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ECONOMIC SURVEYS

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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UNITED STATES

ORGANISATION DE COOPÉRATION ET DE DÉVELOPPEMENT ÉCONOMIQUES

DEC. 1967

BASIC STATISTICS OF THE UNITED STATES

THE LAND

Area, Continental United States, plus Hawaii and Alaska (thous. sq. km.)	9,363

Population of major cities, including their metropolitan areas (1965) :	
New York	11,366,000
Chicago	6,689,000
Los Angeles-Long Beach	6,765,000

THE PEOPLE

Population (Sept. 1967)	199,530,000
Number of inhabitants per sq. km.	21
Population, annual net natural increase (average 1962-66)	2,163,400
Net rate of annual natural increase per 1 000 inhabitants (average 1962-66)	11.3

Civilian labour force, 1966	75,770,000
of which:	
Employed in agriculture	3,979,000
Unemployed	2,875,000
Net civilian immigration (annual average 1962-66)	364,800

PRODUCTION

Gross national product in 1966 (billions of US $)	743.3
GNP per head in 1966 (US $)	3,775
Gross fixed capital formation:	
Per cent of GNP in 1966	14.1
Per head in 1966 (US $)	531

Origin of national income in 1966: (Per cent of national income)	
Agriculture, forestry and fishing	3.7
Manufacturing	31.1
Construction and mining	6.2
Government and government enterprises	13.7
Other	45.3

THE GOVERNMENT

Government purchases of goods and services, 1966 (per cent of GNP)	20.8
Revenue of Federal, state and local governments, 1966 (per cent of GNP)	28.7
Federal Government debt as ratio of cash receipts from the public, 1966 (per cent)	223.3

Composition of the 90th Congress, 1967:	House of Representatives	Senate
Democrats	247	64
Republicans	187	36
Vacant seat	1	
Total	435	100

LIVING STANDARDS

Food consumption, calories per head per day, 1965	3,140
Consumption of energy per head, 1965 (metric tons of coal equivalent)	9.2

Average hourly gross earnings in manufacturing, 1966 (US dollars)	2.72
Number of passenger cars in use per 1 000 inhabitants, 1965	386
Number of telephones in use per 1 000 inhabitants, 1965	483

FOREIGN TRADE

Exports:

Exports of goods and services as per cent of GNP in 1966	5.8
Main exports 1966 (per cent of US merchandise exports):	
Manufactured goods	11.9
Machinery	25.7
Chemicals	9.2
Transport equipment	12.8
Food and live animals	15.8
Crude materials (inedible)	14.0
All other	10.6

Imports:

Imports of goods and services as per cent of GNP in 1966	5.1
Main imports 1966 (per cent of merchandise imports):	
Foods, feeds and beverages	17.6
Industrial supplies and materials	47.3
Capital goods	8.4
Automotive vehicles and parts	7.4
Consumer goods (non-food)	15.3
All other	3.9

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UNITED STATES

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

The Organisation for Economic Co-operation and Development was set up under a Convention signed in Paris on 14th December 1960 by the Member countries of the Organisation for European Economic Co-operation and by Canada and the United States. This Convention provides that the OECD shall promote policies designed:

- *to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;*
- *to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development;*
- *to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.*

The legal personality possessed by the Organisation for European Economic Co-operation continues in the OECD, which came into being on 30th September 1961.

The members of OECD are: Austria, Belgium, Canada, Denmark, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

The Socialist Federal Republic of Yugoslavia is associated in certain work of the OECD, particularly that of the Economic and Development Review Committee.

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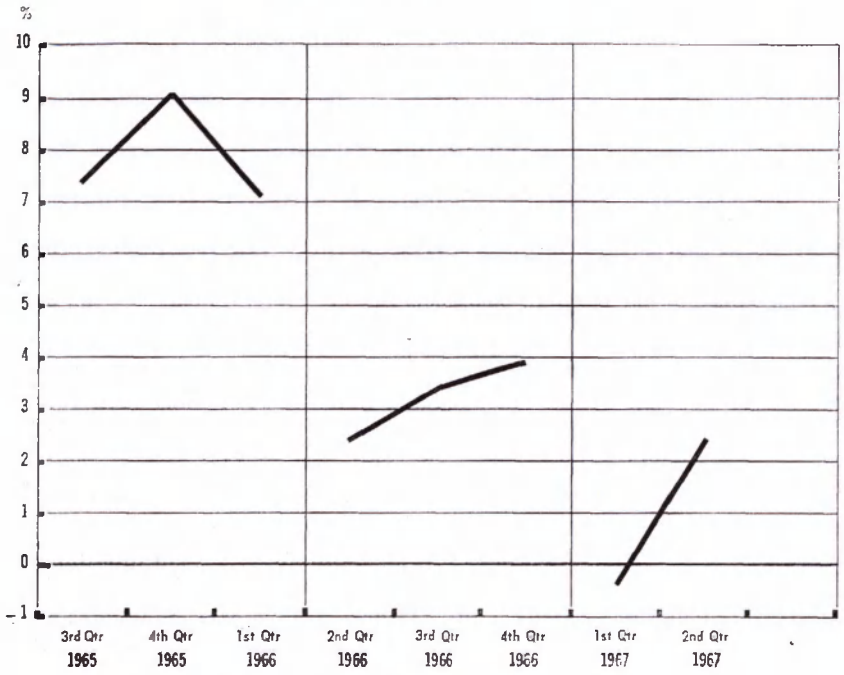
INTRODUCTION

Over the last two years the US economy has been operating close to full employment, after almost a decade with under-utilisation of resources. The new situation has entailed new tasks for economic policy. In the first half of the 1960's the main effort was directed at stimulating demand to absorb the slack in the economy. In the last two years, however, with the trend of business conditions changing quickly, policy has been called upon alternately to stimulate and restrict demand to keep it expanding in line with the growth of capacity. The first part of this Survey reviews recent policy experiences and possible lessons for the future. Part II considers the current situation and demand prospects, suggesting that activity is likely to rise fast in 1968, perhaps with some strengthening of inflationary pressures, even assuming early Congress enactment of fiscal restraint. Part III, discussing prospects for the balance of payments, concludes that the external position is likely to remain difficult. Part IV summarizes the main policy conclusions.

I RECENT POLICY EXPERIENCE

The last two years demanded very flexible policy responses if the economy was to be kept on a suitable course. The trends of important types of demand have changed quickly and significantly, calling for equally quick and significant counteractive measures. The sharp and largely unpredictable increase in defence spending has been a particular difficulty, inventory accumulation has been very irregular, and the personal savings ratio has changed considerably. In the event, demand management policy can point to the successful maintenance of GNP growth roughly in line with capacity, and unemployment settling down to narrow fluctuations near the 4 per cent rate. Nonetheless, the advance of activity has been more irregular than earlier and accompanied by certain undesirable internal and external features. From the point of view of policy-making, two periods can be distinguished—mid-1965 to the end of 1966, and the first half of 1967.

Diagram 1 **Percentage Change in the Volume of GNP on the Preceding Quarter**
At seasonally adjusted annual rates



Sources: Survey of Current Business.

Mid-1965 to end 1966. Inflationary pressures

In the middle of 1965, activity had been expanding steadily for a long period, significantly helped by the 1964 tax cut and other stimulative measures. A margin of unused resources still remained, with unemployment at 4.5 per cent, compared with the authorities' interim target of 4 per cent. With the effects of the tax cut wearing off, there was some concern that the expansion might slow down in the second half of the year. Further stimulative measures—notably cuts in excise taxes and higher social security benefits—were in course of preparation to ensure a rate of expansion sufficient to absorb the remaining slack in the economy. But the business climate changed significantly, as a result of increased defence expenditure which, as foreshadowed by the President in July, rose by about $ 2 billion a quarter (annual rate) in late 1965 and early 1966. In the year ending mid-1966, the expansionary impact of higher military expenditure can be estimated at about 1.0 per cent of GNP including multiplier effects on consumers' incomes and expenditure. Moreover, the change in the busi-

ness climate no doubt served, in addition, to accelerate the rise in business fixed investment. As a result, real GNP rose at the unsustainable annual rate of 7.9 per cent between the second quarter of 1965 and the first quarter of 1966, creating bottle-necks and price pressures in many areas.

The first measure of restraint was taken in December 1965, when the Federal Reserve System raised the discount rate from 4.0 to 4.5 per cent. During 1966 the expansion of bank reserves was slowed down and with demand for credit outpacing the supply of funds in money and capital markets, interest rates rose sharply. Restrictive fiscal measures were also taken. A $ 6 billion increase in payroll taxes was already due to take effect at the beginning of 1966, following the increase in social security benefits in the second half of 1965. Certain excise tax reductions which had just gone into force were rescinded and a system of graduated withholding for individual income taxes was proposed in January and enacted in March; these two measures increased Federal revenue in the national income accounts at an annual rate of $ 2.5 billion. On a cash basis the budget also benefited from action taken to accelerate the payment of corporate and other tax liabilities. Moreover, non-defence purchases of goods and services, at an annual rate, was reduced by $ 1.5 billion (9 per cent) between the fourth quarters of 1965 and 1966; over the preceding four quarters it had risen by $ 2 billion. The need for a general increase in income taxes was advocated by many observers, and appears to have been kept under consideration after it was clear that aggregate demand was rising faster than expected; in the event, additional fiscal restraint was limited to the suspension in September of the 7 per cent tax credit on investment in machinery and equipment and accelerated depreciation provisions on new building.

The combination of monetary and fiscal restraints brought the advance of real GNP in the last three quarters of 1966 down to an annual rate of 3.2 per cent, but the impact on individual demand components was distinctly uneven, reflecting the emphasis on monetary policy. The first and main effect was on residential construction, which by the fourth quarter of 1966 had fallen 25 per cent below its level of a year earlier. Estimates put forward by the Council of Economic Advisers in its January 1967 annual report suggest that the direct effects of monetary restraint on housing, other construction and, to a smaller degree, producers' durable equipment and consumers' durables, may have amounted to about 1 per cent of GNP; including multiplier effects on private consumption, the impact may have been of the order of 1.5 to 2 per cent of GNP.

The effect of fiscal measures became progressively important. The net increase in taxes from early 1966, after making allowance for the higher Social Security benefits that accompanied the payroll tax, amounted to

some $ 6.5 billion at an annual rate. The turnaround in non-defence purchases eventually amounted to $ 3.5 billion. The suspension of the investment tax credit in September probably had little direct economic impact in 1966, but in conjunction with other measures it had a favourable psychological impact and reduced the mounting pressures on financial markets. In total the ultimate demand impact of discretionary fiscal measures may have been about the same as that of monetary measures, almost 2 per cent of GNP. In addition, the automatic rise in tax receipts resulting from the growth of the tax base served to moderate the rise in incomes and demand.

In retrospect, it seems probable that restrictive measures should have been taken before the end of 1965; real GNP was already rising at an annual rate of 7.4 per cent in the third quarter of 1965. Delay was occasioned by uncertainty as to the prospective scale of defence expenditures and the resulting impact on the economy. Indeed, in the summer of 1965 there had been widespread expectation of a relatively weak advance in the second half-year, partly because steel inventories were expected to be reduced after the precautionary pre-strike build-up in the first half. And since there was still some slack in the economy, a significant expansion of demand could be accommodated without generating inflationary pressures. Statistics showing the strength of the expansion did not become available until late in the year. The forecasts of the Council of Economic Advisers were more bullish than those of most private observers, but did not, in the summer, envisage so fast an advance as actually took place.

It is also likely, as many observers argued at the time, that the measures that were taken early in 1966 should have included a general increase in income taxes. This could have reduced the reliance on monetary policy and produced a better pattern of demand, with more restraint on personal consumption and, possibly, business fixed investment, and less on residential construction. It is also possible that the increase in business plant and equipment expenditure would have been slowed down sooner had the investment tax credit been suspended before September. It was in the industries supplying machinery and equipment that the pressure on capacity was most strongly felt.

The first half of 1967. Temporary slowdown

The movement of aggregate demand in the first half of this year was heavily influenced by an adjustment of inventories in relation to sales. By the second half on 1966, restrictive policies had reduced the rate of growth of final demand. But production continued to rise rather fast, resulting in an unprecedented accumulation of inventories in the last quarter. As might be expected, this was followed by a sharp adjustment. Inventory

accumulation fell from an annual rate of $ 18.5 billion in the last quarter of 1966 to practically zero in the second quarter of 1967—a fall in demand corresponding to as much as 2.3 per cent of GNP and constituting the sharpest inventory adjustment to take place over two quarters since 1949. The striking fact is that output showed no significant fall, a small decline in the first quarter being more than offset by an increase in the second. This was possible because of a consistently strong rise in final demand.

Table 1 **Inventory Adjustments and the Movement of Real GNP in Five Post-War Periods**

Percentage changes in volume, at seasonally adjusted annual rates

	1967 I 1966 II	1960 Q4-1961 Q1 1960 Q 2-Q3	1958 I 1957 II	1953 II 1953 I	1949 I 1948 II
Final sales (GNP minus stock)	4.7	0.4	— 3.4	1.0	2.9
Change in the rate of business inventory accumulation as percentage of GNP	— 3.2	— 2.6	— 2.5	— 2.4	— 5.2
GNP	1.4	— 2.2	— 5.9	— 1.4	— 2.2

Source: Survey of Current Business.

Fiscal and monetary policies have both played a major role in offsetting the inventory recession. Federal expenditure on goods and services—mainly military—rose at an annual rate of $ 8 billion during the first half-year, almost half the decline in inventory demand. The decision was taken not to match this by tax increases—on the contrary, the investment tax credit was reinstated in March. The broad profile of the expansion this year—a relatively weak first half followed by a stronger second half—was correctly predicted by the Administration at the beginning of the year. On this basis, a large Federal budget deficit was allowed to develop in the first half of the year, but a surcharge on personal and corporate income tax was proposed by the Administration as from mid-year. On a national accounts basis the budget deficit rose from a seasonally adjusted annual rate of $ 2 billion in the second half of 1966 to one of $ 13.3 billion in the first half of the present year, the increase representing 1.5 per cent of GNP.

The prompt and significant relaxation of monetary restraints late in 1966 when inflationary pressures receded also played an important role, permitting a sharp revival of residential construction. Business fixed investment fell somewhat, but easier monetary conditions, including the lowering

of the discount rate back to 4 per cent in April, and re-introduction of the investment tax credit probably moderated the decline. Private consumption, after some hesitation in the early months of the year, recovered strongly in the second quarter in line with growing household incomes. The personal savings ratio, however, which had risen sharply towards the end of 1966, remained relatively high. It is difficult to estimate the individual contribution of fiscal and monetary policy in this period, but it is clear that their combined effects were significant.

Lessons for the Future

While the record is not without blemish, one feature of recent policy experience has been the more active use of fiscal policy that the authorities made, or sought to make. When pressures developed, it proved possible not only to slow down but to reverse the rise in Federal non-defence purchases of goods and services. And although enactment of tax changes is often a drawn-out process, Congress acted quickly early in 1966 on the proposal to reinstate certain excise taxes and accelerate the payment of other taxes. Moreover, budget policy was promptly and significantly changed in the first half of 1967. The speed with which excise taxes were reinstated in early 1966 was probably helped by the fact that they had been reviewed in some detail by Congress in 1965 when they were reduced; moreover, the amount of the increase involved was small ($ 1 billion a year). Experience of recent months is a reminder that enactment of tax increases may take time. The fiscal stimulus in the first half of 1967 was provided by the fact that defence expenditure continued to rise rapidly but the decision was taken not to request counteractive measures. It may, as in most countries, still be easier to change policy in a stimulative than a restrictive direction, and fiscal decisions can still take more time than is appropriate for modern demand-management policies. Until further progress has been made towards the flexible use of the budget, counter-cyclical policy under full employment conditions will still require very active use of monetary policy. And even under the best of conditions. monetary policy will still have a significant domestic role.

Important lessons can be drawn from recent experience of the demand effects of monetary policy. Because unless a more even impact can be secured its use could be seriously inhibited.

The mechanism of the process that led to the slump in housing can be summarized briefly. The savings institutions—the savings and loan associations and the mutual savings banks—normally supply about 60 per cent of total mortgage funds with commercial banks, life insurance companies, the Federal Government and individuals supplying most of the remainder

(see Table 2). In 1966 the increase in these institutions' time and savings deposits or savings shares fell sharply, reflecting a marked change in the pattern of the flow of savings. As in other periods of tight money and increasing market yields the volume of funds flowing directly to the capital market increased; funds deposited with financial institutions, notably savings institutions, actually fell (Table 3). These institutions, whose major assets are in mortgages, had great difficulty in maintaining competitive deposit rates. The extent to which they could afford to increase these rates was severely limited by the fact that the rates they were receiving on outstanding mortgages are contractually fixed—in most contracts for the lifetime of the mortgage loan—and could not therefore be changed. The inflow of time and savings deposits at commercial banks declined much less markedly, because of the greater flexibility they enjoy in raising the rates charged on outstanding loans.

Towards the end of the year, although the total supply of credit fell, the decline in the net inflow of savings to savings institutions was checked. Because of the relaxation of monetary restraints in autumn, short-term market yields fell rapidly, rendering the deposit rates offered by savings institutions more competitive. The shift in the flow of savings was also influenced by measures taken in July and September, notably the increase in member bank reserve requirements against time deposits in excess of $ 5 million, the reduction to 5 per cent of the maximum interest rate that member banks could pay on individual time deposits of under $ 100 000, and the imposition of ceilings ranging from 4.75 to 5.25 per cent on interest payable on deposits at savings and loan associations. This limited the escalation in interest rates paid in competition for consumer savings, and put the savings institutions in a better position to attract them.

According to a recent study by the Board of Governors of the Federal Reserve System[1] a number of other factors also reduced the availability of new mortgage credit last year, including:

(*a*) Return flows from prepayments fell sharply as the reduced volume of new lending slowed turnover in older properties and as more buyers were obliged to assume outstanding loans in order to finance real estate transactions.

(*b*) The limited degree of liquidity at savings institutions—reflecting the fact that their liquid assets were not increased in line with total resources during the early 1960's when credit conditions were easier—restricted their ability to adjust to large withdrawals of funds and to continue to meet demands for mortgage credit. At

1 Monetary Policy and the Residential Mortgage Market, Federal Reserve Bulletin, May 1967.

Table 2 **Supply of Mortgage Funds by Type of Institutions**
$ billion, without seasonal adjustment

	1964	1965	1966	1965 I	1965 II	1965 III	1965 IV	1966 I	1966 II	1966 III	1966 IV
Total	21.3	21.5	15.1	4.4	5.7	5.9	5.6	4.2	4.6	3.4	2.8
Financial institutions—Total	18.5	18.5	10.9	3.8	5.0	5.1	4.6	3.3	3.5	2.3	1.8
Commercial banks	2.5	3.5	2.7	0.5	1.0	1.2	0.8	0.4	1.0	0.8	0.5
Saving banks	3.8	3.6	2.2	0.9	0.9	0.9	0.9	0.6	0.4	0.6	0.6
Savings and loan associations	9.3	8.7	3.7	1.8	2.6	2.4	2.0	1.6	1.6	0.4	0.1
Life insurance companies	2.9	2.7	2.2	0.7	0.5	0.6	0.9	0.7	0.5	0.5	0.6
Federal agencies	— 0.2	0.4	2.8	*	— 0.1	0.1	0.4	1.0	0.6	0.6	0.6
All others	3.2	2.7	1.4	0.6	0.9	0.7	0.6	— 0.1	0.5	0.5	0.5

* Less than $ 50 million.

Source: Board of Governors of the Federal Reserve System, new series. Details may not add to totals because of rounding, which also affects comparisons between quarters and years.

Table 3 **The Flow of Savings**
$ billion, seasonally adjusted annual rates

	1964	1965	1966	1965 I	1965 II	1965 III	1965 IV	1966 I	1966 II	1966 III	1966 IV
Private domestic non-financial sectors	44.1	48.9	43.9	45.3	45.5	53.8	50.9	55.1	44.4	36.1	40.2
Deposits	35.3	40.4	22.5	38.3	31.5	43.4	48.6	27.7	27.3	13.4	21.6
Demand deposits + currency	6.5	7.8	2.9	3.1	2.6	8.7	16.8	2.8	3.5	— 2.5	7.5
Time and savings accounts	28.8	32.6	19.6	35.1	28.9	34.7	31.8	24.8	23.8	15.9	14.0
At commercial banks	13.0	19.5	12.3	21.8	16.6	21.5	18.1	15.1	19.0	10.6	4.6
At savings institutions	15.8	13.1	7.3	13.3	12.3	13.2	13.6	9.7	4.8	5.3	9.4
US government securities	0.8	3.0	8.1	5.6	7.2	— 0.1	— 0.6	13.0	6.3	5.6	7.5
Private credit market instruments	7.8	6.1	13.1	1.8	6.1	10.4	5.9	13.1	10.4	20.1	8.8
Less security debt	— 0.2	0.6	— 0.3	0.3	— 0.7	— 0.2	3.0	— 1.3	— 0.4	2.9	— 2.3
Other sectors	23.0	23.2	27.1	30.9	26.8	7.4	27.9	29.0	38.5	27.5	13.4
Total	67.0	72.1	71.1	76.3	72.3	61.2	78.8	84.1	82.9	63.5	53.7

Source: Federal Reserve Bulletin.

the end of 1965 the savings and loan associations' holdings of cash and US government securities accounted for the smallest share of their total assets in 24 years. The average liquidity of mutual savings banks was the lowest in several decades.

(*c*) Heavy borrowing by savings and loan associations from Federal home loan banks[1] in recent years, and the fact that nearly all open market borrowing by the latter was short-term, limited the degree to which these banks could provide new money when financial conditions tightened. Even so, the home loan banks in 1966 raised $ 8.8 billion in the money market—$ 7.2 billion to refinance outstanding obligations and about $ 1.6 billion in new money. This was about twice the average amount of new money raised annually in the 1960-1965 period. To be able to provide assistance to cover possible withdrawals of share capital from the associations, and for other reasons, the home loan banks stopped making advances to them for purposes of expanding mortgage credit in the spring. After mid-year, there was a temporary reduction in required liquidity and this provided added funds to the mortgage market.

Thus, apart from the fact that savings institutions borrow short and lend long, a basic difficulty stemmed from the fact that they have no possibility of changing the rates on outstanding mortgages. Moreover, low secondary reserves in relation to total resources limited their ability to withstand pressures when monetary conditions tightened. Possible remedies could therefore include measures to improve the savings institutions' reserve position, to provide greater flexibility in adjusting their earnings, and to broaden the sources of funds available for mortgage financing. Some steps have already been taken in this direction, and a number of other possibilities have been recommended for further study, inter alia by the Board of Governors of the Federal Reserve System in its study referred to earlier, and by the Council of Economic Advisers in its annual report published in January 1967. These proposals are briefly summarized in the following paragraphs.

The liquidity position of the savings institutions could be strengthened by:

1 The Federal Home Loan Bank System (FHLBS) is predominantly composed of savings and loan associations engaged in home financing. The Federal home loan banks provide a permanent reserve credit system for member institutions. The banks are privately owned by their members and are entirely self-sustaining. The Federal Home Loan Bank Board supervises the operations of the 12 Federal home loan banks, and of the Federal Savings and Loan Insurance Corporation, and charters and regulates Federal savings and loan associations.

the introduction of flexible secondary reserve requirements which should be implemented so as to provide a cushion in periods of tight monetary conditions;

an increase in the statutory and financial capacity of the Federal Home Loan Bank System to assist its members, including a better-balanced debt structure of home loan banks, thereby lessening the need to refinance outstanding indebtedness during periods of tightness.

The sources of funds available to savings institutions could be broadened, and their earning potential improved by:

further encouraging the institutions to issue a greater variety of longer-term liabilities, including certificates of deposits (CDs), returning a higher yield to investors; this tends to increase the institutions' ability to hold on to interest-sensitive deposits when rates rise without having to increase the yield to every depositor or shareholder. A variety of instruments have already been issued, but the amount raised in this way has been relatively small;

permitting and encouraging sales of participation certificates or other instruments against pools of residential mortgages. This should help to attract funds from investors such as pension funds or trusts that are reluctant to purchase and service individual mortgages outright and prefer to invest large blocks of funds in instruments payable only at maturity;

improving the marketability of residential mortgages so as to make them more attractive and permit lenders to adjust their portfolio more readily to conditions of general credit restraint. One measure proposed to this end is to explore through the FNMA[1] the feasibility of setting up a trading desk which could act as a dealer in residential mortgages. Another proposal is to study the possibility of enhancing the marketability of FHA—insured mortgages so that they would be traded more like corporate and municipal securities or Treasury obligations. Both measures would give mortgage institutions better access to the capital market, increasing their ability to attract funds if the inflow of savings deposits should fall off;

increasing the investment options available to savings institutions specialising in mortgage financing. Although this would initially divert

1 The Federal National Mortgage Association (FNMA) operates three programmes—secondary mortgage operations, special assistance programmes and management and liquidation functions. Secondary mortgage operations (purchases *and* sales) are conducted in residential mortgages guaranteed by the Veterans Administration (VA) or insured by the Federal Housing Administration (FHA). Through its special assistance functions, FNMA is involved in the financing of special purpose housing programmes and residentaial mortgages at below market rates. The management and liquidation function is the terminal phase of earlier activity.

some funds from the mortgage market, it could enhance their mortgage lending potential at times when general interest rates levels were rising; first, because improved flexibility in earnings might help the institutions to arrest the withdrawal of deposits during periods of credit tightness by making more rapid upward adjustments in the rates they pay on new and existing savings accounts; and, second, because a more diversified portfolio might permit the liquidation of short-term assets to provide additional funds for re-lending. Legislation designed to accomplish this objective has been endorsed by the Administration and is now before the Congress.

Such measures, if adopted, would have rather significant impacts, although considerable time would be required before the measures could become fully effective. With secondary reserves like the commercial banks, the savings institutions could better stabilize their mortgage lending. CDs and participation certificates would place savings institutions in a better position to attract new savings when interest rates are rising without having to increase rates paid on existing passbook deposits. Commercial bank experience suggests that it is possible to maintain different rates, although there are obviously limits to the extent to which the differential can be increased without generating a switch from passbook savings to CDs. The proposals to give mortgage institutions better access to the open capital markets would also enable them to attract funds at competitive rates without raising rates paid on existing deposit accounts. The efficiency of the measures, however, can only be tested in practice. Savings institutions are already free to issue CDs, and important progress has recently been made towards the introduction of a variety of such instruments with different maturities. Nevertheless, there would seem to be scope for substantial further improvements through devices that more effectively channel funds from bond markets to mortgage markets.

In a number of European countries, institutions specialising in mortgage financing raise all or part of their funds in the capital market through the flotation of their own bonds. This means that the long-term nature of their assets is to a large extent matched by a long-term maturity structure of their liabilities, with two obvious advantages:

(*a*) it reduces the mortgage institutions' exposure to abrupt withdrawals on the liability side; and

(*b*) it places them in a better position to raise interest rates in competition with others for new savings.

The measures now being considered in the United States to permit sales of participation certificates or other instruments against pools or residential mortgages would represent an important step in this direction. The increase in the marketability of residential mortgages might also give the

savings institutions some access to the open capital market, but it would not lengthen the maturity of their liabilities.

Greater access to the capital market can at times also be achieved indirectly through the Federal home loan banks. As noted earlier, however, the main role of these banks is to provide a reserve credit system for member institutions based on borrowing in the market rather than to secure a regular flow of capital to them. This has meant that the advances of the FHLB have remained small in relation to total mortgage debt outstanding, and most advances have been short-term.

Table 3*a* **Federal Home Loan Banks**
$ million, end of year

	1961	1964	1965	1966
Advances outstanding	2 662	5 325	5 997	6 935
— Short-term	1 447	2 846	3 074	5 006
— Long-term	1 216	2 479	2 923	1 929

Source: Federal Reserve Bulletin.

Greater involvement by the Federal or State governments in mortgage financing might help to create more stable conditions. At present, State governments are apparently not engaged in this activity at all, and the Federal authorities to a relatively limited extent. The Federal Housing Administration (FHA) guarantees, and the Veteran Administration (VA) insures mortgages, but they provide only limited amounts of financing under special programmes. The Federal National Mortgage Association plays an important role in the secondary market for residential mortgages, although its net purchases are normally small, less than $ 1 billion a year recently. At the end of 1966 its holdings of mortgages represented about 2 per cent of total outstanding mortgages. In 1966, however, FNMA added $ 2.7 billion to its portfolio—about 16 per cent of the increase in total mortgage debt outstanding. FNMA finances its operations by borrowings from the Treasury or in the capital market. During 1966, legislation was passed which raised FNMA's potential to expand its borrowings, and hence its mortgage holdings, by $ 4.8 billion.

A common feature of European mortgage financing—in contrast to US practices—is the use of mortgages carrying rates that can be changed

during the contract period, often but not always in a stated relation to another interest rate such as, for instance, the Central Bank discount rate or long-term government bond rates. From the point of view of the institutions the advantage of a system of variable-rate mortgages lies in the possibility it offers for raising rates on outstanding mortgages in periods of tight money, thus placing them in a better position to avoid withdrawals of savings deposits and to attract new ones. Given the flexibility the

Table 4 Federal National Mortgage Association
$ million, end of period

	1961	1964	1965	1966
Mortgage holdings	6 093	4 412	4 731	7 063
Mortgage transactions during period:				
— Purchases	815	424	913	2 701
— Sales	541	251	200	—

Source: Federal Reserve Bulletin.

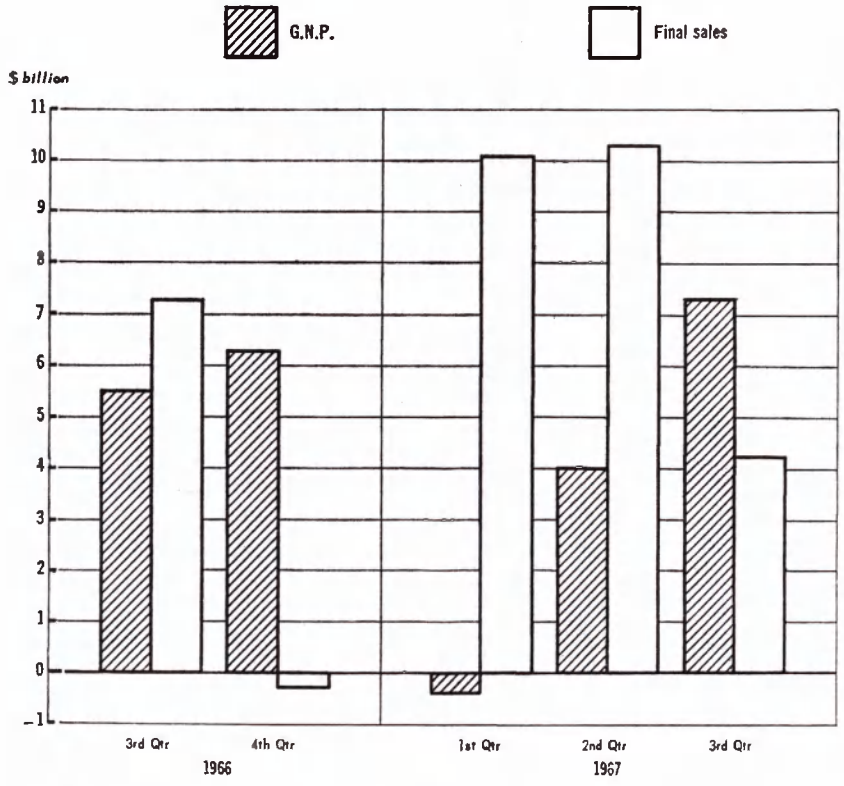
system provides for increasing earnings on existing assets, it would seem likely to ease the problems involved in borrowing short and lending long, the basic problem of US savings institutions specializing in mortgage financing. However, a recent study[1] suggests that variable-rate mortgages might be difficult to apply in US conditions, and would seem to offer no basic answer to the problem of portfolio flexibility. Institutions holding portfolios of variable-rate mortgages, although better placed than they otherwise would have been, might still have difficulty in maintaining earlier growth rates in savings accounts under tight money conditions. Diversified lenders (commercial banks and life insurance companies) would shift out of mortgages into fixed interest rate investments in periods of tight money and high interest rates, accentuating cyclical fluctuations in the availability of mortgage funds. Variable-rate mortgages would be even less saleable in the secondary market than fixed-rate loans, working against the greater marketability of mortgages. Policies of variable-rate mortgages would be difficult to implement, requiring in particular numerous changes in Federal and State laws, and would meet with strong resistance from the general public.

1 Variable-Rate Mortgages by Robert Moore Fisher, Staff Economic Studies, Board of Governors of the Federal Reserve System.

II THE DOMESTIC ECONOMY. CURRENT SITUATION AND PROSPECTS

Following the slowdown in the first half of 1967, the expansion of activity quickened in the third quarter, when GNP rose by some $ 16 billion or at an annual rate of about 4.4 per cent in volume. The advance was slowed by the Ford automobile strike in the last three weeks of September, entailing a decline in total industrial production in that month. There may, however, have been a compensating acceleration of automobile production in the two preceding months in anticipation of the strike.

Diagram 2 **Quarterly Changes in GNP and Final Sales**
Billion of 1958 dollars[1]



1 Change from previous quarter, seasonally adjusted annual rates.
Source: Survey of Current Business.

The rise of final demand in current prices, although not as great as in the first half, remained substantial. Public expenditure increased less rapidly, reflecting the modest rise in defence spending. Private consumption also slowed down. On the other hand, the recovery in residential construction accelerated, with a sharp increase in building starts facilitated by a large inflow of funds to savings institutions. According to the official survey conducted in July and August, business expenditures for new plant and equipment may have shown a small increase, following the decline in the first half-year. Inventary demand started recovering, rising from a negligible annual rate of $ 0.5 billion in the second quarter to $ 3.8 billion. The most notable shift was in trade inventories where the marked liquidation of the second quarter was not repeated in the third.

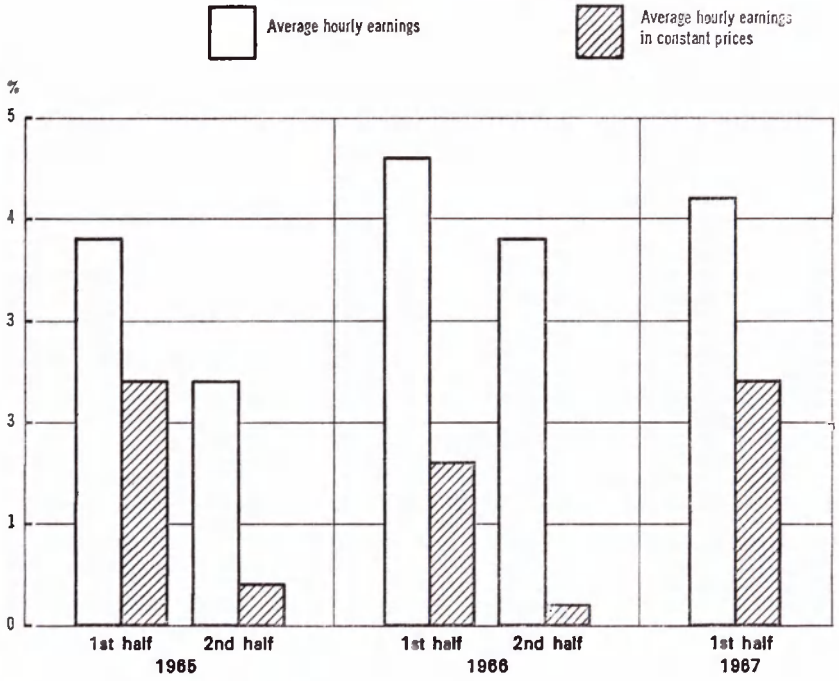
The slow advance of demand in the first half of the year had been accompanied by an easing of the pressure on resources. The average rate of capacity utilisation in manufacturing fell below 85 per cent in the second quarter compared with the unusually high rate of about 91 per cent reached a year ago. The rise in employment slowed down, and was largely confined to the service industries and the public sectors. In manufacturing, the number of employed fell, and the average working week declined by as much as $1\frac{3}{4}$ per cent. Nevertheless, the rise in the unemployment ratio was modest—from 3.7 per cent at the end of last year to 4 per cent in June— mainly because of withdrawals from the labour force as demand for labour weakened.

Demand for labour strengthened in the third quarter. Non-farm payroll employment turned up in June, and continued to rise in the following two months, particularly in August. The August figure reflected a sharp increase in manufacturing employment, partly because of the early model-changeover in the automobile industry. Average weekly hours worked in manufacturing lengthened somewhat in July and August but remained below the levels of a year earlier. The unemployment ratio fell to 3.8 per cent in August. Its rise to 4.1 per cent in September and to 4.3 per cent in October was influenced by an unusually large increase in the female labour force.

The rise in labour costs has accelerated. In the first half of the year average hourly compensation in the private non-farm economy was rising at an annual rate of about 6 per cent, much faster than the normal increase in labour productivity (about $2\frac{3}{4}$ per cent a year in the non-farm economy). In manufacturing, average hourly earnings were rising at an annual rate of almost 4.5 per cent, somewhat faster than in the second half of last year, and also faster than during the preceding 12-months period. In 1966 unit labour costs in manufacturing had risen by 2.2 per cent over the

1965 average, breaking their virtual stability since 1958; this upward movement has accelerated somewhat in the first half of 1967. The recent wage settlement in the automobile industry, although providing for substantial hourly wage increases, was not greatly out of line with the pattern of other recent settlements, given the many special factors in the automobile industry. Its impact on other union settlements is expected to be rather limited.

Diagram 3 **Earnings in Manufacturing**
Percentage Change at Annual Rates



Source: Economic Indicators.

Despite the accelerated increase in costs, the rise in prices slowed down somewhat at both wholesale and retail levels in the first half of the year. In June, wholesale prices were only 0.6 per cent higher than a year earlier compared with a rise of 2.8 per cent over the previous twelve months; the index showed no rise in the first quarter and declined slightly in the second. Over the year ended in June the consumer price index rose by 2.7 per cent, slightly more than over the previous twelve months, but the rise had slowed down since the beginning of the present year. This more favourable price picture can mainly be ascribed to a better trend in food

prices and a sharp decline in non-food raw material prices. At the wholesale level, food prices showed a decline during the twelve months, influenced by more abundant supply, following an earlier sharp advance. At the wholesale level the rise in prices of industrial finished goods has slowed down somewhat, probably influenced by the better balance between demand and supply; but this tendency has not been reflected at the retail level where, in the first half of the year, non-food commodity prices rose rather faster than earlier.

In the third quarter, the pressure on prices seems to have strengthened again. The consumer price index rose almost 1 per cent between May and September, and wholesale industrial prices 0.75 per cent in August and September, following 6 months' stability. The recent increase in industrial prices probably reflected a catching-up of prices with earlier increases in costs, given the more buoyant trend in aggregate demand.

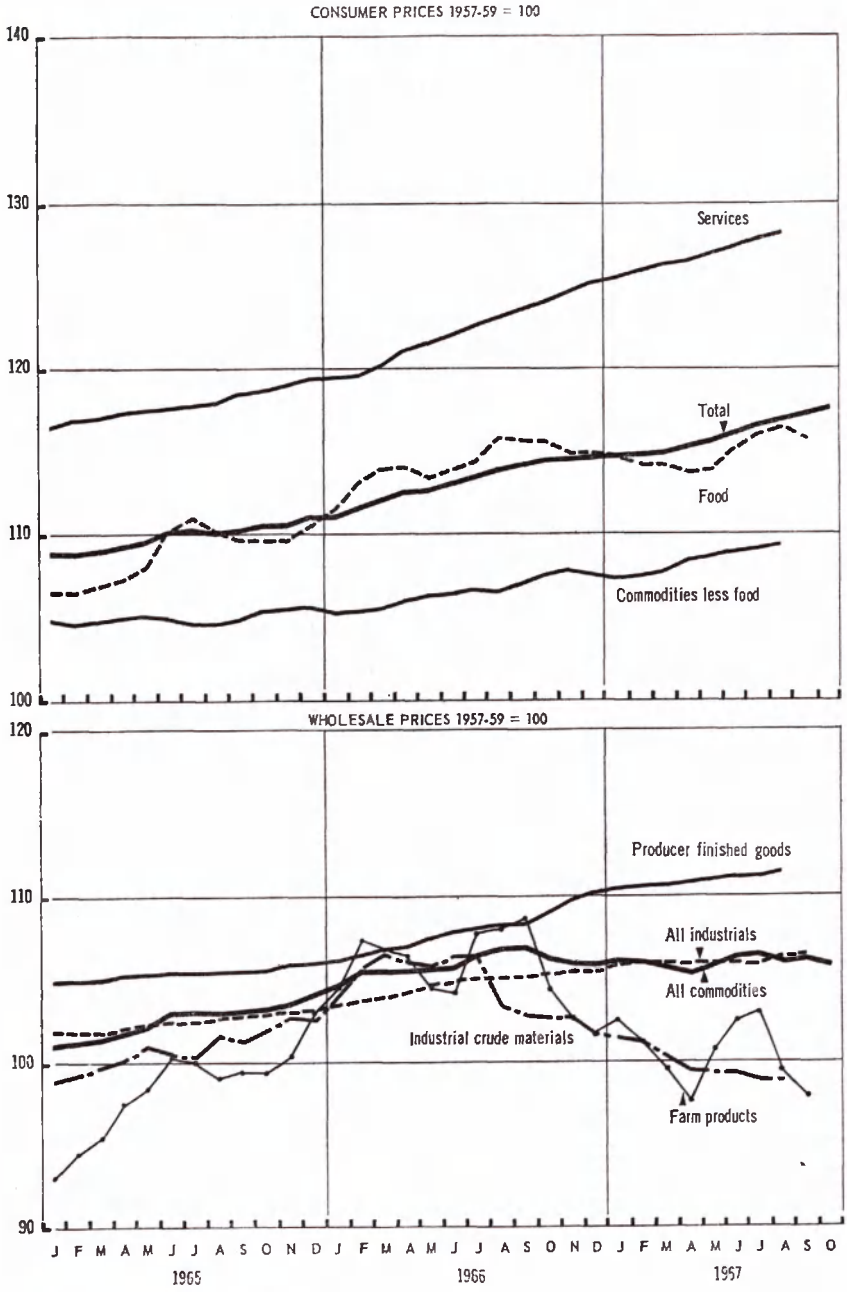
Monetary and fiscal developments

The less restrictive monetary policy adopted in the autumn of 1966 has been maintained in 1967, with the Federal Reserve System operating so as to ease the pressure on bank reserves, partly through open market operations and partly through a reduction of reserve requirements on time and passbook savings deposits at member banks. Moreover, in April the discount rate was reduced from 4½ to 4 per cent. Following the devaluation of the pound sterling and the consequent rise in the British bank rate from 6½ to 8 per cent, the Federal Reserve discount rate was raised from 4 to 4½ per cent in November.

The expansionary posture of monetary policy has been reflected in a strong rise in the money supply, non-bank liquid assets in relation to GNP, and banks' free reserves. Nevertheless, the rapid decline in interest rates which began when monetary policy was eased in the autumn of last year was reversed by the end of the first half of 1967. Long-term bond yields turned up in March and by mid-year had regained the peak levels of last year. Short-term rates continued to decline through May, but generally rose sharply in last June and early July, reducing the large gap which had opened up between short- and long-term rates. However, because long-term rates have continued upward, the spread between long- and short-term rates—though it is now less than it was in June—remains unusually wide. The movements of both short- and long-term rates have been somewhat irregular in recent months, but the underlying tendency has remained upwards.

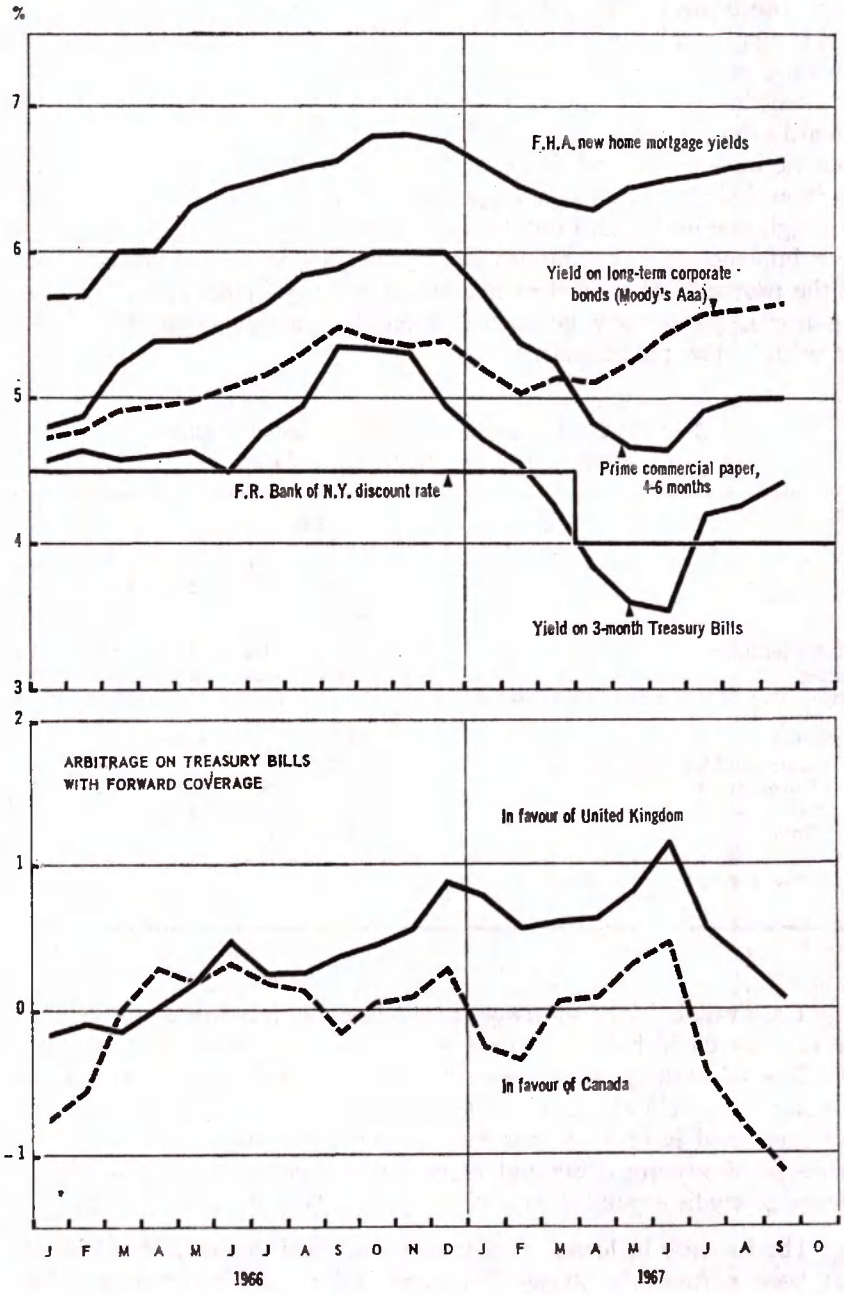
The upturn in market yields in the spring was influenced by a sharp increase in credit demand. The total volume of funds raised in credit

Diagram 4 **Prices**



Source: Economic Indicators.

Diagram 5 **Interest Rates**



Source: Federal Reserve Bulletin.

and capital markets, which had fallen sharply in the second half of last year, rose again in the first half of 1967. The Federal Government was a net supplier of funds through repayments, but borrowing by private domestic non-financial sectors as well as foreigners increased sharply. The scheduled acceleration of Federal income tax collections served to intensify the private demand for funds. There was a particularly marked increase in sales of corporate securities as corporations rebuilt their liquid position following last year's squeeze. Corporate bond sales continued at a high rate in the third quarter. The rise in interest rates may also have been influenced by expectations of a further rise in market yields in view of the prospects of revived economic expansion and large Federal borrowing needs, particularly given the uncertainty about enactment of the President's tax programme.

Table 5 Total Borrowing in Credit and Capital Markets
$ billion, seasonally adjusted annual rates

	1965		1966		1967
	1st half	2nd half	1st half	2nd half	1st half
US Government	5.2	1.9	8.9	4.6	— 5.5
Foreign	3.4	1.9	2.4	0.5	4.9
Private domestic non-financial sectors	65.7	66.3	72.4	53.4	62.5
Loans	27.7	27.7	28.2	21.1	19.8
Securities	13.1	12.6	19.9	14.7	25.3
States and local authorities	7.4	7.5	6.3	5.5	10.8
Corporations	5.7	5.2	13.6	9.3	14.5
Mortgages	24.9	26.1	24.4	17.6	17.4
Total	74.3	70.0	83.5	58.6	61.9

Source: Federal Reserve Bulletin.

The availability of mortgage credit has also increased, although not as much as could have been expected on the basis of the marked rise in the flow of savings to mortgage institutions. Table 6 shows that the increase in the volume of funds flowing to the savings and loans associations has been used in part to improve their liquidity position through repayments of short-term debts and purchases of liquid assets. Nevertheless, mortgage credit expanded rapidly in the second and third quarters.

The increase in loans—consumer credit, bank loans, and other—has not been particularly strong this year. Private consumption has been low in relation to personal income. Corporations have covered part of

Table 6 Savings and Loan Associations - Sources and Uses of Funds
$ billion, seasonally adjusted annual rates

	1966				1967	
	1st qtr.	2nd qtr.	3rd qtr.	4th qtr.	1st qtr.	2nd qtr.
Savings shares	5.8	2.5	1.4	4.7	10.2	13.8
Main uses:						
Mortgages	8.4	5.1	0.6	1.0	3.7	7.0
Liquid assets[1]	0.6	— 1.2	— 0.3	0.9	0.2	1.4
Borrowing (—) or repayments of debts	— 2.9	— 1.4	0.6	2.7	2.6	4.0
Other	— 0.3	—	0.5	0.1	3.7	1.4

1 Demand deposits, currency, and US government securities.
Source: Federal Reserve Bulletin.

their need for short-term funds by borrowing in the market for commercial papers. Moreover, the corporations' efforts to improve their liquidity position have partly taken the form of repayment of bank loans; as a result, the annual rate of increase in business loans fell to 4.9 per cent during the third quarter.

Table 7 shows the main fiscal developments. On a national accounts basis the deficit on the Federal budget rose sharply in the first half-year. Government spending, led by military expenditure, continued to rise sharply.

Table 7 Federal Government Finance
National accounts basis
$ billion, seasonally adjusted annual rates

	1965	1966	1965		1966		1967	
	Year	Year	1st half	2nd half	1st half	2nd half	1st half	3rd qtr
Receipts	124.8	143.2	124.2	125.5	139.3	147.1	148.6	152.8
Expenditures	123.4	142.9	119.4	127.3	136.6	149.1	161.9	165.9
Goods and services	66.8	77.0	64.9	68.7	73.5	80.5	88.3	90.9
Defence	50.1	60.5	48.8	51.4	56.8	64.3	71.4	73.3
Transfers, etc.	56.6	65.9	54.5	58.6	63.1	68.6	73.6	75.0
Balance	1.4	0.3	4.7	— 1.8	2.7	— 2.0	— 13.3	— 13.1

Source: Survey of Current Business.

The increase in tax revenue, however, flattened out, reflecting the moderate growth of the tax base; corporate profits tax accruals fell because of the decline in profits. In the third quarter the deficit narrowed somewhat as receipts rose faster than earlier and the rise in defence spending slowed down considerably.

The outlook for the Federal budget 1967-68 is still not clear. Federal purchases of goods and services may continue to rise, although at a more moderate pace than during the preceding 12 months; the Administration expects a slower rise in defence spending and little if any increase in non-defence purchases. The tax changes proposed are:

(*a*) An increase in social security benefits adding $ 4 billion a year (0.6 per cent) to personal incomes, and an increase in the maximum income to which payroll taxes apply resulting in a revenue increase of $ 2 billion at an annual rate.

(*b*) A surcharge on personal and corporate income taxes of 10 per cent (rather than the 6 per cent proposed earlier), given the likelihood of a strong upsurge in demand in the months ahead. The surcharge would yield $ 10 billion a year (1¼ per cent of GNP).

(*c*) A speed-up in corporate income tax collections, placing them on the same basis as those for individuals and partnerships.

(*d*) A postponement of scheduled excise tax reductions for the period during which the proposed tax surcharge is in effect.

The tax programme has encountered strong resistance in Congress, where the need for expenditure cuts has been stressed. The timing and extent of legislative action to give effect to the President's proposal are therefore uncertain.

Prospects

Aggregate demand has probably continued rising fast in the final quarter of the year, with the pattern of the expansion remaining much as in the third quarter. GNP may prove to have shown an increase of about 4 per cent in real terms (annual rate) from the first to the second half-year. The automobile strike is assumed to shift an estimated $ 3 billion of personal consumption and inventory accumulation from 1967 to the first half of 1968.

Prospects for 1968 will depend heavily on fiscal and monetary policy. Although the outlook is still uncertain, early Congress approval of fiscal measures representing about the same restrictive demand effect as those proposed by the Administration is assumed. This would make the Federal

budget much less stimulative in 1968 than in 1967; the deficit should fall considerably towards the end of the year, partly because of the increase in the tax base associated with the expansion of activity. The outlook for interest rates and credit flows is difficult to assess. In the absence of any significant fiscal action, the burden of controlling the growth of demand would fall heavily on monetary policy, with the possibility of a repetition of some of the financial pressures associated with the 1966 experience. Even with prompt and fairly complete enactment of the President's tax programme or measures with similar demand effects, some slowdown of the monetary expansion may be appropriate to avoid the resurgence of excessive demand conditions.

Even with higher taxes and some slowdown in the increase of government expenditure on goods and services, the present strong momentum is likely to maintain a high rate of expansion in 1968. The inventory adjustment should be over and renewed accumulation would seem likely. Residential construction should continue to rise, given the existing high rate of family formation and low vacancy rates, but the advance may slow down in the course of the year if growing pressures on financial markets have an adverse effect on the availability of mortgage funds. With aggregate demand rising relatively fast and a renewed rise in profits, the incentive for business to invest in plant and equipment should strengthen gradually throughout 1968. Given that investment expenditures in 1967 will increase manufacturing capacity by some 6 per cent for 1968, there is little prospect that capacity utilization by the second half of 1968 will have changed substantially from the 84 per cent rate of the second half of 1967. Two private surveys (by Rinfret-Boston and Lionel Edie) report an anticipated rise of somewhat more than 8 per cent in current prices in business plant and equipment expenditure from 1967 to 1968. The more recent McGraw-Hill survey shows a 5 per cent increase in current prices, and the responses to an explicit question show an expected rise in price of 5 per cent. But investment plans are frequently revised upwards in the course of an expansion, so some strengthening of investment demand in the course of 1968 is possible. Private consumption may be an important dynamic factor in 1968 since a decline in the personal savings ratio from the high level prevailing in 1967 would seem likely. On this basis, real GNP could increase by some 4½ per cent from 1967 to 1968.

With tax measures assumed to take effect early in the year, and the possible strengthening of business fixed investment demand only coming later, a stronger advance would have been expected in the second half-year than in the first. However, a revival of car sales and some re-stocking after the automobile strike may inflate demand in the first half of the year. And with existing wage contracts in the steel industry falling due in the latter part of 1968, precautionary stockbuilding in anticipation of a strike

may also add to demand in the first half of the year. In these circumstances the rise in activity could be particularly strong in the first half of 1968; in the latter half the pace of the advance is likely to be more moderate.

If GNP rose at about 4½ per cent, the pressure of demand would not become excessive. Given a normal growth of potential of about 4 per cent, the under-utilisation of manpower resources that existed in 1967 might be re-absorbed by the second half of 1968. The rise in employment could be only moderate in relation to the advance in activity in the months immediately ahead, given the existence of some under-utilisation of labour and some scope for a lengthening of the working week in manufacturing. And the labour force could increase quite rapidly because of higher participation rates as demand for labour strengthens. Nevertheless, the slack in the labour market would seem likely to disappear in the course of the year. Under conditions of approximately stable capacity utilization in manufacturing, the overall tightening of labour markets is likely to constitute the main constraint on increased growth of output.

Should demand rise as expected, rather stronger pressures on prices than in 1967 would seem likely. At best the rise in total hourly compensation might remain about the same as in 1967—more than 6 per cent, well in excess of the trend growth of productivity, with the result that labour costs overall per unit of output may rise about 2½ to 3 per cent a year in the private economy.

III BALANCE OF PAYMENTS

The Vietnam situation and rising domestic demand pressures of 1966 had been accompanied by a shrinking external surplus on current account. This was just about offset by a smaller capital outflow[1], under the influence of the voluntary balance of payments programme and the tightening of monetary conditions at home. (The former encouraged US firms to borrow abroad even through domestic long-term rates generally remained lower than those elsewhere. The latter attracted foreign funds into assets with a shorter maturity.) Thus, as in 1965, the deficit remained at $ 1.4 billion on a liquidity basis. Because of the tight monetary situation and the pressure on sterling, there was actually a sizeable surplus in the third quarter on the balance of official reserve transactions—large enough to result in a surplus of $ 0.2 billion for the year—the first in a decade.

1 Excluding changes in official reserve assets and in liquid liabilities to foreigners.

Table 8 Balance of Payments
$ million

	1961	1962	1963	1964	1965	1966	1966[1] 1st half	1966[1] 3rd qtr.	1966[1] 4th qtr.	1967[1] 1st qtr.	1967[1] 2nd qtr.
Current account	2 933	2 348	3 045	5 680	4 120	2 177	2 566	1 768	1 808	2 484	2 052
Capital account (excluding reserve and liquid assets)	—5 303	—4 551	—5 716	—8 480	—5 455	—3 534	—4 112	—2 428	—3 484	—4 636	—4 100
Balance on liquidity basis[2]	—2 370	—2 203	—2 671	—2 800	—1 335	—1 357	—1 546	—660	—1 676	—2 152	—2 048
Balance on official reserve transactions[3]	—1 347	—2 705	—2 044	—1 549	—1 304	225	—2 472	—3 444	—72	—7 308	—3 256

1 Seasonally adjusted annual rates.
2 Changes in liquid liabilities to all foreign holders, plus changes in official reserve assets (gold, convertible currencies and the US gold tranche position in the IMF).
3 Changes in liquid and certain non-liquid liabilities to foreign official holders, plus changes in official reserve assets.
Source: Survey of Current Business.

Table 9 Balance of Payments - Current Account
$ million

	1961	1962	1963	1964	1965	1966	1966[1] 1st half	1966[1] 3rd qtr.	1966[1] 4th qtr.	1967[1] 1st qtr.	1967[1] 2nd qtr.
Merchandise exports[2]	19 954	20 604	22 071	25 297	26 244	29 168	28 768	29 528	29 608	30 764	30 892
Merchandise imports	14 510	16 187	16 992	18 621	21 472	25 510	24 500	26 320	26 720	26 768	26 348
Trade balance	5 444	4 417	5 079	6 676	4 772	3 658	4 268	3 208	2 888	3 996	4 544
Military expenditures	—2 981	—3 083	—2 936	—2 861	—2 921	—3 694	—3 544	—3 812	—3 876	—4 180	—4 208
Transportation	—138	—164	—201	—138	—284	—325	—306	—264	—424	—360	—240
Travel	—838	—982	—1 099	—1 004	—1 058	—1 084	—1 108	—1 056	—1 064	—1 052	—1 828
Income on investments, net	2 934	3 309	3 325	3 934	4 159	4 171	4 120	4 088	4 364	4 112	4 020
Other services, net	1 088	1 548	1 685	1 855	2 276	2 376	2 308	2 440	2 448	2 880	2 912
Balance on services	65	628	774	1 786	2 172	1 444	1 470	1 396	1 448	1 400	656
Unilateral transfers, net	—2 576	—2 697	—2 808	—2 782	—2 824	—2 925	—3 168	—2 836	—2 528	—2 912	—3 148
Current account balance[3]	2 933	2 348	3 045	5 680	4 120	2 177	2 566	1 768	1 808	2 484	2 052

1 Seasonally adjusted annual rates.
2 Excluding transfers under military grants.
3 Balance on goods, services and unilateral transfers.
Source: Survey of Current Business.

In December 1966, new guidelines were issued for the voluntary restraint programmes in 1967. As foreign lending by the commercial banks was still about $ 1.2 billion below the ceiling fixed in 1966 by the authorities, at 109 per cent of claims outstanding at the end of 1964, it was requested that each bank should continue to observe that ceiling throughout 1967, and only use up the leeway slowly. To ensure that the loans would be devoted primarily to the financing of exports, or to meet the credit needs of developing countries, the increase in credit, other than for exports, to the developed countries was closely limited. New and simplified guidelines were issued for non-bank financial institutions, permitting an increase in foreign credits covered by the programme of 5 per cent over the amount outstanding as of October 1st, 1966. The guidelines for non-financial corporations were also tightened. With regard to direct investment, the programme involved a ceiling for outflows of US funds plus reinvested earnings that was several hundred million dollars lower in 1967 than in 1966. In August 1967 legislation was enacted, extending the Interest Equalization Tax for two years and giving the President authority to vary its rate between 0 and 1.5 per cent. Making use of the new authority, the President fixed the tax at a new level of 1.25 per cent which, though lower than the maximum 1.5 per cent rate temporarily applicable during the period of congressional consultation, represents a moderate increase from the previous statutory rate of 1.0 per cent.

In the first half of 1967, the current account surplus on a seasonally adjusted basis rose from its low-point of the previous six months. A marked increase in the trade surplus more than offset a deterioration of the non-merchandise account. The rise in imports levelled off, reflecting the easing of domestic demand pressures; the second quarter, indeed, showed an absolute decline which continued in July/August. The rise in exports continued, although it slowed down significantly after the first quarter mainly because of the weakening of demand in certain foreign markets, notably in Europe. The deterioration of the non-merchandise account reflected a further increase in military expenditure abroad, and a decline in net investment earnings. Moreover, Expo '67 in Montreal attracted an unusually large number of US tourists to Canada, and the Middle East crisis led to a sharp increase in private remittances to Israel in the second quarter.

But this improvement was more than offset by a deterioration of the capital account. The official capital outflow rose, partly reflecting rising disbursements under Foreign Assistance Act programmes and greater lending by the Export-Import Bank. On private account, direct investment abroad fell, but this was due to special liquidations of investments in Latin America and the reversal of a 1966 transaction with Canada. The outflow of capital through new foreign issues rose as conditions in

US capital markets eased; a special factor was the relatively large sales of securities by the Government of Israel in the second quarter. New bank credit to abroad increased temporarily, reversing the reflow of funds that had taken place in 1966. The effect of these greater outflows was partly eased by a further increase in the inflow of foreign capital; most of this increase reflected foreign official purchases of certificates of deposits, which rose to an annual rate of $ 2 billion helping the liquidity balance but not the balance on official transactions. But there was a large outflow under " errors and omissions ", which appears to have been reversed in the third quarter.

All in all, the deficit on the liquidity basis rose to a seasonally adjusted annual rate of $ 2.1 billion. The balance on official reserve transactions turned very sharply into deficit. This reflected a shift back into foreign official holdings of funds which US banks had obtained from their foreign branches and the latter had obtained as Eurodollar deposits. The shift occurred as confidence in sterling was strengthened and as the credit situations in the US eased.

The actual balance on official reserve transactions (without seasonal adjustment) amounted to $ 1.9 billion in the first half of the year. It was financed to the extent of $ 1.3 billion by an increase in liabilities to official foreign authorities. The reserves fell by $ 0.6 billion, most of this reflecting a decline in holdings of convertible currencies, largely sterling. The fall in the gold stock was negligible ($ 66 million).

The surplus on the current account could show a small further increase in the second half, mainly because imports are not likely to increase much; they declined again in the third quarter and although the last months of the year may see a renewed rise as domestic demand strengthens in the half-year as a whole they may remain at the level of the first half. Some small increase in exports can be hoped for. But this improvement may be accompanied by some further rise in military expenditure abroad and relatively large payments on invisible account. The long-term capital outflow could increase. New issues of foreign securities will be swollen because of relatively heavy borrowing by Israel and an IBRD issue ($ 90 million). But this will be offset to a considerable extent by investment of part of the proceeds in assets in the US. Direct investment abroad is likely to increase since special factors kept the first half-year figure low; part of the increase, however, may be financed by funds raised by corporations abroad. Sales of certificates of deposits with maturity of more than one year may decline from the high level of the first months of the year. The large reduction in US banks' liquid liabilities to their foreign branches during the first four months of the year gradually reversed itself as US interest rates began to rise in May and June, and as renewed

Table 10 **Balance of Payments - Capital Account and Overall Balances**
$ million

	1961	1962	1963	1964	1965	1966	1966 1st half	1966 3rd qtr.	1966 4th qtr.	1967 1st qtr.	1967 2nd qtr.
							(seasonally adjusted annual rates)				
Transactions in US private assets, net	—4 180	—3 425	—4 456	—6 542	—3 743	— 4213	—4 232	—3 728	—4 660	—3 832	—4 520
— direct investment	—1 599	—1 654	—1 976	—2 435	—3 418	3 543	—3 280	—3 600	—4 012	—2 488	—2 736
— new issues	—523	—1 076	—1 250	—1 063	—1 206	—1 210	—1 400	—1 120	—908	—1 412	—1 352
— claims reported by US banks	—1 261	—451	—1 535	—2 464	93	253	240	356	176	248	—704
— claims reported by non-bank sector	—558	—351	159	—966	340	—441	—494	—284	—492	—540	—396
— other	—239	107	146	386	448	728	708	920	576	360	668
Transactions in foreign assets in the US, net (excl. liquid assets)	707	1 021	689	685	278	2 512	2 712	1 504	3 120	3 296	5 164
US Govt. assets, excl. official reserve assets, net	—926	—1 094	—1 664	—1 674	—1 575	—1 531	—1 730	—1 312	—1 352	—2 964	—2 136
Errors and omissions, net	—904	—1 053	—285	—949	—415	—302	—862	1 108	—592	—1 136	—2 608
Balance on liquidity basis	—2 370	—2 203	—2 671	—2 800	—1 335	—1 357	—1 546	—660	—1 676	—2 144	—2 052
financed by:											
— change in US official reserve assets, net	606	1 533	378	171	1 222	568	984	328	—24	4 108	—1 676
— change in liquid liabilities to foreigners	1 764	670	2 293	2 629	113	789	562	332	1 700	—1 956	3 724
Balance on official reserve transactions	—1 347	—2 705	—2 044	—1 549	—1 304	225	—1 236	3 444	—72	—7 308	—3 256

Source: Survey of Current Business.

concern about sterling arose. The deficit on official settlements should therefore fall considerably or be replaced by a surplus. Preliminary estimates for the third quarter showed that the deficit on the liquidity basis rose to a seasonally adjusted annual rate of $ 2.7 billion, but the balance on official settlements showed a seasonally adjusted annual rate surplus of $ 1.8 billion.

In 1968, the current account may be unfavourably affected by a relative increase in the pressure of demand in the United States, given the relatively weak demand prospects in Europe. Imports will rise faster than in 1967, as domestic demand strengthens, but the expected ample margin of unutilised capacity (particularly as compared with 1966) will moderate the import rise. On the export side, shipments to Canada and Japan could rise well and sales to Europe should accelerate during the year as business activity picks up there. Exports to some non-OECD countries will reflect only with a lag the pick-up in the US and in other industrial countries, but exports to other non-OECD countries will be sustained by military expenditures abroad. The non-merchandise current account should improve with a rise in investment earnings, no further deterioration (possibly an improvement) in the travel account, and lower private remittances to abroad; moreover the US authorities expect a smaller increase in defence expenditure abroad. If adequate fiscal action was taken to restrict the growth of domestic demand, there would seem no firm reason to expect much change in the current account surplus in either direction. In the absence of fiscal restraint, however, the current account might deteriorate.

The voluntary balance of payments programmes relating to both the financial and non-financial sectors which were announced in November, involve some tightening. The ceiling on the outflow of commercial bank credit in 1968 has been maintained unchanged at 109 per cent of the banks' foreign assets held at the end of 1964. In addition the banks were requested not to use more than 20 per cent each quarter of their leeway for increasing credit abroad, estimated at $ 783 million as of September 30th 1967. The non-bank financial institutions have been asked not to increase their credits to abroad to more than 109 per cent of their September 30th 1966 holdings against a ceiling of 105 per cent in 1967. The programme covering non-financial corporations permits for 1967 and 1968 together an average outflow for investment in developed countries including reinvested earnings not higher than the 1962-64 average. The present formula permitted capital outflow in 1966 and 1967 20 per cent higher than the annual average in the 1962-64 base period. The new programme also places greater emphasis on borrowing from abroad to finance direct investment there.

In view of the possibility of a relative tightening of financial markets in the United States and the disappearance of some of the special factors affecting 1967 (notably Israel and IBRD borrowings), the long-term capital account might be expected to improve. Much, however, will depend on whether the sales of long-term certificates of deposits can be maintained at the high level achieved in 1967; a decline in this item could more than offset improvements on other long-term items. The short-term account could well show an inflow, attracted by relatively high interest rates in the United States.

Assessment of the basic position of the external balance is complicated by the need to discount numerous special factors affecting both the current and the capital account. It seems clear that the current account is at present adversely affected by the difference between the cyclical positions of the United States and Europe, which should not be regarded as lasting. With activity at a high level and expanding at home, imports are turning up. The rise in exports, however, is limited by weak business conditions abroad, especially in Europe. This results not only in sluggish sales to Europe itself, but also to weak demand from other countries whose export earnings are adversely affected by the European recession. Cyclical slack abroad has also had an unfavourable impact on invisible earnings, especially net investment income, which has been stagnant since 1965; in the first half of this decade it had risen by 12 per cent a year. Although difficult to quantify, the effect of cyclical factors may well be important.

A second special factor aggravating the balance of payments problem has been the defence build-up associated with the Vietnam conflict, entailing both direct expenditures abroad and higher imports. Its eventual reversal should improve the foreign balance considerably. Among other considerations suggesting a longer-term strengthening of the balance is the fact that net invisible earnings (excluding military transactions) have shown an average annual improvement of about $ 1/4 billion since 1960, reflecting higher investment income. This should continue in the years ahead, assuming a continued improvement of the US foreign investment position, and expanding economic activity abroad. It could also be argued, with less certainty, that the trade surplus should show a secular increase, resuming the rising trend of the 1960-64 period. The increase in the disadvantage to US exports resulting from the establishment of the European Economic Community and the European Free Trade Association is coming to an end; the removal of internal tariffs in EFTA was completed in 1967 and in the EEC completion of both internal free trade and the harmonisation of external tariffs is expected by 1968. But much will depend on demand management and the relative movement of costs. The US cost position has improved significantly compared to that of other countries

so far in the 1960's. But recent developments suggest that stable costs will be more difficult to maintain under full employment conditions, while the strong efforts made in Europe to improve its own cost performance may yield some results.

Despite the uncertainties, there seem, on balance, reasons for expecting the current account to improve both because of cyclical factors and certain elements of underlying strength. But it is not clear that the surplus will be big enough to accommodate the capital outflow. Recent surveys of investment intentions indicate that the rise in plant and equipment expenditure by foreign affiliates of US companies is slowing down; the rise is projected to fall from 17 per cent in 1966 to a currently estimated 12 per cent in 1967.[1] If the current 1967 estimate turns out to be correct, there will be an actual decline in expenditure in 1968 on the basis of the initial estimate. The slowdown is particularly marked in Europe, but is accompanied by increases in Asia, Africa and Latin America. The shift away from Europe has been encouraged by the voluntary programme. It may also reflect longer-term expectations of slower growth and narrower profit margins in Europe and the prospect of lower trade barriers as a result of the Kennedy round. But it is also possible that cyclical factors are involved, with the implication that capital expenditure may rise again in Europe as economic activity resumes a faster rate of growth.

In the last few years the outflow of portfolio capital has been checked by selective measures, notably the interest equalisation tax and voluntary programmes. In the absence of such measures the outflow would probably have tended to increase, responding to continuing forces such as the size of the US capital market and less efficient methods of mobilising long-term savings in Europe, and substantial interest rate differentials. The interest rate differential narrowed in 1966 and 1967, but at least part of this movement may have been due to cyclical factors. Prudence dictates that policy must take into account the possibility that the propensity to export capital will remain strong. Selective measures may continue to be used. But the efficiency of some of the measures adopted in the last few years (the voluntary programmes, for instance) may at some point begin to diminish. And it is hardly possible to cover all types of flows by selective measures. Although the current account should improve, a balance of payments problem may remain for some time.

1 These figures exclude the expansion of foreign investments through purchases of equity interests in existing enterprises and capital requirements in other assets such as inventories or credit on sales.

IV POLICY CONCLUSIONS

An immediate concern of the authorities must be to avoid an excessive increase in demand, which would strengthen cost/price pressures and aggravate the balance of payments problem. Given the likely strength of the expansion now developing, this can hardly be achieved without the tightening of fiscal policy proposed by the President. Even with early adoption of the programme, or measures with similar demand effects, there is always the risk that the expansion of demand will be stronger than expected and therefore stronger than desirable from the point of view of the cost/price situation and the balance of payments. In that event, monetary policy might have to move somewhat further in the direction of restraint.

Failure of Congress to approve adequate fiscal measures at an early date would give rise to a difficult situation. A significant tightening of monetary policy could hardly be avoided, with the risk of the recurrence of some of the problems encountered in 1966.

The balance of payments remains difficult. An important responsibility on the United States side will be to maintain relatively stable costs and prices. Recent experience suggests that this may be more difficult now that full employment conditions have been achieved. Although US policy performance has been impressive in the last few years, further progress in the flexible use of fiscal and monetary policies will be required if satisfactory growth is to be combined with the cost and price stability necessary to strengthen the current account surplus, and the authorities will have to continue their efforts to influence wage and price decisions in the direction of restraint.

The balance of payments deficit is not only a US problem. The deficit has as its counterpart a surplus in continental Europe, and the responsibility for adjustment must fall on both surplus and deficit countries. A particularly important problem concerns European capital markets. Their activity has grown significantly over the years, and the development of the Euro-bond market has helped. Nevertheless, European current account surpluses have tended to be associated with a net inflow of private long-term capital rather than an outflow. The efforts which it is desirable for European countries to take to increase the efficiency of capital markets and reduce interest rates should contribute to a better international payments equilibrium. But it is probably realistic to recognize that there are limits to the speed with which a significant decline in long-term rates can be achieved. Changes in institutions and

practices will be required, and interest rates are partly determined by traditions and attitudes which cannot be changed overnight.

Thus, it remains desirable that US monetary policy should continue to take account of the needs of the balance of payments. The implication is that the recent rise in US interest rates in the long-term end of the market is not inappropriate from the point of view of international payments equilibrium.

The requirements of the balance of payments with regard to monetary policy are not necessarily in conflict with the needs of the domestic economy. Full employment conditions, with business trends liable to rapid change, may mean that interest rates are likely to fluctuate more than in previous years of under-utilisation of resources, and may tend, on average, to be higher than in such earlier periods. This will primarily depend on how far fiscal policy can be used for the management of demand. Nevertheless, it will remain desirable, from the point of view of demand management as well as the balance of payments, that possible hindrances to an active use of monetary policy should be removed.

The 1966 experience showed that, given existing institutional arrangements, a tightening of monetary policy may have a very uneven effect on demand. To a certain extent this may be inevitable, given the different degree to which various sectors are dependent on credit and sensitive to changes in interest rates. But so one-sided an effect as the slump in house-building in 1966 can inhibit the active use of monetary policy. Several measures to improve the situation have been taken and others are being considered by the authorities. However, changes in this area cannot be expected to be very rapid.

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STATISTICAL ANNEX

Table I National Product and Expenditure in Current Prices

Billions of dollars

	Personal consumption expenditure	Gross private domestic investment	of which: New construction	of which: Producers' durable equipment	of which: Change in business inventories	Net exports of goods and services	Govt. purchases of goods and services	of which: Federal	of which: State and local	Gross National Product
1952	216.7	51.9	28.6	20.2	3.1	2.2	74.7	51.8	22.9	345.5
1953	230.0	52.6	30.6	21.5	0.4	0.4	81.6	57.0	24.6	364.8
1954	236.5	51.7	32.7	20.6	—1.5	1.8	74.8	47.4	27.4	364.8
1955	254.4	67.4	37.6	23.8	6.0	2.0	74.2	44.1	30.1	398.0
1956	266.7	70.0	38.9	26.5	4.7	4.0	78.6	45.6	33.0	419.2
1957	281.4	67.9	38.1	28.4	1.3	5.7	86.1	49.5	36.6	441.1
1958	290.1	60.9	37.4	25.0	—1.5	2.2	94.2	53.6	40.6	447.3
1959	311.2	75.3	42.1	28.4	4.8	0.1	97.0	53.7	43.3	483.7
1960	325.2	74.8	41.0	30.3	3.6	4.0	99.6	53.5	46.1	503.7
1961	335.2	71.7	41.0	28.6	2.0	5.6	107.6	57.4	50.2	520.1
1962	355.1	83.0	44.6	32.5	6.0	5.1	117.1	63.4	53.7	560.3
1963	375.0	87.1	46.5	34.8	5.9	5.9	122.5	64.2	58.2	590.5
1964	401.2	94.0	48.3	39.9	5.8	8.5	128.7	65.2	63.5	632.4
1965	433.1	107.4	52.1	46.0	9.4	6.9	136.4	66.8	69.6	683.9
1966	465.9	118.0	52.2	52.3	13.4	5.1	154.3	77.0	77.2	743.3
1964[1]: 1st quarter	391.7	90.8	48.0	37.9	4.8	8.9	126.4	65.0	61.4	617.7
2nd quarter	397.6	93.4	48.2	39.0	6.1	7.8	129.2	66.0	63.2	628.0
3rd quarter	406.6	94.2	48.4	41.0	4.8	8.7	129.4	65.2	64.3	638.9
4th quarter	408.9	97.9	48.6	41.6	7.7	8.5	129.8	64.5	65.3	645.1
1965[1]: 1st quarter	420.2	105.1	50.3	44.1	10.6	6.1	131.3	64.3	66.9	662.7
2nd quarter	428.1	105.1	51.7	44.6	8.8	8.2	133.9	65.4	68.6	675.4
3rd quarter	436.4	108.2	52.0	46.8	9.4	7.4	138.1	67.6	70.4	690.0
4th quarter	447.8	112.3	54.1	48.3	9.9	6.1	142.3	69.8	72.5	708.4
1966[1]: 1st quarter	458.2	115.2	55.3	50.0	9.9	6.1	146.5	72.1	74.3	725.9
2nd quarter	461.6	118.5	53.3	51.2	14.0	5.4	151.2	74.9	76.2	736.7
3rd quarter	470.1	116.4	51.9	53.1	11.4	4.6	157.7	79.5	78.1	748.8
4th quarter	473.8	122.2	48.6	55.1	18.5	4.3	161.7	81.5	80.2	762.1
1967[1]: 1st quarter	480.2	110.4	49.1	54.2	7.1	5.3	170.4	87.1	83.3	766.3
2nd quarter	489.7	105.1	49.4	55.2	0.5	5.3	175.0	89.5	85.4	775.1
3rd quarter	495.3	112.2	52.2	56.2	3.8	5.4	178.2	90.9	87.4	791.2

1 Seasonally adjusted quarterly totals at annual rates.

Source: Survey of Current Business.

Table II **National Product and Expenditure in Constant (1958) Prices**
Billions of 1958 dollars

	Personal consumption expenditure	Gross private domestic investment	*of which:* New construction	*of which:* Producers' durable equipment	*of which:* Change in business inventories	Net exports of goods and services	Govt. purchases of goods and services	*of which:* Federal	*of which:* State and local	Gross national product
1952	239.4	60.5	32.6	24.6	3.3	3.0	92.1	63.8	28.4	395.1
1953	250.8	61.2	34.5	25.8	0.9	1.1	99.8	70.0	29.7	412.8
1954	255.7	59.4	36.9	24.5	—2.0	3.0	88.9	56.8	32.1	407.0
1955	274.2	75.4	41.3	27.7	6.4	3.2	85.2	50.7	34.4	438.0
1956	281.4	74.3	40.7	28.8	4.8	5.0	85.3	49.7	35.6	446.1
1957	288.2	68.8	38.4	29.1	1.2	6.2	89.3	51.7	37.6	452.5
1958	290.1	60.9	37.4	25.0	—1.5	2.2	94.2	53.6	40.6	447.3
1959	307.3	73.6	40.9	27.9	4.8	0.3	94.7	52.5	42.2	475.9
1960	316.1	72.4	39.3	29.6	3.5	4.3	94.9	51.4	43.5	487.7
1961	322.5	69.0	39.0	28.1	2.0	5.1	100.5	54.6	45.9	497.2
1962	338.4	79.4	41.7	31.7	6.0	4.5	107.5	60.0	47.5	529.8
1963	353.3	82.5	42.7	34.0	5.8	5.6	109.6	59.5	50.1	551.0
1964	373.7	87.8	43.3	38.7	5.8	8.3	111.2	58.1	53.2	581.1
1965	398.4	98.0	45.1	44.1	8.8	6.0	114.3	57.8	56.4	616.7
1966	418.0	105.6	43.8	49.2	12.6	4.4	124.5	64.7	59.9	652.6
1964[1]: 1st quarter	366.3	85.3	43.6	36.9	4.8	9.1	110.4	58.5	51.9	571.1
2nd quarter	370.7	87.3	43.3	37.9	6.1	8.0	112.6	59.3	53.3	578.6
3rd quarter	378.6	87.6	43.1	39.8	4.8	8.4	111.2	57.8	53.5	585.8
4th quarter	379.3	90.8	43.0	40.3	7.6	7.9	110.5	56.7	53.8	588.5
1965[1]: 1st quarter	389.1	95.9	44.1	42.5	9.3	5.2	111.3	56.3	55.0	601.5
2nd quarter	394.1	95.9	45.1	42.8	8.0	6.8	112.9	57.1	55.8	609.7
3rd quarter	400.7	98.3	44.8	44.9	8.7	6.4	115.3	58.5	56.7	620.7
4th quarter	409.9	101.6	46.2	46.2	9.2	5.6	117.4	59.3	58.0	634.4
1966[1]: 1st quarter	416.2	104.0	47.0	47.5	9.5	5.4	119.9	61.2	58.7	645.4
2nd quarter	415.2	106.5	44.8	48.3	13.4	4.8	122.7	63.4	59.4	649.3
3rd quarter	420.4	103.6	43.1	49.9	10.6	4.1	126.6	66.4	60.1	654.8
4th quarter	420.4	108.4	40.0	51.2	17.2	3.2	129.1	67.8	61.3	661.1
1967[1]: 1st quarter	424.2	96.9	40.2	50.1	6.7	4.1	135.5	72.3	63.2	660.7
2nd quarter	430.6	91.3	40.0	51.0	0.4	4.1	138.7	74.4	64.3	664.7
3rd quarter	431.5	96.4	41.2	51.7	3.5	4.2	139.9	75.1	64.9	672.0

1 Seasonally adjusted quarterly totals at annual rates.

Source: Survey of Current Business.

Table III **Monetary Indicators**
Seasonally adjusted (in billions of dollars)

	Money Supply[1]			Loans and Investments at Commercial Banks[2]			
						Securities	
	Total	Currency	Demand deposits	Total	Loans	US Govt.	Other
1959: December	141.9	28.9	113.1	185.9	107.5	57.9	20.5
1960: December	141.1	28.9	112.1	194.5	113.8	59.8	20.8
1961: December	145.4	29.6	115.9	209.6	120.5	65.2	23.9
1962: December	147.4	30.6	116.8	227.9	134.1	64.5	29.2
1963: December	153.0	32.5	120.5	246.2	149.7	61.5	35.0
1964: December	159.3	34.2	125.1	267.2	167.7	60.7	38.7
1965: December	166.8	36.3	130.5	294.4	192.4	57.3	44.8
1966: October	170.1	38.0	132.1	308.9	207.2	53.4	48.4
November	170.1	38.1	132.0	309.3	207.5	53.4	48.4
December	170.4	38.3	132.1	310.2	207.8	53.7	48.7
1967: January	170.3	38.5	131.8	314.4	210.4	54.2	49.9
February	171.5	38.7	132.8	318.0	211.0	55.9	51.1
March	173.1	38.9	134.2	321.4	211.3	57.8	52.3
April	172.7	39.1	133.6	323.0	213.3	56.1	53.6
May	174.5	39.2	135.3	324.3	213.1	56.2	55.1
June	176.2	39.3	136.8	324.9	213.2	55.9	55.8
July	177.9	39.4	138.4	333.2	216.5	58.9	56.7
August	179.1	39.6	139.6	337.1	217.7	61.9	57.5
September	179.3	39.8	139.5	339.3	219.7	61.7	57.9

1 Averages of daily figures.
2 Data are for last Wednesday of month.
Source: Federal Reserve Bulletin.

Table IV **Monetary Indicators**
Millions of dollars

End of period	Mutual savings banks						Savings and loan associations		
	Loans		Securities			Deposits	Mortgages	US Govt securities	Savings capital
	Mortgage	Other	US Govt.	State and local	Corporate and other				
1959	24 769	358	6 871	721	4 845	34 977	53 141	4 477	54 583
1960	26 702	416	6 243	672	5 076	36 343	60 070	4 595	62 142
1961	28 902	475	6 160	667	5 040	38 277	68 834	5 211	70 885
1962	32 056	602	6 107	527	5 177	41 336	78 770	5 563	80 236
1963	36 007	607	5 863	440	5 074	44 606	90 944	6 445	91 308
1964	40 328	739	5 791	391	5 099	48 849	101 333	6 966	101 887
1965	44 433	862	5 485	320	5 170	52 443	110 306	7 414	110 385
1966: August	46 232	1 095	5 063	276	5 659	53 689	114 002	7 361	111 098
September	46 450	1 052	5 078	270	5 603	54 073	114 107	7 482	111 720
October	46 736	1 023	4 913	260	5 588	54 178	114 102	7 634	111 664
November	46 953	1 131	4 848	254	5 644	54 326	114 081	7 935	112 278
December	47 193	1 078	4 764	251	5 719	55 006	114 192	7 772	114 010
1967: January	47 484	1 076	4 679	247	6 053	55 456	114 229	7 883	114 194
February	47 692	1 137	4 700	249	6 251	55 788	114 395	8 079	114 957
March	47 973	1 136	4 645	246	6 480	56 538	114 797	8 058	116 414
April	48 236	1 075	4 481	243	6 803	56 739	115 233	7 950	116 911
May	48 493	1 261	4 433	235	7 062	57 185	115 909	8 072	118 041
June	48 771	1 226	4 336	249	7 313	57 836	116 944	7 987	119 976
July	49 010	1 144	4 396	246	7 642	58 169	117 676	8 378	120 031
August	49 322	1 210	4 367	242	7 910	58 499	118 659	8 768	120 677

Source: Federal Reserve Bulletin.

Table V Balance of Payments OECD Basis

Millions of dollars

	1960	1961	1962	1963	1964	1965	1966	1967/Ist half seas. adj. annual rates
Exports, f.o.b.	19 489	19 954	20 604	22 071	25 297	26 244	29 168	30 828
Imports, f.o.b.	14 732	14 510	16 187	16 992	18 621	21 472	25 510	26 558
Trade balance	4 757	5 444	4 417	5 079	6 676	4 772	3 658	4 270
Services, net	— 756	65	628	974	1 858[1]	2 244[1]	1 444	1 028
Balance on goods and services	4 001	5 509	5 045	5 853	8 534	7 016	5 102	5 298
Private transfers, net	— 483	— 487	— 533	— 629	— 617	— 658	— 647	— 928
Official transfers, net	— 1 878	2 089	— 2 164	— 2 179	— 2 165	— 2 166	— 2 278	— 2 102
Current balance	1 640	2 933	2 348	3 045	5 752	4 192	2 177	2 268
Long-term capital (ex. spec. trans.)	— 3 222	— 3 714	— 4 246	— 5 302	— 5 996	— 6 106	— 4 734	— 4 526
(*a*) US direct investment	— 1 674	— 1 599	— 1 654	— 1 976	— 2 435	— 3 418	— 3 543	— 2 612
(*b*) New issues	— 555	— 523	— 1 076	— 1 250	— 1 063	— 1 206	— 1 210	— 1 382
(*c*) US long-term bank loans	— 153	— 136	— 127	— 754	— 941	— 232	337	606
(*d*) Government capital, net	— 1 116	— 1 542	— 1 632	— 1 895	— 1 472[2]	— 1 839[2]	— 2 184	— 2 608
(*e*) Other, net[3]	276	86	243	573	— 85	589[4]	1 866[4]	1 470
Basic balance	— 1 582	— 781	— 1 898	— 2 257	— 244	— 1 914	— 2 557	— 2 258
Non-monetary short-term capital	— 461	— 251	135	307	— 269	731	338	870
Errors and omissions	— 922	— 904	— 1 053	— 285	— 949	— 415	— 383	— 1 872
Balance on non-monetary transactions	— 2 965	— 1 936	— 2 816	— 2 235	— 1 462	— 1 598	— 2 602	— 3 260
Private monetary institutions' short-term assets	— 995	— 1 125	— 324	— 781	— 1 523	325	— 84	— 834
Liquid liabilities to non-official holders	— 21	671	7	908	1 794	486	2 886	— 1 128
Balance on official settlements	— 3 981	— 2 390	— 3 133	— 2 108	— 1 191	— 787	200	— 5 222
Liabilities to national monetary authorities	1 364	714	676	1 515	1 234	— 465	— 922	3 348
IMF	742	— 135	626	30	266	— 60[5]	715[5]	— 38[5]
Special transactions[6]	53	696	681	344	— 19[7]	75[7]	425	—
Liabilities to other official institutions	119	374	243	— 129	— 195	— 79	— 449	612
Change in reserves (+ = increase)	— 1 703	— 741	— 907	— 348	95	— 1 316	— 31	— 1 298
(*a*) Gold	— 1 703	— 857	— 890	— 461	— 125	— 1 665	— 571	— 132
(*b*) Convertible foreign exchange	—	116	— 17	113	220	349	540	— 1 160
(*c*) Other assets	—	—	—	—	—	—	—	—

1 Includes $ 72 million debt obligation payable by the UK but waived.
2 Includes $ 67 million debt obligation payable by the UK but waived.
3 Excludes changes in foreign long-term claims on United States commercial banks.
4 Excludes liquification of UK Govt. portfolio (estimated at $ 500 million for 1965 and $ 50 million for 1966).
5 Includes gold deposits by the IMF.
6 Debt prepayments received and Eximbank portfolio participation sales.
7 Includes waiver to United Kingdom. See notes 1 and 2.

Source: U.S. Balance of Payments Statistics. as adjusted by the Secretariat.

NOTE Detail may not add due to rounding.

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