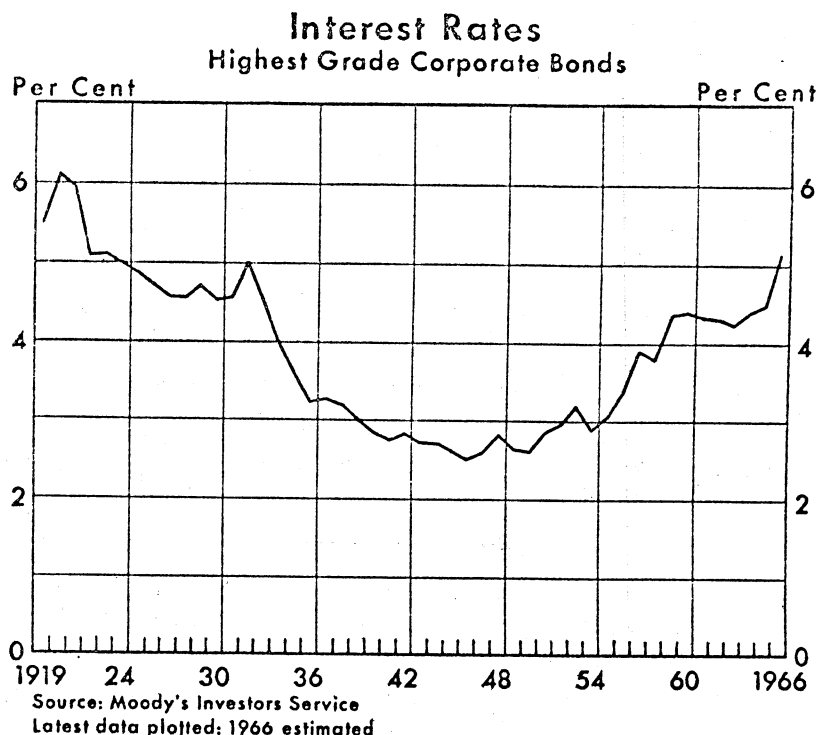


rates resulted primarily from a huge demand for funds accompanying Federal budget policy and the strong demand for goods and services. Since yields on market securities rose much more than interest rates offered by banks and savings and loan associations, a greater share of the public's funds than in many years flowed directly from savers to investors without passing through an intermediary.



The nation's balance of payments with other countries deteriorated in some major respects but improved in others. On the one hand, the strong domestic demands for goods and services, the higher prices in this country, and the shortage of some items domestically caused a jump in our imports and a marked reduction in our trade surplus. On the other hand, the higher interest rates in this country were helpful in reducing the net outflow of capital and money market funds from the United States. For a fuller analysis and some background on the balance-of-payments problems, see "1966 Balance of Payments in Perspective," on page 17 of this Review.

In late 1966 there were indications that the increase in total demand was moderating. Spending was less bouyant, credit demands were less vigorous, and interest rates receded from the peaks reached in the early fall. The abrupt shift in the thrust of monetary variables, which turned from expansion to restraint in the spring of 1966, may have been a major restraining force on total demand later in the year.

Total demand serves as a convenient theme for analyzing economic conditions. All of the above developments, together with many