

CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

**Prepared for the
Federal Open Market Committee**

By the Staff

**BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM**

February 1, 1967

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GROSS NATIONAL PRODUCT AND RELATED ITEMS
 (Expenditures and income figures are billions of dollars
 seasonally adjusted annual rates)

	1965	1966p	1966				1967	
			I	II	III	IVp	Projected	
							I	II
Gross National Product	681.2	739.5	721.2	732.3	745.3	759.1	766.1	773.5
Final sales	672.1	728.1	712.3	720.0	735.4	744.7	757.1	769.1
Personal consumption expenditures	431.5	465.0	455.6	460.1	469.9	474.4	480.8	487.8
Durable goods	66.1	69.4	70.3	67.1	70.2	70.1	69.2	69.2
Nondurable goods	190.6	206.1	201.9	205.6	208.1	208.7	212.0	215.0
Services	174.8	189.5	183.4	187.4	191.5	195.6	199.6	203.6
Gross private domestic investment	106.6	116.5	114.5	118.5	115.0	118.0	113.1	108.3
Residential construction	27.8	25.8	28.6	28.0	24.8	21.9	21.8	21.9
Business fixed investment	69.7	79.3	77.0	78.2	80.3	81.7	82.3	82.0
Change in business inventories	9.1	11.4	8.9	12.3	9.9	14.4	9.0	4.4
Nonfarm	8.1	11.7	8.5	12.1	10.4	15.6	9.5	4.5
Net exports	7.0	4.9	6.0	4.7	4.2	4.8	5.9	6.8
Gov't purchases of goods & services	136.2	153.1	145.0	149.0	156.2	161.9	166.3	170.6
Federal	66.8	77.0	71.9	74.0	79.0	82.5	85.1	87.6
Defense	50.1	60.0	54.6	57.1	62.0	65.5	67.8	69.3
Other	16.7	17.0	17.4	16.9	17.0	17.0	17.3	18.3
State & local	69.4	76.2	73.1	75.0	77.2	79.4	81.2	83.0
Gross National Product in constant (1958) dollars	614.4	647.7	640.5	643.5	649.9	657.0	659.1	662.2
GNP Implicit deflator(1958=100)	110.9	114.2	112.6	113.8	114.7	115.6	116.2	116.8
Per cent change, annual rate								
GNP current dollars	7.8	8.6	9.5	6.2	7.1	7.4	3.7	3.9
GNP constant dollars	5.9	5.4	5.9	1.9	4.0	4.4	1.3	1.9
Implicit deflator	1.8	3.0	3.6	4.3	3.2	3.1	2.1	2.1
Personal income	535.1	580.4	564.6	573.5	585.2	598.1	607.4	615.1
Wage and salaries	358.4	392.3	380.0	387.4	396.7	405.0	410.7	416.5
Disposable income	469.1	505.3	495.1	499.9	507.8	518.2	526.9	534.1
Personal saving	25.7	26.9	26.7	26.6	24.5	29.9	31.8	31.7
Saving rate (per cent)	5.5	5.3	5.4	5.3	4.8	5.8	6.0	5.9
Total labor force (millions)	78.4	80.2	79.4	79.7	80.4	81.1	81.5	81.7
Armed forces "	2.7	3.1	2.9	3.1	3.2	3.3	3.4	3.5
Civilian labor force "	75.6	77.0	76.5	76.7	77.2	77.8	78.1	78.2
Unemployment rate (per cent)	4.6	3.9	3.8	3.9	3.9	3.8	3.9	4.0
Nonfarm payroll employment (millions)	60.8	63.9	62.8	63.6	64.1	64.8	65.2	65.5

p -- preliminary figures.

high October-November average -- advanced by 2 per cent from the third quarter to an annual rate of \$30.2 billion (estimated balance of payments basis).

A further increase in imports of machinery and motor vehicles in the fourth quarter was offset by declines in imports of industrial materials, food and consumer goods other than autos. The decline in imports of industrial materials included a fall-off in imports of steel and petroleum which had bulged high in the third quarter; but imports of other materials (constituting 30 per cent of total imports) also fell in the fourth quarter after having levelled off in the third quarter. The fourth quarter decline in imports of consumer goods other than autos was rather small, but it followed a 25 per cent annual rate of growth in purchases of these goods between early 1965 and mid-1966.

Agricultural exports declined from the third to the fourth quarters, while non-agricultural exports rose. However, strength in

U.S. EXPORTS
(billions of dollars, seasonally adjusted annual rates)

	<u>1965</u>	<u>1966</u>	<u>1966</u>		
			1st Half	3rd Qtr.	4th Qtr.
Agricultural	6.3	7.1	6.8	7.4	7.1
Non-agricultural, excl. military grant aid	<u>20.1</u>	<u>22.4</u>	<u>21.9</u>	<u>22.6</u>	<u>23.2</u>
Total, Census basis	26.4	29.5	28.7	30.0	30.3
Total, Balance of Payments basis	26.3	29.3 ^{e/}	28.6	29.8	30.2 ^{e/}

^{e/} Estimate.

APPENDIX A: THE FEDERAL BUDGET*

The President's Budget Document predicts Federal deficits on all three bases in fiscal 1967 and 1968. All of the deficits would be even larger if the proposed \$5 billion tax increase is not enacted. The NIA budget, stressed by the Document because of its greater usefulness for economic analysis, shows the smallest deficit of the three types; the cash deficit is larger because it includes a sizeable amount of net lending (which is a cash expenditure but not a NIA expenditure), and the administrative deficit is even larger because it excludes the surplus-prone trust funds.

The first table gives the three budgets for fiscal 1966, 1967, and 1968. Both receipts and expenditures are expected to grow rapidly in all budgets, with expenditures generally growing somewhat more rapidly to create the increasing deficits.

TABLE I

FEDERAL BUDGETS BY FISCAL YEARS
(In billions of dollars)

	1966 actual	1967 projected	1968 projected
<hr/> NIA Budget:			
Receipts	132.6	149.8	167.1
Expenditures	<u>132.3</u>	<u>153.6</u>	<u>169.2</u>
Surplus or deficit	.3	- 3.8	- 2.1
 Cash Budget:			
Receipts	134.5	154.7	168.1
Expenditures	<u>137.8</u>	<u>160.9</u>	<u>172.4</u>
Surplus or deficit	- 3.3	- 6.2	- 4.3
 Administrative Budget:			
Receipts	104.7	117.0	126.9
Expenditures	<u>107.0</u>	<u>126.7</u>	<u>135.0</u>
Surplus or deficit	- 2.3	- 9.7	- 8.1

* Prepared by Government Finance Section

The major increases in expenditures are for National Defense and Social Security. Other civilian expenditures are projected to show a rather small increase. Table II gives this information on an NIA basis (thus eliminating the effect sales of participation certificates).

TABLE II
PROJECTED GROWTH IN FEDERAL EXPENDITURES, FISCAL YEARS
(Billions of dollars)

	1966 actual	1967 proj.	1968 proj.	Change	
				1966-67	1967-68
National Defense	56.5	68.3	74.1	11.8	5.8
Health & Welfare	33.0	39.2	46.4	6.2*	7.8*
Space	5.9	5.6	5.3	- .3	- .3
Great Society Sector**	12.0	14.0	14.9	2.0	.9
All other***	24.9	26.5	28.5	1.6	2.0
Total	132.3	153.6	169.2	21.3	16.2

* Includes increased Social Security payments and Medicare payments.

** Education, Housing, Communication, and Transportation, National Resources.

*** Int. Affairs, Agriculture, Veterans, Interest, General Government.

The projected growth in revenues has two explanations. First, a succession of discretionary tax rate changes are expected to result in revenue increases of \$8.0 in fiscal '67 and \$5.1 billion in fiscal '68. The important changes are the 1966 increase in Social Security tax rates and the proposed surtax on corporate and personal incomes. Over and above these discretionary changes, revenues are expected to grow with the growth in projected income. Table III breaks down the growth in revenue into these two components for each type of tax. The table suggests that the Budget Document has projected quite an optimistic automatic revenue increase between fiscal 1967 and 1968, but it is not clear whether this optimism pertains to the level of income in January-June 1968 or to the relationship between revenues and income.

TABLE III

PROJECTED GROWTH IN REVENUES
(Billions of dollars)

	1966 actual	1967 proj.	1968 proj.	Change	
				1966-67	1967-68
Personal taxes	57.9	65.5	76.8	7.6	11.3
Discretionary	--	--	--	<u>1.2</u>	<u>3.4*</u>
Automatic	--	--	--	6.4	7.9
Corp. taxes	30.7	32.3	35.3	1.6	3.0
Discretionary	--	--	--	<u>.6*</u>	<u>.7*</u>
Automatic	--	--	--	1.0	2.3
Social Insurance	28.1	35.5	38.1	7.4	2.6
Discretionary	--	--	--	<u>5.8</u>	<u>1.0</u>
Automatic	--	--	--	1.6	1.6
Indirect taxes**	<u>15.9</u>	<u>16.5</u>	<u>16.9</u>	<u>.6</u>	<u>.4</u>
Total revenue	132.6	149.8	167.1	<u>17.2</u>	<u>17.3</u>
Discretionary	--	--	--	8.0	5.1
Automatic	--	--	--	9.2	12.2

* Proposed surtax.

** Discretionary changes are small and mutually offsetting.

Another highlight pertains to the credit programs embodied in the budget. These credit programs involve a simple transfer of assets between the Government and the private sector, and for this reason are not included in the NIA budget. Yet they do affect the liquidity of the private sector, and are important from a monetary and economic stabilization standpoint.

The table IV gives information on net new lending by the Government. According to the Document projections, the large amount of net lending the Government has been doing for the past few years will begin to tail off in fiscal 1968. New loans are expected to run at about the same rate, but more of the loans will be sold to the private sector in the form of participation certificates. There also is projected to be a shift in the timing of new loans. In fiscal years 1966 and 1967 most of the new loans came and are expected to come in the January-June period, primarily because of the large spring outflows from the Federal Home Loan Banks. But in fiscal 1968 the FHLB is expected to stop its January-June net lending, and with it the seasonal pattern of total Federal lending will change markedly.

TABLE IV

FEDERAL CREDIT PROGRAMS

	<u>1965</u>	<u>1966</u>		<u>1967</u>		<u>1968</u>	<u>Fiscal years</u>		
	<u>II</u>	<u>I</u>	<u>II</u>	<u>I</u>	<u>II</u>	<u>I</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>
Total new loans	<u>1.6</u>	<u>4.7</u>	<u>2.4</u>	<u>4.5</u>	<u>3.6</u>	<u>3.2</u>	<u>6.3</u>	<u>6.9</u>	<u>6.8</u>
Less: Sales of participation certificates to public	.9	2.2	-.5	3.1	2.5	2.5	3.1	2.6	5.0
Net Govt. lending	.7	2.5	2.9	1.4	1.1	.7	3.2	4.3	1.8

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SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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maximum on lines of credit will continue to be discouraged from incurring further Bank indebtedness.

The Treasury's \$7.5 billion cash refunding drew over \$42 billion of subscriptions for the new 15-month and 5-year notes. Allotments were set at 10 per cent of subscriptions for the shorter-term issue with subscriptions up to \$100,000 awarded in full. On the 5-year note, the allotment was an unusually low 7 per cent and subscriptions up to \$50,000 were allotted in full.

International Developments

The Swedish central bank (Sveriges Riksbank) has reduced its discount rate from 6 per cent to 5-1/2 per cent effective February 3.

Corrections:

Page III-18. Third sentence, first paragraph, should begin as follows: "Commercial banks, which had stayed fairly near their unusually high year-earlier levels of net takings in the second and third quarters, and life insurance companies . . .".

The heading of the table on page IV-6 should be "Short-term Rates," and after each rate except Federal Funds "3-month" should be inserted. Insert after Federal Funds: Euro-dollar call money: 4-7/8 per cent at end January 1966, 6-1/4 per cent in middle of September 1966, 5-1/8 per cent near end of January 1967.