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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

May 19, 1965

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IN BROAD REVIEW

Expansion in domestic economic activity has slowed from the very rapid pace of the winter. While a slow-down had been generally anticipated, its appearance nonetheless has tended to cause some reexamination of optimistic predictions for the remainder of the year. Any examination must start from the interim settlement of the steel labor situation and the consequent easing of demand tension in that industry. Steel output declined 5 per cent in the 3 weeks following this settlement.

In April the increase in industrial production was small, retail sales drifted down further, and the labor market barely held its own. On the other hand, new and unfilled orders for durable goods rose in April, with defense orders up very sharply. The number of housing starts remained at the improved March level. As reported earlier, business plans for spending on fixed capital have been stepped up.

Industrial commodity prices at wholesale continued to move up very slightly through mid-May but prices of farm products and foodstuffs have increased appreciably. Unit labor costs in manufacturing in April continued to edge lower.

Total bank credit expansion has been less sharp than in the first quarter, although the demand for bank loans continues very strong. In capital markets, dealer inventories of unsold issues are high reflecting heavy financing, but thus far upward pressure on bond yields has remained moderate. In the money markets, Treasury bill rates have remained around their recent lows. The money supply, which

increased rapidly in March and April, dropped sharply in the first half of May. Time deposit growth has continued at the reduced March-April rate.

The Federal fiscal position has strengthened with receipts larger than expected earlier and expenditures under some restraint. The cash deficit for fiscal 1965 is now estimated at only $2 billion as compared with $4 billion projected in January. For calendar 1965, a similar cutback in the deficit is now indicated. Excise cuts proposed this week by the President are more than double the amount indicated in the Budget Message. The bulk of the cuts would take effect in two approximately equal stages--on July 1, 1965, and January 1, 1966.

The U. S. balance of payments was in surplus in April, as in March. Without adjustment for seasonal influences, which are less favorable in April than March, the surplus was $160 million. Data are not available on bank credit outflow in April. The net outflow of long-term bank credit in March was sharply reduced from earlier levels, but there was still a considerable net outflow of short-term bank credit, including in particular acceptance credits to Japan.

Industrial production in Europe advanced further in the first quarter of 1965, following a 2-1/2 per cent rise from the third to the fourth quarter of 1964. Despite resource limitations, German production continued to rise. In Italy, recovery from recession gained further ground.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per cent change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Yrs. Ago*
Civilian labor force (mil.)	Apr.'65	75.4	74.9	74.5	1.2	3.5
Unemployment (mil.)	"	3.7	3.5	4.0	- 9.0	-11.5
Unemployment (per cent)	"	4.9	4.7	5.4	-	-
Nonfarm employment, payroll (mil.)	"	59.9	60.0	57.8	3.6	6.3
Manufacturing	"	17.9	17.9	17.2	3.9	5.3
Other industrial	"	7.9	8.0	7.7	2.5	4.9
Nondustrial	"	34.2	34.1	32.9	3.8	7.2
Industrial production (57-59=100)	"	140.8	140.5	130.5	7.9	14.8
Final products	"	139.9	139.7	130.6	7.1	14.0
Materials	"	141.8	141.2	130.6	8.6	15.6
Wholesale prices (57-59=100)1/	"	101.7	101.3	100.3	1.4	2.0
Industrial commodities	"	101.7	101.6	100.8	0.9	1.5
Sensitive materials	"	101.6	101.4	99.3	2.3	5.3
Farm products and foods	"	100.2	99.0	97.8	2.5	2.7
Consumer prices (57-59=100)1/	Mar.'65	109.0	108.9	107.7	1.2	2.6
Commodities except food	"	104.8	104.7	104.3	0.5	1.8
Food	"	106.9	106.6	105.7	1.1	2.2
Services	"	117.0	116.9	114.5	2.2	4.2
Hourly earnings, mfg. ($)	Apr.'65	2.59	2.60	2.52	2.8	6.1
Weekly earnings, mfg. ($)	"	105.67	107.55	102.57	3.0	8.4
Personal income ($ bil.)2/	"	514.5	513.8	486.6	5.7	12.4
Retail sales, total ($ bil.)	"	22.8	22.9	21.4	6.6	12.5
Autos (million units)2/	"	8.2	8.8	7.7	6.4	13.8
GAF ($ bil.)	"	5.2	5.2	4.9	7.0	18.3
Selected leading indicators						
Housing starts, pvt. (thous.)2/	Mar.'65	1,549	1,420	1,663	-6.9	-1.8
Factory workweek (hours)	Apr.'65	40.8	41.4	40.7	0.2	1.7
New orders, dur. goods ($ bil.)	Mar.'65	21.6	21.1	19.3	12.4	15.3
New orders, nonel. mach. ($ bil.)	"	3.1	3.1	2.8	10.6	22.4
Common stock prices (1941-43=10)1/	Apr.'65	87.97	86.83	79.94	10.0	27.9
Inventories, book val. ($ bil.)	Mar.'65	111.2	110.3	105.7	5.2	10.1
Gross national product ($ bil.)2/	Q1-65	648.8	634.6	608.8	6.6	13.5
Real GNP ($ bil., 1964 prices)2/	"	641.5	630.6	612.9	4.7	9.3

*Based on unrounded data. 1/ Not seasonally adjusted. 2/ Annual rates.

GROSS NATIONAL PRODUCT

(Seasonally adjusted at annual rates)
Billions of dollars

	1965	1964			
	I	IV	III	II	I
GROSS NATIONAL PRODUCT	648.8	634.6	628.4	618.6	608.8
Final purchases	641.9	628.8	625.7	614.9	606.4
Personal consumption expenditures	418.1	406.5	404.6	396.1	390.0
Durable goods	62.0	56.3	58.7	57.0	55.9
Nondurable goods	184.3	181.3	179.5	175.3	172.9
Services	171.7	169.0	166.4	163.8	161.1
Gross private domestic investment	94.7	90.4	87.3	87.2	85.9
Residential nonfarm	26.2	25.1	25.7	26.2	26.9
Other	23.7	23.6	23.1	22.7	22.3
Producers' durable equipment	37.9	36.0	35.6	34.6	34.2
Change in business inventories	6.8	5.7	2.8	3.7	2.5
Net exports of goods and services	5.0	7.7	7.0	5.7	7.7
Exports	33.7	37.1	35.7	33.7	34.5
Imports	28.7	29.4	28.7	27.9	26.8
Government purchases of goods and services	131.0	130.0	129.5	129.6	125.2
Federal	65.1	65.3	65.5	67.1	64.3
National defense	54.4	55.3	55.2	57.0	54.0
State and local	65.9	64.6	64.1	62.5	60.9
GROSS NATIONAL PRODUCT, 1964 PRICES	641.5	630.6	626.6	620.2	612.9
PERSONAL INCOME	511.6	502.2	494.5	487.9	480.9
Disposable personal income	448.3	442.1	435.6	430.2	419.5
Personal saving	30.2	35.5	31.0	34.0	29.5
Personal saving/disposable income (per cent)	6.7	8.0	7.1	7.9	7.0
CORPORATE PROFITS BEFORE TAX p/	64.0	57.7	58.0	57.9	56.6
FEDERAL GOVERNMENT -- GNP					
Receipts p/	120.2	115.2	114.0	112.3	114.8
Personal tax and nontax	52.0	49.3	48.2	47.3	51.2
Corporate profits tax p/	25.9	24.3	24.4	24.4	23.9
Expenditures	120.3	120.1	119.2	120.2	117.2
Surplus or deficit(-) p/	-.1	-5.0	-5.2	-7.8	-2.4
STATE & LOCAL GOVERNMENT SURPLUS OR DEFICIT (-) - GNP p/	2.3	2.6	2.3	2.3	2.4

p/ Preliminary

SELECTED DOMESTIC FINANCIAL DATA

	Week ended May 14	Four-Week Average	Last six months High	Last six months Low
Money Market1/ (N.S.A.)				
Federal funds rate (per cent)	4.05	4.07	4.12	2.00
U.S. Treas. bills, 3-mo. yield (per cent)	3.89	3.90	3.94	3.76
Net free reserves 2/ (mil. $)	-120	-118	256	-198
Member bank borrowings 2/ (mil. $)	498	473	590	122
Security Markets (N.S.A.)				
Market yields1/ (per cent)				
5-year U.S. Treas. bonds	4.15	4.15	4.18	4.04
20-year U.S. Treas. bonds	4.21	4.21	4.21	4.15
Corporate new bond issues, Aaa	4.51	4.51	4.51	4.33
Corporate seasoned bonds, Aaa	4.45	4.44	4.45	4.41
Municipal seasoned bonds, Aaa	3.09	3.09	3.09	2.94
FHA home mortgages, 30-year3/	5.45	5.45	5.45	5.45
Common stocks S&P composit index4/				
Prices, closing (1941-43=10)	90.10	89.49	90.10	83.66
Dividend yield (per cent)	2.89	2.91	3.05	2.89

	Change in April	Average change-- last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	216	183	10.2	6.0
Bank loans and investments:				
Total	1,800	2,500	11.3	9.7
Business loans	700	1,000	20.2	16.2
Other loans	600	1,300	14.1	12.5
U.S. Government securities	-500	-300	-6.7	-3.8
Other securities	1,000	600	17.3	15.2
Money and liquid assets:				
Demand dep. & currency5/	800	400	2.8	4.0
Time and savings dep. 5/	1,300	1,500	14.3	14.6
Nonbank liquid assets	6/ 800	1,300	6.5	5.3

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted. n.a.--not available
1/ Average of daily figures. 2/ Averages for statement week ending May 12
3/ Latest figure indicated is for month of April 4/ Data are for weekly closing prices. 5/ Based on preliminary revised seasonally adjusted data; not for publication. 6/ Change in March.

U.S. BALANCE OF PAYMENTS

	1965				1964			1964
	Apr.	Mar.	Feb.	QI	QIV	QIII	QII	Year
	Seasonally adjusted annual rates, in billions of dollars							
Balance on regular transactions				- 3.1	- 6.0	- 2.4	- 2.2	- 3.1
Current account balance					7.5	7.6	6.6	7.4
Trade balance 1/		10.4	- 0.3	3.3	7.1	6.6	5.8	6.6
Exports 1/		32.6	18.7	21.8	26.7	25.5	24.2	25.2
Imports 1/		-22.2	-19.0	-18.5	-19.6	-18.9	-18.4	-18.6
Services, etc., net					0.4	1.0	0.8	0.8
Capital account balance					-11.8	- 9.0	- 8.7	- 9.5
Govt. grants & capital 2/					- 4.0	- 3.7	- 3.7	- 3.7
U.S. private direct inv.				(- 2.2)	- 2.6	- 2.4	- 2.2	- 2.3
U.S. priv. long-term portfolio				(- 3.0)	- 3.3	- 2.4	- 1.0	- 2.0
U.S. priv. short-term				(+ 1.0)	- 2.2	- 1.6	- 2.2	- 2.1
Foreign nonliquid					.5	.8	.5	.5
Errors and omissions					- 1.7	- 0.7	- .3	- .9
	Monthly averages, in millions of dollars							
Deficit on regular transactions (seas. adjusted)				256	502	202	182	254
Additional seasonal element				162	- 6	- 135	- 14	---
Financing (unadjusted)	- 160	- 483	510	94	508	337	196	254
Special receipts 3/	0	0	0	19	51	1	- 10	27
Liabilities increase								
Nonofficial 4/	- 397	(- 285	8	81	207	184	36	126
Official		(- 363	154	- 287	299	129	69	86
Monetary reserves decrease	237	165	348	281	- 50	23	101	14
of which: Gold sales	(158)	(354)	(215)	(277)	(57)	(- 7)	(- 24)	(10)
[Memo: Official financing] 6/		(- 198)	(502)	(13)	(300)	(153)	(159)	(128)

1/ Balance of payments basis which differs a little from Census basis.
2/ Net of associated liabilities and of scheduled loan repayments.
3/ Advance repayments on U.S. Govt. loans and advance payments for military exports: assumed zero in absence of information.
4/ Includes international institutions (except IMF), commercial banks and private nonbank.
5/ Includes nonmarketable bonds.
6/ Decrease in monetary reserves, increase in liabilities to foreign official institutions, and special receipts.

THE DOMESTIC ECONOMY

Industrial production. The preliminary index of industrial production in April was 140.8 per cent, up slightly from the revised level of 140.5 in March, and 8 per cent above a year earlier. In contrast, the index had increased an average of one point a month from September to March. Over-all output of consumer goods was maintained in April despite a decline in auto assemblies. Production of trucks increased to a record high and activity in other equipment industries remained at advanced levels. Production of nondurable materials increased somewhat.

Auto assemblies declined in April to a seasonally adjusted annual rate of 9.4 million units from the record March rate of nearly 10 million. Assemblies are scheduled at about a 9.5 million rate in May and June. Output of television sets, some other household goods, and consumer staples increased somewhat further in April. Among materials, output of industrial chemicals continued to rise and output of metal and glass containers recovered from strike reduced levels. Production and shipments of steel increased further, but then steel ingot production declined 5 per cent over the 3 weeks following the April 26 announcement of the extension of the labor contract.

Gross national product. Gross national product increased $14 billion in the first quarter to an annual rate of $649 billion. This estimate differs little in total from the advance estimate

published a month ago. The total was $40 billion, or 6.6 per cent, higher than a year earlier. In constant prices, it was up 4.8 per cent, well above the 1957-64 average growth rate of about 3.5 per cent. The unusually large rise in the first quarter reflected exceptional increases in both personal consumption expenditures and gross private domestic investment. (For details, see Table I -- T-2.)

Consumer income and spending. Personal income edged up in April to a seasonally adjusted annual rate of $514.5 billion, 5.7 per cent higher than a year earlier. The April advance was one of the smallest in two years. Wage and salary payments in manufacturing declined $500 million because of a cutback in average hours of work per week, while payroll increases in other private activities were small. State and local government payrolls showed their usual rise. Other types of personal income increased slightly or were unchanged.

Total retail sales in April were off slightly from the reduced March level and 2.2 per cent from the February peak, according to the advance report. Durable goods sales were down 1.5 per cent from March and 4.4 per cent from the February high. Sales at nondurable goods outlets remained virtually unchanged in April from their slightly reduced March level.

CHANGES IN RETAIL SALES*
(Seasonally adjusted, per cent)

	April from Mar. 1965	April from Feb. 1965	April 1965 from April 1964	April 1965 from 1st Qtr. 1965
Total	- 0.4	- 2.2	+ 6.6	- 1.6
Durables	- 1.5	- 4.4	+ 8.6	- 3.6
Automotive	- 3.1	- 7.7	+11.4	- 5.5
Furn. & appli.	- 1.8	+ 0.1	- 1.2	- 1.6
Nondurables	+ 0.2	- 1.0	+ 5.7	- 0.6
Food	+ 1.8	+ 1.3	+ 6.8	+ 1.8
Dept. stores	+ 1.8	- 0.3	+16.4	+ 1.2
GAF total	+ 0.6	- 0.8	+ 7.0	- 0.2

* Based on Commerce advance figures for April.

In the first third of May, deliveries of new domestic autos rose contraseasonally above a month earlier and were 17 per cent above a year ago. A contest among Chevrolet dealers, which began May 1, apparently induced some postponement of deliveries from the last third of April, when deliveries dropped to the level of a year ago. This decline brought the annual rate for April down to 8.2 million. Present indications are that sales in May will be at the April rate or a little higher, and well below the peak 9.6 million rate of January and February.

Stocks of new cars were up slightly on May 10 from a month earlier and represented 45 days' supply at the current daily sales rate. This is about equal to the average for this season in other recent years.

Used car sales in the first period of May were down modestly from a month earlier, although they usually rise in this period. Used car prices have eased somewhat since early this year.

Orders for durable goods. Seasonally adjusted new orders for durable goods increased 2 per cent further in April, with the rise reflecting primarily a sharp upturn in defense ordering. For all civilian products combined new orders were down slightly because of a decline from the pronounced March peak in the auto industry and some further slackening in ordering of steel. New orders for machinery and equipment expanded further.

NEW ORDERS FOR DURABLE GOODS
(Millions of dollars, seasonally adjusted)

	April	March	Percent change
Total	22.051	21,647	2
Defense products	3,022	2,407	26
Civilian products	19,029	19,240	-1
Primary metals	3,464	3,598	-4
Motor vehicles	3,861	4,168	-7
Machinery & equipment	4,106	3,976	3
All other	7,598	7,498	1

Sales of durable goods declined moderately from the record March level as sales by the auto and aircraft industries decreased. Steel shipments showed a sizable further increase.

Unfilled orders increased again in April after showing no change in March. The order backlog spurted in defense industries and continued to expand in the machinery and equipment sector, while unfilled orders for steel declined considerably further.

Labor market. The labor market eased somewhat in April following the substantial gains reported in the first three months of

this year. Nonfarm employment did not advance above the March level and hours of work declined. Unemployment rose slightly under the increased pressure of the growing supply of young people entering the labor force. This pressure will mount even further by midsummer.

The small decline in April in nonfarm employment was partly due to unusually bad weather in the Midwest during the survey week, which depressed employment in construction and retail trade. However, there were fairly widespread indications of a general slowing down in employment gains. Only State and local government employment continued to show its earlier strength.

CHANGES IN NONFARM EMPLOYMENT
(Seasonally adjusted, thousands of persons)

	March 1965 to April 1965	November 1964 to March 1965 1/	April 1964 to April 1965 1/
Total	-51	272	174
Manufacturing	36	87	55
Durable goods	31	68	41
Nondurable goods	5	19	14
Nonmanufacturing	-87	186	119
Mining	0	-2	0
Construction	-108	35	9
Transportation and public utilities	-1	11	6
Trade	-51	75	39
Finance and service	9	36	30
Government	64	31	34
Federal	8	-3	1
State and local	56	34	33

1/ Average monthly changes.

Employment in manufacturing rose by 36,000, to a total of 17.9 million in April; the increase was much smaller than earlier and about two-thirds was accounted for by settlement of the can strike. In the auto, nonelectrical and electrical machinery industries, employment continued to show further advances, but in most other industries changes were quite small.

Despite the leveling off in April, nonfarm employment was still about 2.1 million above the level of a year earlier. Manufacturing accounted for 665,000 or almost one-third of the year-over-year rise. Retail trade added about one-half million workers; services and State and local government also reported sharp increases.

Younger workers entered the labor force in larger than seasonally expected numbers in April causing the overall unemployment rate to rise to 4.9 per cent from 4.7 per cent in the previous month; a year ago, the rate was 5.4 per cent. Usually the influx of summer workers and graduates into the job market does not go into high gear until May and June. The participation rate for young workers was extremely low in the first quarter and there may have been some statistical catching-up in April. Almost the entire increase in the labor force in April was concentrated among people 14-24 years of age. There were 350,000 more teenagers in the labor force than in April 1964; in contrast, in the first quarter the margin was only 100,000. The differential year-over-year increase should widen to about 600,000 by midsummer and add further pressure on the unemployment rate for youths.

For teenagers the unemployment rate rose to 15.2 per cent in April from 13.9 per cent in the previous month, and for youths 20-24 years of age, the rate went up to 7.1 from 6.3 per cent. For other groups the changes were mainly seasonal. Unemployment for adult workers in April remained at the relatively low rates of recent months--for married men it was 2.5 per cent, a rate which has changed little since last November.

Hours and labor costs. The seasonally adjusted workweek in manufacturing declined 0.6 hours in April to 40.8 hours. While observance of religious holidays during the reporting week appears to have been responsible for some of the decline, it seems likely that the May workweek will continue to be below the first quarter record levels. The workweek declined in April by more than an hour in the machinery, transportation equipment, and rubber industries. Slightly less sharp were the reductions in electrical equipment and apparel.

A new seasonally adjusted series showed average weekly overtime hours in April down to 3.2 from 3.8 in March. Because of cutbacks in premium pay for overtime work in many high wage durable goods industries, average hourly earnings in manufacturing as a whole, seasonally adjusted, declined 1 cent to $2.59, an amount 2.8 per cent above a year ago. Weekly earnings also declined somewhat in April to $105.67, which was 3 per cent above a year earlier.

With both earnings and manhours of work in manufacturing below the March level and with output up slightly further, unit labor costs declined in April. The index of unit labor costs, at 96.8,

was below a year ago and was at the lowest level reported for the month in a number of years.

Prices. The industrial commodity price index increased .1 per cent from mid-March to mid-April, and the weekly estimates indicate a further .1 per cent rise to mid-May. At 101.8 per cent of the 1957-59 average, the estimated index for May was up 1 per cent from a year ago and fractionally above the peak reached early in 1960. The recent increases have continued to be concentrated among metals and machinery, and an index for all other industrial commodities has changed little.

Major aluminum producers, in response to sharply increased demands, have advanced selling prices of semifabricated shapes by 9 per cent. These products, accounting for about 25 per cent of total mill shipments, are used in items such as doors, windows, and auto trim. Chronic excess capacity in recent years has caused considerable price discounting, and the new prices are still almost a fifth below nominal lists.

Zinc remains in very short supply and domestic stocks are approaching low levels of the Korean War period. But the opening of new mines and the reopening of old ones closed because of past low prices is proceeding. Since the steel and auto industries each account for one-third of U.S. zinc consumption, easing of some of the recent pressures may occur when steel and auto output declines.

Tin prices continue to fluctuate at advanced levels not far from last autumn's peak. Stockpiling of tinplate by U.S. container

manufacturers has been an important factor in the demand for tin. Domestic copper and brass fabricators have increased prices to reflect the new world copper price of 36 cents a pound. Unfilled orders for copper and copper products continue to rise, and a recent stockpile release was oversubscribed by three times. But barring further supply disruptions, industry executives expect supplies and demands to come into balance by the end of the year.

Some smaller steel firms have advanced prices on an important tin plate product. Increases of up to 2-1/2 per cent have been announced by major tire manufacturers, but reports indicate that these increases may not stick.

Wholesale prices of foodstuffs have continued to increase in recent weeks and are about 5 per cent higher than a year ago. As a result of reduced marketings, hog prices this year have risen to the highest levels since mid-1958. Unusual weather in many parts of the country has hampered the harvesting of fresh fruits and vegetables. Reflecting mainly the rise in foodstuffs, the total wholesale price index so far this year has increased about 1 per cent.

Farm income. Net realized income of farm operators in the first quarter was $12.4 billion dollars (seasonally adjusted annual rate), a little below a year earlier largely because of the continued edging upward of costs of production. Cash receipts from sales of farm products were about the same as a year earlier and government payments were higher. Receipts from crops were down both because volume of marketings was lower and because prices were lower, reflecting

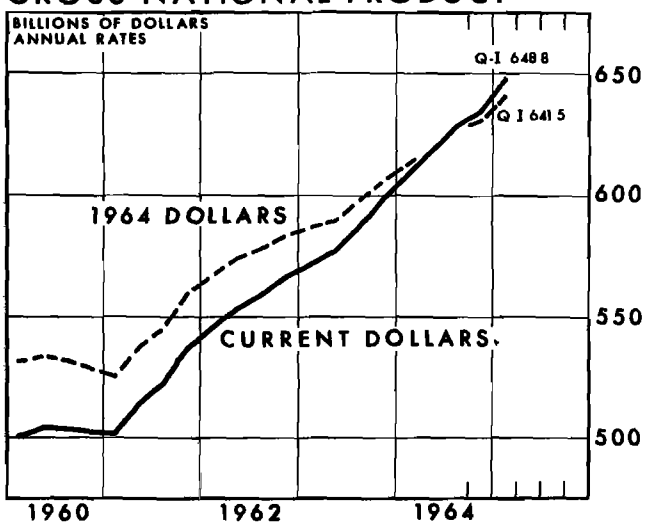
for the most part the effect of reductions in price support loan levels on cotton and wheat. Receipts from livestock products were up, however, as larger marketings of beef, dairy products, and eggs more than offset lower marketings of hogs. Higher hog prices provided an offset to slightly lower prices received for other livestock products.

The Department of Agriculture in April published a reappraisal of the farm outlook for 1965 in which realized gross farm income was projected at a little higher level than the $42.0 billion realized in 1964. Higher hog prices throughout the year and larger government payments were important factors in this forecast. Higher costs for feed, livestock, and overhead items were expected to hold net realized income around the $12.6 billion of 1964. Exports of agricultural products in fiscal 1964-65 were expected to be down slightly from last year's record $6.1 billion. Expected declines in exports of wheat, cotton and tobacco were attributed to a return to a more normal demand for wheat and sharply increased competition facing cotton and tobacco.

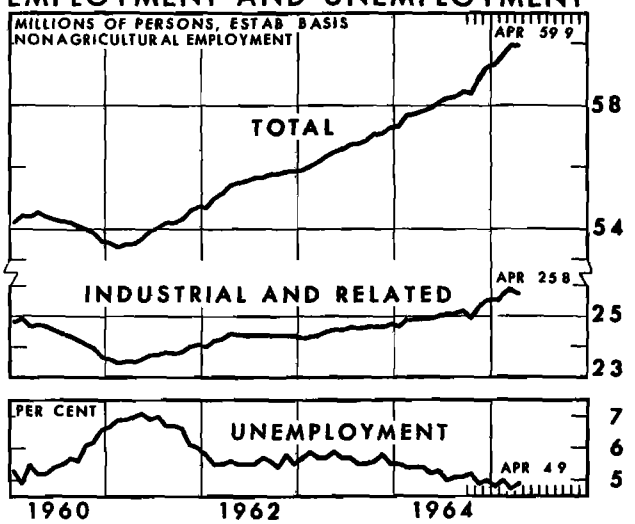
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

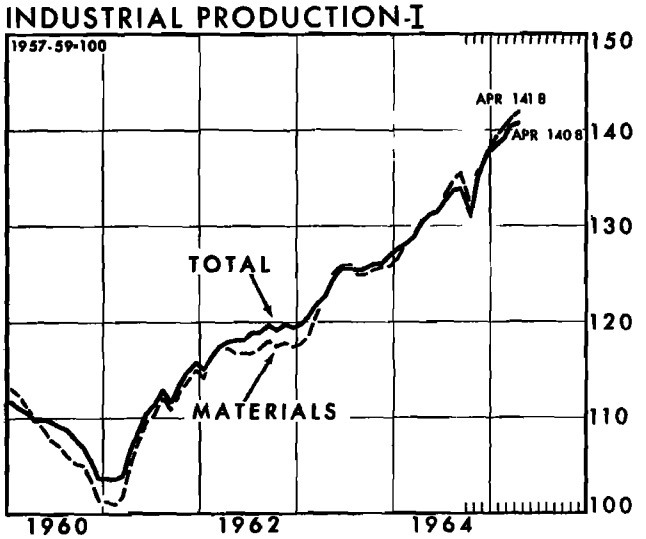
GROSS NATIONAL PRODUCT



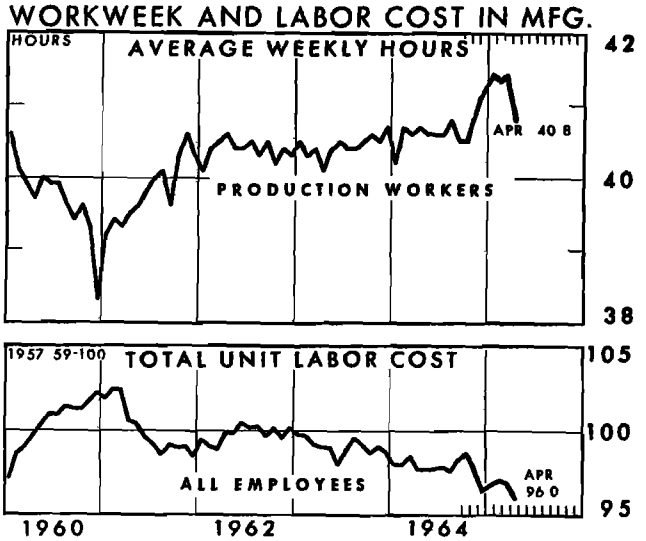
EMPLOYMENT AND UNEMPLOYMENT



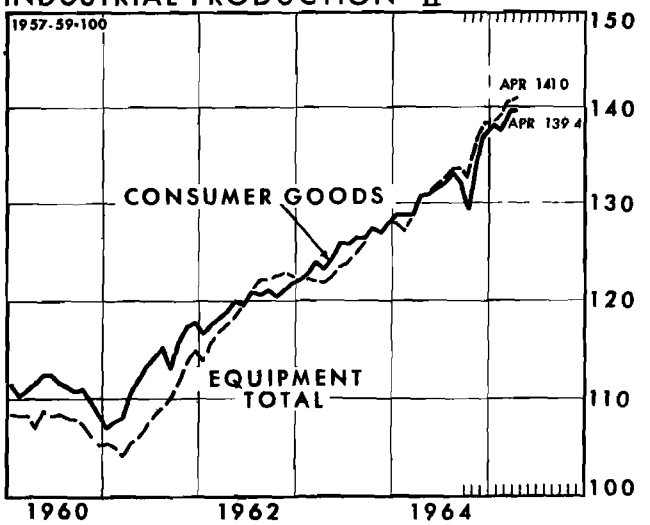
INDUSTRIAL PRODUCTION-I



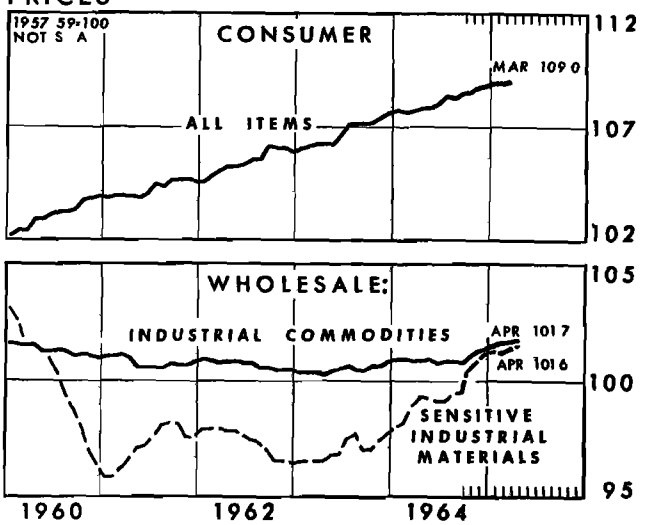
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION—II



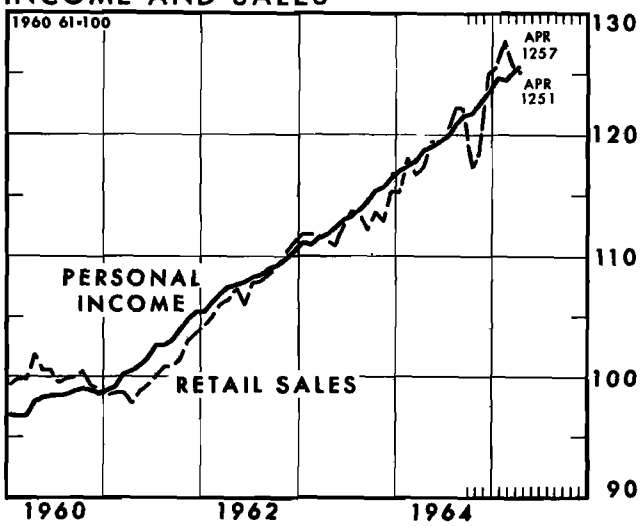
PRICES



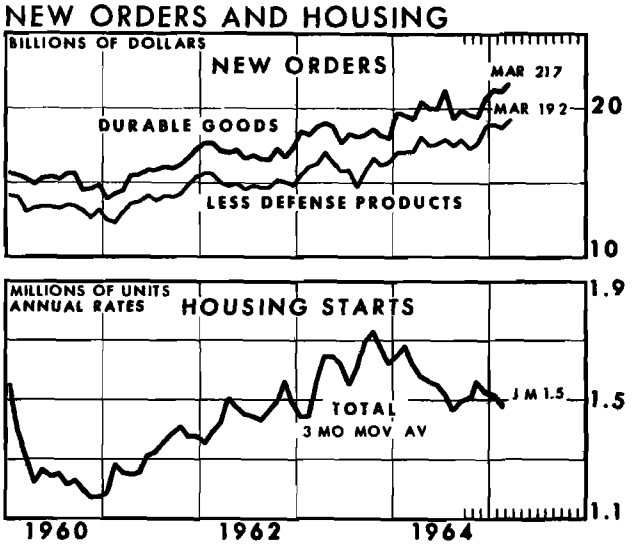
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

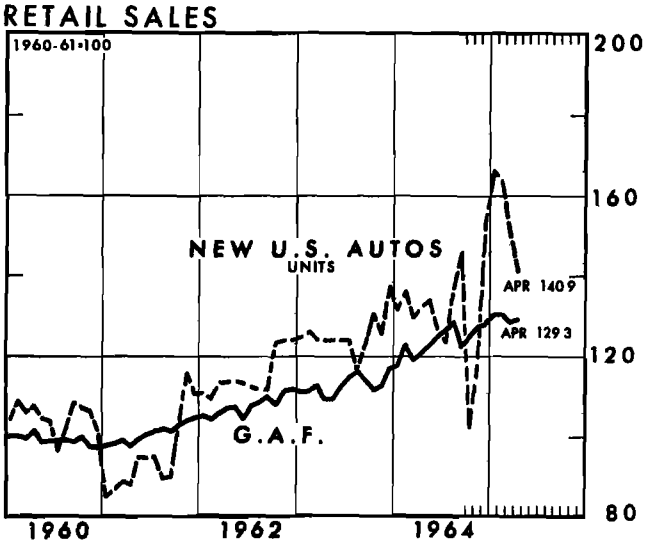
INCOME AND SALES



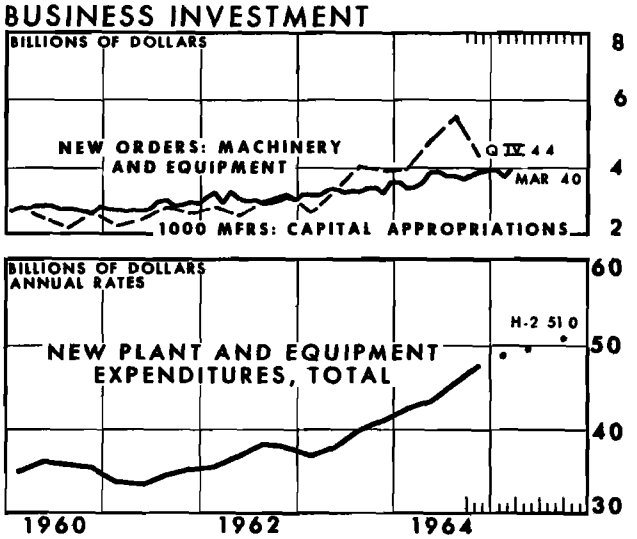
NEW ORDERS AND HOUSING



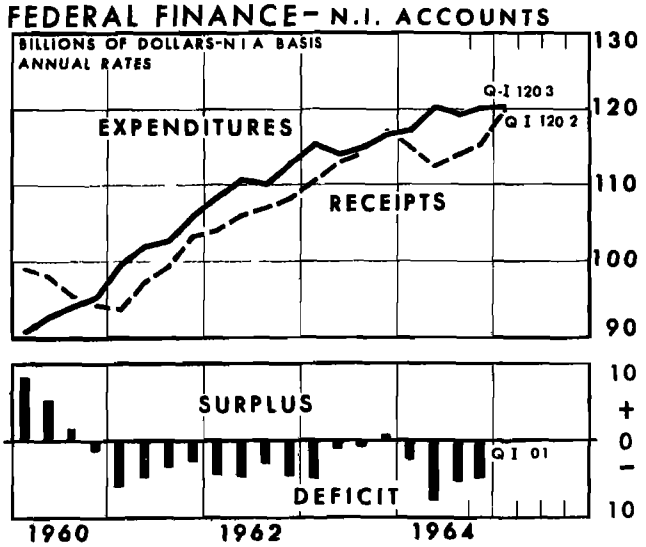
RETAIL SALES



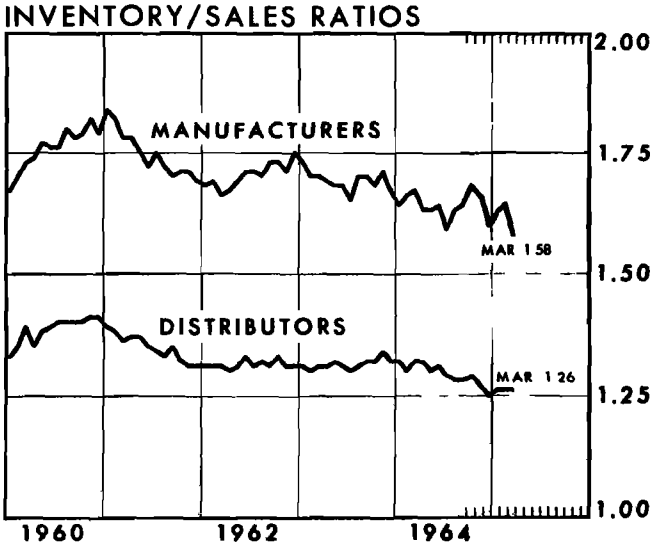
BUSINESS INVESTMENT



FEDERAL FINANCE- N.I. ACCOUNTS



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

Bank credit. Available data suggest that the slower growth of total bank credit evident during April has continued in May. Strength in demand for bank loans also has continued, however, and banks are meeting this demand by liquidating securities and, in New York City, by increasing sales of negotiable CD's.

Total loans at city banks in the week ended May 5 increased $725 million, considerably more than in the comparable week in recent years. One-half of this growth occurred at New York City--loan growth at other city banks was not unusually strong. The large increase in loans was not translated to total bank credit because almost $600 million in securities were liquidated by reporting banks; three-fourths of the liquidation was in holdings of Treasury issues. Perhaps indicative of heavier loan demands and increasing reserve pressures is the fact that commercial banks, in the April 30 roll-over of 1-year bills, took only $100 million of the $1 billion issue. Last year, they took over half of an issue of the same size.

Three-fifths of the over $500 million increase in business loans during the week of May 5 occurred at New York City banks; business loans at other banks increased about in line with the 1964 pattern. Expansion of commercial and industrial loans continued at New York City banks in the week ended May 12, although at a somewhat reduced pace. These data suggest that the widespread strength of business loan demand in April continued into early May. Loans to metal and metal products industries continued to show more than seasonal expansion, and the liquidation of commodity dealer loans built up during the dock strike moderated.

While the growth in business loans at New York City banks during the first two reporting weeks in May was unusually strong, one-fourth of the increase was accounted for by purchases of bankers acceptances. These purchases apparently represent, in part, a temporary reinvestment of funds obtained from maturing City of New York notes. One large New York bank also was reported to have temporarily invested some of the proceeds of CD sales in bankers acceptances in anticipation of future loan demand.

Money supply and time deposits. On the basis of new seasonal adjustments and a new weekly series, described in Appendix B, the money stock increased at a seasonally adjusted annual rate of 6.0 per cent in April, rather than 5.3 per cent as estimated earlier. All of this increase occurred during the first three weeks of April; preliminary estimates suggest that the money stock has declined sharply since then. From November through April demand deposits and currency increased at an annual rate of 2.7 per cent, compared to 2.1 per cent on the old seasonals.

Growth in time and savings deposits, on the basis of the new seasonal factors was a shade higher in April than in March, but both months were considerably below the substantial rates of growth earlier this year. Preliminary estimates for the first two reporting weeks of May indicate a continuation of the March-April rate of expansion. Despite the moderation of time deposit growth since February, expansion of these deposits has continued more rapid than in the corresponding months of last year.

During the first two reporting weeks in May, New York City banks increased their outstanding negotiable CD's by slightly over $200 million, much more than in comparable periods of previous years. CD's of city banks outside New York, on the other hand, continue to fluctuate below the peak of early March. Offering rates on CD's have not increased since April, with the most often quoted rate for 180-day prime CD's remaining at 4-3/8 per cent.

Bank reserves. Average net borrowed reserves during the first two weeks in May remained close to the $130 million level recorded in April.[1/] However, both average excess reserves and borrowings rose somewhat from their April levels. A fuller discussion of excess reserves and borrowings in the current expansion can be found in Appendix A.

Federal funds traded more frequently at 4-1/8 per cent during the first week in May than in the second, when additional funds were supplied by country banks in the last week of their bi-weekly reserve settlement period.

Corporate and municipal bond markets. In the past two weeks yields on corporate bonds have advanced to new highs for the year, but those on seasoned municipal issues have remained on the plateau that has prevailed since late February.

1/ Based on average daily figures for all of the reserve weeks ending in the month as used in the reserve memorandum to the FOMC.

BOND YIELDS

	Corporate Aaa		State and local government	
	New	Seasoned	Moody's Aaa	Bond Buyer (mixed qualities)
1964				
High	4.53	4.45	3.16	3.32
Low	4.30	4.35	2.99	3.12
1965				
High	4.51(5/14)	4.45(5/15)	3.09(5/14)	3.20(3/4)
Low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(3/4)
Week ending April 30	4.47 1/	4.43	3.09	3.15
" " May 14	4.51	4.45	3.09	3.14

1/ Week ending April 23.

The further advance in corporate bond yields has carried series on both new and seasoned issues up about to their 1964 highs and has increased spreads against yields on long-term U.S. Government bonds to the widest margins of the year--31 basis points in the case of seasoned issues. These spreads are well above those that prevailed during most of 1963 and 1964.

Upward pressures on corporate bond yields have reflected the heavy volume of new offerings. Publicly offered bonds are expected to total nearly $700 million in May, the largest monthly supply of such issues in nearly four years. And total corporate financing--including stock and private placements of bonds--is projected at more than $1.5 billion for the month, also a relatively high figure. With the supply of new bond offerings unusually large, investors have remained selective, notwithstanding the general availability of more generous yields. Underwriters have had to break syndicates on five recent offerings in

order to move small, but hard-core, unsold remnants. The price adjustments necessary to attract buyers have resulted in yields 2 to 7 basis points above those at which originally offered.

BOND OFFERINGS 1/
(In millions of dollars)

	Corporate				State & local govt.	
	Public offerings		Private placements			
	1965 e/	1964	1965 e/	1964	1965 e/	1964
Jan.-May average	405	366	535	448	922	947
March	557	361	658	353	950	868
April	420	383	500	480	950	1,293
May	700	470	500	537	900	709

1/ Includes refundings--data are gross proceeds for corporate offerings and principal amounts for State and local government issues.

In the municipal market, yields on seasoned bonds have been stable for the past eleven weeks despite the heavy new supply and the continuing large overhang of dealers' advertised inventories--currently totaling about $800 million. During this period of relative yield stability, reception for the large issues of well-known borrowers has generally been favorable, but that for other issues has been less enthusiastic. One factor that may help to explain why the near record level of inventories has not caused further advances in municipal yields is that bank dealers presently account for about one-half of the "blue list" total, substantially more than was generally the case in most earlier years of the present economic expansion. Moreover, banks have accounted for about four-fifths of the $250 million increase in this total from its January low. As inventories build up, banks--with

their internally available financing--are under less immediate market pressure than nonbank dealers to offer yield concessions to investors.

Stock market. After rising to an all-time high of 90.27 on May 13, common stock prices (as measured by Standard and Poor's index of 500 stocks) have eased off somewhat. Closing at 89.36 on May 18, prices were one per cent below their recent high, but were up 4 per cent from their late March low. At their recent high, the Standard and Poor's "500" was selling at a price-earnings ratio of 18.05, considerably below the 20.99 ratio at the mid-December 1961 peak. Since the beginning of 1964, when the price-earnings ratio was 17.34--the Standard & Poor's index has risen about 20 per cent while earnings have increased less--about 15 per cent. Trading volume averaged 5.9 million shares a day during the past two weeks.

Despite the 3-1/2 per cent advance in stock prices during April, total customer credit in the stock market rose only $63 million during the month. Most of this gain occurred in bank loans to others than brokers and dealers which rose $49 million; customers' net debit balances increased $14 million.

Mortgage markets. Mortgage funds generally have continued in ample supply this spring, and trade expectations for coming months are for little change in this situation. Contract interest rates on conventional home mortgages, as reported by the FHA, remained unchanged in April at 5.80 per cent for loans on new homes and 5.85 per cent for loans on existing homes. The FHA-yield series on secondary market transactions also remained unchanged at 5.45 per cent, marking the 25th month of virtual stability at this reduced level.

Delinquency rates continued to decline in the first quarter of the year below year-earlier levels, according to the regular survey of the Mortgage Bankers Association of America. At 2.94 per cent of total loans serviced by member respondents in the survey, the rate was the lowest for a first quarter since 1962 and compared with 3.01 per cent in the first quarter of 1964. Among other things, improvement has reflected the generally higher level of after-tax incomes and better lender screening and collection procedures.

The ratio of mortgages in the process of foreclosure at the end of March was also under a year earlier--at 0.37 per cent of mortgages serviced by MBA respondents--and was only slightly higher than at the end of the first quarters of 1962 and 1963.

U.S. Government securities markets. Trading activity in the Treasury bond market contracted sharply in the wake of the May refunding operation, and some weakening in prices developed. While results of the financing were initially taken in stride by the market, investment demand has been negligible and dealers have made little progress in redistributing either their sizable holdings of the new note and bond or of other longer-term issues. When books were closed on May 5, dealers had $499 million of the 4-1/4's of May 1974 and another $114 million of the 4's of August 1966, and by May 17 payment date their positions in these issues were virtually unchanged. Moreover, dealers' inventories of all bonds maturing after 5 years remained around $800 million.

With disappointment in the distribution of the new issues, dealers tended to mark down prices. The reopened 4-1/4 per cent bond declined an 1/8 of a point between the time books were closed and payment date. On that date some support was given the market by

Treasury account purchases amounting to about $50 million in the coupon area, four-fifths of which were the reopened 4-1/4's. Long-run market expectations so far appear to have changed little, however, even in the face of distribution problems in the refunding and other bearish factors, such as disappointment in United Kingdom's April trade figures.

YIELDS ON U. S. GOVERNMENT SECURITIES

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1965						
Highs	4.00	4.05	4.16	4.18	4.24	4.21
Lows	3.76	3.91	4.00	4.08	4.17	4.17
1964-65						
December 31	3.82	3.92	4.06	4.12	4.21	4.21
April 13	3.94	4.00	4.11	4.14	4.20	4.20
April 28	3.92	3.97	4.12	4.16	4.21	4.21
May 5	3.90	3.95	4.09	4.14	4.20	4.20
May 17	3.89	3.95	4.12	4.15	4.21	4.21

Treasury bill rates changed little over the past few weeks, despite a sharp contraction in demand. Dealers' positions in bills have risen somewhat from the relatively low level reached during the recent financing. But dealers appear to be willing holders of bills at current rate levels, given prospective market demand and the relative availability of financing.

The market is not expecting any additions to the bill supply in view of the Treasury's extremely comfortable cash position. In fact, one factor influencing interest rates in recent months has been the larger than expected surplus that has developed in the Government's cash budget, as noted in the section on the budget. In addition, bill demands from official and private investors associated with the May refunding also tended to put rates under downward pressure. Under these conditions, the market may be accustoming itself to the idea that bill rates could have a somewhat wider range of movement than previously expected.

Federal budget. A larger than projected inflow of tax receipts during the spring, together with some restraint on expenditures, has curtailed the size of the cash deficit likely to develop for fiscal 1965. Instead of the $4 billion deficit originally anticipated, it now appears that the deficit will be on the order of $2 billion, as shown in the table below. A commensurate decline is also expected for the deficit as measured in the national income accounts.

FEDERAL BUDGET PROJECTIONS
(Billions of dollars)

	Fiscal 1965		Calendar years	
	FRB projection (May 1965)	Budget document (January 1965)	1965 (projected)	1964
Cash budget				
Receipts	119.1	117.4	121.9	115.0
Payments	121.2	121.4	124.5	120.3
Deficit/surplus	- 2.1	- 4.0	- 2.6	- 5.3
National income				
Receipts	117.9	116.0	121.4	114.1
Payments	120.5	121.0	123.5	119.2
Deficit/surplus	- 2.6	- 5.0	- 2.1	- 5.1

The bulge in tax receipts is reflected in the enlarged cash surplus expected in January-June 1965. This surplus, which is currently projected at $8.1 billion, would be substantially larger than in any of the previous four years; the only significantly larger first half surplus during the post-war period occurred in 1956.

One of the factors influencing receipts appears to be that final settlements on 1964 individual tax liabilities were $1.0 to $1.5 billion higher than anticipated. Preliminary indications are that these increased collections of nonwithheld taxes for the most part reflect last year's liability rather than the first instalment on estimated 1965 taxes. With national and personal income in 1964 about as originally projected and with withholdings in 1964 actually above the minimum rate, such an increase in tax collections indicates that the decline in 1964 tax liabilities as a result of the tax cut was not as large as first anticipated. Moreover, thus far in 1965 withheld taxes have run well above expectations, with May collections of such taxes especially large. As a result of these developments, not only have actual collections been increased for fiscal 1965 but estimates for fiscal 1966 have also been revised upward.

With the surplus developing as these projections indicate, the Treasury could enter the second half of calendar 1965 with a cash operating balance of over $11 billion. Moreover, the deficit anticipated in July-December 1965 is now projected at just over $10.5, having been reduced somewhat by the carry-through of higher tax receipts. The slightly reduced deficit in conjunction with the much enlarged cash balance would enable the Treasury to undertake less net cash borrowing

in July-December 1965 than in the same period a year ago, as shown in the accompanying table. This is contrary to expectations held only a few weeks ago.

FEDERAL CASH BUDGET AND CASH BALANCE, BY HALF YEARS
(Billions of dollars)

	1965 (projected)		1964	
	Jan.-June	July-Dec.	Jan.-June	July-Dec.
Receipts	67.8	54.1	63.7	51.4
Payments	59.7	64.8	58.8	61.5
Surplus/deficit	8.1	-10.7	4.9	-10.2
Borrowing	-3.0	6.1	-1.0	6.7
Cash balance (end of period)	11.1	6.5	10.2	6.4

The projections shown above for the second half of calendar 1965 include the effect of the original excise tax and social security proposals. The President's most recent tax proposal would reduce excises by a further $1-3/4 billion effective January 1, 1966. This will reduce receipts in January-June 1966 by about $700 million; in addition, the proposed Federal pay increase would add about $425 million to expenditures. One might now expect, therefore, that the January-June 1966 surplus would be reduced to around $7 billion.

Looking ahead then, two factors stand out: In fiscal 1966, under the assumption of continued growth in income, the swing from deficit to surplus in the cash budget is not likely to be any greater, and possibly smaller, than has developed in fiscal 1965. At the same time net cash borrowing in fiscal 1966 may be less than in fiscal 1965, since the cash need has been reduced by the increase in current tax receipts.

"Fiscal Drag". The larger surplus in the cash budget now expected for the first half of 1965 is likely to be associated with a virtual balance for seasonally adjusted Federal receipts and payments in the national income accounts, as shown below. At the time of the January budget document it had been anticipated that a moderate deficit would develop in these accounts.

FEDERAL RECEIPTS AND EXPENDITURES, BY HALF YEARS
(In billions of dollars, seasonally adjusted annual rates)

	1964		1965		1965
	Jan.-June	July-Dec.	Jan.-June	July-Dec.	Jan.-June
National income					
Receipts	113.6	114.6	121.1	121.4	127.2
Expenditures	118.7	119.7	121.3	125.6	130.0
Surplus/Deficit	- 5.1	- 5.0	- .2	- 4.2	- 2.8
Full-employment					
Receipts	122.3	122.9	126.0	126.3	134.0
Expenditures	118.1	119.3	120.8	125.1	129.5
Surplus/Deficit	4.2	3.6	5.2	1.2	4.5

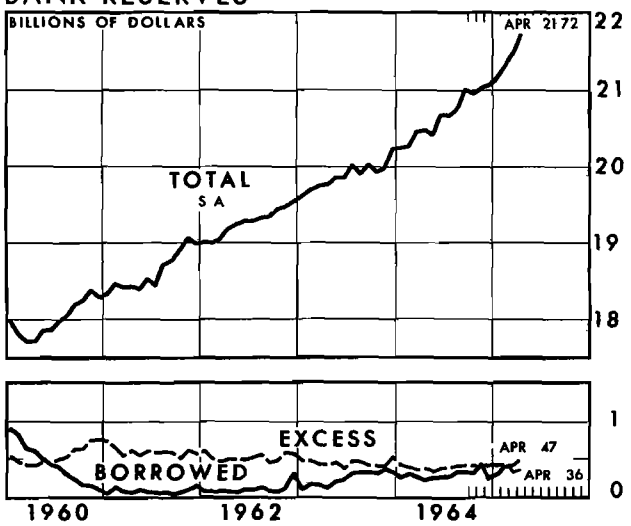
The balance which is apparently developing this half year in the Federal sector of the national income accounts is the result not only of higher individual tax payments and restraint on Federal expenditures noted above but also of the enlarged corporate tax liability reported for the first quarter of 1965. Translated to a "full-employment" surplus calculation this balance in the accounts corresponds to a surplus of about $5 billion. This is a somewhat larger surplus than earlier calculations indicated and is accounted for by the apparently larger individual tax liability at any given level of income and by the somewhat smaller expenditures.

These factors carry through the second half of 1965, so that while the national income accounts are again likely to show a deficit, this deficit is projected to be smaller than was implicit in the January budget document. Still, the associated full employment surplus in July-December would decline to about $1 billion in reflection of the initial stage of the excise tax cut and the increased and retroactive social security payments.

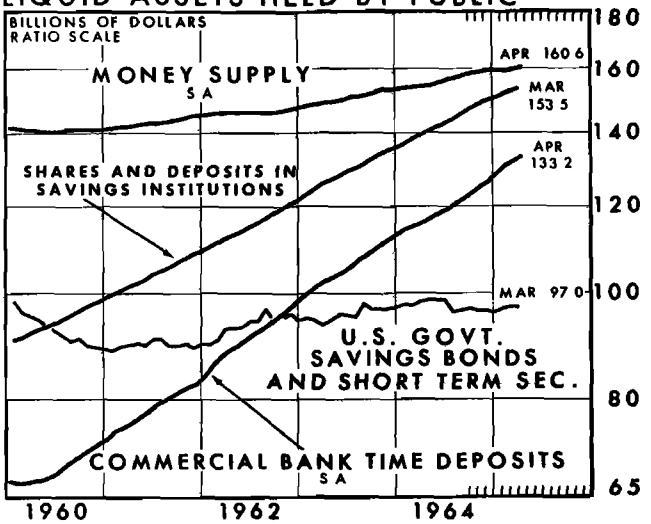
The "fiscal drag", as measured by the full employment surplus would rise in January-June 1966, when the new social security taxes are proposed to go into effect. But the rise would be moderated by enactment of the Administration's most recent fiscal proposals--i.e., by the second stage of the excise tax cut and the Federal pay rise. In that case, the surplus at full employment may be under $5 billion.

FINANCIAL DEVELOPMENTS - UNITED STATES

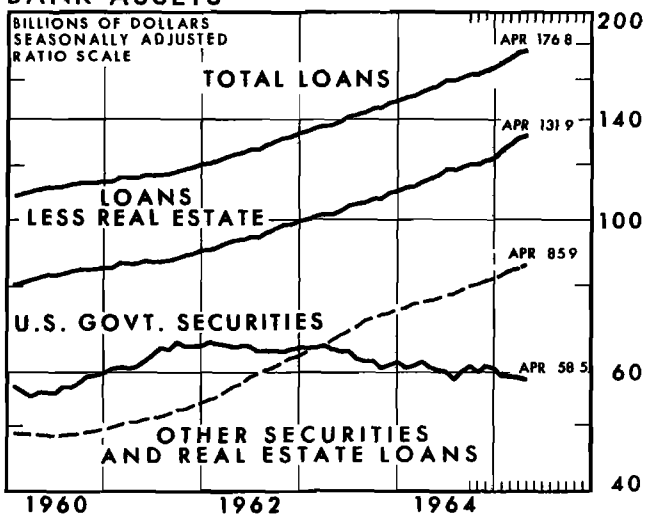
BANK RESERVES



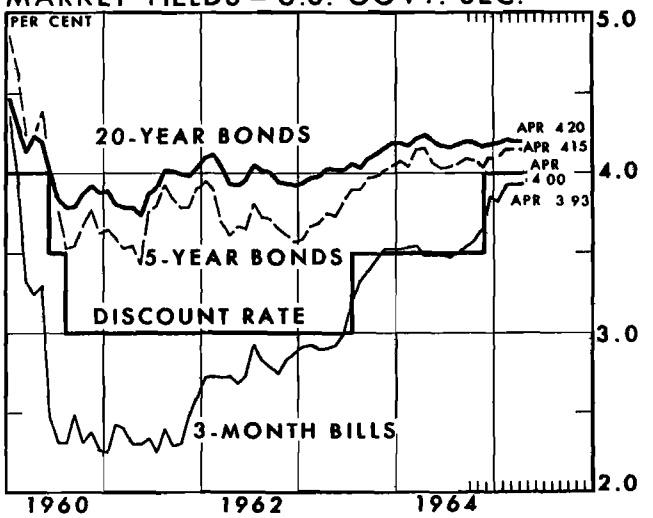
LIQUID ASSETS HELD BY PUBLIC



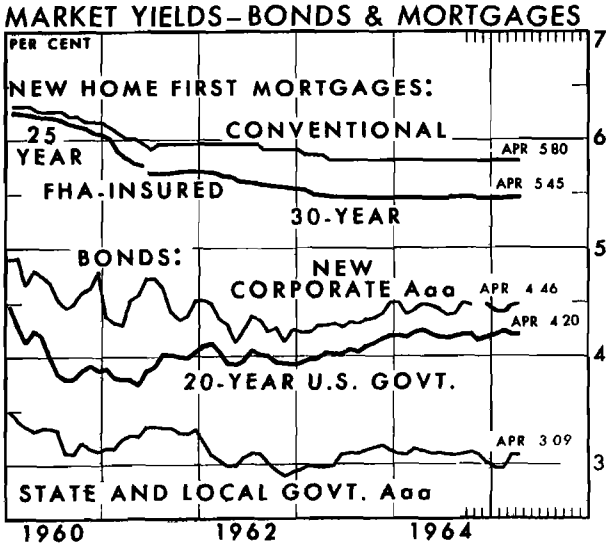
BANK ASSETS



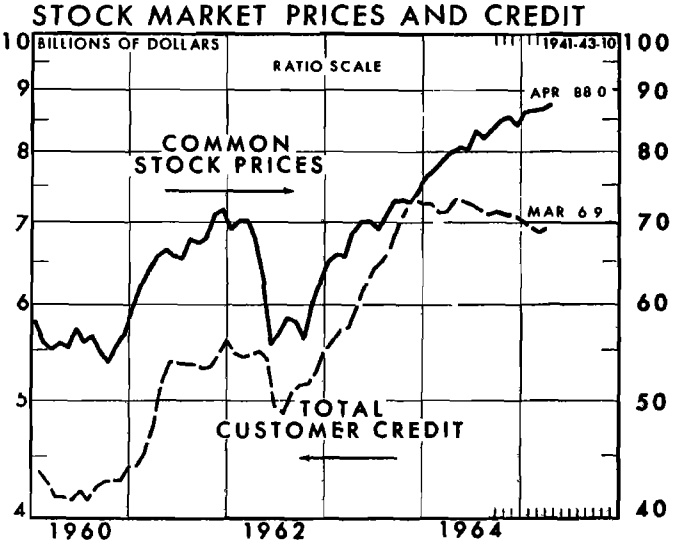
MARKET YIELDS – U.S. GOVT. SEC.



MARKET YIELDS–BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Preliminary monthly data for April show an over-all payments surplus of $160 million, about one-third the size of the large March surplus, while external transactions in early May were apparently in rough balance. The smaller surplus since March represents, at least in part, less favorable seasonal influences. One known unfavorable influence was a $50 million rise in U.S. purchases of new foreign security issues as compared with March.

The large March surplus had benefitted from the unwinding of the after-effects of the dock strike on trade movements and trade payments. Export shipments rebounded in March, reflecting the catching up on shipments delayed by the dock strike. At $2.8 billion, exports were nearly 75 per cent higher than in February, and the trade surplus jumped by nearly $900 million. Progress in clearing the docks exercised a favorable influence on net receipts in April as well.

Further detail is now available on bank credit outflows in March. Net outflows of loans and acceptance credits in the month totaled $157 million, about forty per cent less than average outflow of the preceding two months. Net outflows of long-term loans were very sharply reduced from the extraordinarily high levels of January and February to less than $50 million. However, short-term bank credit outflow increased, for the most part because of a large rise in acceptance credits to Japan. (These outflows include credits extended by branches and agencies of foreign banks in the United States as well as by domestic banks. Credits to foreigners by domestic banks within the VFCR increased by $40 million in March.)

The large outflows of long-term bank credits in January and the early part of February reflected not only continued heavy lending to European countries, but also a substantial increase in loans to less-developed countries. Net borrowings by Latin American countries in January-February were more than twice the average during the fourth quarter of 1964, and outflows to African countries also rose very sharply.

In March, though the net flow of long-term bank credit to Latin America was much reduced, there were continued large outflows to nonindustrial Asian and African countries. There were small net repayments on loans to Europe and Canada, as new lending dried up following the extension of the IET to long-term loans to these areas.

Bank Credit Outflows*
(Monthly averages, millions of dollars)

	1964		1965			
	Oct.-Dec.		Jan.-Feb.		March	
	Long	Short	Long	Short	Long	Short
Total	127	176	244	40	43	114
Europe	89	30	83	33	-14	-10
Canada	-7	10	35	5	-13	21
Japan	11	44	12	-13	20	99
Latin America	30	77	75	15	8	-39
All Other	4	15	39	0	42	43

* Loans and acceptance credits only.

The outflow of short-term bank loans and acceptance credits in March was little changed from the average of the preceding five months. Following an exceptionally large outflow of short-term bank credits in December, there was a net reflow in January; resumed outflows in February and March averaged $130 million a month. Much of the fluctuations in this period have reflected variations in acceptance credits extended to Japan. A rise of $100 million in these credits in March reflected renewed Japanese borrowing in part to finance imports from the U.S. following the end of the dock strike. There has been a net reflow on short-term bank credits to Latin America since the beginning of the year, following exceptionally large outflows in the fourth quarter.

The net reflux of liquid funds in March may have been very large. Data reported by U.S. banks indicate a reflow out of short-term investments in Canada of at least $75 million; but the total March reflow, when complete data is available, may prove to have been several times as large. There is some evidence of very large repatriations of such funds by nonfinancial concerns, particularly from Canada. The March reflow followed an average net flow during the previous five months that was close to zero. In this five month period, there were some outflows of such funds into U.S. dollar denominated deposits in Canada and, during the fourth quarter of last year, in Britain as well. These outflows were offset by reflows from foreign-currency-denominated investments, largely from Britain and Canada.

Industrial production in Western Europe. Under current conditions, trends in industrial production in most European countries provide only a very imperfect measure of trends in demand, because plant capacity and labor supply have been limiting the growth of output. In most countries expansion of output is proceeding about as quickly as supply possibilities allow. However, this is not at present the case in Italy and France, and perhaps also not in Belgium. In these countries current movements of industrial production are reflecting the development of demand more closely than elsewhere.

INDUSTRIAL PRODUCTION -- OECD EUROPE
(Seasonally adjusted, Q-IV 1963 = 100)

	1964				1965	
	Q-I	Q-II	Q-III	Q-IV	Jan.	Feb.
TOTAL	103.5	103.5	102.5	105	107	107 e.
United Kingdom	103	103	103	105.5	107.5	106.5
E.E.C.	102.5	102.5	101.5	105	106.5	107.5 e.
France	102.5	104	100 a/	102.5	101	102.5 b/
Germany	103	104	105	107.5	112	c/
Italy	100	98	95.5	97	98.5	99
Sweden	102.5	102.5	105.5	105.5	109	106

a/ The third-quarter figure for France is not significant because of difficulties of seasonal adjustment during the vacation period.
b/ Followed by March 101.5.
c/ Jan.-Mar. average, as seasonally adjusted by the Bundesbank, is 110 on the base used here.
Note. Data computed from rounded OECD indexes on base 1960 = 100.

Since the halt of the decline in output in Italy last summer and in France around the beginning of this year, aggregate Western European industrial production has been rising again. After virtually no change from February 1964 through the third quarter of 1964, output rose by 2-1/2 per cent in the fourth quarter and by a further 2 per cent from the fourth-quarter average to February.

In France, industrial activity has not yet turned up decisively; the March index was a little below February's. The February-March average was slightly above the December-January level, reflecting in part the ending of work stoppages in the public sector.

Recent stability of the rate of output characterizes conditions in most industrial sectors in France. Textile output had dropped by one-fifth from the spring of 1964 to December, and passenger automobile output by one-fourth from January to October 1964. Steel ingot production continued to rise in November, and then declined a little to the lower level that was maintained in January-March. Output in other sectors rose through most of last year, but leveled off around the year-end.

Producers' stocks of finished goods, which had been rising since the spring of 1964, apparently stopped increasing in March and were cut back in April, according to the INSEE April survey of business opinion. Deterioration in producers' assessments of their order books has also halted. Expectations found in the survey were that output should be rising, on balance, in the current quarter.

Italian industrial output, after about a year during which

began to turn up in the final quarter of 1964. By February, the index of industrial production was 2-1/2 per cent above its September-October level.

The restrictive actions taken by the Italian authorities during 1963-64, particularly in the monetary field, affected primarily private demand for automobiles and investment demand. Investment demand was weakened also by shrinkage of profit margins, as wage costs continued to rise. Production of investment goods dropped by 10 per cent from January 1964 to midyear. From July 1964 to December-January, output in this field moved up by about 1 per cent. Consumer goods output declined until the end of 1964: from April 1964 to December it dropped by 8 per cent as production of motor vehicles and textiles, in particular, fell. In early 1965 consumer goods output appeared to be stabilizing.

The rise in Italian industrial production since last autumn has been most marked for iron and steel, chemicals, and petroleum products. These industries have had strong growth trends, and their output declined very little during last year's recession.

In Britain industrial output is believed to be still on an upswing, although the recorded monthly movements are indecisive. After remaining level for nine months, the index of industrial production rose by 3-1/2 per cent from September to December, 1964. January showed a further rise, but the February index was again at the December level.

In so far as the apparent flattening out of the production trend in early 1965 is not due to statistical measurement problems, it

can probably be ascribed more to resource limitations than to a slackening of demand. Fixed capital outlays have continued to rise and, in addition, there was a sharp expansion of consumer and inventory demand in the first quarter, partly because of pre-Budget buying.

Last year's rise in industrial production after September was particularly strong in the engineering and allied industries, and also in furniture and wood product industries. This advance was made possible, in part, by an appreciable rise in labor productivity. In the textile and apparel industries output remained level throughout 1964.

Industrial production in Germany is increasingly hampered by supply difficulties. The labor situation remains very tight and in March there were four times as many jobs vacant as persons unemployed (after seasonal adjustment). According to recent surveys, producers are working at the highest levels of capacity utilization ever recorded. Demand, as measured by the inflow of new orders, continues to increase in all industrial sectors. February-March new orders were 1-1/2 per cent above the very high November-December (1964) level.

Despite the pressures on resources, German industrial production rose 2-1/2 per cent between the third and fourth quarters of 1964, and jumped sharply higher in January. For the first quarter as a whole another advance of 2-1/2 per cent appears to have been made over the preceding quarter.

Industrial production in Japan. Revised data for March indicate a net decline in output of less than 1 per cent since last October's peak. March output was up 1 per cent from February. Producers' (unsold)

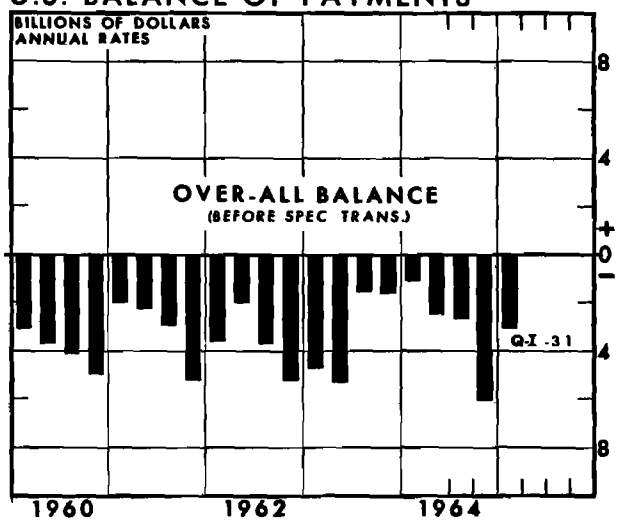
inventories of finished goods, seasonally adjusted, fell 2 per cent further in March, possibly indicating a significant favorable change from the position that had been reached in January, when these stocks were at their highest of the current cycle.

Consumer durables output, including automobiles, had fallen off during 1964 and continued to decline through February. Production of investment goods appears to have been relatively level in recent months.

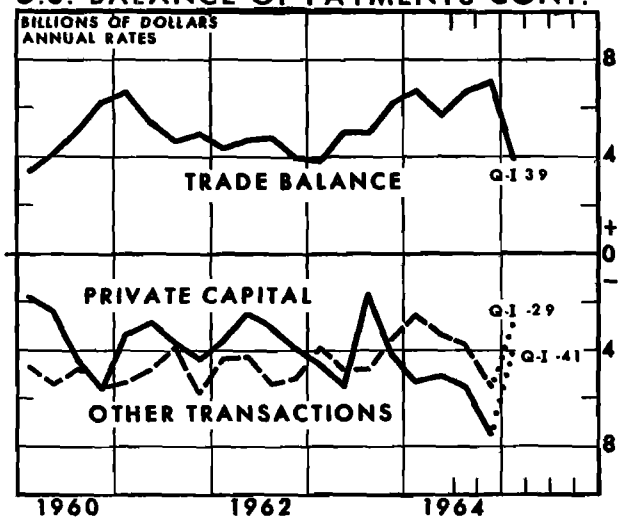
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

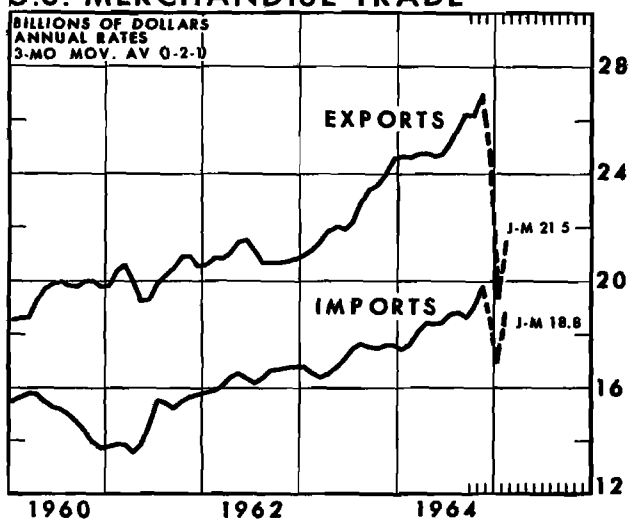
U.S. BALANCE OF PAYMENTS



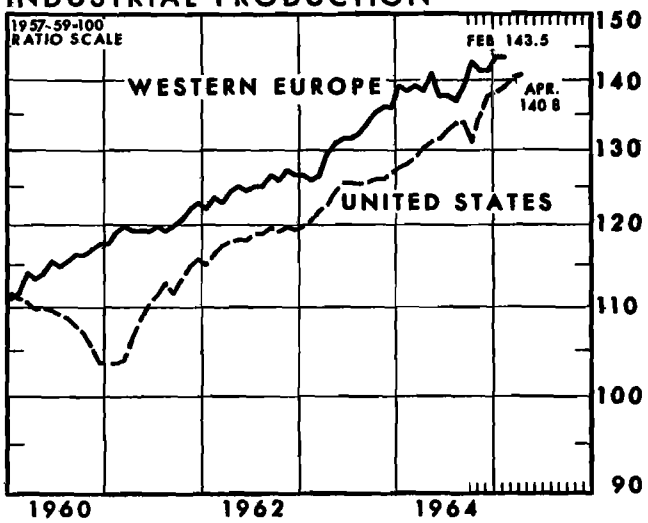
U.S. BALANCE OF PAYMENTS-CONT.



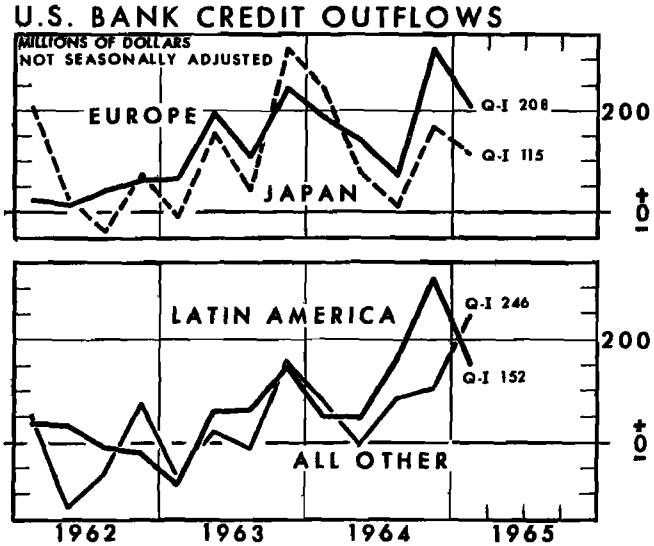
U.S. MERCHANDISE TRADE



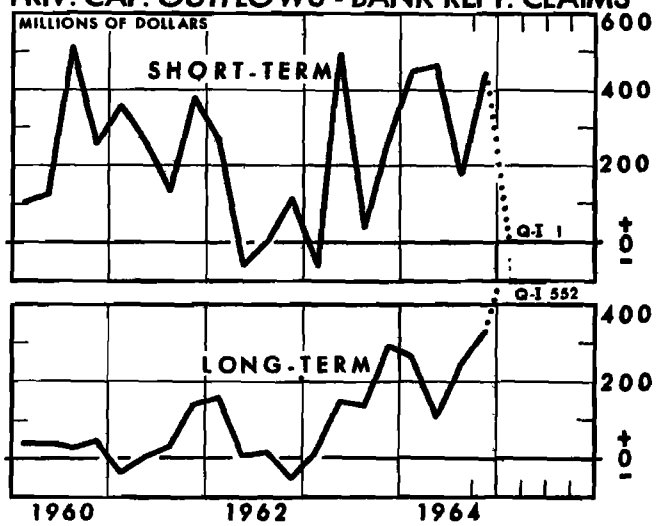
INDUSTRIAL PRODUCTION



U.S. BANK CREDIT OUTFLOWS



PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



APPENDIX A: EXCESS RESERVES*

Excess reserves of member banks have moved steadily downward throughout most of the current expansion, reaching the lowest level of the post-war period in the first half of 1964, and again in March and April of this year.

The decline in excess reserves represents the continuation of a trend which has prevailed throughout the post-accord period. During each of the post-accord expansions, excess reserves declined, and each time their level ultimately fell below the previous cyclical low. What is worthy of note, however, is that bank reserve pressures have not intensified as much during the current expansion as in previous cycles. Thus, the forces influencing the trend and level of excess reserves since 1962 are not fully comparable with those of previous periods of expansion.

Country banks account, on the average, for about 85 per cent of excess reserves. Therefore, any discussion of the factors tending to reduce the level of excess reserves must revolve around the smaller banks.

In recent years country banks have found it easier to enter the Federal funds market (both as buyers and as sellers) because of the growth of regional markets dealing in smaller transactions. They have entered these markets in increasing numbers, although those regularly doing so are still a small minority of all country banks. Larger correspondent banks and brokers have advised country banks as to the profits to be gained in the Federal funds market. Moreover, as the average size of all banks increase, more banks find that they are able to deal in units large enough to enter regional markets.

Higher levels of short-term interest rates always have encouraged banks to reduce their surplus reserves. This tendency has been reinforced in the present expansion by emergence of a premium on Federal funds over the discount rate. In this expansion, higher levels of short-term rates also seem to have made larger banks more aggressive both in seeking balances from their smaller correspondents and in making efforts to purchase Federal funds from smaller banks, even if the size of the trade is relatively small. Increased solicitation of their funds has reinforced the tendency for smaller banks to manage their reserves more closely.

Higher levels of short-term interest rates have been paralleled by an increase in the rates paid on time deposits. With the rapid increase in the quantity of time deposits, it is likely that increased bank costs have also added to the pressure on banks to hold more of their liquidity in short-term earning assets rather than in excess reserves.

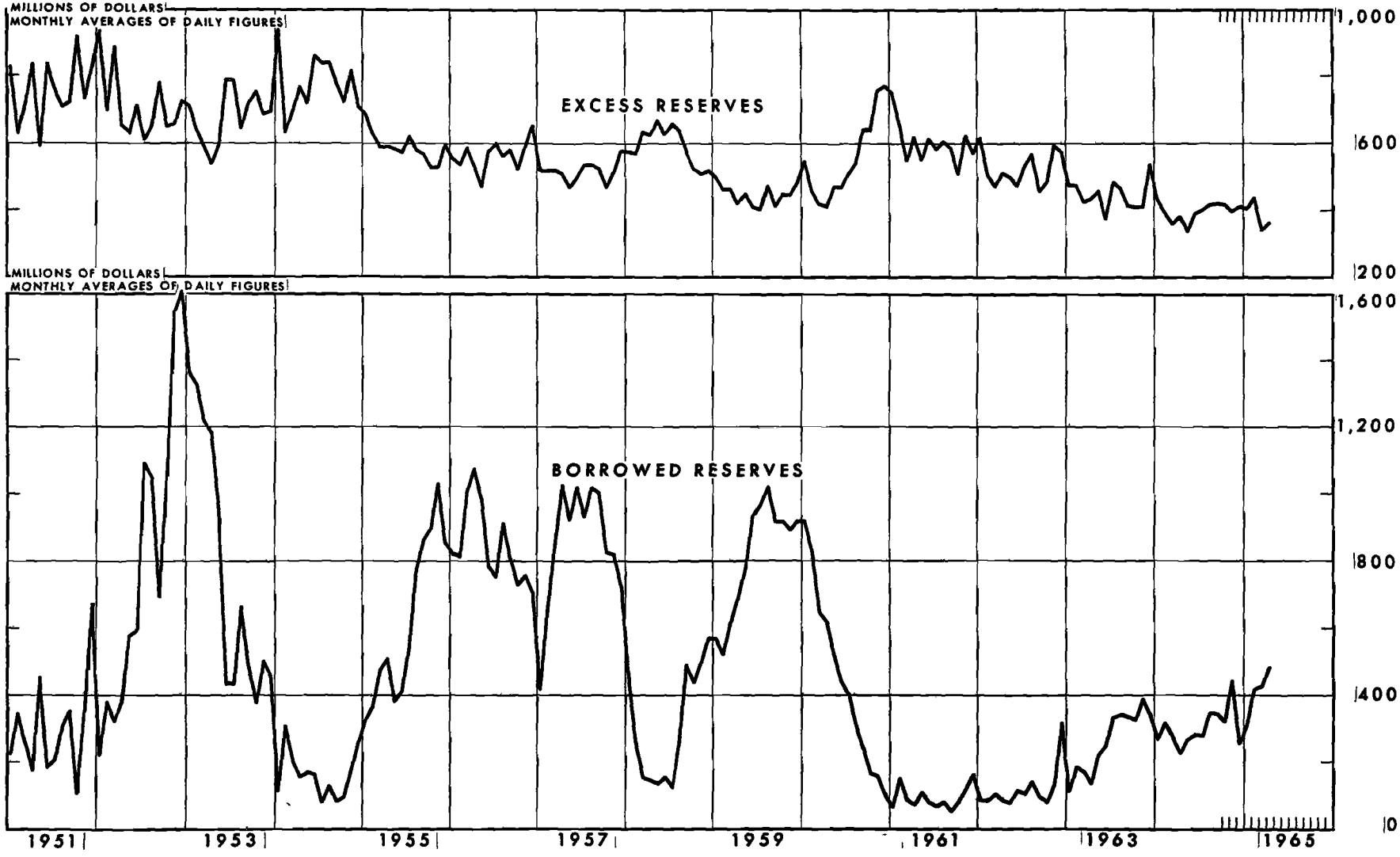
*Prepared by E. C. Ettin, Economist, Banking Section.

As the chart makes clear, changes in bank reserve pressures generally affect excess reserves less than member bank borrowings. At this stage of the current expansion, any additional restriction of reserve availability might influence excess reserves relatively little, since they are already at unusually low levels. The behavior of excess reserves within the current expansion period provides some confirmation of this possibility. Excess reserves declined more in 1962-63 than in 1964-65, even though interest rates continued to rise and reserve availability was more limited in the latter period.

5/18/65

EXCESS AND BORROWED RESERVES, ALL MEMBER BANKS

NOT SEASONALLY ADJUSTED



APPENDIX B: REVISION OF MONEY SUPPLY AND COMMERCIAL BANK TIME DEPOSITS SERIES*

The annual review of seasonal factors and benchmark corrections are nearly completed for the daily average money supply and commercial bank time deposit series. This revision is not yet ready for publication due to delay of the December benchmarks, but revised data will be used internally, subject to such further revision as may result from the new benchmarks. This will enable us to use the latest available seasonal factors and to maintain consistency with the recently revised data on member bank reserves, deposits, and the credit proxy.

When the revised series are published, the semimonthly data will be discontinued, and weekly seasonally adjusted series will be substituted. The new weekly series will be published for the period 1959 to date, the same period covered by the revision of monthly seasonal factors.

The accompanying table compares the revised and old series from 1963 to date and provides weekly data beginning with March 1965. Revisions in the monthly data are relatively small, with little effect on the patterns of growth shown by the old series. Benchmarks for June 1964 reduced the levels of money supply and time deposits by $300 and $100 million, respectively. The principal effects of changes in seasonal factors on money supply were to smooth the November-February fluctuations slightly. Changes in seasonal factors for time deposits reduced the seasonally adjusted series from November to April, with the largest reductions occurring in the first three months of the year, and increased the level of the series from August to October.

As indicated below, growth rates for the revised and old series are quite similar for 1963 and 1964. In the most recent months, the revised money supply series shows slightly smaller fluctuations than before revision, with growth from November to April at a 2.7 per cent annual rate compared to 2.1 per cent for the old series. Time deposit expansion over the same five months was at an annual rate of 15.7 on both the revised and old basis, but the January-February acceleration in growth has been revised downward slightly and expansion since February has averaged slightly higher in the revised series than in the old. Weekly seasonally adjusted figures for the two weeks ending May 12 indicate a substantial reduction in money supply from the April average, while time and savings deposits continued to expand at about the March-April rate.

*Edward R. Fry, Economist, Banking Section.

REVISED MONEY SUPPLY AND TIME DEPOSITS
(Seasonally adjusted, annual rate of change in per cent)

Period	Money supply		Time deposits	
	Revised series	Old series	Revised series	Old series
Dec. 1962-Dec. 1963	3.8	3.8	14.7	14.7
1st half 1963	3.7	3.5	13.9	13.7
2nd half 1963	3.9	4.0	14.5	14.7
Dec. 1963-Dec. 1964	4.1	4.0	12.6	12.6
1st half 1963	3.0	3.1	11.2	11.0
2nd half 1963	5.1	4.9	13.2	13.5
Nov. 1964-Apr. 1965	2.7	2.1	15.7	15.7

REVISION OF MONEY SUPPLY AND TIME DEPOSITS ADJUSTED SERIES

Seasonally Adjusted
(Dollar amounts in billions, averages of daily figures)

Period	Total Money Supply			Time Deposits Adjusted		
	Revised 1/	Old	Change	Revised 1/	Old	Change
MONTHLY						
1963--January	148.0	148.0	--	99.1	99.2	-0.1
February	148.6	148.4	+0.2	100.3	100.5	-0.2
March	148.8	148.9	-0.1	101.6	101.9	-0.3
April	149.3	149.2	+0.1	102.7	102.8	-0.1
May	149.7	149.6	+0.1	103.6	103.6	--
June	150.2	150.2	--	104.6	104.6	--
July	151.0	151.0	--	105.7	105.6	+0.1
August	151.2	151.2	--	107.3	107.1	+0.2
September	151.6	151.6	--	108.4	108.1	+0.3
October	152.3	152.3	--	109.6	109.3	+0.3
November	153.2	153.5	-0.3	111.1	111.1	--
December	153.1	153.2	-0.1	112.2	112.3	-0.1
1964--January	153.5	153.8	-0.3	113.5	113.9	-0.4
February	153.8	153.8	--	114.6	115.1	-0.5
March	154.0	154.2	-0.2	115.3	115.7	-0.4
April	154.4	154.5	-0.1	116.2	116.4	-0.2
May	154.5	154.5	--	117.3	117.4	-0.1
June	155.4	155.6	-0.2	118.5	118.5	--
July	156.5	156.7	-0.2	119.4	119.4	--
August	157.0	157.2	-0.2	120.9	120.6	+0.3
September	157.8	158.0	-0.2	122.0	121.7	+0.3
October	158.5	158.6	-0.1	123.4	123.1	+0.3
November	158.8	159.1	-0.3	125.0	125.1	-0.1
December	159.4	159.4	--	126.3	126.5	-0.2
1965--January	159.5	159.8	-0.3	128.6	128.9	-0.3
February	159.2	159.1	+0.1	130.7	131.1	-0.4
March	159.8	159.8	--	131.9	132.4	-0.5
April p	160.6	160.5	+0.1	133.2	133.3	-0.1
WEEKLY						
1965--March 3	160.3			131.3		
10	159.9			131.6		
17	160.3			131.9		
24	159.1			132.0		
31	159.3			132.3		
April 7	161.0			132.7		
14	160.8			132.9		
21	161.5			133.2		
28	159.5			133.5		
May 5 p	160.0			133.7		
12 p	159.2			134.1		

p - Preliminary
1/- Revision reflects adjustment of data to June 1964 benchmark and review of seasonal factors.

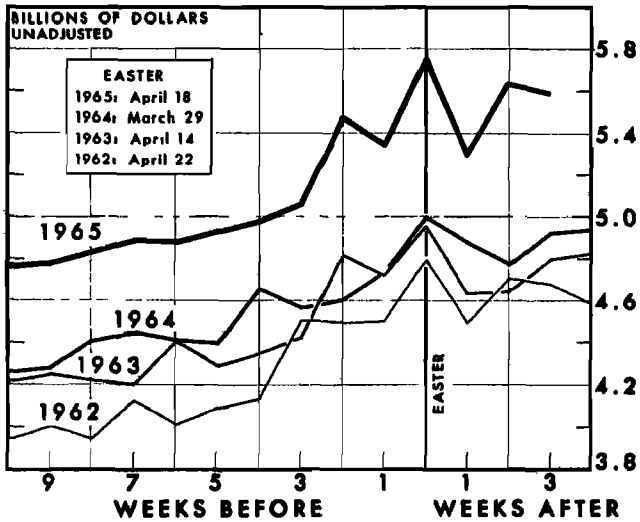
APPENDIX C: WEEKLY RETAIL SALES

Retail sales, as noted here two weeks ago, exhibited the same pattern of general but uneven rise in the eight or so weeks prior to Easter Sunday and a rather sharp decline the following week as they had in each of the three preceding years. (See top panels of the following chart.) Total sales in the second week following Easter rose rather sharply and in the third week only a little. Excluding sales of the automotive group from the total, the sharp rise of the second week continued in the third week.

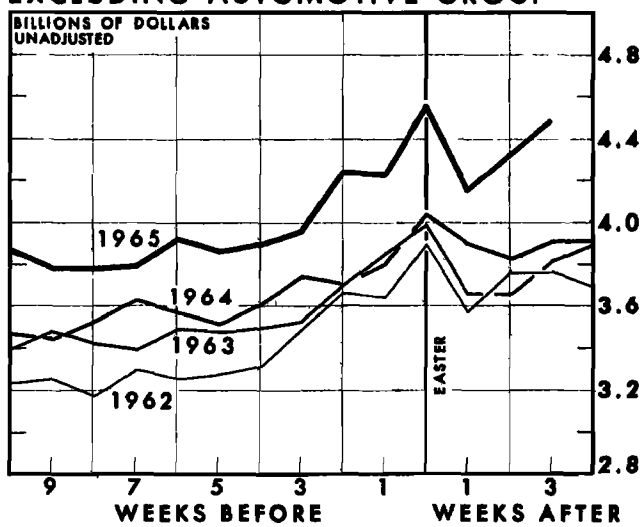
The gains in retail sales in the weeks ending May 1 and May 8 (the latest data available) are very similar to those in the corresponding weeks of the three preceding years, as is evident from the lower panels of the chart. Thus, the effect of Easter on retail sales appears to have run its course, and sales are now being affected by the usual seasonal influences for this time of year.

WEEKLY RETAIL SALES

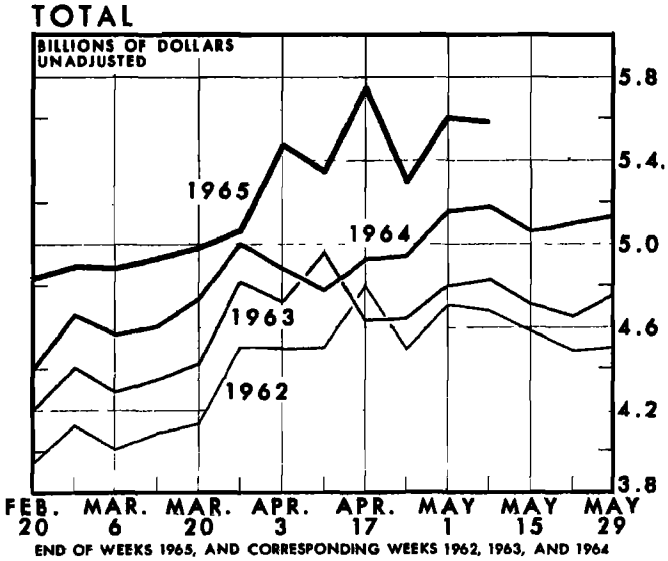
TOTAL



EXCLUDING AUTOMOTIVE GROUP

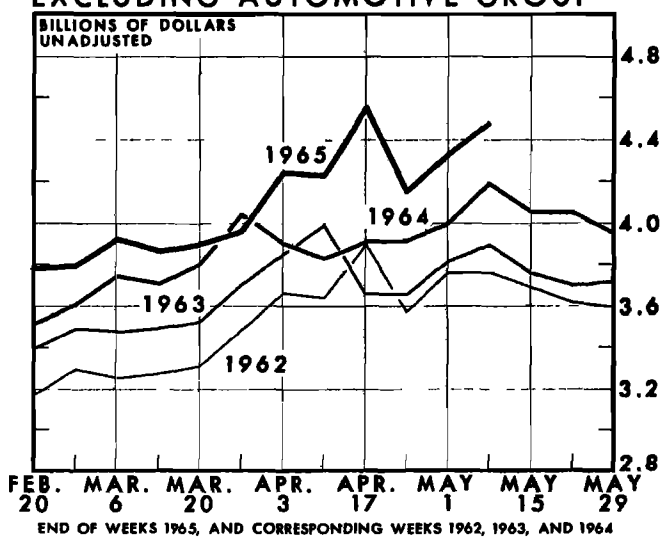


TOTAL



END OF WEEKS 1965, AND CORRESPONDING WEEKS 1962, 1963, AND 1964

EXCLUDING AUTOMOTIVE GROUP



END OF WEEKS 1965, AND CORRESPONDING WEEKS 1962, 1963, AND 1964