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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

September 24, 1965

SUPPLEMENTAL NOTES

The Domestic Financial Situation

Yields on recently issued corporate bonds have changed little from last week's somewhat lower levels. But in the municipal market, yields on seasoned Aaa-rated bonds advanced further -- 6 basis points this week. At 3.31 per cent, the Moody's series is at its highest level since late 1961, prior to the change in Regulation Q. These attractive yields have reportedly stimulated some investor interest in older tax exempts. Moreover, this week's new issues were accorded a more favorable reception.

Common stock prices -- as measured by Standard & Poor's index of 500 stocks -- have declined very slightly (0.2 per cent) this week in extremely heavy trading averaging 8.3 million shares daily. On September 23, the index was 89.86, only a fraction below its high last May.

On September 22, the Treasury announced a cash financing to raise $4.0 billion in early October through the auction of $3.0 billion March tax bills and $1.0 billion June tax bills with 100 per cent tax and loan account credit. The size of the cash financing created some uncertainties about the extent of the Treasury's total cash needs and Treasury bill rates adjusted higher.

International developments

The U.S. payments deficit on regular transactions in August is now estimated at $427 million, and the July-August rate of deficit now

appears to have been at an annual rate in the range of $1-1/2 to $1-3/4 billion, after rough allowance for seasonal variation.

U.S. banking claims on foreigners were essentially unchanged in August, as declines in short-term claims offset increases in outstanding long-term credits.

CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

October 8, 1965

IN BROAD REVIEW

Overall domestic economic activity has apparently continued to expand, eventhough industrial production appears to have declined a little in September, mainly because excess inventories of steel were beginning to be worked off. The labor market remained strong in September, with the unemployment rate dropping slightly to 4.4 per cent, the lowest in many years. Retail sales apparently remained at a high level. Construction activity in the third quarter was unchanged from the second.

In financial markets, there was a slackening in bank credit expansion in September. The volume of corporate and municipal security issues in October is expected to be substantially below the large September total. Money market conditions have generally eased a little,with bill and other interest rates dropping back somewhat from recent advanced levels. Stock market trading has remained high but below the very high September level while prices have moved in a narrow range around their May highs. Price-earning ratios, however, are well below those last May.

U.S. foreign trade in July and August showed improvement as exports rose in both months while growth in imports appeared to have tapered off.

The Domestic Economy

A decline in the industrial production index of around 1 point still appears likely for September but data are not yet available to make a firm estimate. In addition to a sharp drop in steel production, strikes and Hurricane Betsy were drags on the total index. With the manufacturing production index lower in September, the third quarter rate of capacity utilization was little changed from the 90 per cent level estimated for the first and second quarters of the year.

Steel ingot production fell 15 per cent in September and is declining further this month. Auto assemblies declined about 3 per cent due to the strike at American Motors, but truck production was not affected and remained at the August level. The Boeing strike that began in mid-September curtailed output in the aircraft industry. Output of crude and refined petroleum products was reduced by Hurricane Betsy. Meanwhile, output of television sets increased further and paperboard production remained at a high rate.

According to the weekly estimates, the industrial commodity price index has edged up .1 per cent further since mid-August, bringing the rise to .3 per cent since May and 1.5 per cent since the summer of 1964. Foodstuffs have continued to decline from their July peak, and the total wholesale price index has remained at the June-August level.

The consumer price index, after rising more than 1 per cent from March to July chiefly because of reduced supplies of foods, declined .2 per cent in August. Average food prices fell .7 per cent mainly as a result of increased supplies of vegetables. Nonfood commodities as a group were unchanged and services rose slightly.

Sales of new domestic automobiles in September remained at the 8.9 million annual rate of the previous three months and were about the same as a year ago after allowance for later new model introductions this year. With most 1966 models now introduced, prices appear close to those for 1965 models. One company indicated that prices were a little higher while the other major producers claimed small price reductions after allowance for added safety equipment.

The growth of consumer instalment credit slowed in August, seasonally adjusted. The flow of repayments was higher on most types of loans, while the rate of new credit extensions leveled off. First reports coming in for September suggest that net borrowing returned to levels somewhat above August.

Commercial bank delinquencies, which usually trend upward in late summer and early fall, rose somewhat more than seasonally. Delinquencies in purchased automobile paper which had been stable during the first half of the year, accounted for most of the recent change.

CONSUMER INSTALMENT CREDIT
(Seasonally adjusted annual rate, in billions of dollars)

1965	Net Change in Outstandings	Extensions	Repayments
First quarter	7.8	71.7	63.9
Second quarter	8.0	73.7	65.7
Third quarter			
July	8.0	75.3	67.3
August	7.3	75.4	68.1
Average of 2 months	7.7	75.4	67.7

New orders for durable goods showed somewhat less decline in August than the advance figures had indicated -- 3 instead of 4 per cent -- and unfilled orders continued to rise. The improvement was due mainly to an upward revision in new orders for defense products, which now show a steady rise from May to August. Orders for the strategic non-electrical machinery group also rose, while orders for steel, as expected, were down sharply.

Business inventory accumulation in August was larger than expected but not so large as in July, and for the two months accumulation exceeded the second quarter rate and approached the very high rate at the beginning of the year. Accumulation in the third quarter at a slower rate than in the second quarter is still possible, however, if factory stocks, because of steel liquidation, show little net change in September and distributors stocks continue to rise at the moderate July-August pace.

At manufacturers, accumulation totaled $400 million in August and nearly $800 million in July for a monthly average of about $600 million. This was double the average for the second quarter and stemmed from: (a) continued rapid accumulation of steel stocks by metal-using industries; (b) a sharp spurt in work-in-process stocks in machinery and transportation equipment industries; and (c) an increase in accumulation by nondurable goods producers following little change earlier in the year.

At distributors, stocks increased at a steady rate of about $200 million a month in July and August, as compared with $365 million

in the second quarter and $580 million in the first quarter. Auto and apparel stocks rose but most other stocks at retail showed little change in July and August. Total wholesale inventories were about unchanged between June and August.

Expenditures for new construction edged up in September and at $68.5 billion remained near the record level reached in June. Residential construction activity continued down moderately while outlays for business and other private nonresidential construction were higher. Public construction expenditures also increased slightly in September. For the third quarter as a whole, construction expenditures were unchanged from the second quarter, as can be seen in the table.

NEW CONSTRUCTION PUT IN PLACE

	Q 3 1965 (Billions) 1/	Per cent change from	
		Q 2 1965	Q 2 1964
Total	$68.3	--	4
Private	48.2	--	6
Residential	26.5	-2	1
Nonresidential	21.7	+3	11
Business	16.2	+5	17
Public	20.1	+1	-1

1/ Seasonally adjusted annual rate; preliminary.

Home mortgage markets have recently showed some signs of a less easy tone. Symptomatic of the change was a further sharp increase in offerings of FHA and VA loans to the Federal National Mortgage Association for purchase under its secondary market operations. For August, data just recently available indicate that average loan amounts,

loan-to-value ratios, and maturities for conventional first mortgages on both new and existing homes were slightly less liberal than in July. Contract interest rates, however, were little changed.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASE

	July	August	Per cent increase in August 1965 from a year ago
New home loans			
Contract rate (per cent)	5.77	5.76	--
Purchase price ($1,000)	24.7	24.9	3
Loan amount ($1,000)	18.3	18.2	2
Loan/price (per cent)	75.0	73.8	1
Maturity (years)	25.0	24.5	-1
Existing home loans			
Contract rate (per cent)	5.86	5.86	-1
Purchase price ($1,000)	20.2	19.7	3
Loan amount ($1,000)	14.5	14.1	4
Loan/price (per cent)	72.5	72.1	1
Maturity (years)	20.6	20.4	2

Demands for labor continued strong in September. Unemployment declined slightly to 4.4 per cent from 4.5 per cent in July and August. In September 1964, the rate was 5.1 per cent. The jobless rate for adult men was down to 3.1 and for married men to 2.2 per cent; a lower rate also was reported for adult women. For teenagers and nonwhites, however, unemployment increased somewhat following fairly sharp reductions in August, but for these groups rates were slightly lower than in July and also below a year earlier. At 8.2 per cent, the unemployment rate for nonwhite workers remained more than double that of white workers.

Another significant labor market development in September was a fairly sharp reduction to 1.7 million in the number of workers on part-time for economic reasons -- about 300,000 below a year ago and the smallest number since early 1956. The decline in this group apparently reflected fairly large shifts of involuntary part-time workers to full-time jobs.

In July and August the labor force had expanded sharply as an unusually large number of students entered the labor market and found jobs. As expected, a large proportion of these returned to school in September and the labor force declined sharply. Part of the decline in the labor force in September also was attributed to an unusually large reduction in farm employment because of generally unfavorable weather during the survey week.

Despite the large withdrawal of young workers following re-opening of schools, there were 550,000 more youths in the labor force this September than a year ago. The rise this year was more than double that in the preceding year, owing primarily to the rapid growth in population of youths of working age.

The Domestic Financial Situation

Total loans and investments at all commercial banks are estimated to have increased only about $500 million in September. Even with the large increase in August, the annual rate of growth in the third quarter fell to 5.8 per cent, compared with almost 10 per cent in the second quarter and about 12.5 per cent during the unusual first quarter.

Loan expansion was at a reduced rate in September, mainly reflecting a large reduction in security loans. Dealer loans declined substantially at the end of the month in response to large System purchases of Treasury issues, and broker loans also declined. Excluding security loans, total loans rose at an annual rate of 13-1/2 per cent in the third quarter, a little below that of the second quarter but 1-1/2 percentage points above the 1964 rate.

Additional factors contributing to the reduced rate of credit expansion in September were a further decline in holdings of U.S. Government securities and sharply reduced acquisitions of municipal and Federal agency issues. The decline in holdings of Governments was associated in part with the decline in Treasury balances at commercial banks, which was unusually large in the absence of Treasury cash financing. The small rise in holdings of other securities presumably reflects both the reduced volume of new municipal offerings in August and pressures of other demands on banks under conditions of reduced liquidity.

Demand for business loans was strong around and subsequent to the tax date after having moderated considerably in late August and early September. For the month as a whole, these loans expanded at an annual rate of close to 13 per cent, about the same as in August. Outstanding loans to the public utilities, trade, and miscellaneous

manufacturing and mining groups all rose more than seasonally. Those to the metals group, which had declined in late August and early September, rose sharply over the tax date and then declined again later in the month.

Loans to finance companies, which had expanded sharply in late August and early September as these firms borrowed to finance automobile dealer inventories at the end of the model run, declined substantially in the second half of the month. Further liquidation of finance company loans is expected, mainly of a seasonal character but partly also in response to recent increases in interest rates on loans to these companies.

Following a slowdown in August, the money supply rose in September at a seasonally adjusted annaul rate of almost 12 per cent. This increase was associated in part with an unusually large run-down of U.S. Government deposits. So far this year, however, the money supply has grown at an annual rate of 3.8 per cent--a little below that for the whole year 1964.

Time and savings deposit growth in September was at an annual rate of 12 per cent, considerably below the high rates of the previous two months. While savings deposit inflows remained strong, CD run-offs during the tax and dividend period were unusually heavy, and only about half the run-off had been replaced by the month end.

Over the last two or three weeks, in response to money market tightness and a large loan demand, prime banks pushed their offering rates on CD's to or near the Regulation Q ceiling of 4.5 per cent. New York banks attracted over $500 million of CD funds at these rates in the three weeks since the tax date, with rates receding somewhat toward the end of this period. With prime bank rates at this level, nonprime banks are likely to encounter some difficulty in rolling over their maturing CD's.