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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

November 10, 1970

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INTERNATIONAL DEVELOPMENTS IV

SUMMARY AND OUTLOOK

Nonfinancial

The extended GM strike, along with weakness in some key sectors not directly affected by the strike, may result in no change, or a slight decline, in real GNP in the fourth quarter. Industrial production is tentatively estimated to have dropped about 2-1/2 per cent further from September to October; somewhat more than half of this was attributable to the auto industry and its suppliers, but the decline in other industries was larger than in September. Output of business and defense equipment fell further in October, as did output of most materials. The shortage of GM autos resulted in a decline in total retail sales from September to October, but sales other than for autos increased after showing little net change since April.

The labor market weakened further in October with the unemployment rate edging up to 5.6 per cent from 5.5 per cent in September. A sharp reduction in nonfarm employment was largely attributable to the direct and indirect effects of the GM strike. Nevertheless, weakness was also fairly widespread among other manufacturing industries, although employment rose moderately in nonmanufacturing activities.

The latest price information for the most part suggests a somewhat slower response than we had anticipated to easing demands and to ample margins of unused manpower and industrial resources. The sharpness of the increase in wholesale prices of industrial commodities, seasonally adjusted, from mid-September to mid-October was largely the result of a considerable advance in prices on new model autos. But numerous other increases also were posted. Most of the rise in industrial commodity prices was offset in the total index, however, by a substantial decline in prices of farm products. After several months of moderating increases, consumer prices rose more rapidly in September, but the increase over the quarter still was smaller than over the preceding two quarters.

Outlook. After discounting GM strike effects (estimated at around $5 billion on current dollar GNP in the fourth quarter, our analysis of recent data suggests that the economy is not very expansive. On balance, we now expect no change this quarter from last in total real GNP, on the assumption that autos will be in full production by early December. Next quarter, we expect a very large advance in current dollar GNP, with real GNP growth around a 4 per cent rate, as strike losses are partially made up. But the rates of nominal and real growth are projected to fall back in the second quarter, as auto output--reflected in auto sales and inventories--is cut back from its catch-up pace.

The expansion in real GNP from the third quarter of 1970 to the second quarter of 1971 is projected to average only about a 2 per cent annual rate. Further sizable advances in residential construction activity and State and local purchases are expected, and consumer spending is projected to increase moderately. On the other hand, business spending on fixed capital is expected to decline moderately in dollar terms and more in real terms. This pattern appears consistent with the continued weakness in new orders for capital equipment and with the marginal increase in spending indicated for 1971 in the recent McGraw-Hill Survey.

With growth in real GNP expected to be smaller to mid-1971 than in our previous projection, we have raised the unemployment rate and lowered the manufacturing capacity utilization rate. The recent behavior of prices and very large increases in wage rates--past and in prospect following the GM settlement--suggest the continued stubborness of inflationary price pressures. Although price increases are still expected to slow, we have raised the rate of projected increase in the GNP deflator next spring from 3 per cent to around a 3-1/2 per cent annual rate.

Financial

Interest rates have declined significantly in long as well as short-term markets over the past two weeks as softness in the economy and a sharp drop in business borrowing at banks have led market participants to anticipate cuts in the prime rate and the discount rate. In this changing market environment the November Treasury financing proved to be a resounding success, and new corporate and municipal bonds began to be readily distributed even at declining yields. Currently, bond yields are again close to or somewhat below their levels prevailing at the time of the last Committee meeting, and short rates are substantially below theirs.

Contraction of business borrowing at banks intensified in October. While loan repayments financed by heavy capital market borrowing probably contributed importantly to this shrinkage, the general softness of the economy and the spreading effects of the General Motors strike also exerted a strong influence. With overall loan growth very small, banks continued to add substantially to their investment portfolios, chiefly in State and local government securities.

Weakness in the economy, including strike effects, apparently also affected the demand for money balances. Thus, the average level of the money stock in October was about unchanged from September. Growth of time and savings deposits slowed somewhat from the very rapid July-September rate, although net funds provided to banks from this source still remained very large. Nevertheless, with U.S. Government deposits declining, and banks continuing to reduce their reliance on nondeposit sources of funds, growth of total bank credit, as measured by the adjusted credit proxy, virtually halted.

Preliminary data for nonbank thrift institutions suggest that their savings inflows continued relatively large in October, particularly after allowance for seasonal factors. As a result, the build-up of loan commitments and the enlargement of mortgage loan flows evident at these institutions during the third quarter were apparently extended into October.

Outlook. If full production of autos is resumed by early December, as is assumed in the economic projection, business and consumer demands for bank credit are likely to strengthen appreciably, although the full effect of this change may not develop until after the turn of the year. As these demands develop, it would not be surprising if banks became somewhat more aggressive in the CD market than recently and/or slowed the rate at which they repaid nondeposit sources of funds. However, business loan repayments financed by new issues of securities are likely to remain large at least through year-end, and with commercial paper rates now below the prime rate, some prime borrowers may elect to finance short-term needs outside the banks. On balance, therefore, with rate ceilings no longer a constraint on the sale of CD's, banks should have ample leeway to move toward more expansive loan policies.

Business financing in capital markets is scheduled to remain large in November and probably December (after adjustment for the usual holiday lull). Moreover, early listings for the January calendar are on the high side for this far ahead. There are scattered reports from underwriters, however, of fewer large corporate financing projects in the pipeline, and this might be the first indication of the drop-off in corporate capital market borrowing generally anticipated sometime in early 1971.

In the State and local government bond market, expanded bank interest in October stimulated the largest volume of new offerings for any month since October 1968. While listings for November and December now appear to be somewhat lighter than for October, future months are likely to see enlarged calendars again, given the large back-log of already authorized issues. In the market for Treasury debt, on the other hand, once the Treasury has completed its seasonal cash borrowing--with an expected $2 billion offering of Treasury bills for payment early in December--no further need for new cash is anticipated until late February or early March. Likewise, borrowing by Federal agencies is expected to slacken appreciably, due mainly to reduced new money requirements of the Home Loan Bank System.

The expected reduction of FHL Bank borrowing partly reflects a presumption that S&L's will continue to refrain from borrowing and--in the spring--begin to use more of their future net savings inflows to repay FHLB advances. At the same time, any significant resurgence of consumer spending following the strike--or for that matter any continuation of the strike beyond the point of exhaustion of the union strike fund--may cause some slowing in the pace of consumer-type savings flows to all types of thrift institutions--including commercial banks. Since the degree of slowing is not expected to be very drastic, however, conditions in mortgage markets should continue to ease.

On balance, when the financial outlook is viewed _in toto_, credit demands still appear strong enough to cushion declines of long-term interest rates in the absence of a significant further easing in money market conditions that would be taken as a reflection of a change in monetary policy. Moreover, again on the assumption of unchanged money market conditions, short-term credit market rates may decline little further, if at all, in view of the sharp anticipatory drop off in rates that has already occurred.

Balance of payments

The sharp drop in imports in September expected at the time of the last meeting did not materialize after all, and the trade surplus now appears to have been a little smaller in the third quarter than in the second, not larger. Nevertheless, with our current projections of slack domestic demand and an anticipated pickup in commercial aircraft export deliveries, we expect the trade balance to improve somewhat in the current quarter and the next.

Projections of foreign countries' demand in world trade in the current period and on into next year have been reduced a little since last summer. Industrial production in Western Europe has been virtually level since the beginning of 1970, but forecasts are that output may be rising again before long. This year's leveling off seems to have reflected a drop in inventory investment demand, while the growth of final sales (in real terms) has not ceased. Inflationary pressures continue to be felt from the side of wage costs--though in some countries not so strongly as at the beginning of 1970--while some easing on the demand side is becoming noticeable, particularly for machinery and equipment.

This outlook carries mixed implications for U.S. exports. With costs and prices rising both here and abroad, no clear trend in the international competitive position in finished goods is visible. Order backlogs for machinery are still large in Europe, and U.S. exports in this category should continue strong. Growth in U.S. exports of materials, however, is likely to slow.

In the over-all balance of payments, the marked improvement (on the liquidity basis) in the third quarter--a drop to a $3 billion annual rate from a $6-1/2 billion rate in the first half--was the result mainly of a favorable swing in U.S. bank lending to foreigners and a renewal of foreign buying of U.S. stocks. A substantial shrinkage of U.S. corporate outflows is expected at the end of the year, to keep within the limits set by the direct investment control regulations. However, with U.S. credit conditions easing, U.S. bank lending flows may be less favorable this quarter than in the third quarter. Farther ahead, the trends of private capital flows will be influenced by the relative degrees of easing in financial markets here and abroad.

The outlook for the official settlements balance continues to be more unsatisfactory than for the liquidity balance. Repayment of Euro-dollar borrowings by U.S. banks has been going on at a moderate but fairly steady pace, and seems likely to continue.

October 10, 1970

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SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1970				Per Cent Change* From		
	July	Aug.	Sept.	Oct.	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	82.8	82.7	83.0	83.4	0.4	0.7	2.2
Unemployment rate (%)	5.0	5.1	5.5	5.6	--	--	[3.8] 4/
Insured unempl. rate (%)	3.6	3.7	4.1	n.a.	--	--	[2.2] 4/
Nonfarm employment, payroll (mil.)	70.6	70.4	70.6	70.1	-0.7	-0.6	1.0
Manufacturing	19.4	19.3	19.3	18.7	-3.2	-3.7	-7.6
Nonmanufacturing	51.2	51.1	51.3	51.4	0.2	0.5	1.7
Industrial production (57-59=100) 5/	169.2	168.9	166.0	n.a.	-1.7	-1.7	-4.5
Final products, total	167.5	166.8	162.9	n.a.	-2.3	-2.5	-5.4
Consumer goods	164.7	164.2	160.3	n.a.	-2.4	-1.5	-1.5
Business equipment	186.1	184.9	181.1	n.a.	-2.1	-3.7	-9.6
Materials	171.8	170.9	168.8	n.a.	-1.2	-1.4	-4.1
Capacity util, rate, mfg.	77.3	76.6	74.7	n.a.	--	--	[83.7] 4/
Wholesale prices (57-59=100) 1/	117.7	117.2	117.8	117.8	0.0	0.1	3.3
Industrial commodities (FR) 5/	115.9	116.1	116.3	n.a.	0.2	0.5	3.7
Sensitive materials (FR) 5/	114.7	114.5	114.0	n.a.	-0.4	-1.6	0.4
Farm products, foods & feeds	119.3	117.0	118.5	116.0	-2.1	-2.8	1.5
Consumer prices (57-59=100) 1/ 5/	135.7	136.0	136.6	n.a.	0.4	1.0	5.6
Food	133.4	133.5	133.3	n.a.	-0.1	0.5	4.5
Commodities except food	122.9	123.0	123.8	n.a.	0.7	0.8	4.3
Services	155.8	156.7	157.7	n.a.	0.6	1.7	8.0
Hourly earnings, pvt. nonfarm ($)	3.23	3.26	3.26	3.27	0.3	1.2	5.1
Hourly earnings, mfg. ($)	3.38	3.41	3.42	3.38	-1.1	0.0	4.0
Weekly earnings, mfg. ($)	135.82	135.21	133.96	133.32	-0.5	-1.8	1.2
Net spend. weekly earnings, mfg. (3 dependents 57-59 $) 1/ 5/	85.84	85.46	86.27	n.a.	0.9	0.2	-2.2
Personal income ($ bil.) 2/ 5/	803.3	806.4	811.8	n.a.	0.7	1.7	6.4
Retail sales, total ($ bil.) 5/	30.7	30.8	30.8	n.a.	0.1	1.0	5.3
Autos (million units) 2/	8.5	8.4	7.1	6.1	-13.0	-27.8	-26.9
GAAF ($ bil.) 3/ 5/	8.3	8.3	8.2	n.a.	-0.7	0.4	4.3
12 leaders, composite (1967=100) 5/	115.8	114.6	113.4	n.a.	-1.0	-0.6	-4.3
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/ 5/	1,603	1,412	1,504	n.a.	6.5	8.0	1.6
Factory workweek (hours)	40.1	39.8	39.3	39.4	0.3	-1.7	-2.7
Unempl. claims, initial (thous.) 5/	270	298	342	n.a.	-14.8 6/	-9.5 6/	-70.2 6/
New orders, dur. goods ($ bil.) 5/	31.4	30.5	29.6	n.a.	-3.0	-1.4	-7.4
Producers capital goods indus.	6.4	6.3	6.7	n.a.	5.8	6.1	-6.0
Common stock prices (41-43=10)	75.72	77.92	82.58	84.37	2.2	11.4	-11.7

* Based on unround 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 September 1970. 6/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	1970 Averages					1970
Interest rates, per cent	QI	QII	QIII	Sept.	Oct.	Week ended Nov. 4
Federal funds	8.56	7.88	6.71	6.29	6.20	6.07
3-mo. Treasury bills	7.21	6.67	6.33	6.13	5.91	5.74
3-mo. Federal agencies	7.72	7.09	6.67	6.56	6.23	5.92
3-mo. Euro-dollars	9.26	8.87	8.34	8.03	7.94	7.50
3-mo. finance co. paper	7.94	7.41	7.31	7.12	6.76	6.61
4-6 mo. commercial paper	8.55	8.16	7.73	7.32	6.85	6.63
Bond buyer municipals	6.35	6.81	6.33	6.25	6.39	6.40
Aaa corporate-new issues	8.45	8.94	8.51	8.42	8.55	8.77
20-year Treasury bonds	6.78	7.14	6.96	6.88	6.88	6.84
FHA mortgages, 30-year	9.25	9.12	9.06	9.01	n.a.	--

	1970				
Change in monetary aggregates (SAAR, per cent)	QI	QII	QIII	Sept.	Oct.
Total reserves	- 2.9	2.6	19.2	27.5	5.5
Nonborrowed reserves	- 0.4	4.1	24.4	40.5	9.6
Credit proxy	0.6	6.0	24.1	19.0	9.7
Credit proxy + nondep. funds	0.5	6.5	17.2	9.7	0.5
Money supply	3.8	4.2	5.1	1.2	- 1.2
Time and savings deposits	0.4	13.8	31.8	29.5	22.1
Deposits at S&L's and MSB's	1.7	6.9	10.0	10.5	9.8
Bank credit, end-of-month 1/	2.5	6.6	13.9	7.3	- 1.7
Treasury securities	-12.3	30.2	25.9	2.1	-27.1
Other securities	9.5	11.0	20.3	32.8	30.5
Total loans 1/	3.4	1.4	9.8	1.6	- 5.3
Business 1/	6.3	9.8	1.8	- 8.4	-13.8

	1970				
Change in commercial paper (in mil. of $)	QI	QII	QIII	Sept.	Oct.
Total, SA	3,185	2,091	-4,298	-1,413	- 132
Bank related, NSA	2,226	1,033	-2,967	-2,670	- 915

	1968	1969			1970	
New security issues (NSA, $ mil.)	H2	H2	QIII	Oct.	QIII	Oct.
Total corp. issues	11,083	13,172	6,332	1,933	8,798e	3,800e
Public offerings	7,801	10,769	4,984	1,620	7,661e	3,400e
State and local government bond offerings	8,978	5,446	2,464	1,280	4,376	1,900e
Fed. sponsored agency debt (change)	798	5,687	2,717	1,397	1,442	480e
Fed. gov't. debt (change)	11,072	9,811	4,740	4,388	7,366	2,693p

n.a. - Not available. e - Estimated. p - Preliminary.
SAAR - Seasonally adjusted annual rate. NSA - Not seasonally adjusted.
1/ Includes loans sold to affiliates.

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

	1969 Year	1970 P I	II	III	SEPT. *
Goods and services, net 1/	1,949	851	1,119		
Trade balance 2/	638	518	847	780	167
Exports 2/	36,473	10,241	10,714	10,680	3,494
Imports 2/	-35,835	-9,723	-9,867	-9,900	-3,327
Service balance	1,311	333	272		
Remittances and pensions	-1,191	-328	-359		
Govt. grants & capital, net	-3,828	-855	-785		
U.S. private capital	-5,233	-1,686	-1,813		
Direct investment	-3,070	-1,411	-1,363		
Foreign securities	-1,494	-133	64	-352	3
Banking claims	-541	147	-459	134	-239
Other	-128	-289	-55		
Foreign capital	12,330	1,679	1,547		
Official foreign, liquid	-517	3,044	450	1,487	747
Official reserve holders, nonliquid	-996	-422	506	-243	-54
Other official foreign, nonliquid	259	-32	-175		
Foreign commercial banks, liquid	9,217	-1,916	-118	-1,359	-407
New direct investment issues 3/	1,029	155	267		
U.S. corporate stocks	1,565	-85	-123	364	207
Other	1,773	935	740		
U.S. monetary reserves (inc.-)	-1,187	481	1,022	801	269
Gold stock	-967	-44	14	395	323
Special drawing rights	--	-53	-37	-34	-30
IMF gold tranche	-1,034	-253	227	406	379
Convertible currencies	814	831	818	34	-403
Errors and omissions	-2,841	-144	-729		
BALANCES (deficit -) 4/					
Official settlements, S.A.		-3,103	-1,978	-2,045	
" " , N.S.A.	2,700	-2,829	-2,061	-2,612	-962
Liquidity, S.A.		-1,598	-1,421	-878	
" , N.S.A.	-7,012	-1,496	-1,412	-1,687	-508
Adjusted over-all, S.A.		-1,187	-1,860	-686	
" " , N.S.A.	-6,517	-1,093	-1,858	-1,503	-555
Financed by: 5/					
Liab. to comm. banks	9,217	-1,736	-203	-1,109	-407
Official settlements	-2,700	2,829	2,061	2,612	962

* 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.

Gross national product. The economy continues to register weakness. The persistence of the GM strike into November has eroded activity levels this quarter and has tended to obscure underlying trends. But weakness in production and employment had continued prior to the strike, and October declines appeared to be larger than could be explained by the direct and indirect impact of the strike. Assuming that the strike is brought to an end by mid-November and that full-scale production is underway by December 1, we now anticipate growth of GNP of about $9 billion this quarter compared to the estimated increase of $14 billion last quarter. With price advances persisting and somewhat stronger than we had expected, we now expect no growth in real GNP for the current quarter.

The impact of the strike on fourth quarter GNP is being manifested mostly in consumer expenditures and inventories. As a result of the increasing shortage of 1971 model GM cars, we have further reduced our estimate of consumer durable goods outlays by $2 billion this quarter; our projection of nonfarm inventory investment is reduced by about $2-1/2 billion -- less because of an actual run-down of car stocks than because of the absence of the usual inventory build-up at this time of year.

Aside from the impact of the strike, the pace of activity has been modest so far this quarter. Even if allowance is made for the strike, auto sales in October were no better than the unimpressive third quarter rate. Other categories of retail sales look somewhat better; sales of furniture and appliance stores in October apparently showed the first appreciable improvement in six months, and we are estimating a good recovery for nondurable goods stores following two months of little change.

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

	Third Quarter	Fourth Quarter	
	Commerce Prel. 10/14/70	Projection of 10/14/70	Current Projection
	--------Billions of dollars---------		
GNP	14.1	12.5	9.3
Final Sales	13.1	14.0	13.3
Personal consumption	8.0	9.9	8.0
Residential construction	.7	2.6	2.9
Business fixed investment	.9	- .5	- .5
Net exports	.6	.3	1.0
Federal purchases	- .7	- 1.3	-1.2
State and local purchases	3.7	2.9	3.0
Inventory change	.9	- 1.5	-4.0
	-------------Per cent-------------		
Real GNP	1.4	1.5	- .2
GNP deflator	4.4	3.6	4.0

But output of business equipment has continued to trend down and we are still projecting a small downturn in dollar outlays for business fixed investment this quarter. On the other hand, residential construction activity continues to generate substantial additional strength with a broadly-based rise in starts and permits suggesting a rise in outlays in the current quarter of about $3 billion, somewhat more than we had anticipated last month. In addition, net exports appear likely to improve a little with merchandise exports expected to recover somewhat from their recent slowdown.

With the fourth quarter now expected to be weakened substantially further by the protracted strike, the first quarter increase in GNP should rebound sharply, to $22-1/2 billion as the loss in auto sales and output is largely made up. Sales of new domestic autos are expected to average about 9 million units, annual rate, and production about 9-1/2 million. We thus expect a strong gain of $15 billion in consumer outlays and a $2 billion increase in inventory investment.

Further gains in residential construction activity and faster growth of State and local government outlays should accompany the continuing easing of credit conditions, reflecting an assumed rate of growth of the money supply of about 5 per cent, and should provide an element of strength through next year. However, defense outlays and business fixed investment are expected to decline further and growth in consumer spending is likely to fall off sharply as auto sales drop back from the high rate in the first quarter catch-up period. As a result, the increase in GNP is expected to slip to about $13.5 billion in the second quarter. In order to avoid further distortion of the underlying situation, we have excluded from the projection any assumption of a probable build-up of steel stocks in the first half of the year as a hedge against a possible strike when the contract expires on July 31.

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

	First Quarter		Second Quarter	
	Projection of 10/14/70	Current Projection	Projection of 10/14/70	Current Projection
	----------------Billions of dollars-----------			
GNP	20.5	22.5	15.0	13.5
Final sales	20.2	20.5	12.1	11.5
Personal consumption	13.5	15.0	9.0	7.9
Residential construction	2.4	2.2	1.4	1.6
Business fixed investment	-1.0	-1.2	-1.0	-1.0
Net exports	.6	.3	.1	.2
Federal purchases	1.2	1.2	-1.2	-1.0
State and local purchases	3.5	3.0	3.8	3.8
Inventory change	.3	2.0	2.9	2.0
	-------------------Per cent-----------------			
Real GNP	3.8	4.3	2.9	1.7
GNP deflator	4.3	4.7 1/	3.0	3.6

1/ Excluding effects of Federal pay increase, 3.8 per cent per year.

Despite a fairly strong pickup in productivity in the past two quarters and an associated moderation of the rise in unit labor costs, price increases have continued at a disappointingly sharp rate in the industrial sphere. The wage settlement in autos will presumably be large and will likely set a pattern for upcoming negotiations in such important industries as cans, aluminum and steel. As a result, and reflecting also the likely reemergence of some increases in food prices by next spring, we have adjusted up our projections of the GNP deflator. But we still anticipate a moderate down drift, to a 3.6 per cent rate of increase by the second quarter of 1971 instead of the 3.0 per cent estimated previously. The annual rate of growth in real GNP is expected to average only 2 per cent over the current and the next two quarters, as compared to about 2-3/4 per cent in our previous projection, suggesting a sharper rise in unemployment and even less pressure on industrial resources. Hopefully, this will pave the way for a further easing of the rate of price increases in the latter part of 1971.

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

	1970 Proj.	1971 Proj.	1970 III	1970 IV	1971 Projection I	1971 Projection II	1971 Projection III	1971 Projection IV
Gross National Product	977.6	1,039.4	985.2	994.5	1,017.0	1,030.5	1,046.5	1,063.5
Final purchases	975.4	1,035.5	981.2	994.5	1,015.0	1,026.5	1,042.0	1,058.5
Private	754 8	802.4	759.9	771.3	787.6	796.3	806.8	819.0
Excluding net exports	750.3	796.3	755.2	765.6	781.6	790.1	800.6	812.8
Personal consumption expenditures	617.6	658.4	622.4	630.4	645.4	653.3	662.3	672.6
Durable goods	90.6	95.4	91.4	90.0	96.0	95.0	94.5	96.0
Nondurable goods	264.2	279.3	265.5	269.7	273.7	277.1	281.4	285 0
Services	262.8	283.7	265.4	270.7	275.7	281.2	286.4	291.6
Gross private domestic investment	134.9	141.8	136.8	135.2	138.2	140.8	142.8	145.2
Residential construction	29.7	36.5	29.1	32.0	34.2	35.8	37.3	38.7
Business fixed investment	103.1	101.4	103.7	103.2	102.0	101.0	101.0	101 5
Change in business inventories	2.2	3.9	4.0	0.0	2.0	4.0	4.5	5.0
Nonfarm	1.8	3.9	3.5	0.0	2.0	4.0	4.5	5.0
Net exports of goods and services	4.5	6.2	4.7	5.7	6.0	6.2	6.2	6.2
Gov't. purchases of goods & services	220.6	233.1	221 3	223.2	227.4	230.2	235.2	239.5
Federal	99.7	99.0	99.0	97.8	99.0	98.0	99.2	99.6
Defense	76.2	72.7	75.2	73.3	73.5	71.8	72.4	73.1
Other	23.6	26.3	23.8	24.5	25.5	26.2	26.8	26.5
State & local	121.0	134.1	122.4	125.4	128.4	132.2	136.0	139 9
Gross national product in constant (1958) dollars	725.8	741.3	727.5	727.1	734.9	738.0	743.1	749.2
GNP implicit deflator (1958 = 100)	134.7	140.2	135.4	136.8	138.4	139.6	140.8	142.0
Personal income	801.2	848.3	807.1	814.0	830.5	843.0	854.0	865.5
Wages and salaries	540.9	570.6	543.8	548.4	559.8	566.4	573.9	582.3
Disposable income	685.1	728.9	693.0	698.6	715.0	724.8	733.4	742.2
Personal saving	49.6	51.0	52.5	49.6	50.6	52.2	51.4	49.6
Saving rate (per cent)	7.2	7.0	7.6	7.1	7.1	7.2	7.0	6.7
Corporate profits before tax	82.5	85.9	83.5	82.0	84.0	85 0	86.0	88.5
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	195.5	206.6	194.5	195.0	201.6	204.9	208.0	211.9
Expenditures	206.4	221.0	207.7	209.1	216.8	220.3	222.4	224.4
Surplus or deficit (-)	-10.9	-14.4	-13.2	-14.1	-15.2	-15.4	-14.4	-12.5
High employment surplus or deficit (-)	-1.1	5.8	-3.0	1.8	3.1	5.6	7.0	7.4
Total labor force (millions)	85.9	87.2	86.0	86.4	86.7	87.0	87.4	87.7
Armed forces "	3.2	2.9	3.1	3.1	3.0	2.9	2.9	2.9
Civilian labor force "	82.7	84.3	82.8	83.3	83.7	84.1	84.5	84.8
Unemployment rate (per cent)	5.0	6.4	5.2	5.7	6.0	6.3	6.6	6.7
Nonfarm payroll employment (millions)	70.6	70.8	70.5	70.2	70.6	70.7	70.8	71.0
Manufacturing	19.5	19.1	19.3	18.9	19.2	19.1	19.1	19.1
Industrial production (1957-59=100)	167.9	168.8	168.0	163.5	167.0	167.7	169.0	171.5
Capacity utilization, manufacturing (per cent)	76.8	73.3	76.2	73.2	73.9	73.2	72.9	73.1
Housing starts, private (millions A.R.)	1.40	1.77	1 51	1 55	1.65	1.75	1.82	1.85
Sales new domestic autos (millions, A.R.)	7.57	8.79	7.99	6.98	9.10	8.80	8.50	8.75

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1970 Proj.	1971 Proj.	1970 III	1970 IV	1971 Projection I	1971 Projection II	1971 Projection III	1971 Projection IV
	Billions of dollars							
Gross National Product	46.2	61.8	14.1	9.3	22.5	13.5	16.0	17.0
Inventory change	-6.3	1.7	0.9	-4.0	2.0	2.0	0.5	0.5
Final purchases	52.5	60.1	13.1	13.3	20.5	11.5	15.5	16.5
Private	44.1	47.6	10.2	11.4	16.3	8.7	10.5	12.2
Excluding net exports	41.5	46.0	9.6	10.4	16.0	8.5	10.5	12.2
Net exports	2.6	1.7	0.6	1.0	0 3	0.2	0.0	0.0
Government	8.4	12.5	2.9	1.9	4.2	2.8	5.0	4.3
GNP in constant (1958) dollars	-1.3	15.5	2.6	-0.4	7.8	3.1	5.1	6.1
Final purchases	4.1	13.8	2.4	3.0	5.9	1.2	4.6	5.7
Private	9.5	15.1	2.4	3 5	6.8	1.5	3.0	4.7
	In per cent per year							
Gross National Product	5.0	6.3	5.8	3.8	9.0	5.3	6.2	6.5
Final purchases	5.7	6.2	5.4	5.4	8.2	4.5	6.0	6.3
Private	6.2	6.3	5.4	6.0	8.5	4 4	5.3	6.0
Personal consumption expenditures	6.9	6.6	5.2	5 1	9.5	4.9	5.5	6.2
Durable goods	0.7	5.3	-2.2	-6.1	26.7	-4.2	-2.1	6.3
Nondurable goods	7.5	5.7	4.4	6.3	5.9	5.0	6.2	5.1
Services	8.8	8.0	8.5	8.0	7.4	8.0	7.4	7.3
Gross private domestic investment	-3.5	5.1	7.4	-4.7	8.9	7.5	5.7	6.7
Residential construction	-7.2	22.9	9.9	39.9	27.5	18.7	16.8	15.0
Business fixed investment	3.8	-1.6	3.5	-1.9	-4.6	-3.9	0.0	2.0
Gov't. purchases of goods & services	4.0	5.7	5.3	3.4	7.5	4.9	8.7	7.3
Federal	-1.6	-0.7	-2.8	-4.8	4.9	-4.0	4.9	1.6
Defense	-3.3	-4.6	-8.3	-10.1	1.1	-9.2	3.3	3.9
Other	4.4	11.4	15.7	11.8	16.3	11.0	9.2	-4 5
State & local	9.2	10.8	12.5	9.8	9.6	11.8	11.5	11.5
GNP in constant (1958) dollars	-0.2	2.1	1.4	-0.2	4.3	1.7	2.8	3.3
Final purchases	0.6	1.9	1.3	1.7	3.2	0.7	2.5	3.1
Private	1.7	2.6	1.7	2.4	4.6	1.0	2.0	3.1
GNP implicit deflator	5.1	4.1	4.4	4.0	4.7 1/	3.6	3.4	3.2
Personal income	7.0	5.9	2.9	3.4	8.1	6.0	5.2	5.4
Wages and salaries	6.3	5.5	3.2	3.4	8.3	4.7	5.3	5.9
Disposable income	8.5	6.4	5.5	3 2	9.4	5.5	4.7	4.8
Corporate profits before tax	-9.5	7.5	7.3	-7.2	9.8	4.8	4.7	11.6
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	-2.5	5.7	-4.5	1.0	13.5	6.5	6.0	7.5
Expenditures	7.9	7.1	-6.1	2.7	14.7	6.5	3.8	3.6
Nonfarm payroll employment	0.4	0.3	-1.9	-1.7	2.3	0.6	0.6	1.1
Manufacturing	-3.5	-2.1	-5.9	-8.3	6.3	-2.1	0.0	0.0
Industrial production	-3.1	0.5	-3.1	-10.8	8.6	1.7	3.1	5.9
Housing starts, private	-4.6	26.4	68.4	12.5	25.0	24.2	17.1	5.5
Sales new domestic autos	-10.6	13.5	2.0	-50.5	121.6	-13.2	-13.6	11.8

1/ Excluding effects of Federal pay increase, 3.8 per cent per year.

Industrial production. Industrial production in October is tentatively estimated to have declined about 4 points or about 2-1/2 per cent to an index level of around 162 per cent, as compared with the preliminary September figure of 166. At 162, the total index would be 6.5 per cent below a year earlier and 7.2 per cent below the July 1969 high. As indicated in the table, the October decline in the nonautomotive sector of the index is estimated to have been larger than in September.

INDUSTRIAL PRODUCTION
1957-59=100, Seasonally adjusted

	1970		
	August	September p	October e
Total index	168.9	166.0	162.0
Motor vehicles & parts	164.1	128.8	100.0
All other	169.0	167.7	165.0
	Change in points in total index from previous month		
Total index	-.3	-2.9	-4.0
Motor vehicles & parts	.0	-1.6	-1.4
Auto supplying industries e	-.0	- .4	- .7
All other	-.3	- .9	-1.9

e - estimated
p - preliminary

Because of the GM strike, auto assemblies declined further in October to an annual rate of 4.0 million units. Production of furniture, appliances, and television sets was maintained at about the September level. Output of apparel probably eased off in October but this may have been offset by a rise in consumer staples. Output of business and defense equipment declined further in October as did production of most materials--steel, nonferrous metals, chemicals, paper, and rubber.

In 1964, the strike against GM. was settled in the last week of October and the rise in the motor vehicle and parts index amounted to 2.2 points in the total index for November and an additional 1 point in December.

Retail sales. Retail sales in October declined 1.5 per cent from September, according to estimates based on reports for the five weeks through October 31. Sales of automotive stores dropped about 16 per cent, largely reflecting the GM strike. Excluding the automotive sector, retail sales were indicated to be up about 1.5 per cent in October following a period of little change since April.

Among durable goods stores, furniture and appliance sales are estimated to have increased 6 per cent in October for the first sizable improvement in six months. Sales of nondurable goods stores apparently increased 1.5 per cent, with all major categories except food reporting higher sales. Sales of general merchandise stores may have increased close to 2 per cent.

SALES OF RETAIL STORES, 1970

	July	Aug.	Sept.	Oct.*	July	Aug.	Sept.	Oct.*
	-----(Billions of $)----				--Per cent change from-- previous month			
All stores	30.8	30.7	30.8	30.3	.7	.2	.1	-1.5
Total, excluding auto	25.3	25.2	25.2	25.6	.6	.3	.4	1.5
Durable goods	9.5	9.5	9.5	8.7	.8	.2	.5	-8.0
Auto	5.5	5.5	5.6	4.7	1.1	-.4	2.2	-16.0
Furniture & appliance	1.4	1.4	1.3	1.4	-1.3	.3	-3.6	6.0
Nondurable	21.2	21.3	21.3	21.6	.6	.2	- .1	1.5
Food	6.8	6.8	6.8	6.7	-1.0	.9	.4	-1.5
General merchandise	5.2	5.2	5.2	5.4	2.7	-1.1	1.0	2.0

* Estimated on the basis of reports for the five weeks ending October 31.

Autos. Sales of new domestic autos declined further in October and were at a seasonally adjusted annual rate of 6.1 million units, 13 per cent below September and 27 per cent below a year earlier. The decline in sales was primarily due to the GM strike, as indicated by the table.

UNIT AUTO SALES
(Seasonally Adjusted, Per cent change)

	September 1970 to October 1970	October 1969 to October 1970
GM	-33	-56
All other	15	4

Stocks of new domestic autos at the end of October were 17 per cent below a month ago and 27 per cent below a year earlier. Because of the decline in sales, the days supply continued high and was the same as a year earlier, 61 days.

Sales of foreign cars rose sharply in October to a new high from the reduced September rate, when Volkswagen sales declined 37 per cent because of shortages, and, at an annual rate of 1.3 million units were 10 per cent above a year earlier.

Consumer credit. Consumer instalment credit outstanding rose at a seasonally adjusted annual rate of $4.3 billion in September; for the third quarter as a whole the rate was $4.1 billion--compared with $4.6 billion in the second quarter and $4.0 billion in the first quarter. The increase in September was centered in personal loans and nonautomotive consumer goods, although automobile credit, which had declined in July and August, rose slightly. For the third quarter as a whole the reduction in auto credit was the largest for any quarter since the third quarter of 1961.

Both extensions and repayments of instalment credit reached new highs during the third quarter but the September figures for these series were below the peak levels recorded in July. Extensions of auto credit, relative to retail sales of the automotive group, declined 2 percentage points from July to September (from 49.3 per cent to 47.3 per cent) and the ratio of credit extensions for non-automotive consumer goods to GAF sales eased slightly (37.4 per cent to 37.0 per cent) in this two-month period.

NET CHANGE IN CONSUMER INSTALMENT CREDIT OUTSTANDING
(Billions of dollars, seasonally adjusted annual rates)

	Total	Automobile	Other consumer goods	Personal loans	Home repair and modernization
1969--QI	$8.3	$2.7	$2.5	$3.0	$ .2
QII	9.6	3.1	2.9	3.2	.4
QIII	7.7	1.9	2.6	3.1	.0
QIV	6.8	2.0	2.4	2.6	- .2
1970--QI	4.0	.0	2.4	1.7	.0
QII	4.6	.2	2.3	1.9	.1
QIII	4.1	- .6	2.4	2.1	.1

Census consumer purchase and income expectations. The October Census Survey can be interpreted as suggesting that households probably will not be expanding non-essential purchases soon. There was a decrease in households reporting current income higher than a year earlier and the percentage of households expecting substantial decreases in income remains relatively high. Buying plans for new cars declined but purchase plans for houses increased further -- however, the Census Bureau does not believe either change was statistically significant.

SELECTED SURVEY RESULTS
(Seasonally adjusted)

	1969	1970			
	October	January	April	July	October
Index of Expected Unit Purchases in the Next Year (January - April 1967 = 100)					
All Households:					
New cars	103.1	106.0	105.8	105.8	103.8
Houses	96.7	93.6	87.9	92.9	95.6
Actual and Expected Changes in Income					
All Households:					
Per cent reporting higher current income compared to a year earlier	37.4	35.4	41.3	39.9	37.3
Per cent reporting lower current income compared to a year earlier	11.1	11.3	12.4	13.0	13.6
Probability of substantial future decrease in income*	6.0	6.3	7.0	7.3	7.3

* This is the average chance in 100 which all respondents assign to a substantial future decrease in income.

Inventories. Growth in book value of manufacturers' inventories slowed further in September, according to preliminary data. The August rate, however, was revised up to $2.7 billion from the $1 billion originally reported. Book values declined in September at durable goods manufacturers; the strike-related decline at motor vehicle plants was at a $2.1 billion annual rate and was largely offset by increases elsewhere, notably at construction materials industries. Manufacturers of household durables cut back their stocks, which still remained heavy relatively to their order backlogs.

CHANGE IN BOOK VALUE OF MANUFACTURERS' INVENTORIES
(Seas. adjusted annual rates, billions of dollars)

	1970		1970	
	QII	QIII	August	September
Manufacturing, total	2.9	3.6	2.7	1.4
Durable	.5	3.5	2.5	- .2
Nondurable	2.4	.1	.2	1.6

For the third quarter as a whole, the book value increase was slightly larger than in the second quarter, but only because of a high July rate. There was less liquidation in the third quarter of defense inventories and more growth at construction-related industries, as orders increased at both groups.

INVENTORY RATIOS

	1969		1970	
	August	September	August	September
Inventories to sales				
Manufacturing, total	1.67	1.66	1.74	1.76
Durable	1.95	1.95	2.09	2.13
Nondurable	1.31	1.30	1.31	1.31
Inventories to unfilled orders				
Durable manufacturing	.711	.715	.810	.821

The September increase in the durable goods manufacturers' inventory-sales ratio reflects mainly the auto strike, as auto shipments declined more than inventories. The inventory-backlog ratio continued to rise, reflecting increases in the primary metals, defense, capital equipment, and construction materials industries.

Dealer sales of domestic new autos also declined more than their stocks and their stock-sales ratio, still high by historical standards, rose further, affected by both the strike and by the late model changeover dates.

Manufacturers' new orders. New orders for durable goods declined 3 per cent in September, according to preliminary data. In addition to the decline in motor vehicles there was a drop in orders for capital equipment from an upward-revised August level. Defense orders increased, reflecting the placing of large shipbuilding orders. Orders for the "all other" group also rose, mainly as a result of increases at construction materials industries, and orders for household durables strengthened.

MANUFACTURERS' NEW ORDERS
(Seasonally adjusted montlhy averages, billions of dollars)

	1969	1970			
	Q III	Q II	Q III prel.	August	September prel.
Durable goods, total	31.5	29.5	30.5	30.5	29.6
Primary metals	5.2	4.8	4.8	4.8	4.7
Iron and steel	2.6	2.2	2.3	2.3	2.3
Other primary metals	2.7	2.7	2.5	2.5	2.4
Motor behicles and parts	4.6	3.9	4.1	4.4	3.6
Household durable goods	2.3	2.1	2.1	2.0	2.1
Defense products	1.8	1.7	2.3	1.8	2.0
Capital equipment	8.6	8.2	8.3	8.5	8.1
All other durable goods	8.9	8.8	9.0	8.9	9.2
Nondurable goods, total	24.5	25.3	25.6	25.4	25.6

NOTE: Detail may not add to totals because of rounding.

For the third quarter as a whole, orders for most groups were above their second-quarter levels; but capital equipment orders were little changed, and the average for this group was 5.5 per cent below its peak reached in the fourth quarter of last year. Defense orders increased sharply in the third quarter, bringing the six-month average for this group to a level 12 per cent above a year earlier.

The durable goods order backlog was down further in September, by more than 1 per cent. Declines in unfilled orders were fairly widespread, but were particularly sharp at both ferrous and nonferrous primary metals industries.

Cyclical indicators. In September, the preliminary composite leading indicator dropped 1 per cent, to a level below its most recent low point last May. The August decline, originally reported at 0.4 per cent, was revised down and is now also a drop of 1 per cent. The coincident composite declined 0.9 per cent in September to well below its May low, and the lagging composite increased 1.2 per cent to a new high. The September declines in the leading and coincident composite indicators and the September rise in the lagging composite were all caused, to a considerable extent, by the auto strike.

COMPOSITE CYCLICAL INDICATORS
(1967 = 100)

	12 Leading Trend Adjusted	5 Coincident	6 Lagging
1970:			
April	114.9	122.1	130.6
May	113.6	121.2	130.7
June	114.1	121.3	130.6
July	115.8	121.4	130.7
August	114.6	121.1	131.7
Sept. (Prel.)	113.4	120.0	133.3 (H)

(H) Current high value.

Leading indicators contributing to the September decline were the manufacturing workweek, unemployment insurance claims, new orders for durable goods, industrial materials prices, and the ratio of price to unit labor cost. There were increases in common stock prices, housing permits, and contracts and orders for plant and equipment. This last series would have declined, however, except for a sharp increase in defense shipbuilding orders.

In October, according to preliminary data, upward influences on the leading composite may be provided by common stock prices, the workweek, and unemployment claims, while industrial materials prices declined.

Construction and real estate. Seasonally adjusted value of new construction put in place, which in September had about matched its April 1969 high, continued upward in October for the fifth consecutive month. The annual rate of $93.7 billion was a new peak in current dollars, 3 per cent higher than a year earlier. However, it was 4 per cent lower than a year earlier after allowance for cost increases as measured by the Census Bureau.

Residential outlays--bolstered by the appreciably improved rate of housing starts in recent months--continued to dominate the over-all advance. On a current dollar basis in October, they were more than a tenth above their low of last May, although still moderately short of their peak in April of 1969. Outlays for private nonresidential construction also were estimated to have increased from September, to a rate about 4 per cent under the high reached last March. Reflecting mainly a decline in outlays for Federally owned projects, public construction expenditures edged off in October, but remained relatively near the high established in April 1969.

NEW CONSTRUCTION PUT IN PLACE
(Confidential FRB)

	October 1970 ($ billions) 1/	Per cent change from	
		September 1970	October 1969
Total	93.7	+1	+3
Private	65.1	+2	+2
Residential	31.6	+3	+8
Nonresidential	33.5	+1	-2
Public	28.6	-1	+5
Federal	3.4	-5	-2
State and local	25.2	--	+7

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

Sales of new homes by merchant builders rose further in September and, at a seasonally adjusted annual rate of 566,000 units, were the highest since early 1966. Reflecting a continuing shift in the sales mix toward smaller and less expensive houses, the median price of homes sold dropped again, to $22,500, as much as 13 per cent below a year earlier and the lowest since late 1967. By contrast, prices of homes being held for sale by builders remained little changed at a median level of $27,100. And in the market for used homes, the median price of the units actually sold was $23,100 in September; this was 6 per cent above a year earlier, the same as the average year-to-year increase in the first nine months as a whole.

Anticipated plant and equipment spending. The McGraw-Hill fall survey of business plans for new plant and equipment expenditures in 1971 indicates that such spending will be up about 2 per cent from 1970. (The Commerce-SEC August survey indicated an increase in 1970 of about 6.5 per cent.) Manufacturers expect spending on new plant and equipment in 1971 to decline 2 per cent; relatively large percentage cutbacks are indicated by producers of primary metals, aircraft, other non-auto and nonaircraft transportation equipment, rubber, paper, and nonelectric machinery. Nonmanufacturing outlays are expected to rise about 5 per cent, mainly as the result of large increases in communications and electric utilities spending. Overall, these anticipated expenditures for 1971 are at about the same level as the fourth quarter 1970 annual rate shown in the August Commerce-SEC survey. The McGraw-Hill respondents also indicated that they expect price increases of about 7 per cent for their purchases of fixed capital, which implies a decline in real spending in 1971.

While the plans indicated in this survey are, in large part, still subject to final approval by boards of directors, it should be noted that in the past 15 years the McGraw-Hill fall survey has consistently indicated correctly the direction of change. The surveys, however, have overstated the actual year-to-year changes in about two-thirds of these years.

ANTICIPATED PLANT AND EQUIPMENT SPENDING, 1971
(McGraw-Hill Fall Survey)

	Per cent change from prior year		
	1969 Actual	1970[1/]	1971
All business	11.5	6.6	2
Manufacturing	11.7	1.2	-2
Durable	13.0	- .5	-3
Nondurable	10.3	2.3	-1
Nonmanufacturing	11.4	10.5	5
Utilities	13.9	16.5	8
Communications	21.6	22.4	15
Commercial	6.0	4.5	3

1/ Planned according to the August 1970 Commerce-SEC survey.

Labor market. The labor market has eased further, with the strike at General Motors accounting for much of the softening. Nonfarm payroll employment fell by 480,000 in October, reflecting a sharp decline in factory employment. The unemployment rate edged up to 5.6 per cent at mid-month from 5.5 per cent in September, and insured unemployment continued to rise through month's end.

Employment and hours. Employment in manufacturing fell by 609,000 in October, with all but 12,000 of the drop occurring among production workers. Compared to a year earlier, manufacturing employment was down more than 1.5 million, with about 175,000 of the drop occurring among nonproduction workers.

The General Motors strike was directly responsible for close to two-thirds of the October drop in manufacturing jobs, with the remaining decline reflecting both secondary layoffs at supplier firms and some further general easing of demand for factory labor. There were reductions of employment in all durable goods manufacturing industries, totaling 525,000. Employment declined by 85,000 in the nondurable goods industries, with the largest reductions in food, rubber, apparel and textiles.

The average factory workweek, at 39.4 hours in October, was up only slightly from the 39.3 hours of September, when it reached its lowest level since the 1960-61 recession. Some firms probably were on short workweeks because of the auto strike.

Employment rose moderately in nonmanufacturing industries in October, and September estimates were revised up substantially, especially in services. Private nonmanufacturing employment now shows increases in excess of 100,000 in September and also in October. Total payroll employment now shows a rise of 200,000 in September; preliminary estimates had shown no change in total nonfarm employment.

CHANGES IN NONFARM PAYROLL EMPLOYMENT, 1970
(Seasonally adjusted, in thousands)

	July	August	September	October
Total	-42	-173	196	-481
Government	32	5	51	19
Private	-74	-178	145	-500
Manufacturing	-75	-131	27	-609
Nonmanufacturing	1	-47	118	109

Unemployment. Unemployment rates for adult men rose in October, after showing signs of leveling off over the summer, while rates for younger workers and women held near the high September levels. In durable-goods manufacturing industries, the jobless rate rose sharply to 7.1 per cent in October from 6.3 per cent in September. The rise was partly due to secondary layoffs resulting from the General Motors strike; it was heavily concentrated among semi-skilled operatives. Insured unemployment continued to move higher through month's end, suggesting a widening impact of the GM strike and the likelihood of a further rise in the total unemployment rate in November.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1970				
	Q I	Q II	Q III	September	October
Total	4.1	4.8	5.2	5.5	5.6
Men:					
20 to 24	6.5	7.6	9.5	11.0	11.3
25 years and over	2.2	2.8	3.0	3.0	3.2
Women aged 20 and over	4.1	4.7	5.0	5.1	5.1
Teenagers	13.7	14.9	15.6	16.8	17.1
Whites	3.8	4.4	4.9	5.1	5.2
Negroes	6.8	8.4	8.5	9.0	9.3
Insured unemployed	2.6	3.5	3.3	4.2	4.4

Productivity. Productivity growth quickened in the third quarter. Judging by preliminary GNP data, output per manhour rose at an annual rate of nearly 5 per cent in the private nonfarm sector, as employment and hours were cut while output rose modestly. This was the second sizable quarterly advance in productivity after five quarters of downdrift. With productivity advancing more rapidly, unit labor costs continued to rise more moderately. In the second and third quarters together, the increases were at the lowest rate since mid-1967. However, unit labor costs are still running about 5-1/2 per cent higher than a year ago, compared to an average rise of 6-1/2 per cent in 1969.

COMPENSATION, PRODUCTIVITY AND UNIT LABOR COSTS
Private Nonfarm Sector

	Compensation per manhour	Output per manhour	Unit Labor Costs
Per cent change from previous quarter, annual rate			
1969: QIII	7.3	.6	6.6
QIV	7.7	.3	7.3
1970: QI	6.6	-2.9	9.8
QII	5.9	3.9	1.9
QIII	7.8	4.8	2.9
Per cent change from a year earlier			
1968	7.3	2.9	4.3
1969	6.7	.3	6.4
1970: QI	6.8	-.6	7.5
QII	6.9	.5	6.4
QIII	7.0	1.5	5.4

<u>Industrial relations and wages</u>. General Motors and the UAW stepped-up their bargaining sessions and agreed to a news blackout at the end of October in an apparent effort to reach an early agreement on national issues.

The General Motors settlement will provide the basis for contracts negotiated by the other automobile companies and will be an important factor in settlements in the farm and construction equipment industry. It will also influence settlements in major negotiations involving about 1.5 million workers in the can, aluminum, aerospace and steel industries in 1971.

Wage rates increases provided in contract settlements concluded during the third quarter in private nonfarm industries were somewhat smaller than during the second quarter, but were significantly larger than in 1968 and 1969. Most of the slowdown was in the nonmanufacturing sector outside of the construction industry. In manufacturing settlements, first-year wage increases continued to rise rapidly, averaging 9 per cent in the third quarter compared with 8 per cent in 1969 and 7 per cent in 1968.

The Board appointed by the President to avert a threatened strike of over 400,000 members of four railroad unions this fall submitted its recommendation for a wage settlement which would provide wage rate increases averaging about 11 per cent a year over the life of the three-year contract. This about in line with increases negotiated in major nonmanufacturing contracts settled this year. If the proposals are accepted the unions are free to strike on December 10.

Inflationary anticipations continued to play a large role in recent contract settlements. Wage increases provided in the second and third years of long-term contracts were somewhat larger than in 1969, and considerably larger than in 1968. These large deferred wage raises are laying the groundwork for continuing pressures on unit labor costs in unionized industries in 1971 and 1972, regardless of demand conditions.

WAGE RATE ADJUSTMENTS IN MAJOR COLLECTIVE BARGAINING SETTLEMENTS

	1968	1969	1970 I	1970 II	1970 III
All private nonfarm industries 1/					
Average over life of contract:	5.9	7.6	7.7	10.6	9.7
First year	7.4	9.2	10.2	15.4	13.1
Average 2nd and 3rd year increases:	5.2	6.8	6.5	8.2	8.0
Manufacturing					
Average over life of contract:	5.2	6.0	5.5	6.6	6.9
First year	7.0	7.9	8.2	8.4	9.0
Average 2nd and 3rd year increases:	4.3	5.1	4.2	5.7	5.9
Construction					
Average over life of contract:	8.6	13.1	13.1	14.6	16.0
First year	8.7	13.1	15.5	18.2	22.1
Average 2nd and 3rd year increases:	8.5	13.1	11.9	12.8	13.0

1/ Covers settlements affecting 1,000 workers or more.

Average hourly earnings increased more slowly from a year earlier in private nonfarm industries in the third quarter of 1970 than over the comparable periods of 1968 and 1969. In manufacturing, retail trade, transportation and public utilities increases in average hourly earnings have been smaller this year, in part because of large reductions in overtime and layoffs in higher-wage industries, both of which tend to dampen the rate of increase of average hourly earnings. In construction, the sharp acceleration in the rate of increase from 1968 to 1969 has not continued this year. In the expanding service sector, however, hourly earnings have continued to climb at a more rapid pace this year.

CHANGES IN AVERAGE HOURLY EARNINGS
SELECTED INDUSTRIES

	Per cent increase from year earlier		
	QIII 1968	QIII 1969	QIII 1970
Private nonfarm industries	6.5	6.9	5.8
Manufacturing	6.5	6.5	5.5
Construction	6.8	9.1	9.5
Retail trade	7.9	6.5	6.2
Transportation & public utilities	6.5	6.2	6.0
Services	6.5	7.6	8.3

Wholesale Prices. Wholesale prices increased at a seasonally adjusted annual rate of 2.5 per cent from mid-September to mid-October despite a large decline in prices of farm and food products. The 7.8 per cent annual rate of increase in prices of industrial commodities was the largest in 15 years. A major contribution to the overall increase was a much larger than seasonal rise in prices of new-model automobiles, but large increases were also reported for fuels, machinery, chemicals, and pulp and paper.

It now appears that the 1970 (December 1969 to December 1970) rise in prices of industrial commodities will approximate the 3.9 per cent advance of 1969, with little slowing, if any, between the first and second halves of the year. The widespread October rise in prices of industrial commodities (nearly one-half of the 228 industrial product classes posted price increases) will offset several months of relatively slow increases. However, farm and food products are expected to show little change compared with the large increase of 1969, so that the rise in the overall average this year is likely to be less than 3 per cent compared with 4-3.4 per cent last year.

WHOLESALE PRICES
(Seasonally adjusted percentage changes at annual rates)

	Dec 1969 to June 1970	June 1970 to Sept 1970	Aug 1970 to Sept 1970	Sept 1970 to Oct 1970
All commodities	2.6	3.9	5.8	2.5
Farm & food products	-1.9	8.9	16.5	-14.7
Industrial commodities	3.8	2.9	3.4	7.8
Transportation equipment 1/	11.7	1.2	3.5	68.4
Fuels & related products & power 1/	4.8	9.1	16.5	18.7
Machinery and equipment 1/	3.6	3.9	4.9	6.9
Hides, skins, leather, & related products 1/	1.3	0.0	1.9	5.8
Chemicals and allied products 1/	3.5	1.6	-2.3	6.1
Pulp, paper, & allied products 1/	5.0	0.7	1.1	6.6
Lumber & wood products 1/	-3.7	0.7	2.0	-11.3

1/ Not seasonally adjusted.

Price increases for 1971-model passenger cars averaged 5.9 per cent and accounted for about half of the unadjusted rise of 0.8 per cent in industrial commodities in October. Advances in the prices of fuels and power, machinery, and chemicals accounted for most of the remaining increase. Agricultural and industrial machinery increased sharply. Price delcines were reported for lumber and wood products, textiles and apparel, and some paper products.

Prices of metal products rose in October, despite a decline in nonferrous metals for the fifth consecutive month. Most nonferrous metals are now substantially below levels at mid-year, but aluminum producers have thus far maintained the price of aluminum ingots by cutting back production. Ferro-alloys increased in October, and a recent rise in the U.S. dollar price of nickel (which is largely imported from Canada) was posted by the International Nickel Company of Canada to compensate for the rise in the value of the Canadian dollar resulting from the new floating exchange rate policy.

PRICES OF SELECTED METAL AND METAL PRODUCTS
(Percentage changes at annual rates)

	Dec 1968 to June 1969	June 1969 to Dec 1969	Dec 1969 to June 1970	June 1970 to Sept 1970	Sept 1970 to Oct 1970
Metals and metal products	9.2	10.3	8.7	- 1.2	2.8
Iron and steel	8.1	6.6	11.4	2.3	7.2
Steel mill products	6.9	6.5	9.9	2.6	7.1
Foundry and forge shop products	3.6	2.2	7.1	5.9	19.6
Pig iron and ferroalloys	-2.7	12.1	11.4	30.3	26.8
Iron and steel scrap	50.6	24.2	45.1	-15.5	-22.1
Nonferrous metals	20.4	22.7	6.6	-16.0	- 7.0
Aluminum ingot	7.9	9.4	7.3	0.0	0.0
Copper ingot	20.4	28.4	32.0	- 0.2	0.0
Copper ingot (foreign)	54.3	34.1	-19.4	-50.3	-48.3
Lead	33.1	13.8	6.4	-36.2	0.0
Zinc (prime Western)	14.9	13.8	0.0	-12.1	0.0
Mill shapes	5.5	19.6	4.3	-14.6	- 1.8
Wire and cable	20.8	23.6	22.6	- 6.2	- 0.7
Nonferrous scrap	47.3	34.7	-23.9	-38.5	-15.4

Steel mill product prices are continuing to rise, as costs reflect large increases for metallurgical grade coal, pig-iron, and alloys, as well as for wage rates. Ferrous scrap prices have fallen sharply as a result of the General Motors strike but are still above a year earlier. Steel prices are generally expected to continue on an upward trend.

Since the October pricing date, domestic producers have cut the price of copper ingots by 4 cents per pound, or nearly 7 per cent. The reduction was the first since January 1961 and stemmed largely from drastically-reduced prices of imported copper; the cut in the ingot price has been reflected in the prices of fabricated products.

Wholesale prices of livestock and meat have declined steadily since July, primarily as a result of increased supplies of hogs and pork. Livestock prices were about 11 per cent lower in mdd-October than in mid-July, while the price for hogs was down 28 per cent. Meats declined 9 per cent over the same period, while the price of pork dropped 17 per cent.

Consumer prices. In September consumer prices rose at a seasonally adjusted annual rate of 6.5 per cent. Food and gasoline prices rose, following declines in August, and there were substantial increases for houses, cars, and apparel. However, the rate of rise in the CPI over the three-month period ending in September--4.2 per cent--was well below that for the preceding two quarters and for 1969.

The recent slowing in the pace of price increase is still centered on food, although increases for apparel and household durables goods have been less rapid this year than last. The decline in meat

Consumer durable goods prices have been rising strongly despite declines in used car prices. The continued rise in prices of 1970 model new cars prior to the introduction of the 1971 models suggests that list prices for the more expensive 1971 models may be well maintained. The increase in prices resulting from their introduction will be phased out over several months starting in October, as the mix of sales shifts toward the 1971's. Large increases in the price of houses have been the major factor responsible for the fast rise in the durables component of the consumer price index in recent months, but even excluding houses and used cars the annual rate of increase from June through September was 4 per cent.

DURABLE GOODS PRICES
(Per cent change, seasonally adjusted annual rates)

	Dec 1968 to Dec 1969	Dec 1969 to Mar 1970	Mar 1970 to June 1970	June 1970 to Sept 1970	Aug 1970 to Sept 1970
All durable goods	4.5	3.0	8.1	4.6	8.2
Used cars 1/	4.4	-18.8	58.7	-13.2	-15.3
Home purchase 1/ 2/	6.9	9.3	8.4	9.1	13.6
New cars	2.1	2.5	1.3	6.9	12.0
Household durables 2/	3.4	2.6	3.0	2.3	2.2
Addendum:					
Durable goods less used cars and home purchase 2/	3.0	3.7	2.0	4.0	4.9

1/ Not seasonally adjusted

2/ Not for publication

prices at retail has been slow with retailers taking advantage of falling pork prices to widen the spread over wholesale prices. According to the Department of Agriculture, retail prices of pork in October had fallen from October 1969 levels by less than 10 per cent, wholesale prices by about 17.5 per cent, and farm prices by about 31 per cent. However, meat prices did decline significantly in October, and further declines are expected this month and next. Nevertheless, the favorable effect of lower meat prices on the consumer food budget may be offset by further rises in prices of other foods and in the cost of restaurant meals and snacks.

CONSUMER PRICES
(Per cent change, seasonally adjusted annual rates)

	Dec 1968 to Dec 1969	Dec 1969 to Mar 1970	Mar 1970 to June 1970	June 1970 to Sept 1970	Aug 1970 to Sept 1970
All items	6.1	6.3	5.8	4.2	6.5
Foods	7.2	5.4	1.3	1.4	4.2
Nondurable commodities less foods	4.5	2.5	4.7	3.6	6.3
Apparel	5.3	2.4	3.5	4.1	7.6
Other	4.0	3.0	5.3	3.5	3.6
Durables	4.5	3.0	8.1	4.6	8.2
Services 1/	7.4	11.2	7.3	7.2	7.9
Services less home finance 1/ 2/	6.0	7.9	6.2	7.0	7.4

1/ Not seasonally adjusted

2/ Confidential

The rise in the cost of consumer services does not appear to be moderating. However, in the estimates to be released for October, the average increase is expected to be reduced by a downward adjustment in medical service prices, for which the rise over the past year has been over-estimated.

GNP deflators. The rate of price increase in the private economy has been unchanged at close to a 5 per cent annual rate over the past year, according to the deflator for the gross private product estimated on a constant weight basis. This is contrary to the impression conveyed by the implicit deflator for the GNP that the peak rate of price rise was in the first quarter of this year.

Price rises for items of personal consumption, particularly food, have moderated somewhat, but this has been offset by an apparent acceleration in construction .

CHANGES IN THE GNP DEFLATOR
(Per cent changes at annual rates)

	TOTAL GNP	PRIVATE GNP	
	Implicit deflator	Implicit deflator	Fixed-weight Deflator 1/ 2/
1968 3/	4.5	3.8	4.1
1969			
Q I	4.7	4.8	4.5
QII	5.0	4.9	5.0
QIII	5.6	4.4	5.1
Q IV	4.9	4.6	4.8
1970			
Q I	6.4	5.3	4.8
QII	4.3	4.0	4.8
QIIIp	4.4	4.5	4.8

1/ Fourth quarter 1965 weights
2/ Confidential
3/ Average of the four quarterly rates.

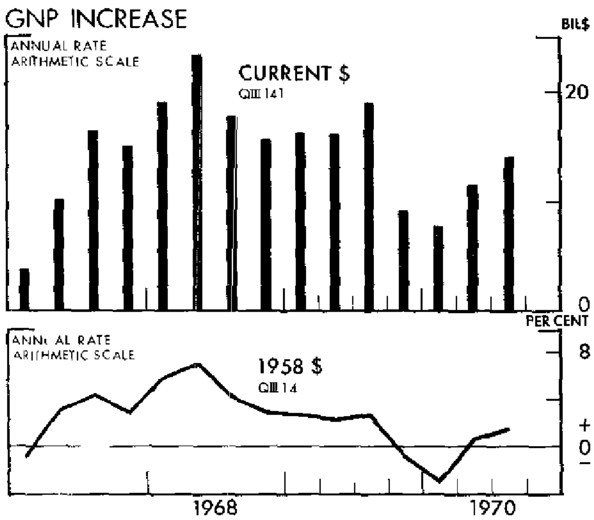
Meat supply prospects. Record supplies of red meats are in prospect during the next five or six months as producers market the large output already in process before the likelihood of a short corn crop boosted feed costs. Livestock-feed price ratios new are far less favorable than a year ago both because of lower livestock prices and higher feed costs. As a result, producers are likely to be less expansion-minded in planning production of short cycle products, such as pork and poultry, for marketing next summer and fall.

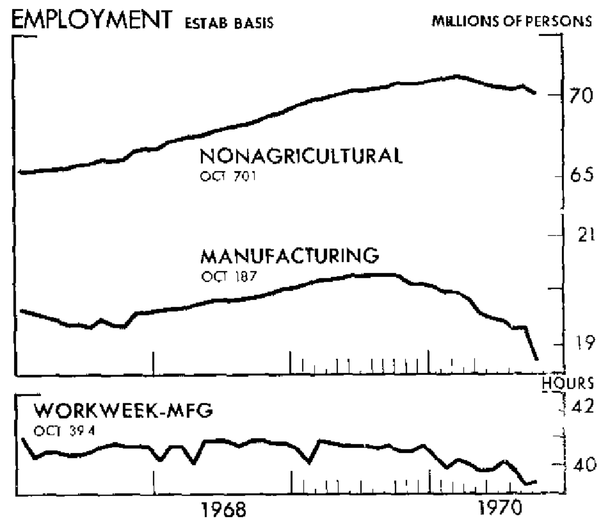
Normally, supplies of meats are 5 to 6 per cent larger in the fall and winter months because of seasonally larger marketings of hogs, grass-fed cattle, and turkeys. The major change in supply prospects this fall and winter compared with a year ago is the return to a more normal seasonal pattern in hog marketings. Last fall and winter, the increase was less than half the normal rise and hog prices rose sharply. The price rise spread to other livestock prices and producers expanded output in response to generally favorable profit prospects. Hog producers raised 13 per cent more hogs for this year's fall and winter markets. October is the seasonal peak month in marketings. This October, output of pork was up 13 per cent from a year earlier.

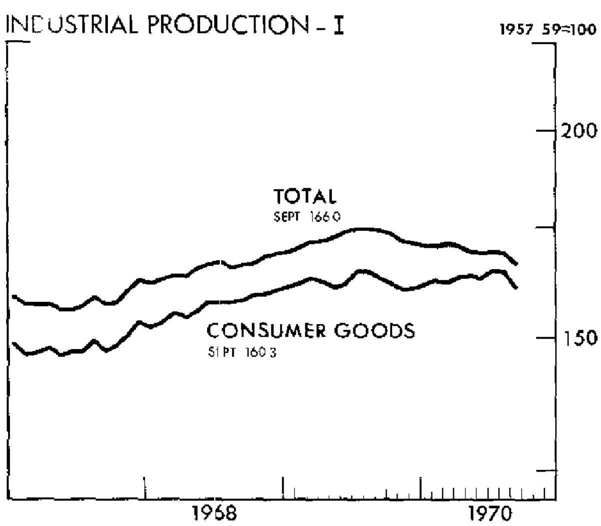
Supplies of fed cattle are larger than last year. The turkey crop is also larger but broiler production is slackening from the earlier record levels.

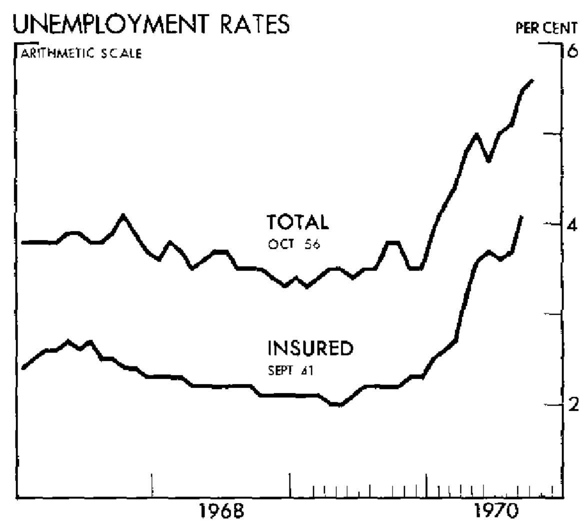
ECONOMIC DEVELOPMENTS - UNITED STATES

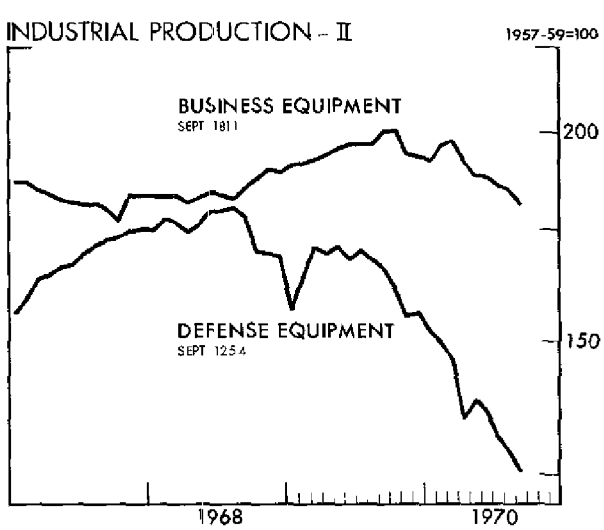
SEASONALLY ADJUSTED, RATIO SCALE

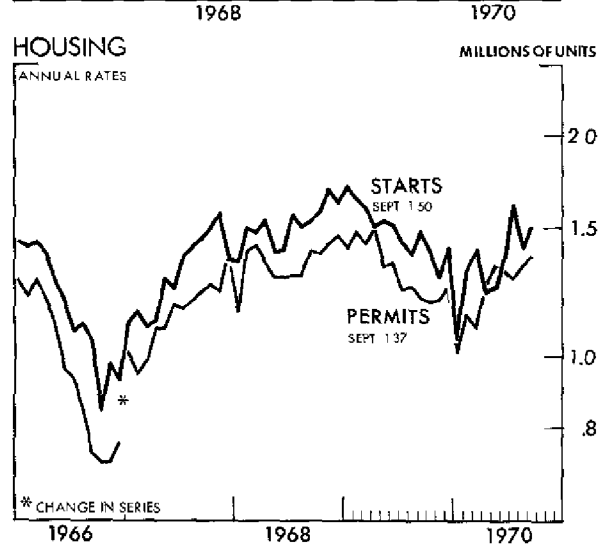






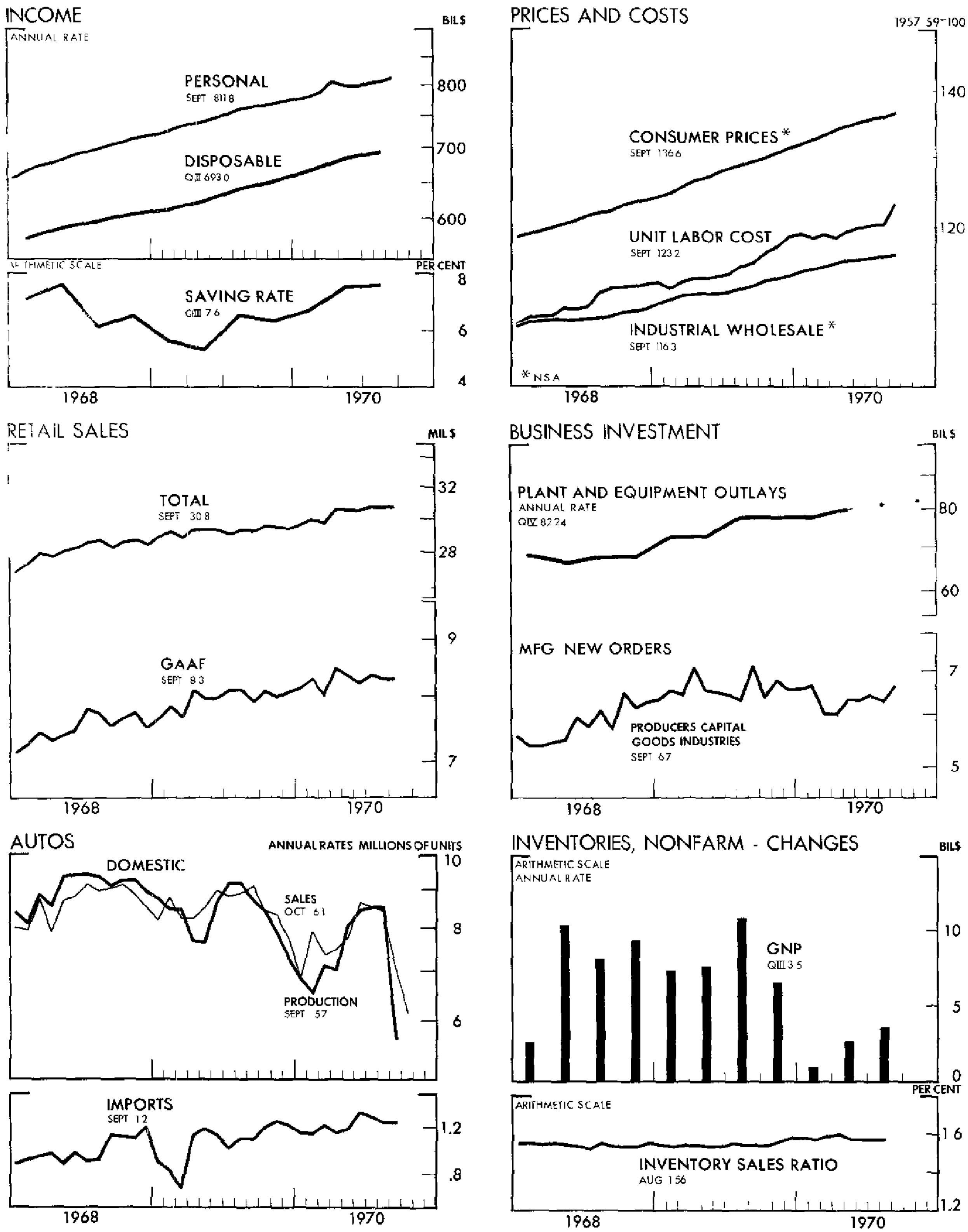






ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Monetary aggregates. The money supply (as currently published) declined slightly in October, as a drop in private demand deposits more than offset a fairly sharp advance in currency holdings. This was the second consecutive month of weakness in the money stock. Over a longer period, the money supply still shows moderate growth--at a seasonally adjusted annual rate of 3.5 per cent since June and at a 3.8 per cent annual rate since the beginning of this year.

Growth of time deposits declined to a seasonally adjusted annual rate of 20 per cent in October, about 9 percentage points below the rate in August and September and 15 percentage points below that for July, despite continued strong inflows at country banks. The slowing was partly attributable to a marked reduction in CD sales, which reflected some decline in the size of the runoff of affiliates' indebtedness in the commercial paper market. At large commercial banks, CD's showed an average weekly increase of about $325 million during October, about $80 million less than the average weekly advance recorded in September. Other time deposit categories at large commercial banks were also weaker in October. Consumer-type deposits increased at a much slower pace than in other recent months. And "other" time deposits dropped sharply, mainly as a result of a sharp cut-back in foreign official deposits, a development which apparently reflected bank decisions to compete less aggressively for the funds of these institutions--the rates offered on these deposits in most maturity ranges dropped further in October after having declined substantially from mid-August to the end of September.

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

	1970		1970		
	QII	QIII	August	September	October p
Money supply	4.2	4.5	10.0	1.2	-1.0
Commercial bank time and savings deposits	13.8	31.6	28.4	29.5	22.0
Member bank deposits plus nondeposit sources 2/	6.5	16.8	23.2	9.7	.5

p - Preliminary.
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.

NET CHANGE IN TIME AND SAVINGS DEPOSITS
(Billions of dollars, seasonally unadjusted)

	Aug. 26-Sept. 30 1/		Sept. 30-Oct. 28	
	1967-69 average	1970	3-year average	1970
Weekly reporting banks				
Total time and savings	0	3.9	-.3	1.2
Consumer-type	.7	2.0	0	.4
CD's	-.5	2.2	-.3	1.3
All other	-.2	.2	0	-.6
Country banks				
Total time and savings	.6	1.1	.5	1.1

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

Large banks continued to use a large portion of their incoming deposit funds in October to reduce their nondeposit liabilities. Further substantial reductions were made in the commercial paper indebtedness of affiliates and in borrowings from foreign branches. Funds obtained from other sources outside the United States also declined moderately, and outstanding loan RP's edged off slightly. These reductions in nondeposit liabilities, combined with declines in private demand deposits and in U.S. Treasury deposits, about offset growth in total time and savings deposits and the adjusted credit proxy remained essentially unchanged over the month.

Bank credit. Commercial bank credit, adjusted for loans sold to affiliates, declined at a 1.7 per cent seasonally adjusted annual rate from the last Wednesday in September to the last Wednesday in October. A $1.3 billion reduction in total loans (adjusted for loans sold), which followed a marked slowdown in growth in September, was partly responsible for this further weakening in the bank credit picture. In addition, bank holdings of U.S. Treasury securities, which had remained essentially unchanged in September after growing at an exceptionally strong pace earlier in the summer, also declined $1.3 billion. In contrast to these developments, bank acquisitions of other securities rose approximately $2 billion further, about matching the strong September advance in holdings of these securities.

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

	1969	1970		1970	
	H2	H1 r	Q3 r	Sept. r	Oct. p
Total loans & investments 2/	2.9	4.5	13.9	7.3	- 1.7
U.S. Govt. securities	-15.6	8.5	25.9	2.1	-27.1
Other securities	- 1.4	10.4	20.3	32.9	30.5
Total loans 2/	7.8	2.4	9.8	1.6	- 5.3
Business loans 3/	9.5	8.1	1.8	-8.4	-13.8

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.
r - Revised.
NOTE: Data are revised to reflect adjustments to June 30, 1970, Call Report benchmarks.

A sharp decline in business loans (after adjustment for loans sold) was responsible for the reduction in total loans in October. The drop reflects a continuation of sluggish business conditions currently accentuated by the auto strike and additional reductions of bank loans with funds acquired in capital market financing. Commercial paper dealers also reported that some firms have been shifting their short-term borrowing to the commercial paper market as borrowing costs there have dropped below those charged by banks.

Loans to brokers and dealers in securities rose substantially further in October, while loans to nonbank financial institutions remained essentially unchanged as they did in September. Real estate loans and consumer loans continued to expand at roughly the same modest pace that prevailed in the third quarter.

The expansion in "other" security holdings in October included a substantial increase in holdings of Federal Agency issues as well as a sharp advance in holdings of municipal securities. Most of the acquisitions of municipal securities were reported to be in the short and intermediate maturity range, but some dealers have reported bank purchases of such securities with maturities as long as 15 to 20 years. The fairly substantial decline in Treasury security holdings may be attributable in part to a smaller than normal volume of Treasury financing during the month. Holdings of Treasury issues had shown little net change in September after having risen by more than $7 billion since February of this year. After rebuilding liquidity, banks apparently have been placing more emphasis on yield in their allocation of investment funds over the past two months.

Nonbank depositary institutions. Preliminary indications are that deposit growth at savings banks and savings and loan associations continued very strong during October. As during the favorable reinvestment period earlier in the month, thrift institution inflows have been bolstered by lower short-term market yields, as well as consumers' hesitancy to spend and their related desire for safe and liquid assets. There were no reports of particularly heavy individual purchases in the recently-concluded Treasury note auction, although it may be a bit premature to assess its impact on deposit flow patterns at the thrift institutions.

DEPOSIT GROWTH AT NONBANK THRIFT INSTITUTIONS
(Seasonally adjusted annual rates, in per cent)1/

	Mutual Savings Banks	Savings and Loan Associations	Both
1970 - QI	2.4	1.4	1.7
QII	6.3	7.1	6.9
QIII	6.6	11.5	9.9
August*	4.7	6.8	6.1
September* p/	7.6	12.0	10.5
October* e/	5.5	11.9	9.8

1/ Table reflects updated seasonal adjustment.
* Monthly patterns may not be significant because of difficulties with seasonal adjustment.
p/ Preliminary.
e/ Estimated on the basis of sample data.

During the third quarter, savings and loan associations not only acquired a larger volume of mortgages--both gross and net--but also allocated more funds to liquid assets than in any other comparable period since before 1965. In part, this reflects the strong improvement realized in deposit inflows. But it also reflects special conditions this year that have served to preclude repayment, in any volume, of funds borrowed from the FHLBanks; as a condition of the FHLB's program to subsidize the cost to S&Ls of advances, the associations agreed not to repay them for a one year period that expires in the spring of 1971. During October, there appeared to be a continuation of the minimal net change in these outstanding advances that has obtained, with only one exception, in every month since January.

SOURCES AND USES OF FUNDS
AT INSURED SAVINGS AND LOAN ASSOCIATIONS
(Billions of dollars, not seasonally adjusted)

	First Three Quarters			Third Quarter		
	1968	1969	1970	1968	1969	1970
Sources						
Deposit accounts 1/	4.6	3.0	6.0	.9	-.2	2.8
Borrowed funds	.6	2.6	.9	.1	1.5	.2
Subtotal	5.2	5.6	6.9	1.0	1.3	3.0
Gross mortgage repayments 2/	10.8	10.8	10.4	3.7	3.6	4.0
Other sources, net 3/	1.3	1.4	1.2	.7	.3	.7
Total	17.3	17.8	18.5	5.5	5.2	7.7
Uses						
Increase in liquid assets	-.2	-.8	1.9	-.6	-.8	.5
Gross mortgage acquisitions	17.5	18.6	16.6	6.1	6.0	7.2
Total	17.3	17.8	18.5	5.5	5.2	7.7

1/ Net change in deposits, including interest credited.
2/ Includes, in addition to repayments, proceeds from sales of loans and participations and miscellaneous credits. Excludes interest, taxes, etc.
3/ Includes net changes in loans in process, reserves and surplus, and other liabilities minus the net changes in miscellaneous loans and assets not set out separately in the "uses" statement.

FHLB System liquidity remained unchanged at $1.5 billion as of the end of October. In light of its own strong liquidity and the improved deposit growth and liquidity position of member associations, the System now plans to retire some of its own outstanding debt during both the fourth quarter of 1970 and the first quarter of 1971. To the extent that advances scheduled to mature in the spring are repaid, System liquidity would also be increased, at least temporarily. The FHLBB is now considering means to minimize the potentiality of large repayments.

The Federal Home Loan Mortgage Corporation recently completed its first issue of securities connected with the mortgage pool it acquired from member associations this past summer. The issue was split between a long-term $140 million security and a 2-year $175 million security, with $77 million of the latter acquired by Government Trust Funds.[1/] The Corporation is now endeavoring to amass a new pool of mortgages.

Mortgage market. With savings inflows to nonbank thrift institutions apparently continuing strong, field reports and trade opinion suggest that the volume of new residential mortgage commitments picked up again last month at the savings and loan associations--which have thus far accounted for most of the recovery in over-all commitment activity since last spring--as well as at the savings banks. During September, when savings inflows to nonbank thrift institutions were also quite strong, a large amount of new mortgage commitments was approved by these lenders and S&L new commitments attained the highest seasonally adjusted rate in more than three years. The aggregate seasonally adjusted backlog of mortgage commitments outstanding at both institutions reached the largest total in a year.

With new mortgage commitment volume apparently rising, returns required by lenders on home mortgages, which were edging down in September, may have declined a little further during October on conventional loans, according to field reports and trade opinion. However,

1/ The long-term issue was an 8.60 per cent, 25-year security with 12 year call protection. The 2-year issue yielded 7.10 per cent.

data on either conventional loan rates or mortgage commitment volume are not yet available for October.

In FNMA's latest (November 2) auction of its forward commitments to purchase Government underwritten home mortgages, yields remained close to their recent lows, which were about 40 basis points below the peak reached earlier this year. The large volume of offerings did not reflect an inability to obtain commitments from private investors. Rather, FNMA field reports indicate that bidders continued to be interested in replacing lower older-priced commitments with newer higher-priced ones, as is also suggested by the unusually large share of bids for short-term commitments. Also, as in other recent auctions, some bidders were said to be seeking FNMA commitments for loans being accumulated in warehouse. The FNMA commitments have been needed in order to obtain interim warehousing credit from commercial banks, and as a hedge against the anticipated sale of the mortgages to private investors (rather than for delivery to FNMA, which is optional) at prices that the trade generally believes will rise further.

The resulting volume of recent and prospective cancellations and expirations of FNMA's commitments has led to a sharp reduction in FNMA's borrowing plans for the first quarter of next year. FNMA's borrowings could ease still further if the growing number of inquiries about purchasing loans out of its portfolio eventuates in sales.

FNMA AUCTION

	Amount of total offers		Implicit private market yield on 6-month commitments
	Received	Accepted	
	(Millions of dollars)		(Per cent)
Weekly			
1969 high	$410 (6/16)	$152 (9/8)	8.87 (12/29)
1970 high	705 (1/5)	151 (1/12)	9.36 (1/12)
Bi-weekly			
1970 high	581 (1/26)	298 (1/26)	9.33 (6/29)
Sept. 8	384	200	9.04
21	208	195	9.01
Oct. 5	268	150	8.92
19	353	150	8.90
Nov. 2	342	181	8.93

NOTE: Average secondary market yield after allowance for commitment fee and required purchase and holding of FNMA stock, assuming prepayment period of 15 years for 30-year Government-underwritten mortgages. Yields shown are gross, before deduction of fee paid by investors to servicers of 50 basis points prior to August 10 auction, and 38 basis points thereafter. At least partially offsetting the effect of the reduction in servicing fees on bid prices and gross yields in the August 10 and following auctions was another FNMA regulatory change permitting mortgage servicers to retain all escrow funds received on mortgage serviced under the reduced fee schedule. Under earlier practice, FNMA had retained most of these funds itself.

Reflecting the general improvement in availability of mortgage funds which began in the second quarter of 1970, net expansion of total mortgage debt outstanding increased again during the third quarter, reaching a seasonally adjusted annual rate of more than $28 billion. Nearly all the gain was concentrated in residential mortgage debt, where the net seasonally adjusted increase of approximately $22 billion at an annual rate was almost as large as the record volume added in the first quarter of 1969. Savings and loan associations continued to account for most of the net growth in total mortgage debt. At commercial banks in the third quarter, there was some pick-up in the pace of net mortgage lending from the reduced second quarter levels.

<u>Corporate and municipal security markets</u>. Yields on newly issued corporate bonds rose about 40 basis points during October, in response to the steady pressure of a very high pace of public bond offerings and the prospect of an even higher volume in November. But in recent days, corporate yields dropped sharply as a rally developed in the long-term markets. This rally was based, in part, on growing speculation that the improved position of the money markets and the banking system, combined with the continued sluggishness of the economy, would result in near-term cuts in both the discount rate and the prime rate. But it also reflected the conviction that the volume of new offerings will subside in early 1971.

The general improvement in early November extended to the municipal market, where yields declined somewhat. Supported by heavy bank buying, tax-exempt yields had shown less upward movement in October than corporates, despite the heaviest monthly volume of new State and local offerings in two years.

BOND YIELDS

	New Aaa Corporate Bonds 1/	Long-term State and Local Bonds 2/
1970		
Low	8.20 (2/27)	5.95 (3/12)
High	9.30 (6/18)	7.12 (5/28)
Week of:		
October 9	8.35	6.38
16	8.53	6.35
23	8.64	6.45
30	8.77	6.40
November 6	8.63	6.28

1/ With call protection (includes some issues with 10-year protection).
2/ Bond Buyer (mixed qualities).

In the equity markets, a relatively strong rise in stock prices during the first week of November carried prices generally to the late September level. But trading volume, which set a new record weekly total a month ago, has fallen off about one-third in recent weeks to a level below the average volume thus far in 1970.

Despite shifts in timing of several large bond issues that reduced the scheduled October volume, new corporate bond and stock offerings last month reached the second highest total in the postwar period. Equity issues were boosted by an unusual volume of public utility offerings, and public bond issues remained at the September level of $2.4 billion. The staff estimates that the November bond volume will be over 10 per cent higher but expects some decline in stock offerings. Most of the issues postponed in late October--when some congestion developed--were sold at declining yields in the first week of November. Another factor that might contribute to some bond market buoyance is the possibility of some slight improvement during the fourth quarter in the availability of funds for takedowns of securities placed privately.

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

	Bonds			
	Public Offerings	Private Placements	Stocks	Total
1969 - entire year	1,061	468	700	2,229
1970 - entire year	2,013e	423e	692e	3,129e
1970 - QI	1,525	420	712	2,659
QII	2,331 1/	427	730	3,489 1/
QIII	1,994e	379e	560e	2,933e
QIV	2,200e	467e	767e	3,433e
October	2,400e	400e	1,000e	3,800
November	2,700e	300e	800e	3,800e
December	1,500e	700e	500e	2,700e

e/ Estimated.
1/ The second quarter "Public Offerings" and "Total" figures reflect the $1.569 billion AT&T offering. The monthly averages for the second quarter, excluding AT&T, would be $1,808 for "Public Bond Offering" and $2,966 for "Total Offerings."

The forward calendar for new offerings of State and local governments shows signs of a slight easing over the rest of the quarter. However, the backlog of authorized but unsold issues is still high, and new offerings could pick up sharply--especially if yields continue to decline. Trading inventories of tax-exempt securities have risen in recent weeks, probably indicating dealer expectations of further price rises.

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

1969 - entire year	990
1970 - entire year	1,393e
1970 - QI	1,368
QII	1,237
QIII	1,449e
QIV	1,533e
October	1,900e
November	1,700e
December	1,000e

e/ Estimated.

Government securities market. Attention in the U.S. Government securities market over the last four weeks has been primarily focused on the Treasury's November rights financing and the subsequent note auction. Both of these financings were extremely well received, with attrition on the rights exchange amount to only about 11 per cent--or about $650 million--and with the average issuing rate on the auctioned 6-3/4 per cent 18-month note turning out at 6.21, well below earlier expectations. Yields throughout the Government market, particularly in the bill area, were also pushed sharply lower in recent weeks by heightened expectations of a near-term reduction in the discount rate and/or the commercial bank prime rate. In all, yields on Treasury notes and bonds are generally 15 to 45 basis points lower than at the time of the mid-October meeting, while Treasury bill rates have declined by around 40 to 50 basis points, with the 3-month issue recently at a 24-month low of 5.50 per cent.

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

	1970		Week ending			
	Daily Highs	Daily Lows	Oct. 20	Oct. 27	Nov. 3	Nov. 9
Bills						
1-month	7.84 (1/28)	5.15 (11/9)	5.51	5.36	5.42	5.27
3-month	7.93 (1/16)	5.49 (11/9)	5.92	5.80	5.82	5.51
6-month	7.99 (1/5)	5.74 (11/9)	6.15	6.13	6.00	5.77
1-year	7.62 (1/30)	5.73 (11/9)	6.22	6.20	6.06	5.83
Coupons						
3-year	8.42 (1/7)	6.54 (11/9)	6.98	7.01	6.85	6.65
5-year	8.30 (1/7)	6.74 (11/9)	7.12	7.16	7.03	6.87
7-year	8.12 (4/26)	6.98 (11/9)	7.35	7.39	7.22	7.07
10-year	8.22 (5/26)	6.90 (2/27)	7.33	7.44	7.32	7.17
20-year	7.73 (5/26)	6.55 (2/27)	6.88	6.98	6.89	6.76
Agencies						
6-month	8.65 (1/27)	6.24 (11/9)	6.80	6.73	6.65	6.35
1-year	8.75 (1/2)	6.58 (11/9)	6.96	6.96	6.93	6.69
3-year	8.54 (1/2)	7.12 (11/9)	7.25	7.30	7.30	7.17
5-year	8.43 (1/15)	7.37 (11/9)	7.52	7.55	7.52	7.42

1/ Latest dates of high or low rates in parentheses.

On October 23, the Treasury announced a rights exchange for holders of the maturing 5 per cent notes, $6.0 billion of which were publicly held, either into a new 7-1/4 per cent 3-1/2 year note at par or into a re-opened 7-1/2 per cent 5-3/4 year note priced to yield 7.39 per cent. The announcement was enthusiastically received by the market and all of the issues involved rose to substantial premiums over the period for which books were open. Attrition on the $5.6 billion public holdings amounted to about $650 million, compared with earlier estimates of $1.0 billion; and the when-issued securities have continued to post price gains in subsequent trading sessions. At the time the Treasury announced the results of the rights exchange, it also announced that it would auction, in the same manner as Treasury bills, $2.0 billion of 18-month, 6-3/4 per cent notes, with a minimum acceptable bid of 99.76, or about 6.93 per cent. As it turned out, the average issuing rate was 6.21 per cent. Noncompetitive tenders, thought to be largely from smaller banks, were quite heavy totalling $500 million, or 25 per cent of the issue.

Dealers' positions in Treasury bills were inflated somewhat by the tax bill financing in mid-October. However, this build-up was perhaps less than expected since in a number of instances the banks that had initially been awarded the bills took them into portfolio rather than selling them to dealers. At month-end dealer bill positions were also augmented by awards from the regular monthly auction. Coupon positions, of course, have been swollen by the November rights financing (about $950 million) and the recent note auction ($195 million). In all, total positions have risen by around $1.0 billion since about the time of the October 20 meeting. Despite the large increase in positions, there has been little in the way of apparent restiveness on the part of the dealers, as the Federal funds rate has declined to around 6 per cent and financing costs, both in New York and outside, have also moved lower and as expectations of a discount rate cut have heightened.

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

	October daily average	Oct. 19	Oct. 26	Nov. 2	Nov. 9
Treasury securities					
Total	3,962	3,243	3,961	5,267	4,865
Treasury bills (total)	2,840	2,218	2,665	3,662	3,107
Due in 92 days or less	707	487	491	470	340
Due in 93 days or over	2,133	1,731	2,174	3,192	2,767
Treasury notes and bonds (total)	1,121	1,025	1,297	1,605	1,759
Due within 1 year	606	609	1,024	219	211
1-5 years	103	46	-58	505	760
over 5 years	412	370	331	881	788
Agency securities					
Total	998	972	1,063	1,140	1,070
Due within 1 year	519	454	608	519	543
other 1 year	479	518	455	621	527

The market for Federal agency securities was very quiet until the end of October. In the last few days of the month, however, the Federal Home Loan Mortgage Corporation offered $140 million of 25-year securities and $175 million of 2-year notes, all raising new cash, and FNMA marketed $750 million of 2- to 5-year notes of which $400 million represented new cash. Yield movements have been roughly in line with the Treasury market, but there has been a slight upward yield adjustment in the 3-year area.

Other short-term credit markets. Commercial paper outstandings on a seasonally adjusted basis in October gained about $300 million (based on data available through October 28) as compared with a decline of \$1.4 billion in September. The October increase was the result of large rises in direct and dealer nonbank paper that more than offset the \$915 million decline in bank-related paper. This third consecutive monthly decline in bank-related paper has reduced outstandings to \$3.7 billion, \$4.0 billion below the mid-August level, when the new reserve requirement was announced.

Finance company paper outstanding rose about \$450 million, with other borrowers picking up the funds usually absorbed by General Motors. This greater availability of funds also explains in part the increase of \$760 million over the month in dealer-issued paper outstanding. However, small firms with excellent credit ratings are still having difficulty raising money in the commercial paper market.

Short-term rates continued to move down during the month, the declines ranging from 1/4 to 6/10's of a point. The spread between commercial paper and Treasury bills has narrowed somewhat to 114 basis points in one-month maturities, but remains unchanged at 132 basis points in three-month maturities. With the prime rate at 7.50 per cent, there may be a shifting out of bank loans into commercial paper. At this time, however, commercial paper rates as quoted may be somewhat misleading, as lower-quality borrowers are paying higher rates and other borrowers are paying a slight premium on funds for the year-end.

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

	1969 Nov.-Dec. highs 1/	Oct. 7	Oct. 21	Nov. 4	Net change (Oct. 7-Nov. 4)
1-month					
Commercial paper	9.25 (12/31)	6.88	6.75	6.50	-.38
Finance paper	9.00 (12/31)	6.75	6.63	6.38	-.37
Bankers' acceptances	9.00 (12/31)	6.88	6.50	6.38	-.50
Certificate of deposit--new issue 2/	6.25	6.75	6.50	6.38	-.37
Treasury bill	7.54 (12/31)	5.63	5.42	5.36	-.27
3-month					
Commercial paper	9.25 (12/31)	7.38	7.13	6.88	-.50
Finance paper	8.13 (12/31)	6.75	6.75	6.50	-.25
Bankers' acceptances	9.00 (12/31)	6.88	6.50	6.38	-.50
Certificate of deposit--new issue 2/	6.50	6.88	6.75	6.50	-.38
Treasury bill	8.00 (12/29)	6.32	5.82	5.56	-.50
6-month					
Bankers' acceptances	9.00 (12/31)	6.88	6.50	6.38	-.50
Treasury bill	8.09 (12/29)	6.32	6.16	5.78	-.54
12-month					
Certificates of deposit--new issue 2/	7.50	7.00	7.00	6.75	-.25
Treasury bill	7.86 (11/24)	6.26	6.23	5.89	-.37
Prime municipals 2/	6.25 (11/12)	3.90	3.65	3.30	-.60

1/ Dates of highs in parentheses; latest date used if high occurred on more than one date.
2/ Investment yield basis. Highs for certificates of deposit are ceilings effective as of January 21, 1970.
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.

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

	August	September	October 1/
	Amounts Outstanding		
Total commercial and finance paper 2/	35,697r	34,284r	34,591e
Bank related 3/	7,257r	4,586	3,671e
Nonbank related 4/			
Placed through dealers	10,872	11,365	12,129e
Placed directly	17,568	18,333r	18,791e
	Net Change		
Total commercial and finance paper 2/	-852	-1,413r	+307e
Bank related 3/	-513	-2,671r	-915e
Nonbank related 4/			
Placed through dealers	-577	+493	+764e
Placed directly	+238	+765r	+458e

r - Revised.
e - Estimated; see footnote 1.
1/ As of October 28. 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.

Federal finance. The staff's present projections indicate a budget deficit for the current fiscal year of nearly $15 billion. The best evidence available tentatively suggests a deficit of about the same magnitude for calendar 1971. Considerable uncertainty still exists, however, because Congress failed to act on several important tax and appropriations bills--including defense--before it adjourned temporarily in mid-October, and, of course, the Administration's fiscal 1972 budget estimates will not be released until next January.

Staff projection of outlays for fiscal 1971 is now about $211.4 billion, an increase of $.8 billion since the last Greenbook. The revision is mostly attributable to anticipated increases for unemployment compensation and veterans benefits and to the assumption of a larger increase in social security benefits (effective January 1971) than previously allowed for. The projection assumes that there will be a compromise in Congress between those who favor the 5 per cent increase in social security benefits provided in the House bill (last Greenbook assumption) and the 10 per cent increase proposed in the Senate. Recent data on defense orders and contract awards suggest that defense expenditures may eventually begin to reverse the present decline, but this is not expected to occur until after the end of the current fiscal year.

On the receipts side, the staff estimate for the fiscal year of $196.6 billion is $.8 billion below the amount forecast in the last Greenbook. The downward revision is mostly in the areas of social insurance tax receipts and corporate tax receipts and is the result of lower income assumptions than those used previously.

Subject to the Budget uncertainties mentioned above, the staff projects a NIA Federal deficit of about $14.5 billion in the 1971 calendar year compared to about $11.0 billion in calendar 1970. This projected increase in the deficit is not an indication of an easing in fiscal policy--in fact, the high employment budget moves in the direction of greater restraint, as shown in the table at the end of this section.[1/] The projected $11.0 billion growth in actual receipts from calendar 1970 to calendar 1971 compares to an estimated $21 billion increase at high employment; both include a $2.7 billion increase resulting from discretionary changes in the tax law (mainly social security taxes). The projected $15 billion increase in expenditures is the same as in the previous calendar year.

In its recent quarterly refunding and note auction the Treasury raised $1.4 billion of net new money, payable November 16. As a result, the Treasury's end-of-November cash balance is expected to be $4.3 billion. The Treasury is expected to raise an additional $2.0 billion in early December, probably through the offering of tax bills. Also additions to weekly and monthly bill auctions are assumed to continue until the cycle is completed in mid-February. Alternatively, the Treasury could sell a bill strip early in December; this option would probably result in a larger one-time financing and substitute for continuing additions to weekly and monthly bill auctions. After allowance for this December financing, present estimates of Treasury cash flows over the next few months suggest that no further special financing operations will be needed until the February refunding.

1/ For further discussion of the high employment budget, see Appendix B.

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

	Fiscal Year		Calendar Years F.R. Estimates		Calendar Quarters 1970		1971 e/			
	1970*	1971e/	1970	1971	III*	IVe/	I	II	III	IV
Federal Budget										
(Quarterly data, unadjusted)										
Surplus/deficit	-2.9	-14.8	-12.3	-15.2	-7.8	-9.7	-5.2	7.9	-8.1	-9.8
Receipts	193.8	196.6	190.6	203.2	46.5	41.0	48.0	61.1	49.4	44.7
Outlays	196.8	211.4	202.8	218.4	54.3	50.7	53.2	53.2	57.5	54.5
Means of financing:										
Net borrowing from the public 1/	3.8	13.0	10.6	14.5	7.4	7.6	4.3	-6.3	8.3	8.2
Decrease in cash operating balance	-2.1	1.1	-.4	--	-.8	3.1	-1.1	-.1	-1.5	2.7
Other 2/	1.2	.7	2.2	.7	1.2	-1.0	2.0	-1.5	1.3	-1.1
Cash operating balance, end of period	8.0	6.9	5.7	5.7	8.8	5.7	6.8	6.9	8.4	5.7
National Income Sector										
(Seasonally adjusted annual rate)										
Surplus/deficit	-.4	-14.5	-10.8	-14.4	-13.2	-14.1	-15.2	-15.4	-14.4	-12.5
Receipts	198.9	199.0	195.5	206.6	194.5	195.0	201.6	204.9	208.0	211.9
Expenditures	199.3	213.5	206.4	221.0	207.7	209.1	216.8	220.3	222.4	224.4
High employment surplus deficit 3/	1.0	1.9	-1.1	5.8	-3.0	1.8	3.1	5.6	7.0	7.4

* Actual
e--projected
n.a.--not available
1/ 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.
2/ Includes such items as deposit fund accounts and clearing accounts.
3/ Estimated by Federal Reserve Board Staff.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

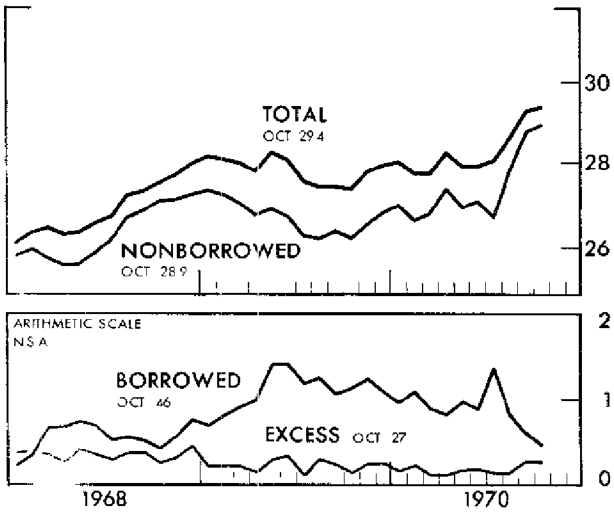
	Oct.	Nov.	Dec.	Jan.
Total net borrowing:	2.7	2.0	2.9	.2
Weekly and monthly bills	.5	.8	.7	.4
Tax bills	2.5		--,	--
Coupon issues	--	2.0	--	--
As yet unspecified new borrowing	--	--	2.0	--
Other (agency, debt repayments, etc.)	-.3	-.8	.2	-.2
Plus: Other net financial sources a/	1.2	-.6	-1.6	.9
Plus: Budget surplus or deficit (-)	-6.3	-3.5	.1	.2
Equals: Change in cash balance	-2.4	-2.1	1.4	1.3
Memoranda: Level of cash balance, end of period	6.4	4.3	5.7	7.0
Derivation of budget surplus or deficit:				
Budget receipts	11.5	13.8	15.7	18.0
Budget outlays	17.8	17.3	15.6	17.8
Maturing coupon issues held by public	--	6.0	--	--

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

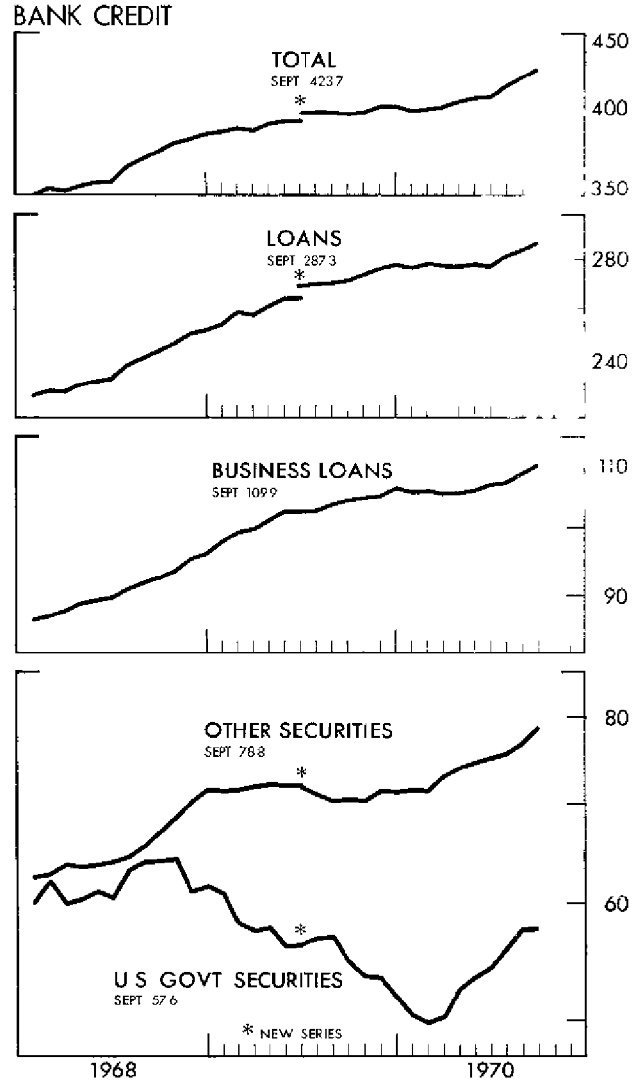
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

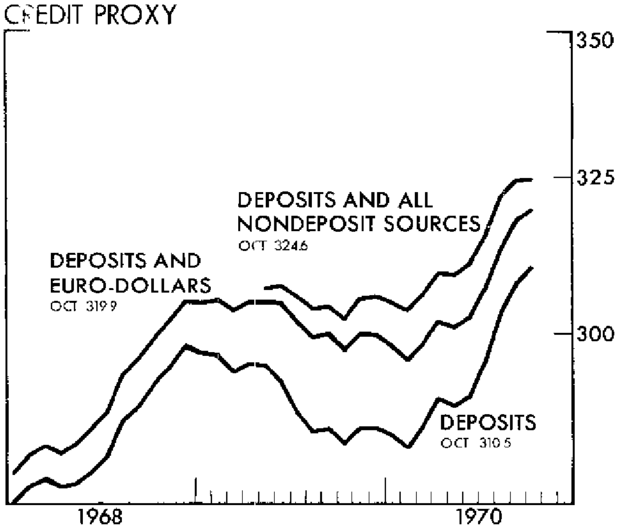
BANK RESERVES



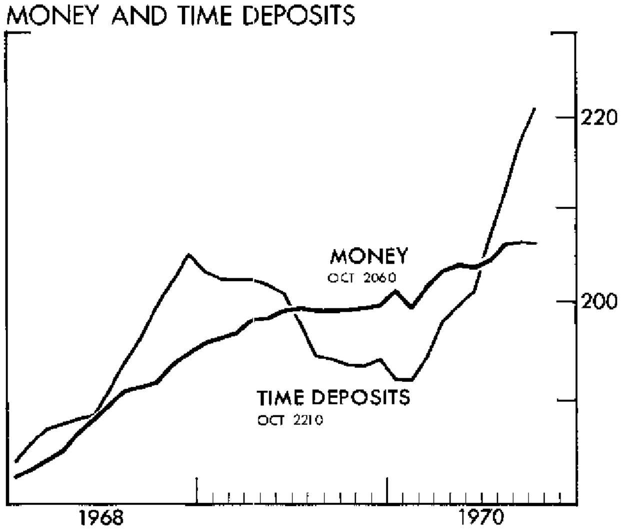
BANK CREDIT



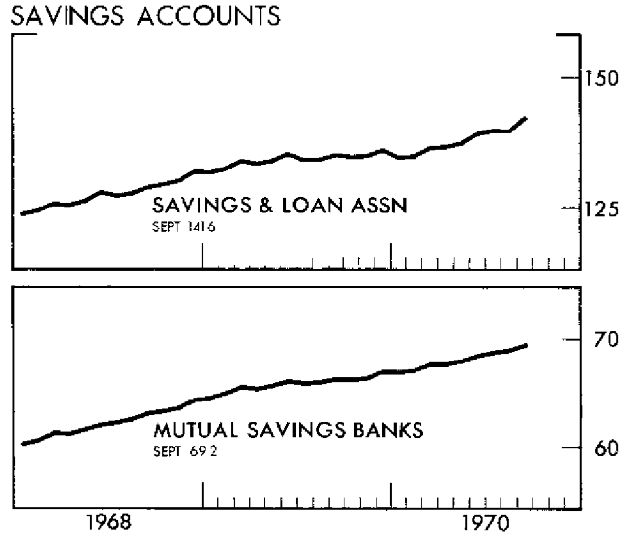
CREDIT PROXY



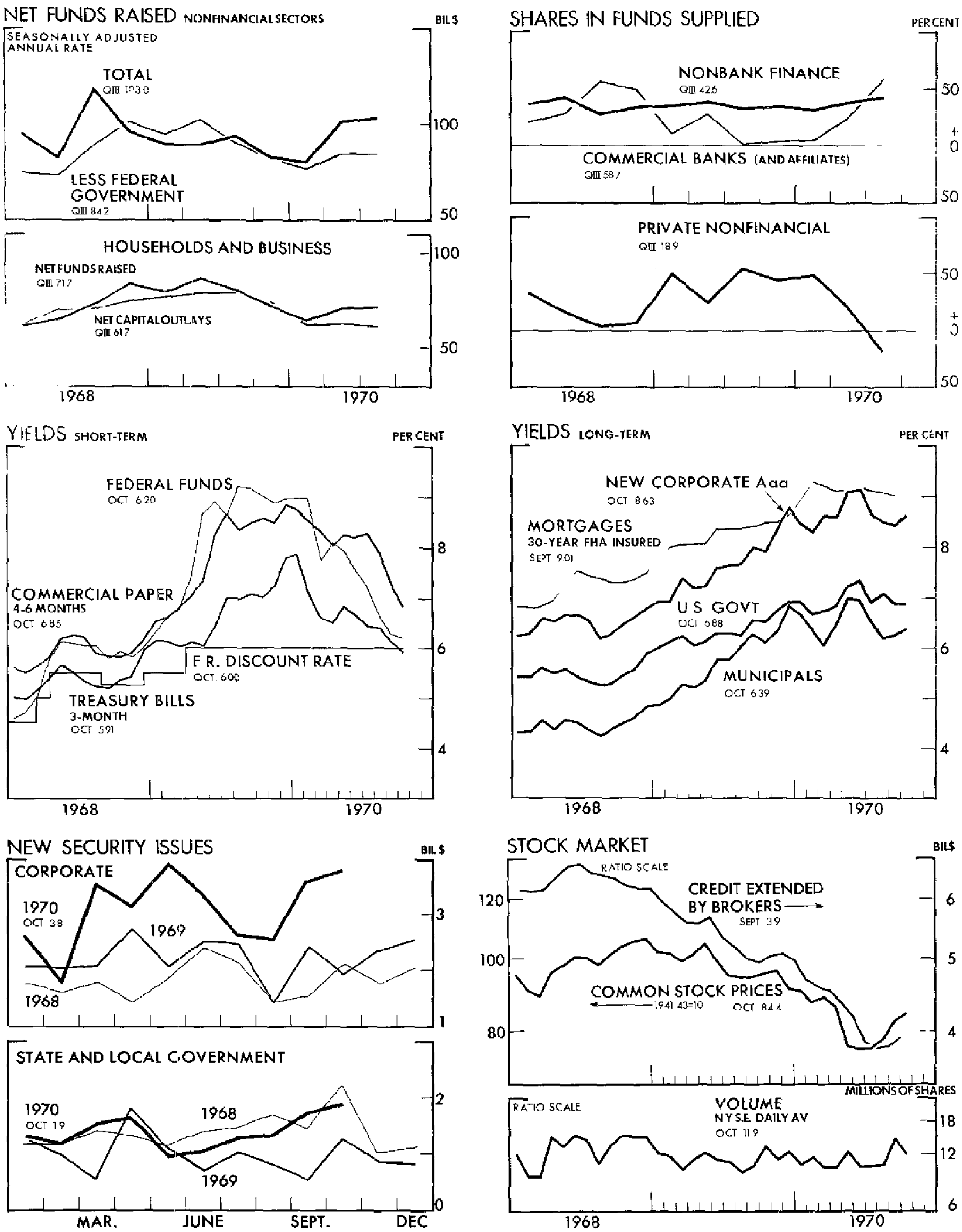
MONEY AND TIME DEPOSITS



SAVINGS ACCOUNTS



FINANCIAL DEVELOPMENTS - UNITED STATES



THE ECONOMIC PICTURE IN DETAIL

International Developments

U.S. balance of payments. More complete information confirms the earlier impression that the liquidity deficit in the third quarter was considerably improved -- to an annual rate of about $3 billion, compared with a rate of about $6-1/2 billion in the first half (seasonally adjusted and before SDR allocations and special transactions). Incomplete weekly data for October and the first few days of November, after allowance for seasonal factors, suggest a continuation of liquidity deficits at about the third quarter rate.

There have been a few modifications in the pattern of third-quarter transactions previously estimated. The trade balance weakened slightly to about a $3.1 billion annual rate in the third quarter, instead of rising as expected from the $3.4 billion second-quarter rate. Nevertheless, in the current quarter the trade balance is expected to edge up again, partly on the strength of a resurgence of aircraft exports.

The flow of bank-reported claims on foreigners was also somewhat less favorable in the third quarter than earlier expected, because of sizable outflows in September. But even so, there was a net inflow through repayments of $135 million, compared with an outflow of $460 million in the second quarter. This accounts for nearly half of the shift in the over-all liquidity balance between the two quarters. The

MEASURES OF THE OVER-ALL BALANCE OF PAYMENTS
(In millions of dollars; seasonally adjusted; deficit, -)

	1969				1970		
	Q-1	Q-2	Q-3	Q-4	Q-1	Q-2	Q-3
Liquidity balance 1/	-1,375	-3,461	-1,600	498	-1,249	-2,067	-723
Official settlements balance 1/	1,467	1,281	-420	450	-3,176	-2,120	-2,120
Adjusted over-all balance 2/	-1,485	-3,524	-1,731	301	-1,260	-2,002	-777
Memo: Net transactions excluded above:							
Liquidity basis							
Special transactions	23	-340	-679	-78	-349	647	-155
Seasonal fluctuations	84	-15	-693	624	102	9	-809
Official settlements basis							
Special transactions	-14	34	-162	64	73	142	75
Seasonal fluctuations	258	-111	-458	311	274	-83	-567

1/ Before special transactions and allocation of SDRs. Special transactions are redefined to exclude non-liquid assets held by international and regional institutions -- this does not affect the official settlements balance.
2/ The balance financed by official reserve transactions (as adjusted) and changes in liabilities to foreign commercial banks.

increase of some $250 million in short-term bank loans to foreigners in September suggests that an easing of credit conditions in this country could lead to considerably greater outflows. The September outflow was spread over many countries, although there was a small reduction in claims on Japan.

A more encouraging development in September was a net inflow of over $200 million of foreign capital to purchase U.S. corporate stocks, bringing the third quarter net inflow to $365 million. There was also a continued relatively small inflow to purchase corporate bonds. Another factor tending to improve the balance has been a renewed slowdown in the sale of new foreign bonds in the United States, following a spurt in July and August. In September sales of new issues were negligible, and in October the only significant issue was $95 million by the Inter-American Development Bank -- and most of the proceeds were invested in long-term time deposits. The calendar of known new foreign issues for the rest of the year is at present quite small -- reflecting largely a slowdown in offerings of Canadian issues.

The deficit on the official settlements basis was about as large in the third quarter as in the second, at $2.1 billion (seasonally adjusted and before SDR allocations and special transactions). The October deficit rate appears to be little changed. Although liabilities to foreign branches dropped by about $800 million in October, this was partly offset by increases in liabilities to other foreign commercial banks. U.S. reserve assets fell by $801 million in the third quarter -- there was a $395 million reduction in the gold stock (largely because of the unwinding of part of the IMF's 1956-60 sales of gold to United States to acquire earning assets) and a reduction of $406 million in our reserve position in the IMF as France and others repaid drawings, on balance, and the IMF sold $102 million of gold to the United States to obtain dollars. Liabilities to foreign official accounts rose by $1.8 billion, including $2.1 billion for Germany. In October U.S. reserve assets declined by $407 million -- mainly reflecting U.K. repayments of swap drawings, and a reduction in the U.S. reserve position with the IMF as the IMF sold $129 million of gold to the United States to offset U.S. gold sales to other countries needing to provide the gold portions of their increased IMF quotas. Liabilities to foreign official accounts rose by about $400 million; again the major increase in liabilities was for German account.

U.S. foreign trade. In September, the export surplus declined as exports fell while imports held at the high August level. In the third quarter, the export surplus was at an annual rate of $3.1 billion, slightly lower than in the second quarter.

U.S. MERCHANDISE TRADE, BALANCE OF PAYMENTS BASIS
(billions of dollars; seasonally adjusted annual rates)

			1 9 7 0		
	1968	1969	Q-1	Q-2	Q-3p
Exports, total	33.6	36.5	41.0	42.9	42.7
Agricultural	6.3	6.0	6.7	7.2	7.4
Nonagricultural	27.3	30.5	34.3	35.7	35.3
Imports, total	33.0	35.8	38.9	39.5	39.6
Balance, total	0.6	0.6	2.1	3.4	3.1

p=Preliminary.

Exports in the third quarter were at a seasonally adjusted annual rate of $42.7 billion, slightly below the level of the second quarter. Exports to Japan and to Australia, New Zealand and South Africa increased while those to Western Europe declined. Exports to Canada and the less developed countries were virtually unchanged.

Agricultural exports rose moderately from the second to the third quarter as increases in exports of soybeans and grains -- especially corn and wheat -- more than offset sharp declines in exports of cotton and tobacco. The increase in corn exports is attributable to anticipation of possible shortages in the U.S. resulting from the corn blight, a smaller-than-expected Argentine corn crop, and higher export prices. Foreign demand for wheat has also been strong because new harvests abroad are somewhat smaller than in the last few years. The drop in cotton exports in the third quarter was primarily caused by shortages in U.S. supplies of short-staple cotton preferred by foreign customers.

Exports of non-agricultural products declined slightly between the second and third quarters. With the easing of supply conditions in Western Europe and Japan, exports of iron and steel products fell from the peak levels of the second quarter. Almost all other industrial materials, except copper, also registered declines. Exports of copper advanced because of the change in the U.S. export controls on copper in July, which allows U.S. companies having difficulty in meeting the more stringent U.S. pollution regulations, to ship copper ore abroad for refining if the refined copper is returned to the United States. As noted below, U.S. imports of refined copper also increased from the second to the third quarter.

Exports of commercial aircraft fell abruptly in the third quarter, but delivery schedules indicate that aircraft exports will begin to increase again in the fourth quarter. Exports of autos to areas other than Canada rose in the third quarter but not by enough to offset a decline in exports of automotive equipment to Canada attributable to early model changeovers and the General Motors strike. However, exports of machinery increased strongly in the third quarter in response to continued strength in demand abroad.

Imports in the third quarter were at an annual rate of $39.6 billion (balance of payments basis), slightly above the second-quarter level. Significant increases were registered in imports of industrial supplies, but these increases were offset by declines in imports of automotive vehicles and of foods, principally coffee and sugar.

Iron and steel imports reached their highest levels since the fourth quarter of 1969, reflecting a considerable easing of steel supplies in Europe. A rise in imports of refined copper occurred as a consequence of the change in export controls mentioned above. Increases were also registered in nickel, lead and tin. The unit values of metals imports remained high, despite declines in world prices.

Crude oil imports fell because of supply shortages abroad arising from pipeline breakdowns in Syria and the lowering of production quotas by the Libyan government. Imports of fuel oil continued to increase in the third quarter to meet growing U.S. requirements. It is expected that fourth-quarter imports of fuel oils will be even larger because of liberalized U.S. import quotas and increased domestic demand.

Total imports of automobiles declined in the third quarter. A decrease in imports from Canada caused by the early model changeover and the GM strike outweighed increases in imports of European and Japanese automobiles. In October, domestic sales of foreign-type cars -- especially Japanese Toyotas and Datsuns -- continued to expand, raising the share of such cars in the U.S. market above the 13.1 per cent in the second quarter.

Despite the sluggishness in the U.S. economy, the ratio of imports to GNP was still a very high 4.01 per cent in the third quarter. This is only slightly below the 4.05 per cent in the first and second quarters and higher than the 3.85 per cent in calendar 1969. The ratio of imports of non-food consumer goods (other than automotive) to personal consumption expenditures on similar types of goods in the third quarter remained at the high 4.66 per cent level of the first half of 1970.

Foreign exchange markets. Most major foreign currencies moved higher against the dollar in the period since the last Green Book, reflecting in part a sharp decline in Euro-dollar interest rates. Several central banks made large additions to their reserves during the period.

Sterling posted a strong advance between mid-October and early November, with the exchange rate climbing to well over $2.39 and the Bank of England purchasing over $450 million. Bank of England reserve gains were particularly large following the announcement in late October of an increase in reserve requirements of British commercial banks, and throughout most of the period under review sterling benefited from a flow of short-term interest arbitrage funds from the Euro-dollar market. In the most recent week, however, some softness developed in the sterling market as a new round of very high wage settlements in Britain's public sector again aroused concern over Britain's inflation problem. During October the Bank of England repaid $275 million of its swap indebtedness to the System, reducing the outstanding balance on that line to $125 million.

The lira continued its strong recovery, and the Bank of Italy purchased $360 million from October 14 to November 4, bringing its reserve gains since the first of August to just over $700 million. Most of the recent strength in the lira is apparently the result of short-term capital flows, although Italian exports have begun to pick up lately.

The German mark eased substantially in the last two weeks of October, following the passing of the mid-month tax date and large deliveries of marks to the market by the Bundesbank as its forward exchange market contracts matured. Call money rates in Germany, which had been running at around 9 per cent, dropped to an average of 5-6 per cent during these two-weeks, and may have contributed to the sharp decline in very short-term Euro-dollar rates. At the beginning of November, however, the German call rate shot back up to 9 per cent. As it became apparent to the market that no end of German monetary restraint was in sight, the exchange rate moved to the ceiling, and on November 4 the Bundesbank purchased $130 million -- its first market intervention in about a month.

Despite a cut in the Belgian discount rate, the Belgian franc remained at or near its ceiling during the period, and the National Bank of Belgium purchased about $100 million. The System drew $95 million on the Belgian swap line, bringing its outstanding indebtedness on that line to $250 million.

The Dutch guilder remained very firm, mainly as a result of relatively tight Dutch money market conditions plus some foreign interest in guilder-denominated bond issues. The Netherlands Bank purchased over $100 million spot and $85 million in swaps with Dutch commercial banks from mid-October to November 6. In early November, the central bank raised its intervention point, presumably lessening the accruals to its reserves. The System drew the remaining $30 million on the $300 million swap facility with the Netherlands Bank so that that facility is now fully drawn. On November 5, the Dutch purchased $30 million in gold and $30 million in SDRs from the U.S. Treasury.

The French franc firmed towards the end of October, mainly reflecting the monthly pattern of conversion of French export proceeds, and the Bank of France purchased $100 million in late October and early November.

Among other major currencies, the Swiss franc remained quite soft throughout October, then firmed in early November as domestic money markets tightened somewhat. The Canadian dollar firmed toward month-end, then eased as Canadian interest rates declined fairly sharply.

The gold price fluctuated widely during the period, hitting a peak of well over $39 per ounce on October 27. The price broke sharply on October 29, as the rumor (subsequently confirmed) swept the market that the Swiss Banking Commission had advised Swiss banks of its view that gold should no longer be included as part of the banks' cash reserves. By early November the price had fallen to the $37.20-40 range, about the same as a month earlier.

Euro-dollar market. Euro-dollar interest rates, after moving up in September (counter to the trend in U.S. rates) declined substantially during October and then held relatively stable in early November. Call deposits averaged 6.38 per cent in November 5-10, down nearly 1/2 percentage points from early October; the three-month, which averaged about 7-1/2 per cent in the latest week, declined about 7/8 per cent.

The excess of Euro-dollar rates over the cost of domestic sources of funds, which had widened markedly in late September, was reduced by the October decline in Euro-dollar rates. In early October the call Euro-dollar rate exceeded the Federal funds rate by more than a full percentage point; by late October call Euro-dollars were somewhat cheaper, on average, than Federal funds. The three-month Euro-dollar rate exceeded the cost of 60-89 day CD's (adjusted for the cost of required reserves) by nearly 1-1/4 per cent in the second week of October; but in late October this differential had narrowed to about 0.8 per cent.

In recent days, however, the excess of Euro-dollar rates over the cost of domestic sources of funds has widened once again as Euro-dollar rates have remained fairly stable in the longer maturities (and advanced moderately on call and one-month funds) while U.S. rates have declined. On November 10, call Euro-dollars were quoted at 6-1/2 per cent, or 1-1/4 per cent in excess of the Federal funds rate; three-month Euro-dollars, at 7-1/2 per cent, exceeded the (adjusted) cost of 60-89 day CD's by about 0.9 per cent.

Gross liabilities of U.S. banks to their foreign branches (including participations in domestic loans) declined about $550 million from October 14 to November 4, to a total of $9.3 billion. This decline in part reflected a decision by at least two banks to give up some of their reserve-free historical bases (for calculation of required reserves against Euro-dollar positions). In the four-week computation period ended October 28, First National City of New York (which in late October announced its intention to reduce its Euro-dollar takings) gave up about $270 million of its reserve-free base and one other New York City Bank reduced its reserve-free base by $165 million. Thus, it appears that in the computation period ended October 28 the reserve-free base for banks using an historical base was reduced by about $435 million, to $10.3 billion, compared to the original May 1969 base of $11.2 billion. (Data are not yet available for banks outside of New York).

Developments in some foreign national money markets may have also contributed to the decline in Euro-dollar rates in recent weeks. The Bank of France, on October 20, announced a 1/2 per cent reduction in its discount rate, to 7 per cent, and the Belgian National Bank, a day later, reduced its discount rate by 1/2 per cent, to 7 per cent. Near the end of October major Canadian banks cut their prime lending rates by 1/2 per cent to 7-1/2 per cent. Very short-term rates in the German money market dropped sharply in late October (to about 5-6 per cent) but have since rebounded to about 9 per cent. Until very recently the Swiss money market was quite liquid, since large repatriations of funds had been made by Swiss banks at the end of September.

SELECTED EURO DOLLAR AND U.S. MONEY MARKET RATES
(monthly or weekly averages of daily figures)

Average for month or week ending Wednesday	(1) Call Euro-$ Deposit	(2) Federal Funds	(3)= (1)-(2) Differ-ential	(4) 3-month Euro-$ Deposit	(5) 60-89 day CD Rate (Adj) 1/	(6) =(4)-(5) Differ-ential
August	7.26	6.61	0.65	8.19	8.17	0.02
Sept.	7.68	6.29	1.39	8.03	7.64	0.39
Oct. 7	7.73	6.36	1.37	8.35	7.24	1.11
14	7.13	6.21	0.92	8.18	6.97	1.21
21	6.08	6.18	-0.10	7.76	6.84	0.92
28	6.00	6.11	-0.11	7.66	6.84	0.82
Nov. 4	6.10	6.07	0.03	7.58	6.65	0.93
10 2/	6.38	5.86p/	0.52p/	7.53	6.65p/	0.88p/

p/ Preliminary.
1/ Median rate offered by prime banks in New York (adjusted for the cost of holding required reserves).
2/ Data through Tuesday.

Cyclical developments in major industrial nations. In most industrial countries, the main policy problem over the past year has been to bring inflation under control by reducing the pressures of excess demand on resources. This process has gone furthest in the United States, Canada, and the United Kingdom, where there have been actual declines in output, and where renewed advances in activity at a moderate rate are now looked for. By the summer, some easing of demand pressures had also been achieved in Germany, France and Japan, permitting some recent relaxation of policies of restraint in the latter two countries. In Italy there appears to be scope for further rapid advances in output. In most smaller European countries, excess demand pressures have remained severe, and new measures of restraint have recently been introduced. For all countries, and especially for the United Kingdom, the problems of cost-push inflation after excess demand is reduced remain serious.

In the two major continental countries, Germany and France, industrial production has been flat through the first 8 months of 1970, unchanged from the high levels of activity reached by these economies by the end of 1969. In Germany the economy's resources remain strained; new orders in real terms have fallen since the beginning of the year, but backlogs are still large. In France pressure on resources has moderated sufficiently during the year to lead the authorities to reduce credit restraint, particularly on consumer demand.

In Britain, some slack in the economy has developed this year. Real output dipped in the first quarter, but since then has been rising again. In Canada, real GNP has shown virtually no growth since the first quarter of 1970, industrial production has declined slightly, and unemployment has increased.

While inflationary pressures seem to be moderating in many major countries, excess demand, rapidly rising prices, and growing current account deficits have recently forced several smaller European countries to take severely restrictive measures. These include a price freeze in Sweden, both a price and a wage freeze in Denmark, and price and wage controls in the Netherlands. The slowing in German economic expansion may help the effectiveness of the various restraining measures that the Dutch government is imposing on the economy.

For the future, there is uncertainty as to whether the desired reduction in excess demand pressures in continental European countries will be possible without some actual declines in real GNP next year, and also whether the desired slowing of wage and price advances will follow easily. But country representatives at an OECD forecasting session in mid-October were reasonably optimistic on both scores.

In Germany pressures on resources have moderated slightly since the beginning of the year. Industrial production has been essentially flat and the inflow of orders in real terms has fallen. However, indicators of final demand remain strong. Since the spring retail sales have been advancing fairly strongly; in particular, consumer demand for durable goods has been expanding rapidly. Domestic private investment demand has remained at a high level. The current flatness of industrial output is largely explained by the cessation and reversal of the inventory build-up of steel and other materials that had been occurring earlier.

The German trade surplus continues large. While imports of finished goods have continued to grow strongly, imports of crude and semifinished materials have leveled off since the spring. On the other hand, exports are continuing to rise rapidly, supported by large order backlogs. Unit values of imports have declined since the spring, but those of exports have risen, adding to the trade surplus in current value terms. The surplus for 1970 is likely to equal the $5.2 billion registered in 1969.

The German labor market, although remaining very tight, shows signs of easing a little -- with job vacancies edging down and unemployment up. Average hourly earnings rose very rapidly after the large wage settlements of September 1969, but increases -- although large -- have been on a smaller scale this year.

Wholesale prices for finished consumer goods and capital equipment have continued to rise, while prices of materials have declined a little since the spring. The consumer price index is rising at a year-to-year rate of 4 per cent; recent slowing in monthly increases has been due to decreases in food prices which are largely seasonal.

In France, the stabilization program that was introduced just over a year ago has met with mixed success. The huge trade deficit of 1969 shifted to a small surplus and French official reserves grew as confidence in the franc returned. Price increases, however, have been larger than hoped for and unemployment has been increasing throughout the year largely because of labor force growth. Industrial production was flat in the January-August period.

In September 1969, as part of a post-devaluation package, the Government had imposed severe restrictions on installment purchasing, in order to reduce the level of imports and to curb consumer demand. At the same time, tax and interest rate inducements to private savings were offered. France's trade account rapidly returned to equilibrium and consumer demand leveled off at the end of 1969 and remained virtually unchanged through August 1970. The shift of resources to export production exceeded official expectations.

Supported by buoyant external demand and a high level of private domestic investment, real GNP was growing rapidly until recently -- at a rate of about 6 per cent between the first half of 1969 and the first half of 1970. When external and investment demand began to slacken off, the authorities found it desirable to relax their restrictive policies somewhat. The Bank of France's discount rate was lowered in two steps from 8 to 7 per cent this summer, as the Euro-dollar rates declined. In September, installment purchase terms were relaxed a little, and late in October the National Credit Council abolished all bank credit expansion ceilings. However, rediscount ceilings for individual banks were reduced. The Government has drawn up a balanced budget for 1971; the 1970 budget will probably register a small surplus.

In the United Kingdom, real GNP fell by over 1 per cent in the first quarter of this year as both fixed capital investment and inventories declined. However, GNP rebounded in the second quarter to about the level of the last quarter of 1969, and has since apparently continued to grow at about a 3 per cent annual rate, a rate that seems likely to be sustained well into next year. The advance in consumption is expected to continue. Also, export order backlogs are still substantial and the export sector should contribute to continuing economic expansion.

The pattern of growth in the British economy since last spring suggests future problems. Growth has been consumption-led, while industrial investment lags, and wage and price increases continue to be rapid. The United Kingdom is the clearest example among the industrialized countries of inflation that is primarily of a cost-push nature. From January-February through July-August of this year weekly wage earnings rose at an annual rate of 13 per cent, while retail and wholesale prices rose at an annual rate of 7 per cent from the first through the third quarter.

The Conservative Government has emphasized the importance of tightening monetary policy to counter inflation, and at the end of October the Bank of England announced a rise in the special deposits requirements effective November 11. The move is mainly significant as a signal that the Bank of England and the Chancellor intend to press the clearing banks to curb the rate of growth in their lending.

The Government has recently announced that it will cut public expenditures and personal and corporate income taxes as of April 1971 (see Appendix A).

In the small open economies of continental Europe demand pressures and external deficits created mounting problems and forced the authorities to adopt some unusually stringent measures. In Denmark and Sweden the already very restrictive monetary stance was reinforced by a general price freeze and Danish wage rates have also been partially frozen. Norway's inflation seems less serious and its currency has not been subjected to periodic speculative attacks this year as has been the case in Denmark and Sweden. Nonetheless, demand pressures and worsening external accounts forced the authorities recently to adopt a pointedly restrictive stance. Finland also has been pursuing a strict incomes policy and Iceland has imposed price controls.

The economy of the Netherlands is faced with similar problems. Pressure on resources remains severe because of high domestic as well as foreign demand. The labor market is very tight, with the labor shortage aggravated by an accelerated movement of border residents to Germany, where wages are higher partly because of large increases in wage rates and partly because of revaluation. Wage increases continue to be very large. The resulting cost push on prices, augmented by the DM revaluation, forced a relaxation in August of price controls that were instituted in April 1969. Retail prices have been rising at an annual rate of nearly 7 per cent, with non-food prices rising rather faster.

The Dutch authorities recently announced very restrictive measures in the 1971 budget. These measures, which will be in effect for a period of 12 months, include a wage freeze (effective January 1), cutback in government spending and temporary hikes in some tax rates. Monetary policy remains restrictive and consumer credit has been further tightened.

Italy is one major European country where no slowing of economic growth is likely next year. The Italian economy has been bedeviled by damaging strikes that started in the autumn of 1969. Although the major strikes were settled by the end of last year, industrial activity continued to be affected by localized stoppages and a prolonged political crisis through August of this year. Not until the Colombo cabinet took office in August did confidence in the lira reappear. Italian industrial production in the first 9 months of the year was only 4 per cent higher than a year earlier, and after the initial recovery at the turn of the year it remained fairly level until September, when a sharp pickup occurred.

Domestic output, reduced by the labor unrest, has been insufficient to meet internal demand, particularly since inventories had to be replenished after their severe rundown in 1969. This was a major cause of the deficit in the external balance on goods and services in the first half of 1970, equal perhaps to as much as 1.5 per cent of GNP.

Throughout 1970, monetary policy in Italy has been restrictive, and since August it has been reinforced by some fiscal restraint in the form of increased taxes on gasoline and on other items. Although the restraining effects of these fiscal measures may be partially offset by a reduction in the savings ratio -- which has been unusually high this year -- demand pressures in Italy should moderate.

In Canada, this has been a year of economic adjustment, with the Government vigorously pursuing anti-inflationary policies. Real GNP hardly increased in the second quarter, after a strong 6.7 per cent annual rate rise in the first quarter and a 5.6 per cent rise in the last quarter of 1969. Industrial production declined slightly in the second quarter, and this tendency persisted in the third quarter. Labor disputes, including the continuing automobile strike, contributed to this leveling in output and to the high level of unemployment in recent months. Exports and construction have been major elements sustaining domestic output this year. There has been a marked slowing in the rate of price increases, but wage increases in recent settlements exceed 8 per cent per year when averaged out over the contract period.

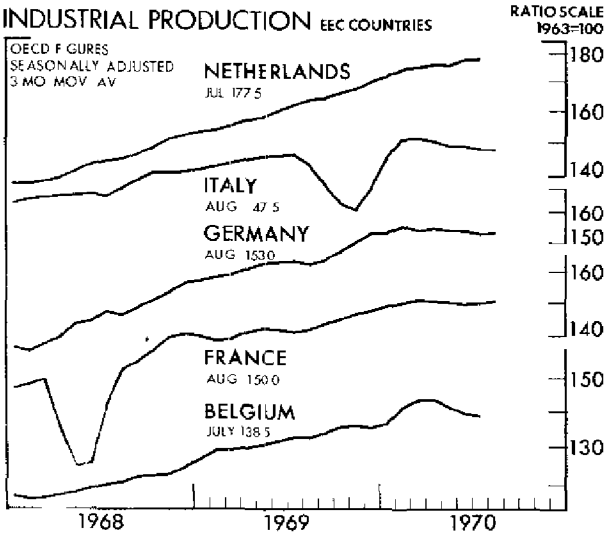
In Japan, the economy is experiencing its longest advance in postwar history. Most signs point to a further strong advance next year. For the fiscal year ending March 1971, the GNP is estimated by the Japanese Economic Research Center to increase by 11.4 per cent in real terms as compared with a 13 per cent real growth in the preceding fiscal year.

All sectors of the Japanese economy have shared in this year's expansion but business investment plans appear to have eased moderately since mid-year. From September 1969 to mid-1970 the Bank of Japan pursued a tight monetary policy. Since July, however, commercial banks have been allowed to expand their credits at a faster rate. On October 28, the Bank of Japan lowered its basic discount rate by one-quarter of a point.

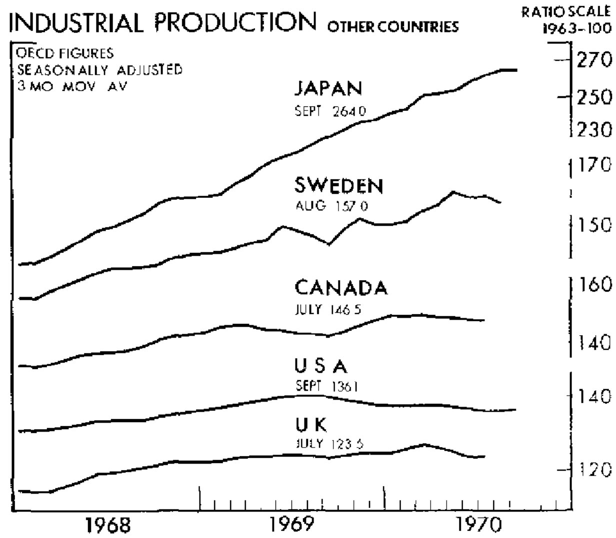
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

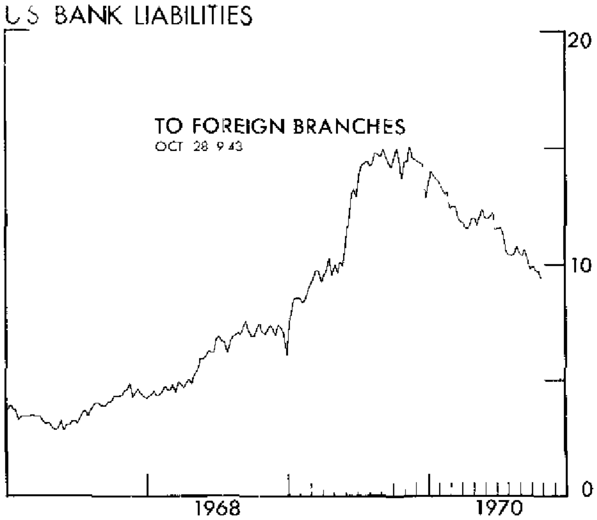
INDUSTRIAL PRODUCTION EEC COUNTRIES



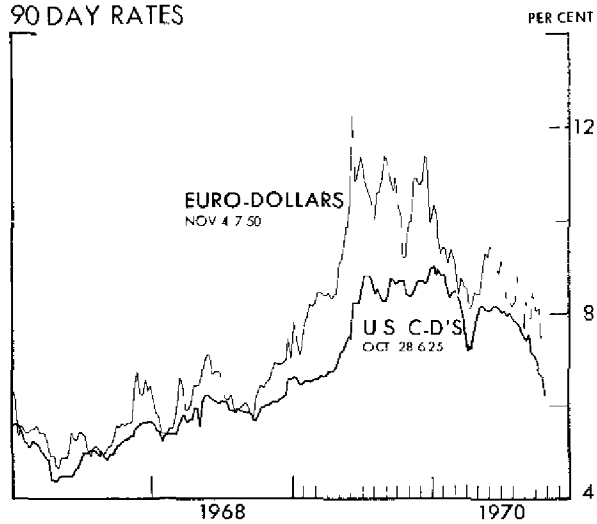
INDUSTRIAL PRODUCTION OTHER COUNTRIES



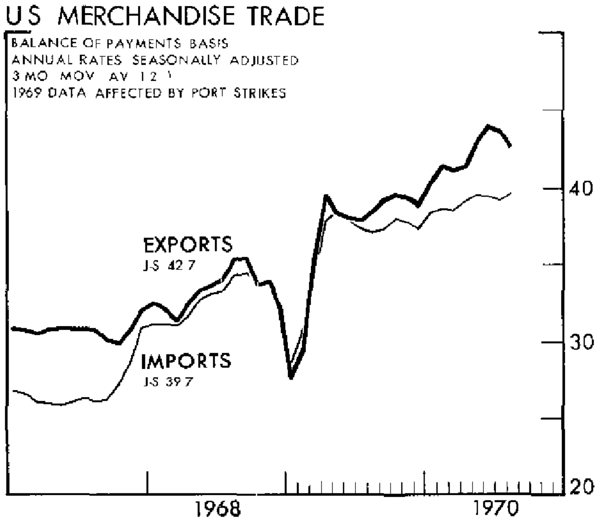
U.S. BANK LIABILITIES



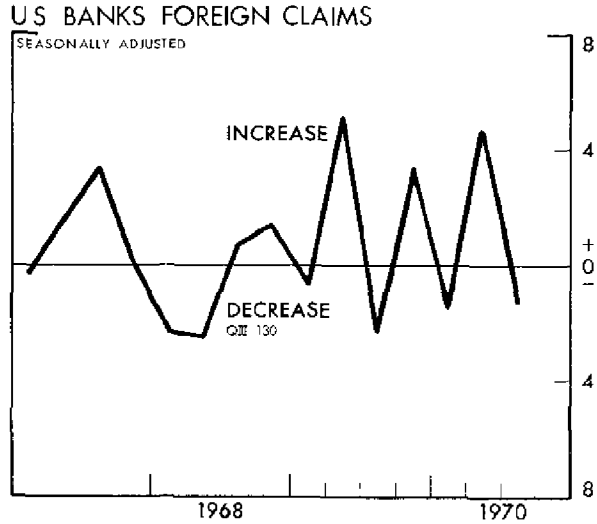
90 DAY RATES



U.S. MERCHANDISE TRADE



U.S. BANKS FOREIGN CLAIMS



Appendix A: BRITISH GOVERNMENT ANNOUNCES TAX AND EXPENDITURE CUTS*

Britain's Conservative Government announced on October 27 that it will reduce public sector expenditures below the amounts that would have been spent had the Labor Government remained in office. The decreases in planned outlays will be accompanied by moderate cuts in both personal and corporate income taxes.

The measures presented to Parliament by Chancellor Barber are intended primarily as a long-range program for reducing the government's role in guiding economic activity and in subsidizing a variety of goods and services consumed by the public. Chief among the slashes in public sector outlays -- which include total net expenditures by the central government and local authorities and capital expenditures by the nationalized industries and other public corporations -- are the abolition of grants to finance private sector capital investment; the replacement of deficiency payments to British farmers by a system of variable levies on agricultural imports to maintain a floor under farm prices; and elimination or reduction of a number of social welfare subsidies. For example, prescription charges will be raised, recipients of dental care will have to pay half of the cost of treatment, the price of school meals will be raised, and -- in 1972 -- rents in public sector housing are to be raised to more economic levels.

Though there will be some decrease below previous plans in public sector demand for goods and services -- for instance, defense spending and capital investment by nationalized industries will be cut -- the emphasis is on curtailing transfer payments, the program not being intended to restrict total output or growth. Thus investment grants will give way to more liberal depreciation allowances, in order to encourage private sector capital investment with a minimum of government participation in determining the allocation of investment. The objective of switching to import levies is not to reduce farm income but to transfer the burden of supporting it from the taxpayer to the consumer, who will have to pay higher prices for farm produce. Nor are the cutbacks in social welfare subsidies intended to reduce consumption of the items they help pay for. The theory is that offsetting reductions in taxes will prevent such a decline.

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* Prepared by Martin J. Kohn, Europe and British Commonwealth Section, Division of International Finance.

However, to prevent hardship resulting from the redistribution of income implicit in the program, the Government will increase welfare benefits for those at the bottom of the income scale. Thus the maximum level of income below which individuals or families are entitled to receive various welfare benefits free of charge is being raised. Furthermore, the raising of rents on public sector housing will be accompanied by a system of rebates to needy tenants occupying rental housing, privately as well as publicly owned. What amounts to a small negative income tax -- to be known as the Family Income Supplement -- will also be introduced in 1972. It will take the form of weekly payments up to £3 to poor families, even where the head of the household is employed, and will be in addition to other welfare benefits.

The full impact of the program will not be felt for several years. In 1974-75, it is anticipated that public sector expenditures will be reduced by about £1.1 billion in 1970-71 prices (after deducting the revenue loss from the liberalized depreciation allowances) -- or by about 4-1/2 per cent -- below what they otherwise would have been. The Government estimates that the new program will cut the rate of growth of real public sector expenditures to 2.8 per cent per annum from 1971-72 to 1974-75 from the 3.5 per cent annual rate it maintains they would otherwise have grown at in the absence of these changes.

In the fiscal year 1971-72 -- which begins April 1 -- savings will total about £330 million (equal to about 3/4 of one per cent of GNP) and will apparently be slightly more than offset by the tax cuts. The basic rate of personal income tax is being reduced, effective next April, from 41.25 to 38.75 per cent, a step expected to cost the Government over £300 million annually. The corporate tax reduction, from 45 to 42.5 per cent, applies to taxes due in the current fiscal year and will lower revenue in 1969-70 by about £60 million. The estimated loss in the next fiscal year will be about £90 million.

Though the margin by which tax cuts are expected to exceed spending cuts is narrow, the new program may nevertheless have some inflationary repercussions, for two main reasons. First, cutting taxes in the current inflationary climate may further fuel inflationary expectations; and second, the rise in food prices stemming in particular from the new method of supporting farm income -- expected to be introduced soon -- will increase already high wage demands. Consequently, the new program, whatever its long-range merits, seems likely to hamper the Government in dealing with Britain's most pressing economic problem -- severe wage and price inflation.

APPENDIX B: STAFF ESTIMATE OF HIGH EMPLOYMENT SURPLUS*

The high employment surplus is an estimate of the surplus or deficit in the Federal sector (NIA accounts) that would exist if the economy were operating at a hypothetical high employment level of economic activity. Our estimates show a shift in the high employment budget from a large deficit (about $12.0 billion) in the 1967-68 period to a surplus of nearly $4.0 billion in calendar year 1969. The staff now projects a small high employment budget deficit of $1.1 billion in calendar 1970 followed by a nearly $6.0 billion surplus in 1971 as shown in Table I below. This projected shift toward fiscal restriction in 1971 is expected to occur despite an estimated increase in the actual NIA budget deficit from $11 billion in 1970 to almost $15 billion in 1971. Thus the projected deficit in the NIA budget is viewed entirely as the result of a shortfall in receipts arising from reduced economic growth. The staff estimates indicate that the gap between potential and actual GNP will be $24.6 billion for the 1970 calendar year and $57.5 billion for 1971. The shortfall in actual receipts associated with these gaps is $8.2 billion and $18.9 billion respectively. The large relative shortfall in receipts results from the fact that corporate profits--on which marginal tax rates are high--have declined relative to other income shares under current sluggish economic conditions. In calculating the high employment budget, however, income shares are calculated at high employment levels, as discussed below.

Calculating and Interpreting the High Employment Budget

The high employment budget is an attempt to measure discretionary fiscal activity alone. It has long been recognized that the actual Federal surplus or deficit is not a satisfactory measure of discretionary fiscal policy because changes in revenues and to some extent expenditures reflect not only the budget's influence on the economy but also the economy's influence on the budget. Any analysis of the total fiscal impact of the budget should include both the automatic and the discretionary aspects. But measures of discretionary fiscal policy must abstract from the automatic feedback effect of fluctuations deriving from business cycles. 1/ The high employment budget seeks to accomplish this objective by estimating what the budget position would be if there were no business cycle and if the economy were growing along a path of relatively full capacity output.

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1/ The feedback effect occurs mainly because of the sensitivity of Federal receipts, particularly corporate profit and personal income tax receipts, to business fluctuations.

HIGH EMPLOYMENT BUDGET
(Billions of current dollars; seasonally adjusted annual rates)

Calendar Year	Receipts	Expenditures	Surplus or Deficit	GNP Gap	Receipts Gap
1967	150.6	163.7	-13.1	- 6.0	- .6
I	146.2	159.4	-13.2		
II	148.5	161.3	-12.8		
III	152.7	165.0	-12.3		
IV	155.1	169.0	-13.9		
1968	170.6	181.8	-11.2	-19.2	- 4.8
I	158.0	174.5	-16.5		
II	161.6	180.8	-19.2		
III	179.2	184.3	- 5.1		
IV	183.7	187.4	- 3.7		
1969	195.3	191.4	3.9	-12.8	- 5.3
I	190.4	187.7	2.7		
II	194.9	189.4	5.5		
III	195.6	192.5	3.1		
IV	200.1	195.9	4.2		
1970[e]	204.3	205.4	- 1.1	+24.6	+ 8.2
I	199.8	197.1	2.7		
II	204.0	209.9	- 5.9		
III	203.7	206.7	- 3.0		
IV[e]	209.7	207.9	1.8		
1971[e]	225.5	219.7	5.8	+57.5	+18.9
I[e]	218.6	215.5	3.1		
II[e]	224.5	218.9	5.6		
III[e]	228.2	221.2	7.0		
IV[e]	230.7	223.3	7.4		

e--projected

A general description of the method employed by the staff and most other analysts to estimate the high employment budget is rather straight forward. The staff estimate of high employment receipts involves (1) defining high employment and calculating a hypothetical high-employment level of GNP in current dollars, (2) estimating three income components of high employment GNP--corporate profits, personal income and wages and salaries, and (3) applying the appropriate tax rates to the income components to get the high employment estimate of the four categories of receipts in the Federal sector accounts. 2/ All receipts that result from the trend growth in potential output and incomes are included in high employment receipts. Thus the difference between high employment and actual receipts measures the effect of purely cyclical automatic flexibility in tax collections.

Adjustments of expenditures are less complicated, since it is assumed that, except for unemployment compensation, actual expenditures are not related to cyclical movements in the level of economic activity. Thus high employment expenditures equal actual expenditures adjusted for changes in unemployment compensation. However an increase in expenditures does not appear as a discretionary change in the budget balance if there is a corresponding growth in potential receipts. Thus the secular growth in the size of the economy shows up as a growth trend in potential receipts. If there is no corresponding growth in expenditures the high employment surplus would increase to huge amounts over time. The presumption is that the budget would maintain a constant degree of influence on an economy that operates along a given growth path, when the trend growth in receipts and expenditures is the same.

Changes in the high employment budget surplus or deficit give an indication of the direction of change in discretionary fiscal policy. The budget balance, however, does not measure discretionary changes in the size of the public sector relative to total output if, for example, both receipts and expenditures increase faster than potential GNP. This is an aspect of fiscal policy which is also important according to traditional theory. An additional shortcoming of the high employment budget (as well as the actual budget) is that any dollar of receipts and expenditures is given the same weight, though the impact on the economy of different categories need not be identical.

A number of technical problems arise in estimating high employment receipts. Because a considerable amount of judgement must

2/ These income components are proxies for the actual tax base. The four categories of NIA receipts are personal taxes, corporate profit tax accruals, indirect business taxes, and social insurance contributions.

be used to resolve these problems, there is substantial variability in the estimates of different analysts. Some of the problem areas and the staff method of dealing with them are discussed briefly below.

(1) Treatment of price level changes

Perhaps the most serious difficulty involves the choice of deflator used to convert potential real GNP to current dollars. 3/ Ideally, the deflator employed in the calculation should not be affected by economic conditions. Since the GNP deflator includes the impact of price conditions generated by the cycle, it is not an appropriate measure. Yet most estimates of high employment GNP--both for the past and the projected period--use the GNP deflator and thereby seriously bias the estimate of the high employment receipts.

When actual prices (rather than prices that would prevail in the economy of steady high employment growth) are incorporated into receipts estimates for historical periods of excess demand inflation, estimates of high employment income and receipts are overstated because no adjustment is made for (stabilizing) revenue gains arising from price acceleration. Similarly in projections for future periods, the high employment budget can be made to appear more restrictive simply by assuming a higher rate of inflation.

The effects are not symmetrical over the cycle. High employment revenues are exaggerated during periods of excess demand inflation, but when output is below potential, high employment revenues are understated because the price rise is lower than it would be at high employment. The latter distortion is not as important, however, because average prices rarely decline even during a recession (only the rate of increase is slowed). The upward ratchet effect on prices of excess demand inflation on the other hand has a cumulative effect over a period of years that can seriously distort the estimates. Nevertheless the effect of inflation on receipts needs to be incorporated in the estimates at some point--at least into the historical data--since public policy generally does not seek to push prices back to the level that existed prior to an inflation.

No completely satisfactory method of dealing with the price problem has been found. The Board staff has chosen not to employ the published implicit price deflator, but instead the staff estimates for past and projected periods uses a moving average of the deflator proposed by Arthur Okun. This method was designed to compensate for inflation that is avoidable in the short-run while permitting the upward ratchet of the past to stand. The Okun deflator is, in effect,

3/ The prior estimate of the growth in potential real GNP also raises some difficulties. The higher the growth rate assumed, the more restrictive discretionary policy appears. However, the staff does not attempt to estimate this figure, but adopts the growth path calculated by the CEA.

an average of the rate of price increase four quarters prior to the estimated quarter and a "reasonable" high employment increase of 2 per cent annually. The staff uses a moving average of the Okun deflator because of the instability in the series reflecting changes in the GNP deflator four quarters past. The calculated change in the deflator is added to the actual level of prices four quarters ago.

The substitution of the staff's adjusted deflator for the published GNP deflator has a considerable impact on the estimate of potential GNP. During periods of rapid price acceleration the adjusted deflator increases less rapidly and follows a relatively smooth growth path at a level below the published deflator. This price adjustment tends to make the Staff estimate of high employment receipts systemtically lower in periods of inflation than other estimates using the actual deflator. 4/

(2) Measurement of income components

The estimation of the major components of GNP at high employment (the proxies for the tax base) is a critical step in the calculations because shifts in the components over time greatly affect receipts. In general, estimates of high employment income shares are based upon an examination of actual shares in past periods of high employment, generally specified as approximately 4 per cent unemployment. The corporate component is far more critical than the estimate of the other income shares--personal income and wages and salaries--used in the calculations. A dollar increase in the corporate share will add more than 42 cents to high employment revenues, while a dollar increase in the personal income share will increase personal tax receipts by only about 11.5 cents. Variations in estimates of the high employment corporate profits share over time account for some of the discrepancies among estimates of the high employment budget by various analysts.

Figure 1, below, shows measured corporate profits before tax as a per cent of actual GNP for most of the post- World War II period. Though there appears to be a downward trend in the corporate profit component over the period, this trend is somewhat obscured by the large cyclical movements of the corporate profit share. 5/ In

4/ Although the adjusted deflator appears to be appropriate in early periods of excess demand inflation, its treatment of the (cost push) inflation momentum during economic slowdown is more questionable. During such periods, the attainment of high employment presumably would require greater than actual inflation. Thus the Okun formula does not show the level of receipts that would be attained if employment were maintained (or restored) under the condition actually prevailing, but rather the condition that might have been achieved if the price momentum begun in a earlier period were not so strong.

5/ These are not income shares in the traditional sense because they do not relate total factor payments but to GNP.

an effort to isolate the time trend from cyclical behavior, the corporate profits share for the 1949-1969 period was regressed on time and the rate of change in real GNP. The resulting time trend in the corporate profits share at high employment is also shown in Figure 1.[6/] These corporate shares, which are incorporated in the Staff estimates, are somewhat lower than the shares used by some outside analysts, particularly for the period after 1960. This fact partially explains that our estimates of the high employment surplus are often lower than those of other analysts.

(3) Calculations of tax receipts

All major discretionary changes in the tax system must be incorporated in the effective tax rates applied to the income shares. Initially these effective tax rates are the tax rates observed in benchmark high employment years. Between these benchmark years the effective rates have to be adjusted for the effects of major discretionary changes in the tax laws.

In some cases considerable judgement is involved in estimating the future revenue effect at high employment of these tax law changes. Generally the staff incorporates the expected (or historical) effect on actual receipts rather than on high employment receipts, as the difference is rather small. Another complication arises in the matter of the timing of the effects of discretionary tax changes. As a general rule the high employment budget follows the procedure used in NIA accounts which puts most categories of receipts on a liability basis. But in some instances NIA procedures are not followed, if such treatment is inappropriate for purposes of measuring stabilization policy. For example, retroactive changes are phased into the high employment budget from the time the change becomes a law rather than from the period of liability. Finally the tax rates must be adjusted between benchmarks to allow for drift in effective tax rates due to the combined effect of such things as economic growth and the progressivity of tax rates.

6/ Of the several equations examined the best fitting equation was:

$$\pi = 7.68 + 6.55 \left(\frac{1}{\sqrt{t}}\right) + 0.27G \quad R^2 = .78$$

where π is the corporate profits share before taxes, t is time, and G is the rate of change in real GNP. All of the coefficients were significant in terms of t-tests.

FIGURE I

ACTUAL & HIGH EMPLOYMENT CORPORATE PROFITS
AS A % OF GNP (1949-1969)