurables, seasonally adjusted apparel prices rose at a rate of 3.5 per cent in the second quarter, following a decline in the first, but in July prices were reduced slightly. Other nondurables (excluding food), which have more relative importance than apparel, rose at a rate of about 4 per cent in July, faster than in June but less than in the second quarter. Numerous increases have been reported for such items as gasoline and fuel oil, newspapers, cigarettes, liquor, and nondurable housefurnishings.

The rise in service costs has moderated from a rate of almost 11 per cent in the first quarter to 7 per cent in the second quarter and 6.2 per cent in July. However, most of the drop is due to the reversal in mortgage interest rates; if we exclude the cost of mortgage finance, the price of services has increased at the rate of about 7.5 per cent annually this year compared to 5.7 per cent last year. Medical care costs and transportation service costs (insurance, licenses, taxes, and public transportation) are rising even more rapidly than last year and the rise in rents has speeded up somewhat.

PER CENT CHANGES IN CONSUMER PRICES
(Seasonally adjusted annual rates)

	Dec '69 to March '70	March '70 to June '70	May '70 to June '70	June '70 to July '70
All items	6.2	5.6	4.2	3.4
Food	5.2	1.2	- 4.5	.9
Non-food commodities	2.9	6.2	4.9	1.9
Durables	3.0	7.9	7.2	2.1
New cars	2.5	1.2	.0	2.3
Nondurables	3.9	3.6	- .9	.9
Apparel	- 2.4	3.5	4.6	- .9
Other	2.5	4.7	1.9	3.8
Services	10.8	7.1	7.0	6.2
Medical care	9.7	8.1	8.7	8.0
Mortgage interest rates	26.6	.5	- .8	.0
Addendum				
Services less home finance	7.5	7.7	6.5	7.6
Consumer durable products 1/	2.9	2.2	2.2	2.2
Used cars (unadjusted)	-20.3	49.0	42.3	- 1.8

1/ Excludes used cars and houses.

Changes in the GNP deflators for consumer expenditures in the last four quarters are shown below. The lower rate of rise for durable goods in the deflator as compared to the durable goods component of the CPI reflects in part the exclusion of house and used car prices. (These are also excluded in "consumer durable products" appearing in the addendum to the preceding table.) The increase in the rate of rise in the deflator for services from the second half of 1969 to the first half of this year is similar to the rise in "services less morrgage finance". (In the national income accounts residential construction is classified in investment, and consumer expenditures for housing by owner-occupants are represented by "imputed rent".)

Per Cent Changes in Deflators
(Seasonally adjusted annual rates)

	1969		1970	
	QIII	QIV	QI	QII
Consumer expenditures	4.8	4.8	5.1	4.0
Durable	2.6	2.3	3.0	1.5
Nondurables	4.7	5.5	4.5	3.7
Services	4.8	5.0	5.7	5.9

Corn blight. The first assessment of damage to livestock feed supplies from a new and more virulent strain of the corn fungus will be made in the crop report to be released September 11. This survey will allay some of the uncertainty which has sent grain and oilseed futures prices up sharply since August 24 but it will be November or later before firm corn crop estimates are available.

The impact of the blight on food supplies is not expected to be immediate. The main effect will be on livestock products and it will be governed by the extent of the cut in corn, the principal feed grain. If the crop is reduced sharply, livestock producers can be expected to reassess their plans for increasing output of hogs and poultry for the next year's markets in the light of higher feed costs. Instead of the expanded production which had been counted on earlier to hold the line on retail food prices, we could have more moderate production and a rise in the price structure of the whole livestock-feed complex by spring. Expanded production already in process for the fall and winter markets will be little affected. Slaughter might be cut a little by marketings of hogs and fed cattle at lighter weights because of higher feed costs. On the other hand, slaughter might be increased a little by marketings of hog breeding stock. So far, no shifts in production plans are evident but the pig crop report to be released September 22 may shed some light on producer plans.

Unexpected cuts in corn crops have occurred before and farmers have demonstrated considerable flexibility in stretching their feed supplies. Feed use projected for 1970/71 before the blight emerged as a problem indicated that use would exceed output by a small margin. More livestock were expected to be fed at slightly lower per unit feeding rates. If the corn crop is 10 per cent below the August 1 estimate, prices of all feedstuffs will be higher and the higher prices will ration use. Producers can be expected to reduce feeding rates and possibly numbers of animals fed, and they may feed more wheat since stocks are large. Exports may decline a little.

* * * * * * *

Southern corn leaf blight was first identified in the South in the 1920's where it had long been a problem. Sometime between 1963 and 1969 a new race of the fungus developed which attacks the corn stalk and ear as well as the leaf. Little is known about this new strain. The spores are windborne and need free moisture for 4 to 6 hours for germination and penetration of the plant. Heavy dew can provide the free moisture if the weather is humid enough. Mature corn is less susceptible than young corn to the disease.

This year the blight appeared on winter sweet corn in Florida and spread rapidly to field corn in the Southeastern states. In July the spores moved northward with the prevailing winds into all of the Corn Belt States. August weather was relatively favorable for development of the spores in Southern parts of the Corn Belt and in the Southeast. The forecast for September is for drier weather which will curb the growth of the fungus.

Use of blight resistant varieties of corn is the most practical method of control of the blight. It is believed that the spores can overwinter in the Corn Belt and many grasses and weeds are hosts to the spores. But this is considered to be of minor importance compared with the problem of wind blown spores. From 70 to 90 per cent of the corn acreage this year was planted to hybrids carrying a "T" gene which is susceptible to the new blight. Seed companies are planning winter production of resistant varieties in Hawaii and Latin America to supplement normal supplies of seeds of non "T" corn hybrids.

FEED: SUPPLY, USE AND PRICE RELATIONSHIP
(Feed in millions of tons)

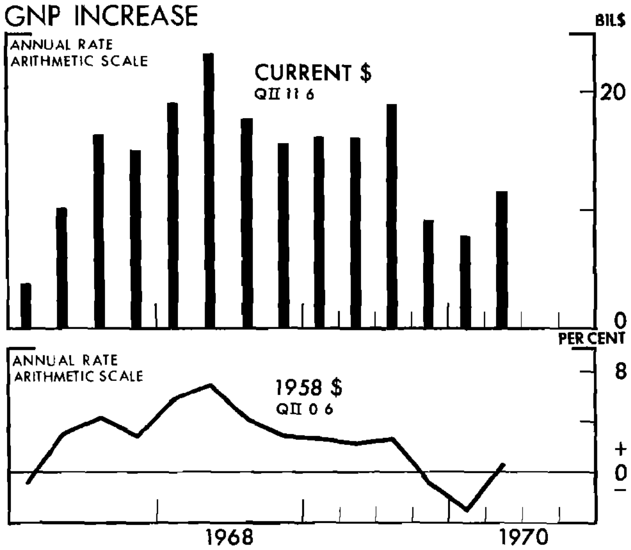
	Marketing year beginning October 1			
	1964-68 average	1969	1970 August 1 estimate	1970 Assuming 10% cut in corn crop
Feed grains 1/				
Supply	209	225	222	209
Stocks, October 1	50	50	47	47
Production	159	174	175	162
Use	162	178	179	169
Feed	125	141	142	134
Food, industry	15	17	17	17
Exports	23	20	20	18
Ending stock	47	47	44	40
Livestock-feed concentrate relationship				
Amount fed	160	182	183	178-182
Feed grains	125	141	142	134
Wheat & rye	4	6	6	8-10
By-product feeds	31	35	35	36-38
Animal units fed 2/	110	118	122	122
Amount fed per unit	1.46	1.55	1.50	1.46-1.49
Livestock-feed price ratio (1957-59+100) 3/	100	121	115 4/	

1/Corn, grain sorghum, oats, barley.
2/Millions of units: A unit is the equivalent of 1 milk cow in terms of feed consumed in one year.
3/Prices received by farmers for livestock divided by prices paid for feed. Calendar years.
4/ August 15, 1970 relationship.

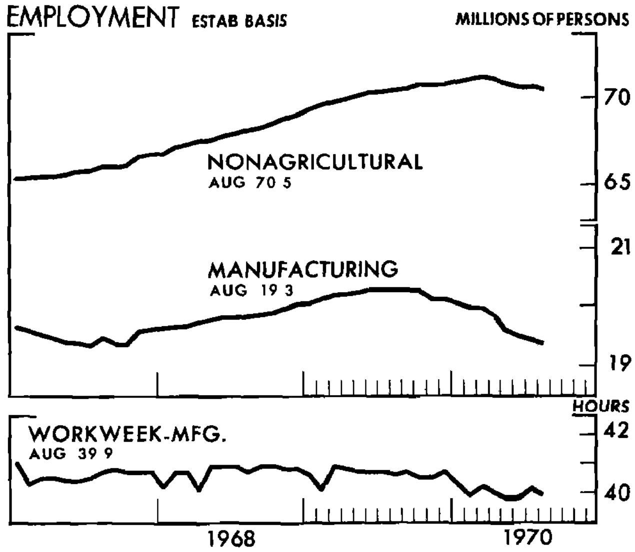
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

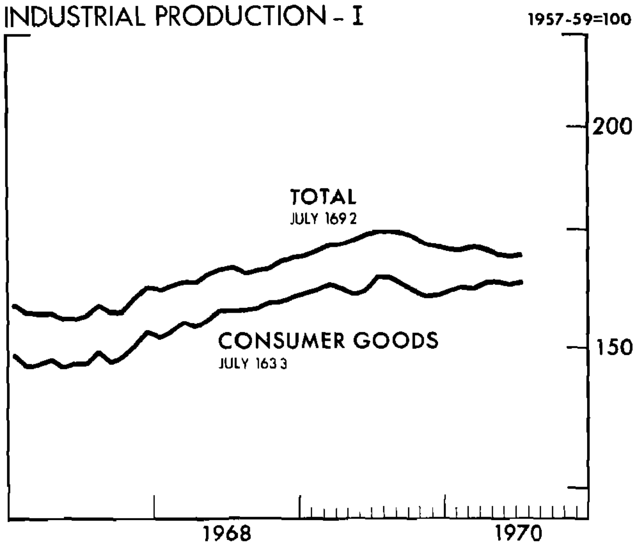
GNP INCREASE



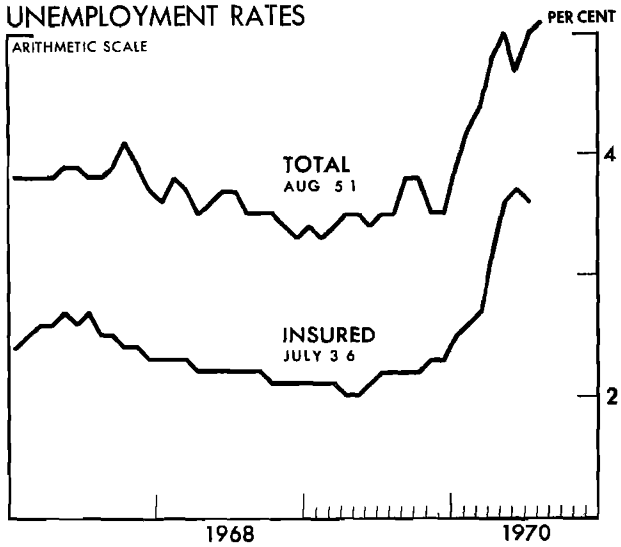
EMPLOYMENT ESTAB BASIS



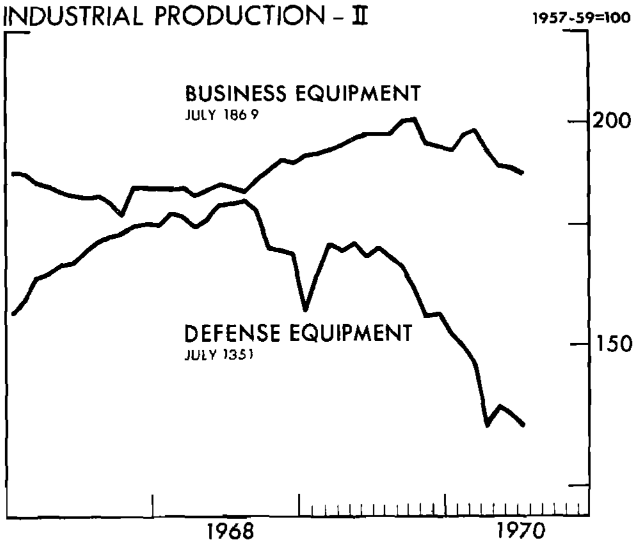
INDUSTRIAL PRODUCTION - I



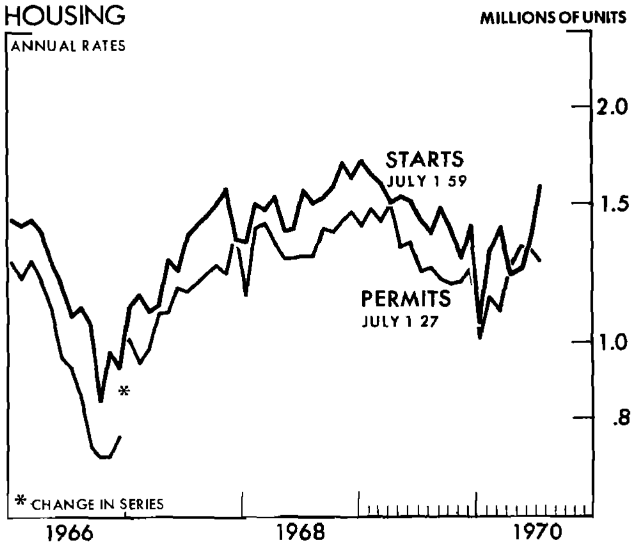
UNEMPLOYMENT RATES



INDUSTRIAL PRODUCTION - II



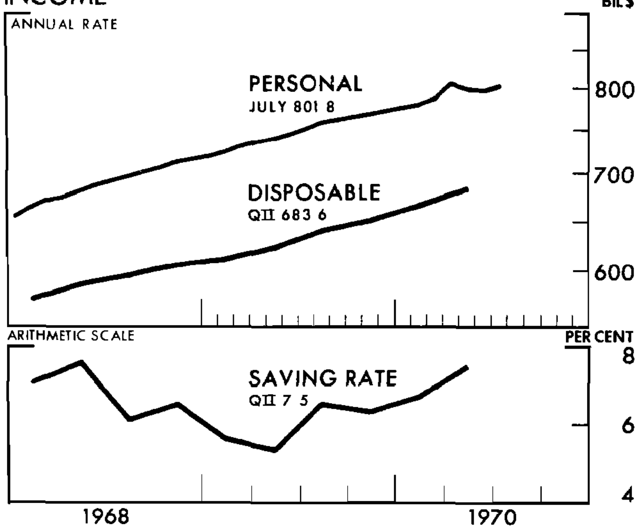
HOUSING



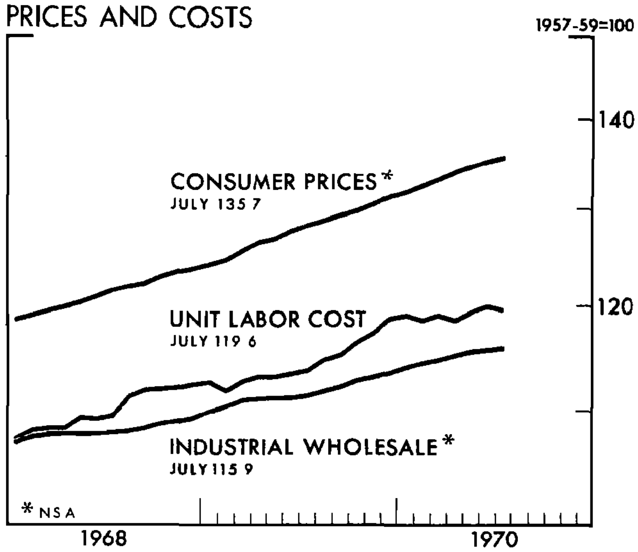
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

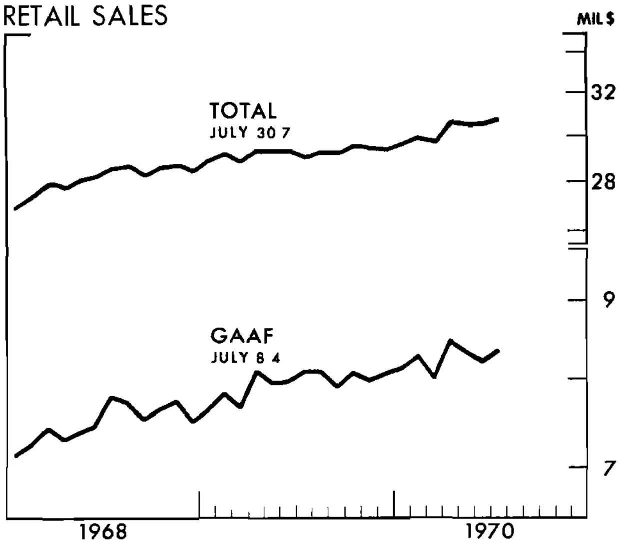
INCOME



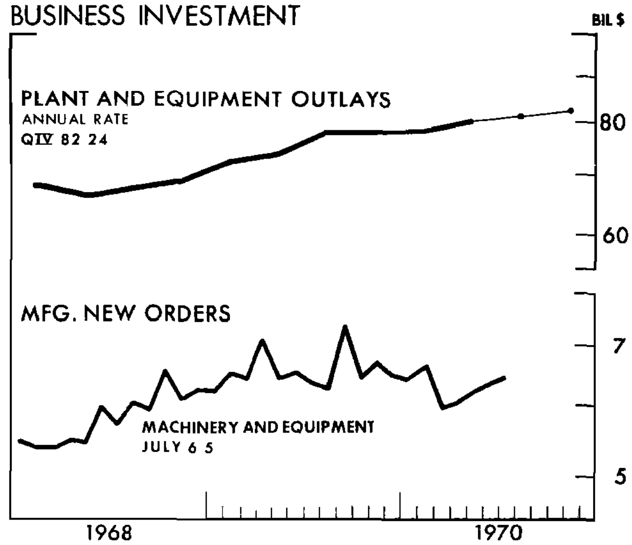
PRICES AND COSTS



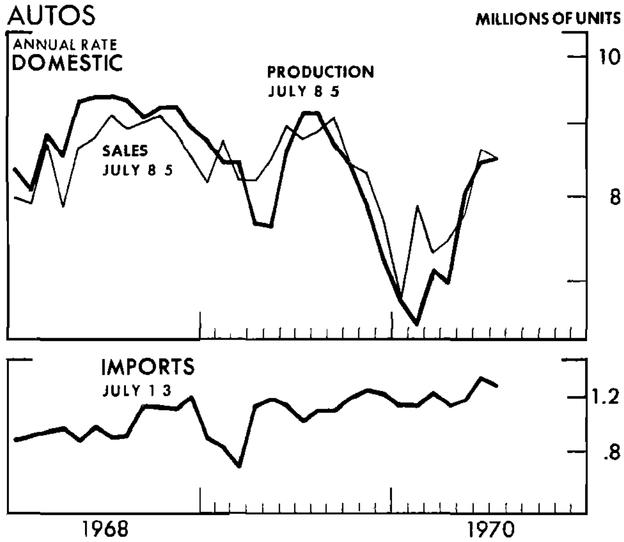
RETAIL SALES



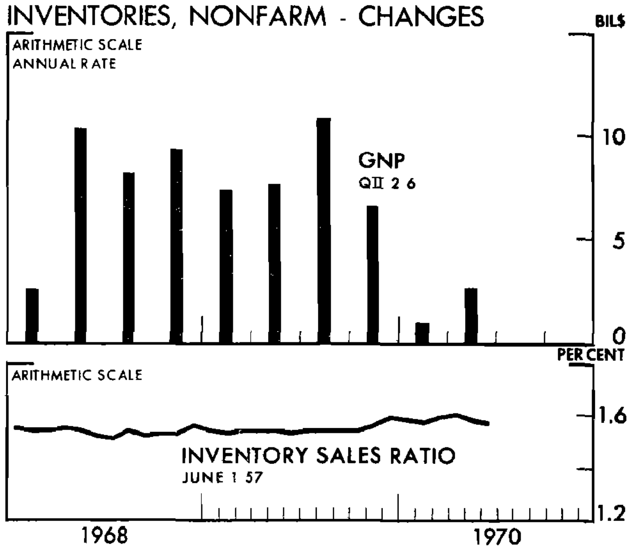
BUSINESS INVESTMENT



AUTOS



INVENTORIES, NONFARM - CHANGES



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Monetary aggregates. After growing at a 1.2 per cent annual rate from May to July, the money supply, according to preliminary estimates, grew on average at about an 11 per cent seasonally adjusted annual rate from July to August. For the year to date, the rate of growth has been at a 5.0 per cent annual rate.

Time deposits continued flowing into the banking system at a very rapid rate in August, although the increase for the month was somewhat less than that recorded in July. Sales of large CD's paced the August advance, as they had in July. On a seasonally unadjusted basis, large CD's at weekly reporting banks rose by slightly more than $2.3 billion during the 4 weeks ending August 26, compared to a rise of about $3.8 billion in the preceding 4-week period. About 90 per cent of the negotiable CD's sold at weekly reporting banks in August had maturity dates of less than 90 days and about 70 per cent of the $20.2 billion of CD's outstanding at these banks on the August 26 survey date were scheduled to mature by the end of November.

Moderation in the rate of CD inflow was evident during the early weeks of August. However, the application of reserve requirements to bank-related commercial paper and the reduction of requirements against time and savings deposits above $5 million from 6 to 5 per cent provided further stimulus to growth of CD inflows. With commercial paper with original maturity of less than 30 days becoming subject to the same reserve requirements as demand deposits, banks began issuing CD's in anticipation of the maturing of outstanding short notes.

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

	QI	QII	June	July	August p/
Money stock	3.8	4.2	-1.8	4.1	11.0
Commercial bank time and savings deposits	.4	13.8	8.4	35.2	27.5
Member bank deposits	.6	6.0	5.8	22.3	29.6
Member bank deposits plus nondeposit sources 2/	.5	6.5	7.0	18.1	23.9

1/ Based on monthly average of daily figures for deposits and monthly average of weekly figures for nondeposit funds. Quarterly changes are calculated from the average amounts outstanding in the last months of each quarter.

2/ Includes all deposits subject to reserve requirements plus the following nondeposit sources: commercial paper issued by a holding company or bank affiliate; loans or participation in pools of loans sold under repurchase agreement to other than banks and other than banks' own affiliates or subsidiaries; Euro-dollars borrowed directly through brokers or dealers; liabilities to banks' own branches in U.S. territories and possessions; and liabilities to banks' own foreign branches.

p/ Preliminary.

Weekly reporting banks continued to record substantial growth in consumer-type time and savings deposits during August and total time deposits inflows at country member banks also remained relatively large. In both cases, the gains fell somewhat short of the unusually large advances recorded in July. The mid-month Treasury financing may have been at least partly responsible for the slackening in growth of these deposits.

Growth in the adjusted credit proxy (total member bank deposits plus nondeposit sources of funds) was at an annual rate of about 24 per cent in August. This was above the rate recorded in July, reflecting mainly a larger increase in private demand deposits was somewhat less rapid than in July and banks reduced their use of nondeposit sources of funds. There was a marked decline in commercial paper issues of affiliates and in borrowings from foreign branches.

Bank credit. Commercial bank credit adjusted for loan sales to affiliates is estimated to have increased at a 15.5 per cent seasonally adjusted annual rate from the last Wednesday in July to the last Wednesday in August; this was fractionally below July's rapid rate of advance. Increased security holdings accounted for slightly more than half of the total expansion in earning assets, with banks acquiring a large volume of securities at the Treasury's mid-month financing and also adding substantially to their holdings of other securities, mainly municipal and agency securities. Loans to brokers and dealers continued to advance in August at the rapid pace of July, and business loans, which rose only moderately in July, also increased sharply. On the other hand, with the commercial paper market improving, loans to nonbank financial institutions declined slightly over the month in marked contrast to the record gain recorded in July. The generally weak trends shown in real estate and consumer loans in recent months continued in August.

COMMERCIAL BANK CREDIT ADJUSTED
TO INCLUDE LOAN SALES TO AFFILIATES 1/
(Seasonally adjusted percentage changes, at annual rates)

	1969	1970			
	2nd Half	Q I	Q II	July	August
Total loans & investments 2/	2.9	2.5	5.3	16.6	15.5
U.S. Govt. securities	-15.6	-12.3	30.2	31.1	36.8
Other securities	- 1.4	9.5	9.9	8.0	20.7
Total loans 2/	7.8	3.4	- .3	16.1	9.6
Business loans 3/	9.5	5.5	5.8	3.2	13.9

1/ Last Wednesday of month series.

2/ Includes outright sales of loans by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

3/ Includes outright sales of business loans by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

The sharp advance in business loans--adjusted for bank reacquisition of loans previously sold to affiliates at an annual rate of more than 14 per cent--was a striking bank credit development in August. Several factors seem to have accounted for this surge in business loan growth. Holdings of bankers' acceptances rose sharply over the month. A greater than seasonal growth in loans to commodity dealers apparently reflected the impact of the corn blight on commodity market activity. Loans to machinery manufacturers and to retail trade were also up more than seasonally. But aside from these special factors, the August business loan growth still appears stronger than in other recent months.

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

	July 8 - July 29 1/		July 29 - August 26 1/	
	1967-69 average	1970	1967-69 average	1970
Weekly reporting banks				
Total time and savings	.6	4.9	.4	3.2
Consumer-type	.1	.5	.1	.6
CD's	.6	3.8	.2	2.3
All other	- .1	.6	.1	.3
Country banks				
Total time and savings	.6	1.4	.5	1.0

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

Nonbank depositary intermediaries. More complete data have confirmed earlier indications of exceptionally large deposit inflows during July, particularly at savings and loan associations. There have been scattered indications that the pattern of deposit inflows will be relatively strong in August, with no discernible impact on deposit flows from the August 17 payment date for the Treasury's cash offering of low-denomination short term notes.

DEP`SIT GROWTH AT NONBANK THRIFT INSTITUTIONS
(Seasonally adjusted annual rates, in per cent)

	Mutual Savings Banks	Savings and Loan Associations	Both
1969 Q III	2.0	2.1	2.1
Q IV	3.3	0.4	1.4
1970 Q I	2.6	1.5	1.9
Q IIp/	6.4	7.4	7.1
May*	6.4	5.6	5.9
June*p/	6.0	7.8	7.2
July*p/	7.1	14.8	12.3

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

p/ reliminary.

Savings and loan associations continued to limit their borrowing activity during August, when advances from the FHLBanks increased by less than $100 million. With inflows unusually large in July, S&Ls also continued to increase their liquid asset holdings, contrary to the usual July run-off of such assets.

The liquidity of the FHLB System, bolstered by a modest addition of new money from its August security issue, remained more than ample at $1.8 billion as of the end of August. Despite its large holdings of liquid assets and reduced lending to member associations, the FHLB still plans to raise a sizeable amount of new money during the remainder of 1970. Some of these additional funds are intended for acquisitions of conventional mortgages in the secondary market through the new Federal Home Loan Mortgage Corporation created by the Emergency Home Finance Act of 1970.1/

Mortgage market. While no firm data are yet available, new residential mortgage commitments probably increased somewhat further in August, judging from savings flows, trade opinion, and field reports. Minor reductions in mortgage rates were also indicated.

During July, when savings inflows to the nonbank thrift institutions were exceptionally large, seasonally adjusted new

1/ The FHLB Board has not yet made definite plans for use of funds voted in the Emergency Home Finance Act of 1970 to subsidize the cost to member associations of FHLB advances. Funds have not yet been appropriated for this program.

mortgage commitments picked up at S&Ls as well as at the mutual savings banks in New York State. For both lender groups combined, July new commitment volume was the largest in nearly a year and a half, and double the unusually small March total.[1/] By the end of July, the combined amount of outstanding mortgage commitments at these institutions was the highest of the year. In addition, FNMA reported a record $4-3/4 billion backlog of outstanding commitments, suggesting that its takedowns and borrowings will remain substantial in the period ahead.

During August, FNMA weekly field reports indicated that improvement among different regions in the availability of funds for home mortgages was rather spotty in the primary market, where usury ceilings in numerous States still posed a restraint on investment, particularly in conventional home loans. Yields in the secondary mortgage market remained under a downward pressure owing to a shortgage of loans available to a gradually increasing number of prospective investors. Lender demand for loans was apparently being encouraged by growing expectations of some further easing in yields, including the belief in some quarters that the present 8-1/2 per cent ceiling rate on FHA and VA mortgages might be reduced before the November elections. In FNMA's bi-weekly auction of August 24, yields on 6-month forward commitments to purchase Government underwritten home mortgages remained at 9.03 per cent--9 basis points below the month-earlier level.

1/ Only a very minor part of the July increase in the mortgage commitments at these thrift institutions seems to have reflected commitments made on FHA and VA loans for subsequent resale to the FHLBanks to back a proposed GNMA-guaranteed bond issue.

An innovation in the mortgage market during 1970--designed to broaden sources of funds for housing finance--has been the issuance of securities guaranteed by GNMA and backed by pools of FHA and VA mortgages. Through the end of August, two bond-type issues of GNMA guaranteed securities totaling $800 million had been publicly offered by FNMA, and another $200 million has been announced for sale on September 11.[1/] Also, the Federal Home Loan Banks have been assembling a $300 million-plus pool of mortgages to back still another GNMA-guaranteed bond issue. In addition, 16 issues of GNMA guaranteed "pass-through" type securities had been privately placed by mortgage companies by the end of last month. Slightly less than half of the $64 million total was purchased by private or public pension funds. The remainder was taken by savings and loan associations, banks, and insurance companies. Judging from the $260 million backlog of pass-through securities approved by GNMA but not yet floated, more issues will be forthcoming, depending partly on the future course of market rates.

<u>Corporate and municipal bond markets</u>. While corporate and municipal bond yields declined noticeably following the mid-August announcement of the cut in reserve requirements, the bond rally, which

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1/ On bond-type mortgage-backed securities, GNMA guarantees that the bond payments will be made to the holder as scheduled. On the most commonly used form of "pass-through" securities, GNMA guarantees the timely payment to the holder of specified principal payments and a fixed rate of interest on the unpaid balance, with all principal prepayments passed through to the holder.

had stalled earlier in August, again faltered in early September. Commercial bank acquisitions of tax-exempt bonds continued to form a solid demand base in that market; but the mounting forward calendar of both corporate and municipal offerings has tended to dampen investor enthusiasm, and new issues in the week immediately preceding the Labor-Day weekend moved slowly. However, on balance, in the 5 trading weeks since July 31, these long-term yields have shown declines of 15 to 20 basis points.

BOND YIELDS

	New Aaa Corporate Bonds 1/	Long-term State and Local Bonds 2/
1969		
Low	6.90 (2/21)	4.82 (2/23)
High	8.85 (12/5)	6.90 (12/18)
1970		
Low	8.20 (2/27)	5.95 (3/12)
High	9.30 (6/18)	7.12 (5/28)
Week of:		
August 7	8.35	6.25
14	8.53	6.30
21	8.70	6.17
28	8.38	6.07
Sept. 4	8.40	6.16

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

2/ Bond Buyer (mixed qualities).

Public issues of corporate bonds remain large, with $2.1 billion now expected by the staff in September and about $1.9 billion in October, suggesting no near-term let-up in the pace of offerings. Underwriters confirm the continued large volume of prospective issues by utilities, large manufacturing corporations, and firms that had postponed or cancelled issues earlier in the year. Private placements of bonds and offerings of equities are expected to be maintained at a pace about equal to the average of the first three quarters. Stock offerings, however, are expected to increase in September, with a number of large utility and several mortgage trust offerings scheduled for that month.

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

	Bonds		Stocks	Total
	Public Offerings	Private Placements		
1969-entire year	1,061	468	700	2,229
1970-through October	1,914e1/	426e	652e	2,992e 1/
1970 - Q I	1,525	420	712	2,659
Q II	2,329e1/	437e	658e	3,424e1/
Q III	1,892e	433e	600e	2,925e
August	1,750e	400e	450e	2,600e
September	2,100e	500e	700e	3,300e
October	1,900e	400e	600e	2,900e

e/ Estimated.

1/ The second quarter "Public Offerings" and "Total" figures included the $1,569 billion AT&T offering. The monthly average for "Public Bond Offerings" excluding AT&T would be $1,757(e) for the year through October and $1,806(e) for the second quarter. The ex-AT&T monthly averages for "Total Offerings" would be $2,835(e) for the year through October and $2,901 for the second quarter.

Sales of long-term bonds by State and local governments in August were about $1.3 billion, the same as in uly. But with the continued improvement in market conditions, the forward calendar is beginning to build, and new offerings are expected to increase significantly in coming months. The most recent Federal Reserve-Census survey of State and local borrowing anticipations, which is reported in Appendix B, tends to confirm this view. Planned borrowing in the second half of 1970 is large but actual borrowing in the third quarter will apparently again be below their anticipations. With rates now more attractive, and banks more actively purchasing tax-exempts, the survey results suggest the possibility of a significant rise in offerings during the final months of the year.

STATE AND L CAL GOVERNMENT OFFERINGS
(Monthly or monthly averages, in millions of dollars)

1969-entire year	90
1970-through October	1,380e
1970 - Q I	1,368
Q II	1,237
Q III	1,390e
August	1,275e
September	1,600e
October	1,800e

e/ Estimated.

Stock market. Stock prices moved up sharply during the third week of August, with investor optimism apparently rekindled by the Board's action on reserve requirements which, along with recent declines in money market rates, has been widely interpreted by market analysts as a significant sign of credit easing. Over the past few days, short-term profit taking and uncertainties over the possible impact of a strike in the automobile industry as well as over the likelihood of an impasse in the Mideast peace talks have contributed to a retreat from recent gains, but as of the close of trading on September 4, the NYSE and AMEX indices were respectively 19 and 10 per cent above their end-of-May 1970 lows. As the percentage price change table indicates, these indices are still well below (10 and 15 per cent, respectively) their 1970 highs of early April and substantially depressed from levels reached during the height of the intensely speculative market of 1968.

Large institutional investors, which had reportedly been very inactive in the past few months, now appear to be back in the market on a limited scale, primarily for the purpose of upgrading their portfolios. Mutual funds in particular are in a position to add substantially to market demand whenever they become convinced that a sustained market upturn has begun. At the end of July, open-end funds' liquid balances represented an historically high 11.8 per cent of total assets.

PERCENTAGE CHANGE IN STOCK PRICES INDICES

To: \ From:	1968 High		1969 Low		1970 High (April)		1970 Low (May)	
	NYSE	AMEX	NYSE	AMEX	NYSE	AMEX	NYSE	AMEX
1969 low	-20	-25	--	--	--	--	--	--
1970 high (April)	-18	-25	+ 2	No Change	--	--	--	--
1970 low (May)	-39	-42	-24	-23	-25	-23	--	--
Sept. 4, 1970	-27	-36	- 9	-15	-10	-15	+19	+10

Added institutional buying interest would help to bolster sagging trading volume, which has led to substantial declines in the profits of most brokerage firms, and the failure of several recently. On the average, trading volume for 1970 is down 17 per cent from 1968 on the NYSE and 45 per cent on the AMEX.

AVERAGE STOCK TRADING VOLUME
(THOUSANDS OF SHARES)

	NYSE	AMEX
1968	12,971	6,187
1969	11,452	5,047
1970 (8 months)	10,776	3,410
Week ended:		
July 31	10,239	2,264
August 7	8,114	2,083
14	7,775	1,805
21	9,991	2,148
28	15,732	4,353
Sept. 4	12,072	3,428

Government securities market. In the latter half of August, yields declined throughout the U.S. Government securities market as market professionals and final investors reacted favorably to the System's August 17 reserve requirement changes and to a substantial easing of money market conditions. In the note and bond sector of the market, yields declined by around 20 basis points on average in the three weeks ending September 1, while Treasury bill rates moved from 10 to nearly 25 basis points lower on balance. More recently, however, the large volume of new corporate issues has attracted investors' attention and the earlier decline in yields on Treasury coupon issues has stalled. At the same time, the money market has turned somewhat firmer, despite substantial System reserve-supplying operations; and, with the higher cost of day-to-day money, Treasury bill rates have backed up somewhat, although they still remain below their mid-August levels.

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

	1970 Highs	1970 Lows	Week ending Aug. 18	Aug. 25	Sept. 1	Sept. 8
Bills						
1-month	7.84 (1/28)	6.02 (6/24)	6.41	6.29	6.27	6.28
3-month	7.93 (1/16)	6.08 (3/24)	6.52	6.31	6.30	6.38
6-month	7.99 (1/5)	6.18 (3/23)	6.62	6.46	6.51	6.58
1-year	7.62 (1/30)	6.20 (4/13)	6.61	6.44	6.49	6.50
Coupons						
3-year	8.42 (1/7)	6.87 (3/25)	7.55	7.37	7.33	7.31
5-year	8.30 (1/7)	7.05 (3/25)	7.65	7.51	7.44	7.41
7-year	8.12 (4/26)	6.98 (3/25)	7.68	7.56	7.47	7.46
10-year	8.22 (5/26)	6.90 (2/27)	7.64	7.57	7.48	7.49
20-year	7.73 (5/26)	6.55 (2/27)	7.20	7.14	7.04	7.05
Agencies						
6-month	8.65 (1/27)	7.17 (4/15)	7.48	7.35	7.24	7.24
1-year	8.75 (1/2)	7.46 (4/14)	7.66	7.55	7.40	7.39
3-year	8.54 (1/2)	7.75 (3/25)	8.00	7.91	7.81	7.81
5-year	8.43 (1/15)	7.78 (3/25)	8.06	7.98	7.89	7.87

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

Dealers' positions in all Treasury securities increased on balance in the latter half of August and early September, largely in reflection of a $1.4 billion rise in holdings of Treasury bills. Positions in coupon issues declined fairly steadily over the month of August and thus far in September as dealers continued to distribute the issues offered in the Treasury's mid-August refunding; but the level of these coupon positions remains higher than at any other time this year before mid-August. In the expectation that the longer-term outlook is for declining interest rates, dealers have not been particularly restive with their enlarged bill and coupon positions. But dealers' attitudes toward their positions are clearly still very sensitive, as the most recent back-up in bill rates with the emergence of tauter money market conditions has shown.

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

	August (Daily Average)	Aug. 17	Aug. 24	Aug. 31	Sept. 8
Treasury securities					
Total	4,476	3,919	3,780	4,487	5,038
Treasury bills (total)	3,041	2,482	2,526	3,243	3,837
Due in 92 days or less	596	472	399	612	989
93 days or over	2,446	2,010	2,127	2,631	2,848
Treasury notes and bonds (total)	1,435	1,437	1,254	1,245	1,201
Due within 1 year	349	214	193	305	388
1-5 years	455	511	440	369	321
over 5 years	630	712	621	571	492
Agency securities					
Total	810	783	831	727	657
Due within 1-year	564	539	583	492	469
other 1 year	247	244	248	235	187

In the market for Federal agency securities, new issue activity has been fairly limited, although GNMA has announced that the $200 million 20-year offering, originally scheduled for August 26 but postponed at mid-month, will be offered September 11. A $200 million, 25-month portion of the earlier GNMA financing, however, was well received at a 7.50 per cent yield and subsequently traded at a modest premium. In the short- and intermediate-term market for outstanding agency issues yields have generally declined about in line with Treasury issues.

Other short-term credit markets. Total commercial and finance company paper outstanding declined $173 million to a seasonally adjusted level of $36.3 billion in August based on data through the last Wednesday of the month. This decrease was more than accounted for by the $512 million drop in bank-related paper; nonbank related paper rose $339 million over the month on an adjusted basis (representing an unadjusted gain of $821 million). The increase in nonbank related paper reflected a sharp recovery in directly-placed paper and a continuing reduction in paper placed through dealers.

The decline in bank-related paper was concentrated in the second half of August, and reflected bank reaction to the Board's mid-August action imposing reserve requirements on bank-related commercial paper. Banks have replaced these funds through the issuance of additional CD's.

COMMERCIAL AND FINANCE COMPANY PAPER
(End-of-month data, in millions of dollars)

	June	July	August 1/
		Amounts Outstanding	
Total commercial and finance paper 2/	38,497	36,464	36,291e/
Bank related 3/	7,468	7,685	7,173
Nonbank related 4/			
Placed through dealers	12,482	11,449	10,847e/
Placed directly	18,547	17,330	18,271e/
		Net Change	
Total commercial and finance paper 2/	-1,006	-2,033	- 173e/
Bank related 3/	+ 3	+ 217	- 512
Nonbank related 4/			
Placed through dealers	- 487	-1,033	- 602e/
Placed directly	- 522	-1,217	+ 941e/

e/ Estimated; see footnote 1.

1/ As of August 26. The end-of-month data will differ from these Wednesday figures, due to the difference in dating.

2/ Combines seasonally adjusted nonbank related paper and seasonally unadjusted bank related paper.

3/ Seasonally unadjusted.

4/ Seasonally adjusted.

Rates on commercial and finance paper fell another 1/2 of a percentage point and yields on acceptances dropped 3/8 of a percentage point during August, with most of the declines coming in the latter half of the month when money market condtiions eased substantially and market expectations of lower interest rates generally became stronger. Reflecting the declines, commercial paper was quoted at 7-5/8 per cent on one-month and 8-1/4 per cent on three-month maturities at the beginning of September. The rate decreases on commercial paper were much sharper than those on Treasury bills, with the result that spreads have narrowed from around 180 basis points to 135 basis points on one-month maturities and from 225 to 185 basis points on three-month obligations.

Yields on new issue short-term CD's also fell further during August. One-month maturities dropped 37 basis points to 7.25 per cent, while three-month issues fell 31 basis points to 7.44 per cent. Although the rate on new CD's in the 1-year area is still generally at the 7-1/2 per cent ceiling, at least one large New York bank has reduced its offering rate for this maturity to 7-1/4 per cent.

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

	1969 Nov.-Dec. highs 1/	Aug. 5	Aug. 19	Sept. 2	Net Change (Aug. 5-Sept. 2)
1-month					
Commercial paper	9.25 (12/31)	8.12	8.00	7.62	-.50
Finance paper	9.00 (12/31)	7.75	7.75	7.25	-.50
Bankers' acceptances	9.00 (12/31)	7.62	7.50	7.25	-.37
Certificate of deposit--new issue 2/	6.25	7.62	7.56	7.25	-.37
Treasury bill	7.54 (12/31)	6.30	6.38	6.29	-.01
3-month					
Commercial paper	9.25 (12/31)	8.75	8.50	8.25	-.50
Finance paper	8.13(12/31)	7.75	7.75	7.25	-.50
Bankers' acceptances	9.00 (12/31)	7 38	7.38	7.00	-.38
Certificate of deposit--new issue 2/	6.50	7.75	7.73	7.44	-.31
Treasury bill	8.00(12/29)	6.50	6.41	6.40	-.10
6-month					
Bankers' acceptances	9.00 (12/31)	7.38	7.38	7.00	-.38
Treasury bill	8.09 (12/29)	6.65	6.47	6.61	-.04
12-month					
Prime municipals 2/	6.25 (12/12)	4.30	4.10	4.00	-.30
Treasury bill	7.86 (11/24)	6.66	6.45	6.54	-.12

1/ Dates of highs in parentheses; latest date used if high occurred on more than one date.

2/ Investment yield basis.

Source: Wall Street Journal's Money Rates for commercial and finance paper and bankers' acceptances; all other data from the Federal Reserve Bank of New York.

Federal finance. The Board staff estimate of total receipts and outlays in the unified budget for fiscal 1971 remains unchanged from the previous Greenbook. The $11.7 billion deficit projected by the staff is much higher than the official (May 19th) Administration estimate of only $1.3 billion for fiscal 1971, but there have been unofficial reports that Administration economists now estimate a budget deficit in the range of $10 to $15 billion.

There is still considerable uncertainty in the staff estimate of budget outlays, among others in the area of defense spending, because the defense appropriations bill is still being worked out in Congress. The amendment proposing a $66 billion ceiling in defense spending (i.e., a $5.2 billion cut in the proposed defense budget) was defeated in the Senate. Nevertheless, it appears likely at this date that the combination of pressure by Congress and by the Administration will result in a cut in defense spending by perhaps as much as $1 billion. The staff expects that such a cut in outlays will be offset by increased interest payments on the public debt and by other items such as a higher-than-projected Post Office deficit arising from a further delay in the projected postal rate increase.

On a National Income Accounts basis the staff is projecting a $10.7 billion deficit for the Federal sector for calendar 1970 and $11.8 billion deficit for fiscal 1971. The small increase in the deficit since the previous Greenbook partly reflects reduced corporate profit tax accruals, due to a reduction in projected profits. On a seasonally adjusted basis, the NIA deficit is expected to become progressively smaller, declining from $14.3 billion in the third quarter of 1970 to $10.1 billion in the second quarter of 1971, as total expenditures during that period are projected to grow at an annual rate of about 5.5 per cent while receipts grow somewhat faster.

With Federal expenditures under constraint, staff estimates of high employment surplus or deficit still show that Federal fiscal policy will shift in a more restrictive direction during fiscal 1971. The high employment budget is expected to move from a $2.0 billion deficit in the second half of calendar 1970 to an $8 billion surplus in the first half of calendar 1971.

The Treasury's cash balance will be cut during September by an anticipated German redemption of $800 million in special Treasury foreign issues that will be reinvested by market purchases of outstanding Treasury bills. Taking this into account, the end-of-September cash balance is expected to be $7.6 billion. The Treasury is expected to raise around $2.5 billion of new money in late October, probably through an offering of tax bills, along with the already-scheduled additions to weekly and monthly bill offerings.

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

	Fiscal Year 1970*	Calendar Year 1970 F.R. Board	Fiscal Year 1971 Revised Budget 1/	Fiscal Year 1971 F. R. Board	Calendar Quarters 1970 I*	II*	IIIe/	IVe/	1971 Ie/	IIe/
Federal Budget										
(Quarterly data, unadjusted)										
Surplus/deficit	-2.9	-10.2	-1.3	-11.7	-3.5	8.7	-7.4	-8.0	-6.1	9.7
Receipts	193.8	193.5	204.3	199.4	44.4	58.7	47.6	42.8	46.4	62.5
Outlays	196.8	203.6	205.6	211.1	47.8	50.0	55.0	50.8	52.5	52.8
Means of financing:										
Net borrowing from the public 2/	3.8	10.0		11.0	2.0	-6.4	6.9	7.5	4.2	-7.6
Decrease in cash operating balance	-2.1	-1.1		1.0	-1.6	-1.1	.4	1.2	.4	-1.0
Other 3/	1.2	1.4	n.a.	-.2	3.1	-1.1	.1	-.7	1.5	-1.1
Cash operating balance, end of period	8.0	6.4		7.0	6.9	8.0	7.6	6.4	6.0	7.0
National Income Sector										
(Seasonally adjusted annual rate)										
Surplus/deficit	-.4	-10.7	n.a.	-11.8	-1.7	-14.3	-14.3	-12.6	-10.3	-10.1
Receipts	198.8	196.2	n.a.	201.2	195.9	196.6	194.7	197.4	204.7	207.9
Expenditures	199.3	206.9	208.3	213.0	197.7	210.9	209.0	210.0	215.0	218.0
High employment budget surplus/deficit 4/	1.2	-1.6	n.a.	3.0	2.9	-5.4	-4.3	.3	8.0	8.1

* Actual
e--projected
n.a.--not available
1/ Official Budget Revision: May 19, 1970
2/ Excludes effect of reclassification of $1.6 billion of CCC certificates of interest, as of July 1, 1969. This reclassification increased Federal debt, but is not treated as borrowing from the public.
3/ Includes such items as deposit fund accounts and clearing accounts.
4/ Estimated by Federal Reserve Board Staff. Since the last Greenbook, the high employment figures have been revised to include the effect on the GNP price deflator of the assumed Federal pay raise beginning in the first quarter of 1971.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

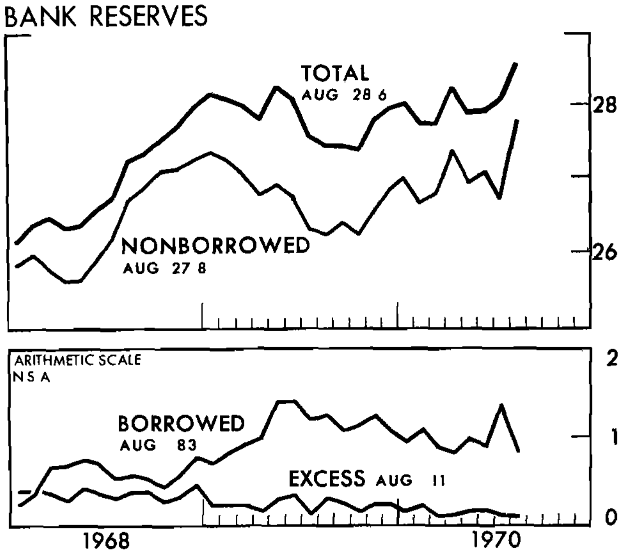
	Aug.	Sept.	Oct.	Nov.	Dec.
Total net borrowing:	2.8	-1.9	2.8	2.4	2.3
Weekly and monthly bills	.4	.6	.5	.8	.7
Tax bills	--	--	--	--	--
Coupon issues	3.1	--	--	--	--
As yet unspecified new borrowing	--	--	2.3	2.6	1.5
Other (agency, debt repayment, etc.)	-.7	-2.5	--	-1.0	.1
Plus: Other net financial sources a/	-.2	.2	.6	-.6	-.7
Plus: Budget surplus or deficit (-)	-2.7	2.0	-6.0	-2.4	.4
Equals: Change in cash balance	-.1 b/	.3	-2.6	-.6	2.0
Memoranda: Level of cash balance, end of period	7.3 b/	7.6	5.0	4.4	6.4
Derivation of budget surplus or deficit:					
Budget receipts	15.4	19.6	11.9	14.4	16.5
Budget outlays	18.1	17.6	17.9	16.8	16.1
Maturing coupon issues held by public	5.6	--	--	6.0	--

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

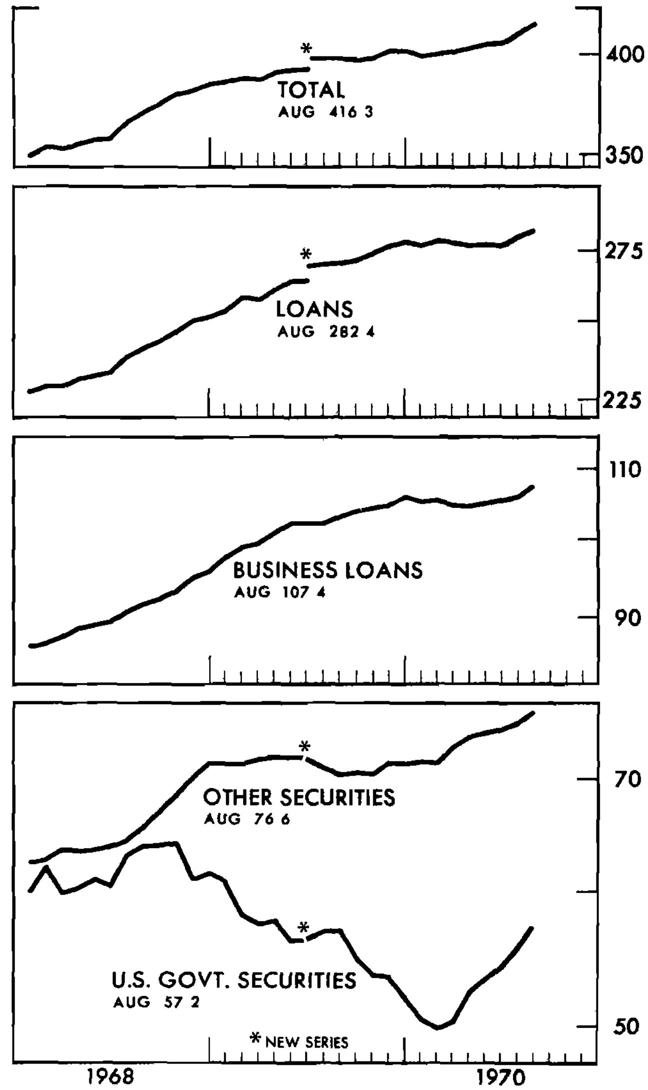
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

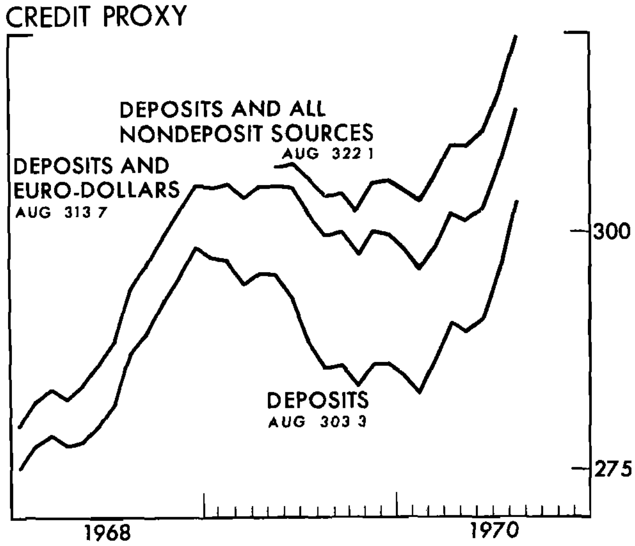
BANK RESERVES



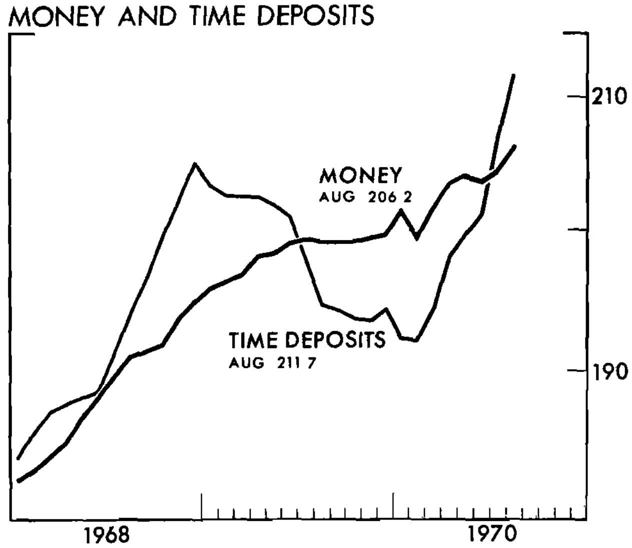
BANK CREDIT



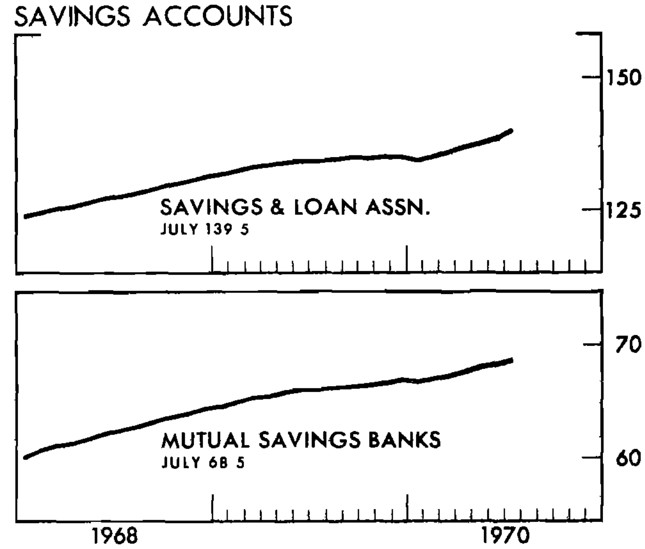
CREDIT PROXY



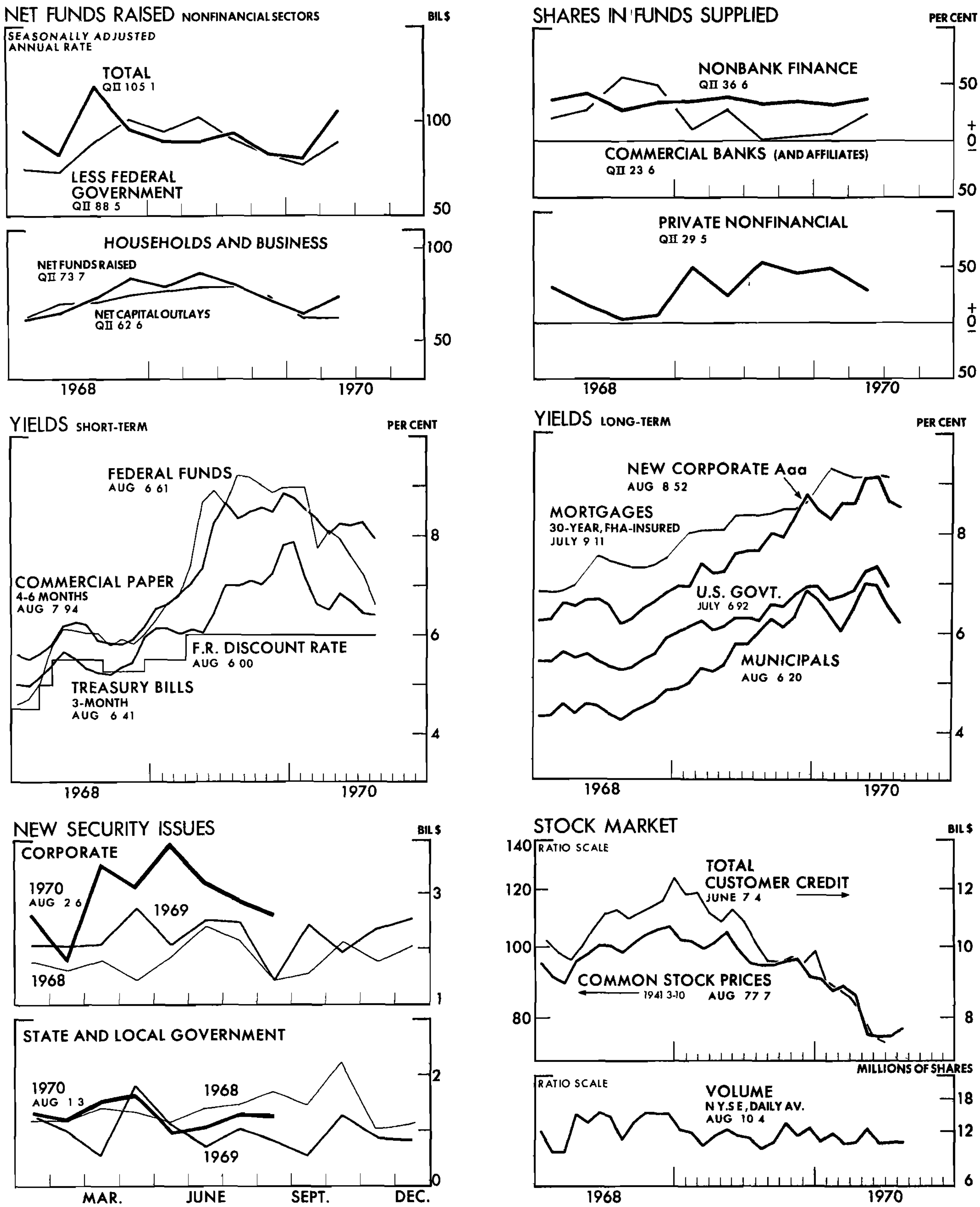
MONEY AND TIME DEPOSITS



SAVINGS ACCOUNTS



FINANCIAL DEVELOPMENTS - UNITED STATES



THE ECONOMIC PICTURE IN DETAIL

International Developments

U.S. balance of payments. The rate of over-all deficit on the liquidity basis (before special transactions and seasonally adjusted) appears to have abated considerably since June. In July this deficit was on the order of $100 million, and though the weekly data for August show some increase the deficit for the month was probably under $500 million. Barring a major change in September, the third-quarter deficit should be much improved as compared with the $1.3 billion of the first quarter or the $2.2 billion of the second.

Improvement in the liquidity balance in July reflected not only the favorable trade balance (discussed below) but also favorable capital flows. There was a net reduction of $350 million of bank-reported claims on foreigners, which was a more-than-seasonal reversal of second-quarter outflows. In addition, for the second month foreigners were net purchasers of U.S. equity securities to the extent of about $50 million, while U.S. purchases of foreign bonds were still lower than in other recent years.

Relatively complete data for the second quarter (confidential until published late in the month) confirm earlier impressions that recorded outflows of U.S. private capital were high, and that unrecorded net payments were also large. In particular, direct investment outflows were about as high as the $1.4 billion of the first quarter; the total of $2.8 billion for the first half was much larger than for any earlier six-month period. At the same time, U.S. companies were raising only small amounts of funds abroad to help finance these investments, and apparently were not drawing down funds held abroad that were the proceeds of earlier borrowing. These results strongly suggest that direct investors will have to cut back very sharply on their capital outflows in the second half, and may have to increase their income remittances over the moderate second-quarter rate, in order to stay within the limits of the controls. In fact, reports to the OFDI still indicate that the year-over-year increase in capital outflows will be much smaller than these first-half figures would suggest, pointing to a repetition of last year's experience, when outflows fell sharply in the final quarter.

Improvement in the third-quarter liquidity balance, therefore, clearly reflects primarily a cessation of unsustainably large capital outflows in the first half, probably aided by a moderate gain in the current account. On the official settlements basis, however, the third quarter deficit will still be large. The July-August deficit on this basis (seasonally adjusted) was about $2 billion, as liabilities to private foreigners were reduced by about $1.6 billion -- including a decline of $1.5 billion in liabilities to foreign branches. The decline in liabilities to private foreign accounts was much smaller in August than in July, and further reductions in the rest of the year may be limited by the fact that most banks are close to their reserve-free bases on their Euro-dollar borrowings.

U.S. foreign trade. In July, the export surplus held at the very high June level as both exports and imports fell by about the same amount. For the three months of May-July combined the surplus was $4.3 billion at an annual rate (balance of payments basis). This compares with rates of $2.8 billion in February-April and $1.5 billion in the second half of 1969.

The very large increase in the export surplus in the May-July period results from a sharp acceleration in exports -- over 20 per cent at an annual rate from the February-April level -- while imports rose much more moderately -- by 8 per cent. The commodities accounting for the recent export expansion differ from those responsible for the advance in exports in the earlier months of the year. Shipments of machinery bulk much more importantly in the latest gain while the earlier advance was led by greater exports of industrial materials -- steel, copper, aluminum, coal and chemicals -- and deliveries of large numbers of commercial aircraft. Exports of automotive equipment to Canada, which had sagged earlier this year, picked up sharply in May-July. Shipments of agricultural commodities have continued to advance. The rise in imports in the last three months was concentrated in May; imports fell in the following two months, and in July were no higher than the levels registered in February-April.

Exports in May-July were at an annual rate of $43.8 billion, about $2-1/2 billion more than the rate in the preceding three months. Agricultural items accounted for about one-fifth of the increase, reflecting a further rise in corn shipments, and in deliveries of rice to Korea under the P.L. 480 program. Cotton and tobacco exports were also greater. Among the non-agricultural items, the largest advances were recorded in machinery -- particularly in June and July -- and in cars to Canada as automobile sales there improved. Exports of ferrous scrap, particularly to Japan, also increased, while shipments of steel, copper, coal and chemicals in May-July were maintained at the high values recorded in the first part of this year.

Exports of steel peaked in May, and there has been a sharp drop in export orders for U.S. steel, suggesting that such shipments will probably continue to slide. Supplies of steel have become more plentiful in Europe and production in countries like Germany appears to have stabilized as large stocks there are being worked off. The increased deliveries of machinery reflect the continued heavy demand for producers' equipment in foreign industrial countries, some of which are experiencing record rates of capacity utilization in manufacturing.

By areas, the largest increases in U.S. exports in May-July have been in shipments to the United Kingdom, Germany and other Common Market countries, and to Japan. Exports to the less-developed countries of Asia and Africa have also risen but shipments to Canada and to the Latin-American countries have declined.

Despite the very strong growth in U.S. exports of non-agricultural products, the United States share of world exports of manufactured goods in the first half of this year has remained unchanged from the relatively low ratio to which it had dipped in 1969. Germany, France, Italy and Japan have increased their shares. The United Kingdom's share, however, shrank appreciably this year.

Imports in May-July were at an annual rate of $39.4 billion (balance of payments basis) about 2 per cent greater than the rate in February-April. As in the earlier months, machinery, automobiles from Canada, and other nonfood consumer goods, accounted for most of the recent rise. Imports of European and Japanese cars fell; continued growth in sales of those cars in the United States was met by drawing down stocks. Arrivals of foodstuffs, which had risen strongly in the early part of the year, declined slightly in May-July, mainly because of a substantial drop in imports of meat. The value of coffee imports was up because of a further rise in prices, but the volume of coffee imported was lower.

The rise in imports of consumer goods was centered in footwear -- possibly reflecting purchases in anticipation of quotas -- and in TV sets. Imports of radios and clothing were lower.

Imports of industrial materials, in the aggregate, showed little change in May-July from those in February-April. The movements by individual commodities vary. Arrivals of petroleum dropped sharply and there was a further decline in lumber imports. However, imports of fabrics, steel, copper, and nickel rose in May-July. The increase in nickel imports probably represents a final recovery in shipments from the low level which had prevailed since the strike at Canadian nickel plants last year. Higher steel imports stem from the easing in the European steel supply position.

Although world prices of copper and other metals have been declining in recent months, there has, as yet, been no downward movement in the import price of those metals. With the copper price on the London Metal Exchange falling about 4 cents below U.S. producers' prices in August, there will probably be a weakening in the import price of copper and possibly in other metals in the closing months of this year.

Foreign exchange markets. Since mid-August there has been a serious deterioration in the strength of the pound sterling, and a remarkable turnaround in the fortunes of the Italian lira. Among other major foreign currencies, the German mark and the French franc firmed somewhat, while the Belgian franc eased modestly, and the Canadian dollar showed a further substantial advance.

The sterling exchange rate has fallen from just over $2.39 at the beginning of August to just over $2.38 at present. Forward sterling has weakened even more, and the three-month forward discount is currently running at about 2 per cent per annum, compared with

1/4 per cent around the first of August. The Bank of England allowed the exchange rate to take most of the selling pressure during August -- its intervention losses in that month totaled $72 million. With the intensification of selling pressures in early September, the Bank of England intervened on a much larger scale and sold more than $425 million from September 4-8.

The bearish mood in the sterling market is a reflection of the poor outlook for the British economy, as discussed in the latest report of the National Institute for Economic and Social Research, which called for additional stimulus to aggregate demand and suggested that in the absence of a firm incomes policy there was a likelihood of another devaluation.

The Italian lira began to firm during the third week of August when the new government announced that it was preparing new fiscal measures to stabilize the Italian economy. Within two weeks the exchange rate rose from its lower limit to well above parity. For the month of August the Bank of Italy had net intervention gains of $75 million, in sharp contrast to its losses of nearly $350 million in July. During the first four days of September it purchased an additional $95 million in the market. At the beginning of the second week in September, however, the exchange rate slipped below parity, possibly reflecting an earlier "over-buying" of lire, as well as some spillover of the market's nervousness with respect to sterling.

The German mark, after easing somewhat during the first two weeks of August in response to a decline in domestic short-term money market rates, firmed moderately through early September. The Bundesbank's intervention purchases of dollars in August amounted to only $120 million spot and $100 million forward, compared to July's purchases of $1.1 billion spot and nearly $300 million forward. In the first week of September, with renewed tightening in the domestic money market (the result of higher reserve requirements on commercial banks), the exchange rate firmed and the Bundesbank purchased $150 million in the spot market.

The market for French francs was quiet for most of August, with very little intervention by the Bank of France. Late in the month the exchange rate firmed, despite a decrease in the discount rate. Demand for francs was particularly strong in the last two days of August, and the Bank of France purchased $100 million. The exchange rate remained firm during the first week of September.

The demand for Dutch guilders remained strong in the first three weeks of August. The exchange rate eased moderately toward the end of August but firmed again in early September. The Netherlands Bank purchased almost $275 million in the market from mid-July to mid-August, and the System provided cover for most of this dollar intake by drawing $220 million equivalent on the swap facility with the Dutch.

Demand for the Belgian franc eased considerably in August, and for the month the Belgian central bank had dollar purchases of only

$25 million compared with $125 million in July. Since mid-August, the System has drawn an additional $10 million equivalent on the swap facility with the National Bank of Belgium, bringing its outstanding indebtedness on that line to $95 million.

The Canadian dollar exchange rate advanced from a little less than 97.5 U.S. cents in early August to about 98.5 cents currently, mainly reflecting seasonal strength in an already strong Canadian balance of payments. The Bank of Canada purchased $110 million spot and did $27 million in swaps with the market during August. The cut in the Bank of Canada's discount rate on September 1 had no noticeable effect on the spot rate, but did induce a modest narrowing of the premium on forward Canadian dollars, now at a little less than 1/2 per cent per annum on three-month contracts.

Euro-dollar market. Euro-dollar interest rates for three-month and longer maturities declined in the latter half of August and the first week of September, reaching their lowest levels since April, but advanced sharply on September 8 and 9. The three-month deposit rate -- which had been about 8-3/8 per cent in early August -- declined to about 7-15/16 per cent in the week ended September 2, but firmed to 8-1/4 per cent on September 9. Call Euro-dollar funds declined to less than 7 per cent in the third week of August but have since advanced rather steadily and were quoted at 8-1/4 per cent on September 9.

Euro-dollar borrowings by U.S. banks through their foreign branches declined, net, by about $300 million from August 12 through September 2. These borrowings rose by over $400 million in the two weeks to August 26, but declined by more than $700 million in the following week. As of September 2, gross liabilities to foreign branches (including domestic loan participations) totaled about $10.7 billion, about $0.9 billion below the average of the four Wednesdays in the reserve requirement computation period ended August 5.

Recent developments in certain of the major foreign national money markets may have contributed to the easing in longer maturity Euro-dollar rates from mid-August to early September. Canadian interest rates declined fairly sharply in the latter half of August and on September 1 the Bank of Canada reduced its discount rate by 1/2 per cent, to 6-1/2 per cent. The Bank of France reduced its discount rate on August 27 to 7-1/2 per cent, from 8 per cent. Although German money markets have remained very tight since mid-August, the Bundesbank's decision (announced August 12 and effective September 1) to impose a substantial additional reserve requirement on all classes of German bank liabilities in excess of the second-quarter-1970 average of such liabilities has perhaps discouraged German banks from adding to their liabilities to the Euro-dollar market.

SELECTED EURO-DOLLAR AND U.S. MONEY MARKET RATES
(weekly averages 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
July 29	6.95	6.89	0.06	8.36	6.34	2.02
Aug. 5	7.13	6.93	0.20	8.37	6.43	1.94
12	7.53	6.82	0.71	8.33	6.51	1.82
19	6.98	6.64	0.34	8.08	6.50	1.58
26	7.23	6.34	0.89	8.15	6.28	1.87
Sept. 2	7.35	6.46	0.89	7.94	6.33	1.61
9	7.63	6.65[p]	0.98	7.97	6.35[p]	1.62

Payments and reserve changes of major industrial nations. In the spring and summer of this year the major industrial countries other than the United States have had a combined payments surplus[1/] that was larger than the surpluses experienced in the first quarter and in the same period of 1969. Net official reserve assets (excluding initial allocations of SDR's) of the G-10 countries other than United States rose by $3.6 billion during the second quarter compared with $2.3 billion in the

TABLE 1. CHANGES IN OFFICIAL NET FOREIGN ASSETS
(in millions of dollars; no sign=increase)

	1969				1970[1/]		
	I	II	III	IV	I	II	July
United Kingdom	433	196	-142	845	1,865	486	14
France	185	-1,219	-264	198	529	471	218
Germany	-1,804	1,893	1,828	-4,954	167	1,484	1,043
Italy	-381	16	-192	43	-877	238	-124
Belgium	-106	82	-146	278	-31	118	72
Netherlands	-58	-127	-26	272	51	14	119
Sweden	-68	-165	-49	141	-77	-8	25
Japan	319	-94	168	407	283	-1	-172
Canada	-38	-45	-1	138	378	840	113
Total for G-10 countries excluding United States	-1,518	537	1,176	-2,632	2,288	3,642	1,308
Switzerland	-778	5	192	590	-432	384	-376

1/ Excluding initial allocation of SDR's.
Source: Confidential BIS data.

1/ In this section the term "overall balance of payments surplus (or deficit)" is used to refer to the balance financed by changes in official net foreign assets and net foreign assets of commercial banks.

first quarter and $0.5 billion in the second quarter of 1969 (Table 1). In July these countries had further net reserve asset gains of $1.3 billion. On an overall balance of payments basis, the results were similar (Table 2).

TABLE 2. OVERALL BALANCE OF PAYMENTS SURPLUSES OR DEFICITS[1/]
(in millions of dollars; no sign=surplus)

	1969				1970[2/]		
	I	II	III	IV	I	II	July
United Kingdom	421	254	236	870	1,351	271	n.a.
France	-559	-1,150	-219	263	434	586[3/]	n.a.
Germany	-625	1,803	784	-6,185	-250	1,161	n.a.
Italy	-357	-515	-117	-186	-711	223	-48
Belgium	-50	100	-68	164	-1	90	n.a.
Netherlands	89	-112	-73	246	4	156	n.a.
Sweden	-132	-150	-81	32	-77	40	54
Japan	278	637	658	710	-16	23	n.a.
Canada	23	235	107	184	87	723[3/]	n.a.
Total for G-10 countries excluding United States	-912	1,102	1,227	-3,902	821	3,273	n.a.
Switzerland	-327	301	347	-164	421	n.a.	n.a.

1/ Measured by changes in net foreign assets of the monetary authorities and commercial banks.
2/ Excluding initial allocation of SDR's.
3/ Excluding change in commercial bank positions in June.
n.a. - Not available.
Source: Confidential BIS data and FR estimates.

The analysis that follows is based on reported changes in reserves and in positions of commercial banks. It is worth noting that the aggregate gain in net reserves of the industrial countries in the second quarter, plus what is known about reserve gains by the rest of the world, is much greater than can be accounted for by the deficit in the U.S. balance of payments on the official settlements basis. Such discrepancies have occurred frequently, and probably reflect the difficulties in accounting for flows of official foreign dollar holdings through the Euro-dollar market. For instance, if one central bank places newly received funds in the Euro-dollar market, and the funds accrue to another central bank as a result of loans to residents of its country from that market, the sum of the foreign exchange reserves reported by both banks will increase. In the U.S. balance of payments, however, there will be no effect on the official settlements balance, since reported liabilities of U.S. banks to foreign monetary authorities will be unchanged. (If--when foreign central banks are increasing their Euro-dollar holdings--U.S. banks increase their borrowings in the Euro-dollar market or other foreign private accounts here increase, that activity would prevent the additional accrual of funds to foreign central banks but the U.S. official settlements deficit would be reduced below the amount reflected in changes in total holdings of dollars by foreign central banks. However, U.S. bank liabilities to private foreigners were reduced in the second quarter.)

German foreign exchange reserves have grown rapidly since the first quarter after a massive reduction in reserves in October-March following last autumn's revaluation of the mark. The German trade account has remained very strong despite the continued boom which has been little restrained by revaluation or subsequent deflationary measures. Continued strong demand pressures in major German export markets such as Italy and the Netherlands and the terms-of-trade effects of the revaluation are reflected in German trade developments this year. The German capital account has also shifted because of a rather tight monetary policy and other factors.

Rapidly rising Canadian reserves and the prospect of large speculative inflows led to a June 1 decision to abandon the fixed exchange rate for the Canadian dollar. Despite a 5.4 per cent appreciation since early June the Canadian payments position remains strong and the Bank of Canada has purchased sizable amounts of U.S. dollars to avoid a still larger appreciation. The U.K. payments situation, in contrast, has deteriorated since the first quarter. The British trade surplus has declined in recent months; this--together with rapidly rising wages and prices plus continued unemployment and labor strife--has shaken market confidence in sterling and has led to a decline in capital inflows. A slight easing of monetary conditions in Britain has also adversely affected capital inflows.

The French balance of payments position remains strong. Since devaluation, French exports have risen rapidly while the rate of increase in imports has slackened. Italy's external position improved significantly in the second quarter after very heavy reserve losses early in the year; the political crisis of July was accompanied by a reserve loss which, however, ended in the latter half of August. Dutch reserves have risen rapidly in recent weeks largely as a result of speculation on a guilder revaluation. Japan's external payments have been in near balance this year, after a substantial surplus in 1969.

A strong second quarter performance of Canada's balance of payments was primarily the result of an unusually large trade account surplus of $630 million compared to $93 million in the same period of 1969. Preliminary figures for July show a trade surplus of $306 million compared with $73 million last July despite the appreciation of the currency. Primary forces behind Canada's trade surplus this year are continuing inflation in Europe, a noticeable easing of demand in Canada, and the unwinding of the effects of 1969 strikes on exports of commodities such as nickel and iron ore.

Canada's capital account was also strong in the second quarter when $529 million (net) flowed in compared to $239 million in the same period of 1969. The improvement mainly represented shifts in flows of short-term funds. Canadian banks reduced their net foreign assets and a shift appears to have occurred in the leads and lags in payments for merchandise trade. The strong trade position and reserve gains by the Bank of Canada apparently led some market participants to cover outstanding positions in U.S. dollars or to take positions in Canadian dollars. Although these flows were relatively small in volume, fear of much larger speculative flows led to the June 1 decision of the Canadian government to float the exchange rate.

The continuing strength of the Canadian payments position is suggested by the Bank of Canada's decisions to intervene in the exchange market to purchase U.S. $111 million in July and $172 million in August in order to keep the Canadian dollar from appreciating much beyond 98 U.S. cents. The effects of the recent further easing of Canadian monetary policy and autumn's seasonally weak period in Canada's trade may end the upward pressure on the exchange rate.

The United Kingdom's balance of payments surplus, which was very large in the last quarter of 1969 and the first quarter of 1970 has declined sharply, and questions of confidence are again being raised about sterling. A net reserve gain of $1.9 billion in the first quarter was followed by one of $486 million in the second quarter. Britain's official reserve position was virtually unchanged during July and August. The U.K. overall balance of payments showed a surplus of $1.4 billion in the first quarter and only $271 million in the second quarter.

The U.K. current account surplus declined from $346 million in the first quarter to $127 million in the second quarter, largely as a result of an adverse movement in the visible trade balance. The U.K. trade account, seasonally adjusted, moved from a surplus of $77 million in the first quarter to a deficit of $223 million in the second quarter. Although a number of special factors may have affected the British trade balance, the continuation of rapid wage and price inflation despite stagnant output and high unemployment has been a vital factor.

The worsening of Britain's trade position was accompanied by a diminution in capital inflows during the second quarter resulting from completion of any likely improvements in the leads and lags in Britain's payments, an easing of liquidity pressures, and the reemergence of market uncertainty about the prospects for sterling. The recent pressure on sterling in exchange markets suggests that Britain's payments position may be continuing to worsen through the summer, although this may also in part be the result of seasonal weakness in the balance of payments of the rest of the sterling area.

In Germany the maintenance of a substantial trade surplus and a recurrence of large scale short-term capital imports have caused German official reserves to rise rapidly in recent months. The German overall balance of payments also produced a large surplus during the second quarter. The German trade account surpluses of $898 million, seasonally adjusted, and $920 million in the first two quarters of this year are only slightly lower than those recorded for the first two quarters of 1969. The German current account surplus is down from last year, however, owing to an increased travel deficit, foreign workers remittances, and the unwinding of dividend payments held back until after the revaluation.

A restrictive monetary policy has been imposed in Germany to restrain inflation. German banks have reduced their assets abroad in response to the squeeze in their liquidity and non-banks have imported large amounts of short-term capital. The Bundesbank has attempted, thus far unsuccessfully, to discourage these inflows and is moving to offset their effect on internal liquidity through higher marginal reserve requirements on increases in all bank liabilities, domestic and foreign, above the average level of the second quarter. Long-term capital exports have declined as a result of the unwinding of speculative positions, the weakness of the U.S. stock market and tight domestic monetary conditions, thus no longer providing a major offset to inflows on other accounts. If credit remains scarce in Germany, it is difficult to foresee an end of German reserve gains.

In Italy the heavy reserve losses of the first quarter have been followed by rather wide month-to-month fluctuations. There was a surplus in the second quarter but in July, when seasonal factors should have brought further improvement, there was a sizable reserve loss. With the formation of an anti-inflation program by the new government, the lira has strengthened since mid-August.

The Italian trade balance has deteriorated seriously this year; the deficit on a payments basis (imports, c.i.f.) was $1,139 million for the first six months, compared with $394 million in the same period of 1969. Imports were up by 22 per cent and exports by 10 per cent. Export proceeds in recent months have suffered from strikes and other labor difficulties which have held back production of export goods. The rise in imports reflects rapidly rising aggregate demand as well as the impact of labor troubles on the availability of home-produced goods. (In judging the change in Italy's trade position, one should recall that in recent years, Italy was thought to have an excessively large trade surplus.)

The Italian non-bank capital account for the first half of this year was greatly improved from last year, the improvement being largely concentrated in the second quarter. Foreign borrowing by state enterprises, which has been strongly encouraged by the government as well as by rapidly rising Italian interest rates, has accounted for much of this shift in the capital account. Sizable month-to-month swings have occurred in commercial bank flows owing to changes in government banking regulations and shifts in confidence in the lira.

In France the balance of payments has remained strong since the beginning of this year. The second quarter produced an official reserve asset gain of $471 million compared to $529 million in the first three months of the year. The French gained another $218 million in July and smaller but still significant reserve increases were registered in August and early September. France's overall balance of payments surplus has been sizable thus far this year, following a smaller surplus in the fourth quarter of 1969 and a large deficit in the year and a half before devaluation.

This remarkable turnaround from the reserve losses of 1969 has been caused by a number of factors, including primarily a reversal of leads and lags and a surprisingly fast improvement of the French trade balance after the 1969 devaluation. The French trade deficit, which set a record of $800 million in the second quarter of 1969, dropped to $60 million in the fourth quarter, and the trade account has been in approximate balance for the first seven months of 1970. French exports to countries outside the franc area, valued in U.S. dollars, rose by 37 per cent during the first half of 1970 compared to a year earlier, while imports increased by only 8 per cent. The French capital account has been strong both because of the return of previously stretched leads and lags (a source of inflows which is now finished), and the flow of short-term funds into France seeking high interest rates. The recent reduction of the French discount rate should reduce these flows, with a corresponding effect on French reserve gains.

The Netherlands reserves grew slowly in both the first and second quarters of this year, but have risen more rapidly during the summer. Official reserves rose by $65 million in the first half, and by $119 million during July. The overall balance of payments was in balance during the first quarter and showed a surplus of $156 million during the following three months. The increase in the rate of reserve accretion is not the result of a shift in the current account, but instead reflects primarily speculation in anticipation of an unlikely revaluation of the guilder. The basis for speculation on a guilder revaluation was apparently in part the OECD Annual Review of the Dutch economy which some have interpreted as recommending such a move. The past strength of Dutch foreign exchange reserves, the fact that the guilder was revalued together with the German mark in 1961, and the close ties between the Dutch and German economies might also lead some to expect the Dutch eventually to follow the mark's appreciation of October 1969. This speculation persists despite a deficit of $780 million, seasonally adjusted, in the Dutch trade account during the first half of this year compared to $555 million in the second half of last year and $450 million during the first half.

The reserves of Belgium-Luxembourg rose by $118 million during the second quarter of 1970 after a small decline in the previous quarter and a $132 million gain in the second half of 1969. A further increase of $72 million occurred during July. The overall balance of payments accounts showed a surplus of $89 million for the first half of this year. This was more than the $50 million surplus in the first half of 1969, but less than the $164 million surplus of the fourth quarter of 1969 that was swelled not only by a temporary trade balance improvement but also, more importantly, by the unwinding of speculation in German marks after the mark revaluation. For the first quarter of this year, Belgian trade results were unchanged from the same period a year earlier, but a further shift in leads and lags contributed to the continued strength of the balance of payments. Other non-bank capital showed a net outflow of $84 million during the first quarter compared to a $146 million inflow during all of 1969. Part of this shift was the result of a decline in direct investment in Belgium-Luxembourg from the unusually high levels of the second half of 1969.

Sweden ran a balance of payments deficit in the first half of 1970, but this was smaller than in the corresponding period of 1969. Sweden's trade balance, however, has deteriorated this year, reflecting the influence of excessive domestic demand pressures. Sweden's official reserves rose in July, apparently as a result of the tight money policy instituted by the Bank of Sweden to restrain inflation.

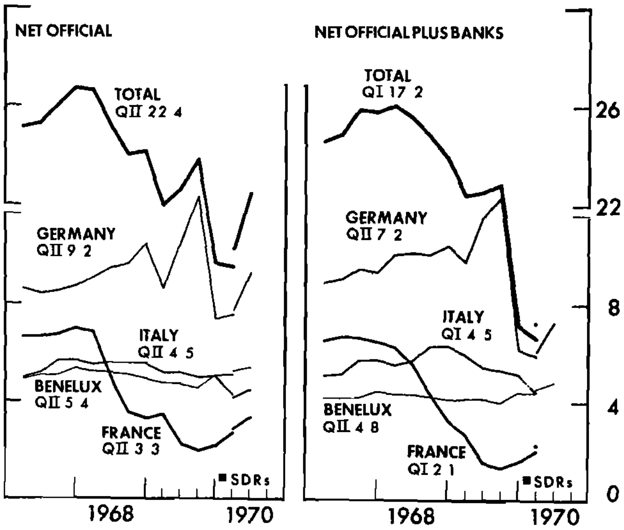
Switzerland's overall balance of payments surplus of $421 million in the first quarter contrasted sharply with the $327 million deficit of a year earlier. The first quarter trade deficit this year showed a large year-to-year increase which, however, was more than offset by a favorable shift on capital account related at least in part to the heavy exodus of capital from Italy.

Japan's overall balance of payments showed a very small surplus in the first half of this year after the very large surplus of 1969. Japan's trade surplus remained strong throughout the first half of 1970, but increased service payments reduced the current account surplus by about $230 million. In addition, long-term capital movements contributed to the smaller reserve gains in recent months. An outflow of $917 million in the first half of this year contrasted with an inflow of $129 million the same period of 1969. The primary factors causing this shift were a sharp decline in net foreign purchases of Japanese securities, and an increase in Japanese trade credits and long-term loans. Because of official actions to reduce reserves, official reserves remained unchanged in the second quarter and declined by $172 million in July. These actions included a $200 million loan to the World Bank and the purchase of $83 million in U.S. Eximbank participation certificates.

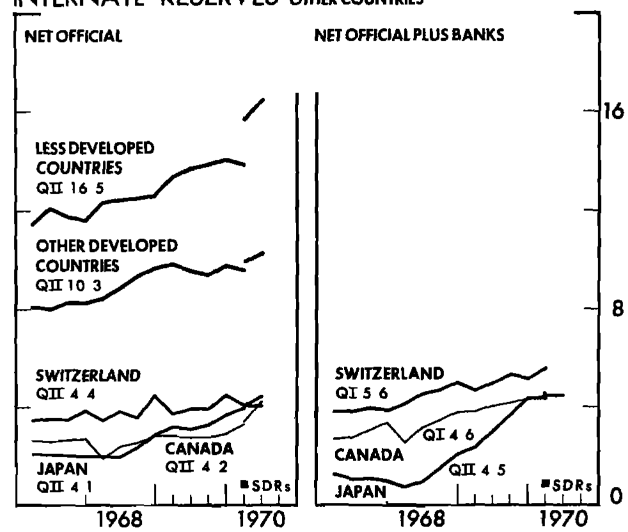
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

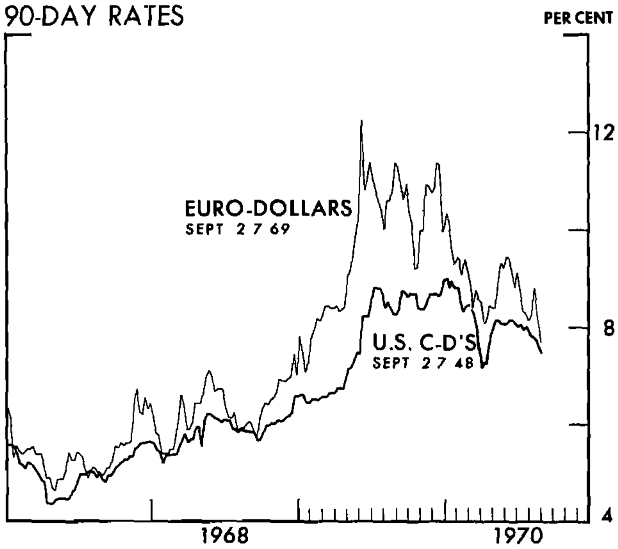
INTERNATL RESERVES EEC COUNTRIES



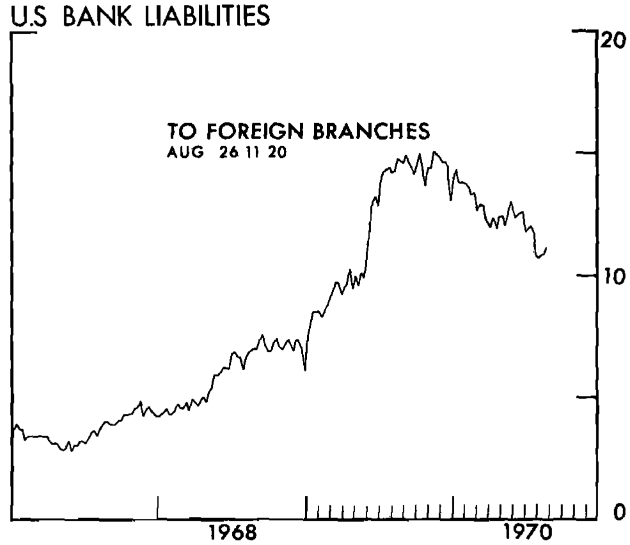
INTERNATL RESERVES OTHER COUNTRIES



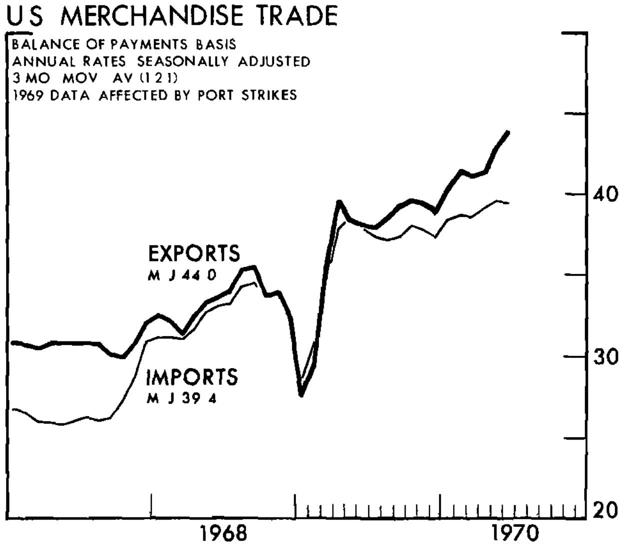
90-DAY RATES



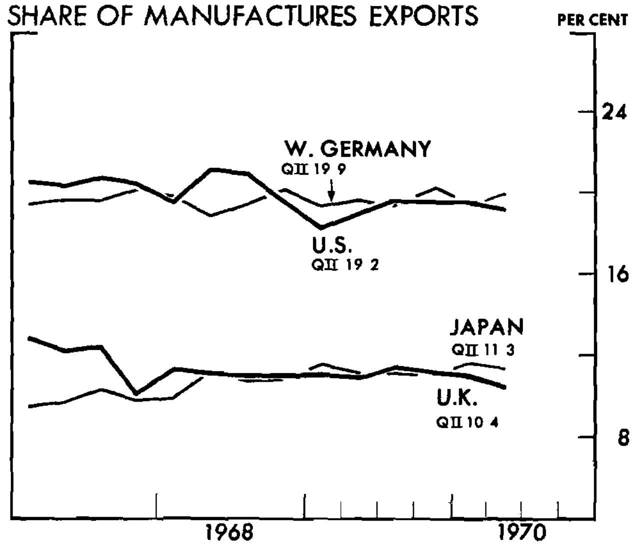
U.S BANK LIABILITIES



U S MERCHANDISE TRADE



SHARE OF MANUFACTURES EXPORTS



APPENDIX A: REVISED PROJECTIONS FOR HOUSING STARTS AND RESIDENTIAL EXPENDITURES*

Greenbook projections of seasonally adjusted private housing starts and the related series for residential construction expenditures have been revised appreciably upward. The revisions reflect altered projections of inflows of funds to the major lending institutions--in line with the most recent fund flow data--and the evidence, based on the July spurt, that multifamily starts have more momentum than the drop in the second quarter of this year had suggested.

PRIVATE HOUSING STARTS AND
RESIDENTIAL CONSTRUCTION EXPENDITURES
(Seasonally adjusted annual rates)

	Starts, including farm (thousands of units)		Residential construction expenditures (billions of dollars)	
	Old	New	Old	New
1970-QI	1,252	1,252	29.1	29.1
QII	1,280	1,280	28.4	28.4
QIIIp	1,350	1,490	29.0	30.0
QIVp	1,500	1,533	31.7	32.6
1971-QIp	1,575	1,650	34.1	34.7
QIIp	1,625	1,750	35.2	36.1

p - Projected.

Because of the lag between net inflows of funds to mortgage lenders and housing starts, starts for the remainder of this year are essentially established by the level of net inflows and commitments that occurred in the first half of this year. By the same token, of course, the starts pattern for the first half of next year still remains largely to be determined. Assuming the money stock rises at an annual rate of about 5 per cent over the rest of the year, staff projections are that net inflows to thrift institutions will be at an annual rate of 7.5 per cent and at about a 12 per cent annual rate for consumer-type time and savings deposits at commercial banks. This means that even if flows to the life insurance companies fall below the earlier projection, net inflows to the four lending institutions

* Prepared by Bernard Freedman, Economist, Capital Markets Section, Division of Research and Statistics.

combined may now exceed $20 billion for the second half as a whole or about $4 billion more than was projected earlier. (If, moreover, large CD's to commercial banks were also included, the combined level would actually be raised substantially further.) Allowing for repayment flows of at least $21 billion to the four intermediaries during this period, and for direct support on the order of $4 billion from FNMA, GNMA and the FHLBB in the same interval, total loanable funds could come to nearly $45 billion. This would compare with only $30 billion a year earlier.

Because of institutional and other shifts over the past few years, the relationship between flows to the major intermediaries in a given half-year period and actual housing starts during the subsequent half year--the "funds/starts-commitment ratio"--has, of course, varied considerably over time. However, in determining the size of the ratio for this period, attention must be given not only to the magnitude of the over-all rise in net inflows now expected, but also to its composition.

Commercial banks have received a very large share of the increased net inflows. This has taken the form of the extremely large expansion in regular time and savings deposits and an even greater expansion than had been projected earlier for CD's. The expansion in time deposits together with the distributional effect by type of bank of the recent reserve requirement reduction gives reason to expect that commercial banks will contribute much more than their normal share to construction lending and the mortgage market in general.

At the same time, the projected rise in net inflows to the thrift institutions which specialize in mortgage lending is substantial and would come at a time when their own liquidity positions have already been much improved and when additional assistance from the Federal Home Loan Banks is readily available. Moreover, given the possibility that mortgage rates will ease further, all lenders will most likely be tempted to attempt to "lock in" commitments to the extent possible.

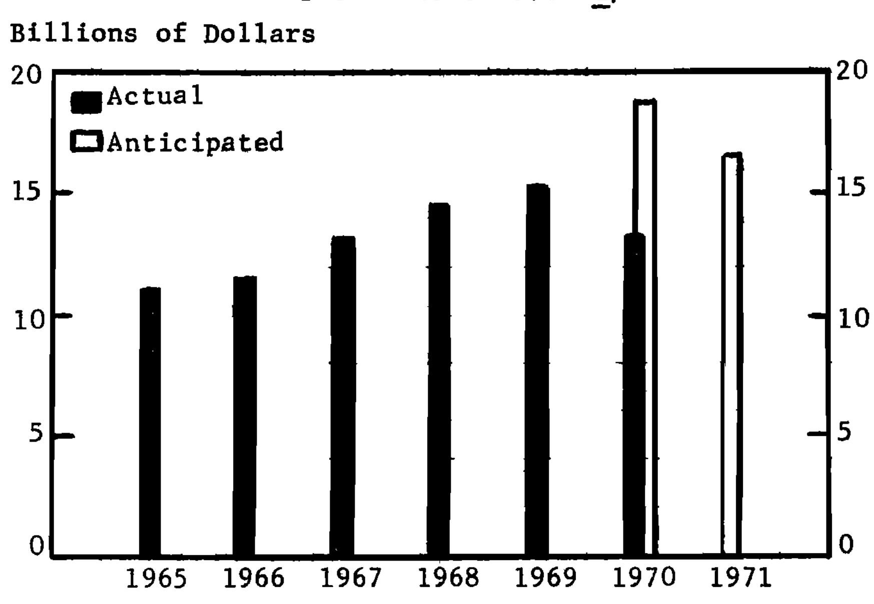
There are, of course, a number of factors that will tend to limit the rise in housing starts even with the improvement in funds-availability indicated. Among these are the strong possibility of a revival in refinancing activity for existing homes. Also, the generally high costs of housing and the still high level of mortgage rates will continue to be a resistance factor, although some allowance has been made in the projection for a tendency--particularly by builders of single family homes--to operate to a greater extent than earlier in the lower-priced home market. (This allowance is, of course, included in the expenditures figures shown in the table.) However, given the extent of underbuilding that has prevailed since 1965 and the exceptionally low level of vacancy rates for both multifamily and single-family housing, the improved availability of funds which presently seems tenable raises the prospects for a more rapid expansion next year than seemed possible earlier this year.

APPENDIX B: STATE AND LOCAL GOVERNMENT BORROWING ANTICIPATIONS AND REALIZATIONS*

Preliminary results of the second annual FRB-Census survey of State and local government long-term borrowing anticipations, conducted as of June 30, 1970, suggest that these units plan gross long-term borrowing of $16.6 billion over the course of fiscal year 1971 (July 1970 through June 1971).1/ Of this amount, over $13 billion had already been authorized by the electorate or appropriate legislative body. On the basis of the survey, the staff calculates that an additional $3.3 billion of planned borrowing not yet legally authorized will probably receive approval during the fiscal year, bringing total anticipations to over $16 billion.

These anticipations for fiscal 1971 are significantly more modest than the $18.8 billion of planned borrowing for fiscal year 1970, indicated by the first FRB Survey,2/ although $3.3 billion more than the actual borrowing carried out during that period. The year-over-year reduction in anticipations probably reflects increased

Actual and Anticipated Long-term Borrowing
State and Local Governments
Fiscal 1965-1971 1/



1/ Anticipations were gathered by the first and second annual surveys (fiscal 1970 and 1971).

1/ Census is responsible for the design of the sample as well as the polling of respondents. Its cooperation, diligence and expertise have added much to the quality of this survey.
2/ See Greenbook appendix of September 5, 1969.
* Prepared by Paul Schneiderman, Economist, Capital Markets Section, Division of Research and Statistics.

uncertainty, given the disappointing borrowing experience of fiscal year 1970 when market conditions forced the first decline in actual borrowing in a decade. Should tax-exempt yields continue to decline over the next few months, however, it would be reasonable to assume that follow-up surveys will indicate increased borrowing anticipations.

I. STATE AND LOCAL GOVERNMENTAL BORROWING REALIZATIONS DURING FISCAL YEAR 1970

The four follow-up surveys of State and local government borrowing realizations for fiscal year 1970 indicated that high interest rates induced approximately $6 billion in gross cumulative shortfalls from planned long-term borrowings. Even after allowing for borrowings repeatedly offered but not carried through, successful sales of previously deferred bond issues, and downward revisions in borrowing plans due to high interest rates, it appears that net unsatisfied borrowing demands induced both directly by the high cost of money and by legal rate ceilings over the 12-month interval came to between $4 and $5 billion.3/ Shortfalls of this magnitude are equal to 30 to 40 per cent of the $13.25 billion in long-term borrowing actually accomplished in fiscal year 1970. It is estimated that for the fiscal year as a whole, State and local government capital outlays (net) were reduced by $2 billion as a result of credit market conditions. Approximately half of these cutbacks occurred among local school districts. For the entire State and local sector, capital spending cutbacks stemming from high interest rates were equivalent to about 9 per cent of actual construction spending in fiscal year 1970.

Borrowing Shortfalls

Table 1 displays the quarterly pattern of the long-term borrowing experience of State and local governments in fiscal year 1970, based on the quarterly follow-up surveys. The columns give, respectively, the amount of long-term borrowing actually accomplished, gross cumulative borrowing shortfalls induced by high interest rates, downward revisions in ensuing quarterly borrowing plans induced by high interest rates (shown in the quarters that they were revised), and

3/ All data, unless otherwise indicated, unfortunately cumulate borrowing shortfalls at each occurence for issues rescheduled and repeatedly postponed. More precise estimates of the net impacts of high interest rates and other factors on the borrowing experience of the units will be available when the quarterly data have been tabulated on a unit-by-unit basis. Moreover, the overall accuracy of the sample's responses is being checked through the use of Investment Bankers Association's records of bond sales.

resumption of issues previously delayed because of high interest rates.4/ The final column shows "net" interest rate impacts.

Table 1

LONG-TERM BORROWING ADJUSTMENTS INDUCED BY HIGH INTEREST RATES
Fiscal year 1970 (1969-III to 1970-II)
(Billions of dollars)

Calendar Quarter	Actual Borrowing	Interest Rate Impacts1/ Short-falls2/	Downward Revisions	Comebacks of Previously Induced Postponements3/	Net Interest Rate Impacts4/
	(1)	(2)	(3)	(4)	(5)
1969-III	2.46	1.67	n.a.	n.a.	n.a.
IV	2.98	2.24	.40	.69	1.95
1970-I	4.10	.97	.40	1.20	.17
II	3.71	1.10	.46	.40	1.16
Total	13.25	5.98	1.265/	2.295/	3.285/

1/ Adjustments to actual borrowing which would have taken place if not for adverse market conditions.
2/ Gross (i.e., units continually rescheduling, but not successfully borrowing due to interest rates, as shortfalls at each postponement).
3/ Borrowing previously postponed due to high interest rates.
4/ Columns 2+3-4.
5/ Three quarter totals only.

Long-term borrowing shortfalls were concentrated in the last two quarters of calendar 1969 when interest rates on municipal bonds rose by over 100 basis points. Approximately two-thirds of all displacements during the fiscal year occurred in those two quarters. The easing of municipal bond market conditions in the first quarter of 1970

4/ The actual borrowing data are from the IBA. The survey units (on a blown-up basis) accounted for $12.5 billion, or 95 per cent of the universe of borrowing. About $1 billion of the sample's borrowing evidently took place in the first half of 1970 (the last half of the survey year) after respondents involved expressed no intention to borrow during that period.

caused a rapid turnaround in the volume of sales. On the basis of the Board's preliminary survey of State and local government realizations, it appears that approximately $1.2 billion of the borrowing accomplished in that quarter represented successful issuance of long-term issues previously postponed because of high interest rates. Nevertheless, the continued high level of interest rates still induced approximately $1 billion in long-term borrowing shortfalls among units that had originally planned to borrow in the first quarter of 1970. Hence, while some earlier borrowing shortfalls were made up when conditions eased, these successful fundings were accompanied by another--if smaller--round of postponements by other State and local governments. As interest rates rose in the second calendar quarter of 1970, the volume of "comebacks" declined sharply, while shortfalls increased somewhat.

Altogether, $6 billion of gross cumulative long-term debt sales planned for fiscal year 1970 were not accomplished because of higher interest rates. In addition, it is estimated that units revised their borrowing expectations downward by about $1.2 billion primarily because of high interest rates. Offsetting these two setbacks were an estimated $2.3 billion in comebacks of long-term debt that had been postponed earlier at least in part for interest-rate reasons. These comebacks were particularly large in the first quarter of 1970, accounting for about 30 per cent of the $4.1 billion in actual long-term debt sales in that quarter.

Effects on Capital Spending

Table 2 displays the pattern of capital spending cutbacks induced by high interest rates as reported in the quarterly follow-up surveys. Such cutbacks were by far most severe in the last half of calendar 1969, although they continued in early 1970. The figures reported show spending cutbacks initiated as the result of unrealized borrowing in each quarter. Also shown are projects that evidently were resumed when previously postponed borrowing was later carried out. These data do not give temporal net impacts, both because in some instances the same construction cutbacks were reported in more than one quarter and because the entire impact is shown for the quarter of the borrowing shortfall. Moreover, they do not make allowance for cutbacks due to downward revisions in borrowing expectations for future quarters. Tabulations have not yet been completed to calculate these influences accurately; nevertheless it appears that net construction cutbacks (counting each deferred project only once) amounted to approximately $2 billion over fiscal 1970.

Table 2

CONSTRUCTION SPENDING AND CONTRACT AWARD CUTBACKS INDUCED BY HIGH INTEREST RATES, FISCAL YEAR 1970 (1969-III to 1970-II)

(Millions of dollars)

Calendar quarter	Contract and spending cutbacks 1/	Makeups of cutbacks 2/
69-III	680	n.a.
69-IV	1,200	75
70-I	200	400
70-II	250	60
Total	2,330	535 3/

1/ Midpoint of range given by addition of proxy amounts of spending reduction where units indicated spending cutbacks but failed to give a dollar estimate.
2/ Projects evidently reinstated when deferred issues were sold later in the year.
3/ Three quarter total.

Table 3 gives a breakdown of capital spending reductions by type of government. Given the limitations on the data indicated above, it appears that the bulk of spending cutbacks induced by high borrowing costs occurred in school districts, amounting to over $1.0 billion. For local government units of all types, reported spending impacts resulting from high interest rates came to an estimated $1.7 billion, or about 13 per cent of actual construction expenditures by such units in fiscal year 1970. State units fared somewhat better, their reductions amounting to less than 6 per cent of their actual total construction spending for the fiscal year.

Table 3

CAPITAL SPENDING AND CONTRACT AWARD CUTBACKS INDUCED BY HIGH INTEREST RATES RELATIVE TO ACTUAL CONSTRUCTION SPENDING
Fiscal year 1970 (1969-III to 1970-II)

	Contract and spending cutbacks 1/ (Millions of dollars)	Actual construction spending 2/ (Millions of dollars)	Ratio (per cent)
State 3/	640	11,300	5.7
County	120		
City & town	360	12,800	13.2
Special Dist.	110		
School Dist.	1,110		
Total	2,340	24,100	9.7

1/ Long-term borrowing shortfalls induced by high interest are given in Table 1.
2/ Census Bureau.
3/ Includes state colleges.

For the past few years, State and local construction expenditures had been growing by approximately $2 billion a year. However, figures recently released by the Bureau of the Census show that in fiscal 1970, State and local construction spending fell by 3 per cent, or by approximately $800 million, from the previous year. While other factors may have played a role in this strong reversal of trend, it appears that high interest rates were the dominant cause. Moreover, given the long lags inherent in the capital spending impacts, the effects of past monetary restraint will continue to be felt for some time to come.

Alternative Means of Financing

Table 4 gives the quarterly pattern and yearly total of alternative sources used to compensate for long-term borrowing shortfalls due to high interest rates by units that did not reduce their capital spending as the result of borrowing shortfalls.5/ The experience of fiscal 1970 verifies both the heavy reliance placed on short-term borrowing and the relative lack of importance of current budget aids, such as inter-governmental loans and reductions in current expenditures.

5/ Again, these tables are based on quarterly experiences and therefore involve some continuations of issues which were postponed for more than one quarter.

Table 4

ALTERNATIVE MEANS OF FINANCING SHORTFALLS DUE TO HIGH INTEREST RATES
Fiscal Year 1970 (1969-III to 1970-II)

(Millions of dollars)

	Year/quarter				Total	Per cent of total
	69-III	69-IV	70-I	70-II		
Short-term borrowing	464	437	342	526	1,769	60
Reductions in liquid assets	60	175	140	73	448	15
Reductions in current expenditures	9	4	15	0	28	1
No immediate need	128	71	86	129	414	14
Governmental loans	13	79	13	56	161	5
Other means	50	31	52	2	135	5
Total	724	797	648	786	2,955	100

Of the $3 billion in interest rate induced shortfalls that did not lead to spending cutbacks, 60 per cent or $1.8 billion was alternatively financed through short-term loans. The bulk of the remainder was covered by reductions in current assets (15 per cent) and by the fact that the bond proceeds were not immediately needed for construction purposes (14 per cent).

Although the conclusion must remain tentative at this stage, it nonetheless is evident that one-half of the $3.6 billion increase in State and local short-term debt in fiscal 1970 was attributable to long-term borrowing postponements induced by high interest rates.

II. LONG-TERM BORROWING ANTICIPATIONS: FISCAL YEAR 1971

The June 30, 1970 Federal Reserve Board survey of State and local governments long-term gross borrowing expectations for fiscal year 1971, conducted by the Governments Division of the Bureau of the Census in replies from 4,226 sample units indicates planned fiscal year 1971 borrowing of $16.6 billion.6/

6/ On a unit basis, the response rate was 96 per cent; nevertheless, the response rate in dollar terms is much higher. Those units not reporting represent only a small share of actual borrowing (approximately 1 to 3 per cent).

Planned Borrowing by Quarter

Table 5 presents the survey results for fiscal year 1971 by quarter. It is estimated that approximately one half of the not yet approved issues will gain approval by the proper authorizing body during the fiscal year.7/ Experience with the survey suggests that plans for the immediate future are more certain than expectations for the later quarters of the fiscal year. A repolling of our sample will take place late in December in order to gain better estimates for third and fourth quarter anticipations.8/

Table 5

ANTICIPATED GROSS LONG-TERM BORROWING BY STATE AND LOCAL GOVERNMENTS BY QUARTERS OF FISCAL 1971
(Billions of dollars)

	July-Sept. 1970	Oct.-Dec. 1970	Jan.-Mar. 1971	Apr.-June 1971	Fiscal year 1971
Authorized	5.05	3.76	1.95	2.59	13.35
Unauthorized	.89	2.27	1.83	1.50	6.49
Total	5.94	6.03	3.78	4.09	19.84
Adjusted total 1/	5.50	4.90	2.86	3.34	16.60

1/ Authorized plus 50 per cent of unauthorized, assuming that 50 per cent of unauthorized is approved and sold according to schedule.

7/ This estimate is based on the assumption that the bulk of not yet authorized debt represents scheduled bond elections. Lately, about 50 per cent of dollar volume of issues has been approved in these elections.

8/ The survey system has been redesigned to allow for more accurate reporting. Anticipations will now be gathered semi-annually so that we may ascertain changes in expectations due to expected changes in conditions and past performance of State and local units in the municipal market place.

Comparison with Earlier Period and Recent Developments

The anticipated borrowing for fiscal year 1971 represents a return to a higher pace of long-term financing after the turndown in actual borrowing in fiscal 1970. The long-term borrowing anticipations by State and local units represent an increase over actual fiscal 1970 levels of about $3.3 billion. This figure may even move higher should credit conditions continue to relax, and postponed issues reenter the market.

Table 6

ACTUAL AND ANTICIPATED GROSS LONG-TERM BORROWING BY STATE AND LOCAL GOVERNMENTS 1/
(Billions of dollars)

Quarter	Calendar Year			
	1968	1969	1970	1971
I	3.7	2.8	4.1	2.9 antic.
II	3.9	3.8	3.7	3.3 antic.
III	4.6	2.5	5.5 antic.	--
IV	4.4	3.0	4.9 antic.	--

1/ Investment Bankers Association data through 1970-II, adjusted anticipations thereafter.

However, shortfalls are already apparent for the third calendar quarter of 1970. With two months of this period already complete, staff estimates imply shortfalls from expectation of about $1.3 billion in the current quarter. These shortfalls can still be attributed mainly to the high cost of borrowing but expectations of further declines in interest rates may also be partly responsible. At the end of September, units planning to borrow this quarter will be surveyed, and reasons for the shortfall will be available by November. But, in any event, if market conditions improve in the October to December quarter, it is likely that continued attempts at reentry by previously postponed issues will lead to a sharp increase in actual long-term financing--as well as anticipated borrowing--over the balance of fiscal 1971.