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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

August 18, 1971

TABLE OF CONTENTS

SUMMARY AND OUTLOOK

Nonfinancial

Prior to the President's announcement of a new and far-ranging economic program on August 15, incoming economic news had been on the disappointing side. The labor market had continued weak and industrial production declined appreciably in July; a rapid rate of increase had resumed for both consumer and wholesale industrial prices, and the foreign trade balance had deteriorated greatly.

The decline in industrial production in July was close to 1 per cent, bringing the index to 5 per cent below the 1969 high. A further sizable reduction still seems in prospect for August--mainly because of sharp cutbacks in output of steel. New orders for durable goods edged down in June, with orders for capital equipment remaining at about the same level that has prevailed since late last year. Although the overall inventory-sales ratio declined in June to the lowest point in almost five years--as total business sales rose faster than book value of stocks--the ratio of inventories to unfilled orders at durable goods manufacturers rose further to a new high.

After a strong showing in June, retail sales declined about 1 per cent in July, according to the advance estimate, but remained at the advanced second quarter average. Sales of new domestic-type autos in early August were at just over 8 million units, annual rate--about the same as for the year to date. An exception to the sluggishness prevailing in most major demand sectors was the sharp rise in housing starts in July to a seasonally adjusted annual rate of 2.2 million units from the 2 million rate in June.

Nonfarm payroll employment showed a large decline in July for the second consecutive month. The bulk of the drop was accounted for by manufacturing, but weakness in labor demand was widespread. The unemployment rate rose to 5.8 per cent in July from 5.6 per cent in June. A rise had been expected since the sharp decline in June was apparently attributable in part to technical problems of measurement. Although the civilian labor force increased sharply, it did not rise above the level of last January.

In July, seasonally adjusted wholesale prices of industrial commodities posted the largest rise in almost five years, following sizable increases over the previous three months. A number of announcements of forthcoming price increases were made in important industries after the July pricing date, but most of these cannot now go into effect--at least until after the expiration of the wage-price freeze. Prices of farm products and foods declined sharply in July, and very large supplies are in prospect.

Revised Commerce estimates indicate that real GNP increased at an annual rate of 4 per cent in the second quarter, compared with a preliminary estimate of 3.6 per cent. Net exports for the second quarter were revised down by $2.3 billion, but there were compensating increases in a number of other components of GNP.

Outlook. The staff has not had time to evalute the probable response of the economy to the policy actions announced by the President.

Because of time constraints and numerous uncertainties about which we are still making judgments, GNP projections are not shown in this Greenbook but are planned to be presented for the last two quarters of this year in the Supplement.

Our present tentative assessment is that expansion in real GNP will be stimulated significantly. The initial stimulus to greater production should be evident in the fourth quarter, and seems likely to center in largerdemands for U.S.-type cars. Price increases for 1972 models have been rescinded; the excise tax reduction will result in an appreciable drop in new car prices, while imported cars will become relatively more expensive because of the import surcharge.

Our GNP projection is being based on the assumption that the 90-day price-wage freeze will be effective, although some upcreep seems inevitable. Another assumption is that the freeze will be followed by resumption of wage and price increases, but at significantly lower rates than prevailed so far this year, although there may be an interval of some catch-up in the closing weeks of 1971. We also assume no new major strikes the rest of this year.

Financial

Financial market participants reacted favorably to announcement of the President's new economic package. Demand for fixed income securities and equities increased sharply during the first two trading days following the President's speech; short-term yields declined 10 to 40 basis points, long-term yields dropped 40 to over 60 basis points, and stock prices rose very sharply on record volume.

Just prior to the President's speech, market concerns about inflation prospects, exchange market developments, and monetary policy had kept interest rates steady to somewhat higher, despite a continued ample supply of investible funds and declining credit demands. Business credit demand at banks and in the commercial paper market remained modest in July and corporate bond offerings declined to the lowest level in over a year. While the volume of State and local bond offerings continued large, casualty insurance companies maintained and banks stepped-up their acquisitions of such issues. Treasury and Agency financings in July and early August were well received.

Deposit inflows at nonbank thrift institutions were large again in July, and apparently continued strong in early August; whereas similar inflows at commercial banks weakened generally. This contrasting performance apparently reflects both the higher rate ceilings at non-bank institutions and a failure of banks to seek consumer-type deposits aggressively in light of their ample portfolio liquidity and weak loan demand.

Mortgage rates continued to rise in July, in sympathy with other market rates. Early in August, however, the President decided to maintain the 7 per cent rate ceilings on FHA and VA mortgages despite the near-record discounts recently prevailing on such obligations. The plan is to use GNMA funds to subsidize a number of the discount points on certain types of FHA/VA mortgages.

Outlook. The President's program helped to dissipate the earlier market uncertainties regarding inflationary pressures, international financial developments, and the likely thrust of monetary policy. As a result, expectations now seem more likely to reinforce the pressures of underlying supply-demand forces toward lower interest rates--particularly in long-term markets.

In the months immediately ahead, the President's program seems unlikely to add significantly to business demands for credit. From now until early fall, inventory accumulation is expected to be modest, plant and equipment outlays sluggish, and internal funds generation improved; these factors should keep business credit demands at banks and in the commercial paper market relatively small. Moreover, with a long period of balance sheet restructuring already behind us, the preceding factors can also be expected to lead to a continued slower pace of public bond offerings by corporations.

The volume of tax exempt bond issues is also likely to slacken. And banks--facing weak loan demands--are likely to continue to absorb a significant share of such offerings. Demands for tax exempts should remain large on the part of fire and casualty insurance companies, as well, since their insurance underwriting experience has been unusually profitable this year.

Treasury demands over the remainder of the calendar year will be very large, but the timing of such offerings is less clear. Most of the scheduled debt expansion for the current quarter has been completed. The magnitude of the fourth quarter financing will be somewhat affected by Congressional actions on the fiscal elements of the President's program, as well as by any net redemptions of special Treasury issues held by foreign central banks. Debt offerings of the Federal housing finance agencies are projected to rise, but the precise financing pattern for such issuers is also subject to some doubt until the implications of the GNMA subsidy program are clarified.

In deposit markets, a continuation of lower short-term market rates could sustain the high pace of savings inflows to nonbank thrift institutions and reverse the slowing of flows to commercial banks. Thus, it appears likely that deposit flows will be sufficient to assure a continued large supply of mortgage funds. If the high cost of Euro-dollars encourages major banks to make further repayments of such borrowing to their foreign branches, then banks could become more aggressive issuers of CD's despite their weak loan demands.

Balance of payments

The Presidential action restricting convertibility of the dollar into gold or other reserve assets was taken in the light of accumulated evidence of the existence of a substantial disequilibrium in exchange rates between the dollar and other major foreign currencies, and of massive short-term capital flows that were provoked by market realization of the extent of the disequilibrium.

Large capital flows in the first half of August produced further exceptionally large U.S. payments deficits; through the first seven months of the year the official settlements deficit totaled $14 billion (not an annual rate).

Following announcement of the President's program, all major European central banks halted purchases of dollars, and European exchange rates generally appreciated beyond previous support levels in very light trading. The Bank of Japan continued to purchase dollars, and in the period August 16-18 had gained $1-1/2 billion.

The Administration's action on international monetary arrangements suspended convertibility of the dollar into gold and other reserve assets, and requested the Federal Reserve to cease providing exchange cover through the swap network for foreign official dollar balances.

The White House release stated that "the official U.S. dollar price of gold is not altered by the present action, and the President has directed that that price be maintained."

The economic program also involved, as a temporary measure, imposition of an import surcharge of 10 per cent on dutiable imports, which comprise roughly one-half of total U.S. imports; exempt from the surcharge are nondutiable items such as coffee and raw materials and all products subject to mandatory quotas, including oil, meats, sugar, and cotton textiles, as well as Canadian autos.

The program set the stage for a necessary realignment of international exchange rates, and for review of other aspects of international trade and payments.

The extent of the U.S. disequilibrium became clear when the U.S. trade balance deteriorated to a deficit of $4 billion (seasonally adjusted annual rate) in the second quarter. As financial markets became aware of the size of the overall payments deficit in the second quarter, speculation heightened, and following publication of a report by the Reuss Subcommittee of the Joint Economic Committee calling for exchange rate realighment, capital flows from the United States into European countries accelerated further.

Even large appreciations of foreign currencies could not be expected to benefit the U.S. trade balance before 1972, and any improvement from the President's economic program during the remainder of 1971 should be expected to be on the import side, reflecting the impact of the 10 per cent surcharge. However, there could be immediate benefits for the capital account of the U.S. payments balance from sizable appreciations of foreign currencies--notably the impetus such actions might give to unwinding speculative positions, and the elimination of the special incentives for long-term capital outflows from the United States that exist so long as markets judge the dollar to be overvalued.

August 17, 1971

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	1971				Per Cent Change* From		
	April	May	June	July	1 mo. ago	3 mos. ago	Year ago
Civilian labor force (mil.)	83.8	84.2	83.1	83.8	0.8	0.1	1.4
Unemployment rate (%)	6.1	6.2	5.6	5.8	--	--	5.0 4/
Insured unempl. rate (%)	4.0	4.2	4.4	4.0	--	--	3.5 4/
Nonfarm employment, payroll (mil.)	70.7	70.9	70.6	70.5	-0.3	-0.4	-0.2
Manufacturing	18.7	18.7	18.6	18.5	-0.7	-1.0	-4.6
Nonmanufacturing	52.0	52.1	52.0	52.0	-0.1	-0.2	1.5
Industrial production (1967=100)	106.2	107.0	106.9	106.0	-0.8	-0.2	-1.4
Final products, total	103.6	104.0	104.2	104.0	-0.2	0.4	-1.4
Consumer goods	114.6	115.8	116.0	115.9	-0.1	-1.1	3.3
Business equipment	95.1	94.4	94.2	93.6	-0.6	-1.6	-8.7
Materials	107.5	108.9	108.7	107.1	-1.5	-0.4	-1.3
Capacity util. rate, mfg. 5/	n.a.	n.a.	n.a.	n.a.	--	--	--
Wholesale prices (1967=100) 1/	113.3	113.8	114.3	114.6	0.3	1.1	3.3
Industrial commodities (FR)	113.1	113.4	113.7	114.3	0.5	1.1	4.0
Sensitive materials (FR)	113.1	113.3	113.6	115.1	1.3	1.8	1.6
Farm products, foods & feeds	113.3	114.3	115.4	115.0	-0.3	1.5	1.4
Consumer prices (1967=100) 1/ 6/	120.2	120.8	121.5	n.a.	0.6	1.4	4.5
Food	117.8	118.2	119.2	n.a.	0.8	1.9	3.5
Commodities except food	115.8	116.6	117.1	n.a.	0.4	1.4	4.1
Services	126.8	127.5	128.2	n.a.	0.5	1.3	5.6
Hourly earnings, pvt. nonfarm ($)	3.39	3.42	3.42	3.42	0.0	0.9	5.9
Hourly earnings, mfg. ($)	3.54	3.56	3.57	3.57	0.0	0.8	5.6
Weekly earnings, mfg. ($)	140.67	142.40	142.80	142.76	0.0	1.5	5.1
Net spend. weekly earnings, mfg. (3 dependents 1967 $) 1/ 6/	101.11	101.81	102.45	n.a.	0.6	1.0	2.3
Personal income ($ bil.) 2/ 6/	844.7	850.1	870.3	n.a.	2.4	3.6	8.6
Retail sales, total ($ bil.)	32.8	32.7	33.1	32.9	-0.8	0.0	6.9
Autos (million units) 2/	8.3	8.4	8.2	8.4	2.0	1.2	4.3
GAAF ($ bil.) 3/	9.0	8.9	9.2	8.9	-2.9	-0.2	7.1
12 leaders, composite (1967=100) 6/	124.1	124.5	123.9	n.a.	-0.5	1.1	8.3
Selected leading indicators:							
Housing starts, pvt. (thous.) 2/	1,912	1,975	1,995	2,218	11.2	16.0	38.4
Factory workweek (hours)	39.8	40.0	40.0	39.9	-0.3	0.3	-0.5
Unempl. claims, initial (thous.)	283	304	307	275	10.5 7/	2.8 7/	-1.7 7/
New orders, dur. goods, ($ bil.) 6/	30.6	31.2	31.0	n.a.	-0.6	-2.5	3.2
Capital equipment	8.4	8.7	8.8	n.a.	0.4	-1.6	10.4
Common stock prices (41-43=10)	103.04	101.64	99.72	99.00	-0.7	-3.9	30.7

* Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.
3/ Gen'l. merchandise, apparel, and furniture and appliances. 4/ Actual figures.
5/ To be revised. 6/ Per cent calculated to June 1971. 7/ Sign reversed.

SELECTED DOMESTIC FINANCIAL DATA

	1970	1971 Averages				1971
	QIV	QI	Q2	June	July	Week ended Aug. 11
Interest rates, per cent						
Federal funds	5.57	3.86	4.56	4.91	5.31	5.59
3-mo. Treasury bills	5.35	3.76	4.26	4.75	5.40	5.30
3-mo. Federal agencies	5.50	3.78	4.43	4.89	5.56	5.58
3-mo. Euro-dollars	7.46	5.50	6.72	7.15	6.47	7.53
3-mo. finance co. paper	6.12	4.48	4.74	5.24	5.54	5.60
4-6 mo. commercial paper	6.28	4.57	5.05	5.45	5.75	5.75
Bond buyer municipals	5.93	5.25	5.74	5.95	6.06	6.07
Aaa corporate-new issues	8.26	7.33	7.83	7.90	7.96	8.02
20-year Treasury bonds	6.57	6.00	6.24	6.38	6.38	6.44
FHA mortgages, 30-year	8.76	--	7.67	7.89	n.a.	--

	1970	1971			
	QIV	QI	Q2	June	July
Change in monetary aggregates (SAAR, per cent)					
Total reserves	6.6	11.0	6.6	0.2	0.3
Nonborrowed reserves	9.4	11.0	5.3	-6.2	-13.1
Credit proxy	15.1	17.0	9.6	5.3	9.1
Credit proxy + nondep. funds	8.3	10.9	6.5	6.6	7.6
Money supply	3.4	8.9	11.3	9.1	10.6
Time and savings deposits	21.8	27.3	13.5	14.3	11.3
Deposits at S&L's and MSB's	11.6	23.3	17.2	14.9	16.1
Bank credit, end-of-month 1/	8.6	12.2	7.4	10.8	7.6
Treasury securities	6.2	19.8	11.1	55.8	-20.9
Other securities	36.5	27.9	15.7	8.9	18.7
Total loans 1/	1.4	6.3	4.2	2.0	10.0
Business 1/	-4.9	1.4	2.5	-10.5	11.7

	1970	1971			
	QIV	QI	Q2	June	July
Change in commercial paper ($ millions)					
Total (SA)	- 760	-2,581	- 941	- 717	n.a.
Bank-related (NSA)	-2,269	- 657	41	- 16	75

	1970			1971		
	QII	June	July	QII	June	July
New security issues (NSA, $ millions)						
Total corp. issues	10,468	3,389	2,768	11,689	4,375	3,900
Public offerings	9,185	2,952	2,448	9,931	3,615	3,400
State and local government bond offerings	3,728	1,085	1,348	6,050	2,008	1,900
Fed. sponsored agency debt (change)	1,542	728	576	- 924	- 381	59
Fed. govt. debt (change)	-6,394	-3,164	5,997	1,616	- 310	4,300

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.

I -- T - 3
U.S. Balance of Payments
In millions of dollars; seasonally adjusted

	1 9 7 1 p/				
	I	II	May*	June*	July*
Goods and services, net 1/	1,051	e/-550			
Trade balance 2/	272	-1,040	-306	-424	
Exports 2/	11,032	10,710	3,670	3,594	
Imports 2/	-10,760	-11,750	-3,976	-4,018	
Service balance	779	e/490			
Remittances and pensions	-351				
Govt. grants & capital, net	-1,031				
U.S. private capital (- = outflow)	-2,147				
Direct investment abroad	-1,357				
Foreign securities	-362	-416	-126	-150	
Bank-reported claims-- liquid	-72	38	-453	409	
" " " other	-53	-317	-550	182	
Nonbank-reported claims-- liquid	-280	68	-75	e/89	
" " " other	-23				
Foreign capital (excl. reserve trans.)	-2,073				
Direct investment in U.S.	50				
U.S. corporate stocks	75	-11	10	-11	
New U.S. direct investment issues	392	239			
Other U.S. securities (excl. U.S. Treas.)	160	-32			
Liquid liabilities to:	-2,680	-24	-675	1,074	e/-589
Commercial banks abroad	-3,025	-58	-598	1,179	
Other private foreign	76	-146	-119	-86	
Intl. & regional institutions	269	180	42	-19	
Nonliquid liab. to banks and others	-70				
Foreign official reserve claims	4,846	5,107	4,811	-1,520	e/2,279
Liquid	5,060	5,273	4,826	-1,460	2,330
Other	-214	-166	-15	-60	-51
U.S. monetary reserves (increase, -)	862	838	496	307	221
Gold stock	109	456	357	61	54
Special drawing rights 3/	125	196	196	--	100
IMF gold tranche	255	252	4	250	-5
Convertible currencies	373	-66	-61	-4	72
Errors and omissions	-1,157				
BALANCES (deficit -) 3/					
Official settlements, S.A.	-5,708	-5,945			
" " N.S.A.	-5,408	-6,497	-5,307	1,213	e/-2,500
Net Liquidity, S.A.	-2,676	-6,027			
" , N.S.A.	-2,530	-6,662	-4,104	-359	
Adjusted liquidity, S.A. 4/	-3,028	-5,921			
" " , N.S.A.	-2,908	-6,636	-4,632	139	-1,911

* Monthly, only exports and imports are seasonally adjusted. e/ Estimate.
1/ Equals "net exports" in the GNP, except for latest revisions.
2/ Balance of payments basis which differs a little from Census basis.
3/ Excludes allocations of SDRs: $867 million on 1/1/70; and $717 million on 1/1/71.
4/ Measured by changes in U.S. monetary reserves, all liabilities to foreign official reserve agencies and liquid liabilities to commercial banks and other foreigners.

THE ECONOMIC PICTURE IN DETAIL

Domestic Nonfinancial Scene

Gross national product--second quarter revisions. Revisions for the second quarter show somewhat greater strength in GNP than originally reported--particularly in the domestic sector. Total GNP rose by $20.5 billion, $0.8 billion more than reported earlier. But net exports were revised down by $2.3 billion to a negative $2.2 billion--$6-1/2 billion below the second quarter level--while outlays for other sectors were raised by $3.1 billion. Excluding net exports, GNP rose by almost $27 billion. (Confidential until release August 20.)

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

	First Quarter	Second Quarter	
	OBE	OBE Preliminary	Revised
	-----------Billions of dollars--------		
GNP	32.4	19.7	20.5
Final sales	32.9	18.2	18.0
Personal consumption	19.9	15.5	16.3
Residential construction	3.6	2.9	3.3
Business fixed investment	3.5	1.8	2.7
Net exports	1.5	-4.1	-6.4
Federal purchases	.8	- .7	-1.0
State & local purchases	3.6	2.7	3.0
Inventory change	- .5	1.5	2.5
	----------Per Cent Per Year 1/----------		
Real GNP	8.0	3.6	4.0
GNP deflator	5.3	4.2	4.1

1/ At compound rates.

Revised second quarter figures showed greater strength in consumer demand than reported earlier. Durable goods outlays were raised almost $1 billion and personal consumption expenditures for the second quarter now total $16.3 billion more than in the first. With strong gains in disposable income, reflecting in part the retroactive increase in Social Security benefits, the saving rate remained high, at 8.2 per cent.

Stocks accumulated in anticipation of a possible steel strike were somewhat larger than expected, and inventory investment was revised up $1 billion to $5.7 billion, an increase of $2-1/2 billion from the first quarter. Business fixed investment outlays were revised up by almost $1 billion to an increase of over $2-1/2 billion and residential construction expenditures continued to show strong growth, rising by $3.3 billion, as housing starts rose further.

The rise in the implicit GNP deflator moderated slightly more in the second quarter than earlier reported, to a 4.1 per cent rate rate of increase. In real terms GNP growth was at a 4 per cent annual rate, the largest quarterly increase, other than the post-GM strike rebound, since early 1968.

A tentative set of projections reflecting the expected short term impact of the new economic policies announced earlier this week will be presented in the Supplement to be distributed August 20.

CONFIDENTIAL - FR

August 18, 1971

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		Change from Preceding Quarter			
				Billions of Dollars		Per Cent, Annual Rates	
		I	II	I	II	I	II
Gross National Product	974.1	1020.8	1041.3	32.4	20.5	13.8 1/	8.2 1/
Final purchases	971.3	1017.6	1035.6	32.9	18.0	13.4	7.1
Private	751.9	789.4	805.4	28.4	16.0	14.9	8.1
Excluding net exports	748.3	785.2	807.6	26.9	22.4	14.2	11.4
Personal consumption expenditures	615.8	644.6	660.9	19.9	16.3	12.7	10.1
Durable goods	88.6	97.6	100.8	12.7	3.2	59.8	13.1
Nondurable goods	264.7	272.0	279.8	1.1	7.8	1.6	11.5
Services	262.5	275.0	280.4	6.1	5.4	9.1	7.9
Gross private domestic investment	135.3	143.8	152.4	6.5	8.6	18.9	23.9
Residential construction	30.4	36.4	39.7	3.6	3.3	43.9	36.3
Business fixed investment	102.1	104.3	107.0	3.5	2.7	13.9	10.4
Change in business inventories	2.8	3.2	5.7	-0.5	2.5	--	--
Nonfarm	2.5	3.0	5.2	-0.3	2.2	--	--
Net exports of goods and services	3.6	4.2	-2.2	1.5	-6.4	--	--
Gov't. purchases of goods & services	219.4	228.2	230.2	4.5	2.0	8.0	3.5
Federal	97.2	96.7	95.7	0.8	-1.0	3.3	-4.1
Defense	75.4	73.0	71.8	-0.2	-1.2	-1.1	-6.6
Other	21.9	23.7	23.9	1.0	0.2	17.6	3.4
State & local	122.2	131.5	134.5	3.6	3.0	11.3	9.1
Gross national product in constant (1958) dollars	720.0	729.7	737.0	13.8	7.3	8.0 1/	4.0 1/
GNP implicit deflator (1958 = 100)	135.3	139.9	141.3	--	--	5.3 1/ 2/	4.1 1/
Private GNP fix weight price index 4/	--	--	--	--	--	5.5 1/	5.0 1/
Personal income 3/	803.6	834.3	854.8	17.6	20.5	8.4	9.8
Wage and salary disbursements	541.4	562.3	572.4	15.1	10.1	11.0	7.2
Disposable income 3/	687.8	721.6	740.8	20.1	19.2	11.3	10.6
Personal saving 3/	54.1	58.4	60.9	-0.1	2.5	--	--
Saving rate (per cent) 3/	7.9	8.1	8.2	--	--	--	--
Corporate profits before tax 3/	75.4	79.1	82.0	7.5	2.9	41.9	14.7
Corp. cash flow, net of div. (domestic) 3/	69.8	n.a.	n.a.	--	--	--	--
Federal government receipts and expenditures (N.I.A. basis)							
Receipts 3/	191.5	195.6	198.3	6.3	2.7	13.3	5.5
Expenditures	205.1	213.2	220.9	3.4	7.7	6.5	14.4
Surplus or deficit (-) 3/	-13.6	-17.5	-22.5	3.0	-5.0	--	--
High employment surplus or deficit (-) 3/	0.9	2.5	0.9	0.4	-1.6	--	--
Total labor force (millions)	85.9	86.5	86.5	--	--	0.2	0.0
Armed forces "	3.2	3.0	2.8	--	--	-12.1	-14.0
Civilian labor force "	82.7	83.6	83.7	--	--	0.6	0.5
Unemployment rate (per cent)	4.9	5.9	6.0	--	--	--	--
Nonfarm payroll employment (millions)	70.7	70.6	70.7	--	--	2.5	0.6
Manufacturing	19.4	18.7	18.7	--	--	1.0	-1.4
Industrial production (1957-59=100)	106.7	105.5	106.7	--	--	7.3	4.4
Capacity utilization, manufacturing (per cent)	n.a.	n.a.	n.a.	--	--	--	--
Housing starts, private (millions A.R.)	1.43	1.81	1.96	--	--	8.1	32.6
Sales new autos (millions, A.R.)							
Domestic models	7.12	8.39	8.28	--	--	216.4	-5.1
Foreign models	1.23	1.50	1.57	--	--	60.2	19.7

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/ At compounded annual rates as published by Commerce.

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

3/ As of the beginning of 1971 figures reflect effects of additional depreciation allowable under Treasury's newly-approved "accelerated depreciation range" guidelines. 4/ Using expenditures in 1967 as weights.

Industrial production. Industrial production declined 0.8 per cent in July and at 106.0 per cent of the 1967 average was 5.3 per cent below the 1969 high and 3.3 per cent above the low of last November. Output declines were concentrated in the materials producing sector although production of equipment was also off somewhat further. Output of consumer goods changed little.

Steel production was cut back further in July and in early August reflecting the lack of current demand as steel users began efforts to reduce excessive inventories. Output of copper was sharply reduced in July by strikes, and coal production declined because of lack of freight cars resulting from the railroad strike. These reductions accounted for almost .8 of the .9 point decline in the total index. A moderate further drop in output of business and defense equipment accounted for the rest of the decline.

Output of consumer goods in July was 3.2 per cent above its 1969 peak but has changed little since May. Auto production schedules for August and September, after allowance for the model changeover period, are set at the 8.5 million unit rate of July. With stocks of other consumer durable goods--appliances, radios, and TV sets--at record levels, consumer demand does not seem to be strong enough to warrant significantly increased output of these goods in the next few months, although the President's new economic program may stimulate consumer buying in this area as well as of autos. While the rate of decline in production of business equipment has slowed considerably in the past 3 months, a marked recovery in output of these goods in the next month or two appears unlikely in view of the recent course of new orders.

From May to July, the decline in steel production resulted in .5 of a point decline in the total production index. In August, cutbacks in steel will exert a downdrag of 1 to 2 points but a partial offset -- .3-.4 of a point -- will result from settlement of the copper and railroad strikes. Altogether, the total production index is likely to register a sizable decline.

INDUSTRIAL PRODUCTION
1967=100, seasonally adjusted

	1969	1971			Per cent change
	Sept 1/	May	June	July	Sept 1969 to July 1971
Total index	111.9	107.0	106.9	106.0	- 5.3
Consumer goods	112.3	115.8	116.0	115.9	3.2
Autos	116.6	108.3	107.9	107.9	- 7.5
Home goods	111.6	113.9	113.5	113.2	1.4
Apparel & staples	111.3	115.3	115.9	116.1	4.3
Business equipment	110.3	94.4	94.2	93.6	-15.1
Defense equipment	102.1	76.9	76.6	76.1	-25.5
Intermediate products	112.1	112.9	112.5	110.6	- 1.3
Construction products	111.9	114.1	113.2	110.1	- 1.6
Materials, total	114.4	108.9	108.7	107.1	- 7.3
Durable	114.9	104.8	103.3	101.2	-12.0
Steel	117.0	112.9	105.5	101.1	-13.6
Nondurable	113.8	112.7	113.9	113.9	.1

1/ Pre-recession peak of the total index.

Retail sales. Retail sales in July declined 0.8 per cent from June, according to the advance report, but remained at the advanced second quarter rate. Sales of nondurable goods were down 1.0 per cent, largely because general merchandise stores were down from the very strong pace of June. Sales of durable goods stores changed little, with a small rise in the automotive group and a decline of nearly 2 per cent at furniture and appliance stores.

Sales in the March through July period averaged 7.7 per cent above a year earlier, the strongest year-to-year comparison since early 1969. The automotive and general merchandise groups were primarily responsible for the stronger showing.

RETAIL SALES
(Seasonally adjusted)

	1971								
	I Q	II Q	July	I Q	II Q	April	May	June	July
	----Billions $----			-Percentage change from previous period-					
Total sales	31.7	32.9	32.9	4.2	3.6	1.8	- .5	1.3	- .8
Durable goods	9.8	10.4	10.4	13.4	5.1	2.6	-2.2	1.6	- .2
Automotive	5.8	6.2	6.2	24.3	6.8	2.9	-3.4	.7	.6
Furniture & appl.	1.5	1.5	1.4	5.6	-1.0	- .7	-2.9	2.4	-1.8
Nondurable goods	21.9	22.5	22.5	.5	2.9	1.4	.4	1.1	-1.0
Food	7.0	7.1	7.1	1.1	2.8	1.3	1.5	-1.2	- .1
General merchandise	5.5	5.8	5.8	2.6	4.5	1.6	- .6	4.1	-3.2
Total, less autos and nonconsumer items	24.1	24.9	24.8	.6	2.6	1.4	.1	1.2	-1.1
Total, deflated by all commodity CPI	27.3	28.0	n.a.	3.4	2.5	1.5	-1.4	1.3	n.a.

Consumer credit. The increase in consumer instalment credit outstanding during June amounted to $6.3 billion, seasonally adjusted annual rate. This was somewhat greater than the $5.9 billion increase in May but well below the $8.0 billion advance in April. While the $6.7 billion rise in outstandings for the second quarter as a whole was the largest quarterly increase since the fourth quarter of 1969, it was substantially less than the record $10 billion increases in the final two quarters of 1968.

Although the proportion of both new and used cars sold on credit has declined in recent months, total extensions have risen because of an increase in the absolute number of vehicles financed and a sizable advance in the average size of instalment contracts.

The average size of new car contracts was up nearly $200 since the last half of 1970, with accompanying higher montly payments; this has prompted further movement toward a lengthening of terms from the present standard 36 month financing. While a few commercial banks in scattered areas have extended maturities on new car contracts to 42 or even 48 months, the most important break-through has been made by Ford Motor Credit Company. New car buyers in the San Diego metropolitan area have been offered 42 month financing by FMCC since April 1. This has enabled the company to compete with local banks granting such terms, and has helped dealers in meeting competition of import sales in the area by holding down monthly payments on domestic units. Since the program began approximately 10 per cent of Ford sales in the area have been financed for 42 months.

NEW CAR FINANCING
(Seasonally adjusted)

	Extensions 1/ (Billions of $)	Average contract ($)	Number financed 1/ (Millions of units)	Proportion financed (per cent)
1970 - QI	18.3	3,159	5.8	66.2
QII	18.9	3,183	5.9	64.5
QIII	19.1	3,183	6.0	68.7
QIV	15.2	3,092	4.9	72.8
1971 - QI	19.9	3,243	6.1	61.9
QII	20.9	3,326	6.3	63.6 2/

1/ Annual rate.
2/ April-May average

Consumer buying and income expections. The July Census survey suggests a deterioration of consumer sentiment, following the slight turn-up that the Census, Michigan and Conference Board surveys began to show at the beginning of the year. Thus, the Census index of expected unit car purchases in the next 6 to 12 months declined to 94.8 in July from 104.7 (Jan.-April 1967 = 100) in April. This is the lowest value for this seasonally adjusted index since April 1967. Buying plans for homes and appliances also declined, and expected expenditures for appliances, furniture and home improvements fell to a low level.

Current income compared with a year earlier improved, with more households reporting higher income and fewer households reporting lower income. However, expectations of future income change deteriorated to about the January level and expected income improvement tends to be much more closely correlated with higher durable goods purchase plans than is recent actual income experience.

EXPECTATIONS TO PURCHASE CARS, HOUSES, AND HOUSEHOLD DURABLES: QUARTERLY SURVEYS, JULY 1970-JULY 1971

Indexes, mean probabilities, and expected expenditures	1970 July	1970 Oct.	1971 Jan.	1971 Apr.	1971 July
INDEXES OF EXPECTED UNIT PURCHASES: BASED ON AVERAGE OF 6-AND 12-MONTH MEAN PURCHASE PROBABILITIES					
(Seasonally adjusted. Average of January 1967 and April 1967 =100)					
All households:					
New cars	105.8	103.8	107.9	104.7	94.8
Houses	92.9	95.6	96.3	101.7	97.7
EXPECTATIONS TO BUY FURNITURE, APPLIANCES, AND HOME IMPROVEMENTS WITHIN 12 MONTHS					
Average expected expenditures on appliance, furniture, and home improvements, dollars:	238	237	233	259	231
Number of major appliances likely to be bought per 100 households	26.3	26.8	24.4	26.1	24.1

HOUSEHOLD INCOME CHANGES

	Family income of house- compared to a year ago, percentage of households			Mean probability of substantial change in family income of households		
	No change in income	Higher income	Lower income	Increase in income	Increase less decrease	Decrease in income
1970						
Third quarter	46.2	39.9	13.0	18.2	10.9	7.3
Fourth quarter	48.3	37.3	13.6	16.7	9.4	7.3
1971						
First quarter	50.3	35.0	14.2	17.2	10.5	6.7
Second quarter	49.8	35.1	14.5	19.9	12.4	7.5
Third quarter	48.5	37.6	12.5	17.0	10.2	6.8

Residential construction and real estate. Seasonally adjusted outlays for new construction, which were revised upward 1 per cent to a new high for June, changed little in July. The July level was 17 per cent above the cyclical low reached in July 1970. Even after allowance for cost increases, the year-to-year advance amounted to 10 per cent, concentrated entirely in outlays for residential structures.

Current dollar outlays for residential structures in July remained at the advanced second quarter rate. However, July outlays may have been appreciably understated in view of the additional upsurge in housing starts which has now been reported for July and which was not anticipated in the Census Bureau's initial outlay estimates.

Expenditures for private nonresidential construction in July apparently continued near the peak registered last April despite a further sharp decline in outlays for the industrial structures component, the major source of weakness in this area. Within the public sector, outlays for State and local projects have remained quite steady in recent months, and in July were only moderately below their record first quarter rate.

NEW CONSTRUCTION PUT IN PLACE
(Seasonally adjusted annual rates)

	All	Private			Public
		Total	Residential	Non-residential	
			Billions of dollars		
1970 - Annual	91.3	63.1	29.3	33.8	28.3
1970 - IVQ	94.8	65.3	31.9	33.4	29.5
1971 - IQ (r)	101.3	70.7	35.4	35.3	30.6
IIQ (r)	104.0	74.3	38.6	35.7	29.7
1971					
May (r)	103.9	74.2	38.9	35.3	29.7
June (r)	104.3	74.4	38.8	35.6	29.8
July (p) 1/	104.2	74.4	38.7	35.7	29.8
			Per cent change in July from a year earlier		
In current dollars	+17	+23	+43	+6	+5
In 1957-59 dollars	+10	+15	+37	-4	-3

1/ Data for the most recent month (July) are confidential Census Bureau extrapolations. In no case should public reference be made to them.

Seasonally adjusted private housing starts in July soared a tenth above the exceptional 2 million unit rate in June. This reflected mainly a 27 per cent surge in multifamily starts to a rate above the 1 million level for the first time on record and a 47 per cent share of the total. A factor in this rise, which coincided with the beginning of the new fiscal year, may have been a substantial pick-up in subsidized multifamily starts. These, unlike subsidized singlefamily starts, had been running appreciably under year-earlier levels since last December.

With mortgage commitments outstanding apparently continuing strong and over-all building permits at a historic high, an annual rate above the 2.05 million unit level initially projected for the third quarter now seems indicated. Assuming mobile home shipments continue close to their recent high, the combined "shelter-count" for the third quarter could move into the 2.6 million unit range. This would compare with a previous record annual rate of 2.44 million units in the second quarter and would exceed the recent low in the first quarter of 1970 by 1 million units.

Seasonally adjusted sales of new homes by merchant builders in June--latest available--and in the second quarter as a whole were holding near the record rate reached in the first quarter of the year despite some apparent slippage in the share represented by subsidized--lower-cost--units. Associated with this development, the median price of new units sold in June rose further, to $26,200, 10 per cent above the declining level a year earlier. While builder stocks of new homes for sale increased in June, they were still comparatively low in relation to sales and were available at a median price only slightly above that of units being sold. In the market for existing homes, the median price of units sold was $25,100 in June or

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				
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
IIQ (r)	1,961	58	22	1,805
1971				
May (r)	1,975	57	21	1,927
June (r)	1,995	59	24	1,847
July (p)	2,218	53	n.a.	2,072

1/ Apart from starts, mobile home shipments for domestic use in June--the latest month for which data are available--were at a record seasonally adjusted annual rate of 490,000. This helped to bring the rate for the second quarter as a whole to 480,000 or 13 per cent above the previous quarterly high in IIIQ, 1970.
2/ Based on unadjusted totals for all periods. FHA-insured starts include both subsidized and nonsubsidized units.

11 per cent above a year earlier, according to the National Association of Real Estate Boards. This compared with a year-to-year margin of about 6 per cent during the first three months of this year and all of 1970.

Manufacturers' orders and shipments. New orders for durable goods declined 0.6 per cent in June, according to still-preliminary data, rather than the 1.1 per cent indicated by the advance report. Excluding steel, new orders were unchanged in June at a level slightly below the first quarter average in current dollars, and off by about 1-1/2 per cent after allowing for the continued increase in durable goods prices. Some of the recent weakness has been in defense orders; excluding both defense and steel, June orders were slightly higher than in May and 2 per cent above the first quarter average in current dollars--about half a per cent above the first quarter in constant dollars.

Capital equipment orders now show a slight increase in June but remain no higher in current dollars than last November; in constant dollars, such orders were off 1-1/2 per cent from the first quarter average.

The durable goods manufacturers' backlog is still indicated to have dropped 3 per cent in June. Unfilled orders declined at all major groups, but the biggest drops were $1.1 billion in defense products and $0.8 billion in iron and steel. The decline in the defense backlog included $0.4 billion ascribed to completion of billings on major aerospace contracts; also included is a $0.5 billion rise in shipments and an equivalent drop in inventories at the aerospace industry.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
(Seasonally adjusted)

	1971				
	Q I	Q II (prel.)	May	June (prel.)	Change, June from May
	Monthly averages, -----billions of dollars-----				--Per cent--
Durable goods, total	31.7	30.9	31.2	31.0	- .6
Excluding steel	29.1	28.8	29.0	29.0	- .0
Excluding steel and defense	27.0	27.3	27.5	27.6	.2
Primary metals	5.2	4.9	5.0	4.7	-6.0
Iron and steel	2.6	2.1	2.1	1.9	-8.9
Motor vehicles & parts	4.6	4.4	4.4	4.4	.8
Household durables	2.2	2.3	2.4	2.3	-1.4
Defense products	2.0	1.5	1.5	1.5	-3.7
Capital equipment	8.8	8.6	8.7	8.8	.4
All other durables	8.8	9.1	9.2	9.3	1.3

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

Since November 1970, the date tentatively chosen as the cycle trough, the durable goods order backlog has declined more than 3 per cent, both including and excluding primary metals. This compares unfavorably with the seven-month periods following previous cycle troughs. Some of the decline in backlogs is accounted for by defense products; but defense backlogs were also declining in the early stages of the previous cyclical recoveries. After eliminating defense, the comparison is still unfavorable in current dollars, and is more so after allowing for the greater price increase in the current period.

Inventories. The book value of business inventories rose at a $4.2 billion annual rate in June, according to preliminary data; this was down from the April and May rates. Sales were rising faster than stocks and the overall business inventory-sales ratio declined to the lowest point since September 1966. However, the inventory-unfilled orders ratio at durable goods manufacturers rose further to a new record high--well above previous steel stockpiling periods.

For the second quarter as a whole, growth in inventories of metal materials at manufacturing and trade establishments was somewhat larger than in the first quarter, accounting for most of the small increase in total second-quarter accumulation. Durable goods manufacturers continued to liquidate stocks other than materials, and growth in retail auto stocks slowed; these negative influences on the second-quarter rate of accumulation were about offset by a somewhat larger growth at nondurable and miscellaneous durable goods establishments.

According to the Census Bureau, completion of billion on contracts in the aerospace industry accounted for a $0.4 billion ($4.8 billion, annual rate) drop in inventories in June; there were corresponding declines in order backlogs and increases in shipments. This usually happens whenever an item with a long production time is paid for, but since the amount appears particularly large and since the transactions may have occurred somewhat earlier than normal, data excluding these changes are also shown in the tables. Excluding the billing completion, inventory growth is raised for the month and the quarter, the inventory-shipments ratios show less improvement, and the inventory-backlog ratios show almost the same increase.

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

	1971			
	Q I	Q II (prel.)	May (rev.)	June (prel.)
Manufacturing and trade, total	5.9	6.5	8.3	4.2
Excl. billing completion		8.1		9.0
Metal materials	1.1	1.8	1.4	.2
Durable manufacturing other than materials	-1.7	-2.4	-1.6	-3.1
Excl. billing completion		- .8		1.7
Retail auto dealers	5.0	2.8	4.6	2.6
Nondurable and misc. durable goods	1.5	4.3	3.8	4.5

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

A part of the recent improvement in the inventory-sales ratio reflected high pre-labor-contract levels of steel sales; but metals sales fell off somewhat in June and should drop further by August. Relative to use, steel stocks appear higher than in previous pre-contract periods.

The inventory-sales ratio has improved for the rest of durable goods manufacturing, but while these manufacturers have been drawing down their inventories and increasing their shipments of goods other than materials, they have also been running down their order backlog, so that even excluding steel stockpiling, the inventory-backlog ratio was high and rising as of the end of June. The dwindling backlog may eventually result in a decline in sales. Until order backlogs stop falling faster than inventories, prospects for inventory growth in this area are poor.

Retail auto dealers' stocks rose relative to sales in May and June, but in July, according to unit data, new car stocks and the stock-sales ratio were reduced. Elsewhere, the ratio of stocks to sales for nondurable goods and miscellaneous durable goods continued to improve through June, but retail sales for this group declined in July, according to the advance report.

INVENTORY RATIOS

	1971			
	Jan.	April	May (rev.)	June (prel.)
Inventories to sales				
Manufacturing and trade, total	1.57	1.53	1.52	1.50
Excl. billing completion				1.51
Metal materials	4.46	4.04	3.90	3.94
Durable mfg. other than materials	1.62	1.57	1.53	1.47
Excl. billing completion				1.51
Retail auto dealers	1.58	1.56	1.68	1.70
Nondurable and misc. durable	1.32	1.30	1.29	1.28
Inventories to unfilled orders				
Durable manufacturing, total	.817	.824	.837	.858
Excl. billing completion				.859
Other than materials	.574	.575	.578	.587
Excl. billing completion				.589

Labor market. The unemployment rate moved up 0.2 percentage points to 5.8 per cent, seasonally adjusted, in July, after dropping sharply in June. Most of the rise occurred among women and teenagers. Nonfarm payroll employment declined by 190,000 in July for the second consecutive month, with manufacturing employment down 130,000.

The civilian labor force rose sharply in July (700,000, seasonally adjusted), but not by enough to offset the drop of 1 million in June. At 83.8 million, the civilian labor force was virtually unchanged from the January level and only 1.2 million above July 1970; the total labor force was only 850,000 above a year earlier--little more than half the increase normally expected on the basis of population growth and trends in labor force participation rates.

Unemployment rate increases in July were widespread among major groups, except adult males; sharpest rate increases were posted for teenage and adult females and young adult males. At 5.3 per cent, the unemployment rate for white workers showed little change in July. However, the rate for Negro workers--which has been more volatile than usual in recent months--moved up 0.7 percentage points to 10.1 per cent.

The July decline in manufacturing employment was widespread with over four-fifths of the job loss among production workers. The largest decline was in primary metals, reflecting cutbacks in steel production and a strike in the copper industry. Factory employment in July was down 300,000 from the post-auto strike high in December and 900,000 from a year earlier.

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1970		1971		
	July	November	March	June	July
Total	5.0	5.9	6.0	5.6	5.8
Men aged:					
20 to 24 years	9.0	10.4	10.0	9.7	10.1
25 and over	2.9	3.4	3.4	3.3	3.4
Women, aged 20 and over	4.9	5.6	5.8	5.5	5.7
Teenagers	14.2	17.6	17.8	15.8	16.2
White-collar	3.0	3.6	3.7	3.1	3.6
Blue-collar	6.5	7.4	7.4	7.0	7.1

Average weekly hours of factory production workers edged down 0.1 hours to 39.9 hours. The decline was centered in durable goods industries and was related to automobile model change-overs. However, factory hours remained somewhat above the winter lows.

Payroll employment in most nonmanufacturing industries has shown no appreciable growth for the last few months. Compared with last July sizable employment gains have been posted only in trade, services and State and local governments and even these increases are smaller than those in other recent years.

NONFARM PAYROLL EMPLOYMENT, JULY 1971
(Seasonally adjusted, in thousands)

	Change from:		
	July 1970*	December 1970	June 1971
Total	-198	153	-191
Goods-producing	-1089	-488	-188
Manufacturing	-943	-340	-132
Mining	-18	- 24	-20
Construction	-128	-124	-36
Service-producing	891	641	- 3
Transportation & P.U.	-65	37	-10
Trade	259	342	22
Finance and services	356	90	-34
Government	341	172	19
Federal	-11	7	4
State and local	352	165	15

*Based on data that have not been seasonally adjusted.

Productivity and labor costs. Output per manhour in the private economy increased at an annual rate of 1.7 per cent in the second quarter. This was substantially below the sharp first quarter rise which was inflated by the recovery from the G.M. strike. Output growth in the second quarter was much slower than in the first, while manhours rose somewhat more rapidly; in fact, the 2.1 per cent increase was the largest since early 1969.

The rise in compensation per manhour slowed to a 6.7 per cent annual rate in the second quarter following an exceptionally rapid first quarter gain; the increase from a year earlier was 8.0 per cent, the largest since early 1969. On the other hand, year-over-year gains in productivity have also been substantially larger than in 1969 and 1970. Thus, the over-the-year rise in unit labor costs has been reduced appreciably, from 7.0 per cent in 1969 to 4.2 per cent in the second quarter of this year.

COMPENSATION, PRODUCTIVITY AND UNIT LABOR COSTS
PRIVATE ECONOMY

	Compensation per manhour	Output per manhour	Unit labor costs
Change from previous quarter: (annual rate)			
1970:II	4.8	3.2	1.6
III	8.9	5.6	3.1
IV	6.7	.6	6.1
1971:I	9.6	6.9	2.6
II	6.7	1.7	5.0
Change from year-earlier			
1969	7.4	.4	7.0
1970	7.0	.8	6.2
1970:IV	6.9	1.7	5.0
1971:I	7.5	4.1	3.3
II	8.0	3.7	4.2

Major contract settlements. Wage rate increases averaged 8.0 per cent a year in major private nonfarm settlements concluded during the first half of this year compared with nearly 9 per cent in 1970 as a whole. Major agreements in this period covered close to 1.35 million workers including those in the petroleum, can, aluminum, apparel, automobile, farm machinery and railroad industries. Few construction workers, however, were included and first year increases in these settlements tended to be smaller than in 1970.

WAGE INCREASES IN MAJOR COLLECTIVE BARGAINING SETTLEMENTS
(Mean adjustments)

	Annual Rate of Increase		
	Year		1st half
	1969	1970	1971
Private nonfarm industries[1/]			
First year	9.2	11.9	10.0
Average over life of contract	7.6	8.9	8.0
Manufacturing			
First year	7.9	8.1	8.7
Average over life of contract	6.0	6.0	6.4
Nonmanufacturing			
First year	10.8	15.2	12.0
Average over life of contract	9.3	11.5	10.8
Construction			
First year	13.1	17.6	13.4
Average over life of contract	13.1	14.9	14.2

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

In manufacturing, wage rate increases were higher than in 1970, averaging 6.4 per cent annually over the life of the contract and 8.7 per cent in the first year. In contrast, the averages for nonmanufacturing were smaller than in 1970, reflecting in part the lower settlements in the construction industry. Large settlements covering almost 700,000 construction workers contributed heavily to the higher averages in 1970. In the first half of this year, only 9 construction settlements covering 35,000 workers were included; for the 3 major settlements subject to approval by the Construction Industry Stabilization Committee, the average wage increase is estimated at 12.3 per cent over the life of the contract.

When wages and benefits are combined, the average increase over the life of the contract was 8.3 per cent a year in major settlements concluded in the first half of 1971 compared with 9.1 per cent in 1970 as a whole.

Industrial relations. Agreement was reached by the steelworkers union and nine major steel companies on August 1 on a new three-year contract covering 350,000 workers. The steel settlement followed closely the pattern of wage and fringe benefit increases established earlier this year in the can contracts and followed later in the aluminum and copper agreements. Wages were increased about $1.18 an hour, totaling close to 30 per cent over the life of the contract. The wage package included the pattern first-year catch-up wage increase of 50 cents an hour followed by 12-1/2 cent increases in both the second and third contract years, and an unlimited quarterly cost-of-living escalator effective the beginning of the second year with a guaranteed minimum 12-1/2 cent adjustment in each year. Further wage increases result from an increase in the increment between job classes and from a 50-cent increase in the base for calculating incentive pay. Improved fringe benefits included vacation bonuses, an increase in premium pay for Sunday work, higher pension and welfare benefits and larger weekly supplementary unemployment payments.

The railroads and 190,000 members of the United Transportation Union reached agreement August 2 after prolonged negotiations on work rule changes; the agreement ended strikes begun during July and finally involving a total of 10 carriers. The settlement provided wage increases totaling 42 per cent over 42 months, the pattern established in agreements reached by other rail unions earlier this year. The controversial work rule requiring a crew change every 100 miles is to be submitted to union-management committees. If no agreement is reached in 90 days, the issue will be subject to binding arbitration. Workers whose jobs are abolished by work rule changes are guaranteed one year of severance pay for each year of service. Still to be completed are settlements with the six shopcraft rail unions where negotiations are already underway. Most of the 39,000 copper workers on strike since July 1 had returned to work by early August following settlements at most major companies. But no progress has been reported in negotiations involving 19,000 longshoremen and West Coast shippers, and the strike begun July 1 continues to tie up West Coast ports.

Wholesale prices. Wholesale prices rose at a seasonally-adjusted annual rate of 2.4 per cent from June to July. The largest increase posted for industrial commodities since August 1956 was largely offset by a sharp decline in prices of farm and food products. Consecutive large monthly increases brought the rise in industrials to an annual rate of 6.1 per cent over the three months ending in July and almost 5 per cent at an annual rate from six months ago; these are the largest sutained increases since 1956.

Higher prices for intermediate materials were mainly responsible for the increase in industrial commodities, reflecting increased demand for lumber and wood products and other building materials and increased prices of steel mill products. The West Coast dock strike is an increasingly important factor in restricting supplies of lumber, prices of which are reported to have risen substantially further in the last three weeks.

WHOLESALE PRICES

(Per cent changes, seasonally adjusted annual rates)

	6-months		3-months		Monthly
	Dec. '69 to June '70	June to Dec. '70	Dec. '70 to Mar. '71	March to June '71	June '71 to July '71
All commodities	2.4	2.2	5.4	4.7	2.4
Farm and food[1]	-1.8	- .4	11.3	3.2	-11.9
Industrial commodities	3.8	3.4	2.9	5.3	8.8
Crude materials[2]	8.5	.8	2.4	7.1	6.0
Intermediate materials[2]	4.3	1.8	4.0	6.9	9.9
Finished goods[2]	3.1	5.4	2.8	1.9	4.7
Producer	4.1	6.0	3.9	2.8	3.1
Consumer[2]	2.7	5.1	2.2	1.5	5.5
	2.7				
Durable	2.9	5.7	2.2	2.9	4.4
Nondurable[2]	2.8	4.7	1.5	.7	5.5

1/ Farm products, and processed foods and feeds.
2/ Excludes food.

Prices of (nonfood) finished goods, following several months of relatively small increases, spurted in July owing mainly to an increase in prices of consumer goods. Prices of apparel and tires and tubes rose strongly, and those for passenger cars moved higher as discounts to dealers were reduced. Machinery and truck prices also increased substantially.

The decline in farm and food products mainly reflected a sharp drop in prices of fresh fruits and vegetables as overlapping of harvests caused by weather conditions was responsible for larger than seasonal increases in vegetables supplies; the dock strike brought about a surplus of citrus fruits on the West Coast. Corn prices recently have dropped further reflecting improved expectations of a large crop.

After the pricing date for the July WPI, a number of important price increases were announced for metals and passenger cars and trucks. These are described below, even though the 90-day price freeze announced by President Nixon will prevent most of them from going into effect as scheduled.

Tentative increases of about 4 to 5 per cent for passenger cars and more than 5 per cent for trucks were announced by major automobile producers. Following the announced price freeze, major producers rescinded these price increases.

The price of prime western zinc in late July was increased 1 cent a pound to 17 cents a pound--the third increase this year. One of the major aluminum producers, despite widespread discounting recently, announced a two-step increase--1/2 cent a pound on September 1 and another 1 cent on January 1--in an effort to raise realized prices for aluminum ingot.

During the first week in August, major steel producers announced a three-step price increase averaging 8 per cent on most steel mill products. If extra charges are considered, the wholesale price index for steel mill products would show about a 7 per cent increase following final-stage increases. First-step increases were made on August 5 for semifinished steel, bars, rod, wire, structural steels, railroad, and tubular products. If allowed to stand, these increases would raise the August WPI by 0.1 per cent and industrial commodities by 0.2 per cent. By December, increases by most producers covering most products were to have been inaugurated. Governmental policy following the present 90-day price freeze is still unknown. As originally announced, however, the rise in prices of steel mill products from July to December would result in an increase in the overall WPI of about 0.2 per cent and a rise in the index of industrial commodities of about 0.3 per cent.

1971 crop prospects. A bumper crop, 11 per cent above last year and 7 per cent above the old 1969 record, is indicated by the August 1 survey of crop conditions. Crop acreage is 3 per cent larger than last year and indicated output per acre is 8 per cent larger. Grains account for the bulk of the prospective gain with feed grain output (mainly corn) forecast at 200 million tons, up 26 per cent from last year's short output, and food grains estimated at 54 million tons, up 15 per cent.

The 5,345 million bushel crop forecast for corn is 30 per cent above last year and 12 per cent above the previous high reached in 1967. Blight beclouds prospects but the large acreage and excellent development of the crop to date indicate that output will be very large in spite of the blight. Gains are in prospect for grain sorghums, barley, wheat, and soybeans.

Feed grain and wheat supplies will probably exceed use in 1971-72 with resulting net additions to stocks, as shown in the table, and prices are likely to stay close to loan rates. Soybean supplies, however, will probably be barely large enough to meet demands and prices may average about a fourth above the loan rate.

SUPPLY AND UTILIZATION OF GRAINS AND SOYBEANS
Marketing years, 1970-71 and 1971-72 projected

	Feed grains (million tons)		All wheat (million bushels)		Soybeans (million bushels)	
	1970-71	1971-72	1970-71	1971-72	1970-71	1971-72
Supply	208	234	2264	2330	1366	1345
Beginning stocks	48	34	885	730	230	110
Production 1/	159	200e	1378	1600e	1136	1235e
Use	174	178e	1534	1430e	1256	1255e
Domestic	155	157e	799	780e	831	845e
Exports	19	21e	735	650e	425	410e
Ending stock 2/	34	56e	730	900e	110	90e

1/ 1971 crop production based on August 1 conditions.
2/ Fall of 1972.

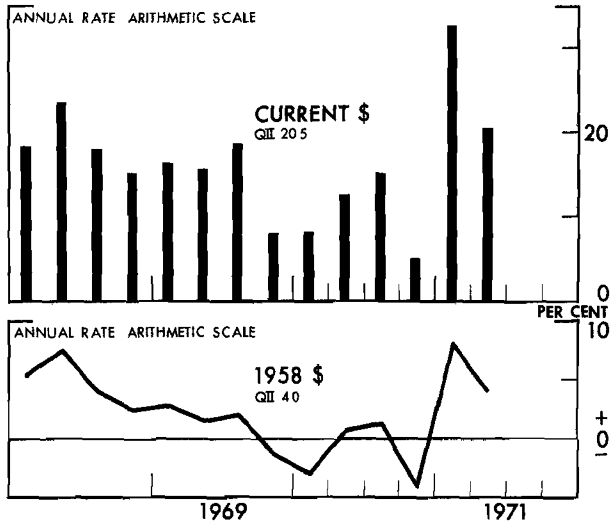
The impact of the big grain crops is likely to show up in the Federal Budget before it is felt by consumers in the form of increased supplies and lower priced livestock food products. Expanded demand for price support loans beginning this fall may boost Commodity Credit Corporation spending by $0.8 to $1.0 billion above the 1972 Budget estimate. Substantially expanded meat supplies will probably reach consumers sometime around mid-1972.

Producers will probably respond to cheaper livestock feed by increasing output. Broiler numbers can be expanded fastest. Broiler output, now below a year ago, is expected to move higher by late fall and possibly average 6 to 8 per cent above a year earlier by next spring. Supplies of feeder cattle are larger than last year and beef output can be expanded by increasing numbers on feed and by feeding to heavier weights. Pork production will probably be the slowest to expand because a cyclical decline in hogs is in progress and a turn-around could not be effected in less than a year. Low profits on hogs since last fall may dampen producers' enthusiasm for an immediate expansion in production.

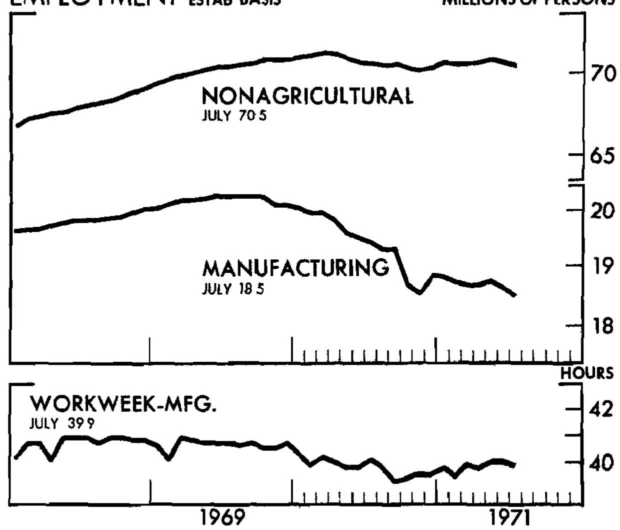
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

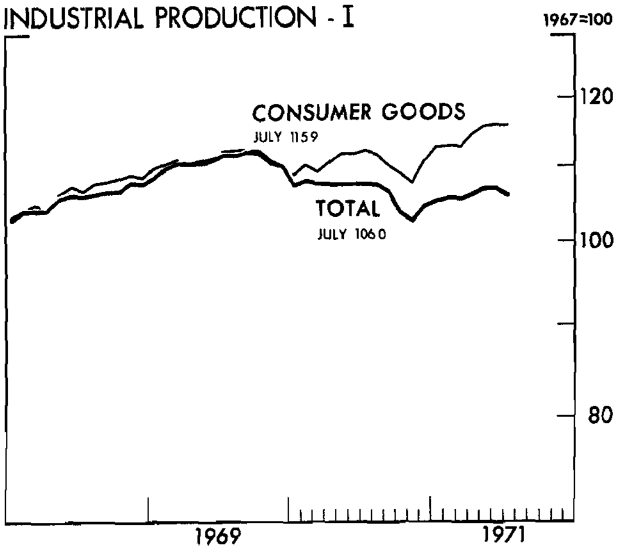
GNP INCREASE



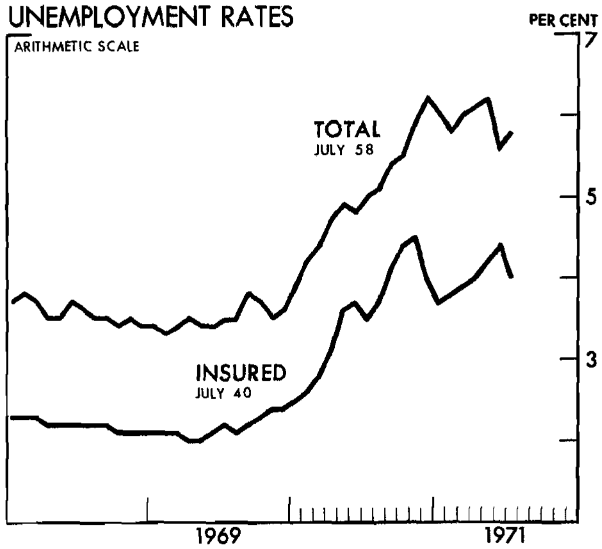
EMPLOYMENT ESTAB BASIS



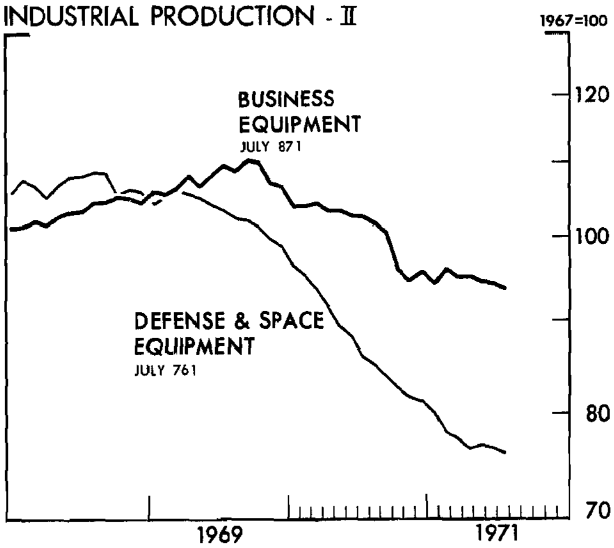
INDUSTRIAL PRODUCTION - I



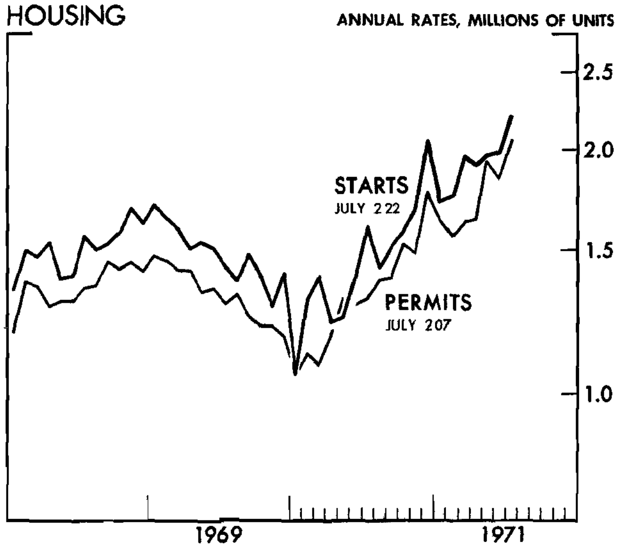
UNEMPLOYMENT RATES



INDUSTRIAL PRODUCTION - II



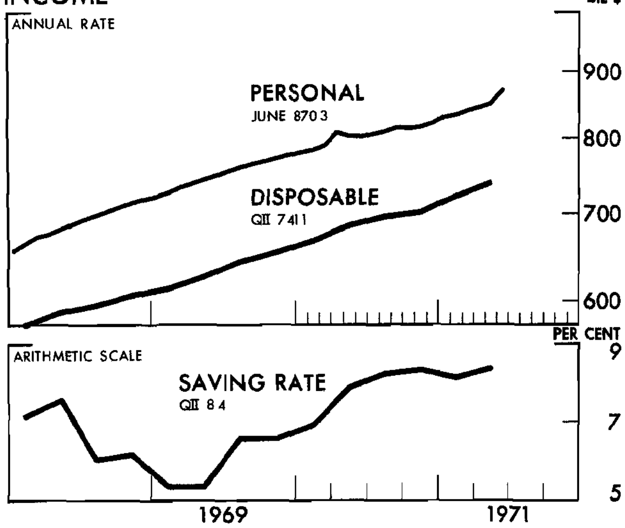
HOUSING



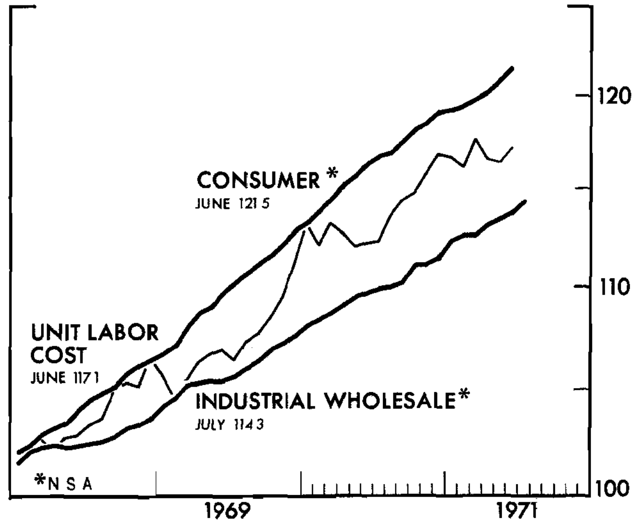
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED, RATIO SCALE

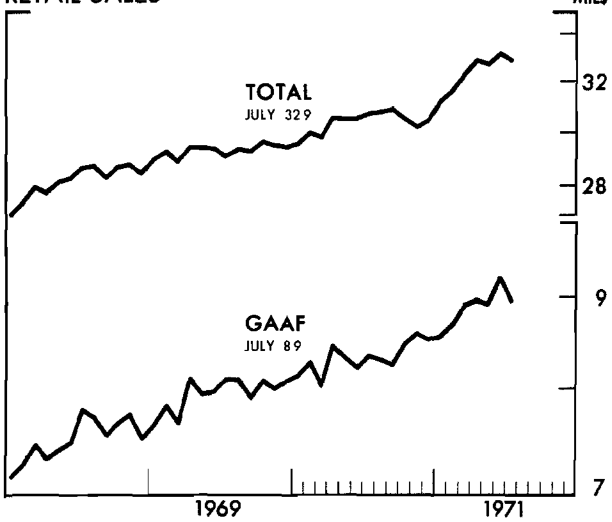
INCOME



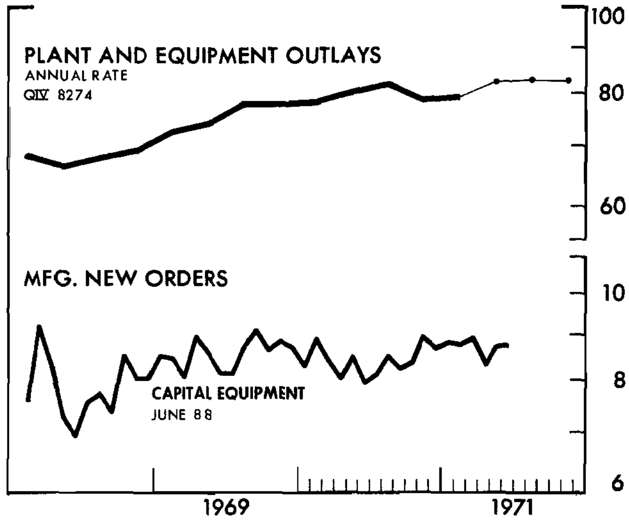
PRICES AND COSTS



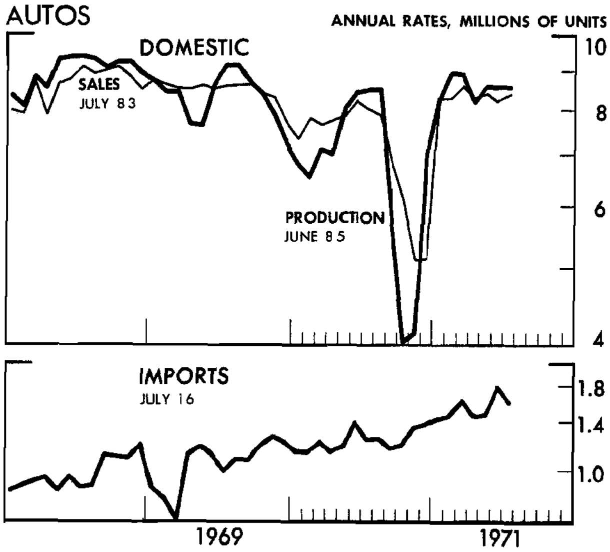
RETAIL SALES



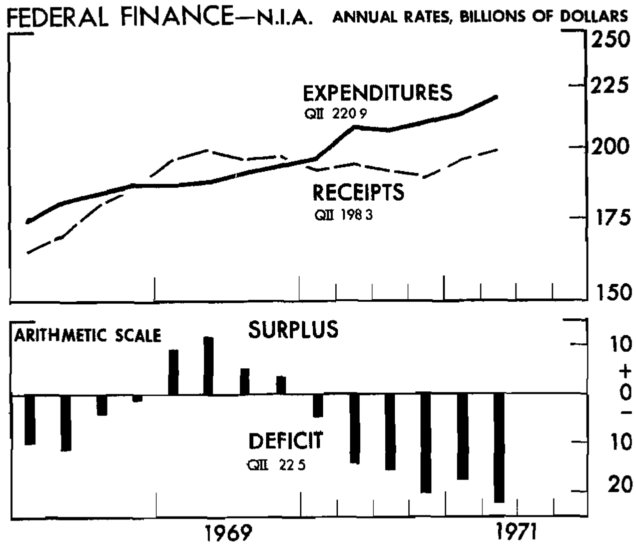
BUSINESS INVESTMENT



AUTOS



FEDERAL FINANCE—N.I.A.



THE ECONOMIC PICTURE IN DETAIL

Domestic Financial Situation

Monetary aggregates. M_1 increased at an annual rate of 10-1/2 per cent in July, about in line with the pace in the second quarter. Preliminary and partial data suggest that during the early part of August the rate of expansion in M_1 moderated somewhat. Because of a marked slackening of flows into bank thrift accounts, M_2 rose more slowly in July than in any other month since March 1970. The July growth rate for M_3 was better sustained, as claims on nonbank thrift institutions continued to increase strongly.

MONETARY AGGREGATES
(Per cent changes, seasonally adjusted annual rates)

	1970	1971				
	QIV	Q I	Q II	May	June	July
1. M_1 (currency plus private demand deposits)	3.4	8.9	11.3	15.2	9.1	10.6
2. M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	9.2	17.8	12.6	14.4	11.0	7.7
3. M_3 (M_2 plus savings deposits at mutual savings banks and S&Ls)	9.7	19.0	14.8	15.5	12.3	10.3
4. Adjusted bank credit proxy	8.3	10.9	6.5	7.4	6.6	7.6

The markedly slower growth of consumer-type time and savings deposits at commercial banks during July apparently continued in the early part of August, as depositors responded further to the rise in market interest rates that had taken place since mid-March. In addition, information obtained by Reserve Bank staffs from commercial banks in their Districts suggests that, with business loan demands modest and asset portfolios liquid, many banks have not been aggressively seeking such deposits.

It is not clear why deposit flows at nonbank thrift institutions have not been as severely affected by the uptrend in market rates as flows at commercial banks. In part, this divergence may be attributable to the higher deposit rates these institutions are allowed to pay. In addition, depositors at banks may be more sensitive to alternative investment opportunities than are depositors at thrift institutions. Such a divergence in investment behavior appears to exist between depositors at large and small commercial banks, as deposits held at large banks, particularly large deposits, tend to respond more quickly and in greater volume to fluctuations in market rates.

Bank sales of large CD's increased sharply in July, but then appeared to slow in the early part of August. The July expansion occurred partly because some of the funds obtained by AT&T in its recent financing were invested temporarily in CD's. In addition, State and local governments and foreign official institutions continued to acquire certificates in large volume. With CD funds readily available in July, banks made only moderate upward adjustments in their offering rates, and sales continued to be concentrated in very short-term maturities. Following the President's announcement, CD offering rates declined in unison with the reduction in open market rates.

The rate of growth in the adjusted credit proxy was slightly more rapid in July than in June, as the sharp increase in CD's and the strong rise in private demand deposits more than offset the marked reduction in growth of other time and savings deposits, a slight drop in U.S. Treasury deposits and a further decline in nondeposit funds. The drop in nondeposit funds mainly reflected a fairly sharp decline in Euro-dollar borrowings. Euro-dollar liabilities also decreased slightly further during the early part of August, and then dropped sharply when Euro-dollar interest rates increased sharply in reaction to the President's new economic program.

Bank credit. Commercial bank credit (end of month series) increased during July at a pace somewhat slower than in June but about in line with the rate of advance during the second quarter. The slowdown was attributable to a sharp drop in holdings of U.S. Treasury securities. In part, this appears to reflect the liquidation of securities acquired in the Treasury's late June financing operation. In addition, the volume of new securities issued by the Treasury over the month was well below the customary volume for July. Bank acquisitions of other securities on the other hand rebounded from the weak June increase to about the pace set earlier in the second quarter. The July increase in other securities was concentrated in municipal issues with growth at smaller commercial banks appearing particularly strong.

COMMERCIAL BANK CREDIT ADJUSTED FOR LOANS
SOLD TO AFFILIATES 1/
(Seasonally adjusted percentage changes, at annual rates)

	1970	1971				
	2nd Half	1st Half	Q I	Q II	June	July
Total loans & investments 2/	11.4	10.0	12.2	7.4	10.8	7.6
U.S. Treasury securities	16.3	15.7	19.8	11.1	57.8	-20.9
Other securities	29.3	22.3	27.9	15.7	8.9	18.7
Total loans	5.6	5.2	6.3	4.2	2.0	10.0
Business loans 3/	-1.6	1.8	1.4	2.5	-10.5	11.7
Real estate loans	4.8	9.4	8.3	10.3	14.4	12.8

1/ Last Wednesday of month series. Data for 1971 are preliminary.
2/ Includes outstanding amounts of loans reported sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
3/ Includes outstanding amounts of business loans reported sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

Note: Annual rates have been revised slightly in accordance with a revision in total loans and business loans sold to affiliates beginning in July 1969.

Total loans increased very sharply in July, expanding at a rate well above that recorded in June and during the second quarter as a whole. The increase reflected large increases in only two major loan categories, real estate loans and business loans; and, as discussed below, the business loan increase appears attributable to a temporary spurt in this series. The strong expansion in real estate loans extends a sharp uptrend that started late last year. As they did earlier in the year, banks in the San Francisco District accounted for a major share of the July increase in real estate loans, which is consistent with the exceptionally strong construction activity in that area.

Our statistics indicate a rise in business loans at a seasonally adjusted annual rate in excess of 10 per cent in July. This increase, which essentially offsets the sharp drop in these loans in June, does not appear to signal a resurgence in business loan demands but rather to reflect a combination of irregular and seasonal factors. Recent discussions that Reserve Bank staffs have had with commercial banks across the country generally lend support to this interpretation of the July developments. Moreover, there are no obvious factors suggesting that loan demands are strengthening. Indeed, business demands for short-term credit are being moderated by the improved flow of internally generated funds and by continued modest accumulations of inventories. The absence of significant business credit demands would appear to explain the reluctance of money market banks to go along immediately with the further hike in the prime rate instituted by a medium-sized Detroit Bank, and with market rates down sharply in reaction to the President's economic plan, a general prime rate advance now seems unlikely.

Nonbank depositary intermediaries. Deposit inflows during July apparently were much better maintained at the nonbank thrift institutions than at commercial banks. On a seasonally unadjusted basis, both major types of nonbank intermediaries received record inflows. After seasonal adjustment, however, they showed a divergent pattern from recent months, with only the savings and loan associations actually increasing their pace of inflows.

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
QII p/	14.8	18.4	17.2
1970 - 2nd half	8.8	11.5	10.6
1971 - 1st Half p/	16.6	22.8	20.7
April*	19.0	23.1	21.8
May*	12.4	15.1	14.2
June*p/	12.4	16.1	14.9
July*p/	9.3	19.5	16.1

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

The further moderation in the rate of deposit inflows during July to mutual savings banks may reflect a somewhat isolated experience of the New York City institutions, which were subject to special competition from a New York City bond issue that offered a particularly attractive yield and carried exemption from income taxes at all three levels of government for City residents. Savings banks elsewhere, such as in Massachusetts, apparently had inflows that were more consistent with the larger earlier growth patterns. At the New York City savings banks, there appears to have been no further pressure on deposit inflows during the first week of August; although the large margin of inflows this year over previous years had begun to narrow during July, it nevertheless continued at a rate suggesting that inflows have not fallen further.

NET DEPOSIT FLOWS AT 17 LARGEST NEW YORK MUTUAL SAVINGS BANKS
FIRST FIVE BUSINESS DAYS OF THE MONTH
(Seasonally unadjusted, in millions of $)

	May*	June*	July	August
1968	26	40	-17	20
1969	16	40	-108	-6
1970	18	26	-28	2
1971	69	62	-14	15

* Figures for May and June are based on data from 16 largest New York Mutual savings banks.

During May and June, savings and loan associations continued to have cash flows agumented not only by their large net savings inflows but also by a substantial volume of mortgage repayments arising largely from the increases in refinancings, as shown in the following table. The large net repayment of borrowed funds shown in the table reflects primarily activity during May related to the FHLBB's then-ending one-year subsidized rate advances program. Since then, there have been only minimal changes in FHLB advances and in S&L liquid asset acquisitions.

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

	May and June of				
	1967	1968	1969	1970	1971
Sources					
Deposit accounts, net 1/	3.0	2.3	1.9	2.5	5.1
Borrowed funds	-.5	.4	.7	.4	-.7
Subtotal	2.5	2.7	2.6	2.9	4.4
Gross mortgage repayments 2/	2.6	2.5	2.6	2.4	4.2
Other sources, net 3/	-.5	-.7	-.5	-.3	.3
Total	4.6	4.5	4.7	5.0	8.9
Uses					
Net increase in liquid assets 4/	.4	.2	-.2	.8	--
Gross mortgage acquisitions	4.2	4.3	4.9	4.2	8.9
Total	4.6	4.5	4.7	5.0	8.9
Memoranda					
Mortgage refinancing	.4	.3	.3	.3	.9
Average ratio of outstanding Mortgage commitments to recent cash flow 5/	.77	.95	1.08	.95	.98

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 the sum of May and June loan commitments held and loans in process by the sum of total sources in each of the previous three month periods.

Mortgage market. Although savings inflows to nonbank thrift institutions remained large during July, average returns to lenders on new home-mortgage loans rose somewhat further in the primary as well as the secondary market. In both cases, yields approached the 8 per cent usury ceilings still prevailing in 11 States and the District of Columbia, chiefly for conventional mortgages.1/ Relative to new issues of high-grade corporate bonds, rates on mortgages improved slightly in July but nevertheless continued quite unfavorable. No data are yet available for August, either before or after the Presidential message.

AVERAGE RATES AND YIELDS ON NEW-HOME MORTGAGES

	Primary market: Conventional loans		Secondary market: FHA-insured loans		
	Level (per cent)	Yield spread (basis points)	Level (per cent)	Yield spread (basis points)	Discount (points)
1970					
Low	8.30 (Dec.)	-56(June)	8.40	1 (May)	3.1 (Nov.)
High	8.60 (July,-Aug.)	50(Dec.)	9.29	99 (Feb.)	6.0 (Feb.)
1971					
January	7.95	71	7.80e	56e	2.5e
February	7.75	47	7.55e	27e	4.5e
March	7.60	14	7.32	-14	2.7
April	7.55	-2	7.37	-20	3.1
May	7.65	-36	7.75	-36	6.1
June	7.70	-20	7.89	- 1	7.2
July	7.80	-16	7.97	1	7.8

Note: FHA series; interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points. On FHA loans carrying the 7 per cent ceiling rate in effect since mid-Februry 1971, a change of 1.0 points in discount is associated with a change of 12 to 14 basis points in yield. Gross yield spread is average mortgage return, before deducting servicing costs, minus average yield on new issue of high grade corporate bonds with 5-year call protection.

e/ Estimated.

1/ A staff tabulation compiled from FRBank replies indicates that 3 additional States had usury ceilings below 8 per cent in August.

On Government-underwritten mortgages bearing the 7 per cent ceiling rate, average discounts reached as high as 7.8 points in July, reinforcing trade expectations that an upward ceiling adjustment would be forthcoming. Instead, the President authorized GNMA to subsidize a portion of the discount points charged on certain mortgages underwritten after August 6 by FHA and VA under their regular non-subsidized programs.[2/] Pending issuance of GNMA's regulation and testing of the ne program, FNMA suspended its periodic auction of forward purchase commitments until August 25.

In the conventional home mortgage sector, the FHLBBoard's subsidized Housing Opportunity Allowance Program (HOAP) has remained quite modest in scope.[3/] In a period of strong savings inflows, S&Ls have generally been reluctant to borrow from the FHLBanks in order to finance these special higher-risk loans. Although activity has nearly doubled since regulations were liberalized in June, by early August--5 months after the program had been initiated--fewer than 2,000 loans had been closed or committed out of some 50,000 potentially available.

2/ The announcement made on August 7 indicated that GNMA will follow the same general procedure already in use under its Tandem Plans, which hitherto have applied solely to FHA's special Sec. 235 and Sec. 236 programs for low-income borrowers. Under the new subsidy plan, GNMA will ;urchase existing-home loans at a price of 95 per cent of par, and new-home loans and apartment-house loans at 96. It will resell the mortgages to FNMA, FHLMC, or other private investors at the prevailing market price. GNMA will absorb any resulting capital loss as part of its special assistance function. To be eligible, loans cannot exceed $22,000 on dwellings with 3 or fewer bedrooms, or $24,500 on units with 4 or more bedrooms. There is no upper limit on borrower incomes.

3/ FHLBanks under the HOAP program provide subsidized advances to member institutions that lend to eligible low- and middle-income homebuyers, often on unusually low downpayment loans. Current regulations authorize an interest rate writedown on each mortgage of $20 per month for the first 5 years the loan remains outstanding; the nominal interest rate on the loan cannot be more than 150 basis points above the cost of the FHLBank advance. On an 8 per cent 25-year $20,000 mortgage, a reduction in interest of $20 monthly for 5 years, totaling $1,200 is roughly equivalent to reducing the borrower's interest cost to 6-3/4 per cent during this period.

Corporate and municipal securities markets. Yields on new Aaa-rated corporate bond issues remained near 8.00 per cent from mid-July to mid-August. Even though the volume of new corporate bonds, both recent and prospective, remained appreciably less than earlier in the year, on the whole institutional investors bought selectively. The upturn in money market rates, rumors of further rises in the prime and discount rates, evidence of continued inflation, and disturbances in international currency markets apparently revived expectations of further increases in yields. Municipal bond rates fluctuated in a narrow range, and at mid-August were unchanged from the mid-July level.

After the Presidential message on August 15, a substantial rally developed, bringing long-term corporate bond yields down 70 basis points by Tuesday, August 17. The quick sellout of Aaa telephone issue on Tuesday at 7.40 per cent is indicative of the surge of optimism in the long-term markets. Yields on tax-exempt bonds fell about 35 to 40 basis points in the two days following the President's announcement.

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 (6/9)	7.12 (5/28)
1971		
Low	6.76 (1/29)	5.00 (3/18)
High	8.23 (5/21)	6.23 (6/24)
Week of:		
July 16	7.82	6.03
23	7.90	5.97
30	8.07	6.05
August 6	8.02	6.07
13	7.97	6.03

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

In reaction to the President's statement on August 15, the stock price indices increased 3 to 5 per cent by August 17, with a record two-day average daily NYSE trading volume of 29 million shares. This rise erased virtually all of the downward drift in stock prices that had occurred since mid-July. Trading volume over this same period had been relatively low averaging, for example, about 12 million shares daily on the NYSE.

STOCK PRICE INDICES

	May 1970 low	August 13, 1971 (Friday before Announcement	August 17, 1971	Per cent Change from May 1970 low to August 17, 1971	Per cent Change from August 13, 1971 to August 17, 1971
NYSE	37.69	52.88	55.27	46.6	4.5
AMEX	19.36	24.59	25.29	30.6	2.8
NASDAQ	n.a.	105.44	108.83	n.a.	3.3

Publicly-offered corporate bonds in July are estimated to have totaled $1.2 billion, the lowest level in the last 16 months. A number of firms deferred issues in the latter half of July when corporate rates began to rise, which accounts for most of the shortfall from earlier estimates. It is too early yet to assess the impact of recent events on the corporate calendar. Prior to the announcement of the new economic policies, the staff had estimated that August and September volume would remain close to $1.5 billion per month, with the third quarter volume thus expected to aggregate ultimately about one-third less than the preceding quarter. In part, the lower level of bond issues reflects the usual summer lull in new issue activity. Much more important, however, is the considerable slowdown in offerings by industrial firms in July and those expected over the near term. Underwriters continue to report a sizable decline in the prospective number of such offerings.

Despite the drop off in public bond issues, total corporate security offerings are expected to remain quite large. New equity offerings remain at a high level, and it appears that the monthly average of stock issues during the third quarter will be about $850 million, exclusive of the large AT&T issue. Revised data indicate that takedowns of private placements in the second quarter were even larger than originally estimated, and this higher rate of activity is expected to continue in the third quarter. Total corporate security offerings in August and September, therefore, are still expected to be around $3 billion.

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

	Bonds			
	Public	Private	Stocks	Total
1970 - Year	2,099	403	713	3,245
First half	1,929	424	721	3,074
1971 - First half	2,486	546	948	3,980
- Q I	2,790	505	769	4,063
- Q II	2,182	586	1,128	3,896
- Q III e/	1,367	567	1,300	3,233
July e/	1,200	500	2,2001/	3,900
August e/	1,400	500	900	2,800
September e/2/	1,500	700	800	3,000

3/ Estimated.
1/ Including $1,375 billion of AT&T preferred stock.
2/ Estimates were made prior to the Presidential message of August 15.

Long-term debt offerings by State and local governments appear to be tapering slightly over the third quarter. July volume was $1.9 billion, and it is now estimated that August will reach $1.8 billion, since two large issues which had been postponed several times finally were marketed successfully. Banks continue to support the market in the short- to intermedaite-term maturity range, and acquisitions by casualty insurance companies in the long-term area have picked up again. These insurance companies have had a favorable loss experience this year and find tax-exempt income still quite attractive. Before the events of recent days the staff had estimated September volume at $1.8 billion. Anticipated bond sales for the third quarter of 1971 will be analyzed in a Greenbook Supplement, based on the FRB-Census Survey of State and Local Long-Term Bond Anticipations and Realizations.

In June and July State and local governments apparently paid down short-term debt on a net basis for the first time in over a year. Gross short-term sales fell off sharply in July, but the August figure will be boosted by a large offering in New York City notes.

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

	Long-term	Net Short-term 1/
1970 - Year	1,515	393
First half	1,306	297
1971 - First half	2,123	478
Q I	2,230	536
Q II	2,016	420
Q III e/	1,833	n.a.
July e/	1,900	-319
August e/	1,800	n.a.
September e 2/	1,800	n.a.

1/ Estimated by Federal Reserve.

2/ Estimate was made prior to the Presidential message of August 15.

Corporate profits in manufacturing. Available information on manufacturing profits in the second quarter suggests that the preliminary estimate of aggregate corporate profits in that quarter, which will become available at the end of this week, will show only a modest rise from the first quarter level. Profits in the important manufacturing sector appear to have increased very little from the first quarter, after rough allowance for seasonal fluctuation, and profits per dollar of sales apparently remained at the first quarter level.

To a considerable extent, this sluggish first-to-second quarter performance in manufacturing reflects developments in the motor vehicle industry. Profits in this industry, which normally rise substantially in the second quarter, remained this year at their first quatter level--which in turn had been swollen by resumption of operations at General Motors. On a year-over-year basis, total manufacturing profits were about 5 per cent larger than in the second quarter of 1970 (3-1/2 per cent excluding autos). This rise, though modest, represents the first year-to-year increase since the third quarter of 1969.

Government securities market. The Government securities market responded strongly to the President's announcement of his program of domestic and international measures. In the note and bond market, price gains of 2-1/2 to 3 full points reduced yields by 20 to 60 basis points from their August 13 levels; and in the bill market rates dropped by around 30 to 60 basis points for most issues. The key 3-month issue, for example, declined to 4.77 per cent on Tuesday, August 17, from 5.15 per cent on the Friday prior to the President's weekend announcement, and 5.46 per cent at the time of the July Committee meeting.

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

	1971		Weekly average for week ending			
	Daily highs 1/	Daily lows 1/	July 27	Aug. 3	Aug. 10	Aug. 17
Bills						
1-month	5.33 (7/19)	2.07 (3/12)	5.21	5.21	5.21	5.06
3-month	5.53 (7/19)	3.22 (3/11)	5.43	5.32	5.32	5.04
6-month	5.84 (7/27)	3.35 (3/11)	5.76	5.71	5.72	5.39
1-year	6.01 (7/28)	3.45 (3/11)	5.79	5.92	5.94	5.69
Coupons						
3-year	6.91 (7/28)	4.27 (3/22)	6.83	6.86	6.86	6.45
5-year	7.03 (8/10)	4.74 (3/22)	6.95	6.99	7.00	6.65
7-year	7.11 (8/10)	5.15 (3/23)	6.99	7.04	7.08	6.77
10-year	6.95 (8/28)	5.38 (3/23)	6.82	6.89	6.88	6.61
20-year	6.56 (6/15)	5.69 (3/23)	6.42	6.44	6.45	6.27
Agencies						
6-month	6.20 (7/23)	3.67 (3/16)	6.15	6.14	6.11	5.92
1-year	6.56 (7/28)	3.93 (3/16)	6.52	6.52	6.52	6.33
3-year	7.33 (8/12)	4.70 (3/24)	7.20	7.28	7.31	7.14
5-year	7.45 (8/13)	5.12 (3/23)	7.34	7.43	7.43	7.31

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

For most of the period since the last Committee meeting, yields on Treauury coupon-bearing issues drifted higher as continued sluggishness in the economy and evidence of some tightening of monetary policy offset whatever optimism aas generated by the relatively successful outcome of the Treasury's August financing operation. Even before the President's statement, however, investor interest in coupon issues seemed to pick up; and with buying by foreign official accounts and System purchases of $109 million, the market improved somewhat and yields tended to move slightly lower.

In the Treasury refunding operation $2.7 billion of the $4.1 billion of publicly-held maturing issues were exchanged--an attrition of 35 per cent--with $251 million of that amount representing exchanges into the 7 per cent, 10-year bond. In addition, $192 million of the 10-year bonds were subscribed to by individuals in small amounts for cash. On August 4, the Treasury auctioned $2.5 billion of 18-month notes at a 6.54 per cent average yield on the 6-1/2 per cent coupon. These notes covered the attrition in the regular refunding and raised about $1.1 billion of new cash.

In the bill market, rates drifted gradually lower following the last Committee meeting, with rate declines becoming increasingly marked even before the President's message as continued large foreign official orders depleted dealers' holdings. Because of these demands and the fact that dealers were often able to sell out their weekly auction awards before having to pay for them, the generally higher level of day-to-day financing costs accompanying the higher level of the Federal funds rate had little dampening effect on the market.

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

	July Daily average	July 26	Aug. 2	Aug. 9	Aug. 16
Treasury securities					
Total	3,008	2,435	2,284	2,604	2,497
Treasury bills (total)	2,567	1,942	1,914	1,950	1,851
Due in 92 days or less	944	763	1,194	1,254	992
93 days or over	1,623	1,179	720	696	858
Treasury notes and bonds (total)	441	492	370	654	647
Due within 1-year	450	788	296	254	189
1-5 years	-23	-254	-15	339	376
Over 5 years	14	- 43	89	61	81
Agency securities					
Total	772	675	734	566	618
Due within 1-year	396	368	414	315	284
Over 1-year	377	307	320	250	334

New issue activity in the Federal agency market has been very light with the only new issues being a $500 million, 2-year 4-month issue by FNMA, offered to replace a $513 million maturing issue and priced to yield 7.15 per cent, and two $250 million issues by FHLB, one a 2-1/2 year maturity yielding 7.10 per cent and the other a 4-1/2 year maturity priced to yield 7-3/8 per cent; these issues were to replace a $650 million maturing issue. In the market for outstanding agency securities, yield changes have paralleled those in the market for direct Treasury obligations.

<u>Other short-term credit markets</u>. Preliminary estimates indicate that seasonally adjusted commercial and finance company paper outstanding declined in July by around $270 million to a level of $29.7 billion. The decrease was entirely accounted for by a seasonally adjusted decline of about $300 million in finance company paper. On an unadjusted basis, finance company paper outstanding rose almost $800 million, largely reflecting an increase in automobile companies' paper outstanding related to an incentive "sale" sponsored by General Motors. However, the total increase was still less than the normal seasonal, resulting in a decline on an adjusted basis.

Interest rates in private credit markets remained relatively stable for the most part through July and into August prior to the President's speech, with gains outside of longer maturities generally amounting to about 12 basis points. There were only minor adjustments in these rates immediately following the President's statement, with scattered declines of 1/8 to 1/4 in bank CD offering rates and of about 1/8 on 3-month commercial paper. It is generally expected, however, that these declines will become more widespread in the near future as market participants continue to assess the impact of the President's program.

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

	1970		1971			Net Change
	High	Lows	July 14	July 28	Aug. 11	July 14-Aug. 11
1-month						
Commercial paper	9.25	5.50	5.63	5.63	5.75	+.12
Finance paper	9.00	5.00	5.38	5.38	5.50	+.12
Bankers' acceptances	9.00	5.50	5.75	5.88	5.75	--
Certificates of Deposit--new issue 1/	7.75	5.00	5.38	5.50	5.50	+.12
Treasury bill	7.84	4.58	5.19	5.27	5.17	-.02
3-month						
Commercial paper	9.25	6.00	6.00	6.00	6.00	--
Finance paper	8.25	5.50	5.50	5.50	5.50	--
Bankers' acceptances	9.00	5.50	5.88	6.00	5.88	--
Certificates of Deposit--new issue 1/	6.75	5.50	5.63	5.75	5.75	+.12
Treasury bill	7.93	4.74	5.35	5.43	5.22	-.13
6-month						
Bankers' acceptances	9.00	5.50	6.00	6.13	6.00	--
Treasury bill	7.99	4.78	5.46	5.83	5.67	+.21
12-month						
Certificates of Deposit--new issue 1/	7.50	5.50	6.00	6.00	6.25	+.25
Treasury bill	7.62	4.74	5.56	6.01	5.91	+.35
Prime municipal notes	5.80	2.95	3.45	3.50	3.60	+.15

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)

	May	June	July 4/
Total commercial and finance paper 1/	30,730	30,013	29,746e
Bank related 2/	1,748	1,733	1,808p
Nonbank related 3/	28,982	28,280	27,938e
Placed through dealers	12,422	11,877	11,548e
Placed directly	16,560	16,703	16,390e
		Net Change	
Total commercial and finance paper 1/	-433	-717	-267
Bank related 2/	- 46	- 15	+ 75
Nonbank related 3/	-387	-702	-342
Placed through dealers	- 26	-845	- 29
Placed directly	-361	+143	-313

1/ Combines seasonally adjusted nonbank-related paper and seasonally unadjusted bank-related paper.
2/ Seasonally unadjusted.
3/ Seasonally adjusted.
4/ Based on data for the week ending July 28, 1971.
e/ -- Estimated. p/ -- preliminary

Federal finance. Rough estimates of the initial effects on the fiscal 1972 budget (without allowing for feedback through impact on the economy) of the President's proposed fiscal actions are listed below .

PRELIMINARY ESTIMATE OF INITIAL EFFECT ON UNIFIED BUDGET
OF FISCAL AND OTHER MEASURES PROPOSED BY
THE PRESIDENT ON AUGUST 15th
(Billions of dollars)

	Fiscal Year 1972 1/	
	Effect on Administration estimates 2/	Effect on staff estimates
Total effect on revenues	- 4.2	- 5.6
10 per cent investment tax credit 3/	- 3.0	- 3.0
Repeal of auto excise tax 3/	- 2.3	- 2.3
10 per cent import surcharge 4/	+ 2.1	+ .9 4/
Personal tax exemption 5/	- 1.0	- 1.0
Standard deduction 5/	- 1.0	- .2
Total effect on outlays	- 4.7	- 3.4
Postponement of general revenue sharing (3 mos.)	- 1.3	--
Postponement of welfare reform (1 yr.)	- .5	- .5
Postponement of Federal pay raise (6 mos.)	- 1.1	- 1.1
Other effects of wage freeze to Jan. 1972 6/	n.a.	- .7
5 per cent reduction in Federal employment	n.a.	- .8
10 per cent reduction in foreign aid	- .3	- .3
Other	n.a.	--

1/ Initial impact, i.e. excludes feedback effects.
2/ As reported in the press.
3/ Assumed to be effective immediately.
4/ Administration figure is for full fiscal year. Staff assumes tax to be effective for less than six months.
5/ Reductions previously scheduled for January 1973 advanced to January 1972.
6/ Assumes postponement to January 1972 of military and postal pay increases previously scheduled for the fourth quarter.

The package of requests for tax cuts--all of which require Congressional approval--are estimated to reduce fiscal year revenue by $6.5 billion. However, some $1 to $2 billion of this may be offset by receipts anticipated from the imposition of the 10 per cent import surcharge, on which no Congressional approval is required. The actual size of the offset will depend upon the duration of the surcharge and the extent to which it curtails the quantity of imports. Similarly, some of the estimated effects of the tax actions may be considered tentative especially the investment tax credit, since the likely timing of business response to this latter action are rather conjectural.

On the expenditure side, the Presidential proposal to postpone general revenue sharing and welfare reform will not greatly affect staff projections for fiscal 1972. Since Congress is still far from completing action on the general revenue sharing and welfare reform recommendations made by the Administration last February, staff projections had already assumed that these measures would not be enacted in time to affect outlays in fiscal 1972 (except for a $.5 billion start-up cost for welfare reform).

The President's other proposals for expenditure reductions do affect staff projections, although the announced wage-price freeze raises some unresolved questions. It is not clear, for example, whether the wage freeze applies to the $2 billion military pay raise which the staff had previously assumed would be effective in October 1971; the present staff projection assumes that this item is postponed until January 1972. Similarly, if the wage freeze is extended beyond the 90-day period it could further effect other budget items such as scheduled postal pay increases and increases in social security benefits, now assumed by the staff to be effective on January 1972. Finally, the expenditure effect of the 5 per cent reduction in the Federal work force is difficult to quantify without some clear basis for measuring the likely timing of attrition.

Staff estimates suggest that the President's recommended actions might add as much as $2.0 billion to our previous Greenbook estimate of the deficit for fiscal 1972. In addition, other changes in the staff's estimates prior to the President's announcement already suggested a deepening of the deficit relative to earlier estimates. A thorough staff review of effective income tax rates--made possible by the Commerce Department's recent revision of the national income and product accounts--had resulted in a $3.0 billion downward revision of expected fiscal year tax receipts, while on the expenditure side, new crop forecasts have resulted in an $800 million upward revision of estimated outlays for agricultural price supports. Finally, the GNMA plan to pay excess discounts on FHA and VA mortgages is estimated to swell outlays by another $400 million.

As estimates of the impact of the President's program on total activity and income are not yet available, no comprehensive new forecast of fiscal year budget totals has been made. However, taking account of the expected initial effects of the President's program, the revised effective tax rates, and the added outlays for farm price supports and housing finance raises the anticipated fiscal year deficit to about $30 billion, a more than $6 billion increase over the previous Greenbook.

Heavy recent cash inflows provided by foreign central bank purchases of special Government securities have provided unexpected support to the Treasury cash balance since the last Committee meeting. Largely as a result of these inflows, the balance is now expected to be around $7 billion at the end of August, nearly $3.0 billion above the level projected in the last Greenbook. Assuming no large abrupt reversal of foreign cash flows, the high end-of-August balance would seem to obviate the previously anticipated need for new money in early September. Even the need for financing in October might be reduced somewhat relative to earlier estimates--although assumptions on the net position of foreign special issues are more difficult to make the further one looks into the future.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

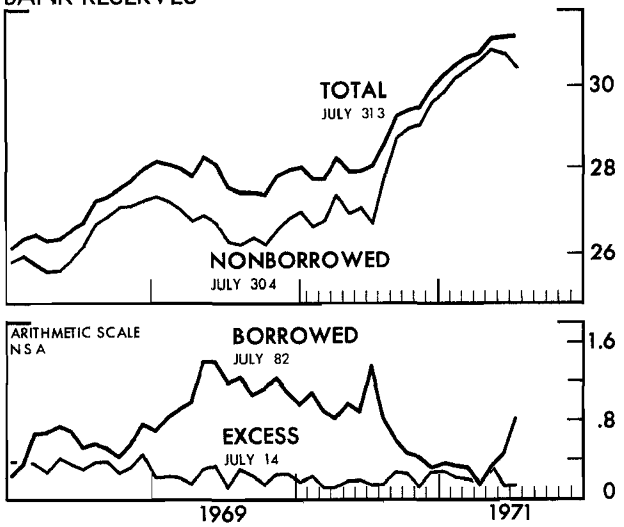
	July	Aug.	Sept.
Total net borrowing	4.3	4.1	-1.8
Weekly and monthly bills	.5	.6	.6
Tax bills	1.8	--	-1.8
Coupon issues	--	2.7	--
As yet unspecified new borrowing	--	--	--
Other (debt repayments, etc.)	2.0	.8	-.6
Plus: Other net financial sources[a/]	.8	--	1.1
Plus: Budget surplus or deficit (-)	-6.7	-4.1	.1
Equals: Change in cash balance	-1.6[b/]	--	-.6
Memoranda: Level of cash balance, end of period	7.2[b/]	7.2	6.6
Derivation of budget surplus or deficit:			
Budget receipts	13.3	15.6	19.5
Budget outlays	20.0	19.7	19.4
Maturing coupon issues held by public	--	4.1	--
Net agency borrowing	.6	.3	.4

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

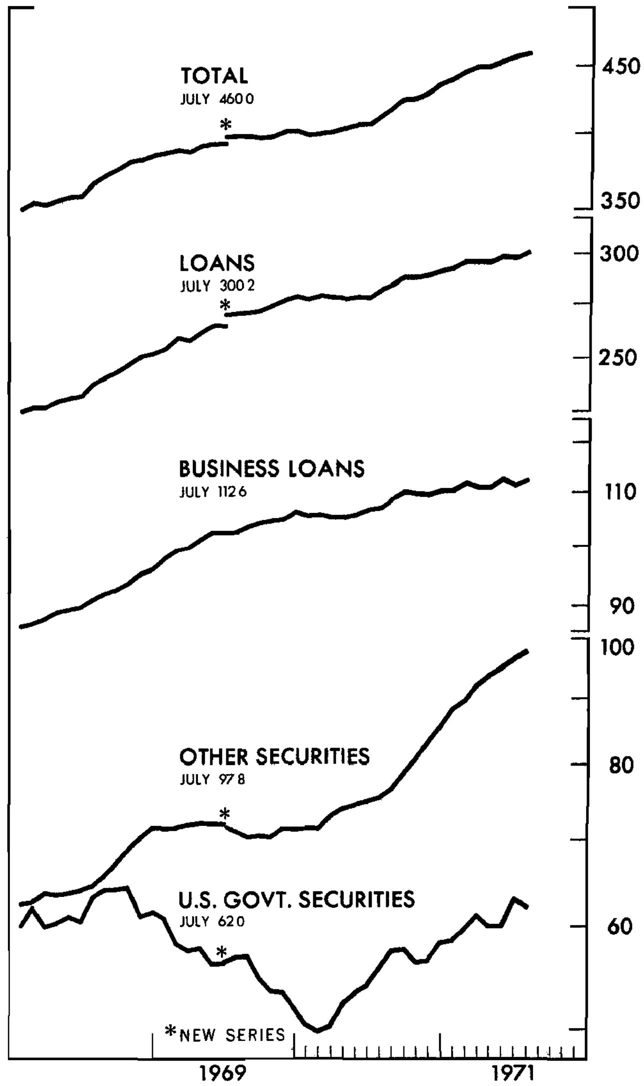
FINANCIAL DEVELOPMENTS - UNITED STATES

BILLIONS OF DOLLARS, SEASONALLY ADJUSTED, RATIO SCALE

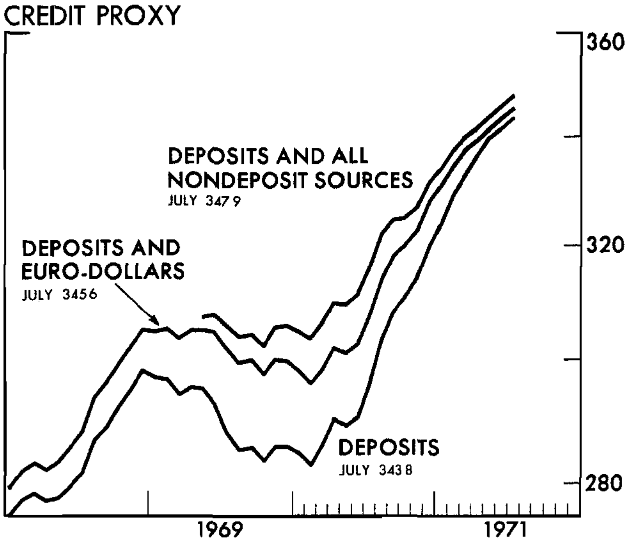
BANK RESERVES



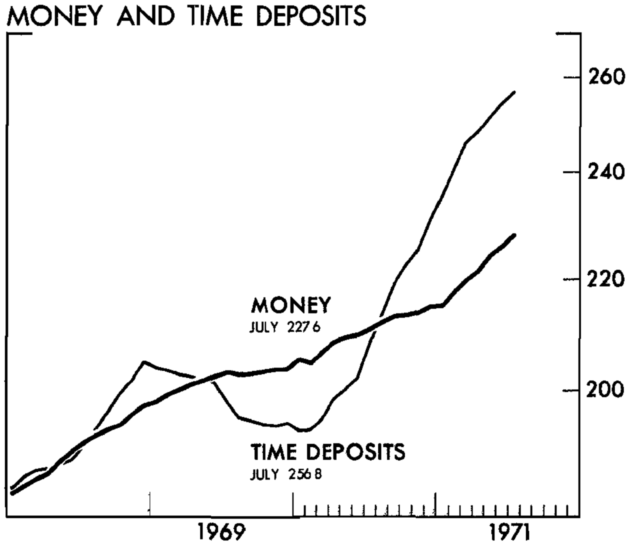
BANK CREDIT



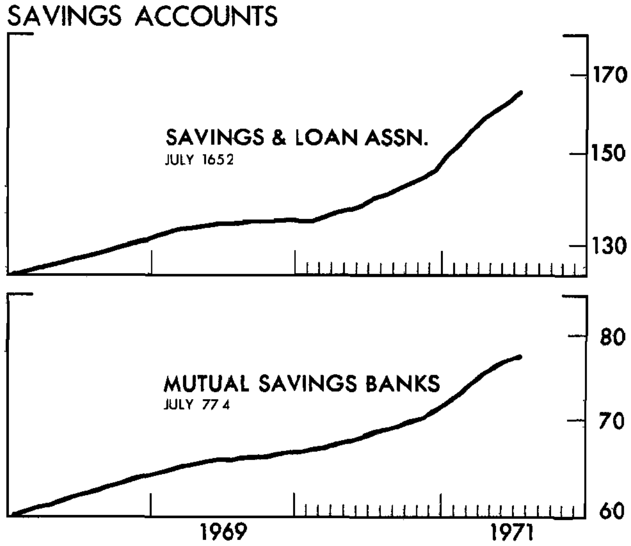
CREDIT PROXY



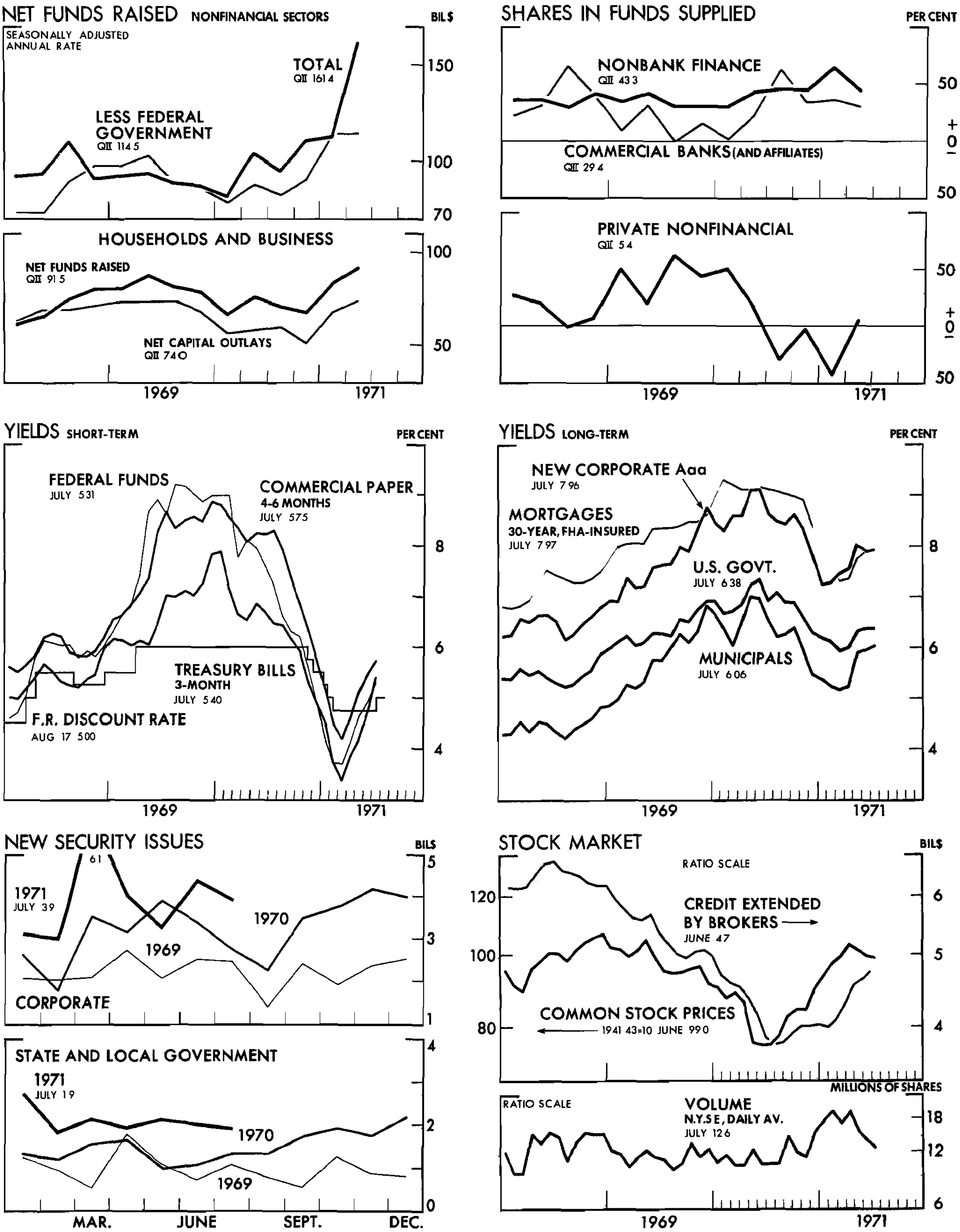
MONEY AND TIME DEPOSITS



SAVINGS ACCOUNTS



FINANCIAL DEVELOPMENTS - UNITED STATES



THE ECONOMIC PICTURE IN DETAIL

International Developments

Foreign exchange markets. All major European exchange markets have been officially closed since the President announced the suspension of gold convertibility of the dollar on August 15. Commercial banks are allowed to deal in these markets, except for London, but the central banks have not operated in the markets. Because of the great uncertainty over what will happen when the markets officially re-open, trading volume has been extremely light, with very wide bid-offer spreads and individual transactions occurring only in small amounts.

Major European currencies have all firmed against the dollar. As of mid-morning in New York on August 18, spot exchange rates, expressed as a per cent over par, were as follows:

Sterling	2.6
DM	8.3
Swiss franc	2.6
Guilder	5.4
French franc	1.8
Belgian franc	4.0
Lira	3.3

The Japanese exchange market has remained open, and the Bank of Japan purchased $1.6 billion in the three days August 16-18. However, the BOJ's intake fell sharply on August 18, reportedly reflecting the fact that Japanese banks had by that date generally worked off their long-positions in dollars, and are constrained by exchange controls from making further large-scale conversions of dollars.

European markets are expected to be closed the rest of this week, pending decisions by the various central banks, either jointly or severally, on whether to revalue, float, or return to existing parities, with or without increased exchange controls. In particular, the EEC countries (perhaps in conjunction with Britain) are faced with a decision on internal exchange rate relationships as well as their joint-relationship with the dollar.

Major European gold markets were closed all day Monday and Tuesday morning, but re-opened Tuesday afternoon. After opening at around \$43.50-\$44.00, prices eased to closing levels of about \$43.00 down almost \$1 from the highs of the previous week.

In the first two weeks of August, during the height of the speculative attack on the dollar, major foreign central banks purchased some \$4.5 billion, \$2 billion of which was accounted for on two days, August 12 and 13, alone. Switzerland was the major reserve gainer (see table), despite the fact that the Swiss franc had been revalued by 7 per cent only three months previously. The reserve gains were very widespread, however, indicating a general unwillingness of the market to hold dollars rather than speculation on revaluation of any particular currency.

Changes in International Reserves
of Major Foreign Industrial Nations, 1971 1/
(millions of dollars)

	IQ	IIQ	July	Aug. 1-13	Year to Aug. 13
Germany	2,095	799	403	-299	2,998
Italy	563	20	27	145	755
Netherlands	230	-47	-20	--	163
France	325	591	634	898	2,448
Belgium	154	113	97	212	576
United Kingdom	1,833	326	254	802	3,215
Canada	54	8	71	39	172
Japan	803	1,992	320	690	3,805
Switzerland	-489	560	-604	2,041	1,508
Total	5,568	4,362	1,182	4,528	15,640

1/ Changes in official reserve assets net of official liabilities through the end of July, 1971, excluding SDR allocations. Data for August 1-13 are reported central bank purchases of dollars in the foreign exchange markets.

The dollar had come under increased selling pressure in late July, with news of the weakening U.S. trade balance, signs of accelerated inflation in the U.S., press reports of the Administration's attack on the independence of the Federal Reserve, publication of Morgan Guaranty's estimates of the second quarter U.S. payments deficit, and rumors of the closing of the gold window. Tightening of French exchange controls in early August, resulting in a sort of two-tier franc exchange rate, plus the later emergence of a dual rate in Switzerland, further intensified the growing reluctance of market participants to hold dollar balances. Late in the afternoon of Friday, August 6, the U.S. announced its Fund drawing of $862 million equivalent in Belgian francs and Dutch guilders plus the sale of $191 million in gold to France. That same afternoon the Reuss subcommittee report was issued, recommending the closing of the gold window and the devaluation of the dollar. Massive dollar sales ensued when European exchange markets opened the following Monday. Rumors of the imminent withdrawal of the Swiss National Bank from the exchange market and a closing of the gold window by the U.S. were widely circulated late in the week, and, as mentioned above, major foreign central banks had to absorb some $2 billion dollars on Thursday and Friday of that week. The following Sunday the gold window was closed and European exchange markets failed to open on Monday.

In announcing his historic decision to suspend the convertibility of dollars into gold, the President also instructed the System to make no further drawings on the reciprocal swap facilities with foreign central banks. System swap commitments now amount to a record $3,045 million, following drawings of $1-1/4 billion in Swiss francs, $3/4 billion in sterling and $220 million in Belgian francs during the period immediately prior to the President's decision.

Euro-dollar market. Conditions in the Euro-dollar market have been dominated by foreign exchange market developments since near the end of July. The continuous decline in Euro-dollar rates from their early June levels was reversed early in the last week of July as a result of increasing exchange market uncertainties, a large amount of dollar deliveries to the Bundesbank on maturing forward contracts, and month-end positioning of European commercial banks.

The first two weeks in August were marked by increasing nervousness in exchange markets and Euro-dollar rates rose as market participants attempted to liquidate dollar claims and acquire dollar liabilities for conversion into other currencies.

Following the President's announcement on August 15, the Euro-dollar market remained open but rates, particularly on shorter maturities, were extremely high and volatile. At one point on Monday overnight deposits were bid at 40 per cent, before moderating to 22 per cent by the end of the day. Rates moderated on Tuesday and Wednesday but remained quite high relative to rates in recent weeks. The very high levels of Euro-dollar rates early this week were in part the result borrowings from the market to deliver on foreign exchange contracts made prior to the weekend. According to market sources, another important source of demand for dollar borrowings was from Japanese commercial banks. These banks reportedly had net uncovered positions in dollars as of Monday and borrowed Euro-dollars (converting the dollars obtained from these borrowings into yen with the bank of Japan) in order to balance their positions.

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) Differ-ential	(4) 3-month Euro-$ Deposit 1/	(5) 60-89 day CD rate (Adj.) 3/	(6) (4)-(5) Differ-ential
1971						
Jan.-Mar.	4.68	3.87	0.81	5.52	4.41	1.11
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	4.89	4.91	0.02	7.15	5.47	1.68
July	5.39	5.28	0.11	6.47	5.81	0.66
July 14	5.25	5.13	0.12	6.41	5 79	0.62
21	5.43[r]	5.46[r]	-0.03[r]	6.41	5.79	0.62
28	5.86	5.38	0.48	6.45	5.88	0.57
Aug. 4	11.54	5.57	5.97	6.84	5.92	0.92
11	5.82	5.59	0.23	7.43	5.92	1.51
18	10.42	5.63	4.79	8.47	5.92	2.55

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 rates are adjusted for the cost of required reserves.
p/ Preliminary.

In the computation period ended August 4 net liabilities of U.S. banks to their foreign branches are estimated to have averaged about $300 million less than in the previous four-week period. This decline may have largely reflected advances in the overnight Euro-dollar rate relative to the Federal funds rate in this period, which eliminated the cost differential favorable to borrowing overnight Euro-dollars prevailing in the previous computation period.

From August 4 to Wednesday, August 11, gross liabilities to branches declined by \$0.8 billion to a level of only \$1.1 billion, reflecting the increasing disadvantage of Euro-dollars relative to domestic sources of funds to U.S. banks. The Treasury has indicated that it will not refund the \$500 million Euro-dollar C/I issue that matures on August 24. The primary reason for the decision was the high cost of Euro-dollars, which was about 10 per cent for 3-month deposits. Unless U.S. banks increase their liabilities to foreign branches the loss of this Euro-dollar issue will reduce their reserve free bases.

U.S. balance of payments. The rate of deterioration of the balance of payments sharply accelerated in July and early August, reaching an intolerable situation in the second week of August. After registering deficits on the official settlements basis (seasonally adjusted) of \$5.7 billion in the first quarter and \$5.9 billion in the second quarter, the July deficit on this basis (not adjusted) probably reached \$2.5 billion and the August deficit -- through the 13th -- was about \$4.2 billion.

The large deficits in July and August reflected mainly an accelerated outflow of speculative funds from the United States in anticipation of exchange rate changes, but quite likely there was also a continued weakening in our underlying payments position, although trade data are not available beyond June. As discussed below, the trade balance in the second quarter was a deficit of over $4 billion at an annual rate; in the first quarter there was a surplus of over $1 billion. In early August an interagency committee on the balance of payments had estimated that the trade balance would continue to show large deficits for the remainder of this year and throughout 1972 -- averaging over $3 billion at an annual rate per quarter.

U.S. foreign trade. Any assessment at this time of the effect on the U.S. trade balance of the recent actions taken by the President can only be highly conjectural. A very rough guess of the effect of the 10 per cent supplemental duty on imports would indicate that imports in the fourth quarter of this year may be as much as $250 million (or $1.0 billion at a seasonally adjusted annual rate) lower than they would otherwise have been. Since the supplemental duty applies only to dutiable imports (see Appendix A), most of this estimated decline will be in imports of finished manufactures. It is unlikely that there will be any improvement in exports during the remainder of the year as a result of exchange rate changes; machinery exports, which would be a major item affected, have a relatively long lead time.

The recent actions of the President can be placed against the background of a rapidly deteriorating trade balance in the second quarter -- the latest period for which data are available -- and projections of worse to come.

The U.S. trade balance in the second quarter was a very large deficit of $4.2 billion at a seasonally adjusted annual rate (balance-of-payments basis), a sharp reversal of the moderate surplus of

$1.1 billion recorded in the first quarter. This dramatic shift in our trade position resulted from both a rapid acceleration in the rate of increase in imports and an absolute decline in exports. Our trade balance vis-à-vis all major areas deteriorated from the first to the second quarters. Our export surplus with the Western European countries virtually disappeared while our deficits with Canada and Japan widened.

While various special or temporary factors undoubtedly tended to exaggerate the second quarter trade deficit, the underlying trend was clearly adverse even after allowing for such factors.

Imports in the second quarter rose to $47.0 billion at a seasonally adjusted annual rate (balance-of-payments basis), up over 9 per cent from the first-quarter level. This sharp increase in imports far outpaced the rise in domestic economic activity. The ratio of imports to GNP rose to 4.52 per cent in the second quarter compared with 4.22 per cent in the first quarter. Import prices rose less than the GNP deflator; thus in real terms, the increase in the import/GNP ratio was even greater. The sharp increase in this ratio in the second quarter was due mainly to the extraordinary rise in imports of industrial materials. Such imports accounted for about half of the increase in total imports.

Most of the rise in imports of industrial supplies was the result of special factors: the hedgebuying of steel and aluminum in anticipation of possible domestic strikes in these industries (which did not materialize), advance shipments of textiles and steel prior to the imposition of "voluntary" restrictions by foreign countries on their exports of these products, exceptionally large arrivals of petroleum attributable to lower tanker rates and more liberal quotas, accumulation of inventories in anticipation of the West Coast dock strike and the possibility of an East and Gulf Coast strike later in the year. However, about one-fourth of the rise in imports of industrial materials is probably attributable to the need for building materials and other industrial supplies as a result of the continuing high level of housing starts and the moderate upturn in domestic industrial production.

Further gains were made in the second quarter in imports of consumer goods and automobiles, especially from Japan -- items which had accounted for almost all of the increase in imports in the first quarter of the year. Such imports also rose faster than domestic consumption. Arrivals of foods -- mainly coffee and perhaps meat and whiskey -- were heavy, possibly reflecting early purchases in anticipation of the possible East and Gulf Coast dock strike this fall.

Exports in the second quarter were $44.0 billion at a seasonally adjusted annual rate (balance-of-payments basis). This represents a 3 per cent decline from the relatively high level of the first quarter when shipments of agricultural products peaked, deliveries of commercial aircraft were very high, and exports of automobiles and parts to Canada recovered from the GM strike.

In the second quarter, agricultural exports were 10 per cent below the high first quarter level, and they are not expected to improve during the rest of the year. Deliveries of aircraft in the second quarter were higher than in the first quarter but schedules call for a somewhat lower delivery rate in the remainder of the year. Automotive exports to Canada were unchanged from the first quarter.

Exports, other than aircraft, agricultural products, and automotive equipment to Canada, fell further in the second quarter, continuing the steady decline in such exports which began in the third quarter of 1970. This decline reflects the slowing in foreign economic activity and the easing of pressure on supply capabilities abroad.

Prices and wages in major industrial countries. Once a basic realignment of exchange rates has been achieved and speculative influences in the market (hopefully) eliminated, or at least greatly diminished, relative price movements will again become a more overt influence on balances of payments and conditions in the exchange markets. In this connection, it is significant that wage and price inflation remains a serious problem in almost all the major industrial countries. Indeed, since the end of 1969, wholesale prices of manufactured goods in six of the eight countries shown in the accompanying table have risen faster than those in the United States; weighted by exports of manufactured goods, the average rose at an annual rate of 4.7 per cent from the last quarter 1969 to first quarter 1971 compared to 3.0 per cent in the United States. The relatively better price performance recently in the United States presumably reflects greater slack in the use of productive capacity here than in most foreign countries; even so, other countries have improved their foreign trade position in 1971 while ours has deteriorated.

So far in 1971, however, the rate of increase of wholesale prices has been decelerating in several countries, although consumer price rises have, generally, speeded up. (The difference between the behavior of wholesale and retail prices is, of course, in part the result of relatively more rapid increases in prices of services, but also reflects the lag in movements between consumer and wholesale prices.) Inflation in both consumer and wholesale prices has intensified in the United Kingdom, France and Canada thus far in 1971, but price increases have decelerated in Japan. In Germany price increases accelerated in the first quarter of 1971, but slowed somewhat in the second. Italian prices have followed a similar pattern, with sharp increases around year-end, followed by a slightly improved situation in more recent months. Increases in wage rates have accelerated thus far in 1971 only in Canada and France. They have apparently slowed somewhat in the United Kingdom, Germany and Japan, but damping their rise remains a target of stabilization policy in virtually all countries.

WHOLESALE PRICES OF MANUFACTURED PRODUCTS
(1963 = 100)

	Level	Percentage change from prev. quarter at annual rates						
		1970				1971		
	1969 IV	I	II	III	IV	I	Last 3 months 1/	
Belgium 2/	115.9	+10.0	+1.7	+5.6	+5.3	-7.2	-3.0	(May)
France 3/	117.8	+ 9.5	+3.6	-3.0	+1.0	+7.3	+8.1	(May)
Germany 4/	112.9	+ 9.2	+3.1	+3.1	+4.8	+8.4	+4.0	(June)
Italy 5/	114.0	+11.2	+4.8	+4.0	+6.0	+4.0	+4.0	(March)
Netherlands 2/	124.0	+ 9.7	+3.2	0	+9.4	n.a.	+9.3	(January)
United Kingdom 6/	121.7	+ 8.2	+7.7	+6.3	+8.4	+8.2	+7.8	(June)
Japan 2/	106.9	+ 7.1	+4.4	-0.4	-1.2	-2.4	0	(June)
Canada 2/	116.6	+ 3.1	0	-1.7	+2.4	+4.1	+3.3	(June)
United States	115.8	+ 5.2	-0.4	+2.4	+2.7	+5.4	+2.0	(June)

1/ Latest months for which data are available is indicated in parenthesis.
2/ Manufactured goods.
3/ Intermediate goods.
4/ Industrial producers prices.
5/ Nonagricultural products.
6/ All manufactured products, home market sales.

Almost all of the major industrial countries seem to be experiencing cost-push pressures. In some, conditions resemble those in the United States, with wages and prices continuing to increase rapidly in the absence of excessive aggregate demand and capacity utilization. Inflation in the United Kingdom and Canada is clearly almost entirely the result of cost pressures, and such pressures are also an important element in the price advance in Germany, France and Italy. Japan seems to have shown the most progress in putting down inflation, but at the cost of producing a near recession -- at least by Japanese standards. The rapid rise in consumer prices in Belgium in 1971 is only partly the result of changes in the tax system, as the Government has attempted to delay some of these effects until later in the year.

CONSUMER PRICES
(1963 = 100)

	Level	Percentage change from prev. quarter at annual rates						
		1970				1971		
	1969 IV	I	II	III	IV	I	Last 3 months 1/	
Belgium	125.7	+ 4.8	+3.4	+2.8	+ 1.8	+ 5.6	+ 6.2	(May)
France	126.5	+ 6.3	+5.6	+4.9	+ 4.2	+ 6.0	+ 7.6	(April)
Germany	117.0	+ 8.2	+3.4	+0.7	+ 4.0	+ 8.5	+ 7.7	(May)
Italy	123.5	+ 6.2	+5.4	+3.2	+ 5.9	+ 7.0	+ 5.7	(April)
Netherlands	136.5	+ 5.0	+6.4	+6.0	+ 4.5	+ 9.2	+11.6	(May)
United Kingdom	129.1	+ 7.4	+9.7	+4.4	+ 8.2	+10.9	+14.3	(June)
Japan	137.5	+10.5	+5.1	+4.8	+12.7	+ 3.5	+ 5.0	(June)
Canada	123.8	+ 3.9	+3.2	+2.2	- 1.0	+ 2.2	+ 5.7	(June)
United States	122.3	+ 6.2	+6.1	+4.8	+ 4.1	+ 2.8	+ 4.6	(June)

1/ Latest month for which data is available is indicated in parenthesis.

The United Kingdom is the most clear-cut example of cost-push inflation among the major industrial countries. Since 1969, the United Kingdom has experienced very high unemployment, but wages and prices have increased at rapid rates. Average earnings rose at an annual rate in excess of 12 per cent throughout 1970 and have only recently slowed somewhat. The recent deceleration stems in part from a decline in the length of the work week, which provides less overtime at extra pay, and from a temporary reduction in the number of new contracts coming up for renegotiation. The government has had some success in restraining public employees' unions and is developing a new incomes policy. However, consumer price increases in excess of 10 per cent per year in recent months will make government anti-inflation attempts more difficult as unions attempt to maintain their members' real income levels.

The new incomes policy being developed is based on the government's acceptance of a proposal by the Confederation of British Industries that price increases be limited to 5 per cent in the next year. The government has committed the nationalized industries to this ceiling and it is hoped that this will result in a reduction in inflationary expectations, which in turn will encourage labor unions to reduce their demands. Wholesale prices have been recently increasing at a rate of 8 per cent; thus, this program, if successful, would result in a significant easing of inflation. Although the Trade Unions Congress has not committed itself to a limit on wage increases, it has indicated that it will take the CBI commitment into account in its contract negotiations. In addition, the British government has recently announced a sales tax reduction, designed to reduce consumer prices while contributing to the reflation of the economy.

Canada is also experiencing severe cost-push inflation accompanied by weak demand. Unemployment is 6.4 per cent, only slightly below the 1970 peak of 6.7 per cent, but wage and price increases are accelerating. After an encouraging price performance in 1970, government attempts to reflate the economy coupled with continued price increases in the United States have rekindled inflationary expectations. During 1970, Canadian wholesale prices rose by less than one-half of a percentage point, in part because of the appreciation of the Canadian dollar, but during the first half of 1971, they spurted at an annual rate of 3.7 per cent. The rate of increase of consumer prices declined from quarter to quarter throughout 1970, and the level of the index actually fell slightly in the fourth quarter. In the first six months of this year, however, consumer prices increased again, reaching an annual rate of 5.7 per cent in the second quarter. Reports of major collective bargaining settlements show a slight jump in the rate of wage increases from 7.0 per cent in the first quarter of 1971 to 7.5 per cent in the second quarter, with average increases for new contracts in June reaching 8.3 per cent. Attempts by the Canadian government in 1970 to apply a voluntary system of wage-price guidelines failed owing to a lack of cooperation by labor unions, and these guidelines were dropped last December. The Prices and Incomes Commission remains in existence, however, and is reporting on inflationary wage and price developments in specific sectors of the economy.

In Germany, both excess demand pressures and the exceedingly high rates of inflation which accompanied high capacity utilization seem to be abating slowly, but inflation is still well above a rate considered acceptable by the authorities.

Capacity utilization remains quite high, but restrictive economic policies have begun to show some effect. The capital investment boom has been tailing off for some time, and the German economy has moved into a period in which consumption is the main driving force. Gross personal income is likely to grow somewhat more slowly -- and may have begun to do so already -- as hours worked have been reduced and wage settlements, though still large, have been a bit more moderate than in preceding months. However, some of the effect on spendable income is being offset by the lifting of the surcharge on income taxes this summer.

Still, price movements have moderated somewhat as demand pressures have receded. The rise in the wholesale price index has slowed from an annual rate of 4.8 per cent in the fourth quarter of 1970 to 4.0 per cent in recent months. (The high first quarter increase was at least partly seasonal.) This movement reflected mainly a slowing of price rises for capital goods. However, the rise in the consumer price index continues virtually unabated, especially for nonfood items.

Thus, the situation in Germany now also reflects a strong element of cost-push inflation and the Government faces the continuing problem of restraining inflation despite the apparent easing of demand pressures. Monetary policy has been tightened further in recent months and can be more effective since the floating of the DM, and tighter government expenditure policy has attempted to offset the easing effect of the removal of the income tax surcharges. In addition, the Government hopes that its voluntary wage-incomes policy will be more effective than it has been in past months. Although the "Concerted Action," which brings together representatives of labor, management and government, has not been able hitherto to contain wage and price movements within the guidelines set by the Government, there now is some evidence that it is making a more significant contribution.

The French economy has not suffered from excess demand pressures for at least a year, and is currently operating at significantly less than full capacity. However, wages and prices have continued to increase and have accelerated in recent months. Wage rates rose at an annual rate of 13 per cent in the second quarter of 1971 despite a relatively high unemployment rate of 2.5 per cent. Consumer prices have been increasing at an annual rate of about

6 per cent in recent months and the rate of increase of wholesale prices has recently been 8.1 per cent. Some of the price increase, however, is related to the 1969 exchange rate changes.

The French government has indicated that it will tighten price controls or even impose a price freeze if the pace of inflation is not reduced. The resistance of employers to union demands has apparently been weakened by the memory of the disturbances of May 1968, so the prospects for a slowing of inflation -- certainly without further government action -- are not encouraging.

The Italian economy, in addition to its socio-political problems which obscure all economic trends, is also suffering from a fairly serious case of cost-push inflation. Price increases have slowed somewhat in recent months, but the period since mid-1969 has produced the most rapid inflation over a comparable period since 1947. Prior to the summer of 1970, excess demand was an important factor in the Italian inflation, but since then a weakening of aggregate demand has occurred which has left the economy with some excess capacity. Despite the easing of demand pressures, wage rates continued to increase rapidly, at least through the end of 1970 (data for 1971 are not available). Although wholesale and consumer prices rose sharply in the first quarter of 1971, at annual rates of 4 and more than 7 per cent respectively, they have since decelerated.

Belgian prices rose quite rapidly in 1970, and the decline in the wholesale price index thus far in 1971 may be more apparent than real. Belgium underwent a major tax reform, replacing a turnover tax with a value-added tax system at the beginning of 1971, and this change seems to have reduced wholesale prices and raised consumer prices. Since the tax reform, however, wholesale prices have been stable as a result of the leveling off of raw materials and import prices.

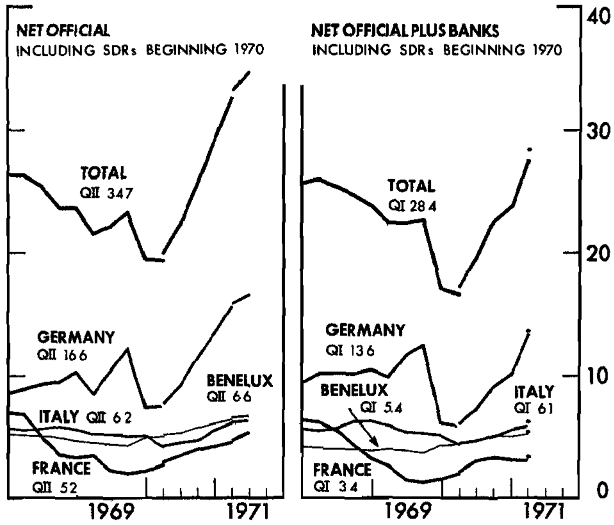
Consumer prices increased at an annual rate of 6 per cent through May, and only part of this increase can be attributed to the tax change. Its effect on consumer prices is expected to total about 2 per cent, most of which is expected in the second half of the year when the government-enforced delays in many consumer price increases expire. The Belgian economy is operating at full capacity; consequently, current wage and price pressures can be attributed more to the pull of aggregate demand than the push of cost increases.

In Japan, inflation is apparently subsiding because of the slowdown in the economy. Consumer prices increased at an annual rate of 4.8 per cent in the first half of 1971 compared with 8.3 per cent during all of 1970. Wholesale prices declined after October 1970 and during the first quarter of 1971, and were virtually unchanged in the following three months. Wages increased rapidly during most of 1970, but have been less buoyant recently. The relative softness of the economy suggests that most of the remaining wage and price pressures may be either a lagged response to excessive demand in the past or the result of cost-push influences. The significant deceleration of inflation as demand pressures have subsided suggests, however, that Japan has less of a problem of cost-push inflation than exists in many other industrial countries.

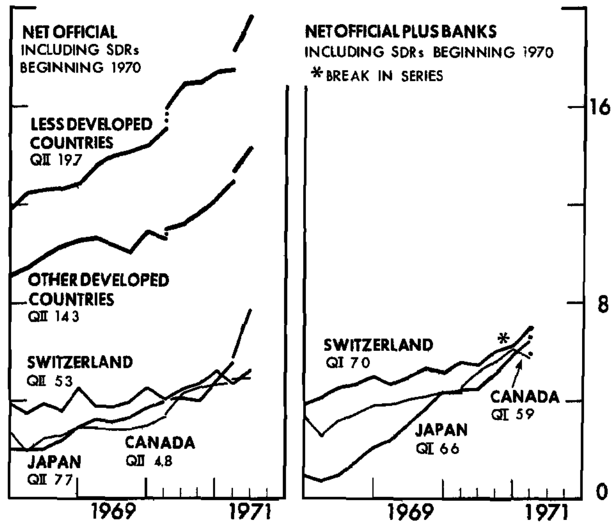
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

BILLIONS OF DOLLARS

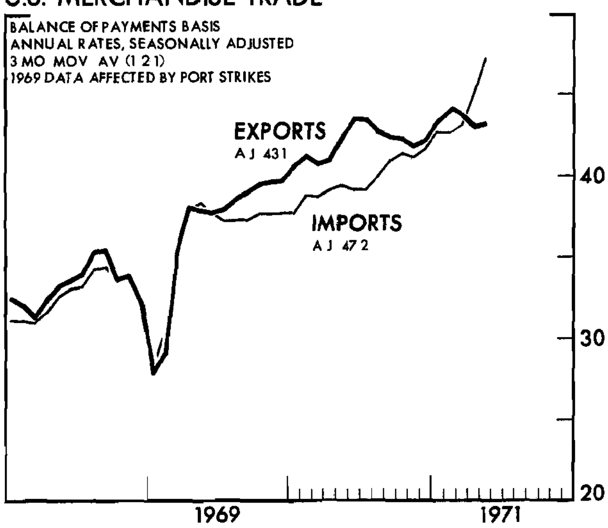
INTERNATIONAL RESERVES EEC COUNTRIES



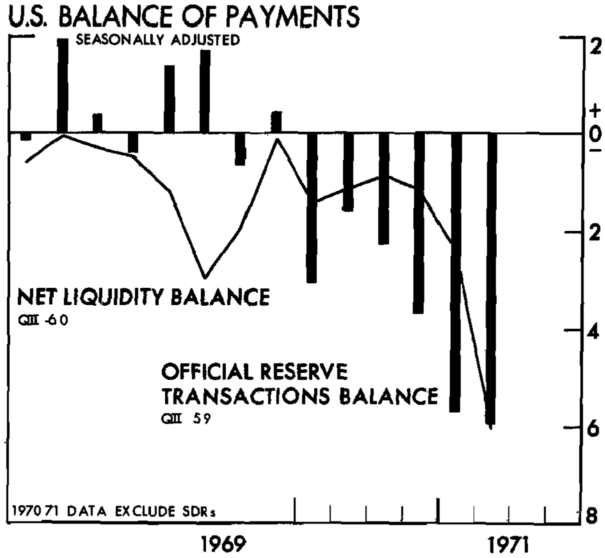
INTERNATIONAL RESERVES OTHER COUNTRIES



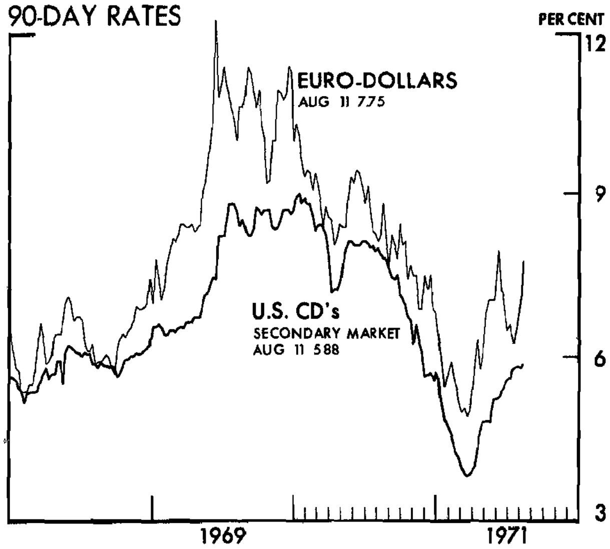
U.S. MERCHANDISE TRADE



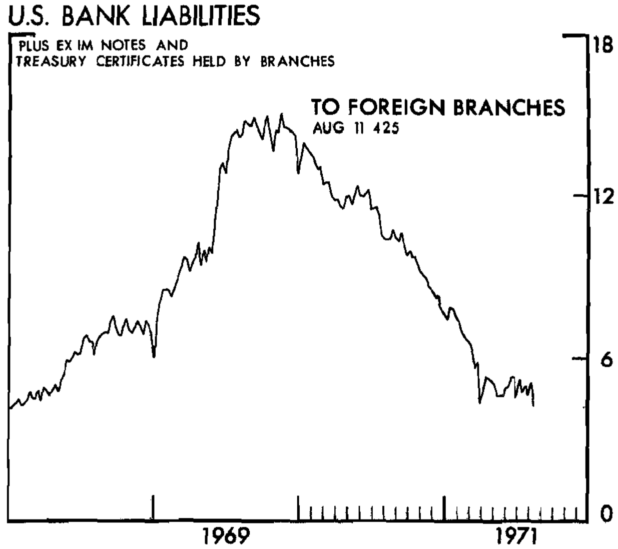
U.S. BALANCE OF PAYMENTS



90-DAY RATES



U.S. BANK LIABILITIES



APPENDIX A: PRESIDENT'S PROCLAMATION ON SUPPLEMENTAL IMPORT DUTIES

President Nixon's proclamation of August 15 imposed a supplemental duty of 10 per cent ad valorem on all dutiable imports which clear customs after 12:01 AM August 16, 1971. Approximately one-half of total imports are subject to this additional duty. The supplemental duty does not apply to duty-free items, such as automotive equipment from Canada, coffee, and industrial raw materials, to items not subject to trade concessions, and to commodities subject to absolute quotas imposed by law or agreement. Exempt items in the last category include meat, sugar, dairy products, crude oil, and petroleum products. Cotton textiles are exempt, at least up to now, from the additional duty, but imports of items that are limited by "voluntary" restraints by foreign suppliers, such as steel, are covered.

If the imposition of the additional duty of 10 per cent would cause the total duty to exceed the original duty rate prescribed by the Tariff Act of 1930, then the duty rate of the Tariff Act would apply. The major example of this is automobiles from Europe and Japan. The present duty on cars, other than from Canada, is 3-1/2 per cent ad valorem. Imposition of the additional 10 per cent stipulated in President Nixon's proclamation would raise the total duty rate to 13-1/2 per cent. The duty rate under the Tariff Act of 1930 is 10 per cent and this, therefore, is the maximum that would apply to cars under the President's proclamation, or an increase of 6-1/2 per cent. There are other items of this type but imports of such items are much less important than automobile imports. More than offsetting the effect on cars of the imposition of the supplemental duty would be the removal of the 7 per cent excise tax on autos which is also applicable to imported cars. As a result of both these actions, prices of European and Japanese cars would actually be reduced, though they would rise relative to domestically-produced cars.

In essence the President's proclamation modifies the tariff concessions made under previous trade agreements, and is based on the authority vested to the President by the Tariff Act of 1930 and the Trade Expansion Act of 1962.

Despite the price freeze on domestically produced items, prices of imported goods would be allowed to rise by the full amount of the additional duty imposed. Prices of items assembled or produced in the United States with foreign components would also be allowed to rise by the amount of the additional duty levied on the foreign components. According to the Treasury Department, however, it has been initially decided not to exempt from the price freeze the higher cost of imported goods -- either complete units or components -- resulting from changes in the exchange rate for the dollar, but a final decision on this has not been made.