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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

June 23, 1971

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SUMMARY AND OUTLOOK

Nonfinancial

The staff continues to expect real GNP in the second quarter to increase at an annual rate of around 3 per cent, less than half the rise in the first quarter and below the trend rise in potential GNP. Residential construction activity is still moving up strongly; housing starts increased somewhat further in May from an already advanced level and building permits rose sharply. Inventory investment is apparently up from the very low first quarter rate. But no new expansive thrust has emerged in other sectors. The labor market remains sluggish. Initial unemployment claims have turned up in recent weeks and insured unemployment has continued to rise.

A sizable and widespread increase in industrial production in May may be followed by a smaller rise in June. Auto assemblies in June are scheduled at the May rate and raw steel output is declining somewhat more than seasonally, with stocks large and steel consumers apparently downgrading chances of a prolonged strike. For the second quarter as a whole, industrial production is estimated to be up at an annual rate of about 4 per cent.

A strengthening of retail sales in March and April was followed by declines in May and apparently in the first half of June. For the quarter as a whole, however, the increase from the first quarter average is likely to be appreciable. Unit sales of domestic autos were down sharply in the first 10 days of June, reflecting mainly the ending of sales incentive contests.

Total new orders for durable goods and for the capital equipment category rose in May, but both remained below the levels of the first quarter. Book values of manufacturers' and trade inventories increased appreciably in April, as in March; the bulk of the April rise was in lines other than autos and steel, in contrast to the pattern of earlier months this year.

Consumer prices rose sharply in May following a marked slowing in the first four months of the year. The rise in food prices slowed, but there were widespread increases in prices of other goods and services. A much smaller decline in mortgage interest rates also provided less of an offset than in earlier months this year.

Outlook. The staff projection of an increase of $20 billion in current dollar GNP this quarter is virtually unchanged from the projection of three weeks ago. Except for a slight upward revision in business fixed investment, the major demand sectors also have not been changed.

A number of modifications, however, have been introduced into the staff projections for the second half of the year. We no longer assume a steel strike, which reduces somewhat the earlier disparity between GNP expansion in the third and fourth quarters. The working off of steel stocks will be more prolonged--probably extending at least through year-end--than if a strike occurs. A second modification, serving to raise GNP expansion in the third quarter, reflects the larger military pay package passed by the Senate. A secondary effect of the larger increase in military pay is an expected larger increase in consumer spending.

The increase in current dollar GNP is now expected to average close to $22 billion in the last two quarters, virtually unchanged on balance from our previous projection. But recent and prospective wage and price developments suggest that our earlier expectations as to the GNP price deflator have been too optimistic. Consequently, we have raised our projections--the fourth quarter increase, at an annual rate of about 4-1/2 per cent, represents only a little slowing in the pace of inflation, and compares with about 4 per cent in our last projection.

Real GNP is now projected to rise at an annual rate of only 3-1/4 per cent over the last two quarters. The unemployment rate is expected to edge up to about 6.5 per cent in the fourth quarter and capacity use in manufacturing to change little from the low rate prevailing currently.

Financial

While interest rates have risen on balance since the last Committee meeting, most recently yields on Treasury coupon issues and corporate bonds have receded from their highs for the month. A stronger demand for corporate bonds developed at mid-month as the forward calendar suggested some tapering of new issue volume. This does not seem to reflect a shift of financing to other markets since the business sector's demand remained small in both the commercial paper market and at banks.

Following the May increase, business loan expansion at banks in June has apparently been modest at best, and major banks have not, at this writing, followed First Pennsylvania Bank in raising the prime rate.

Yields on longer-term tax-exempt bonds remained under upward pressure as banks continued to emphasize acquisitions of shorter-term issues. Other investors in State and local securities also tended to reduce their purchases in anticipation of higher yields. Yields on home mortgages in the secondary market leveled off in early June, following a sharp May run-up, as many market participants continued to be concerned about the future availability of funds; and rates on conventional mortgages rose in May for the first time in nearly a year.

<u>Outlook</u>. Assuming continuation of the recent higher Federal funds rate, the expected relatively large volume of new securities issues--including a much more than seasonal $11 billion demand for funds by the Treasury between the end of June and mid-August--may well constrain the size of the latest recovery in corporate and Treasury bond prices, and could possibly generate some further weakening in the tax-exempt market in coming weeks.

The outlook for a change in the prime rate is uncertain. Current loan demands do not appear large, and the staff expects such demands to remain weak to moderate into the summer. Banks nevertheless might move the prime rate in closer alignment with other short-term rates, as was the case in April. A rise in the prime rate has largely been discounted by the market, although a general move to 6 per cent, rather than 5-3/4 per cent, might lead to some further upward adjustment in market rates.

The mid-year reinvestment period for banks and other thrift institutions is being viewed with caution by some lenders. The current AT&T preferred stock offering, in particular, represents an attractive investment alternative for savers. More generally, however, rate relationships do not suggest a high rate of withdrawal during the reinvestment period. But the rate of savings inflows to thrift institutions over the summer, while expected to remain fairly large by historical standards, will probably decline somewhat further.

Mortgage markets should receive support, however, from the continued high level of institutional liquidity and the Home Loan Banks' announced intention to provide assistance to S&L's in maintaining mortgage credit flows. Nevertheless, the expected slowing of savings inflows this summer could contribute to a further increase in the contract rate on conventional mortgages. And the continued large discount on government insured mortgages has increased the probability of HUD action to lift the FHA/VA ceiling rate.

Balance of payments

Revised data for net exports of goods and services in the first quarter indicate a somewhat larger surplus than the Commerce Department had previously estimated. The difference is due, however, mainly to temporary factors affecting deliveries on military sales contracts and to a decline in interest payments. The merchandise trade position continues to be very unsatisfactory; preliminary indications are that in May imports may have continued to exceed exports of nonmilitary goods, as they did in April.

Data for the over-all balance of payments in the first quarter of 1971 (confidential until published next week) show, as had been expected, a relatively large outflow of U. S. corporate capital and very large unaccounted transactions ("errors and omissions"). Differences between interest rates here and abroad were wide and increasing until mid-March, and before the end of the quarter expectations were beginning to develop of an appreciation of the German mark and perhaps other currencies.

After the flood of funds into marks and other currencies at the end of April and in early May, the Bundesbank stayed out of the exchange market from May 5 to June 1. Since then it has been buying marks (selling dollars) at exchange rates that moved up gradually to a level about 4-1/2 per cent above par (and rose somewhat higher this week). The Bundesbank's spot sales of dollars have exceeded its intake through maturing forward contracts. Although Japan has continued to gain reserves rapidly, the central banks of the major industrial countries in the aggregate have apparently had a small decline in their total reserves since mid-May. This corresponds to the fact that the U. S. official settlements deficit has been small in that period.

The U. S. deficit on the liquidity basis has continued large, according to incomplete preliminary indicators which show considerable variation from week to week. In addition to the underlying deficit on current and long-term capital transactions, a movement by means of commercial leads and lags into the Japanese yen may be taking place. Also, net outflows to Europe of short-term funds of nonbank businesses and individuals may be continuing in response to the existing differences in interest rates, particularly in relation to the Euro-dollar market. Interest rates in most of the major national markets abroad are lower now than they were in March, and there has been a considerable rise in U. S. rates. This rise in U. S. rates was accompanied, however, by an even larger rise in Euro-dollar rates during and after the run into marks. After receding from their peaks, Euro-dollar deposits of 1 month to a year now carry interest rates in the 6-3/4 to 7-1/2 per cent range.

While the Euro-dollar market may thus still be attracting funds of businesses and individuals, the reflux from the German mark has produced relatively easy conditions at the very short end of that market. In the past two weeks the interest rate on overnight Euro-dollars has averaged well below 5 per cent. This has been a factor in an increase in recent days in U. S. banks' outstanding borrowings from their foreign branches. The long-continued run-off in the banks' liabilities to branches stopped earlier this month and there had already been some increases, possibly reflecting an attitude of caution with regard to maintaining sizable liquid asset positions (including claims on head offices) at the branches. With the reversal of the run-off in liabilities to branches, the official settlements balance has shown more favorable results than the liquidity balance in recent weeks.

We may see some tightening in the Euro-dollar market as the OFDI quarter-end reporting date approaches, bringing repatriations of U. S. corporation funds. Further ahead, there will be a period of uncertain length during which the reflux from the German mark will continue, with benefit to the U. S. official settlements balance if flows to other countries through the Euro-dollar market or directly from Germany or the United States are not too large. (How the net flow will be affected in July by the maturing of a large volume of DM forward contracts that month is uncertain.)

Within Germany, a net outflow from the mark will enable the authorities to squeeze the liquid asset position of the banking system, in their effort to cool off the economy and check the continuing inflation of prices and costs. Eventually, there may be favorable repercussions for the U. S. balance of payments both from the appreciation of the German mark and from a possible decline in German interest rates. In the more immediate future, however, the efforts to restrain the growth of demand in Germany will have to be counted as an adverse factor, tending to hold down U. S. net exports.

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SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1971 Feb.	1971 March	1971 April	1971 May	Per Cent Change* From 1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	83.4	83.5	83.8	84.2	0.5	1.0	1.9
Unemployment rate (%)	5.8	6.0	6.1	6.2	--	--	4.9 4/
Insured unempl. rate (%)	3.8	3.9	4.0	4.2	--	--	3.6 4/
Nonfarm employment, payroll (mil.)	70.6	70.7	70.7	70.8	0.2	0.3	0.0
Manufacturing	18.7	18.7	18.7	18.7	0.2	-0.2	-4.5
Nonmanufacturing	51.9	52.0	52.0	52.1	0.2	0.5	1.7
Industrial production (57-59=100)	165.2	165.5	166.2	167.3	0.7	1.3	-1.0
Final products, total	163.0	163.4	163.4	164.3	0.6	0.8	-2.0
Consumer goods	164.6	166.2	167.1	168.3	0.7	2.2	3.1
Business equipment	173.0	170.5	169.5	169.9	0.2	-1.8	-10.0
Materials	167.8	168.0	169.3	170.3	0.6	1.5	-0.1
Capacity util. rate, mfg. 5/	72.8	72.9	72.8	n.a	--	--	78.9 4/
Wholesale prices (1967=100) 1/	112.8	113.0	113.3	113.8	0.4	0.9	3.4
Industrial commodities (FR)	112.3	112.6	113.1	113.4	0.3	1.0	3.6
Sensitive materials (FR)	109.9	111.1	113.1	113.3	0.2	3.1	-1.9
Farm products, foods & feeds	113.6	113.4	113.3	114.3	0.9	0.6	2.8
Consumer prices (1967=100) 1/	119.4	119.8	120.2	120.8	0.5	1.2	4.4
Food	115.9	117.0	117.8	118.2	0.3	2.0	2.9
Commodities except food	115.2	115.5	115.8	116.6	0.7	1.2	4.1
Services	126.6	126.6	126.8	127.5	0.6	0.7	5.6
Hourly earnings, pvt. nonfarm ($)	3.35	3.38	3.39	3.40	0.3	1.5	6.3
Hourly earnings, mfg. ($)	3.50	3.52	3.53	3.55	0.6	1.4	6.3
Weekly earnings, mfg. ($)	139.69	140.02	139.92	141.65	1.2	1.4	6.6
Net spend. weekly earnings, mfg. (3 dependents 1967 $) 1/	100.76	101.39	100.62	101.81	1.2	1.0	2.2
Personal income ($ bil.) 2/	830.4	836.8	841.4	847.4	0.7	2.0	6.0
Retail sales, total ($ bil.)	31.6	32.3	32.6	32.3	-0.8	2.3	6.0
Autos (million units) 2/	8.3	8.6	8.3	8.4	2.0	1.6	7.1
GAAF ($ bil.) 3/	8.8	8.9	8.9	8.9	-0.6	1.0	6.4
12 leaders, composite (1967=100) 5/	119.9	122.4	124.1	n.a	1.4	4.7	8.0
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/	1,754	1,959	1,899	1,931	1.7	10.1	55.5
Factory workweek (hours)	39.5	39.9	39.7	39.9	0.5	1.0	0.3
Unempl. claims, initial (thous.)	284	297	283	304	-7.6 6/	-7.2 6/	3.2 6/
New orders, dur. goods, ($ bil.)	31.9	31.8	30.6	31.2	1.9	-2.0	4.1
Capital equipment	8.8	8.9	8.4	8.5	2.2	-2.6	0.7
Common stock prices (41-43=10)	97.11	99.60	103.04	101.64	-1.4	4.7	33.6

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l. merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ Per cent calculated to April 1971. 6/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	Averages					
	1970		1971			Week ended
	QIII	QIV	QI	April	May	June 16
Interest rates, per cent						
Federal funds	6.71	5.57	3.86	4.15	4.63	4.89
3-mo. Treasury bills	6.33	5.35	3.76	3.86	4.14	4.85
3-mo. Federal agencies	6.67	5.50	3.78	4.00	4.37	4.99
3-mo. Euro-dollars	8.34	7.46	5.50	5.92	7.04	7.19
3-mo. finance co. paper	7.42	6.12	4.48	4.27	4.69	5.13
4-6 mo. commercial paper	7.85	6.28	4.57	4.57	5.10	5.43
Bond buyer municipals	6.33	5.92	5.25	5.37	5.91	5.87
Aaa corporate-new issues	8.51	8.26	7.33	7.57	8.01	7.93
20-year Treasury bonds	6.96	6.57	5.98	6.00	6.32	6.45
FHA mortgages, 30-year	9.06	8.76	--	7.37	n.a.	n.a.

	1970		1971		
	QIII	QIV	QI	April	May
Change in monetary aggregates (SAAR, per cent)					
Total reserves	19.1	6.6	11.0	2.7	17.0
Nonborrowed reserves	24.4	9.4	11.0	9.7	12.4
Credit proxy	24.1	15.1	17.0	12.2	11.4
Credit proxy + nondep. funds	17.2	8.3	10.9	5.3	7.7
Money supply	6.1	3.4	8.9	9.3	16.3
Time and savings deposits	32.2	21.8	27.3	10.7	14.5
Deposits at S&L's and MSB's	9.3	11.6	23.3	21.8	13.4
Bank credit, end-of-month 1/2/	13.9	8.5	12.2	-0.3	11.7
Treasury securities 2/	25.9	6.2	19.8	-23.5	--
Other securities 2/	20.3	36.5	27.9	20.9	16.7
Total loans 1/2/	9.8	1.2	6.3	-2.4	12.9
Business 1/2/	1.8	-4.9	1.0	---	18.2

	1970		1971		
	QIII	QIV	QI	April	May
Change in commercial paper ($ millions)					
Total (SA)	-4,232	-760	-2,581	209	-433
Bank-related (NSA)	-2,985	-2,269	-657	102	-46

	1969	1970			1971	
	2nd Half	QI	QII	May	QI	May
New security issues (NSA, $ millions)						
Total corp. issues	13,172	7,977	10,468	3,909	12,190	3,400 e
Public offerings	10,770	6,715	9,185	3,509	10,675	2,900 e
State and local government bond offerings	5,446	4,109	3,728	996	6,642	1,900 e
Fed. sponsored agency debt (change)	5,586	3,635	1,542	187	-1,031	-413 e
Fed. govt. debt (change)	9,811	1,982	-6,395	1,452	1,575	2,489 e

n.a. - Not available. e - Estimated. p - Preliminary.
SAAR - Seasonally adjusted annual rate. NSA - Not seasonally adjusted.
1/ Adjusted for loans sold to bank affiliates.
2/ Credit figures have been revised beginning QIV, 1970 to reflect adjustments to the December 1970 Call.

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

	1970	1971			
	Year	I	Feb.*	Mar.*	Apr.*
Goods and services, net 1/	3,592	1,051			
Trade balance 2/	2,110	272	95	215	-290
Exports 2/	41,980	11,032	3,630	3,755	3,450
Imports 2/	-39,870	-10,760	-3,535	-3,540	-3,740
Service balance	1,482	779			
Remittances and pensions	-1,410	-351			
Govt. grants & capital, net	-3,332	-1,031			
U.S. private capital (- = outflow)	-6,886	-2,024			
Direct investment abroad	-4,445	-1,357			
Foreign securities	-942	-362	-21	-56	-129
Bank-reported claims--"liquid"	-119	-72	-77	-18	76
" " " other	-832	-50	-67	-190	-144
Nonbank-reported claims--"liquid"	392	-160	-59	-55	-38
" " " other	-940	-23			
Foreign capital (excl. reserve trans.)	-1,519	-2,080			
Direct investment in U.S.	969	50			
U.S. corporate stocks	697	75	-32	-26	-1
New U.S. direct investment issues 3/	822	392			
Other U.S. securities (excl. U.S. Treas.)	347	32			
Liabilities to:					
Commercial banks abroad, "liquid"	-6,507	-3,025	-1,449	-1,210	-479
Other private foreign, "liquid"	86	70	62	-50	65
Intl. & regional institutions, "liquid"	179	268	-75	134	130
" " " , nonliquid	222	-28			
Banks and others, nonliquid	1,666	86			
Foreign official reserve claims	7,344	4,841	1,720	2,456	2,375
"Liquid"	7,619	5,065	1,787	2,545	2,450
Other	-275	-224	-67	-89	-75
U.S. monetary reserves (increase, -)	3,344	862	165	192	35
Gold stock	787	109	1	76	38
Special drawing rights 4/	16	125	--	25	--
IMF gold tranche	389	255	--	20	-2
Convertible currencies	2,152	373	164	71	-1
Errors and omissions	-1,132	-1,268			
BALANCES (deficit -) 4/					
Official settlements, S.A.		-5,703			
" " , N.S.A.	-10,688	-5,403	-1,885	-2,648	-2,410
Net liquidity, S.A.		-2,784			
" , N.S.A.	-4,719	-2,638	-287	-1,449	-2,164

* 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 allocations of SDRs: $867 million on Jan. 1, 1970; and $717 million on Jan. 1, 1971.

Domestic Nonfinancial Scene

Gross national product. The economic situation appears to be developing this quarter about as we had expected, a modest rate of economic growth is occurring, fueled mainly by strength in residential construction activity and some expansion in non-auto retail sales. Steel stock-piling also has been a factor contributing to overall inventory accumulation, although less so than expected earlier.

Moreover, the incoming economic news does not suggest any major change in the underlying outlook for the remainder of the year. We continue to anticipate relatively moderate gains in output in the second half, and our GNP projection for the year as a whole remains only a little above the $1050 billion level.

A more satisfactory rate of economic growth now appears likely in the first half of next year, however, sparked by a rise in the minimum wage, increases in Federal pay, and a rise in social security benefits. The beginnings of a rebound in business fixed capital outlays and a more rapid rate of inventory investment also appear probable after the turn of the year. As will be detailed in the staff presentation on Tuesday, we now anticipate first half 1972 increases in current dollar GNP averaging over $25 billion per quarter and real growth to recover to about a 5 per cent annual rate.

Our projection of GNP increase for the second quarter of this year remains about $20 billion--only two-thirds the rise of the preceding quarter, when the rise was temporarily inflated by the post-strike rebound in auto sales. In real terms, growth of GNP in the second quarter is projected at slightly over 3 per cent, annual rate.

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rates)

	First Quarter	Second Quarter	
		Proj. of 6/2/71	Current
	-------Billions of dollars--------		
GNP	30.8	19.5	20.0
Final sales	33.0	16.4	17.0
Personal consumption	19.4	11.6	11.8
Residential construction	3.6	2.4	2.4
Business fixed investment	3.8	.9	1.4
Net exports	.7	- .8	- .8
Federal purchases	.2	- .7	- .8
State and local purchases	5.2	3.1	3.1
Inventory change	-2.2	3.1	3.0
	--------Per Cent Per Year---------		
Real GNP	7.1	2.9	3.2
GNP deflator	5.6 1/	4.7	4.6

1/ Excluding effects of Federal pay increase, 4.6 per cent.

Housing starts through May are consistent with an annual rate for the quarter in excess of 1.9 million units, indicating a further strong rise in residential construction activity, although by about $1 billion less than in the first quarter. Recent shipments data suggest a slightly larger increase in capital expenditures than we had projected last time. Our projections continue to indicate smaller increases in the second quarter than the first for State and local spending and declines in net exports and in Federal purchases.

The projection of the rise in personal consumption expenditures for the quarter remains approximately as it was in the preceding Greenbook. Revised figures indicate a somewhat larger increase in retail sales than had been indicated earlier for March and April, but sales dropped back in May and were sluggish in early June. Although total unit auto sales have been averaging a respectable annual rate of close to 10 million so far this year, sales of domestic-type models have shown no tendency to climb above the 8.4 million rate of the first quarter.

On the other hand, the expected signs of a moderate pickup of inventory investment have been evident, following the first quarter adjustment. Inventory accumulation in the first quarter reflected stockpiling of steel and rebuilding of auto stocks; in other sectors, inventories were run down slightly on balance. This situation began to change toward the end of last quarter, and in April the book values outside of autos and steel rose appreciably.

GNP AND RELATED ITEMS, 1971
(Changes in seasonally adjusted totals at annual rates)

	Third Quarter		Fourth Quarter	
	Proj. of 6/2/71	Current	Proj. of 6/2/71	Current
	--------Billions of dollars----------			
GNP	18.5	21.0	24.5	22.5
Final sales	22.0	24.1	19.0	20.1
Personal consumption	13.0	14.1	13.0	14.1
Residential construction	1.4	1.4	1.3	1.3
Business fixed investment	.5	.5	.5	.5
Net exports	.0	.0	.0	.0
Federal purchases	2.9	3.9	.0	.0
State & local purchases	4.2	4.2	4.2	4.2
Inventory change	-3.5	-3.1	5.5	2.4
	-----------Per Cent Per Year---------			
Real GNP	2.1	2.5	5.3	4.0
GNP deflator	4.9 1/	5.5 2/	3.9	4.4

1/ Excluding effects of Federal pay increase, 4.25 per cent.
2/ Excluding effects of Federal pay increase, 4.5 per cent.

The outlook for GNP growth in the second half of the year also remains about unchanged overall from the preceding Greenbook--with expected gains averaging over $20 billion a quarter. However, the quarterly pattern has been changed, and we have raised the third quarter increase by $2-1/2 billion. We are now assuming enactment shortly of a military pay increase amounting to $2.7 billion, about $1 billion larger than we had formerly estimated, and this should also increase consumption. Moreover, we believe that the odds have shifted against the likelihood of a steel strike, and have not allowed for one in the current projection. Industry acceptance of something close to the settlements negotiated in the can and aluminum industries would likely result in a somewhat smaller decline in inventory investment in the third quarter than we had projected earlier. In the absence of an August-September strike, however, the fourth quarter GNP increase is expected to be some $2 billion smaller than we had projected a month ago--primarily because excess steel stocks would continue to be drawn down throughout the quarter.

Although GNP growth for the two quarters combined is about the same as in the preceding projection, we have again raised our estimate of the probable rise in the price deflator, and gains in GNP for the period reflect more price and less real increase. Because of recent price increases, and the outlook for continued large wage settlements, we now expect only a little easing of inflationary pressures. The rate of increase in the deflator in the fourth quarter is projected at a 4-1/2 per cent annual rate, rather than the 4 per cent indicated in the preceding Greenbook. Projected real GNP growth, therefore, has been reduced somewhat, averaging 3-1/4 per cent over the second half, and some further increase in unemployment seems in prospect. We expect that the pace of real GNP growth will accelerate in early 1972, however, and the unemployment rate should begin to decline from the 6-1/2 per cent rate we now anticipate for late this year.

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

	1970	1971 Proj.	1971 I	1971 II	1971 III	1971 IV	1972 I	1972 II
				---Projection---				
Gross National Product	976.5	1051.8	1020.7	1040.7	1061.7	1084.2	1111.2	1137.2
Final purchases	973.1	1049.1	1019.3	1036.3	1060.4	1080.5	1104.6	1128.2
Private	752.6	813.7	790.6	805.4	821.4	837.3	854.6	873.6
Excluding net exports	749.0	811.0	787.3	802.9	818.9	834.8	852.1	871.6
Personal consumption expenditures	616.7	665.8	646.4	658.2	672.3	686.4	701.3	717.2
Durable goods	89.4	99.8	97.5	98.2	100.5	103.0	105.5	108.5
Nondurable goods	264.7	281.4	272.8	278.5	284.3	289.9	296.1	302.7
Services	262.6	284.7	276.1	281.5	287.5	293.5	299.7	306.0
Gross private domestic investment	135.7	147.9	142.4	149.1	147.9	152.1	157.4	163.4
Residential construction	29.7	38.6	35.8	38.2	39.6	40.9	42.1	42.9
Business fixed investment	102.6	106.5	105.1	106.5	107.0	107.5	108.7	111.5
Change in business inventories	3.5	2.7	1.4	4.4	1.3	3.7	6.6	9.0
Nonfarm	2.9	2.7	1.2	4.4	1.3	3.7	6.6	9.0
Net exports of goods and services	3.6	2.7	3.3	2.5	2.5	2.5	2.5	2.0
Gov't. purchases of goods & services	220.5	235.5	228.7	230.9	239.0	243.2	250.0	254.6
Federal	99.7	99.8	98.4	97.6	101.5	101.5	104.5	105.3
Defense	76.6	73.9	74.0	72.8	74.8	73.8	75.3	75.3
Other	23.1	26.0	24.5	24.9	26.7	27.7	29.2	30.0
State & local	120.9	135.7	130.2	133.3	137.5	141.7	145.5	149.3
Gross national product in constant (1958) dollars	724.1	741.3	732.7	738.5	743.2	750.7	759.6	769.3
GNP implicit deflator (1958 = 100)	134.9	141.9	139.3	140.9	142.5	144.4	146.3	147.8
Personal income 1/	801.0	858.9	830.7	852.2	868.1	884.6	905.1	923.0
Wage and salary disbursements	540.1	578.0	560.6	571.2	584.3	595.9	609.6	622.2
Disposable income 1/	684.8	737.2	714.3	733.6	745.2	755.5	775.6	790.0
Personal saving 1/	50.2	52.1	49.0	56.2	53.3	49.1	53.9	52.0
Saving rate (per cent) 1/	7.3	7.1	6.9	7.7	7.2	6.5	6.9	6.6
Corporate profits before tax 1/	81.3	85.2	80.8	84.3	85.8	89.7	94.1	100.5
Corp. cash flow, net of div. (domestic) 1/	69.9	79.8	76.7	79.2	80.5	82.9	85.6	89.8
Federal government receipts and expenditures (N.I.A. basis)								
Receipts 1/	194.8	205.5	198.2	202.2	206.9	214.6	219.8	225.7
Expenditures	206.3	224.3	214.2	223.0	228.9	231.0	240.0	243.2
Surplus or deficit (-) 1/	-11.5	-18.8	-16.0	-20.8	-22.0	-16.4	-20.2	-17.5
High employment surplus or deficit (-) 1/	-0.8	-0.4	1.3	-2.0	-2.6	1.6	-1.7	1.0
Total labor force (millions)	85.9	87.0	86.5	86.9	87.2	87.4	87.6	88.0
Armed forces "	3.2	2.8	3.0	2.9	2.8	2.7	2.6	2.6
Civilian labor force "	82.7	84.2	83.6	84.1	84.4	84.7	85.0	85.4
Unemployment rate (per cent)	4.9	6.3	5.9	6.2	6.5	6.6	6.5	6.3
Nonfarm payroll employment (millions)	70.7	71.0	70.6	70.8	71.1	71.4	71.8	72.3
Manufacturing	19.4	18.7	18.7	18.7	18.7	18.8	18.9	19.0
Industrial production (1957-59=100)	168.2	167.7	165.4	167.2	168.0	170.0	172.5	175.5
Capacity utilization, manufacturing (per cent)	76.6	72.8	73.0	73.0	72.6	72.7	73.1	73.6
Housing starts, private (millions A.R.)	1.43	1.97	1.81	1.95	2.05	2.08	2.10	2.10
Sales new domestic autos (millions, A.R.)	7.12	8.42	8.39	8.40	8.40	8.50	8.60	8.75

NOTE: Projection of related items such as employment and industrial production index are based on projection of deflated GNP. Federal budget high employment surplus or deficit (N.I.A. basis) are staff estimates and projections by method suggested by Okun and Teeters.

1/ Reflects effects of total additional depreciation allowable under Treasury's newly-approved "accelerated depreciation range" guidelines, which are effective as of the beginning of 1971.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1970	1971 Proj.	1971 I	1971 II	1971 III	1971 IV	1972 I	1972 II
				---Projection---				
	---Billions of dollars---							
Gross National Product	45.1	75.3	30.8	20.0	21.0	22.5	27.0	26.0
Inventory change	-5.0	-0.8	-2.2	3.0	-3.1	2.4	2.9	2.4
Final purchases	50.2	76.0	33.0	17.0	24.1	20.1	24.1	23.6
Private	41.9	61.1	27.5	14.8	16.0	15.9	17.3	19.0
Excluding net exports	40.2	62.0	26.8	15.6	16.0	15.9	17.3	19.5
Net exports	1.7	-0.9	0.7	-0.8	0.0	0.0	0.0	-0.5
Government	8.3	15.0	5.5	2.2	8.1	4.2	6.8	4.6
GNP in constant (1958) dollars	-3.0	17.2	12.4	5.8	4.7	7.5	8.9	9.7
Final purchases	1.2	18.0	14.4	3.6	6.9	5.6	6.7	7.8
Private	7.2	19.3	14.6	4.2	5.6	5.1	5.9	7.2
	---In Per Cent Per Year---							
Gross National Product	4.8	7.7	13.1	7.8	8.1	8.5	10.0	9.4
Final purchases	5.4	7.8	13.4	6.7	9.3	7.6	8.9	8.5
Private	5.9	8.1	14.4	7.5	7.9	7.7	8.3	8.9
Personal consumption expenditures	6.8	8.0	12.4	7.3	8.6	8.4	8.7	9.1
Durable goods	-0.7	11.6	57.2	2.9	9.4	10.0	9.7	11.4
Nondurable goods	7.7	6.3	1.9	8.4	8.3	7.9	8.6	8.9
Services	8.7	8.4	8.7	7.8	8.5	8.3	8.4	8.4
Gross private domestic investment	-2.9	9.0	15.5	18.8	-3.2	11.4	13.9	15.2
Residential construction	-7.2	30.0	44.7	26.8	14.7	13.1	11.7	7.6
Business fixed investment	3.3	3.8	15.0	5.3	1.9	1.9	4.5	10.3
Gov't. purchases of goods & services	3.9	6.8	9.9	3.8	14.0	7.0	11.2	7.4
Federal	-1.6	0.1	0.8	-3.3	16.0	0.0	11.8	3.1
Defense	-2.8	-3.5	-3.2	-6.5	11.0	-5.3	8.1	0.0
Other	2.2	12.6	17.0	6.5	28.9	15.0	21.7	11.0
State & local	9.1	12.2	16.6	9.5	12.6	12.2	10.7	10.4
GNP in constant (1958) dollars	-0.4	2.4	7.1 1/	3.2	2.5	4.0	4.8	5.1
Final purchases	0.2	2.5	8.1	2.0	3.8	3.0	3.6	4.1
Private	1.3	3.3	10.1	2.9	3.7	3.4	3.9	4.7
GNP implicit deflator	5.3	5.2	5.6 1/	4.6	5.5 2/	4.4	5.1 3/	4.2
Private GNP fixed weight index 4/	4.9	4.9	5.2 1/	4.8	4.5	4.5	4.4	4.2
Personal income 5/	7.0	7.2	8.6	10.4	7.5	7.6	9.3	7.9
Wage and salary disbursements	6.1	7.0	11.3	7.6	9.2	7.9	9.2	8.3
Disposable income 5/	8.4	7.7	9.8	10.8	6.3	5.5	10.6	7.4
Corporate profits before tax 5/	-10.9	4.8	23.6	17.3	7.1	18.2	19.6	27.2
Federal government receipts and expenditures (N.I.A. basis)								
Receipts 5/	-2.9	5.5	13.6	8.1	9.3	14.9	9.7	10.7
Expenditures	7.8	8.7	8.2	16.4	10.6	3.7	15.6	5.3
Nonfarm payroll employment	0.6	0.4	2.5	1.1	1.7	1.7	2.2	2.8
Manufacturing	-3.9	-3.6	1.1	0.0	0.0	2.1	2.1	2.1
Industrial production	-2.7	-0.3	6.6	4.2	2.1	4.7	6.0	6.7
Housing starts, private	-2.6	37.7	8.1	30.4	20.3	6.4	3.3	0.0
Sales new domestic autos	-15.9	18.3	216.4	0.6	0.0	4.8	4.7	7.0

1/ At compounded rates.

2/ Excluding effects of military pay increase, 4.5 per cent per year.

3/ Excluding effects of general Federal government pay increase, 4.3 per cent per year.

4/ Using expenditures in 1965-IV as weights.

5/ Reflects effects of total additional depreciation allowable under Treasury's newly-approved "accelerated depreciation range" guidelines, which are effective as of the beginning of 1971.

Industrial production. The May increase in industrial production was widespread, with the largest advances in autos and steel. However, if the slight rise in output of business equipment is not just a one month "up tick," it could be the most significant production change in May.

INDUSTRIAL PRODUCTION
1957-59=100, seasonally adjusted

	1969	1971			Per cent change	
	July1/	March	April	May	July 1969 to May 1971	April 1971 to May 1971
Total index	174.6	165.5	166.2	167.3	-4.2	.7
Consumer goods	164.4	166.2	167.1	168.3	2.4	.7
Autos	178.7	167.3	153.9	161.4	-9.7	4.9
Home goods	184.4	180.2	184.4	184.6	.1	.1
Apparel & staples	158.1	162.3	163.3	163.9	3.7	.4
Business equipment	196.9	170.5	169.5	169.9	-13.7	.2
Defense equipment	169.9	112.2	108.1	108.5	-36.1	.4
Materials, total	176.5	168.0	169.3	170.3	-3.5	.6
Durable	167.0	151.4	152.8	153.8	-7.9	.7
Steel	145.3	138.3	141.9	144.0	- .9	1.5
Nondurable	186.4	185.2	186.3	187.2	.4	.5

1/ Pre-recession peak.

Industrial production is anticipated to have increased further in June but not by as much as in May. June auto production schedules are set at the May rate. Output of raw steel is being cut back more than usual in June and steel mill finishing operations will probably be at or below the May level. Coal production has been reduced by strikes and Texas "allowable" crude oil extraction was curtailed further in June.

Also, there is lack of expansion in output of appliances, television sets, apparel, and nonferrous metals. But increases are expected in production of consumer staples, furniture, textiles and some other materials.

Retail sales. Retail sales declined 0.8 per cent from April to May, according to the advance report, following two months of substantial increase. Durable goods sales were down 2.9 per cent, with the automotive group off 4.0 per cent and the furniture and appliance group declining 2.9 per cent. Nondurable goods sales as a whole were virtually unchanged from April, as increases in food and apparel offset small declines in general merchandise and various smaller categories. Compared with a year earlier, May sales were up 6.0 per cent.

Sales in March and April were revised upward by more complete sample counts and now appear as the strongest months, compared with a year earlier, since early 1969. The largest increases from a year earlier were shown by the automotive and general merchandise groups.

RETAIL SALES
Seasonally Adjusted

	Percentage change 1971 from:					
	Year earlier			Previous month		
	March	April	May	March	April	May
Total	8.3	6.8	6.0	2.1	1.0	-0.8
Durable	11.5	10.6	7.7	4.0	1.5	-2.9
Auto	15.3	15.2	13.0	5.1	2.1	-4.0
Furniture & appliance	4.7	- .6	-2.2	3.6	-2.6	-2.9
Nondurable	6.9	5.1	5.3	1.2	.9	.1
Food	4.8	4.9	5.8	.9	1.1	1.2
General merchandise	13.5	9.0	10.0	1.5	1.2	- .5
Total, less auto and nonconsumption items	6.4	4.6	4.6	1.2	.7	.0
GAAF	11.1	5.3	6.4	1.8	-.2	- .6
Total real*	4.4	3.1	2.2	1.5	.6	-1.2

* Actual sales deflated by commodity components of the Consumer Price Index, seasonally adjusted.

Unit auto sales. Sales of new domestic-type autos in the first 10 days of June were at an annual rate of 7.4 million units, 12 per cent below the 8.4 million rate prevailing in the first five months of the year. The decline was concentrated at GM dealers and reflected the ending of a sales incentive contest in May.

Inventories. Book value of manufacturing and trade inventories rose at an $8.6 billion annual rate in April, according to preliminary data--only a little less than the upward-revised March rate of $10.3 billion. Sales also rose in April, and inventory-sales ratios were little changed from the reduced March levels.

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

	1970 Q IV	1971 Q I (rev.)	1971 March (rev.)	1971 April (prel.)
Manufacturing and trade, total	4.4	5.9	10.3	8.6
Autos and steel	-4.1	6.5	8.5	3.5
Excluding autos and steel	8.5	- .6	1.8	5.1
Wholesale and retail trade, total	.6	6.7	11.6	7.0
Autos and steel	-5.7	6.0	7.8	2.9
Excluding autos and steel	6.3	.8	3.8	4.2
Manufacturing, total	3.8	-.8	-1.2	1.5
Autos and steel	1.6	.6	.7	.6
Excluding autos and steel	2.3	-1.4	-2.0	.9

The industrial composition of inventory accumulation has changed markedly in recent months. In the first quarter, the only upward impetus to inventories was in the auto-and steel-related sectors; in April, however, more than half of the increase occurred outside of autos and steel.

INVENTORY-SALES RATIOS

	1970 June	1970 December	1971 March (rev.)	1971 April (prel.)
Manufacturing and trade, total	1.56	1.60	1.53	1.54
Autos and steel	1.50	1.61	1.44	1.45
Excluding autos and steel	1.56	1.60	1.55	1.55
Wholesale and retail trade, total	1.36	1.40	1.36	1.36
Autos and steel	1.66	1.76	1.61	1.61
Excluding autos and steel	1.30	1.34	1.31	1.30
Manufacturing, total	1.73	1.78	1.70	1.70
Autos and steel	1.34	1.47	1.27	1.28
Excluding autos and steel	1.80	1.83	1.77	1.78

In May, dealers' stocks of new domestic-make cars rose. Unit sales of these cars also increased and the dealers' stock-sales ratio for new domestic autos declined slightly. However, this ratio was above year-earlier levels in both April and May, and at 58 days' supply, seasonally adjusted, was approaching the level of autumn 1969.

When surveyed in May, manufacturers anticipated adding to their inventories at a $2.4 billion annual rate during the current quarter, somewhat higher than the $1.5 billion rate actually reported by manufacturers in preliminary April data. Manufacturers expected to add to stocks at a $3.6 billion rate in the third quarter, but such "first anticipations" are subject to considerable error. There was a decline in the reported amount of inventory excess to $2.13 billion, the lowest figure since June 1969. Sales were projected to increase 2 per cent in the second quarter and 3 per cent in the third.

Manufacturers' orders and shipments. New orders for durable goods rose 1.9 per cent in May, according to the advance report, after declining 3.6 per cent in April. The May level remains below the first quarter average. Shipments also rose in May and the unfilled order backlog was down 1.3 per cent, the third straight month of decline for this series.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
Seasonally adjusted monthly averages

	1970	1971			
	Q IV	Q I	April (rev.)	May (advance)	Change, May from April
	----Billions of dollars-----				-Per cent-
Durable goods, total	29.4	31.7	30.6	31.2	1.9
Excluding autos and steel	24.0	24.4	23.9	24.5	2.5
Primary metals	4.6	5.2	5.0	5.0	.3
Motor vehicles and parts	3.2	4.6	4.4	4.6	3.6
Household durable goods	2.1	2.2	2.3	2.3	-2.7
Defense products	2.1	2.0	1.5	1.7	10.3
Capital equipment	8.7	8.8	8.4	8.5	2.2
All other durable goods	8.8	8.8	9.0	9.1	1.5

NOTE: Detail may not add to totals because of rounding. Per cent changes calculated from unrounded data.

Orders rose for defense products and capital equipment, but both remain below the first quarter rate; also, backlogs fell for both groups. Iron and steel orders fell further in May, but this drop was offset by increases for other primary metals manufacturers. "All other" durable goods, which include construction materials and miscellaneous producer and consumer goods and materials, rose in May and were above the first quarter average.

Cyclical indicators. The preliminary Census composite index of leading indicators rose 0.6 per cent in May, the seventh straight month of increase. The coincident composite rose for the sixth month in a row, and the lagging composite for the third month in a row.

COMPOSITE CYCLICAL INDICATORS
(1967 = 100)

	12 Leading, trend adjusted	5 Coincident	6 Lagging
1970:			
October	113.8	118.8	130.8
November	114.1	117.9	128.9
December	116.3	119.1	126.7 (r)
1971:			
January	118.5	121.1	125.5 (r)
February	119.9	121.8	124.1 (r)
March	122.6 (r)	122.5 (r)	125.1 (r)
April	124.2 (p)	122.9 (r)	125.5 (r)
May	125.0 (Est.)(H)	123.5 (p)(H)	126.0 (p)

(H) Current high value. The lagging composite reached its high in September 1970.

NOTE: April leading composite still preliminary - net business formation not included.

The lagging composites for December through April were revised downward as much as 4.4 per cent on account of the inclusion of business loan rates and of actual instead of anticipated plant and equipment spending for the first quarter.

The National Bureau of Economic Research, in a paper by Solomon Fabricant published last month, has expressed the judgment that in 1969 and 1970 the U.S. economy experienced a " 'classical' contraction, that is, a contraction of the same general type as those listed in the National Bureau's business-cycle chronology." November 1969 is chosen as the "tentative" peak date. Fabricant judges that the contraction continued to November 1970 but that is too early to tell whether it troughed then or not.

Based on relationships from previous postwar cycles, the leading indicator composite had "predicted" that the recession would be at least as severe as the 1960-61 downturn, but as measured by the coincident composite, it was less severe. Since November, the leading composite has increased slightly more than in the six months following February 1961 but less than in the other comparable recovery periods. The recovery through May in the coincident composite, however, was weaker than six-month rates of recovery from any of the four previous troughs, although it included the recovery from the GM strike.

A coincidence of strike and cycle troughs would not be unprecedented: the Bureau's October 1949 trough coincided with a steel strike. In that case it has been argued by some that the real trough came earlier. In the recent case, it has been similarly argued by some that the recovery began in mid-1970 but was interrupted by the strike, but a case could also be made that the trough in the rest of the economy came later, say in February 1971. The recovery in the coincident composite is equally unimpressive measured from that date, though the number of months since then for which we have data is insufficient for making a good comparison.

<u>Residential construction and real estate</u>. Seasonally adjusted private housing starts turned upward again in May to an annual rate of 1,931,000. Except for March, when the multifamily component of starts reached a record rate, the over-all pace in May was the highest so far this year. Single-family starts also edged higher to maintain the improved relative share--57 per cent--of total starts regained in April.

With commitments and builder permits both at new peaks this spring--permits were up 14 per cent further in May--some further expansion in starts is indicated for June, possibly to or above the 2 million unit rate. Such a rate would carry the average for the second quarter as a whole to an annual rate of 1.95 million units, or more than 50 per cent above the cyclical low in the first quarter of last year. Assuming mobile home shipments hold near the record 478,000 annual rate reported for April, the combined rate of new shelter-units for the second quarter could exceed the previous historic high reached in the first quarter of this year by as much as 200,000 units.

PRIVATE HOUSING STARTS AND PERMITS
(Seasonally adjusted annual rates, in thousands of units)

	Starts			Permits
	Total 1/	Per Cent Single-family	Per Cent FHA-insured 2/ (FHA Series)	
1970 - Annual	1,434	57	29	1,324
1970				
IQ	1,252	54	23	1,085
IIQ	1,286	58	28	1,257
IIIQ	1,512	56	28	1,358
IVQ	1,777	58	35	1,593
1971				
IQ	1,813	55	24	1,608
1971				
March (r)	1,959	53	20	1,627
April (r)	1,899	57	22	1,638
May (p)	1,931	57	n.a.	1,870

1/ Apart from starts, mobile home shipments for domestic use in April--the latest month for which data are available--were at a record seasonally adjusted annual rate of 478,000, 14 per cent higher than in March and 7 per cent above a year earlier.

2/ Based on unadjusted totals for all periods. FHA-insured starts include both subsidized and nonsubsidized units.

Demands for both used and new homes were exceptionally strong in April, the latest month for which data are available. In the case of single-family homes offered by speculative builders--who in recent years have accounted for up to six-tenths of total single-family starts--the annual rate of sales was second only to the record 662,000 reached in March and nearly half again as high as a year earlier. While the number of homes available for sale by such builders rose somewhat, it was only slightly higher than in 1970. Reflecting in part some upgrading in demands, moreover, the composition of such stocks was more closely in line with market requirements, as indicated by the narrowing spread between the median prices of homes sold and homes for sale shown in the table. Altogether, the median price of homes sold in April was back up nearly to the median price in 1969.

NEW SINGLE FAMILY HOMES SOLD AND FOR SALE

	Homes sold 1/	Homes for sale 2/	Median price of: Homes sold	Median price of: Homes for sale
	(Thousands of units)		(Thousands of dollars)	
1969 - Annual	452	228	25.6	27.0
1970	487	226	23.4	26.2
1970				
IQ	408	214	23.9	27.2
IIQ	457	218	24.4	27.0
IIIQ	525	216	23.0	27.1
IVQ	585	226	22.6	26.2
1971				
IQ	636	218	24.3	26.1
1971				
February	604	211	24.7	26.0
March	662	218	24.4	26.1
April	648	228	25.3	26.5

1/ SAAR.
2/ End of period.

Labor market. The labor market has continued slack in recent weeks. Initial claims for unemployment benefits have been rising in recent weeks and total insured unemployment has continued to edge up from its post-auto strike low in January.

STATE INSURED UNEMPLOYMENT
(Seasonally adjusted weekly averages, in thousands)

	Initial Claims	Insured Unemployment
1970:		
May	314	1,885
November	334	2,388
December	292	2,158
1971:		
January	283	1,993
February	284	2,008
March	297	2,060
April	283	2,120
May	304	2,260

The outlook is for some added pressure on unemployment from the supply side. About 4 million persons from 16 to 24 years of age are expected to be added to the civilian labor force between April and July this year--about 150,000 more than last year. The increase over the summer in the 20-24 year group is expected to be double that of years as recent as 1966. With demands for labor still slack, a further rise in unemployment among young job seekers seems likely this summer and fall.

CIVILIAN LABOR FORCE
(Not seasonally adjusted, in thousands)

Age	Change from April to July 1966	1970	1971*
16-24	3,395	3,786	3,950
16-19	2,945	2,819	2,921
20-24	450	967	1,029

* Projected on the basis of population changes.

Personal income. Total personal income rose by $6 billion in May. The annual rate of increase of about 8.5 per cent was close to the average so far this year. Total wages and salaries rose by over $4 billion compared to a $2.7 billion increase in April. A pick-up in nonfarm employment--primarily in retail trade and manufacturing--and an increase in the manufacturing workweek mainly accounted for the larger May increase, although average employee earnings also continued to rise rapidly. Transfer payments were up $1 billion and small gains occurred in interest, dividends and rental income.

PERSONAL INCOME
(Billions of dollars, SAAR)

	1970	1971		Per cent change from:	
	May	April	May	April 1971	May 1970
Total	799.7	841.4	847.4	8.6	6.0
Wages and salaries	540.5	566.9	571.2	9.1	5.7
Government	116.9	120.9	121.3	4.0	3.8
Private	423.6	446.0	449.9	10.5	6.2
Manufacturing	159.2	160.7	162.1	10.5	1.8
Nonmanufacturing	264.4	285.3	287.8	10.5	8.9
Transfer payments	76.6	88.8	89.8	14.9	17.4

Wages and collective bargaining. Wage increases continue large. Hourly earnings of production workers in the private nonfarm sector were up 6.3 per cent over the year ending in May 1971. This is about the same year-over-year increase as reported in earlier months of 1971, and for 1970 as a whole. Collective bargaining agreements concluded in late 1970 have resulted in accelerated earnings increases in the manufacturing and transportation and public utilities industries. In manufacturing, the largest increases have occurred in the automobile industry. In transportation, increases have been large in both the railroads and trucking.

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

	1969	1970	1971	
			Q I	May
Total private	6.7	6.3	6.4	6.3
Manufacturing	6.0	5.3	6.5	6.3
Mining	7.5	6.7	5.9	6.1
Contract construction	8.4	9.2	8.9	9.4
Transportation & public utilities	6.1	6.1	7.7	7.4
Trade	6.7	5.9	5.9	5.9
Finance	6.2	5.1	6.1	7.9
Services	8.2	8.0	8.2	7.5

An affirmative strike vote has been taken among the telephone industry workers (the strike deadline is mid-July). Negotiations in the steel industry are under way, but have not yet started on national issues. Following the lead of recent aluminum and can settlements, the telephone and steel contracts are currently expected to provide first year wage increases of at least 10 per cent, with second and third year boosts of 3 to 4 per cent to be supplemented by an open-ended cost-of-living adjustment clause. Contracts for coal miners and East coast longshoremen will expire September 30, 1971.

Consumer prices. Consumer prices rose at a seasonally adjusted annual rate of 6.9 per cent in May, the sharpest increase in over a year. Acceleration of the rise reflected a rebound in service costs and a sharp increase in non-food commodity prices. The increase in food prices, seasonally adjusted, was modest, especially when compared to experience earlier this year. The decline in mortgage costs was much smaller than over the preceding few months, and the effect on the all-items index was much less than in April or in the first quarter, as may be observed from the table (which shows figures that are not seasonally adjusted).

EFFECT OF MORTGAGE COSTS ON CONSUMER PRICES
(Percentage changes at annual rates, not seasonally adjusted)

	June 1970 to Dec. 1970	Dec. 1970 to March 1971	March 1971 to April 1971	April 1971 to May 1971
All items, CPI	4.9	2.4	4.1	6.2
All items, less mortgage costs 1/	4.8	3.8	6.2	6.2
Services	7.0	3.2	1.9	6.8
Services less home finance 1/ 2/	6.9	8.5	6.0	5.9

1/ Confidential
2/ Excludes mortgage interest costs, property taxes and homeowners' insurance.

The rise in apparel prices accelerated in April, with a particularly large increase for women and girls clothing, which is reported to be selling well this season. Gasoline prices also rose after declining for three months, and were below those of a year earlier.

A major influence on the durable goods group in May was the third consecutive large increase in used car prices, a series that introduces a great deal of distortion in monthly price movements. Also, prices of new and used homes rose substantially after changing little in the period January through April. New cars and household durables rose at relatively moderate rates.

CONSUMER PRICES
(Percentage changes, seasonally adjusted annual rates)

	June 1970 to Dec. 1970	Dec. 1970 to March 1971	March 1971 to April 1971	April 1971 to May 1971
All items	4.9	2.8	3.4	6.9
Food	.9	6.0	10.7	2.1
Commodities less food	5.2	1.0	2.1	8.6
Apparel	4.3	1.0	4.1	9.4
Gasoline 1/	4.0	-5.8	-21.4	3.5
New cars	11.6	4.7	.0	4.3
Used cars 1/	1.7	-9.5	39.5	38.2
Services 1/	7.0	3.2	1.9	6.8

1/ Not seasonally adjusted.

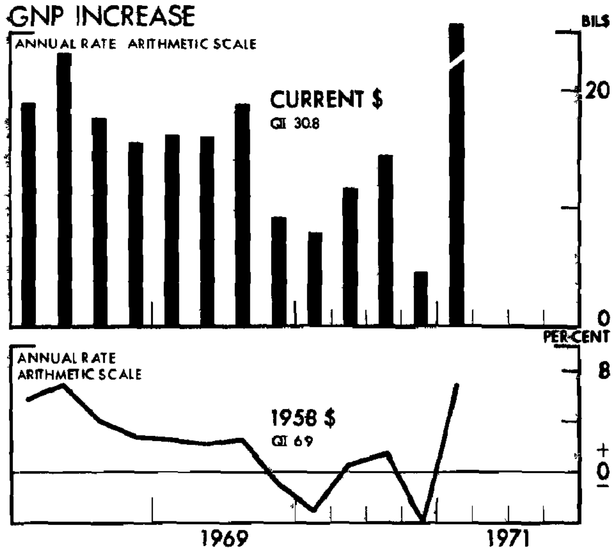
Food prices rose much less in May than in April or in the first quarter; meat prices edged off as declines for beef and pork were mostly offset by increases for poultry and fish. Fresh fruit and vegetable prices declined more than seasonally. Only moderate increases in food prices are expected in the next few months.

Charges for services increased at an annual rate of almost 7 per cent in May, far above the rates earlier this year. The sharp rise in postal rates accounted for about one-fourth of the increase in the service category. Home finance costs rose substantially as increases in property taxes far outweighted the more moderate drop in mortgage rates. But the rise in other service costs was smaller on average than in preceding months.

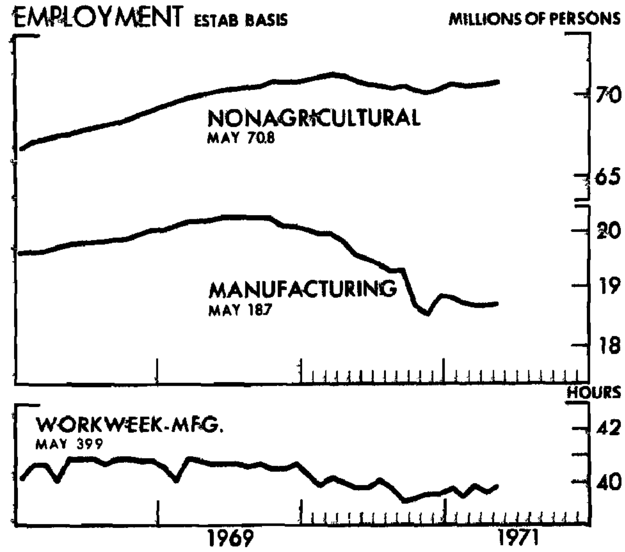
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

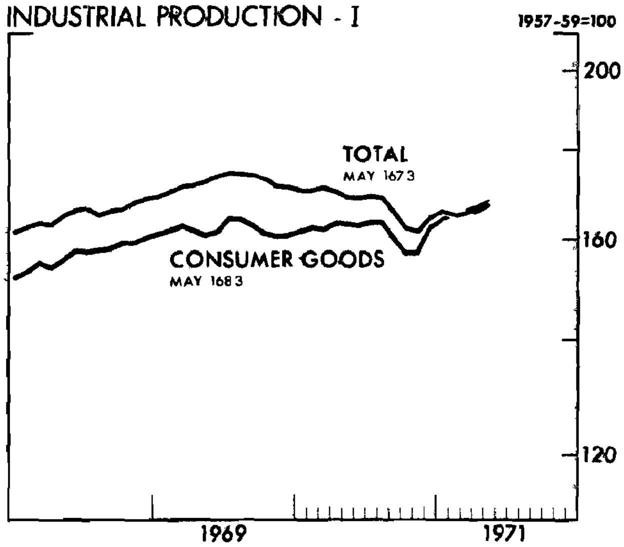
GNP INCREASE



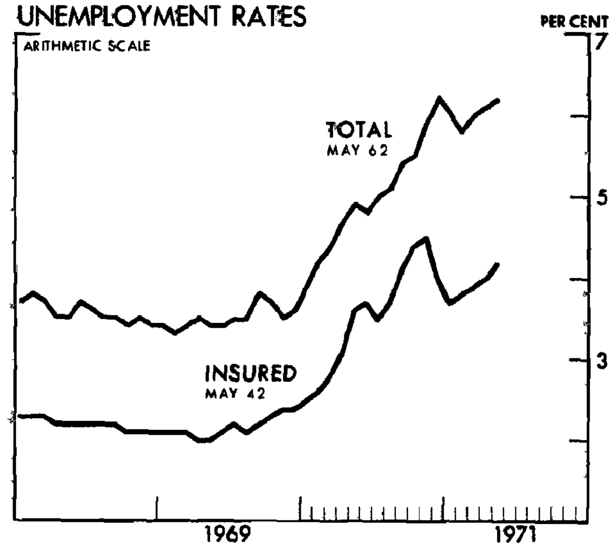
EMPLOYMENT ESTAB BASIS



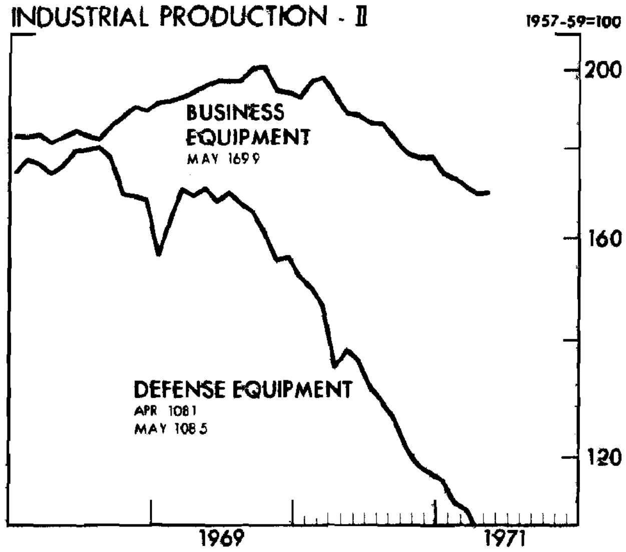
INDUSTRIAL PRODUCTION - I



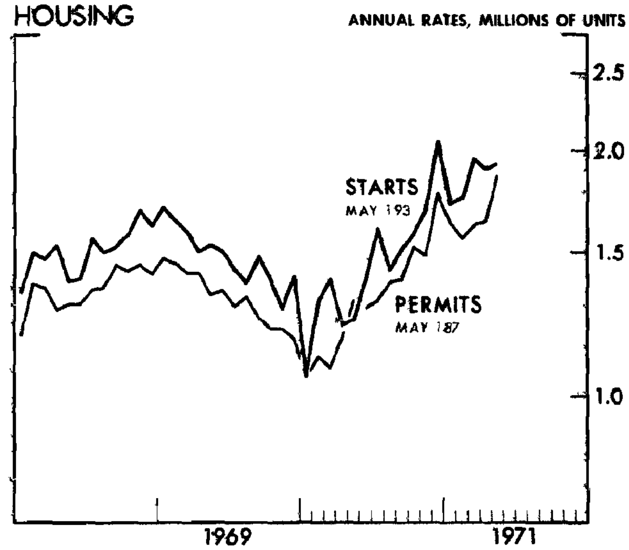
UNEMPLOYMENT RATES



INDUSTRIAL PRODUCTION - II



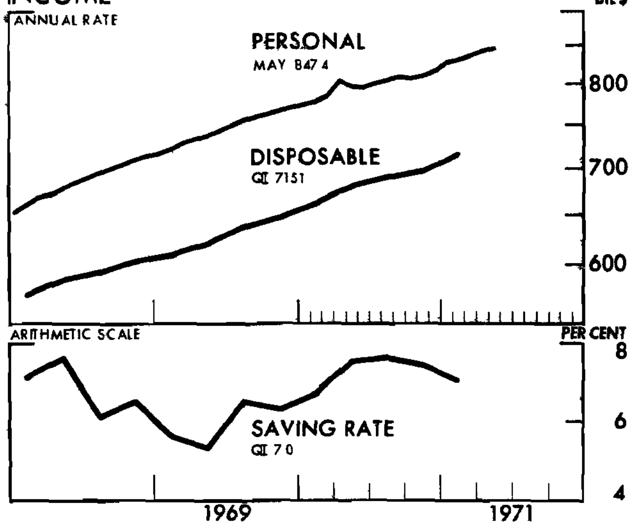
HOUSING



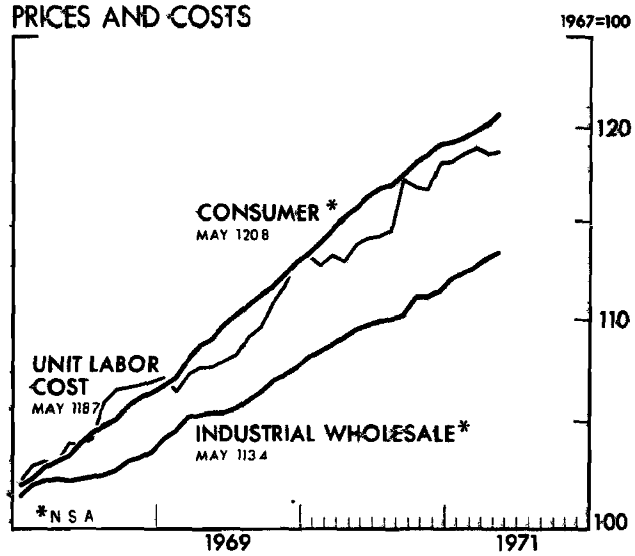
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

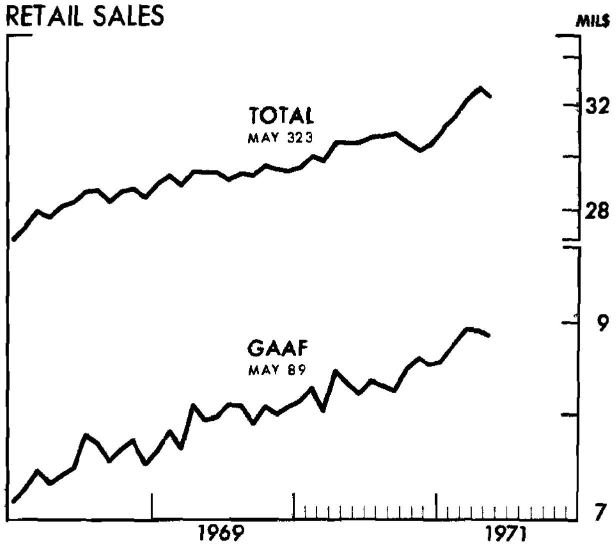
INCOME



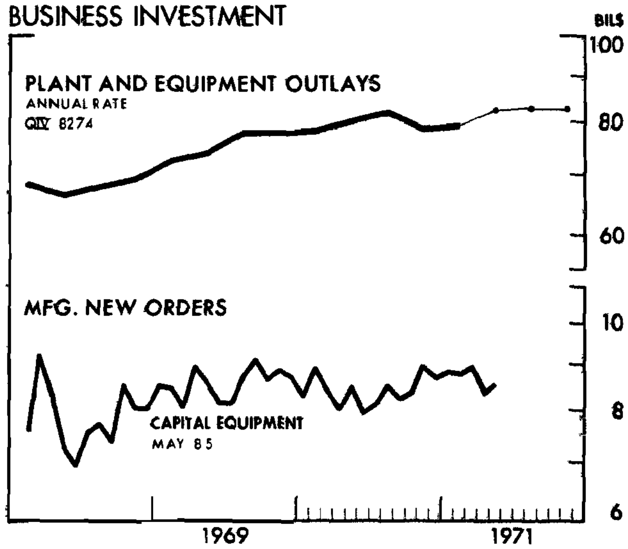
PRICES AND COSTS



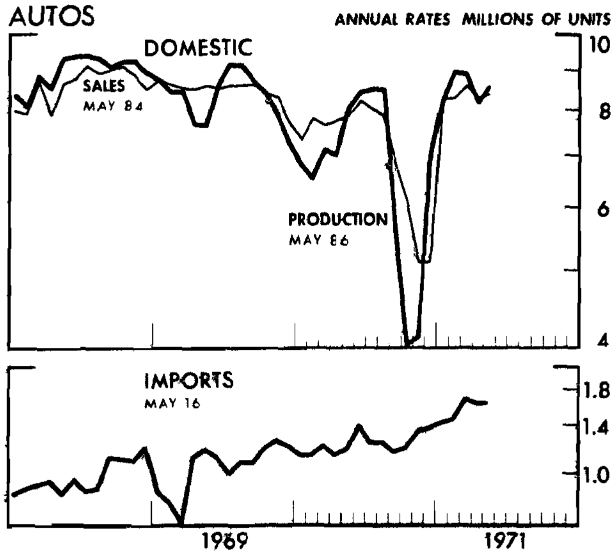
RETAIL SALES



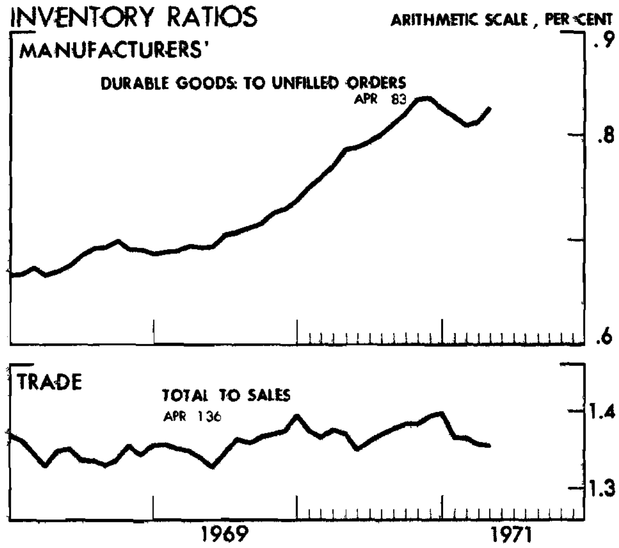
BUSINESS INVESTMENT



AUTOS



INVENTORY RATIOS



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Flow of Funds, Second Quarter. Based on preliminary estimates and partial projections, total credit flows appear to have surged upward in the second quarter to a $140 billion seasonally adjusted annual rate. The $36 billion increase from the first quarter was virtually all a resumption of Treasury borrowing, however, and reflected mainly the Government's efforts to restore its cash balances after the severe runoffs of cash in the first quarter. Other borrowing continued at the high rates of the first quarter relative to investment outlays and other financing requirements. Total credit flows over the half-year were 11.8 per cent of GNP, higher than the peak rate for any full year that was reached in 1968. Given these estimated flows, total debt outstanding was growing during the first half of 1971 at a 7.9 per cent annual rate, well below the 10 per cent rate of increase for GNP over the same period.

TABLE 1. CREDIT MARKET FUNDS RAISED BY NONFINANCIAL SECTORS[a/]
(Net flows in billions of dollars at seasonally adjusted annual rates)

		1969	1970 H1	1970 H2	1971 QI	1971 QIIp	II/71 less I/71
1.	Total funds raised	90.3	92.6	101.4	104.5	140.5	+36.0
2.	U.S. Government[b/]	-3.6	9.5	16.1	.7	35.0	+34.3
3.	Private debt securities and mortgages	49.1	50.2	66.1	83.6	80.7	-2.9
4.	State and local govt.--						
	Short-term	3.1	3.1	4.6	7.4	3.7	-3.7
	Long-term	5.0	6.5	9.5	18.7	13.2	-5.5
5.	Corporate & Foreign bonds c/	13.1	18.7	23.5	28.1	27.3	-.8
6.	Residential mortgages	20.5	15.9	20.2	20.3	27.8	+7.5
7.	Other mortgages	7.4	6.0	8.3	9.1	8.6	-.5
8.	Bank loans[d/]	15.5	8.3	-2.8	1.9	1.8	-.1
9.	Other loans[e/]	24.5	18.6	14.3	12.1	14.2	+2.1
10.	Corporate equities	4.8	6.0	7.6	6.1	8.3	+2.2
	Memo:						
11.	Change in U.S. Govt. cash	.4	1.5	33.7	-19.4	11.5	+30.9

a/ Nonfinancial sectors comprise households, nonfinancial business, state and local governments, foreign, and U.S. Government.
b/ Excludes sponsored credit agencies.
c/ Excludes net issues by financial corporations.
d/ Mainly business and farm loans. Excludes commercial paper and acceptances held by banks; excludes mortgage loans and consumer credit security loans.
e/ Consumer credit, commercial paper issued by nonfinancial companies, acceptances, commercial credit from finance companies, and U.S. Government loans.

Second-quarter private borrowing has been mainly long term, in the pattern that was set late last year. Municipal borrowing--both short term and long term--appears to be tapering off, after allowance for seasonals, from the very high rates that began in December. While public construction is higher this year than last, the first-quarter rate of state and local government net issues was well beyond current financing requirements, and some reduction in offerings was to be expected.

On an NIA basis, State and local government budgets are estimated to be in balance this year even with the higher construction outlays. Including allowances for employee retirement funding and other financial needs, however, these governments appear to have a credit requirement for the year of about $12 billion. With borrowing during the first six months at a $21 billion rate, some governments have clearly made sizable additions to liquidity holdings.

Corporate business net borrowing in the second quarter has been almost entirely in bonds, mortgages, and equity offerings. This is a continuation of the first-quarter structure of flows, and, with short-term debt almost static in amount outstanding, the security offerings have been sufficient to cover all investment requirements and to provide for a more than ample rate of growth in liquid assets. Liquidity ratios to short-term debt have been restored to roughly 1966 year-end levels of about 30 per cent, well up from the 26 per cent trough at the end of 1969. With the improvement in these ratios, long-term financing is losing the urgency it has had for business recently, and the volume of offerings will probably become more sensitive to movements in market rates.

For residential mortgages, the principal sources of increased flows in the second quarter were savings and loan associations and a resumption of net buying by FNMA. First-quarter flows were low relative to estimated construction outlays, and the sharp rise in the second quarter is in part a compensation for that. For the half-year, mortgage flows were somewhat high relative to construction, suggesting that existing house financing had increased from last year.

RESIDENTIAL FINANCE
(Billions of dollars, seasonally adjusted annual rates)

	1970	1971-H1	Change
Residential construction	29.7	37.0	+7.7
Residential mortgages, net change	18.1	24.3	+6.2

On the supply side of credit markets, private investors were evidently still liquidating Governments on a net basis in the second quarter, although by much smaller amounts than in the first quarter. Even with the increase in Treasury issues, Federal Reserve and foreign supply of funds appear to have provided most of the net Treasury requirement. Sponsored-agency borrowing was dominated in both the first and second quarter by retirements of home loan bank debt that had been financing credit to thrift institutions.

TABLE 2. SECURITY MARKETS
(Net flows in billions of dollars at seasonally adjusted annual rates)

	1969	1970 H1	1970 H2	1971 QI	1971 QIIp
U.S. Government and agency securities					
1. Total net issues	5.6	19.5	22.7	-3.6	32.9
2. Treasury & budget agencies a/	-3.5	9.6	16.1	.8	35.1
3. Sponsored credit agencies	9.1	9.9	6.6	-4.4	-2.2
4. Net purchases	5.6	19.5	22.7	-3.6	32.9
5. Federal Reserve	4.2	3.2	6.7	15.2	7.0
6. Foreign	-1.8	8.1	10.1	26.4	20.2
7. Commercial banks	-9.5	3.7	14.3	4.7	15.0
8. Nonbank finance	-2.3	5.3	5.4	7.3	.7
9. Pvt. domestic nonfinancial	15.0	-.8	-13.8	-57.2	-10.1
State and local government securities					
10. Total net issues	8.1	9.5	14.1	26.0	16.9
Net purchases by:					
11. Commercial banks	.4	6.5	13.7	23.9	18.7
12. Others	7.7	3.0	.4	2.1	-1.8
Corporate bonds					
13. Total net issues b/	14.8	20.6	26.8	30.7	28.6
Net purchases by:					
14. Households & personal trusts	5.3	11.0	12.9	11.7	11.3
15. Mutual savings banks	.3	1.3	1.5	7.5	9.0
16. Insurance & pension funds	5.9	8.0	8.4	9.8	9.6
17. Others	3.3	.3	4.0	1.7	1.3

a/ Excludes the small amount of mortgage liabilities that are in U.S. Government borrowing in Table 1, line 2.

b/ Includes issues by banks and finance companies in addition to amounts in Table 1, line 4.

p/ Preliminary. Second quarter estimates are based on partial data and are very preliminary.

The municipal and corporate bond markets apparently had about the same structure of supply as in the first quarter. The second-quarter decrease in municipal borrowing was matched roughly by a drop in commercial bank buying, but banks continued to be the dominant source of funds to this market. In corporate bond markets, mutual savings banks have continued to buy at their high first-quarter rates, providing a major support to this market. Corporate bonds have been a rising component of savings bank portfolios since 1967, growing from 5 per cent of total assets in 1966 to about 14 per cent currently. About half of the rise has been offset by a drop in Government securities as a per cent of assets and the other half by a decrease in the mortgage component. This shift to bonds is related to the favorable yield on bonds relative to mortgages and can be expected to continue unless mortgage yield spreads rise again. The household sector continued to absorb bonds at the very high rates that began in 1970.

In the total structure of credit supply (table 3), the rise in Treasury borrowing from first to second quarter is matched mainly by the halt of security liquidation by private domestic nonfinancial investors (line 10). For these investors, the first-quarter liquidation had been offset by an enormous inflow of deposit money to institutions (line 15), and in the second quarter the rate of these deposit flows receded $40 billion, which was again the principal offset to security market developments. The second quarter drop in private domestic deposit flow--to a rate that was still as high as in the summer of 1970--was at both banks and savings institutions, but it was not reflected in the lending activities of these institutions. At banks, the first-quarter inflow had been countered to some extent by reduction of Euro-dollar borrowings (in line 16) and by the drop in Treasury balances (line 17), and in the second quarter the changes in these other sources of funds fully offset the change in private deposit flow. At savings institutions, the decreased deposit inflow in the second quarter was more than matched by reductions in liquidity and did not impede a 30 per cent increase in net mortgage lending at savings and loan associations.

TABLE 3. STRUCTURE OF CREDIT SUPPLY
(Net flows in billions of dollars at seasonally adjusted annual rates)

		1969	1970 H1	1970 H2	1971 QI	1971 QIIp
1.	Total credit-market funds raised by nonfinancial sectors	90.3	92.6	101.4	104.5	140.5
2.	Credit-market borrowing by finance	31.1	23.9	1.3	-6.7	-9.6
3.	Total funds raised and supplied in credit markets (1+2=4+5+6+7+10)	131.4	116.5	102.7	97.7	130.9
	Funds supplied in credit markets by:					
4.	Federal Reserve	4.2	3.3	6.6	15.5	7.0
5.	Foreign	1.3	9.5	12.3	27.1	20.3
6.	U.S. Govt. & sponsored agencies	11.5	14.1	11.1	1.7	-5.3
7.	Total private finance	66.5	69.6	95.6	108.8	109.6
8.	Commercial banks	17.5	18.8	40.2	45.5	44.8
9.	Pvt. nonbank finance	49.0	40.8	55.4	63.3	64.8
10.	Pvt. domestic nonfinancial sectors	37.9	26.6	-17.2	-55.5	-1.2
11.	U.S. Govt. securities	15.0	-.8	-13.8	-57.2	-10.0
12.	Corporate bonds	7.6	11.1	12.4	11.1	10.8
13.	Other credit	15.3	16.3	2.8	-9.4	-2.0
14.	Deposit claims on financial institutions a/	13.4	32.8	77.9	103.7	105.9
15.	Pvt. domestic nonfin.	4.7	34.0	88.3	135.7	96.0
16.	Foreign a/	8.3	-2.7	-14.1	-12.6	-1.6
17.	U.S. Govt.	.4	1.5	3.7	-19.4	11.5
18.	Commercial-bank credit as per cent of total (line 9/line 1)	19.3%	20.3%	39.6%	43.5%	31.9%

a/ Includes Eurodollar borrowings by banks.
p/ Preliminary second quarter estimates are based on partial data and are very preliminary.

Bank credit. Large banks continued to acquire securities in significant volume in the early weeks of June but their loan expansion moderated; in May, loans had accounted for a major share of the growth in total credit at large banks (as well as at all commercial banks). As in April and May, almost all of the securities acquired were tax-exempt obligations and, with interest rates apparently expected to rise further, banks continued to emphasize short-term maturities.

Business loan growth had accounted for a major share of the increase in total loans in May but the partial data for weekly reporting banks suggest that business loan expansion at all banks in June will be significantly below the strong May pace. Such loans declined contra-seasonally in the first two weeks of the month, as shown in the first line of the table. However, business borrowing did pick up over the mid-month tax date at large New York and Chicago banks (the only institutions for which that week's data are available at this writing) and about equalled the average rate of the corresponding week in other recent years. Even with that, however, an unusually rapid growth in such loans would be required over the balance of June to produce a more than modest seasonally adjusted increase in business loans for the month.

CHANGES IN BUSINESS LOANS AT WEEKLY REPORTING BANKS[1/]
(Millions of dollars, not seasonally adjusted)

	All weekly reporters		Weekly reporters in New York and Chicago	
	Average 1968-70	1971	Average 1968-70	1971
Two weeks: May 26-June 9[2/]	654	-61	289	-77
One week: June 9-June 16[2/]	1,297	n.a.	629	687
Three weeks: May 26-June 16[2/]	1,951	n.a.	918	610

1/ Adjusted for loans reported sold to affiliates.
2/ Dates for 1971; comparable dates used for other years.

Tax borrowing at mid-month appears to have been relatively larger than over the March and April tax dates, even though corporate tax liabilities were at their lowest level for June since 1965.[1/] The satisfaction of a larger proportion of tax borrowing at banks in June no doubt reflected the narrowing of the costs between bank credit and other short-term sources of finance, most of which has occurred since early May. Upward pressure on short-term market rates encouraged two banks outside New York to raise their prime rate in early June. But, with business loan demands remaining weak to moderate at best--and perhaps in view of the political difficulties envisioned--the higher prime rate has not yet spread at this writing.

Note: Final data for bank credit developments in May have become available since the last Greenbook. Also, data for earlier periods have been revised to reflect adjustments to the December 31, 1970 Call Report benchmark. These data, presented in the table below, are quite similar to those presented earlier and need no comment here.

1/ Maturing tax bills were also smaller than in previous periods, but in recent months corporations have not relied heavily on such paper for tax payments.

COMMERCIAL BANK CREDIT ADJUSTED TO INCLUDE OUTSTANDING AMOUNTS OF LOANS SOLD TO AFFILIATES 1/
(seasonally adjusted percentage changes, at annual rates)

	1970	1971		
	QIV 4/	QI 4/	April 4/	May
Total loans & investments 2/	8.5	12.2	-0.3	11.7
U.S. Government securities	6.2	19.8	-23.5	--
Other securities	36.5	27.9	20.9	16.7
Total loans	1.2	6.3	-2.4	12.9
Business loans 3/	-4.9	1.0	--	18.2

1/ Last Wednesday of month series.
2/ Includes outstanding amounts of loans sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
3/ Includes outstanding amounts of business loans, sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
4/ Data revised to reflect adjustments to December 31, 1970 Call Report benchmarks.

Monetary aggregates and bank sources of funds. The table below summarizes recent rates of growth in the monetary aggregates through May. Available data for the first half of June indicate that M_1 remained at near its end of May level. Since M_1 grew rapidly over May, the maintenance of the end-of-month level suggests that, on a daily average basis, growth of M_1 in June will be substantial, but below the record May rate. The rate of advance of M_2 also appears to have moderated in early June, primarily reflecting the slowing of growth in M_1.

MONETARY AGGREGATES
(Seasonally adjusted, annual rates of change, in per cent)

	1970 QIV	1971 QI	1971 March	1971 April	1971 May
1. M_1 (currency plus private demand deposits)	3.4	8.9	11.6	9.3	16.3
2. M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	9.2	17.8	18.9	12.1	14.7
3. M_3 (M_2 plus savings deposits at mutual savings banks and S & L's)	9.7	19.0	19.8	16.1	15.7
4. Adjusted bank credit proxy	8.3	10.9	8.9	5.3	7.5
5. Commercial bank time and savings deposits	21.8	27.3	25.9	10.7	14.5
a. large CD's	79.4	27.9	19.2	-21.3	26.6
b. other time and savings	15.4	27.2	27.0	14.8	13.0
6. Savings deposits at mutual savings banks and S & L's	11.5	23.3	24.9	21.8	13.4

Inflows of time and savings deposits other than large CD's (mainly consumer-type deposits) remained relatively rapid in early June. But with the higher level of competitive market rates of interest, at least two banks on the west coast raised their offering rates on longer-term consumer-type deposits. Offering rates on large CD's were also increased in early June in an effort to keep pace with the advance in rates on competing money market instruments. However, with loan demands modest, the dollar volume of CD's outstanding remained about unchanged on average in the first half of June as a build-up over the earlier part of the month was offset by more than seasonal tax date maturities.

Nondeposit sources of funds, for the first time in several months, increased somewhat in the early weeks of June. Nearly all of the increase was in borrowings from U.S. foreign branches. It is not clear why such borrowings should rise, given the spread of Eurodollar rates over domestic interest rates; the drop in the Eurodollar call loan rate below the Federal funds rate occurred after most of the stepped-up borrowing by U.S. banks.

Nonbank depositary intermediaries. Data thus far available for June do not make it completely clear how much of a moderation in deposit inflows may be accompanying short-term market yields that are rising but are still generally below deposit rate ceilings. Deposit growth in May at nonbank thrift institutions had dropped from the advanced rate of the first four months of this year. But, according to sample data, during the first half of June nonbank thrift institutions continued to receive quite large deposit inflows. In addition, deposit patterns at New York City savings banks have not yet shown any noticeable response to the recent New York City 14-month note, priced to yield about 6 per cent before the triple tax exemption--Federal, State, and local--available to residents.

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

	Mutual Savings Banks	Savings and Loan Associations	Both
1970 - QI	2.7	2.3	2.5
QII	6.4	7.2	7.0
QIII	6.9	10.6	9.3
QIV	10.5	12.1	11.6
1971 - QI	17.7	26.0	23.3
March*	21.2	26.7	24.9
April*	19.0	23.8	22.2
May* p/	12.4	15.0	14.1

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

While the forthcoming reinvestment period could provide some test of the ability of thrift institutions to hold and attract deposits, the traditional quarterly dividend-crediting periods are becoming increasingly less useful in providing insight into the pattern of savings flows. As the following table illustrates, savings and loan associations have locked up an increasing percentage of their deposit liabilities in accounts with a minimum term over one year. Since the January 1970 rate ceiling changes that enabled the S & L's to offer a significant differential for term accounts, those liabilities have grown steadily and strongly--at times at the expense of passbook accounts but creating in the process a more stable deposit structure. Alternative yields at any given reinvestment period would have to be sufficiently higher than the 5.75 per cent one-year and 6 per cent two-year deposit account ceilings to induce payment of the early withdrawal penalty for term accounts before that segment of S&L claims would respond. (The minimum penalty is one quarter's interest.)

COMPOSITION OF DEPOSITS OUTSTANDING AT
INSURED SAVINGS AND LOAN ASSOCIATIONS 1/
(Billions of dollars)

	Total	Passbook	Minimum Term Accounts Total	Minimum Term Accounts Over One Year
1969 - December	131.0	90.0	41.0	.6
1970 - January	129.6	85.8	43.9	5.5
April	131.6	82.3	49.3	19.0
July	134.6	81.9	52.7	26.0
October	137.9	82.4	55.5	29.6
1971 - January	144.2	83.3	60.9	35.0
April	152.7	86.5	66.2	39.5

1/ These account breakdowns are according to their original maturity. The existing rate ceiling structure (adopted January 1970) permits a 6 per cent rate on two-year minimum term accounts, 5.75 per cent on one-year minimum term accounts, and 5.25 per cent on 90-day notice accounts. The minimum penalty for early withdrawal is forfeiture of 90 days' interest.

Even if savings and loan deposit inflows were to drop off suddenly and sharply this summer, it appears that the S & L's have retained considerable leeway to honor their outstanding mortgage commitments during the summer--increased though they certainly are. For one thing, a significant portion of total outstanding commitments probably represents refinancings of mortgages presently held by the S & L's, which would require little new mortgage money from S & L's; this can be inferred from the strong increase in loans actually refinanced during the past three months as mortgage interest rates and lending terms eased considerably. More importantly, as the following table indicates, the ratio of outstanding commitments to current and recent cash flow is much lower than it has been in past years -- and the cash flow total used in calculating the current ratio already excludes the $2.3 billion of borrowed funds repaid to the FHLB. In addition, associations now have an unusually high liquid asset ratio, well above the record-high 7.5 per cent required by the FHLBB since May 1.[1/]

1/ Liquid asset ratios consist of cash, US Government securities, and US Agency issues maturing within five years, as a percentage of the sum of deposit liabilities and borrowed funds due within one year.

SOURCES AND USES OF FUNDS AT INSURED SAVINGS AND LOAN ASSOCIATIONS
(Billions of dollars)

	March, April, and May of			
	1968	1969	1970	1971
Sources				
Deposit accounts, net 1/	1.7	1.4	2.6	8.2
Borrowed funds	.4	.7	-.1	-2.3
Subtotal	2.1	2.1	2.5	5.9
Gross mortgage repayments 2/	3.6	3.6	3.2	5.2
Other sources, net 3/	.8	.9	.4	.7
Total	6.5	6.6	6.1	11.8
Uses				
Net increase in liquid assets 4/	.3	--	1.4	.7
Gross mortgage acquisitions	6.2	6.6	4.7	11.1
Total	6.5	6.6	6.1	11.8
Memoranda				
Mortgage refinancings	.5	.4	.3	1.2
Average ratio of outstanding mortgage commitments to recent cash flow 5/	1.02	1.19	1.10	.86

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.
4/ Reflects all eligible liquid assets according to FHLB requirements. For 1967 and 1968, includes only cash and U.S. Government securities. Since 1968, includes also Federal agency issues maturing within five years.
5/ Represents the average of the monthly ratios produced by dividing outstanding commitments plus loans in process by the sum of cash flow in the current month and previous two months.

Mortgage market. Seasonally adjusted growth in new and outstanding mortgage commitments at insured savings and loan associations continued unusually strong during May. The record amount of S&L mortgage commitments outstanding at the end of last month, which was more than twice the level a year earlier, was bolstered partly by increased borrower demands to refinance old loans.

S&L mortgage commitment and lending activity has assumed greater significance this year as other lender groups, including Federal agencies, has provided less support to the mortgage market. During the first quarter, the share of S&L net takings of mortgages on all types of properties sharply increased to 58 per cent of net acquisitions by all lender groups, as shown in the table. With respect to residential mortgages, the S&L share of net acquisitions increased to 76 per cent of the total. In April, indications are that the S&L share of total net mortgage lending probably increased further.

S&L SHARE OF NET
MORTGAGE LENDING
(Per cent)1/

Period	All mortgages	Residential mortgages
1968	34	44
1969	35	44
1970	40	50
1970 - IQ	17	24
IIQ	38	47
IIIQ	44	55
IVQ	50	50
1971 - IQ	58	76

1/ Net increase in mortgages held by S&L's are share of total net increase in mortgage debt outstanding.

p/ Preliminary.

In the primary market for conventional mortgages on new houses, contract interest rates edged higher during May--the first rise in nearly a year. Even so, returns on this type of investment continued to lose ground relative to yields on new issues of high-grade corporate bonds. In May, the average gross yield spread on such home mortgages over corporate bonds declined to minus 13 basis points--the most unfavorable margin in 7 months, and the fourth largest negative spread in the history of the mortgage series, which goes back to 1954.

CONVENTIONAL HOME MORTGAGES

	Contract Rate (Per cent)	Yield Spread (Basis points above corporate bonds)
1970 - High	8.60	50
1971 - January	7.95	71
February	7.75	47
March	7.60	14
April	7.55	- 2
May	7.65	-13

NOTE: FHA series, rounded to nearest 5 basis points, for first mortgages to finance purchases of new homes. Yield spread is mortgage rate minus yield on new issues of high-grade corporate bonds.

In the more sensitive secondary market for Government underwritten mortgages, FNMA conducted a special auction of its purchase commitments on June 9. This auction was aimed at reducing the speculative overhang of home mortgages, including warehoused loans, held by mortgage companies and others without firm purchase commitments from private investors. In the special auction, FNMA accepted $274 million of the $1,097 million total offers submitted for immediate delivery of FHA and VA loans bearing the current ceiling rate of 7 per cent. FNMA's unprecedented action apparently helped to stabilize this sector of the market, as suggested by the slightly lower level of yields indicated on 6-month purchase commitments in FNMA's regular June 14 auction compared with the results of the June 1 auction. However, average discounts associated with these purchase commitments remained quite restrictive, even after allowance for the unusual conditions prevailing in the secondary market during recent weeks.

FNMA REGULAR PURCHASE AUCTIONS

		Amount of total offers		6-month commitments	
		Received	Accepted	Discount	Private market yield
		(Millions of dollars)		(Points)	(Per cent)
1971 - High		1,168 (5/10)	314 (4/26)	9.4 (6/1)	8.18 (6/1)
April	12	127	54	3.7	7.45
	26	687	314	4.4	7.54
May	10	1,168	237	5.6	7.68
	24*	726	152	7.8	7.97
June	1*	324	147	9.4	8.18
	14	664	191	9.2	8.15

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. Implicit yields shown are gross, before deduction of fee paid by investors to servicers of 38 basis points.

*Dollar limits were announced in advance by FNMA on the total offers it would accept, and on the total competitive offers that any one bidder could make.

<u>Corporate and municipal securities markets.</u> Corporate and municipal bond yields have fluctuated widely since mid-May, as a highly sensitive market reacted to swings in short-term interest rates and to diverse announcements about the domestic and international outlook. Following yield declines late in May and early June, long-term rates began to move up sharply, in anticipation of a rise in the prime rate, as well as in expectation of a shift to a more restrictive monetary policy stance. By mid-June, long-term yields in the corporate markets were within 20 basis points of their 1971 high reached in mid-May, while tax-exempt yields edged above their previous peak in mid-May. More recently, a new Aaa-rated Bell System debenture was offered to yield 7.80 per cent, appreciably below comparable yields in the weak ending June 18. This offering was not well received by investors.

Over the last few days, stock prices have declined sharply on relatively large volume. According to the financial press, the immediate cause for the decline was the announcement of a relatively low May level of mutual fund liquidity and an unprecedented net redemption of mutual fund shares during May; other bearish factors included concern about the strength of economic recovery and the recent increase in interest rates. Prior to the recent decline, stock prices on both the New York and American Exchanges had been relatively stable for the previous four weeks. Combined NYSE and AMEX volume, though still high by historical standards, had been somewhat lower than the average level prevailing from January through April of 1971.

BOND YIELDS
(per cent)

	New Aaa Corporate Bonds 1/	Long-term State and Local Bonds 2/
1970		
Low	7.68 (12/18)	5.33 (12/10)
High	9.30 (6/18)	7.12 (5/28)
1971		
Low	6.76 (1/29)	5.00 (3/18)
High	8.23 (5/21)	6.00 (6/18)
Week of:		
May 21	8.23	5.96
28	8.06	5.86
June 4	7.79	5.70
11	7.93	5.87
18	8.05	6.00

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

When interest rates began to rise in June, a number of corporations postponed issues. It is now estimated that total June public bond offerings will be about $2.2 billion. Filings for July are relatively low, especially in the utility sector; and, even with the rescheduling of several issues from June, the staff estimates that July volume will be about $1.7 billion. This would be the first time in almost a year that public bond volume dropped below $2 billion, but it is still significantly above the average monthly volume in this market in any year before 1970.

New stock issues continued at high levels, even aside from the $1.4 billion AT&T rights issue, which will boost the July total to a record level. The relatively high level of public bond offerings and the surge in equity financing, combined with an apparent pickup in private placements in recent months, have resulted in a near-record monthly average volume of total corporate security offerings from April through July.

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

	Bonds			
	Public	Private	Stocks	Total
1969 - Year	1,061	468	700	2,229
1970 - Year	2,099	403	713	3,245
1971 - QI	2,790	505	769	4,063
QII e/	2,187	550	1,033	3,770
May e/	2,200	500	900	3,600
June e/	2,200	700	900	3,800
July e/	1,700	500	2,000	4,000

e/ Estimated.

Although total second-quarter volume of State and local long-term debt issues is below the record first-quarter level, tax exempt bonds are still being offered at levels close to $2 billion a month. In the last few weeks, the pace of acquisitions by both banks and fire and casualty companies has slackened somewhat, and this has exerted upward pressure on municipal yields. Municipal demands for long-term funds have not abated, but there may be some seasonal tapering in new issues in July.

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

	Long-term	Net Short-term
1969 - Year	991	294
1970 - Year	1,515	383
1971 - QI	2,230	535
QII e/	1,996	436
May e/	2,200	207
June e/	1,900	100
July e/	1,800	n.a.

e/ Estimated.
NOTE: Long-term offerings are gross. Short-term offerings are Federal Reserve Board estimates of net sales.

Net short-term offerings by State and local governments fell in May and June. Even though gross short-term issues averaged more than $2 billion a month over the second quarter--rising to an anticipated $3 billion in June--the increasing volume of maturing issues largely offset the recent rise in gross offerings, with a number of governments apparently deciding to fund their maturing short-term obligations rather than renew them.

<u>Government securities market</u>. Interest rates in all sectors of the government securities market rose sharply in the interval between the early June Open Market Committee meeting and mid-June. Initially, expectations of a tightening of monetary policy and later the observed higher rate levels in the Federal funds market--above the discount rate--contributed to marked downward adjustments in security prices. Also the moves by the two banks to raise their prime interest rates and anticipations of large Treasury borrowing needs added to cautious attitudes. Since mid-month, however--and since Treasury's announcement of financings on June 16 (for details see section on Federal Finance)--the Government securities market recovered and prices have tended to move higher.

MARKET YIELD ON U. S. GOVERNMENT AND AGENCY SECURITIES
(Per cent)

	1971		Weekly average for week ending			
	Daily highs 1/	Daily lows 1/	June 1	June 8	June 15	June 22
Bills						
1-month	4.83 (1/6)	2.07 (3/12)	4.27	4.22	4.54	4.75
3-month	5.02 (6/15)	3.22 (3/11)	4.36	4.36	4.78	4.93
6-month	5.22 (6/16)	3.35 (3/11)	4.51	4.59	4.97	5.14
1-year	5.54 (6/22)	3.45 (3/11)	4.74	4.90	5.27	5.46
Coupons						
3-year	6.61 (6/15)	4.27 (3/22)	5.87	5.91	6.32	6.49
5-year	6.76 (6/15)	4.74 (3/22)	6.21	6.24	6.57	6.61
7-year	6.86 (6/15)	5.15 (3/23)	6.38	6.39	6.69	6.72
10-year	6.73 (6/15)	5.38 (3/23)	6.37	6.28	6.55	6.62
20-year	6.56 (6/15)	5.69 (3/23)	6.26	6.22	6.42	6.47
Agencies						
6-month	5.72 (6/22)	3.67 (3/16)	5.19	5.12	5.39	5.70
1-year	6.11 (6/21)	3.93 (3/16)	5.69	5.58	5.80	6.09
3-year	6.92 (6/22)	4.70 (3/24)	6.45	6.36	6.56	6.89
5-year	7.12 (6/18)	5.12 (3/23)	6.68	6.67	6.84	7.08

1/ Latest dates of high and low rates in parenthesis.

On balance, yields in the bill market have risen 30 to 50 basis points, while intermediate-term yields are up by about 25 basis points. Rates in the coupon sector adjusted sharply upward during the two trading days when the Federal funds rate reached a level of 5 per cent and when some prime rate increases were announced. At the time of the peak in yields--on June 15--intermediate-term interest rates had increased by as much as 40 basis points from June 7, but since then a fair-sized rally has developed. During the period since June 7, dealers' positions have been moderate, suggesting a cautious attitude by dealers.

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

	May Daily average	May 28	June 7	June 14	June 21
Treasury securities					
Total	2,645	2,882	2,611	2,554	1,870
Treasury bills (total)	1,785	2,268	2,075	2,059	1,446
Due in 92 days or less	473	362	447	611	314
93 days or over	1,311	1,906	1,629	1,448	1,132
Treasury notes and bonds (Total)	861	614	535	496	424
Due within 1-year	327	247	221	254	261
1-5 years	192	132	129	95	41
over 5 years	341	236	187	147	123
Agency securities					
Total	819	926	798	777	758
Due within 1-year	400	437	381	401	394
Over 1-year	419	489	417	376	364

In the market for Federal agencies, new issue activity has been relatively light in June. Responding to the general upward movements in interest rates, yields on agency issues have increased by around 35 to 55 basis points since June 7.

Other short-term credit markets. Over the past three weeks, short-term rates, with the exception of finance company paper, continued their upward movement, with gains ranging up to 76 basis points. Several rates--notably those on three-month commercial paper and on bankers' acceptances--are now above the 5-1/2 per cent prime rate. However, commercial paper rates have lagged the very sharp rise in bill rates, the spread narrowing between commercial paper and Treasury bills in the three-month maturity range from 137 basis points on June 2 to 78 basis points on June 16.

On a seasonally-adjusted basis, finance company paper outstanding showed a decline of $361 million for May. Large long-term borrowings on the capital market early in the month by several finance companies and the May increase in bank loans to nonbank financial institutions suggests that these have been alternative sources of funds. Weekly data for June, however, do show a substantial increase in finance paper outstanding.

Total commercial and finance company paper fell by more than $400 million in May to $30.7 billion, the lowest outstanding amount since September 1969. Dealer paper outstanding continued to decline somewhat during May at a time when business loans expanded substantially.

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

	1970		1971			Net change
	High	Lows	June 2	June 9	June 16	June 2-June 16
1-month						
Commercial paper	9.25	5.50	5.25	5.13	5.38	+13
Finance paper	9.00	5.00	5.00	5.00	5.00	--
Bankers' acceptances	9.00	5.50	5.25	5.38	5.63	+38
Certificates of deposit--new issue 1/	7.75	5.00	4.88	5.00	5.25	+37
Treasury bill	7.84	4.58	4.21	4.40	4.74	+53
3-month						
Commercial paper	9.25	6.00	5.63	5.63	5.75	+12
Finance paper	8.25	5.50	5.00	5.00	5.00	--
Bankers' acceptances	9.00	5.50	5.38	5.50	5.75	+37
Certificates of deposit--new issue 1/	6.75	5.50	5.13	5.25	5.50	+37
Treasury bill	7.93	4.74	4.26	4.60	4.97	+71
6-month						
Bankers' acceptances	9.00	5.50	5.38	5.50	5.75	+37
Treasury bill	7.99	4.78	4.46	4.82	5.22	+76
12-month						
Certificates of deposit--new issue 1/	7.50	5.50	5.50	5.50	5.63	+13
Treasury bill	7.62	4.74	4.75	5.14	5.47	+72
Prime municipal notes	5.80	2.95	3.20	3.30	3.45	+25

1/ 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)

	March	April	May	MEMO: Peake values (May 1970)
Total commercial and finance paper 1/	30,954	31,163	30,730	39,318
Bank related 2/	1,692	1.794	1,748	7,600 4/
Nonbank related 3/	29,262	29,369	28,982	31,718
Placed through dealers	12,880	12,448	12,422	12,686
Placed directly	16,382	16,921	16,560	19,032 5/
	Net Change from Previous Month			
Total commercial and finance paper 1/	-1,620	+209	-433	
Bank related 2/	- 209	+102	- 46	
Nonbank related 3/	-1,411	+107	-387	
Placed through dealers	- 878	-432	- 26	
Placed directly	- 533	+539	361	

1/ Combines seasonally adjusted nonbank-related paper and seasonally adjusted bank-related paper.
2/ Seasonally unadjusted.
3/ Seasonally adjusted.
4/ This component showed a peak of $7,820 in July 1970.
5/ This component showed a peak of $19,112 in April 1970.

Federal finance. The staff continues to estimate a Federal deficit in the current fiscal year of about $22 billion. (The actual figures will not be known until late July.) In regard to fiscal year 1972, preliminary Staff estimates suggest a Federal deficit of about $23 billion but the outlook is still highly uncertain because Congress has not completed action on a number of important bills. The two most significant developments since the last Greenbook relate to military pay and public service employment.

The Senate recently passed an amendment to the Selective Service Act that is similar to legislation already passed in the House increasing the total military pay bill by $2.8 billion annually, in a move toward an all volunteer army. This Senate action was unexpected because the Senate had previously rejected the larger House appropriation in the favor of a smaller ($1.2 billion) Administration request. Earlier Staff estimates had allowed for a middle ground $1.8 billion outlay for this program in fiscal 1972, but now incorporate the larger $2.8 billion increase.

Another recent development involves reports that the Administration may not veto the public service employment bill now being deliberated by the House-Senate conference committee. Passage of this bill had been previously assumed in the Staff expenditure estimates.

During the first half of June the Treasury's cash balance was substantially below projected levels and the Treasury resorted to special borrowing from the Federal Reserve. The shortfall in the cash balance was due in part to higher-than-expected expenditures early in the month and to the redemption of special issues held by foreigners. While the special borrowing from the Federal Reserve was repaid following the seasonal mid-month inflow of tax receipts, the Treasury's cash balance was still relatively low and, thus, the Treasury announced on June 16 plans to auction $2.25 billion of 16-1/2 month notes, payable on June 29, and $1.75 billion of tax bills payable on July 6. As a result of this financing announcement, the Staff estimate of the end-of-June cash balance has been revised upward to about $7.8 billion.

Current staff estimates suggest that net Treasury borrowing from the public will be about $23 billion in the second half of calendar 1971, a record for recent half-years and nearly $7 billion higher than last year. Relative to GNP, net Treasury borrowing has been higher in only two periods since 1950--the second half of calendar years 1953 and 1967. Net Treasury borrowing for the period between late June and late August is now estimated to be about $11.0 billion. However, the specific timing and amounts of future Treasury market borrowing operations will be significantly affected by what happens to the special issues held by foreign central banks. A recent Treasury announcement indicates that the June 21 weekly bill auction will be increased by $100 million, and the Staff estimates assume that the Treasury will continue this addition to its regular weekly bill auctions for some time. Given these assumptions, the Treasury will need to go to the market for approximately $2.5 billion in new money late in July and a smaller amount sometime in August. The July borrowing might be tax bills maturing next spring, and perhaps the Treasury will obtain its new money in August in conjunction with the quarterly refunding.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	June	July	Aug.
Total net borrowing	-1.1	6.8	2.1
Weekly and monthly bills	.1	.5	.1
Tax bills	--	1.8	--
Coupon issues	2.3	--	--
As yet unspecified new borrowing	--	4.5	2.6
Other (debt repayments, etc.)	-3.5 a/	--	-.6
Plus: Other net financial sources b/	-1.9	.1	-.4
Plus: Budget surplus or deficit (-)	3.6	-7.2	-3.5
Equals: Change in cash balance	.6	-.3	-1.8
Memoranda: Level of cash balance, end of period	7.5	7.2	5.4
Derivation of budget surplus or deficit:			
Budget receipts	22.6	13.5	16.1
Budget outlays	19.0	20.7	19.6
Maturing coupon issues held by public	--	--	4.1
Net agency borrowing	.3	.5	.2

a/ Includes about $1.0 billion in redemptions of Treasury securities issued to foreign central banks during May.
b/ Checks issued less checks paid and other accrual items.

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

	Fiscal 1971e/		Fiscal 1972e/		F.R. Board Staff estimates						
					Calendar	Calendar Quarters					
					Year	1971				1972 e/	
	Jan. Budget	F.R. Board	Jan. Budget	F.R. Board	1971e/	I*	IIe/	IIIe/	IVe/	I	II
Federal Budget											
(Quarterly data, unadjusted)											
Surplus/deficit	-18.6	-22.0	-11.6	-23.5	-27.5	-8.2	2.6	-10.9	-12.0	-8.3	7.7
Receipts	194.2	189.0	217.6	211.0	194.8	44.1	57.3	49.2	44.2	50.8	66.8
Outlays	212.8	211.0	229.2	234.5	222.2	52.2	54.7	60.1	56.2	59.1	59.1
Means of financing:											
Net borrowing from the public	17.6	19.0	10.6	22.0	25.1	1.6	1.1	9.0	13.4	4.6	-5.0
Decrease in cash operating balance	n.a.	.2	n.a.	.5	.3	3.6	-3.3	.7	-.6	1.7	-1.3
Other [1]	n.a.	2.8	n.a.	1.0	2.0	2.9	-.4	1.2	-.8	2.0	-1.4
Cash operating balance, end of period	n.a.	7.8	n.a.	7.3	7.8	4.5	7.8	7.1	7.7	6.0	7.3
Memo: Net agency borrowing [2]	n.a.	1.7	n.a.	n.e.	n.e.	-1.0	-0.3	1.2	n.e.	n.e.	n.e.
National Income Sector											
(Seasonally adjusted annual rate)											
Surplus/deficit	-15.0	-16.7	-4.2	-19.0	-18.8	-16.0	-20.8	-22.0	-16.4	-20.2	-17.5
Receipts	200.0	196.8	225.9	216.8	205.5	198.2	202.2	206.9	214.6	219.8	225.7
Expenditures	215.0	213.5	230.1	235.8	224.3	214.2	223.0	228.9	231.0	240.0	243.2
High employment surplus/deficit (NIA basis)	n.a.	-.2	n.a.	-.4	-.4	1.3	-2.0	-2.6	1.6	-1.7	1.0

* Actual   e--projected   n.e.--not estimated   n.a.--not available

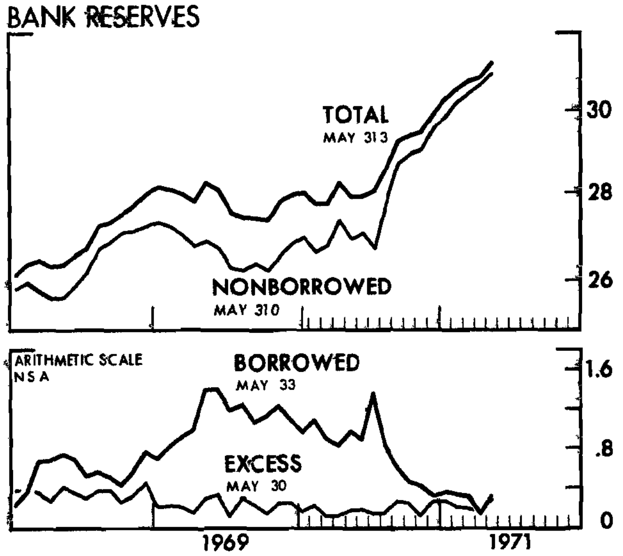
1/ Includes such items as deposit fund accounts and clearing accounts.

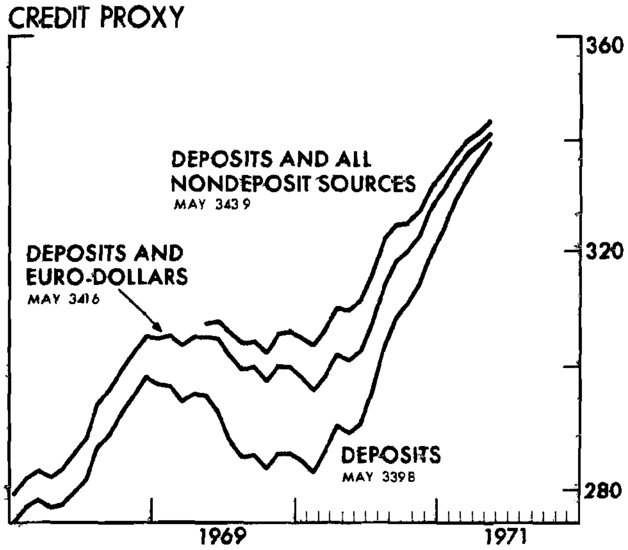
2/ Federally-sponsored credit agencies, i.e., Federal Home Loan Banks, Federal National Mortgage Assn., Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.

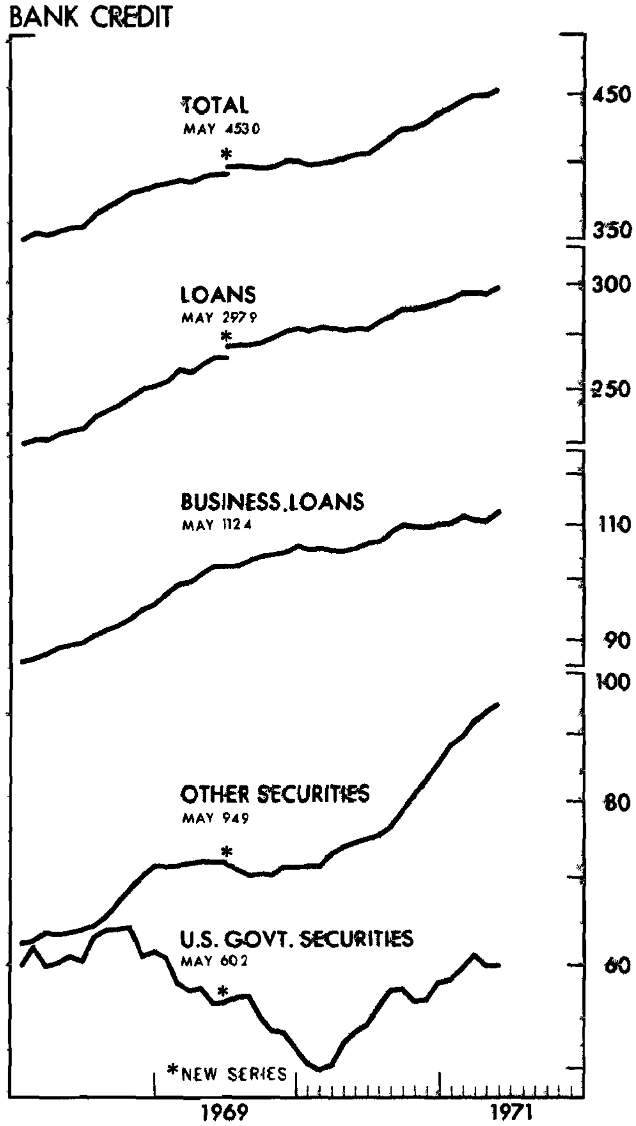
3/ Estimated by Federal Reserve Board Staff. The level of the estimated series shown here differs considerably from the estimates by the Council of Economic Advisers. Continues to show effect of accelerated depreciation proposed by the Treasury.

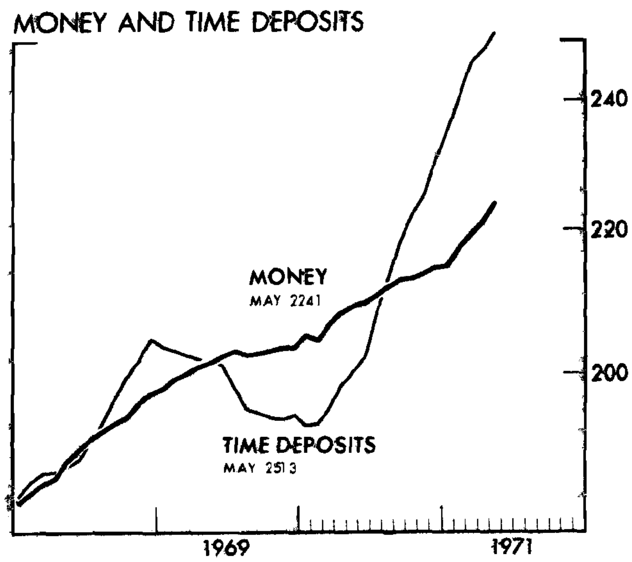
FINANCIAL DEVELOPMENTS - UNITED STATES

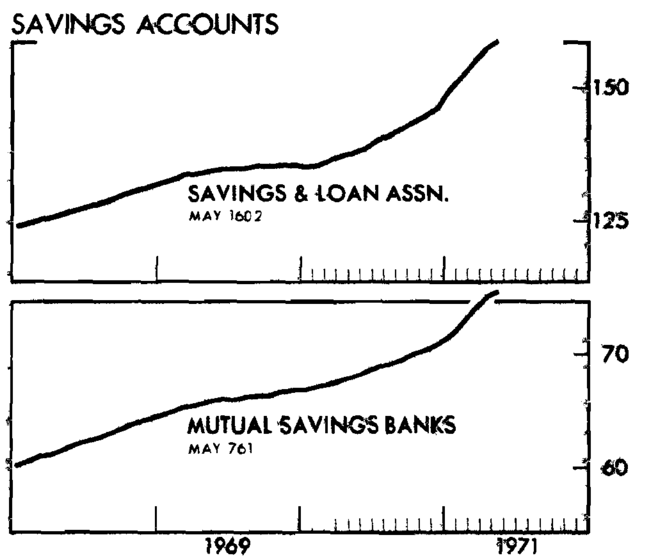
BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE



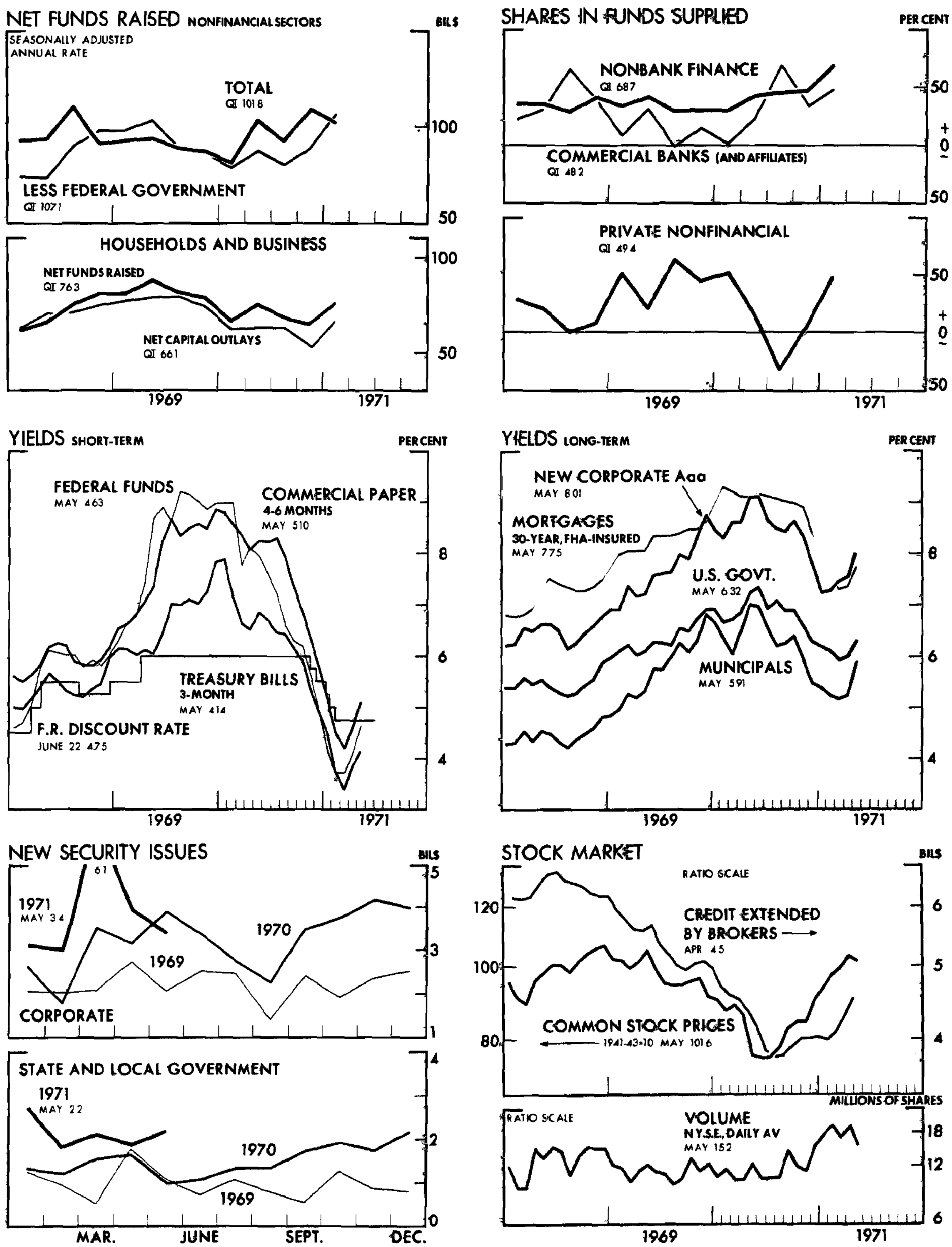








FINANCIAL DEVELOPMENTS - UNITED STATES



THE ECONOMIC PICTURE IN DETAIL

International Developments

Foreign exchange markets. In the three weeks since the last Greenbook the German Federal Bank has undertaken to sell off a large amount of its dollar reserves in order to reduce the domestic monetary base swollen by the speculative inflows of early May. Such sales during June 2-4 amounted to about $150 million, but have since averaged roughly one-quarter of a billion dollars per day. Netting out some $500 million received on maturing forward contracts, the Bundesbank's reserves have declined by nearly $1.9 billion thus far in June. As a result of the Bundesbank's large sales of dollars (purchases of marks), the spot DM appreciated rather steadily, reaching a high of 28.62 U.S. cents, i.e., 4.8 per cent above par, on June 23.

The Bundesbank's reserve drain, and the consequent contraction of the domestic monetary base, has led to a considerably tightening of the German money market. Call money has risen from around 4 per cent on June 1 (and much less in May) to over 8-1/2 per cent currently. Three-month funds in Frankfurt, around 6-1/8 per cent at the first of the month, are now quoted at about 7 per cent. The reversal of the differential between German and Euro-dollar interest rates, combined with the firming of the spot DM, has led to a sharp narrowing of the premium on forward DM. Three-month forward marks were quoted at a premium of about 4 per cent per annum the first two days of this month; this premium has fallen to less than 1/4 per cent per annum at present.

It is not yet completely clear what has happened to the funds coming out of marks. Of course, we can never trace the movement of particular funds, but it appears that of the reserves released by the Bundesbank's dollar sales plus those currently generated by the U.S. liquidity deficit, something over $1-1/4 billion was "absorbed" by net reserve gains of Japan and the U.K. A much smaller amount seems to have returned to the United States through the Euro-dollar market as U.S. banks increased their liabilities to their foreign branches (see Euro-dollar market), thereby holding down the U.S. official settlements deficit.

The Bank of Japan made intervention purchases of dollars totaling nearly $900 million this month, through the 23rd. The U.K. has had spot market intervention purchases totaling just over $200 million, but there are indications that the Bank of England has had additional dollar receipts on maturing forward contracts. Sterling has held fairly close to the upper limit for the past three weeks, partly reflecting reported oil company purchases, but perhaps also reflecting some interest-induced movement of funds into London. Very short-term sterling interest rates (over-night and seven-day) have generally been 1/2 per cent or so above comparable Euro-dollar rates.

Other major European currencies have generally eased over the past couple of weeks, and there has been only scattered intervention by central banks in those markets. The Belgian franc rate weakened sharply on June 10, when the central bank imposed a 100 per cent marginal reserve requirement on Belgian banks' net foreign liabilities. The rate remained depressed until June 23, when it suddenly jumped almost to the ceiling. The Dutch guilder, after advancing sharply in the first few days following the Bundesbank's initiation of dollar sales, has eased substantially, and is currently only 1.6 per cent above its parity rate.

The Canadian dollar has declined by roughly one full cent this month to 97.7 U.S. cents at present, with the Bank of Canada providing modest support. Recent rises in U.S. short-term interest rates relative to Canadian rates are generally regarded as being the most important factor in the weakening of the Canadian dollar.

In official transactions in June, the U.S. Treasury drew \$150 million equivalent in Belgian francs and \$100 million equivalent in Dutch guilders on the IMF. The proceeds were used to repay \$150 million of System swap drawings on the Belgian National Bank, reducing the outstanding amount to \$340 million, and to reduce by \$100 million the Netherlands Bank's holdings of uncovered dollar reserves. The Treasury also sold \$50 million equivalent of gold to the Swiss National Bank.

Euro-dollar market. Some relaxation in the speculative atmosphere in foreign exchange markets and a sizable flow of funds out of the German mark (and to a lesser extent the Swiss franc) have contributed to a fairly steady decline in interest rates in the Euro-dollar market since around the end of May -- in the face of recent advances in U.S. interest rates. One- and three-month Euro-dollar deposit rates are now about 6-3/4 to 7 per cent, compared to about 8 per cent in late May and the first few days of June -- still well above their January-April average level of roughly 5-1/2 per cent and about 1-1/2 per cent above domestic CD rates of comparable maturity. The overnight Euro-dollar deposit rate has

SELECTED EURO-DOLLAR AND U.S. MONEY MARKET RATES

Average for month or week ending Wednesday	(1) Over-Night Euro-$ 1/	(2) Federal Funds 2/	(3)= (1)-(2) Differential	(4) 3-month Euro-$ Deposit 1/	(5) 60-89 day CD rate (Adj.) 3/	(6) (4)-(5) Differential
1971						
January	5.23	4.14	1.09	5.92	5.10	0.82
February	4.38	3.72	0.66	5.54	4.34	1.20
March	4.43	3.76	0.67	5.11	3.79	1.32
April	5.05	4.15	0.90	5.92	4.41	1.51
May	8.52	4.63	3.89	7.04	4.97	2.07
June 2	15.93	4.82	11.11	7.70	5.26	2.44
9	5.04	4.77	0.27	7.31	5.36	1.95
16	4.64	4.89	-0.25	7.19	5.41	1.78
23	4.50	4.98p/	-0.48p/	6.99	5.41p/	1.58p/

1/ All Euro-dollar rates are noon bid rates in the London market; overnight rate adjusted for certain technical factors to reflect the effective cost of funds to U.S. banks.
2/ Effective rate.
3/ Offer rate (median, as of Wednesday) on large denomination CD's by prime banks in New York City; CD rate are adjusted for the cost of required reserves. p/ Preliminary.

declined quite markedly in the last few weeks and of late has been about 1/4 to 1/2 per cent below the Federal funds rate. (See table.)

The low level of overnight Euro-dollar rates relative to longer maturities may reflect funds that have moved out of German marks which have been temporarily placed in Euro-dollars prior to repatriation to the U.S. or other countries shortly before the quarter-end; if so, we may expect a sharp firming in Euro-dollar rates (particularly in the shorter maturities) in the last few days of June -- coupled with a decline in liabilities of U.S. banks to their foreign branches reflecting these repatriations (including U.S. company repatriations under OFDI guidelines).

Gross liabilities of U.S. banks to their foreign branches increased by about $0.6 billion in the three weeks through June 16; from then to June 21 (the last day for which data are available as of this writing) these liabilities have shown little net change. These liabilities plus foreign branch holdings of special Ex-Im and Treasury notes totaled about $5.3 billion as of June 21.

On the basis of partial data it is estimated that U.S. banks' Euro-dollar borrowings and foreign branch holdings of the above mentioned notes averaged about $0.3 billion less in the four weeks ended June 9 than in the previous four week Euro-dollar borrowing reserve requirement computation period, compared to a decline of about $0.4 billion the period before.

U.S. balance of payments. Over the past four weeks the overall balance on the liquidity basis has shown deficits averaging over $100 million a week according to preliminary information. In addition to the underlying deficit, it is probable that nonbank funds have continued to move to the Euro-dollar market and also, through commercial leads and lags, into the Japanese yen. On the official settlements basis, the average balance in the past four weeks has been very small, as borrowing by U.S. banks from their foreign branches has picked up.

With respect to the underlying deficit, there is a strong possibility that developments in trade (as noted below) have been unfavorable. See page IV-8.

Detailed information now available on first-quarter transactions shows that about two-thirds of the worsening in the seasonally adjusted liquidity deficit between the fourth quarter of 1970 and the first quarter of this year resulted from an increase in outflows of U.S. capital attracted by higher interest rates abroad and the possibility of changes in foreign exchange rates. Errors and omissions, the changes in which are presumed to represent largely unidentified capital outflows, increased by more that $1 billion from the fourth quarter. Net outflows of U.S. corporate capital increased by $3/4 billion in the first quarter; this reflected not only a substantial increase in direct investments in affiliates abroad but also a swing in the recorded movement of U.S. corporate short-term funds held abroad, from inflows in the fourth quarter to outflows in the first quarter. The same factors that were responsible for the large increase in errors and omissions, i.e., widening differentials between interest rates here and abroad and exchange market uncertainties, promoted these shifts in the flows of corporate capital.

These adverse changes were only partially offset by an improvement in the first-quarter balances on both goods and services and a temporary reversal of the flow of bank lending to foreigners. The increase in the trade balance stemmed from a peaking in exports of agricultural commodities, from exceptionally large deliveries of jumbo jets, and from an upturn in shipments of automobile parts following the termination of the GM strike. This trade improvement appears to have been transitory and was followed by a deficit in April. Imports may again have exceeded exports in May, as discussed below.

The favorable balance on services in the first quarter rose further -- by $1 billion at an annual rate -- following a nearly equally large rise from the third to the fourth quarter of last year. These increases resulted mainly from a reduction in net payments on military transactions as transfers under sales contracts rose, and an increase in net income receipts as income payments fell with the decline in domestic interest rates.

U.S. foreign trade. Based on partial information (custom receipts, number of shippers' export declarations, and certain commodity data), it appears that the U.S. trade balance in May improved only very moderately from the $300 million import balance (balance of payments basis -- not at annual rate) recorded in April. Exports are estimated to have increased from the relatively low April level but imports in May are estimated to be about as high as the record April value. The official statistics may be available for inclusion in a supplement to the Greenbook.

While much of the poor trade showing this year can be attributed to the exceptional strength in imports, it also appears that the U.S. share of world trade in manufactured goods slipped further in the first quarter of 1971. The U.S. share in that period was more than one percentage point lower than in the corresponding period a year earlier -- roughly equivalent to an annual loss of over $1-1/2 billion. The U.K.'s position in the first quarter of this year also weakened while the shares of Germany and Japan rose very sharply.

Commodity-by-commodity information on market shares is not yet available for the first quarter of this year, but a recent Department of Commerce report indicated that in calendar 1970 declines occurred in all major product groups except chemicals in which our share was unchanged. (The drop in the U.S. share in 1970 was particularly pronounced in transport equipment, partly because of the GM strike.) Although U.S. exports of electric and nonelectric machinery increased by 13 and 17 per cent, respectively, from 1969 to 1970, sales of other countries increased even faster, resulting in a substantial reduction in our share in world exports of machinery.

Interest rate movements in major industrial countries. Domestic short-term interest rates in most major European countries registered net declines in the second quarter. After decreasing everywhere in Europe in April, short-term yields subsequently either held steady or moved upward, but only in France -- where monetary policy was tightened in May -- are interest rates now higher than they were at the end of the first quarter.

The drop in domestic yields in April occurred despite a rise in Euro-dollar rates that began in mid-March (and continued through May) but followed a prolonged downward movement in Euro-dollar yields dating from mid-1970. In June Euro-dollar rates again decreased, reflecting in part net large-scale purchases of marks (sales of dollars) by the Bundesbank. Simultaneously, German money market yields have risen under the consequent tightening of liquidity pressures.

The fall in European money market rates early in the second quarter was in line with the policy in several countries of seeking to halt or reduce dollar inflows. However, in Germany and in the Netherlands, the decline in short-term yields was largely in response to the increased liquidity resulting from the continuation of capital inflows.

Narrowing the differentials between domestic and Euro-dollar yields was the prime reason for the discount rate reductions in late March and early April in Belgium, Germany, the United Kingdom and the Netherlands.

In Germany, it was hoped that a reduction of dollar inflows would support domestic demand-restraint policies by making it easier to restrict the liquidity of the banking system. The cut in the German discount rate was accompanied by a reduction in rediscount quotas and intensification of the Bundesbank's open market operations with nonbanks. In the Netherlands, where inflationary pressures were particularly intense, there was no easing of previously imposed strict quantitative controls on credit expansion.

In Britain, on the other hand, lower interest rates were in harmony with the policy of stimulating the economy adopted by the government

SELECTED SHORT-TERM INTEREST RATES 1/

	1971					
	Jan.	Feb.	Mar.	Apr.	May	Latest
United Kingdom	7.35	7.68	7.70	6.78	6.53	6.44 (6/11)
Switzerland	5.00	4.75	4.25	3.65	3.50	3.50 (6/11)
Japan	7.38	7.25	7.25	6.75	6.56	6.50 (6/11)
Canada	4.50	4.46	3.26	3.00	2.98	3.03 (6/22)
Belgium	6.91	6.28	5.17	4.80	4.80	4.80 (6/21)
Germany	7.50	7.41	7.57	6.41	6.14	6.88 (6/18)
Netherlands	4.46	5.41	3.50	1.19	1.71	2.25 (6/14)
France	6.44	6.00	5.72	5.61	5.87	6.00 (6/10)
Italy	5.50	5.50	5.00	4.75	n.a.	
Euro-dollar	5.89	5.88	5.25	5.94	7.22	7.06 (6/22)
United States	4.30	3.57	3.27	3.76	4.06	4.94 (6/22)

1/ Rates quoted are monthly averages, generally for 3-month funds, as follows: Italy and Switzerland, time deposits; Germany, interbank loan rate; United Kingdom, local authority deposit; Canada and United States, Treasury bills; Belgium, tap rate on Treasury bills; Euro-dollar deposit; France, the Netherlands, and Japan, call money rate. Latest rates are for the dates in parentheses.

at the end of March. In Belgium, too, reduced rates were not unwanted in the light of an anticipated slowdown in domestic growth this year. And declining short-term yields were also welcomed as a tool for promoting economic expansion in Italy, where a downward trend in interest rates that began in the summer of 1970 was given additional impetus by cuts in central bank lending rates in January and April.

Reducing the spread between domestic and Euro-dollar rates helped decrease net capital inflows into Britain. In Germany, however, the demand for marks did not diminish appreciably in April.

When capital inflows based on expectations that the mark would be revalued became overwhelmingly large at the beginning of May, differentials between yields on domestic assets in the Netherlands and comparable Euro-dollar deposits also became irrelevant. The Dutch guilder, along with the Austrian schilling, was subjected to intense speculative demand on the correct assumption that their parities could not survive a revaluation or unpegging of the mark, which was in fact floated on May 9.

Speculative demand outweighed interest rate considerations in Switzerland and Belgium, too, where revaluations were also expected (contrary to the event in the case of the Belgian franc) as part of the general upheaval in the exchange markets.

Outside of Europe, short-term Canadian interest rates fell in the first two months of the year and have since been flat. The stability of Canadian rates in the face of rising yields in the United States reflects, in part, an attempt by the Canadian authorities to ease upward pressure on the exchange rate of the Canadian dollar in order to aid

Canadian export industries, whose profits have suffered from the appreciation of the Canadian dollar. Furthermore, low interest rates are part of the overall stimulative policy now being pursued by the government.

Japanese short-term rates have declined this year, reflecting a loosening of monetary policy.

In general, long-term interest rates fell substantially in late 1970 and in early 1971. In Germany, the United Kingdom and Canada there have been subsequent sharp upturns. In Germany, the rise in long-term yields was initially the result of profit taking but, more recently, has reflected efforts by businesses to replace heavy short-term debt obligations with longer-term liabilities. In the United Kingdom, yields have risen during the second quarter largely in response to expectations of continuing inflation and to doubts about the long-term balance of payments outlook. In Canada, increased demand for funds has combined with a revival of inflationary expectations to push up long-term rates. In France, the recent tightening of monetary policy has driven bond yields up. Elsewhere, there have been no pronounced movements in bond prices in recent months.

After declining substantially in April, German money market rates have risen in June as the liquidity of the banking system has been reduced. Earlier, German interest rates had shown little change during the first quarter. The combination of a ready supply of Euro-dollars, strong demand for funds by both bank and nonbank borrowers in Germany, and a large and widening differential between German and Euro-dollar rates -- the uncovered monthly average excess of the three-month interbank loan rate over the 90-day Euro-dollar deposit rate widened from 1.63 percentage points in January to 2.49 percentage points in March -- helped produce major capital inflows.

Though a large portion of these inflows was absorbed or offset by restrictive reserve requirements and open market sales by the Bundesbank, bank liquidity expanded to the point where the government felt that its stabilization program was in jeopardy. Consequently, the Bundesbank lowered its discount rate from 6 to 5 per cent on April 1 and its rate on advances, which is more closely related to market rates, from 7-1/2 to 6-1/2 per cent. Domestic rates subsequently fell in April. Coupled with rising Euro-dollar rates, this drastically reduced the gap between the latter and German money market rates. The three-month interbank loan rate did not exceed the return on 90-day Euro-dollar deposits by more than half a point at any time in April, and in early May -- before the mark was floated -- the 90-day Euro-dollar rate rose above the interbank loan rate.

Capital inflows -- which were the main cause of the drop in interest rates -- remained heavy through much of April, reflecting strong expectations of a rise in the mark exchange rate. This was indicated by the relatively small decrease in the covered differential in favor of the interbank loan rate, despite the marked change in the uncovered differential.

For almost a month after the mark was floated, short-term rates remained stable; but in early June rates rose, as the capital inflows in the period before the mark was floated were reversed by large-scale dollar sales by the Bundesbank. Interest rates in June have also been pushed up by a rise in minimum reserve requirements on June 1 and by mid-year balance sheet positioning.

Long-term yields in Germany fell sharply from mid-December through January as liquid holdings and savings were shifted into long-term securities on a large scale in anticipation of lower rates and a general relaxation of monetary restraint. The average yield on public authority bonds fell from 8.17 per cent in December to 7.68 per cent in January. Since January, however, yields have edged upward and are now near the levels which prevailed at the end of 1970. In recent months, the market has become congested with new issues. Restrictions on floating new issues were imposed for the month of June, but reportedly the moratorium is being circumvented by direct placing of medium-term notes.

Short-term interest rates in the Netherlands remained high in the first quarter, reflecting the tight credit policy being pursued by the monetary authorities in order to reduce excess demand and inflationary pressures in the Dutch economy.

On April 5, the Netherlands Bank cut its discount rate from 6 to 5-1/2 per cent, following the reduction in the Bundesbank rate a few days earlier. Capital inflows into the Netherlands had been heavy in the first quarter. The Dutch monetary authorities welcomed the opportunity the action of the Bundesbank gave them to reduce the gap between Dutch and Euro-dollar rates without creating the impression of easing domestic restraint (as they might have done had the Dutch discount rate been lowered in the absence of a similar move by the German authorities). Quantitative limitations on extension of credit were maintained.

After the discount rate reduction, short-term interest rates (in particular, the rate on call money) fell and since then have for the most part remained at a low level. The lowering of interest rates failed to check capital inflows. Inflows abated somewhat in April, but resumed on a large scale when speculative demand for the guilder mounted in early May.

Since the guilder was floated there has been no further tightening of monetary restrictions, but there has been no easing; and with capital inflows no longer augmenting liquidity, interest rates may well rise in the future.

Long-term yields in the Netherlands have declined about 50 basis points during 1971, reflecting the large capital inflows before the guilder was floated.

Short-term interest rates in the United Kingdom held stable or edged upward during the first quarter, despite the downward movement in Euro-dollar rates during most of that period, reflecting the government's effort to maintain tight money.

The widening spread between sterling and Euro-dollar rates in the first quarter caused heavy short-term capital inflows. In addition, the prospects of capital gains -- it was generally assumed that British interest rates would fall relatively soon -- made longer-term British assets attractive to foreign investors. Total net capital inflow (including errors and omissions) in January-March exceeded $2 billion and was a major factor in the 13 per cent (seasonally adjusted annual rate) expansion of the money supply in the first quarter.

Largely to stem the capital inflow, the Bank of England lowered its discount rate on April 1 by a full percentage point -- traditionally, Bank rate decreases have been by half a point only -- from 7 to 6 per cent. Though the influx of capital was helping Britain reduce its short-term external debt -- repayments in the first quarter totalled about $1.6 billion, including almost $700 million to the IMF -- the authorities feared that a continuing accumulation of external liabilities based on volatile, interest-sensitive capital could ultimately have destabilizing consequences for the pound, should the massive inflow abruptly become a massive outflow. Furthermore, reducing interest rates was consistent with the stimulative measures the government announced in presenting its annual budget to Parliament on March 30.

Short-term interest rates in Britain have fallen since the beginning of April.

Despite the lower yields on sterling assets and the higher Euro-dollar rates, demand for sterling has generally remained strong in the second quarter and there have reportedly been sizable capital inflows though not as large as in the first three months of the year. The announcement at the end of April by the Bundesbank of its withdrawal from the forward market apparently triggered some purchases of sterling as well as of marks.

Long-term yields in Britain declined during the first quarter, despite large-scale selling of government bonds by the Bank of England which was striving to moderate increases in the money supply and in bond prices. Since Bank rate was cut, however, yields on long-term government bonds have risen somewhat, mainly because of expectation of persisting inflation and doubt about the long-term outlook for the balance of payments.

Short-term interest rates declined sharply in Belgium in the first quarter, as was evidenced by the fall in the tap rate on three-month Treasury bills from 6.95 per cent at the end of December to 4.80 per cent on April 6. The decrease in yields was partly associated with the decline in Euro-dollar rates but also reflected the effects of a large current account surplus. The National Bank of Belgium encouraged the downtrend in interest rates by lowering the discount rate from 6.5 to 6 per cent on March 25.

Short-term rates have been stable in the second quarter, as Euro-dollar rate rises since mid-March have been offset by speculative demand for the Belgian franc, which has led to further increases in bank liquidity and official foreign exchange reserves. Speculation became particularly intense in May.

Long-term yields also dropped this year -- by about 40 basis points in the case of bond yields -- but practically all of the decrease occurred in January and February.

During the first quarter France kept domestic short-term interest rates in line with Euro-dollar rates by frequent reductions in the central bank's money market intervention rate. This tactic, together with exchange controls, partially insulated France from the capital inflows and consequent excess liquidity which plagued other European countries.

Money market rates continued to decline in April but rose substantially in May, as monetary policy, expansionary in the first quarter, was tightened. Commercial bank reserve requirements were raised twice during the month and the Bank of France discount rate was raised from 6-1/2 to 6-3/4 per cent on May 13. The reversal in monetary policy was motivated by the persistence of the rapid rate of increase in both wages and prices.

Long-term yields in France fell by about 15 basis points from January to February. Since then, they have risen moderately and currently stand slightly above the January level.

The general downward movement of Italian interest rates, which began in August 1970, continued through the first four months of 1970. Declines in interest rates outside Italy reinforced the effects on the Italian interest rate structure produced by continuing large increases in the monetary base (currency and other liabilities of the Bank of Italy). The buildup in the monetary base, which began last autumn, reflects the easier monetary policy that the Bank of Italy initiated in the fourth quarter and has maintained this year. The Bank of Italy cut the rate on advances from 5-1/2 to 5 per cent in January and reduced its discount rate from 5-1/2 to 5 per cent in early April.

With respect to short-term yields, the rate on time deposits of 100 million lire or more, which had dropped by two percentage points in the final four months of 1970, declined from 6 per cent at the end of December to 4-3/4 per cent at the end of April. Between December and April banks lowered their lending rates -- something they had not done in the closing months of 1970, despite the fall in deposit rates -- the prime rate reportedly falling by 100 basis points.

Bond yields plummeted in January and February and then edged down a little further in March and April. The decline in yields during these four months amounted to about 75 basis points. The drop in yields from their peak level in July 1970 has been about 150 basis points.

Reflecting the easy monetary policy in force since early 1970, Canadian short-term yields trended downward through most of last year. There was a moderate upturn in rates at the end of the year and through January 1971, followed by an exceptionally sharp decline in February. Since then rates have remained level despite the rise in short-term rates in the United States.

The recent unusual negative spread between Canadian and U.S. 3-month rates may have contributed to the recent decline in the exchange rate of the Canadian dollar, which is expected to bring some relief to export interests. Exporters claim to have suffered serious injury as a result of the appreciation of the Canadian dollar -- from about 93.25

to as high as 100 -- since it was floated on June 1, 1970. The rate is now $97.64.

Easy money, with attendant low interest rates, is also part of a general reflationary policy designed to lift Canada out of a recession which has been steeper than the one in the United States.

Developments in Canadian bond markets have roughly paralleled those in the United States in recent months. Yields declined sharply in late 1970 and early 1971 but have risen noticeably in recent weeks in response to increased demands for long-term funds and revived inflationary expectations.

In Japan, interest rates have generally declined since the Bank of Japan relaxed its tight money policy last summer. The Bank lowered its basic discount rate one-quarter of a percentage point three times -- on October 28, January 20 and May 8 -- and the rate is currently 5-1/2 per cent. The Bank also eased its ceilings on city bank lending in the fourth quarter of last year and suspended them altogether in January 1971. Loan demand increased during the first quarter of this year, but it has reportedly slackened since early April.

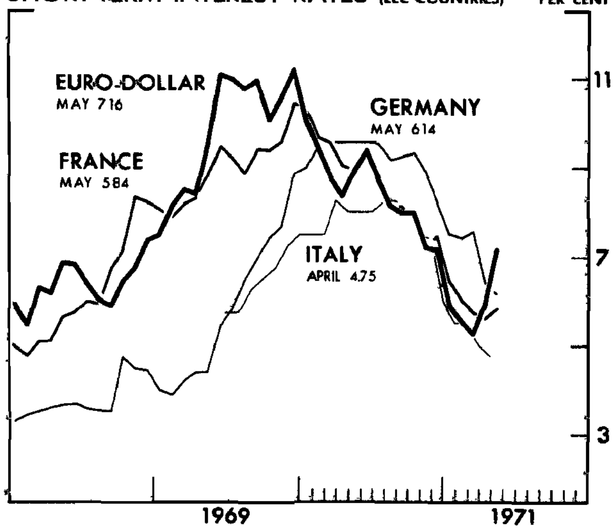
Call loan rates have declined this year, dropping from 8.0 per cent at the end of December to 6.5 per cent on June 5. The yield on long-term industrial bonds has declined moderately, from 8.69 per cent at the end of December to 8.14 per cent in March. The average interest rate on bank loans has also been declining, but at a slower rate than after comparable reductions in the official discount rate in the past.

In May, Japan took a series of modest steps to reduce the excessive rate of accumulation of international reserves. These measures included the establishment of ceilings on the borrowings of overseas Japanese banks and a prohibition against the purchase by foreigners of unlisted Japanese securities.

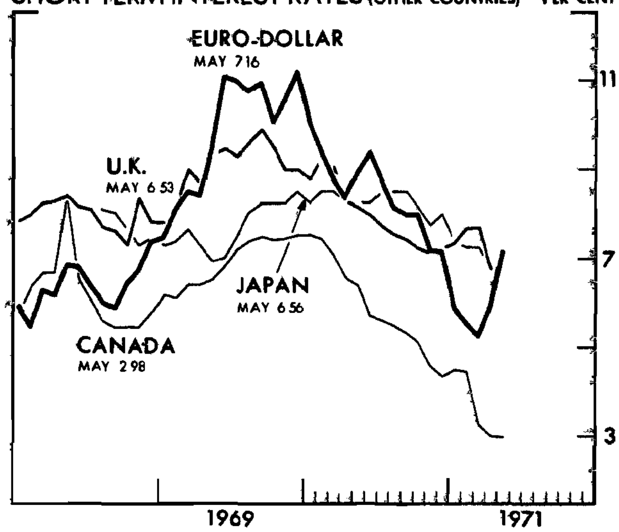
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

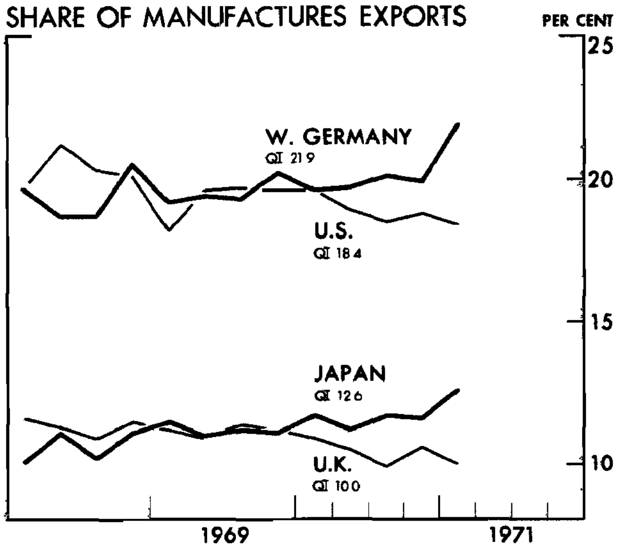
SHORT-TERM INTEREST RATES (EEC COUNTRIES) PER CENT



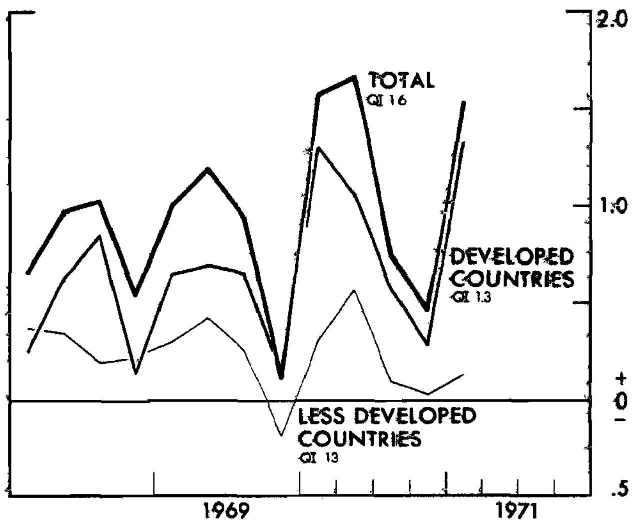
SHORT-TERM INTEREST RATES (OTHER COUNTRIES) PER CENT



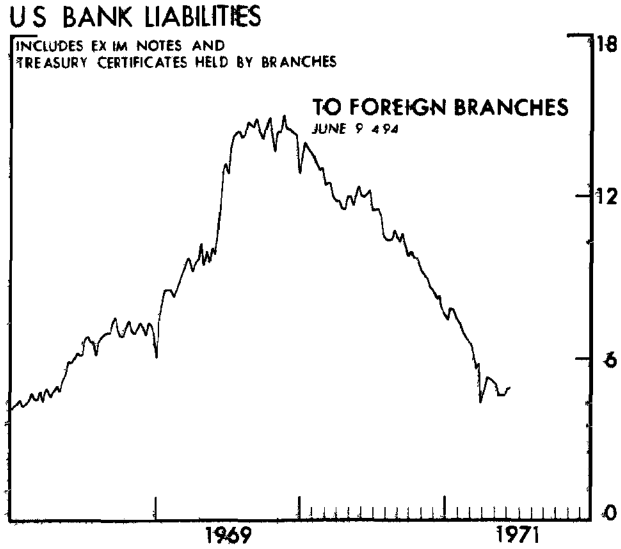
SHARE OF MANUFACTURES EXPORTS PER CENT



U.S. DIRECT INVESTMENT OUTFLOWS (+)



U.S. BANK LIABILITIES



90-DAY RATES PER CENT