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CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

February 13, 1974

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DOMESTIC NONFINANCIAL SCENE

February 13, 1974

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SELECTED DOMESTIC NONFINANCIAL DATA
AVAILABLE SINCE PRECEDING GREENBOOK
(Seasonally adjusted)

	Latest Data			Per Cent Change From		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year Earlier
				(At Annual Rates)		
Civilian labor force	Jan.	2/1/74	90.5	6.8	3.5	4.1
Unemployment rate	Jan.	2/1/74	5.2	4.8 1/	4.6 1/	5.0 1/
Insured unemployment rate	Dec.	1/28/74	2.9	2.8 1/	2.8 1/	3.0 1/
Nonfarm employment, payroll (mil.)	Jan.	2/1/74	76.4	-4.1	.0	2.9
Manufacturing	Jan.	2/1/74	19.9	-7.5	-1.0	2.6
Nonmanufacturing	Jan.	2/1/74	56.4	-2.8	.4	3.0
Private nonfarm:						
Average weekly hours (hours)	Jan.	2/1/74	36.6	37.0 1/	37.0 1/	36.9 1/
Hourly earnings ($)	Jan.	2/1/74	4.02	.0	4.0	6.6
Manufacturing:						
Average weekly hours (hours)	Jan.	2/1/74	39.9	40.7 1/	40.6 1/	40.3 1/
Unit labor cost (1967=100)	Dec.	1/31/74	125.5	-2.9	3.5	6.1
Industrial production (1967=100)	Jan.	2/15/74	125.7	-9.5	-4.1	2.9
Consumer goods	Jan.	2/15/74	129.2	-15.6	-10.3	- .5
Business equipment	Jan.	2/15/74	127.2	- .9	3.2	8.8
Defense & space equipment	Jan.	2/15/74	80.6	-4.4	3.0	1.0
Materials	Jan.	2/15/74	130.3	-6.4	-2.4	4.7
Consumer prices (1967=100)	Dec.	12/21/73	138.4	6.5	8.7	8.8
Food	Dec.	12/21/73	151.6	3.2	8.9	20.0
Commodities except food	Dec.	12/21/73	126.7	8.6	7.7	5.0
Services 2/	Dec.	12/21/73	143.8	6.7	9.1	6.2
Personal income ($ billion) 3/	Dec.	1/16/74	1089.6	11.3	11.8	10.8
				(Not at Annual Rates)		
Mfrs. new orders dur. goods ($ bil.)	Dec.	1/31/74	41.4	-6.6	-2.1	7.9
Capital goods industries:	Dec.	1/31/74	13.0	-8.3	.9	9.6
Nondefense	Dec.	1/31/74	11.6	-3.1	3.0	16.1
Defense	Dec.	1/31/74	1.4	-37.2	-13.6	-25.9
Inventories to sales ratio:						
Manufacturing and trade, total	Dec.	2/14/74	1.44	1.41 1/	1.44 1/	1.45 1/
Manufacturing	Dec.	1/31/74	1.60	1.54 1/	1.59 1/	1.61 1/
Trade	Dec.	2/14/74	1.29	1.28 1/	1.29 1/	1.30 1/
Ratio: Mfrs.' durable goods inventories to unfilled orders	Dec.	1/31/74	.715	.708 1/	.728 1/	.857 1/
Retail sales, total ($ bil.)	Jan.	2/11/74	43.0	2.5	- .1	5.7
GAF	Jan.	2/11/74	11.3	2.2	2.2	7.3
Auto sales, total (mil. units) 3/	Jan.	2/11/74	9.4	-2.4	-8.1	-22.9
Domestic models	Jan.	2/11/74	7.7	-2.9	-12.0	-25.4
Foreign models	Jan.	2/11/74	1.7	- .4	14.8	-9.0
Housing starts, private (thous.) 3/	Dec.	1/17/74	1,355	-20.1	-24.9	-42.8
Leading indicators (1967=100)	Dec.	1/31/74	168.7	.1	2.4	9.9

1/ Actual data. 2/ Not seasonally adjusted. 3/ At annual rate.

DOMESTIC NONFINANCIAL DEVELOPMENTS

Economic activity in the early weeks of this year has been weaker than the staff had anticipated. Industrial production is estimated to have declined 0.8 per cent in January, following a drop of 0.6 per cent in December. Once again, the reduction reflected primarily sharp cuts in auto output and reduced use of electricity and gas, mainly by residential and commercial customers. But the auto supplying industries appear to have been more adversely affected in January than in December, and output of business equipment is estimated to have changed little at a level slightly below the November high.

The labor market has also weakened considerably further. Nonfarm payroll employment fell sharply in January--by over 250,000-- and the declines were widespread by industry. Industries in which activity is closely related to the availability of gasoline--such as auto production and sales, gas stations, and motels--were particularly hard hit. The manufacturing workweek also fell sharply. The unemployment rate rose to 5.2 per cent in January from 4.8 per cent in December, as the labor force increased substantially.

Unit sales of automobiles last month declined a little further from the depressed December level, to an annual rate of 9.4 million (including 1.7 million imports). Sales of large cars were bolstered by substantial rebates to dealers late in the month. Apart from the automotive group, retail sales in January recovered about 1-3/4 per cent from a December level that was revised down considerably; in real terms, the January level was probably below the fourth quarter average.

Wage rates in the private nonfarm economy continued to rise in January; since early last year, the hourly earnings index has increased at a 7 per cent annual rate. In the fourth quarter, a decline in productivity and a continued sharp rise in compensation per manhour resulted in an 11 per cent annual rate of increase in unit labor costs. In the aluminum industry--which is likely to establish a pattern in the can and steel industries--the recently signed contract provided for a basic wage rate increase plus full cost of living adjustments and substantially liberalized pension benefits including an innovative cost of living adjustment provision for retirees.

Prices are continuing to rise rapidly at both retail and wholesale levels. Prices received by farmers showed a steep increase from mid-December to mid-January, following an interval of generally sustained decline. Wholesale and retail prices of gasoline have risen substantially since the last official reports. In December, the consumer price index rose at a 7 per cent annual rate, bringing the increase from a year earlier to almost 9 per cent.

<u>Outlook</u>. Staff assumptions with regard to oil supplies are unchanged from last month--we still assume a short-fall of 2 to 2-1/2 million barrels per day. Several other assumptions have been modified, however. (1) Growth in M_1 is assumed to average about 5-3/4 per cent over the year. This rate of growth appears likely to be associated with some decline in short-term interest rates in the first half, when nominal GNP growth is relatively slow, and with some rise in short-term rates thereafter. (2) Account has been taken of the new budget

for fiscal 1975. However, recent expenditure patterns suggest that outlays in the first half of calendar 1974 will fall short of those implied in the budget, and we have incorporated a lower level into the staff projection. For the second half of calendar 1974, the staff is projecting a somewhat faster rise than implied by the budget, so that our fiscal year totals conform to those of the budget. On taxes, the staff has not incorporated the recommended "emergency windfall profits tax" on petroleum and products, which seems unlikely to pass the Congress. (3) The staff assumes that price and wage controls--except in health services, petroleum and possibly a few other industries--will be ended by April 30, when the enabling legislation expires.

Real GNP is now projected to decline at an annual rate of 3 per cent in the first quarter, compared with a 1-1/4 per cent rate of decline expected last month. Nominal GNP is projected to increase by only $16 billion, rather than $22 billion. Prices are still expected to increase rapidly, with the private GNP fixed-weight index up at an annual rate of 8 per cent.

Declines in real purchases in the first quarter appear to be concentrated in consumer buying--particularly automobiles and other durable goods, foods, gasoline and services--and in residential construction activity, which is down sharply further. A further step-up in inventory investment appears unlikely this quarter following the substantial fourth quarter increase. Inventories in some lines will rise faster due to a declining pace of sales, but the fourth quarter buildup in auto stocks apparently will not be repeated--auto production has been cut back to a level at or below the current sales rate.

Except for the weaker first quarter, the projection for 1974 is little changed from that of a month ago. A small further decline in real activity in the second quarter is expected to be followed by relatively slow growth in the last half of the year. The unemployment rate is now expected to average somewhat higher, and to exceed 6 per cent by the fourth quarter, because of the weaker first quarter.

Consumer spending is expected to firm somewhat in the spring, when the decline in auto sales bottoms out, and residential construction activity is expected to reach a low in the second quarter. In the second half of the year, real consumer purchases are projected to rise more strongly, with auto sales turning up as more small cars become available. Housing starts and residential construction activity are projected to increase moderately, in response to a more ample volume of mortgage funds and gradual adaptations to changed energy supplies.

Price increases are expected to be large in the first half of the year, raising the private fixed weight deflator at a 7-1/2 per cent annual rate. This is the period in which the bulk of the increase in gasoline prices is expected to occur, and when food prices, given the restricted supplies of meat, are likely to rise sharply further. The staff has raised the projected rate of price increase in the second half of the year to an average annual rate of 5-3/4 per cent, from 5-1/2 per cent, reflecting the assumed termination of the controls program on April 30, instead of the more gradual decontrol earlier anticipated. During the second half the basic factor raising prices is expected to be pressure from rising unit labor costs.

STAFF GNP PROJECTIONS

	Changes in nominal GNP ($ billions)		Per cent change annual rate: Real GNP		Per cent change annual rate: Gross private product fixed weighted price index		Unemployment rate (Per cent)	
	1/16/74	2/13/74	1/16/74	2/13/74	1/16/74	2/13/74	1/16/74	2/13/74
1971 1/	78.3	78.3	3.2	3.2	4.6	4.6	5.9	5.9
1972 1/	99.7	99.7	6.1	6.1	3.2	3.2	5.6	5.6
1973 2/	132.7	133.0	5.9	5.9	5.9	5.9	4.9	4.9
1974	101.1	97.2	.6	.3	7.1	7.3	5.6	5.8
1973: I	43.3	43.3	8.7	8.7	7.0	7.0	5.0	5.0
II	29.5	29.5	2.4	2.4	7.9	7.9	4.9	4.9
III	32.5	32.5	3.4	3.4	7.6	7.0	4.8	4.7
IV	28.0	29.5	1.0	1.3	7.0	7.6	4.7	4.7
1974: I	22.0	16.0	-1.3	-3.0	8.0	8.0	5.2	5.4
II	20.5	20.5	- .7	- .7	6.9	7.0	5.5	5.8
III	23.0	24.0	1.3	1.3	5.5	5.8	5.8	6.0
IV	30.5	32.0	2.8	3.0	5.5	5.7	6.0	6.2
Change: 72-IV to 73-IV	133.3	134.8	3.8	3.9	7.4	7.5	- .6	- .6
73-IV to 74-IV	96.0	92.5	.5	.1	6.5	6.6	1.3	1.5

1/ Actual.
2/ Commerce preliminary estimates.

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

	1973	1974 Proj.	1973 III	1973 IVp	1974 Projection I	1974 Projection II	1974 Projection III	1974 Projection IV
Gross National Product	1288.2	1385.4	1304.5	1334.0	1350.0	1370.5	1394.5	1426.5
Final purchases	1280.8	1375.8	1299.8	1318.1	1335.0	1360.0	1387.0	1421.0
Private	1003.6	1068.7	1020.8	1032.3 1/	1040.6	1057.0	1076.5	1100.5
Excluding net exports	999.0	1072.2	1013.2	1024.3	1039.9	1058.5	1081.9	1108.3
Personal consumption expenditures	805.0	875.7	816.0	829.0	847.4	865.7	884.7	904.9
Durable goods	131.1	126.9	132.8	126.8	125.0	125.0	127.0	130.5
Nondurable goods	336.3	376.8	341.6	351.1	362.9	372.7	381.4	390.1
Services	337.6	372.0	341.6	351.2	359.5	368.0	376.3	384.3
Gross private domestic investment	201.5	206.1	202.0	211.2	207.5	203.3	204.7	208.9
Residential construction	58.0	48.4	59.2	54.2	48.5	45.8	47.7	51.4
Business fixed investment	136.0	148.1	138.0	141.1	144.0	147.0	149.5	152.0
Change in business inventories	7.4	9.6	4.7	15.9	15.0	10.5	7.5	5.5
Nonfarm	6.7	9.6	3.2	14.9	16.0	11.0	7.0	4.5
Net exports of goods and services 2/	4.6	-3.5	7.6	8.0 1/	.7	-1.5	-5.4	-7.8
Exports	101.3	121.6	104.5	113.5 1/	116.2	121.4	123.1	125.7
Imports	96.7	125.1	97.0	105.6	115.5	122.9	128.5	133.5
Gov't. purchases of goods and services	277.2	307.1	279.0	285.8 1/	294.4	303.0	310.5	320.5
Federal	106.9	115.6	106.8	107.8 1/	110.9	114.4	116.5	120.5
Defense	74.2	78.2	74.2	74.0 1/	75.4	77.4	78.5	81.5
Other	32.7	37.4	32.7	33.8	35.5	37.0	38.0	39.0
State & local	170.3	191.5	172.2	178.0	183.5	188.6	194.0	200.0
Gross national product in constant (1958) dollars	837.3	839.5	841.3	844.1	837.7	836.1	838.9	845.2
GNP implicit deflator (1958 = 100)	153.9	165.0	155.1	158.0	161.2	163.9	166.2	168.8
Personal income	1035.5	1132.2	1047.1	1079.2	1095.4	1119.5	1144.5	1169.2
Wage and salary disbursements	691.5	745.9	699.3	717.6	725.2	736.0	751.8	770.5
Disposable income	882.6	961.9	891.1	918.0	930.5	951.9	972.6	992.7
Personal saving	53.8	59.5	51.1	63.4	57.5	59.9	60.8	59.9
Saving rate (per cent)	6.1	6.2	5.7	6.9	6.2	6.3	6.3	6.0
Corporate profits before tax	126.4	121.9	129.0	128.0	123.0	121.5	120.5	122.5
Corp. cash flow, net of div. (domestic)	109.0	110.3	110.6	110.2	109.3	109.6	110.0	112.2
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	265.2	288.9	269.5	275.5	281.7	285.9	290.7	297.1
Expenditures	264.7	300.5	265.6	272.4	282.6	303.8 3/	304.3	311.1
Surplus or deficit (-)	.5	-11.6	4.0	3.1	- .9	-17.9 3/	-13.6	-14.0
High employment surplus or deficit (-)	-2.0	- .8	-2.1	-1.7	1.7	-9.1	.3	3.9
State and local government surplus or deficit (-), (N.I.A. basis)	11.0	3.9	10.4	8.4	7.6	4.9	2.9	.1
Total labor force (millions)	91.0	93.4	91.3	92.2	92.9	93.3	93.6	93.8
Armed forces "	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Civilian labor force "	88.7	91.1	89.0	89.9	90.6	91.0	91.3	91.5
Unemployment rate (per cent)	4.9	5.9	4.7	4.7	5.4	5.8	6.0	6.2
Nonfarm payroll employment (millions)	75.6	76.3	75.7	76.6	76.3	76.2	76.2	76.4
Manufacturing	19.8	19.7	19.8	20.1	19.9	19.7	19.6	19.6
Industrial production (1967 = 100)	125.6	125.5	126.7	127.1	125.7	125.0	125.2	126.1
Capacity utilization, mfg. (per cent)	83.0	79.9	83.3	82.8	81.2	79.9	79.3	79.1
Major materials (per cent)	95.1	93.1	96.0	96.0	94.5	93.0	92.5	92.4
Housing starts, private (millions, A.R.)	2.04	1.60	2.03	1.57	1.48	1.50	1.65	1.75
Sales new autos (millions, A.R.)	11.44	9.25	11.74	10.08	9.00	8.75	9.25	10.00
Domestic models	9.67	7.50	10.11	8.44	7.25	7.00	7.50	8.25
Foreign models	1.77	1.75	1.63	1.65	1.75	1.75	1.75	1.75

1/ Includes effects of shipments of military equipment and supplies to Israel; these are now estimated at $2.8 billion annual rate and considered as a sale, with $2.4 billion coming from U.S. military stocks and thus reducing defense purchases by that amount.

2/ Net exports of g. & s. (bal. of paymts.)	6.1	1.2	8.6	12.6	5.4	3.2	- .7	-3.1
Exports	101.9	122.9	104.8	114.8	117.5	122.7	124.4	127.0
Imports	95.8	121.7	96.2	102.2	112.1	119.5	125.1	130.1

3/ Includes a one-time payment of a grant to India of $2.2 billion ($8.8 billion annual rate) worth of rupees as part of an overall rupee debt settlement.

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1973p	1974 Proj.	1973 III	1973 IVp	1974 Projection I	1974 Projection II	1974 Projection III	1974 Projection IV
	-----	-----	-----	-----Billions of Dollars	-----	-----	-----	-----
Gross National Product	133.0	97.2	32.5	29.5	16.0	20.5	24.0	32.0
Inventory change	1.4	2.2	.2	11.2	- .9	-4.5	-3.0	-2.0
Final purchases	131.7	95.0	32.3	18.3	16.9	25.0	27.0	34.0
Private	109.5	65.1	28.6	11.5	8.3	16.4	19.5	24.0
Net exports	9.2	-8.1	4.8	.4	-7.3	-2.2	-3.9	-2.4
Excluding net exports	100.3	73.2	23.8	11.1	15.6	18.6	23.4	26.4
Personal consumption expenditures	78.5	70.7	20.4	13.0	18.4	18.3	19.0	20.2
Durable goods	13.7	-4.2	.0	-6.0	-1.8	.0	2.0	3.5
Nondurable goods	36.4	40.5	11.3	9.5	11.8	9.8	8.7	8.7
Services	28.4	34.4	9.0	9.6	8.3	8.5	8.3	8.0
Residential fixed investment	4.0	-9.6	- .4	-5.0	-5.7	-2.7	1.9	3.7
Business fixed investment	17.8	12.1	3.9	3.1	2.9	3.0	2.5	2.5
Government	22.2	29.9	3.7	6.8	8.6	8.6	7.5	10.0
Federal	2.5	8.7	- .5	1.0	3.1	3.5	2.1	4.0
State and local	19.8	21.2	4.2	5.8	5.5	5.1	5.4	6.0
GNP in constant (1958) dollars	46.6	2.2	7.0	2.8	-6.4	-1.6	6.3	2.8
Final purchases	46.0	.6	7.3	-5.1	-6.2	2.1	4.3	7.9
Private	44.2	-2.7	7.5	-4.9	-7.2	.2	3.1	6.5
	-----	-----	-----	-----Per Cent Per Year 1/	-----	-----	-----	-----
Gross National Product	11.5	7.5	10.6	9.4	4.9	6.2	7.2	9.5
Final purchases	11.5	7.4	10.6	5.8	5.2	7.7	8.2	10.2
Private	12.2	6.5	12.0	4.6	3.3	6.5	7.6	9.2
Personal consumption expenditures	10.8	8.8	10.7	6.5	9.2	8.9	9.1	9.5
Durable goods	11.7	-3.2	.0	-16.9	-5.6	.0	6.6	11.5
Nondurable goods	12.1	12.0	14.4	11.6	14.1	11.2	9.7	9.4
Services	9.2	10.2	11.3	11.7	9.8	9.8	9.3	8.8
Gross private domestic investment	13.0	2.3	7.9	19.5	-6.8	-7.9	2.8	8.5
Residential structures	7.4	-16.6	-2.7	-29.7	-35.9	-20.5	17.7	34.8
Business fixed investment	15.1	8.9	12.2	9.3	8.5	8.6	7.0	6.9
Gov't. purchases of goods & services	8.7	10.8	5.5	10.1	12.6	12.2	10.3	13.5
Federal	2.4	8.1	-1.9	3.8	12.0	13.2	7.5	14.5
Defense	- .3	5.4	.0	-1.1	7.8	11.0	5.8	16.2
Other	8.6	14.4	-4.7	14.1	21.7	18.0	11.3	10.9
State and local	13.2	12.4	10.4	14.2	12.9	11.6	12.0	13.0
GNP in constant (1958) dollars	5.9	.3	3.4	1.3	-3.0	- .7	1.3	3.0
Final purchases	5.9	.1	3.6	-2.4	-2.9	1.0	2.1	3.9
Private	6.9	- .4	4.4	-2.8	-4.1	.1	1.8	3.8
GNP implicit deflator	5.3	7.2	7.0	7.9 2/	8.1 2/	7.0	5.8	6.2 2/
Private GNP fixed weighted index 3/	6.0	7.3	7.6	7.6	8.0	7.0	5.8	5.7
Personal income	10.3	9.3	11.5	12.8	6.1	9.1	9.2	8.9
Wage and salary disbursements	10.1	7.9	10.2	10.9	4.3	6.1	8.9	10.3
Disposable income	10.7	9.0	10.2	12.6	5.6	9.5	9.0	8.5
Corporate profits before tax	29.0	-3.6	.3	-3.0	-14.7	-4.8	-3.3	6.8
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	16.0	8.9	11.3	9.2	9.3	6.1	6.9	9.1
Expenditures	8.2	13.5	5.3	10.6	15.8	33.6	.7	9.2
Nonfarm payroll employment	3.9	1.0	2.2	4.8	-1.6	- .5	.0	1.1
Manufacturing	4.7	- .6	1.2	6.2	-3.9	-4.0	-2.0	.0
Industrial production	9.0	- .1	6.0	1.3	-4.4	-2.1	.8	2.8
Housing starts, private	-13.0	-21.6	-30.2	-64.6	-20.2	5.5	46.4	26.5
Sales new autos	4.6	-19.2	.2	-45.5	-36.6	-10.7	24.9	36.6
Domestic models	3.7	-22.4	10.1	-51.5	-45.5	-13.1	31.8	46.4
Foreign models	9.8	-1.2	-41.7	5.8	26.8	.0	.0	.0

1/ Percentage rates are annual rates compounded quarterly.
2/ Excluding Federal pay increases rates of change are: 1973-IV 7.3 per cent; 1974-I 8.0 per cent; 1974-IV 5.7 per cent.
3/ Using expenditures in 1967 as weights.

<u>Industrial production</u>. Industrial production is estimated to have declined 0.8 per cent further in January when, at 125.7 per cent of the 1967 average, it was about 3 per cent above a year earlier. As in December, a sharp decline in auto assemblies and associated reductions in output of supplying industries, along with further cuts in electric and gas consumption by residential and commercial users accounted for most of the January drop in industrial production. The other major sectors of the index, however, failed to show any upward momentum.

Auto assemblies in January were cut back 15 per cent further to a seasonally adjusted annual rate of 6.9 million units. Production schedules for February were set at a 7.0 million unit rate, but parts shortages because of the truck strikes may lower actual output. Production of household appliances apparently declined in January and output of nondurable consumer goods was also off. Output of business equipment was about unchanged, and down slightly from November, following a period of rapid expansion. Steel production was maintained at record levels in January but there was a decline in raw steel output in early February. Production of consumer durable goods materials dropped sharply in January, but output of nondurable goods materials changed little. Output of construction products was down further.

INDUSTRIAL PRODUCTION
(1967=100, seasonally adjusted)

	1973			1974	Per cent change	
	Jan.	Nov.	Dec.	Jan.	Month ago	Year ago
Total index	122.2	127.5	126.7	125.7	- .8	2.9
Market groupings:						
Final products	118.6	123.5	122.2	121.1	- .9	2.1
Consumer goods	129.8	133.4	130.9	129.2	-1.3	- .5
Business equip.	116.9	127.7	127.3	127.2	- .1	8.8
Materials	124.5	131.7	131.0	130.3	- .5	4.7
Industry groupings:						
Manufacturing	121.4	127.4	126.8	125.8	- .8	3.6
Durables	117.5	124.8	123.9	122.6	-1.0	4.3
Nondurables	127.0	131.3	131.0	130.4	- .5	2.7
Mining & utilities	127.3	130.3	125.9	125.9	0	-1.1

Retail sales. Retail sales in January advanced 2.5 per cent from December; however, this rise only returned dollar volume to the October 1973 level. Compared with a year earlier, sales were up 5.6 per cent--the smallest year-to-year gain since December 1970. More complete sample counts lowered earlier estimates of sales in November and December, and the fourth quarter of 1973 is now indicated to be only 0.3 per cent above the third quarter. Real retail sales in December were 3 per cent below a year ago and fourth quarter sales were down nearly 2 per cent.

Sales of durable goods in January increased sharply, but by less than the December drop. Outlays for furniture and appliances were up 4.4 per cent and sales of the automotive group up 5.6 per cent. (Unit sales of autos dropped between December and January, and the higher sales of the automotive group apparently reflect price increases as well as additional service work.) Sales of nondurables increased 1.4 per cent, with food sales up twice as fast.

RETAIL SALES
(Seasonally adjusted, percentage change from previous period)

	1973		1973		1974
	III	IV	Nov.	Dec.	January
Total sales	2.9	.3	- .2	-2.3	2.5
Durable	1.9	-3.5	-1.7	-6.2	4.8
Auto	3.0	-6.5	-3.5	-9.3	5.6
Furniture and appliance	1.0	-1.1	2.0	-3.8	4.4
Nondurable	3.4	2.2	.5	- .5	1.4
Food	4.7	1.5	- .6	.4	2.9
Gas stations	.4	3.6	-2.8	-1.3	.9
General merchandise	2.0	1.2	3.1	-2.7	1.6
Total, less auto and nonconsumption items	3.1	2.0	.6	- .8	1.6
GAF	2.1	.7	2.2	-2.1	2.2
Real sales*	.3	-1.9	-1.1	-3.0	n.a.

*Deflated by all commodities CPI, seasonally adjusted.

Unit sales of consumer durables. January sales of new domestic-type autos were at a 7.7 million unit annual rate, down 3 per cent from December and a fourth lower than a year earlier. There was a moderate spurt in sales during the last 10 days of the month which reflected in part the offer of substantial rebates to dealers for each large car sold. Small car sales in January accounted for 37 per cent of the domestic-type market, slightly more than December and well above the 25 per cent in January a year ago.

Stocks of domestic-type autos declined slightly during January and at the end of the month were equivalent to a 68 days supply, compared to a 69 days supply at the end of December. The imbalance between large and small car stocks increased, however, with large car stocks approximately triple those of small cars.

Foreign car sales in January were at a 1.7 million unit rate for the third consecutive month, down 9 per cent from a year ago. The import share on a seasonally adjusted basis increased slightly to 18.3 per cent compared with 15.5 per cent in January 1973. A number of foreign car dealers reported that sales were hampered by low stocks, resulting to some extent from ocean transport fuel shortages.

Factory sales of major home appliances, TVs, and radios in January (estimated) were down sharply from both December and January a year earlier. Sales of these items appeared to have reached a peak last spring and then to have leveled off for the rest of the year.

UNIT SALES OF SELECTED CONSUMER DURABLES
(Seasonally adjusted)

	1973	1973-1974			Per cent change from	
	Jan.	Nov.	Dec.	Jan.	Month ago	Year ago
		Annual rates, millions of units				
Auto sales	12.2	10.4	9.6	9.4	-2	-23
Domestic	10.3	8.7	7.9	7.7	-3	-25
Foreign	1.9	1.7	1.7	1.7	0	- 9
		Indexes, 1967=100				
Home goods, factory						
Unit sales	148	152	160r	139e	-13	- 7
TVs 1/	149	166	163	139e	-15	- 7
Radios 1/	130	108	126	70e	-44	-46
Major appliances	149	144	159r	144e	- 9	- 3

1/ Includes domestic and foreign label imports.
e/ Estimated on the basis of data through January 26, 1974.

<u>Consumer surveys</u>. The Conference Board survey conducted in late November and early December indicated a drastic deterioration from September-October in consumer attitudes toward economic conditions and a further drop in buying plans for autos and furniture and appliances. Intentions to take vacations were also off sharply and purchase plans for homes remained at a relatively low level.

The index of confidence, a composite of attitudinal questions about present business and employment conditions as well as expected income and the economic outlook, is now lower than it was during the 1970 recession. Consumer appraisals of business conditions at the time of the survey were more unfavorable than in the preceding survey, and the outlook for the months ahead deteriorated even more. Buying plans indicated by the November-December survey did not decline as much as more general appraisals of the economy, and the composite index of buying plans for durable goods and houses--while quite low--was still somewhat higher than during the 1970 recession.

The previous Conference Board survey--like the October-November Michigan Survey Research Center survey--had found some upturn in consumers' earlier gloomy appraisals of expected income and present and expected business and employment conditions. However, both these surveys were taken before the public was fully aware of the energy shortages. The more favorable attitudes at that time probably reflected the propensity of American households to adjust to unfavorable developments such as continued inflation.

The more moderate decline in the Conference Board index of buying plans than in the index of confidence may reflect some continuation of consumer intentions to buy before prices rise further; this tendency was evident last year in both the Michigan and Conference Board surveys.

Inventories. The book value of manufacturing and trade inventories rose at a $32.0 billion annual rate in December (p)--down from the high $38.5 billion November rate. Manufacturers' inventories increased at an annual rate of $26 billion in December--mainly in durable goods industries, but also in petroleum and other nondurable goods industries where there were rapid price increases. Growth in stocks of materials and supplies, and of finished goods, was substantially faster in December than in November. Wholesale trade inventories rose at a $6 billion annual rate in December. Retail trade inventories showed no change in December, following a $13.4 billion increase in November. December retail auto stocks rose at a $1.5 billion rate--off sharply from the $6.5 billion November rate.

For the fourth quarter as a whole, the book value of manufacturing and trade inventories increased at a $32 billion annual rate--substantially more rapid than the $20 billion third quarter rate. About one quarter of the increased rate of accumulation in the fourth quarter was in auto stocks. Much of the rest of the fourth quarter gain may have been due to rapid price increases.

Manufacturing inventories rose at an $18 billion annual rate--up sharply from the quarterly increases earlier in the year. Almost one-third of the fourth quarter run-up was in machinery--particularly nonelectrical. However, there were substantial increases in stocks of food and beverages and petroleum and coal--industries with rapid price increases in recent months.

Wholesale trade inventories rose at a $6 billion annual rate in the fourth quarter--up from the $4.5 billion third quarter rate but the same as in the first quarter of 1973. Retail trade stocks rose at an $8 billion annual rate--up from the third quarter $3.6 billion rate but the same as in the second quarter. Retail auto inventories in the fourth quarter were up at a $4.5 billion rate--three times as fast as in the third quarter.

BUSINESS INVENTORIES
(Change at annual rates in seasonally adjusted
book values, $ billions)

	1973						
	Q I	Q II	Q III	Q IV (p)	Oct.	Nov.	Dec. (p)
Manufacturing and trade	21.5	22.9	20.4	31.8	24.8	38.5	32.0
Manufacturing, total	9.8	11.4	12.4	17.9	13.3	14.5	25.9
Durable	6.6	7.7	9.8	11.4	8.4	8.3	17.5
Nondurable	3.2	3.7	2.6	6.5	4.9	6.2	8.4
Trade, total	11.7	11.5	8.1	13.9	11.4	24.0	6.2
Wholesale	6.1	3.6	4.5	6.1	1.4	10.6	6.2
Retail	5.6	7.9	3.6	7.8	10.1	13.4	- .1
Auto	.4	2.4	1.5	4.5	5.4	6.5	1.5

Note: Details may not add to totals due to rounding.

The overall manufacturing and trade inventory-sales ratio rose from 1.41 in November to 1.44 in December, a level slightly below a year earlier. The manufacturing inventory-shipments ratio rose sharply, from 1.54 in November to 1.60 in December; the increase was largely in durable goods industries--especially nonelectrical machinery, instruments and transportation equipment (mainly in aircraft and parts). The

December wholesale trade inventory-sales ratio was unchanged at 1.10 (p). The ratio of inventories to unfilled orders at durable goods producers' moved up to .715 (p) in December from .708 in November--the first increase in over two years---but it was far below a year earlier.

INVENTORY RATIOS

	1972		1973	
	Nov.	Dec.	Nov.	Dec. (p)
Inventories to sales:				
Manufacturing and trade	1.46	1.45	1.41	1.44
Manufacturing, total	1.60	1.61	1.54	1.60
Durable	1.89	1.92	1.85	1.96
Nondurable	1.24	1.23	1.16	1.18
Trade, total	1.32	1.30	1.28	1.29
Wholesale	1.19	1.18	1.10	1.10
Retail	1.41	1.39	1.42	1.45
Inventories to unfilled orders:				
Durable manufacturing	.867	.856	.708	.715

Manufacturers' orders and shipments. New orders for durable goods declined 6.6 per cent in December . Much of the drop was centered in motor vehicles and parts and in defense. However, excluding transportation equipment, durable goods orders declined 3.1 per cent, instead of rising slightly, as initially estimated.

For the fourth quarter as a whole, new orders for durable goods rose 1.6 per cent--a bit more rapidly than in the third quarter but substantially below the gains in the first half of 1973; nondefense capital goods were up a strong 4.3 per cent.

Shipments of durable goods declined 3.8 per cent in December--almost entirely in motor vehicles and parts. The rise in unfilled orders for durable goods slowed somewhat in December.

For the quarter as a whole, shipments of durable goods increased 2.7 per cent--about the same as in the third quarter. Backlogs rose 5.7 per cent--compared with an increase of 7.2 per cent in the third quarter.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
(Per cent changes)

	1973			
	QIII from QII 1/	QIV from QIII (p) 1/	Nov. from Oct.	Dec. from Nov. (p)
Durable goods, total	.7	1.6	.6	-6.6
Excluding defense	1.8	1.1	.0	-5.1
Excluding motor vehicles and parts	- .4	3.3	1.4	-4.8
Excluding transportation equipment	.5	3.1	.2	-1.5
Primary metals	-2.8	.0	-2.0	-3.0
Motor vehicles and parts	6.7	-7.2	-3.3	-16.9
Household durables	.5	5.1	4.3	-7.8
Nondefense capital goods	2.3	4.3	3.2	-3.1
Defense capital goods	-22.7	16.9	13.8	-37.2
Construction and other durables	1.7	2.2	- .9	-1.3

1/ Changes between quarters are based on quarterly average levels.

<u>Cyclical indicators.</u> The Census composite cyclical indicators were generally weak in December, as may be noted in the table.

CHANGES IN COMPOSITE CYCLICAL INDICATORS
(Per cent change from prior month)

	1973					
	July	Aug.	Sept.	Oct.	Nov.	Dec. (p)
12 Leading, trend adjusted	.8	1.0	-1.4	.9	1.4	.1
5 Coincident	1.2	.4	.7	1.8	.9	- .1
5 Coincident, deflated	1.5	- .9	.9	1.4	.1	- .2
6 Lagging	2.8	2.2	1.7	1.6	1.2	1.8
	-Leading indexes prior to trend adjustment--					
Census undeflated	.4	.6	-1.7	.6	1.0	- .3
Boston FRB deflated	1.2	- .9	- .7	.6	.3	-1.8

Of the eight leading series available for December, those increasing were industrial materials prices and the ratio of price to unit labor cost. Series declining were new orders for durable goods, initial claims for unemployment insurance (inverted), contracts and orders for plant and equipment, common stock prices and housing permits. The average workweek in manufacturing was unchanged. (Since release of the leading indicators, the change in instalment credit outstanding has become available and it was down sharply.)

Of the leading indicators available for January, the average workweek declined sharply but common stock prices improved slightly.

<u>Construction and real estate</u>. Seasonally adjusted value of new construction put in place, at $131 billion, dropped 2 per cent further in January. Outlays for private residential construction continued to fall and were 18 per cent below the February 1973 high. Expenditures for private nonresidential and public construction, while close to their December rates, remained below earlier peaks. In constant dollars total value of new construction was 12 per cent below the January 1973 peak. In current dollars the decline was 3 per cent.

NEW CONSTRUCTION PUT IN PLACE
(Seasonally adjusted annual rates, in billions of dollars)

	1973			1974	Per cent change in January from	
	QI	QIII(r)	QIV(r)	Jan. 1/	Dec. 1973	Jan. 1973
Total - current dollars	136.5	136.9	135.6	131.3	-2	- 3
Private	103.3	105.0	102.0	97.6	-2	- 4
Residential	60.5	59.4	54.5	50.3	-4	-15
Nonresidential	42.8	45.5	47.5	47.3	--	+11
Public	33.2	31.9	33.6	33.6	--	--
State and local	28.0	27.2	28.8	28.7	--	--
Federal	5.2	4.7	4.8	4.9	+4	- 4
Total - 1967 dollars	94.0	88.9	86.8	83.4	-2	-12

1/ Data for January 1974 are <u>confidential</u> Census Bureau extrapolations. In no case should public reference be made to them.

Reflecting uncertainties stemming from the energy crisis and other factors, seasonally adjusted sales of new single-family homes by merchant builders in December dropped to their lowest level since March 1970. At the current sales rate--down 18 per cent from November--builders' stocks of units available for sale reached a record 13 months' supply. At the same time, the median price of new units actually sold advanced 4 per cent further, remaining above the rising price of unsold new homes. In the market for existing homes, sales in December were below a year earlier for the fifth consecutive month. The median price of such units continued about a tenth higher.

SALES, STOCKS AND PRICES OF NEW SINGLE FAMILY HOMES

	Homes sold 1/	Homes for sale 2/	Months' supply	Median price of: Homes sold	Homes for sale
	(Thousands of units)			(Thousands of dollars)	
1972					
QIV	761	402	6.3	29.2	28.3
1973					
QI	733	426	7.0	30.3	29.4
QII	681	433	7.6	32.6	31.2
QIII(r)	562	454	9.7	33.5	32.1
QIV(p)	481	450	11.2	33.9	32.9
October(r)	515	452	10.5	33.2	32.3
November(r)	510	447	10.5	34.0	32.6
December(p)	417	450	12.9	35.3	32.9

1/ SAAR.
2/ SA, end of period.

With rental demands stimulated in part by reduced interest in single-family homes, the vacancy rate for residential rental properties remained relatively low in the fourth quarter of 1973, despite the still high pace of completions of new units. Although above a year earlier, the average vacancy rate (5.8 per cent) was the same as in the second and third quarters of 1973. The homeowner-unit rate, in contrast, moved up further to 1.2 per cent--the highest since the fourth quarter of 1968.

RESIDENTIAL VACANCY RATES
(Per cent)

	Average for the fourth quarter				
	1965	1970	1971	1972	1973
Rental units	8.5	5.2	5.6	5.6	5.8
Northeast	5.6	2.6	3.5	3.9	4.4
North Central	7.2	5.6	6.0	5.5	6.2
South	9.3	6.8	7.4	7.0	6.9
West	12.5	5.7	5.3	6.1	5.8
Homeowner units	1.5	1.1	1.0	1.0	1.2
Northeast	1.1	.9	.6	.6	.7
North Central	1.2	1.0	.9	1.1	1.0
South	1.8	1.3	1.2	1.2	1.4
West	1.7	1.2	1.2	1.3	1.6

<u>Labor market</u>. The labor market has begun to show substantial effects from fuel and power shortages and weakening demands in some sectors. Payroll employment fell sharply in January, hours of work

declined and the unemployment rate rose .4 percentage points. The number of workers receiving unemployment insurance benefits also has continued rising, to levels 20 per cent above a year earlier. Energy shortages have had major direct and indirect effects on employment in automobile manufacturing and sales, gasoline stations, air transportation, and hotels and motels. Preliminary estimates based on filings for unemployment insurance suggest a cumulative total of 300,000 energy related layoffs since the beginning of December.

The January increase in the unemployment rate to 5.2 per cent was from a revised December rate of 4.8 per cent. As a result of the annual revision of seasonal adjustment factors, the revised data now show that in 1973 the unemployment rate declined during the spring and early summer, held steady until early fall, and then began rising near year end. The January rise in unemployment occurred largely among young adults and teenagers, and was accompanied by a large increase in the labor force. Since October the number of unemployed workers has increased by over 600,000 with increases occurring among nearly all labor force groups.

Nonfarm payroll employment, which grew rapidly for over two years, edged off in December (after a downward revision) and dropped by 260,000 in January. Employment reductions in January were widespread with sharp losses in contract construction and durable goods manufacturing--particularly autos, primary metals and machinery. In addition, average

SELECTED UNEMPLOYMENT RATES
(Per cent, seasonally adjusted)

	1973				1974
	I	II	III	IV	Jan.
Total	5.0	4.9	4.7	4.7	5.2
Males 20 years and over	3.4	3.3	3.0	3.0	3.4
Females 20 years and over	5.0	4.8	4.8	4.7	5.2
Teenagers	14.8	14.7	14.3	14.3	15.6
Household heads	3.0	2.9	2.7	2.8	3.0
State insured	2.9	2.7	2.7	2.7	2.9
White collar	3.0	3.0	2.9	2.8	3.2
Blue-collar	5.6	5.4	5.2	5.3	6.0

weekly hours of manufacturing production workers fell sharply--from 40.7 hours in December to 39.9 hours in January--with declines in nearly all industries. There were also further job cuts in retail trade and services, apparently in part energy-related.

CHANGES IN NONFARM PAYROLL EMPLOYMENT
(In thousands, seasonally adjusted)

	Dec. 1971-Dec. 1972	Dec. 1972-Nov. 1973	Nov. 1973-Dec. 1973	Dec. 1973-Jan. 1974
	----------Average Monthly Change----------			
Total nonfarm	228	243	- 48	-259
Private	189	213	-114	-281
Manufacturing	75	63	- 4	-125
Durable goods	61	54	- 7	-113
Service-producing	115	124	-130	- 27
Trade	51	52	-120	- 37
Service	42	53	2	- 17
Government	39	31	66	22
Federal	- 1	- 1	16	- 6
State and local	41	32	50	28

Earnings. The average hourly earnings index for private nonfarm production workers rose moderately in January. Increases have slowed somewhat in the past several months. But since early 1973, the index has risen at a 7 per cent annual rate faster than during Phase II although slightly slower than during the year and a half prior to the August 1971 wage freeze. Wages in manufacturing recently have been rising at about the same pace as during the pre-freeze period, but there have been noticeable slowdowns in construction and services.

HOURLY EARNINGS INDEX*
(Seasonally adjusted; per cent change at annual rates)

	Jan. 1970- Aug. 1971	Jan. 1972- Mar. 1973	Mar. 1973- Jan. 1974
Total private nonfarm	7.3	5.6	7.0
Manufacturing	6.9	5.4	7.0
Construction	8.9	5.5	6.6
Transportation and p. u.	8.7	9.2	7.4
Trade	6.3	5.0	7.1
Services	7.8	4.7	6.9

* Excludes effects of fluctuations in overtime premiums in manufacturing and shifts of workers between industries.

Productivity and costs. Productivity performance has been sagging since the second quarter of 1973, as often occurs when output growth slows. Output per manhour in the private nonfarm sector declined at a 2.4 per cent annual rate in the fourth quarter; over the year nonfarm productivity rose only .8 per cent, compared with a 4.6 per cent gain during the four quarters of 1973.

Compensation per manhour in the private nonfarm economy increased at an 8.3 per cent annual rate in the fourth quarter; from the fourth quarter of 1972 to the fourth quarter of 1973 hourly compensation increased 8 per cent, reflecting generally strong demands for labor, rising prices, a heavy collective bargaining calendar, and an increase in employer social security taxes at the beginning of the year.

Unit labor costs rose at a rate of 11 per cent in the fourth quarter of 1973--the fourth consecutive quarter of substantial unit labor cost increases. In the nonfarm sector these costs were up 7.1 per cent over the year, compared with 2.4 per cent during the four quarters of 1972.

Collective bargaining. In the first major collective bargaining settlement of 1974 the three major aluminum companies and the United Steel Workers--representing 55,000 workers--agreed to a new forty month contract effective February 1. This contract provides a total wage rate increase of about 15 per cent over its life, an improved cost-of-living adjustment (COLA) provision for wages, and substantial improvements in pension benefits--including a possible pattern-setting cost-of-living escalator. The COLA for wages provides for a 1 cent an hour increase in wage rates for each 0.3 point rise in the CPI with no maximum; this will give the workers approximately a 1 per cent increase in wages for each 1 per cent increase in the CPI. Under their old agreement (1 cent an hour for each 0.4 point rise in the CPI) the workers had received 35 cents or about 9 per cent over their three year contract.

The pension agreement is the most significant feature of the new contract. A pension COLA provision, effective February 1, 1976, will provide all members who retire after February 1, 1974 with 65 per cent of the average annual percentage increase in the CPI in the previous year. The agreement is designed to provide a retired worker initially with an income (including social security) of about 85 per cent of his gross on-the-job pay. In addition, the pension package lowers the retirement age to 62 years from 65, increases the basic monthly pension payments to retirees, and provides full pension benefits plus $230 a month until retirement age for workers who are involuntarily retired as a result of layoff or plant shutdowns. Estimates are not available for the cost of these improvements.

The aluminum agreement has traditionally set a pattern for can, steel and other metal industries that bargain with the steel workers union and it is likely that forthcoming demands in the steel industry will follow closely the provisions of the aluminum agreement.

Major collective bargaining agreements in 1973 as a whole provided smaller pay increases than settlements reached in 1972: first year adjustments declined from the 7.3 per cent average in 1972 to 5.8 per cent in 1973 and a similar decline occurred in wage rate gains over the life of the contract. However, these data may overstate the extent of moderation in wage bargaining for two reasons. First, data on wage rate changes under collective bargaining agreements do not include cost-of-living increases and about 40 per cent of the workers included in the data were covered by agreements containing escalator clauses. Cost-of-living adjustments were higher in 1973 due to rapid price increases. Second, a modest rail wage settlement (less than 4 per cent over the life of the contract) held the average wage increase down in nonmanufacturing activities.

In the manufacturing sector, overall negotiated pay gains also slowed from the previous year. But among factory woerkers not covered by costs of living escalators, negotiated wage increases rose from 6.1 per cent in 1972 to 6.6 per cent in 1973. This apparently reflected an attempt by these workers to keep pace with workers receiving COLA.

About 5 million workers were covered by settlements concluded in 1973--about double the previous year. Contract duration, which decreased in 1972, declined again in 1973 reflecting shorter agreements mainly in the railroad and construction industries--probably an attempt to reduce the period of "locked in" wage increases during a period of rising prices.

WAGE INCREASES PROVIDED BY MAJOR CONTRACT SETTLEMENTS*
(Mean per cent wage adjustment--annual rate)

	1971	1972	1973(p)	1973(p)			
				QI	QII	QIII	QIV
Average-over-life-of contract							
Total	8.1	6.4	5.2	4.5	5.7	5.3	4.3
Manufacturing	7.3	5.6	4.9	6.1	5.2	5.1	3.9
Nonmanufacturing	8.9	6.9	5.4	3.8	5.8	5.5	5.7
Construction	10.8	6.0	5.2	4.9	5.8	4.6	4.9
First year							
Total	11.6	7.3	5.8	5.3	6.1	5.9	5.4
Manufacturing	10.9	6.6	5.9	6.5	6.0	5.9	5.3
Nonmanufacturing	12.2	7.8	5.6	4.7	6.1	5.8	5.7
Construction	12.6	6.9	5.2	4.5	6.3	4.6	4.8

*Applies to settlements affecting 1,000 or more.

Consumer prices. Consumer prices in December rose at an annual rate of nearly 7 per cent, seasonally adjusted--much less than in November--as the advance in food prices slowed sharply to a 3 per cent rate. Prices of other commodities and of services, however, continued to increase at the high November rates of about 9 and 7 per cent, respectively. The rise for "All items" from December 1972 approached 9 per cent, the largest 12-month advance since 1951; however, excluding food and petroleum products the increase was under 5 per cent.

CONSUMER PRICES

(Percentage changes, seasonally adjusted annual rates)

	Relative importance Dec. 1972	Dec. '71 to Dec. '72	Dec. '72 to Dec. '73	Dec.'72 to June'73	June'73 to Sept'73	Sept'73 to Dec.'73	Nov.'73 to Dec.'73
All items	100.0	3.4	8.8	8.0	10.3	9.0	6.7
Food	22.5	4.7	20.1	21.5	28.8	9.2	3.2
Commodities less food	40.1	2.5	5.0	4.7	2.6	7.9	8.9
Services	37.4	3.6	6.2	4.0	7.4	9.4	6.9
Addendum:							
All items less food and energy components 1/ 2/	71.5	3.0	4.7	3.8	5.6	5.5	3.6
All items less mortgage costs	96.3	3.4	8.5	8.1	9.4	8.3	7.3
Services less home finance 1/ 3/ 4/	30.9	3.3	5.1	4.3	4.8	7.2	7.2
Commodities less food, used cars, home purchase 1/	31.8	2.1	5.8	5.3	2.3	10.5	11.1

1/ Confidential--not for publication.
2/ Excludes food, gasoline and motor oil, fuel oil and coal, and gas and electricity.
3/ Not seasonally adjusted.
4/ Home financing costs excluded from services reflect property taxes and insurance rates-- as well as mortgage costs--which in turn move with mortgage interest rates and house prices.

The slower December rate of rise in food prices--reflecting mainly declines for meat and poultry--will likely be reversed in the first quarter of this year. According to preliminary confidential Department of Agriculture estimates, much of the sharp rise in steer prices this year had been passed on quickly to the retail level by the end of January. Thus, the large spread between farm and retail prices which has prevailed for beef, especially in the second half of 1973, appears to be continuing.

Gasoline, motor oil and fuel oil prices climbed further in December, adding about 3 percentage points to the annual rate of rise in the total index in that month and about 2 percentage points in the last three months of the year. Over the 12 months of 1973, however, the impact of fuel price increases was overshadowed by the rise in food prices.

FUEL PRICES AND THE CPI,1/ 1973

(Percentage changes, seasonally adjusted annual rates)

	Relative importance Dec.1972	Dec. 1972 to Dec.1973	Sept.1973 to Dec.1973	Nov.1973 to Dec.1973
Gasoline and motor oil, fuel oil and coal	3.6	23.4	75.0	86.2
All items less gasoline, motor oil, fuel oil	96.5	8.2	6.9	3.5

1/ Confidential--not for publication.

<u>Agriculture</u>. Prices received by farmers increased 9 per cent during the month ending January 15, to a level 39 per cent above a year earlier. Prices of potatoes, cotton, oilseeds, and most livestock and grains contributed to the rise but by early February corn and soybeans were the only major commodities still moving up.

January red meat production was unchanged from the December level, the high for 1973. But the composition of livestock marketings shifted as a 5 per cent drop in beef production was offset by an increase in pork. Beef supplies are expected to continue at low levels since feedlot placements have been down for several months, dropping another 7 per cent (seasonally adjusted) in December. But underlying conditions suggest expansion of beef supplies over the longer term. The 1973 calf crop was 3 per cent larger than the 1972 crop, and 7 per cent larger than the 1971 crop.

Growers intend to plant 5 per cent more feed grains in 1974, and 17 per cent more cotton, but soybean acreage may be down 3 per cent from 1973. Spring wheat plantings are expected to be 25 per cent larger which would push total wheat plantings (winter and spring) to 20 per cent above 1973 acreage. January stocks of wheat were a third below a year ago and feed grain stocks were off 7 per cent. Soybean stocks were up 27 per cent but the prospective drop in 1974 plantings has helped keep prices strong.

Prices of less expensive food commodities were consistently stronger in 1973 than those of higher-priced foodstuffs, and the outlook is still not good. On January 15, the prices of beans, rice, and potatoes were three, two, and one-half times higher, respectively than a year earlier. In comparison, cattle, hogs, and broilers, (having reached highs in August and lows in December) were 20, 29, and 35 per cent above a year ago, respectively. While an expansion in meat production is expected in the second half, 1974 rice and winter potato production (despite the rise in plantings of other crops) are expected to be down 2 and 8 per cent, respectively.

DOMESTIC FINANCIAL SITUATION

SELECTED DOMESTIC FINANCIAL DATA
(Dollar amounts in billions)

Indicator	Latest data: Period	Latest data: Level	Net change from: Month ago	Net change from: Three months ago	Net change from: Year ago
Monetary and credit aggregates				SAAR (per cent)	
Total reserves	January	35.8	34.3	13.8	8.2
Reserves available (PNB)	January	32.8	6.2	3.1	8.4
Money supply					
M1	January	269.6	-3.6	4.7	5.0
M2	January	573.7	6.3	8.6	8.3
M3	January	898.1	6.6	8.3	8.2
Time and savings deposits (Less CDs)	January	304.1	15.2	12.2	11.5
CDs (dollar change in billions)	January	65.5	2.7	1.7	20.8
Savings flows (S&Ls + MSBs)	January	324.4	7.1	7.7	7.8
Bank credit (end of month)	January	638.0	15.8	7.5	12.5
Market yields and stock prices				Percentage of index points	
Federal funds wk. endg.	2/6/74	9.13	-0.63	-0.58	2.92
Treasury bill (90 day) "	2/6/74	7.16	-0.41	-0.68	1.48
Commercial paper (90-119 day) "	2/6/74	8.25	-0.73	-0.53	2.12
New corporate bonds Aaa "	2/8/74	7.95	-0.11	0.20	--
Municipal bonds (Bond Buyer) 1 day	2/7/74	5.16	-0.06	-0.01	--
FNMS auction yield (FHA/VA)	2/11/74	8.53	-0.18	-0.34	8.0
Dividends/price ratio (Common stocks) Wk ending "	1/30/74	3.65	0.01	0.55	0.91
NYSE index (12/31/65=50) end of day	2/11/74	48.57	-1.55	-7.39	-16.91
Credit demands		Net change or gross offerings			
		Current month 1973	Current month 1972	Year to date 1973	Year to date 1972
Municipal long-term bonds (gross offerings)	November	2.2	1.9	21.4	21.9
Consumer instalment credit outstanding	December	0.4	1.7	20.1	15.9
Mortgage debt outst. (major holders)	November	3.6	5.3	54.3	50.9
Corporate bonds (public offerings)	November	2.1	1.4	12.1	17.3
Federally sponsored Agcy. (net borrowing)	February	1974	1973	1974	1973
		-0.3e	0.8	-0.8e	1.3
Business loans at commercial banks	January	2.2	3.6	2.2	3.6
U.S. Treasury (net cash borrowing)	February	-0.5	3.9	-1.2	5.4
Total of above credits		9.7	18.6	108.1	116.3

e - Estimated

DOMESTIC FINANCIAL SITUATION

Financial and nonfinancial businesses raised an unusually large volume of funds at banks and in the money and capital markets in January and early February, while State and local governments maintained their high rate of borrowing and the Treasury lengthened its debt in a refunding. At the same time, reflecting the indications of an easing in monetary policy after the last Committee meeting, and the marked slowing of foreign official sales of dollar assets since late January, short-term interest rates declined from 75 to 100 basis points or more. Longer-term rates also have edged downward recently, partly reflecting weakness in the economic situation.

The very large volume of short- and long-term business borrowing may be associated with the recent step up in inventory accumulation, and the retardation of cash flows outside of the petroleum industry. Banks financed their sharp increase in loans during January in the time deposit market, where CD inflows were large and other time deposit inflows accelerated. Savings and loan associations' deposit growth remained close to its recent rate and preliminary data suggest that they have further increased new commitments for residential mortgages at somewhat lower interest rates. Savings banks' new money inflows were lower than in the fourth quarter. Apparently, these institutions--with their more interest-sensitive depositors--were still being adversely affected by the level of market yields as evidenced by the increase in non-competitive bids on Treasury bills in January.

<u>Outlook</u>. The weakening in economic activity and the expected maintenance of the higher pace of capital market borrowing are likely

to be associated with some moderation in short-term financing by businesses in the months ahead. However, the combination of large corporation tax payments in March and inventory accumulation--in part representing some effort to hoard scarce raw materials and in part involuntary as sales slow--is likely to contribute to relatively strong short-term credit demands in the weeks immediately ahead. Despite these near-term demands, banks may reduce their prime rate further at current levels of market rates; indeed, if the current level of market rates were to persist, a prime rate of 8 3/4 per cent would be indicated for those banks using formulas.

The Federal sector is not expected to be a major borrower in coming months. Although the Treasury will need to raise about $4 to $5 billion of cash by the mid-April tax date, it will thereafter pay down about $9 billion of debt over the rest of the current fiscal year. Projected Federal agency borrowing needs are also expected to be light as savings and loan associations repay debt and demands on FNMA remain small. With net savings inflows at thrift institutions expected to strengthen somewhat, new mortgage commitment activity is likely to increase further. This is likely to lead to some easing of mortgage terms since demands for mortgage credit will continue to be restrained by economic uncertainties as well as credit costs that are still high by historical standards.

Inventories of U.S. Government security dealers are swollen from the recent refunding operation, and those of corporate and municipal dealers have risen as a result of some investor resistance to the recent edging down of new offering yields. Prospective new issues of corporate and municipal bonds remain large, and thus long-term rates could come under upward pressure unless market participants anticipate further monetary ease.

The removal of capital controls by the United States adds another uncertainty to the domestic financial outlook. Both foreign and domestic concerns are likely to take greater advantage than before of borrowing facilities in U.S. markets. Demand pressures may focus most on long-term markets, where U.S. rates currently compare favorably with rates abroad. At the same time, a large volume of foreign, especially oil, money is likely to flow into U.S. financial markets, both through direct and indirect channels. However, these flows may move into the more liquid short-term assets. Thus, international flows could tilt the interest rate structure somewhat toward higher long- and lower short-term rates.

Monetary aggregates. Despite a sharp increase in bank loans and a pick-up in retail sales, M_1 declined in January. Some of the decrease reflected unwinding of the surge in foreign bank deposits at large U. S. banks in late December, but even without this factor M_1 still would have declined. There may also have been some shifting out of demand deposits associated with the large rise in consumer-type time and savings deposits at commercial banks in January.[1/] Notwithstanding the contraction in M_1, M_2, and M_3 grew moderately, supported by the strong rise in time and savings deposits at banks and a lesser, but still positive growth of deposits at thrift institutions.

Although banks did not bid aggressively, net sales of CD's in January were the highest since May 1973 and enabled banks not only to replace earlier runoffs but also to meet loan demands and add substantially to their investment portfolios. U. S. Government deposits and nondeposit sources of funds also grew in January, and with all major sources of funds except demand deposits expanding, the adjusted credit proxy registered its fastest monthly growth since last summer.

Bank credit. Paralleling growth in the member bank adjusted credit proxy, total loans and investments at all commercial banks

1/ Appendix A of the Greenbook Supplement will contain the results of the most recent Demand Deposit Ownership Survey.

MONETARY AGGREGATES[1/]
(Seasonally adjusted changes)

	1973 QII	1973 QIII	1973 QIV	1974 Nov.	1974 Dec.	1974 Jan.
	Per cent at annual rates					
M_1 (Currency plus private demand deposits)	11.5	- .2	7.5	10.4	7.1	- 3.6
M_2 (M_1 plus commercial bank time and savings deposits other than large CD's)	11.1	5.2	10.1	10.9	8.5	6.3
M_3 (M_2 plus time and savings deposits at mutual savings banks and S&L's)	10.4	4.5	9.2	9.7	8.5	6.6
Adjusted bank credit proxy	12.6	10.5	3.3	2.7	5.6	12.0
Time and savings deposits at commercial banks						
a. Total	17.8	14.0	5.8	3.3	10.7	21.5
b. Other than large CD's	10.4	10.4	12.5	11.0	10.1	15.2
	Billions of dollars[2/]					
Memoranda:						
a. U. S. Government demand deposits	- .8	- .1	--	- .2	- .9	1.2
b. Negotiable CD's	2.5	1.6	- 1.3	- 1.8	.8	2.7
c. Nondeposit sources of funds	.2	.5	--	.2	.3	.1

1/ Figures are based on the most recent revisions published January 31.
2/ Change in average levels month-to-month or average monthly change for the quarter, measured from last month in quarter to last month in quarter, not annualized.

(last-Wednesday-of-the-month series, seasonally adjusted) increased at an annual rate of almost 16 per cent in January. Bank holdings of Treasury issues increased for the first time since June, and their holdings of other securities rose as well. Only security loans among the major components showed no growth, although growth in consumer loans slowed. Business loans and loans to nonbank financial institutions were particularly strong in January.

COMMERCIAL BANK CREDIT 1/
(Seasonally adjusted changes at annual percentage rates)

	1973					1974
	QII	QIII	QIV	Nov.	Dec. r	Jan.
Total loans and investments 2/	12.7	11.4	4.4	5.0	1.5	15.8
U. S. Treasury securities	7.9	-34.4	-22.0	- 8.7	-28.6	15.8
Other securities	9.2	12.3	12.6	- 2.8	11.4	16.9
Total loans 2/	14.5	17.8	5.5	8.9	2.4	-15.5
Business loans 2/	18.4	17.3	5.1	9.9	5.3	16.6
Real estate loans	20.2	17.0	14.2	13.6	13.5	14.4
Consumer loans	14.1	14.7	10.1	10.5	4.5	7.4

1/ Last-Wednesday-of-month series except for June and December, which are adjusted to the last business day of the month.
2/ Includes outstanding amounts of loans reported as sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.
r/ Revised.

The 16.6 per cent seasonally adjusted rate of growth of business loans in January was the most rapid since late summer, when the pace of economic expansion was still relatively rapid and the cost of bank credit to business firms was considerably below that of commercial paper. Neither of these factors was operative in January, but nonfinancial businesses borrowed heavily at banks and also in the commercial paper and capital markets. Reflecting the attractive rates in the commercial paper market during the month relative to the prime rate, the volume of dealer-placed commercial paper issued was at a near record rate, and growth in the total volume of short-term business credit--business borrowing at banks plus dealer-placed commercial paper--exceeded the unusually rapid pace of the first quarter of 1973.

While it is possible that January business loan expansion was overstated by misestimated seasonal factors,[1/] detailed analysis of unadjusted data indicates that in several major industry categories business loan expansion was much larger than usual--particularly loans at large banks to commodity dealers and other wholesalers, public utilities, firms in metals and mining, and foreign businesses.

Much of the short-term financing by businesses last month may have been associated with further inventory accumulation. Some

1/ Business loans declined in January, but considerably less than the average of previous Januarys.

RATE SPREADS AND CHANGES IN BUSINESS LOANS AND COMMERCIAL PAPER
(Amounts in billions of dollars, seasonally adjusted monthly changes)

	Prime rate less 30-59 day commercial paper rate (per cent)	Business loans at all commercial banks 2/	Dealer placed commercial paper	Total	Annual rate of change in total 3/ (per cent)
		Average Monthly Changes 1/			
1973-QI	--	4.1	-1.3	2.8	23.7
QII	--	2.2	.2	2.4	19.0
QIII	--	2.2	.1	2.3	17.1
QIV	--	.7	1.2	1.9	13.8
April	-.29	2.4	-.1	2.3	18.2
May	-.05	2.8	--	2.8	21.8
June	-.41	1.4	.7	2.1	16.1
July	-.90	3.6	-.1	3.5	26.1
August	-.93	2.5	-.5	2.0	14.8
Sept.	-.40	.4	.9	1.3	9.5
Oct.	+.52	--	2.7	2.7	19.5
Nov.	+.38	1.3	1.1	2.4	17.1
Dec.	-.04	.7	-.3	.4	2.8
1974-Jan. e/	+.42	2.2	1.5	3.7	25.9
Weekly Pattern:					
1973-Dec. 5	+.10				
12	-.10				
19	-.03				
26	-.03				
1974-Jan. 2	-.03				
9	+.23				
16	+.43				
23	+.40				
30	+.45				

1/ Changes are based on last-Wednesday-of-month data.
2/ Adjusted for outstanding amounts of loans sold to affiliates.
3/ Measured from end-of-month to end-of-month.
e/ Partially estimated.

of the accumulation in industries experiencing slower sales was no doubt involuntary, but in other industries, where shortages and further price rises are anticipated, the accumulation may have represented voluntary stockpiling of raw materials.

Finance companies also raised a considerable volume of funds in commercial paper markets as the increase in outstanding directly-placed paper reached the previous high reported in July 1969. This together with increase in dealer-placed and bank-related commercial paper expanded total commercial paper outstanding by the largest one-month increase on record--$3.5 billion.

COMMERCIAL PAPER OUTSTANDING
(Seasonally adjusted, billions of dollars)1/

	Change in amount outstanding during:			Outstanding
	Nov. 1973	Dec. 1973	Jan. 1974e	Jan. 31, 1974e
Total commercial paper outstanding	1.2	-.5	3.5	45.3
Bank-related	.1	-.1	.6	5.5
Nonbank-related	1.1	-.4	2.9	39.8
Dealer	1.1	-.2	1.5	13.9
Direct	--	-.2	1.4	25.9

1/ Seasonally adjusted figures are unavailable for bank-related paper. The unadjusted data for bank-related paper are combined with seasonally adjusted nonbank-related data to obtain the total for commercial paper outstanding.
e/ Estimated.
NOTE: Components may not add to totals due to rounding.

Finance companies appear to have used the proceeds of their commercial paper financing to reduce bank loans, but nonbank financial institutions other than finance companies borrowed heavily at banks, producing a sharp increase in total loans to nonbank financial institutions. A special Federal Reserve Bank survey of large commercial banks showed that much of the growth in this loan category reflected loans to real estate investment trusts (REIT's). Loan commitments to all nonbank financial institutions had grown steadily in recent months,[1/] and it appears that the REIT's, beleaguered by adverse publicity, are less able to borrow in commercial paper markets and are turning to their bank lines for financing. The survey suggests that the bankers are not concerned by these takedowns, but are watching developments closely nonetheless.

1/ See Supplemental Appendix B for the most recent Monthly Survey of Loan Commitments.

<u>Nonbank financial intermediaries.</u> The January deposit experience at savings and loan associations and mutual savings banks differed substantially, with S&L's receiving an estimated $2.0 billion in net new money, while MSB's received less than $100 million. The seasonally adjusted annual rate of growth for these institutions is estimated at 8.0 per cent for S&L's and 1.0 per cent for MSB's. The increase in non-competitive bids on Treasury bills during January supports the view that the relatively high yields on market instruments represented strong competition for the savings dollar--particularly in New York City where MSB's lost over $100 million in deposits in January

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

	Mutual savings banks	Saving and loan associations	Both
1973 - QI	8.1	16.0	13.6
QII	6.8	10.4	9.2
QIII	-.4	3.1	2.0
QIV p/	5.8	8.9	8.0
November	6.8	8.8	8.3
December p/	8.5	8.8	8.7
1974 - January e/	1.0	8.0	5.5

p/ Preliminary.
e/ Estimated on the basis of sample data.

Recently available balance sheet data for the fourth quarter of 1973 indicate that total sources of funds at insured S&L's were nearly 40 per cent below the fourth quarter 1972 level. After record increases in borrowings during the third quarter, S&L's borrowed only $0.9 billion in the final quarter of 1973--a less-than-seasonal amount. And, although fourth quarter deposit inflows showed marked improvement from the third quarter pace--to a level 22 per cent less than a year earlier--mortgage acquisitions dropped to about half the amount acquired in the comparable period of 1972. This reduction reflects primarily the reduced level of outstanding commitments and a preference for allocating funds to increase liquid assets and reduce other liabilities rather than to acquire new mortgages in the market. Current data suggest that emphasis on rebuilding liquidity and reducing borrowings and other liabilities may continue during the early months of this year.

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

	1972	1973
Sources		
Deposit accounts 1/	7.1	5.0
Borrowed funds	1.8	.9
Subtotal	8.9	5.9
Gross mortgage repayments 2/	7.6	5.9
Other sources, net 3/	-.3	-1.9
Total	16.2	9.9
Uses		
Increase in liquid assets 4/	0.3	1.1
Gross mortgage acquisitions	15.9	8.8
Total	16.2	9.9
Memorandum: Detail of gross mortgage activity		
Loans closed	13.1	7.5
Loans purchased	2.7	1.3
Refinancings (included in loans closed)	1.4	.6

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.

<u>Consumer credit</u>. The increase in total consumer credit outstanding during December slowed to the lowest rate in nearly two years. After adjustment for normal seasonal variation, the gain amounted to $8.4 billion (annual rate). For the full year 1973, however, consumer credit expanded by a record $22.9 billion or 14.5 per cent.

Instalment credit outstanding rose at an annual rate of only $4.9 billion in December, the smallest increase since January 1971. Nonautomotive consumer goods credit, which amounts to less than one-third of total instalment credit outstanding, accounted for more than 60 per cent of the increase, with the remainder about equally divided between home improvement credit and personal loans. Automobile credit outstanding declined slightly during December, the first absolute decrease in this category in three years.

The December slowing of instalment debt growth reflected a slump in extensions in several key categories, with total extensions dropping more than 11 per cent. The seasonally adjusted decline in auto credit extensions--13.2 per cent--was accounted for not only by the reduced level of new and used car sales, but also by a further decrease in average contract size reflecting price concessions on large cars and a further shift in the mix of sales toward smaller cars. Extensions for the acquisition of nonautomotive goods were down more than 12 per cent from November, mainly because bank credit-card extensions during December were far below the normal seasonal pattern following an upsurge in November.

The ratio of consumer instalment credit repayments to disposable personal income, which had stabilized at about 15.5 per cent in each year from 1967 through 1971, increased to an average of 16.4 per cent last year after rising to 15.9 per cent in 1972. During the third quarter of 1973, the ratio reached a record 16.7 per cent, but there was a slight decline in the fourth quarter.

This rising burden of indebtedness may have been a contributing factor in the uptrend in delinquency rates on consumer credit. The seasonally adjusted delinquency rate on consumer instalment loans at commercial banks rose sharply in December to 1.99 per cent, only marginally below the early 1949 peak. Delinquencies were up from November to December for nearly all types of loans. For the full year 1973, the delinquency rate averaged 1.80 per cent, well above the 1.64 per cent rate of 1972 and the 1.54 per cent rate of 1971. This uptrend during the past two years has run counter to the downward movement usu usually associated with an expanding economy.

Short-term interest rates. Rates in short-term credit markets have declined substantially since the January FOMC meeting, mainly in response to System actions which supplied reserves visibly in the market at successively lower levels of the funds rate. Treasury bill rates generally have moved down 60 to 85 basis points, and many private rates have fallen by a full percentage point or more.

On private short-term instruments, rates had been declining slowly but fairly continuously since early December in response to widespread market expectations of some near-term easing in monetary policy. These anticipations, already sufficient to cause private rates to fall well below levels justified by the prevailing level of the funds rate, strengthened around mid-January as published data began to indicate some weakness in monetary growth and a slowdown in real economic activity. Then, after the January FOMC meeting, as conditions in the Federal funds market eased, the decline in private short-term rates accelerated.

In the Treasury bill market, rates had risen counter to the general down trend of private rates from late December through the January FOMC meeting, in part because actual and anticipated sales of bills by foreign central banks were weighing heavily on the market. Beginning in late January, however, foreign central banks became net b buyers of bills; moreover, market participants began to expect added demand for bills from countries receiving enlarged oil revenues. These developments have accentuated the recent decline in bill rates, so that, despite the concurrent decline in dealer carrying costs, the large negative carry on dealer positions persists.

<u>Treasury coupon markets</u>. Yields on Treasury coupon issues also have declined since the January meeting, notwithstanding the February refinancing. The Treasury, encouraged by the strength of the coupon market, chose to lengthen debt in the refinancing, and with an ample cash position, it allowed a net paydown of $450 million. Auction averages on the three new issues were below their coupon rates, as shown in the table. However, dealers received rather large awards, aggregating $1.6 billion for the three issues combined. While they have made progress in distributing their holdings, the overhang of dealer positions has introduced some caution into the market.

FEBRUARY REFUNDING

Issues	Amount 1/	Years to maturity	Coupon	Auction average	Dealer awards 2/
Bond	$0.3	19-1/2	7-1/2% (reopened)	7.46%	$157
Note	2.25	7	7	6.95	771
Note	1.5	3-1/4	6-7/8	6.70	706
Total	4.05				1,604

1/ In billions of dollars offered to public.
2/ In millions of dollars.

Looking ahead, the Treasury probably will need to raise an additional $4 to $5 billion of new money by mid-April in order to meet seasonal needs, possibly through the sale of TABs and short-term notes in early March and again in early April. Such borrowing is made more likely by the expiration of the Treasury's authority to borrow temporarily from the "Fed." These borrowing projections assume that foreign redemptions of special issues will continue their recent slowdown. Redemptions have totaled nearly $700 million since the start of the year, but only about $70 million of this total has occurred since the last Committee meeting.

In the market for Federal agency debt, due to the improved deposit experience of S&L's, the Federal Home Loan Banks may retire more than $1 billion of debt during the rest of fiscal 1974, rather than roll over maturing issues as previously planned. Thus, it now appears that net Agency borrowing and asset sales for the second half of fiscal 1974 will be about $1.1 billion below the amounts projected a month ago--and $5.2 billion below the amounts projected as recently as November.

SELECTED SHORT-TERM INTEREST RATES
(Per cent)

		Daily rates			
	Early Dec. highs	Jan. 22	Jan. 29	Feb. 5	Feb. 11
Treasury bills					
3-months	7.68	7.96	7.62	6.93	7.12
6-months	8.08	7.76	7.39	6.84	6.94
1-year	7.47	7.05	6.89	6.54	6.48
Commercial paper					
1-month	9.88	9.38	9.00	8.63	8.38
90-119 days	9.50	9.00	8.63	8.25	8.00
4-6 months	9.25	8.75	8.50	8.00	7.75
Large negot. CD's 1/					
3-months	9.75	9.10	8.63	8.00	8.00
d 6-months	9.13	8.63	8.38	7.50	7.75
Federal agencies					
1-year	7.83	7.79	7.87	7.42	7.18
Bank prime rate	9.75	9.75	9.50	9.50	9.25

	Statement week ended			
	Jan. 23	Jan. 30	Feb. 6	Feb. 13 2/
Federal funds (weekly average)	9.60	9.47	9.13	8.86

1/ Highest quoted new issues.
2/ Average for first six days of the week.

Private long-term securities markets. Long-term bond yields have declined slightly, on balance, since the last FOMC meeting. A large volume of new issues and concern about the prospective rate of inflation caused bond yields to rise throughout much of January. Late in the month, however, bond markets rallied in response to a substantial decline in short-term rates and widening expectations that the Federal Reserve was easing monetary policy. The yield decline was especially marked in the corporate new issue market, and underwriters found their new issues to be over-priced and moving slowly. In the municipal market, dealers continued to hold substantial inventories in anticipation of further price rises.

In the first quarter, total corporate security offerings are projected to average about $300 million per month more than in the fourth quarter of 1973. The increase is due to the expanded level of public bond offerings by industrial corporations and financial firms. Among financial firms, issues by bank holding companies are expected to be especially large--close to $1 billion in the first quarter. Recently, a number of borrowers have altered the amount, timing, and maturity structure of offerings in response to the congested calendar and prospective interest rate movements. So far this year, there have been approximately $300 million of postponements and $110 million of cancellations in the corporate bond market. Given the sensitivity of borrowers to the current market environment, the projections of long-term security offerings for February and March should be viewed as especially tentative.

SELECTED LONG-TERM INTEREST RATES

	New Aaa utility bonds 1/	Recently offered Aaa utility bonds 1/	Long-term State and local bonds 2/	U.S. Government bonds (10-year constant maturity)
1970 - High	9.43 (6/19)	9.20 (6/26)	7.12 (5/28)	8.06 (5/29)
Low	7.72 (12/11)	8.16 (12/18)	5.33 (12/10)	6.29 (12/18)
1971 - High	8.26 (7/30)	8.19 (1/2)	6.23 (6/24)	6.89 (7/20)
Low	7.02 (2/5)	7.14 (12/31)	4.97 (10/21)	5.87 (1/14)
1972 - High	7.60 (4/21)	7.46 (4/21)	5.54 (4/13)	6.58 (9/27)
Low	6.99 (11/24)	7.21 (12/1)	4.96 (12/7)	5.87 (1/14)
1973 - High	8.52 (8/10)	8.32 (8/10)	5.59 (8/3)	7.55 (8/10)
Low	7.29 (1/12)	7.28 (1/5)	4.99 (10/11)	6.42 (1/3)
Jan. 4	--	8.13	5.18	6.94
11	8.17	8.25	5.22	6.98
18	8.27	8.21	5.24	6.99
25	8.24	8.25	5.26	7.01
Feb. 1	8.11	8.19	5.20	7.01
8	7.95p	8.19p	5.16	6.95p

1/ FRB series.
2/ Bond Buyer.
r/ Revised.
p/ Preliminary.

Stock prices have declined, on balance, since the last FOMC meeting, and the average level of stock issues is expected to show a considerable drop in the first quarter, although February and March will be higher than January because of an expected build-up in utility issues. Prices on utility shares tend to be more interest sensitive than those of other companies and, with the recent drop in market yields, have risen despite the decline in the rest of the stock market.

CORPORATE AND MUNICIPAL LONG-TERM SECURITY OFFERINGS
(Monthly or monthly averages, in millions of dollars)

	1973		1974			
	Year	QIV e/	QI f/	Jan. e/	Feb. f/	Mar. f/
Corporate securities - total	2,779	3,385	3,650	3,450	3,800	3,850
Public bonds	1,125	1,625	2,200	2,200	2,200	2,300
Privately placed bonds	725	715	800	800	800	850
Stock	929	1,045	650	450	800	700
State and local government securities	1,942	2,200	2,100	2,100	2,100	2,100

e/ Estimated.
f/ Forecast.

The monthly volume of municipal financing in the first quarter is projected to average about 10 per cent higher than in the first quarter of 1973. Demand for these issues is being sustained by banks, particularly in the intermediate maturity ranges, while the supply is being kept up by special revenue issues and industrial pollution control bonds.

<u>Mortgage market</u>. Mortgage market conditions apparently have eased somewhat further since year-end, although the demand for funds by builders and buyers continues to be restrained by economic uncertainties and high costs of building and homeownership. Seasonally adjusted new mortgage commitments at savings and loan associations recovered somewhat further in January, according to tentative estimates. The volume of S&L mortgage commitments outstanding (including loans in process)--which edged up in December following nine consecutive months of decline--also apparently increased in January, after seasonal adjustment.

Contract interest rates on new commitments for 80 per cent conventional home loans at selected S&L's drifted downward again over the past several weeks, after levelling off around year-end. By February 8, the rate averaged 8.46 per cent--39 basis points below the September peak but still above the usury ceilings of 8 per cent or less currently prevailing in 10 states and the District of Columbia.[1/] Average rates on conventional home mortgage loans closed, which had been rising since early last year, apparently peaked around year-end and changed little in January. The increase in these rates was an important factor in the 14 per cent rise over the past year in the average principal-plus-interest payments of buyers of new and existing homes.

With 8-1/2 per cent FHA/VAmmortgages selling close to par in the secondary market, the maximum contract rate on Government-underwritten mortgages was reduced by administrative action to 8-1/4 per cent,

1/ On January 30, Pennsylvania abolished an 8 per cent ceiling on conventional home mortgages under $35,000 and replaced it with a flexible ceiling set 2-1/2 percentage points above the market yield on long-term Government bonds and applicable to loans under $50,000.

effective January 22. On the same date, GNMA announced a revised Tandem Plan to purchase up to 200,000 new-home FHA/VA mortgages bearing a special contract interest rate 50 basis points below the new ceiling.[1/] In the first 14 business days following initiation of this interest-rate subsidy program, 4,570 applications for commitments had been received by GNMA--4,193 for single-family and 377 for multifamily mortgages.

1/ Under this plan, no maximum income limits for eligible borrowers have been established and maximum loan limits are about the same as those currently prevailing for FHA-insured mortgages. GNMA commits to buy the 7-3/4 per cent mortgages at a price of 96 (on certification that no more than 4 points have been charged) and later sells the contracts at auction to FNMA and/or other private investors at market price--its loss on the entire transaction representing the amount of the subsidy.

CONVENTIONAL HOME MORTGAGES
At 120 S&L's

	Average going rate on 80% loans (per cent)	Basis point change from month or week earlier	Spread 1/ (basis points)	Number of Federal Home Loan Bank districts with funds in short supply
1972 - High	7.46	--	45	7
Low	7.23	--	-31	0
1973 - High	8.85	--	107	12
Low	7.43	--	-12	0
1973				
Aug.	8.66	+48	72	12
Sept.	8.85	+19	104	11
Oct.	8.68	-17	71	10
Nov.	8.55	-13	70	8
Dec.	8.56	+ 1	n.a.	6
1974				
Jan. 4	8.56	0	n.a.	5
11	8.53	- 3	36	4
18	8.55	+ 2	28	5
25	8.52	- 3	28	4
Feb. 1	8.48	- 4	37	4
8	8.46	- 2	51	3

1/ Gross yield spread is average mortgage return before deducting servicing costs minus average yield on new issues of Aaa utility bonds with 5-year call protection.

Agricultural finance. Several unusual influences evidently stimulated farm loan volume in the closing months of 1973. To minimize or defer income taxes and in anticipation of higher future prices, farmers postponed the sale of 1973 crops, sought to purchase equipment in time to obtain an investment tax credit against 1973 income, and made advance purchases of production inputs to be used in 1974. Curtailment of some trade credit traditionally offered as sales inducement may also have increased farm loan demand at institutional lenders.

Consequently, for the first time ever, outstanding loans at Production Credit Associations (PCA's) rose during the second half of the year--by a significant 5 per cent--bringing the total 1973 gain to 18 per cent, the largest increase since 1959. Loan repayments rose as excellent 1973 net farm income would suggest, but new lending activity was even stronger. Farm lending experience at banks was similar to that at PCA's, as judged from banker responses to January 1 surveys in the Chicago and Minneapolis Districts. Repayments were up and requests for renewals were low, but demand for new loans continued strong through the last two quarters. For the current quarter, somewhat lower over-all demand is expected, particularly for real estate and grain storage loans. Continued strength generally is expected in machinery and operating loan volume.

The farm real estate market continued active in the second half of 1973, pushing outstanding Federal Land Bank loans up 9 per cent. Rural bankers in the Chicago District reported a further average increase of 5 per cent in farm land prices during the fourth quarter.

Interest rates on farm loans edged up only slightly during the fourth quarter of 1973, following sharp third quarter increases. Federal Land Bank billing rates now range from 7.5 to 8 per cent. On January 1 rates at most Production Credit Associations ranged between 8.5 and 10 per cent, while most-common farm loan rates at rural banks in the Seventh and Ninth Districts were concentrated between 8 and 9 per cent.

Federal finance. The Federal budget released by the Administration on February 4 projects a budget deficit of $4.7 billion this year followed by a deficit of $9.4 billion in fiscal year 1975. An analysis of the new budget is contained in Appendix A.

As shown in the table at the end of this section, the Administration's estimate of budget outlays for fiscal 1975 is $304.4 billion, a $30 billion increase over the current year estimate of $274.7 billion. Our estimate of spending in the current year is $2.7 billion below the official budget figure. In recent years, overestimation of outlays in the on-going fiscal year has been a characteristic of the budget document. The rate of spending so far this year is consistent with a final figure of $274.7 billion only if one assumes a considerable speed-up of outlays over the next four months.

Our estimate of fiscal 1974 Federal receipts, $267.1 billion, is also below the Administration's. The $2.9 billion difference exists partly because we have not assumed that the windfall profits tax will be enacted. Since it now appears that Congress may legislate a rollback of crude oil prices, enactment of a windfall profits tax seems unlikely. We should note, however, that tax payments by corporations are nonetheless expected to be high this Spring as firms make unusually large final payments on their 1973 liabilities. In the budget document, corporate tax payments this Spring are estimated to be about $5 billion larger than last year, a figure roughly equal to ours.

We are projecting personal tax refunds of $24.9 billion this fiscal year--a full $2.0 billion above the most recent Administration estimate. This reflects our assumption that overwithholding continued unabated throughout the past year. In fiscal 1973, personal refunds were $21.9 billion.

PROJECTION OF TREASURY CASH OUTLOOK
(In billions of dollars)

	Jan.	Feb.	March	April
Total net borrowing	- .7	- .5	2.3	0.1
Weekly and monthly bills	--	--	--	--
Tax bills	--	--	--	-3.0
Coupon issues, net	--	- .5	--	--
As yet unspecified new borrowing	--	--	2.0	3.0
Special foreign series	- .7	--	--	--
Agency transactions, debt repayment, etc.	--	--	.3	.1
Plus: Other net financial sources a/	1.0	-1.1	2.0	.5
Plus: Budget surplus or deficit (-)	- .2	-3.1	-4.0	4.5
Equals: Change in cash balance	0.1 b/	-4.7	.3	5.1
Memoranda: Level of cash balance, end of period	10.5 b/	5.8	6.1	11.2
Derivation of budget surplus or deficit:				
Budget receipts	23.4	19.8	19.1	28.3
Budget outlays	23.6	22.9	23.1	23.8
Maturing coupon issues held by public	--	4.5	--	--
Sales of financial assets	0.2	0.2	0.7	0.2
Budget agency borrowing	--	0.3	--	0.1
Net borrowing by government-sponsored agencies	-0.4	-0.3	0.7	0.7

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

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

	Fiscal 1974 e/ Budget Doc.	Fiscal 1974 e/ F.R. Board	FY 1975 e/ Budget Doc.	Calendar Years 1973 Actual	Calendar Years 1974 F.R.B. e/	1973 IV*	F.R.B. Staff Estimates Calendar Quarters 1974 I	1974 II	1974 III	1974 IV
Federal Budget										
Surplus/deficit	-4.7	-4.9	-9.4	-7.9	-12.1	-5.0	-7.3	8.4	-4.3	-8.9
Receipts	270.0	267.1	295.0	250.4	278.7	59.9	62.3	80.5	70.3	65.6
Outlays	274.7	272.0	304.4	258.3	290.8	64.9	69.6	72.1	74.6	74.5
Means of financing:										
Net borrowing from the public	3.5	1.3	12.5	7.9	7.3	6.7	1.1	-5.8	4.1	7.9
Decrease in cash operating balance	n.a.	3.9	n.a.	.7	2.9	-2.1	4.3	-2.6	1.2	--
Other 1/	n.a.	-.2	n.a.	-.7	1.9	0.4	1.9	--	-1.0	1.0
Cash operating balance, end of period	n.a.	8.7	n.a.	10.4	7.5	10.4	6.1	8.7	7.5	7.5
Memo 2/: Sales of financial assets 3/	3.7	3.0	4.5	3.6 e/	n.e.	1.0 e/	1.1	1.1	n.e.	n.e.
Budget agency borrowing 4/	1.7	1.1	1.8	0.1	n.e.	0.3	0.3	0.1	n.e.	n.e.
Sponsored agency borrowing 5/	13.6	10.1	1.3	16.3	n.e.	3.2	--	0.9	n.e.	n.e.
National Income Sector						Seasonally adjusted, annual rates				
Surplus/deficit	-4.7	-3.8	-8.6	0.7	-11.6	3.1	-.9	-17.9	-13.6	-14.0
Receipts	280.5	276.5 6/	304.8	265.4	288.9	275.5	281.7	285.9	290.7	297.1
Expenditures	285.2	282.0 7/	313.4	264.8	300.5	272.4	282.6	303.8	304.3	311.1
High Employment surplus/deficit (NIA basis) 7/	n.a.	-2.8	n.a.	-2.0	-0.8	-1.7	1.7	-9.1	0.5	3.9

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

Footnotes continued

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

2/ The sum of sponsored and budget agency debt issues and financial asset sales does not necessarily reflect the volume of debt absorbed by the public, since both the sponsored and budget agencies acquire a portion of these issues.

3/ Includes net sales of loans held by the Commodity Credit Corporation, Farmers Home Adm., Government National Mortgage Assn., Federal Housing Adm., and Veterans Adm. Receipts from these sales are netted against Federal Budget Outlays shown above.

4/ Includes, for example, debt issued by the U.S. Postal Service, Export-Import Bank, and Tennessee Valley Authority, which is included in the Net Treasury Borrowing from the Public shown above.

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

6/ Quarterly average exceeds fiscal year total by $1.7 billion for fiscal 1974 due to spreading of wage base effect over calendar year.

7/ Fiscal year exceeds quarterly average of $.9 billion due to seasonal adjustment.

8/ Estimated by F.R. Board Staff.

INTERNATIONAL DEVELOPMENTS

2/13/74

CONFIDENTIAL (FR)

III -- T - 1

U.S. Balance of Payments
(In missions of dollars; seasonally adjusted)

	1973				
	YEAR	1H	3Q	4Q	DEC.*
Goods and services, net 1/		824	2,148		
Trade balance 2/	794	-1,216	710	1,300	798
Exports 2/	70,310	32,104	18,158	20,048	6,841
Imports 2/	-69,516	-33,320	-17,448	-18,748	-6,043
Service balance		2,040	1,438		
Remittances and pensions		-786	-422		
Govt. grants & capital, net		-1,258	-872		
U.S. private capital (- = outflow)		-8,209	-690		
Direct investment abroad		-2,971	-228		
Foreign securities	-792	-75	-204	-513	-48
Bank-reported claims -- liquid	-1,169	-446	-343	-380	-160
" " " other	-4,783	-3,762	403	-1,424	-1,084
Nonbank-reported claims -- liquid		-769	-5		
" " " other		-186	-313		
Foreign capital (excl. reserve trans.)		2,731	3,299		
Direct investment in U.S.		807	720		
U.S. corporate stocks	2,795	1,426	869	500	-2
New U.S. direct investment issues		658	193		
Other U.S. securities (excl. U.S. Treas.)		158	96		
Liquid liabilities to:	4,435	-771	951	4,255	606
Commercial banks abroad	2,860	-1,185	845	3,200	149
Of which liab. to branches 3/	(277)	(7)	(93)	(177)	(-781)
Other private foreign	1,201	371	156	674	464
Intl. & regional organizations	374	43	-50	381	-7
Other nonliquid liabilities		453	470		
Liab. to foreign official reserve agencies	5,081	9,927	-2,095	-2,751	-576
U.S. monetary reserves (increase, -)	209	237	-13	-15	-5
Gold stock	--	--	--	--	--
Special drawing rights	9	9	--	--	--
IMF gold tranche	-33	-5	-13	-15	-5
Convertible currencies	233	233	--	--	--
Errors and omissions		-3,466	-1,355		
BALANCES (deficit -					
Official settlements, S.A.		-10,164	2,108	2,766	
" " , N.S.A.	-5,290	-9,223	933	3,000	581
Net liquidity, S.A.	n.a.	-8,178	1,505	n.a.	
" " , N.S.A.	n.a.	-8,197	625	n.a.	
Liquidity, S.A. 4/		-9,393	1,157	-1,489	
" , N.S.A.	-9,725	-9,352	128	-501	-25
Basic balance, S.A.		-1,553	2,539		
" " , N.S.A.		-1,646	712		

* Monthly, only exports and imports are seasonally adjusted.
1/ Equals "net exports" in the GNP, except for latest revisions.
2/ Balance of payments basis which differs a little from Census basis.
3/ Not seasonally adjusted.
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.

Summary and outlook. The strong appreciation of the dollar that had begun last October was sustained through most of January but was reversed toward the end of the month. Upward pressure resulted from the market's view that the United States would not be as much affected as others by the late December rise in oil prices, and by such events as the floating of the French franc on January 21, and the announcement of the large U.S. trade surplus in December. The dollar has tended to depreciate somewhat in the past three weeks, reflecting the removal of U.S. capital controls and the relaxation of restraints in some countries against capital inflows, and also in response to a decline in U.S. interest rates relative to those abroad. As of mid-February the dollar had depreciated about 13 per cent since May 1970 (trade-weighted basis) and almost 3 per cent from the late January highs.

Sales of dollars by some foreign central banks to slow the declines of their currencies totaled about $3 billion in January, but such sales diminished toward the end of the month and there were some increases in officially held dollars in early February. One of the flows of funds tending to strengthen the dollar in the first three weeks of January was a large increase in gross liabilities of U.S. banks to foreign commercial banks. These flows, which are highly irregular, probably reflected the reversal of the year-end seasonal decline; over the past 2½ months these liabilities have changed little on balance.

The outlook for the balance on goods and services in the year ahead is that there will be a marked shift from the sizable surplus registered at the end of 1973 to a deficit position in the latter half of 1974. A large part of the shift will reflect much higher payments for oil, and a contributing factor will probably be some reduction from the current very high level of agricultural exports. It is now generally accepted that oil importing countries as a group will have a current account deficit, and that an important concern of international economic management will be to avoid attempts by individual countries to achieve trade balances, apart from oil, that would be unwarranted in terms of longer-run payments aims.

For the United States, the prospective trade deficit, if allowance is made for oil imports, may not be inconsistent with longer-run aims. Some other countries, notably the United Kingdom and Italy, may be in an especially poor position to absorb the increased cost of oil, while such countries as Germany may be able to do so relatively easily.

The over-all pressure felt by each country will depend in part on the direction of the large capital flows that are in prospect. An immediate response of some countries, notably France, has been to prepare for large borrowings in international markets, and to reduce barriers against inflows. While strong flows are expected to come to the United States because of the scope for investment offered by capital markets here, the removal of controls on capital outflows, and relative easing of U.S. interest rates, could generate very substantial offsetting outflows.

Foreign exchange markets. After appreciating by about 12-1/2 per cent (weighted average basis) from end-October through late January, the dollar has depreciated by some 2-1/2-3 per cent in the past three weeks, following the removal of U.S. controls on capital outflows and subsequent foreign relaxation of controls on capital inflows. Central bank intervention, which involved net sales of $4.2 billion in January, has been relatively modest thus far in February.

The dollar actually peaked just after the French franc was allowed to float on January 21. After the initial firming in response to this action, the dollar tended to stabilize and even ease somewhat. On January 28, however, with the announcement of a record U.S. trade surplus in December, the dollar once again rose sharply. This renewed upward movement was decisively ended on January 29 when the U.S. actions on capital controls were announced. On the next day Germany, Belgium, and the Netherlands removed or relaxed restrictions on capital inflows, followed by Switzerland on January 31. (France and Japan had acted earlier. See details on some of these actions on p. III - 6 below).

Contributing to the dollar's decline since the widespread relaxation of capital controls has been a substantial decline in U.S. interest rates relative to rates abroad. Another significant factor was the announcement by the French government that it would float a $1-1/2 billion Euro-dollar loan. While this, of course, affected primarily the franc/dollar exchange rate, it probably also caused other foreign currencies to strengthen against the dollar, since it was indicative of what other major countries might do. It is worth noting that the French franc, after an initial 5-1/2 per cent depreciation against the dollar when the franc was first floated, has now appreciated back to very near its pre-float level.

Other currencies worthy of special mention are the Canadian dollar and the Italian lira. The Canadian dollar has reacted strongly to the decline in U.S. interest rates and the market's re-assessment of Canada's favorable energy position. The Canadian dollar in recent days has risen to over $1.02, its highest level in well over a year, and the Bank of Canada has purchased, net, $140 million thus far in February. The lira has been supported by Bank of Italy intervention on virtually every day this month. (In January the Bank of Italy sold $900 million). An increase in the System's swap line with the Bank of Italy, from $2 billion to $3 billion, was announced on February 4.

In the gold market prices have been extremely volatile in recent weeks. The London price was $130 before the floating of the French franc, jumped to $141 shortly thereafter, receded to near $130 again, then rebounded to reach a new high of $147.75 on February 12. This last spurt seems to have been related, in part, to increasing speculation that European countries may soon raise the official price of gold for intra-European settlements.

Euro-dollar market. Euro-dollar rates have declined in all maturities during the past four weeks, in response to the decrease in short-term rates in the United States, the removal of U.S. controls, and perhaps some shifting out of other currencies into dollars. The 3-month Euro-dollar rate has dropped more than a percentage point, to an average of 8.39 per cent in the week of February 13, reducing the spread over the U.S. 60-89 day CD rate to 26 basis points in the latest week. The supply of funds to the Euro-market was presumably increased during the period by the termination of controls on liquid funds held abroad by U.S. corporations. Funds derived from higher payments for oil also added to supplies, but the higher oil payments also led to higher demand for credit in the Euro-market.

For U.S. banks, the cost of borrowing overnight Euro-dollars remained above the cost of Federal funds when subject to reserve requirements, over most of the period. U.S. banks' gross liabilities to their foreign branches, which have changed little since November, declined slightly to a daily average of $1.96 billion in the week of February 6.

The removal of U.S. capital controls on January 29 opens up the possibility for yield differentials to result in substantial flows of funds to the Euro-currency markets. When these controls were terminated, U.S. CD rates were below rates on Euro-dollar deposits of comparable maturity -- by close to 1/2 percentage point in the case of 3-month funds. Presumably some arbitraging between the two markets has already occurred, tending to reduce the differential. The greater liquidity of the CD as compared with the Euro-dollar deposit may help to prevent complete equalization of the rates on the two instruments, but further flows of funds and a further narrowing of the rate differential would appear likely.

On the borrowing side, U.S. companies that can borrow in the U.S. commercial paper market can at present raise funds there more cheaply than in the Euro-dollar market, where prime borrowers of short-term funds today pay 3/8 to 5/8 over the bid rate on deposits of equivalent maturity, i.e., 8.63 to 8.88 per cent for 3-month loans as of February 13. With the removal of FDIP, many direct investors may elect to pay off some of the $1-1/2 billion of short-term Euro-dollar loans outstanding with funds raised in the commercial paper market. However, the higher effective costs of short- and medium-term bank credit in the United States than in the Euro-dollar market will limit the impact of removal of the FDIP and VFCR.

The Euro-currency markets are being subjected to many cross-currents. While downward pressure on Euro-dollar rates has come from the U.S. side, changes in controls over capital movements by several industrial countries in the last week of January have tended to increase demand in the market. Germany reduced the rate of the Bardepot from 50 to 20 per cent; Belgium abolished several controls that prohibited or discouraged capital inflows through the banking system; and France prohibited all lending of francs to foreigners by banks and other financial institutions. In addition, Japan has moved since October to encourage capital inflows and restrict outflows, reversing the earlier practice of suppling funds to the market through Japanese banks. Finally, as noted, the financial consequences of the increases in oil prices are swelling the flow of funds through these markets, with a net impact on rates that so far is not determinable.

In January, the volume of new medium-term loans of Euro-currencies (almost all Euro-dollars and with adjustable rates based on deposit rates) remained at the very high levels reached last year. Provisional estimates by the World Bank put the January total at $2.4 billion, equal to the average monthly rate in the second half of 1973. Extensions of such loans have increased many fold in the past three years, primarily representing new financing. Italian and British borrowers continue to take a large volume of funds. January borrowings included two 10-1/2 year loans, totalling $750 million, to IMI, an Italian state lending institution, and two 10-year loans totalling $420 million to Burmah Oil of the United Kingdom. In 1973 Italian state agencies borrowed about $4.5 billion to finance Italy's external deficit, while U.K. public sector borrowers took about $2.5 billion. The February total for all borrowers may be larger. It will include a record $1.5 billion 7-year loan to the French Treasury to protect French reserves against higher oil imports, and a $500 million loan to the British Electricity Council. Japanese firms will soon be borrowing on a large scale in the Euro-dollar market or the United States. Italian state agencies' borrowings abroad may increase further, with some funds possibly coming from the United States; British borrowing will also continue heavy and may increase.

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

Average for month or week ending Wednesday	(1) Over-night Euro-$	(2) Federal Funds	(3) Differ-ential (1)-(2)(*)	(4) 3-month Euro-$ Deposit	(5) 60-89 day CD rate	(6) Differ-ential (4)-(5)(*)
1973-Oct.	10.04	10.01	0.03 (0.90)	9.96	9.16	0.80 (0.54)
Nov.	9.51	10.08	-0.57 (0.26)	9.89	9.11	0.78 (0.51)
Dec.	9.73	9.96	-0.23 (0.62)	10.40	9.43	0.97 (0.94)
1974-Jan.	9.10	9.65	-0.55 (0.24)	9.38	8.97	0.41 (0.45)
1974-Jan. 2	11.00	9.88	1.12 (2.08)	10.32	9.25	1.08 (1.17)
9	9.32	9.75	-0.43 (0.38)	9.37	9.00	0.37 (0.40)
16	9.35	9.77	-0.42 (0.39)	9.57	9.13	0.44 (0.48)
23	9.05	9.60	-0.55 (0.24)	9.48	9.13	0.35 (0.38)
30	8.66	9.47	-0.81 (-0.06)	9.09	8.63	0.46 (0.50)
Feb. 6	8.81	9.13	-0.32 (0.45)	8.79	8.13	0.66 (0.72)
13 p/	8.24	8.85	-0.61 (0.11)	8.39	8.13	0.26 (0.28)

*/ Differentials in parentheses are adjusted for the cost of required reserves.
p/ Preliminary

U.S. balance of payments. In January, the official settlements balance is estimated to have been again in large surplus -- over $3 billion (not seasonally adjusted and not at an annual rate) as many foreign central banks sold dollars heavily in their efforts to slow the appreciation of the dollar against their currencies. In the fourth quarter of 1973 the official settlements surplus averaged $1 billion per month (not seasonally adjusted). Inflows of short-term funds from commercial banks abroad continued at a high level in January -- about $1-1/2 billion -- mainly through U.S. agencies and branches of foreign banks.

Complete but still preliminary data on fourth-quarter transactions in trade, securities and long-term bank-lending to foreigners indicate that the net combined overall balance on these "basic" items was a somewhat smaller surplus in that quarter than in the third quarter. This suggests a probable weakening in the surplus on current and long-term capital account in the fourth quarter from the exceptionally large surplus of $2-1/2 billion (seasonally adjusted, not at an annual rate) recorded in the preceding quarter.

The U.S. trade surplus in the fourth quarter increased to nearly $1-1/4 billion (not at an annual rate) from $3/4 billion in the third quarter, with most of the gain accounted for by a very large surplus in December. Foreign net purchases of U.S. stocks, which totaled over $400 million in November, turned to a small net sale in December. For the entire fourth quarter net foreign purchases of U.S. equities were less than $500 million, down from about $900 million in the third quarter. Foreign purchases of offshore Euro-bond issues by U.S. corporations were quite large in December and for the entire fourth quarter but these purchases were partially offset by net sales of U.S. agency bonds by the World Bank. In contrast, U.S. purchases of foreign bonds increased sharply from the third to the fourth quarter -- by over $300 million -- primarily reflecting heavy takings of Israeli bonds following the recent war. Overall, the net inflow on security transactions in the fourth quarter was about $3/4 billion less than the $1 billion inflow in the third quarter.

Bank-reported claims (both long and short-term) on foreigners rose very strongly in the fourth quarter -- by $1-3/4 billion (seasonally adjusted). Long-term bank claims, which had decreased in the third quarter by over $200 million, increased by $475 million in the fourth quarter; short-term claims rose by over $1 billion. The removal or easing of restrictions on capital inflows by Japan possibly contributed to this heavy U.S. outflow of bank credit lending to foreigners. About 25 percent of the large outflow in December was through acceptance credits to Japan as Japanese importers were encouraged to obtain financing for imports from overseas sources.

The restraints on capital outflows from the United States which have been in effect, in various forms, since 1963 were completely removed at the end of January following considerable relaxation of these controls on January 1. The Interest Equalization Tax (IET) was reduced to zero, and the controls on foreign investment (administered by the Department of Commerce) and on bank lending to foreign residents (administered by the Federal Reserve System) were terminated. The early termination of these controls was deemed appropriate in view of the recent improvement in the U.S. trade and long-term capital position, the rise of the dollar in the exchange markets, and the potential need of other countries to finance the cost of higher oil prices.

U.S. foreign trade. In December, the U.S. trade surplus soared as imports fell from the extraordinarily high November level and exports remained strong. For the fourth quarter, the trade surplus was at an annual rate of \$4.7 billion (balance of payments basis), and for calendar 1973 the trade balance was in surplus by \$0.7 billion. In 1972, the trade balance had been in deficit by nearly \$7 billion.

Exports in the fourth quarter were \$80.2 billion, at a seasonally adjusted annual rate (balance of payments basis), up 10-1/2 percent from the preceding quarter. Exports of both agricultural and nonagricultural commodities increased strongly.

Agricultural exports increased by nearly 9 percent in the fourth quarter; all of this increase was in the form of higher prices, as the volume of such exports showed little change. In the case of wheat, the volume of exports fell markedly (particularly in December), and the value of wheat exports showed an increase only because of the 40 percent increase in export prices from the third to fourth quarter. Export prices of nearly all other agricultural commodities, except soybeans, also climbed in the fourth quarter. The continuing increase in agricultural prices, which were nearly 67 percent higher in the fourth quarter of 1973 than a year previous, has been the major factor in raising the value of agricultural exports; the volume of such exports has shown no increase since the first quarter of 1973.

In the fourth quarter, there were large increases in the value of all major categories of nonagricultural exports. More than half of this value increase was due to higher prices, with capital goods, especially non-electric machinery, showing a particularly sharp rise in unit values. Volume gains were evident mainly in exports of consumer durables. It appears that the rate of growth in the volume of the two major categories of nonagricultural exports, machinery and industrial supplies, has slowed since the first quarter. The slowing of growth in exports of industrial supplies may continue as economic activity abroad levels off, but the backlog of foreign orders for U.S. durable equipment will probably sustain machinery exports -- at least through the first part of this year.

Imports in the fourth quarter of 1973 were at an annual rate of $75.5 billion, balance of payments basis, about 8 percent above their third quarter level. Large increases in the prices of imports accounted for all of the rise in the value of total imports, as the volume of imports declined slightly.

The value of fuel imports rose from an annual rate of $9.0 billion in the third quarter to $11.6 billion in the fourth quarter, as import unit values jumped more than 30 percent. The effects of the Arab embargo were clearly evident in December, when the volume declined sharply from the October-November levels. For the quarter as a whole, the volume of fuel imports was 2-1/2 percent below the third quarter level. In January, (based on the weekly reports of the American Petroleum Institute) the volume appears to have been somewhat lower than in December.

The fourth-quarter increase in the value of nonfuel imports was concentrated in the categories of food and industrial supplies, as other import categories showed minor gains or actually declined as in the case of consumer durables and automotive equipment.

In volume terms, imports of capital goods as well as imports of consumer durables and automotive equipment declined in the fourth quarter. These decreases in volume may reflect the continuing effects of the exchange-rate realignments, but they may also reflect supply constraints, or delivery problems associated with bunker fuel shortages reported after the sharp rise in oil prices in mid-October. These bunker fuel shortages were apparently temporary and were presumably alleviated, if not eliminated, in January.

The continuing growth in the volume of nonagricultural exports and the volume declines in most import categories have meant that the external sector has provided a major stimulus to the U.S. economy during the past year. As shown by the table, the $2.0 billion change in the volume of net exports of goods accounted for nearly half of the increase in real GNP goods output in the fourth quarter. The performance of the external sector in 1973 represents a marked change from the previous two years, when negative changes in net exports may have acted to slow down the growth of the economy.

CHANGES IN MERCHANDISE EXPORT AND IMPORT VOLUMES AND IN REAL GNP GOODS OUTPUT
(changes from previous period in billions of 1967 dollars, S.A.A.R.)

	GNP goods output change	Exports change	Imports change	Net exports change
1971	+11.7	-.5	3.1	-3.5
1972	+30.6	+4.0	5.4	-1.4
1973	+35.1	+9.7	2.1	+7.6
1973 - 1	+15.1	+5.1	+2.3	+2.8
2	+1.9	+2.3	-1.8	+4.0
3	+3.2	+.7	-0.6	+1.3
4	+4.3	+1.7	-0.3	+2.0

<u>Current external account positions of major foreign industrial countries</u>. As discussed in the January Greenbook, the outlook for world economic activity in 1974 will be greatly affected by the sharp increases in the price of oil. The oil-import bill for all OECD countries could exceed 1973 levels by about $50 billion and for all non-oil exporting countries by about $60 billion. The associated increases in exports of goods and services to the oil exporting countries from the OECD countries might amount to about $7 billion; therefore, the current accounts of the OECD countries as a whole might deteriorate by almost $45 billion vis-à-vis the oil exporting countries. Accordingly, the combined current account of the OECD area, which might, apart from the oil-price increases, have been in surplus by approximately $4-1/2 billion (about equal to the 1965-1970 average of $4.6 billion) could be in deficit by about $40 billion in 1974.

The $7 billion estimate of the increased imports by the oil exporting countries may be on the low side, since the absorptive capacity of these countries will be expanded by their ability to purchase the necessary technology and skills to go along with their investment expenditures. However, given the overall magnitude of the increases in OECD oil payments, any estimating error attached to the oil exporting countries' purchases of goods and services would probably not be significant. A possible reduction in oil prices from their present levels might have a more important effect on the overall deficit. But even this effect would not be enough to reduce the prospective deficit by sufficient amounts to avoid the kind of financing problems now facing the non-oil exporting nations.

The outlook for the non-oil exporting LDCs is extremely bleak. For most LDCs, the higher oil-import costs -- in the absence of financial aid -- would imply sharp reductions in other imports and in their investment programs. Price increases not only for crude oil, but also for petrochemical products, especially for fertilizer, are likely to have far-reaching effects on the development programs of these countries, particularly of the poorest among them. In addition, demand for non-oil primary products in 1974 will be affected by the slowdown in activity projected for the industrial countries. And, with price inflation continuing in the industrial countries, the purchasing power of the non-oil exporting LDCs may be further reduced by an adverse shift in their terms of trade, not only vis-à-vis the oil exporting countries, but also vis-à-vis the industrial countries.

For the industrial countries, the oil situation is only one factor, although the predominant one, in the changes in balance-of-payments positions foreseen for this year. While it is clear that the sharp deterioration projected in the current accounts of the OECD countries as a whole is associated mainly with the oil situation, the projected changes for individual countries must be viewed against the background of both the oil situation and other forces operating apart from the oil crisis. The outlook for current account positions depends upon several factors: first, the current account positions of the different countries as they appeared before the oil crisis -- at least some of which were far from equilibrium; second, the impact of the policy measures -- generally restrictive -- taken by individual countries to deal with both cyclical conditions and the oil situation; and third, the direct impact of the oil-price increases.

As can be seen from the table on page III-18, the current account positions of individual major industrial countries before the oil crisis began were quite varied. Germany had a large current account surplus in 1973 and, if not for the oil crisis, might have had another substantial surplus in 1974; the current accounts of Japan and France were close to balance in 1973 and might have been in small surplus in 1974; Canada (which is self-sufficient in oil) had a small current account deficit in 1973 and would probably have had a similar position in 1974; the United Kingdom and Italy had sizable deficits in 1973 and would have had substantial deficits in 1974 even in the absence of the oil crisis.

It is generally recognized that the OECD countries in aggregate are bound to see their current account positions deteriorate vis-à-vis the oil exporting countries, and a scramble by individual countries to improve their own positions clearly cannot work in the aggregate. However, it also seems clear that those countries, specifically, the United Kingdom and Italy, that were facing unacceptably large deficits before the crisis need to improve their situation relative to other

CURRENT ACCOUNT BALANCES FOR MAJOR INDUSTRIAL COUNTRIES[1/]
(billions of dollars, seasonally adjusted annual rates)

	1965-70 average	1972 Jan.-June	1972 July-Dec.	1973 Jan.-June	1973 July-Dec.	1974 OECD forecasts[2/] excl. oil effects	1974 OECD forecasts[2/] incl. oil effects
France[3/]	-0.3	0.2	0.3	0.3	0.1(e)	1	-3-1/2
Germany	0.8	-0.1	0.8	2.2	5.1	4	-1
Italy[3/]	1.9	3.7	1.4	-1.7	-2.0(e)	-2	-5-1/2
United Kingdom[4/]	0.2	1.1	-0.5	-2.1	-5.3	-3-3/4	-8
Japan[5/]	1.2	4.3	8.9	0.2	-0.2	3/4	-7-1/2
Canada	-0.4	-0.7	-0.6	-0.2	-0.7(e)	0	0
United States[6/]	1.2	-9.4	-7.3	-1.9	3.9(e)	5	-2-1/2
Total OECD	4.6	3.8	4.7	6.0	1.1(e)	4-1/2	-38-1/2

1/ Data for 1972 and 1973 were converted from local currencies using average quarterly exchange rates (from FRB *Bulletin*), and for 1965-70 using average annual exchange rates; unless indicated otherwise, current account figures are from national sources; all current account figures include government transfers; (e) indicates estimate.

2/ 1974 forecasts are those of OECD; they are based on exchange rates of January 7-11 [see CPE(74)1, Table 7]; the forecasts excluding oil are the forecast balances adjusted by the OECD to eliminate the following three effects of the oil-price increases: 1) the adverse net effect on trade balances; 2) higher interest payments to oil exporting countries; and 3) smaller net transportation balances as demand for the volume of imports reacts to higher prices.

3/ Data are from OECD; 1965-70 average for France is balance with non-franc area and thereafter, with world.

(footnotes continued on next page)

Footnotes continued:

4/ 1974 forecasts for the United Kingdom do not take account of the coal miners' strike.

5/ Not seasonally adjusted; Japanese authorities forecast a much smaller 1974 deficit.

6/ 1974 forecasts for United States are those of FRB staff; they assume a decline in the volume of imports because of a continued embargo; second half 1973 is adjusted for military grant to Israel of $2.8 billion, officially recorded as export sale without offsetting grant entry.

countries. This would imply somewhat larger negative changes for countries such as Germany, the United States, Canada, and also France than might occur solely because of the oil-price increases.

The United Kingdom's trade position deteriorated sharply over the past year. In 1972, the trade balance was in deficit by about $1.7 billion; by the fourth quarter of 1973, however, the deficit had risen nearly sixfold to an annual rate of $9.2 billion. Consequently, the current account, which was approximately in balance in 1972, showed a deficit at an annual rate of about $7.2 billion in the fourth quarter of 1973, despite a continuing increase in the United Kingdom's usual surplus on services and transfers. For 1973 as a whole, the trade and current account deficits were $5.7 billion and $3.7 billion, respectively.

The deterioration in the trade account reflected primarily a worsening of the terms of trade, by approximately 15 per cent from the fourth quarter of 1972 to October-November of last year. Prior to the recent oil-price increases, it was generally expected that the deteriorating trend in the United Kingdom's current account position would be reversed in 1974, partly because increases in commodity prices were expected to subside, and partly because the effects of the large devaluation would become increasingly visible.

It now appears that this reversal of trend will be delayed. The higher oil prices are expected to increase the United Kingdom's current account deficit by about $4-1/4 billion in 1974. Some part of the higher oil-import bill will be offset by increased exports to the oil exporting countries, partly through the market place but also by means of barter deals. According to the agreement reached with Iran, for example, the United Kingdom will essentially exchange $1/4 billion of industrial goods for an additional 5 million tons of Iranian crude petroleum. But the expectation of a reduction of some commodity prices, in particular for food, may no longer hold. Furthermore, the current labor troubles have reduced output substantially, adversely affecting both exports and imports. An inevitable outcome of any settlement will be a somewhat higher rate of domestic inflation. All these factors tend to reduce the chances of improvement in the United Kingdom's competitive position aside from oil.

Germany had a substantial current account surplus last year of $3.7 billion. This large surplus compared with a $0.4 billion surplus in 1972 and the expectation early last year of a fall to about zero for 1973, as the effects of the large DM revaluations of the past years were expected to take hold. In contrast with these expectations, the value of exports rose by almost one quarter during the year, causing the trade surplus to rise to an enormous $12.7 billion. The increase in the trade surplus from 1972 to 1973 was more than twice the increase in the deficit on services and transfers.

A number of factors contributed to the large increase in exports in 1973: speculative buying early in the year in anticipation of the DM revaluations in March and June; a relatively large margin of spare capacity in the capital goods sector; the fact that a large proportion of German trade is conducted with countries whose exchange rates did not change much in relation to the DM; and finally, a sizable rise in German exports to Eastern Europe.

Before the oil crisis, the German authorities were expecting only a small decrease in the large surplus on current account in 1974. With real output expanding slowly this year, imports would not rise much, while exports would continue to grow, reflecting the high rate of order inflows of recent months. However, largely because of the rise in oil prices -- which the authorities estimate will increase the 1974 import bill by about $5.3 billion -- the current account is now expected to be roughly in balance this year.

The probable disappearance of the German current account surplus this year is associated with little, if any, movement towards underlying equilibrium in Germany's payments position. Since Germany's rate of domestic inflation in 1974 is likely to be lower than that in most other industrial countries, the competitive position of German industry may, in fact, improve. Furthermore, the recent depreciation of the DM, at least vis-à-vis the dollar, may further strengthen Germany's position in world markets.

France's current account surplus in 1973 is estimated to have been about equal to the 1972 surplus of $0.3 billion. The increase in the trade surplus in 1973 was sufficient to offset the downward trend in the service balance stemming from increasing remittances of foreign workers and rising French tourist expenditures abroad.

Before the oil crisis, the trade surplus for 1974 was expected to rise by about the same amount it had increased in 1973, primarily because of the generally expected slowing in the price rise for primary commodities. As a whole, the current account position for 1974 was expected to be slightly more in surplus than in 1973.

The oil-price increases are expected to worsen the French trade balance by about $4-1/2 billion. A deterioration of this size -- although not larger than that expected for most other industrial countries -- was considered unacceptable by the French authorities. Accordingly, their decision to opt out of the fixed currency relationship with their European "snake" partners was aimed partly at improving the current account. The fact of the matter is that the trade balance improved considerably in the closing months of 1973. The weakness of the French franc preceding the downward float last month was associated primarily with short-term capital outflows.

The decision of the French authorities to attempt to finance part of the increased oil-import bill by depreciation-stimulated increases in exports appears to contradict the general understanding among industrial countries that their current accounts in aggregate must deteriorate as a consequence of the oil-price increases. However, the decision of the French Treasury to borrow $1.5 billion in the Euro-currency market in order to finance investment expenditures abroad seems to be more in line with this understanding.

Italy's current account moved from a surplus of about $2.6 billion in 1972 to a deficit of about $2 billion in 1973. The main factor in the change was an extremely sharp deterioration in the trade balance.

As in the United Kingdom, the deterioration in the Italian trade account stems mainly from the sharply adverse movement in the terms of trade associated with the depreciation of the lira and the steep rise in world prices of raw materials and foodstuffs. But in addition, Italian output in early 1973 was disrupted by strikes that affected key export sectors and probably also induced a rise in imports.

Even without the higher price for oil, no significant improvement was foreseen in the Italian current account for 1974. The improvement that might have been expected from the large depreciation of the lira vis-à-vis the currencies of Italy's major trading partners may be eroded somewhat by the fact that the Italian inflation rate is rather higher than the OECD average. In addition, economic activity in Italy's major market, Germany, is likely to be depressed.

The net effect of the oil situation is estimated to increase the Italian current account deficit by about $3-1/2 billion, implying a total deficit of about $5-1/2 billion -- well above the expected deficit of any OECD country other than the United Kingdom and Japan.

Japan's trade and current account positions changed substantially in 1973. In 1972, Japan had a merchandise trade surplus of $9.0 billion; with substantial net payments for services, the current account surplus was $6.6 billion. Last year, however, the trade surplus decreased by about three-fifths to an estimated $3-3/4 billion. Net payments for services increased substantially from $2-1/4 billion in 1972 to $3-3/4 billion in 1973; as a result, the current account for 1973 was roughly in balance.

The huge decline in the trade surplus in 1973 resulted in part from policy actions by the Japanese authorities aimed at stimulating imports and restraining exports and in part from market factors. Short supplies of food and industrial materials led to a bidding up of world prices, partly by the Japanese themselves. Consequently, there were substantial increases in import prices at the same time that rapidly accelerating rates of activity pulled up import volumes by about 25 per cent. As a result, import values rose by 70 per cent. Export values, on the other hand, were up 30 per cent with volumes rising only about 5 per cent.

Before the oil crisis, the volume growth of exports was expected to increase somewhat in 1974, while that of imports was expected to decelerate in line with the slowdown in domestic demand. The merchandise trade balance was, therefore, expected to improve in 1974; with no additional substantial increase in non-merchandise payments predicted, the current account was expected to show a small surplus of perhaps \$3/4 billion.

The increase in oil prices is forecast by the OECD secretariat to worsen the trade balance by about \$8-1/4 billion and turn the current account surplus into a deficit of perhaps \$7-1/2 billion. The Japanese authorities are predicting a much smaller deficit of less than \$1 billion. This lower figure might be interpreted as the authorities' policy aim. In recent months, the government has responded to the deterioration in the current account by drawing down reserves, allowing the yen to depreciate, and taking some measures to slow capital outflows and stimulate inflows. Also, fiscal and monetary policies have been increasingly restrictive in order to slow the very rapid rate of inflation.

Canada's merchandise trade balance improved from \$1.6 billion in 1972 to about \$1.8 billion in 1973. However, it appears that the current account deficit for 1973 was approximately equal to the \$0.6 billion deficit of 1972, as the deficit on services and transfers increased. The small increase in the trade surplus in 1973 reflected mainly steeply rising prices for primary commodity exports which were almost offset by rising imports of capital equipment reflecting an upsurge in investment expenditures.

The Canadian current balance, because of Canada's self-sufficiency in energy resources, is likely to be affected only indirectly by the oil-price increases. Therefore, the OECD's post-oil prediction for Canada's current account position is essentially unchanged from the pre-oil estimate. However, since 70 per cent of Canada's trade is with the United States, the response of the U.S. economy to the oil crisis will be extremely important for the Canadian balance of payments. The increase in Canadian investment expenditures expected in 1974 will mean substantial additional imports of machinery and materials. But, in the absence of a recession in the United States, Canada alone among the major OECD countries -- perhaps with the exception of Australia -- possibly might experience a small improvement on its current account in 1974.

APPENDIX A: THE NEW FEDERAL BUDGET*

The Administration's budget for fiscal year 1975 contains few surprises and thus differs little from our previous budget projection. The major initiative in expenditures--the boost in defense spending--was fully reflected in our earlier projection. Receipts projections are based upon income assumptions and tax rates roughly similar to our own, and the emergency windfall profits tax on oil, the most important tax legislation proposed, was announced prior to the budget.

The Administration expects a budget deficit of $4.7 billion this year followed by a moderate increase to $9.4 billion in fiscal year 1975, as shown in the top panel of Table I. The NIA budget follows a similar pattern. The bottom panel of Table I indicates that outlays are expected to increase almost 11 per cent in fiscal 1975, nearly the same pace as in the current year. The 9 per cent growth in budget receipts in fiscal year 1975 is substantially less than the 16 per cent growth expected during fiscal year 1974. For the most part these increases in receipts and expenditures reflect the impact of inflation and previously enacted programs rather than new initiatives.

The Administration has characterized the fiscal 1975 budget as "continuing a posture of moderate restraint". Aside from defense, no new spending programs or tax cuts are initiated that inject significant fiscal stimulus. The Administration's characterization also is evidenced by the projected increase in the full employment surplus from $4 billion this fiscal year to $8 billion (unified budget) in fiscal year 1975. This surplus indicates that the projected shift toward deficit in the actual budget is brought about by economic slowdown rather than by discretionary action.

While moderate restraint may be a fair description of the budget, emphasis is not placed on spending ceilings or on the expenditure reductions and program terminations so prominent in last year's budget. Instead, the emphasis is on resisting a possible economic slowdown, <u>first</u> by letting stand any increase in the deficit generated by a weaker than expected economy and, <u>second</u>, by maintaining flexibility so that timely fiscal stimulus can be undertaken if necessary. Alternative contingency plans for fiscal stimulus are now being prepared, although such plans are not discussed in detail in the budget.

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TABLE I

MAJOR FISCAL INDICATORS
(Fiscal years)

	1972	1973	1974e	1975e
	Billions of Dollars			
Unified budget				
Receipts	208.6	232.2	270.0	295.0
Outlays	231.9	246.5	274.7	304.4
Deficit (-)	-23.2	-14.3	-4.7	-9.4
Full employment receipts 2/	224 1/	243	278	311
Full employment outlays 2/	229	245	274	303
Surplus/deficit (-)	-5	-2	4	8
NIA budget				
Receipts	213.7	243.3	280.5	304.8
Expenditures	233.2	255.1	285.2	313.4
Surplus/deficit (-)	-19.5	-11.8	-4.7	-8.6
	Per cent			
Per cent increase in				
Receipts:				
Budget receipts	10.8	11.3	16.3	9.3
Full employment receipts 2/	5.2	8.5	14.4	11.9
NIA receipts	11.0	13.9	15.3	8.7
Spending:				
Budget outlays	9.7	6.3	11.4	10.8
Full employment outlays 2/	9.6	7.0	11.8	10.6
NIA expenditures	9.7	9.4	11.8	9.9
Per cent of full employment GNP				
NIA receipts	18.4	19.4	20.0	19.6
NIA expenditures	20.1	20.3	20.3	20.2

e: Administration estimate
1/ Administration calculations of full employment receipts exclude impact of overwithholding of personal income taxes beginning January 1972.
2/ Unified budget basis.

The Council estimate of the full employment budget on an NIA basis, shown in Table II, shows stability in the full employment surplus between calendar year 1973 and 1974. All estimates in the Table probably overstate the extent of discretionary fiscal restraint in the current period because, (1) the recent acceleration in prices tends to increase full employment receipts much sooner than expenditures; and (2) the calculation of full employment receipts is based upon estimates of potential GNP which may be significantly overstated in this period of energy shortage. 1/ On the other hand, the staff estimates, discussed below, assume less spending in the first half of this calendar year than the budget document. This may be evidence that the discretionary restriction suggested by the official full employment budget (budget basis) is not greatly exaggerated this fiscal year. The lower staff expenditure estimate also explains why our projection of the full employment budget for calendar 1974 shows more of a change toward restriction than does the Council estimate.

TABLE II

COMPARISON OF FULL EMPLOYMENT BUDGET BALANCE ESTIMATES
(In billions of dollars)

	Calendar years		
	1972	1973	1974e
NIA budget			
Council	-7.7	5.8	6.0
Staff 2/	-1.1	3.7	6.6
Staff, inflation adjusted 3/	-1.4	-2.0	-0.8

1/ Recently, quarterly estimates of the growth in potential GNP have been revised downward from 4.3 to 4.0 per cent (annual rates) back to the first quarter of 1970, but no adjustment has been made in the current period for the reduction in potential GNP due to the energy shortage.

2/ The major difference in 1972 between the staff and Administration calculation is that staff estimates of full employment receipts do not exclude receipts derived from unintended overwithholding of personal income taxes beginning January 1972. For 1974, especially during the first half of the year, the difference is largely attributable to lower staff estimates of expenditures.

3/ This estimate phases in effect of inflation on receipts with a lag of approximately one year.

In summary, the current budget plan, as evaluated by the full-employment figures, can be described either as slightly restrictive--especially if the large targeted near-term spending increases are not achieved--or as essentially unchanged and neutral--a position which is taken in the Council's Economic Report.

Expenditure Projections

Our analysis gives us no reason to question the Administration's estimates of outlays for fiscal year 1975. However, the outlays estimate for the current fiscal year appears to be on the high side given the rate of spending so far this year and the spending programs now in train. Overestimation of outlays in the ongoing fiscal year has been a characteristic of the budget document in recent years. Normally close to 50 per cent of actual expenditures occur in the first half of the fiscal year, but in the first half of this year outlays have totalled only 47.5 per cent of the Administration's projected total. This low ratio cannot be explained by special factors. The low ratios for other recent fiscal years, shown in Table III, are explained by special factors such as the deliberate speed-up in military spending in the second half of fiscal 1972 (offset by greatly reduced spending in the first half of fiscal 1973) and the institution of new spending programs, such as revenue sharing, in fiscal 1973. The pace of outlays this year suggests that spending will be $2-5 billion below the budget estimate given the spending programs explicitly in the budget. Of couse, spending could be significantly accelerated in the remaining months to achieve greater stimulus or new programs could be introduced. However, since there is no evidence of a speed-up, the staff's current estimate of spending for this fiscal year is still $272 billion, $2.7 billion below the Administration's figure.

TABLE III

OUTLAYS IN THE JULY-DECEMBER PERIOD
AS A PERCENT OF FISCAL YEAR SPENDING

	1968	1969	1970	1971	1972	1973	1974e
Total outlays	48.4	50.5	50.3	49.3	48.1	48.1	47.5
Military	48.1	49.0	50.6	50.1	46.0	46.8	43.8

e: Assuming totals shown in budget.

An analysis of the NIA spending pattern on a half-yearly basis also shows that the budget document implies a huge increase in the rate of Federal expenditures during the first half of 1974, and much more moderate growth thereafter. Based on an examination of the various components, staff estimates have been adjusted to take out a considerable portion of this near term bulge (see Table IV). During fiscal 1975, the staff estimates move to the budget path. Even after these adjustments, however, our estimates of spending growth during the first half of 1974 are still quite large--almost 15 per cent per annum.

TABLE IV

GROWTH IN FEDERAL SPENDING--NIA BASIS

Half Years		Per cent Change (Annual Rates)	
		Administration	Board Staff
Calendar 1973	I	9.5	9.5
	II	6.5	6.5
1974	Ie 1/	19.4	14.8
	IIe	9.4	13.0
1975	Ie	5.8	7.5

1/ Excludes special transaction in Indian Rupees.
e: estimated. Allocation of Administration projection by half-years is estimated by Board staff.

The budget for fiscal 1975 contains little in the way of new expenditure programs. The major health and welfare reform measures discussed in the State of the Union message do not significantly affect spending in fiscal 1975. The requested appropriation for public service jobs is $350 million--the minimum provided under the recently enacted Comprehensive Employment and Training Act. It has been estimated that this appropriation will support approximately 40,000 public service jobs. The announced $10 billion energy research program also has a relatively small effect in fiscal 1975. Outlays for energy research are scheduled to increase by $200 million this year and by $600 million in fiscal 1975 to a level of $1.5 billion. It is possible that the full $600 million increment will not be achieved as the research programs for more than 3/4ths of this increment have not been designated.

On a functional basis the largest increase in expenditures is expected in "income security"--a category that includes retirement and disability programs such as social security, unemployment insurance and public assistance (Table V). The recently enacted social security benefit hike--a two-stage increase in payments scheduled for April and July--accounts for nearly half of the change in income security. About $2.0 billion of the $7.3 billion increase in defense represents expected pay raises while the remainder mainly reflects strengthening airlift capabilities and increased research and development on strategic weapons.

TABLE V

SUMMARY OF BUDGET OUTLAYS BY FUNCTION
(Fiscal years, billions of dollars)

	1973	1974e	1975e	Increase 1974-1975
National security and international affairs	$79.0	84.5	91.8	7.3
National defense	76.0	80.6	87.7	7.1
International affairs	3.0	3.9	4.1	.2
Human resources	113.7	132.4	151.5	19.1
Income security	73.1	85.0	100.1	15.1
Health	18.4	23.3	26.3	3.0
Education and manpower	10.2	10.8	11.5	.7
Veterans benefits	12.0	13.3	13.6	.3
Physical resources	24.0	23.5	24.9	1.4
Agriculture and rural development	6.2	4.0	2.7	-1.3
Natural resources and environment	.6	.6	3.1	2.5
Commerce and transportation	13.1	13.5	13.4	-.1
Community development and housing	4.1	5.4	5.7	.3
Revenue sharing	6.6	6.1	6.2	.1
Other	23.2	28.2	30.1	1.8
Total budget outlays	246.5	274.7	304.4	29.7

Receipts Projections

The few tax law proposals contained in the new budget would increase receipts by only $1.3 billion in fiscal year 1975. The major proposals are the emergency windfall profits tax, which adds $3.0 billion to receipts estimates, and the previously proposed tax reform measures and liberalixed pension deductions which together reduce receipts by less than $2 billion.

The Administration estimates of budget receipts, $270 billion this year and $295 billion in fiscal year 1975, appear to be reasonable given previously enacted tax increases and the current economic outlook. These estimates are based on assumed levels of GNP and personal income in calendar 1974 that are somewhat higher--$4.6 billion and $2.8 billion, respectively--than the staff estimates. The assumed level of corporate profits before tax is about $2.0 billion more than our latest estimate and would be, perhaps, $6.0 billion more if we included the windfall profits tax in our projections. In addition to the difference in income assumptions, our estimate of personal tax receipts is lower because we expect a higher level of refunds in the Spring of 1974 and because of our lower estimate of tax rates. Table VI, below, shows the difference between staff and Administration estimates of personal income taxes, NIA basis.

TABLE VI

COMPARISON OF PERSONAL TAX RECEIPTS ESTIMATES
FOR CALENDAR 1974, NIA BASIS
(In billions of dollars)

	Administration	Staff	Difference
1. Personal tax and nontax receipts	132.3	127.5	4.8
2. Personal tax refunds, first half of 1974 1/	21.9	23.9	-2.0
3. Gross receipts (1 + 2)	154.2	151.4	2.8

1/ The corresponding amount in the first half of 1973 was $21.2 billion.

As a result of these different assumptions, including the exclusion of the windfall profits tax from our projections, the staff estimate of budget receipts this fiscal year is about $3 billion less than the Administration estimate. We have not yet prepared a budget receipts projection for fiscal year 1975.