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Content last modified 6/05/2009.

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CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

August 4, 1965

IN BROAD REVIEW

Expansion in production and employment has continued lately, though not at such a rapid pace as early in the year. A downward adjustment in steel output in prospect after May 1 was deferred by extension of the strike deadline to September 1, and meanwhile increasing military commitments in Vietnam, though not immediately large in terms of total economic activity, have tended to strengthen the view that expansion will continue for some time yet. Inventory accumulation, which has continued at a high rate, is widely expected to be at a more moderate pace later in the year. Capital goods outlays, which have been an increasingly important feature of the expansion in activity, are generally expected to continue upward. Consumer spending was strong in July. Personal incomes will be augmented early this autumn by a retroactive increase in social security benefits.

Commodity price changes have continued to be highly selective in recent months, although from mid-March to mid-June the broad averages of prices rose appreciably, reflecting, in wholesale markets, some further increase in industrial prices but mainly a sharp runup in prices of livestock and meats. Since mid-June livestock prices have eased a little. Initial upward pressures in speculative markets in response to developments in Vietnam proved to be largely temporary, apart from copper markets.

Corporate profits continued unusually high in the second quarter. Higher after-tax earnings this year are partly attributable to the cut in income tax rates, but profit margins also have been very well maintained on this year's larger volume of sales.

Security markets have quieted recently, despite uncertainties concerning Vietnam. Stock prices have fluctuated narrowly over the past month on reduced trading volume, remaining about 6 per cent below the mid-May high. Yields on corporate and municipal bonds have dropped back a few basis points, reflecting easing of earlier congestion in new issue markets, while yields on longer-term Treasury bonds have increased slightly to about the year's high. Market reception of the August refunding appears satisfactory; partly reflecting anticipation and announcement of the refunding, bill yields declined in the latter part of July, but in recent days they have firmed somewhat.

Total bank credit seems likely to show little change for the month of July, following the very large June expansion. This difference is largely due to the extension of temporary credits of various kinds toward the end of June, however, and underlying loan trends appear to have continued strong. Recently there appears to have been a shifting in the locus of business loan demands from the New York City banks, where increases were very large earlier in the year, to banks in the other centers.

The money supply rose at a 6 per cent annual rate in July, on a daily average basis, following the very large June expansion. A reduction in the Treasury cash balance, which was only of about seasonal proportions, did not contribute to last month's rise in public money holdings, but a further reduction in the Treasury balance in August is expected to work in this direction. Time deposits also rose in July,

at a somewhat faster rate than in other recent months; increases in individuals' deposit balances probably accounted for the larger rise, since the amount of CD's outstanding declined in New York City while rising at the outlying reporting banks.

The U.S. balance of payments appears to have remained in surplus in July after allowance for seasonal influences. Trade figures for June provide further evidence of a deterioration in the trade surplus since last autumn.

August 3, 1965

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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.)	June '65	75.7	75.4	74.3	1.8	3.9
Unemployment (mil.)	"	3.6	3.5	4.0	-10.2	-13.6
Unemployment (per cent)	"	4.7	4.6	5.3	-	-
Nonfarm employment, payroll (mil.)	"	60.3	60.1	58.1	3.8	6.5
Manufacturing	"	18.0	17.9	17.3	4.2	5.8
Other industrial	"	7.9	7.9	7.7	2.7	4.9
Nonindustrial	"	34.4	34.3	33.1	3.8	7.3
Industrial production (57-59=100)	"	141.9	141.4	131.6	7.8	13.0
Final products	"	139.9	139.7	131.7	6.2	11.8
Materials	"	143.7	142.8	131.8	9.0	14.1
Wholesale prices (57-59=100)1/	"	102.8	102.1	100.0	2.8	2.5
Industrial commodities	"	102.1	102.0	100.7	1.4	1.6
Sensitive materials	"	102.4	102.3	99.1	3.3	5.8
Farm products and foods	"	103.4	101.1	97.1	6.5	4.3
Consumer prices (57-59=100)1/	"	110.1	109.6	108.0	1.9	3.3
Commodities except food	"	105.1	105.2	104.3	0.8	1.7
Food	"	110.1	107.9	106.2	3.7	4.9
Services	"	117.6	117.5	115.1	2.2	4.2
Hourly earnings, mfg. ($)	"	2.62	2.61	2.53	3.6	6.5
Weekly earnings, mfg. ($)	"	107.14	107.10	102.46	4.6	7.7
Personal income ($ bil.)2/	"	523.9	520.0	489.3	7.1	13.2
Retail sales, total ($ bil.)	"	23.3	23.4	21.8	7.0	13.7
Autos (million units)2/	"	8.8	8.1	7.4	19.5	22.0
GAF ($ bil.)	"	5.2	5.3	5.1	3.4	14.8
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,531	1,516	1,621	-5.6	-2.4
Factory workweek (hours)	"	41.0	41.1	40.6	1.0	1.2
New orders, dur. goods ($ bil.)	"	20.9	21.0	20.0	4.7	18.5
New orders, nonel. mach. ($ bil.)	"	3.1	3.1	3.0	2.7	23.3
Common stock prices (1941-43=10)1/	July '65	84.91	85.04	83.22	2.0	22.9
Inventories, book val. ($ bil.)	May '65	112.6	112.2	106.6	5.7	10.8
Gross national product ($ bil.)2/	QII-65	658.0	648.8	618.6	6.4	14.0
Real GNP ($ bil. 1964 prices)2/	"	647.5	641.5	620.2	4.4	9.8

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

August 3, 1965

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SELECTED DOMESTIC FINANCIAL DATA

	Week ended July 30	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.08	4.07	4.13	2.00
U.S. Treas. bills, 3 mo., yield (per cent)	3.81	3.84	4.00	3.77
Net free reserves 2/ (mil. $)	-154	-179	106	-232
Member bank borrowings 2/ (mil. $)	479	527	620	270
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.16	4.15	4.18	4.12
20-year U.S. Treas. bonds	4.21	4.21	4.22	4.19
Corporate new bond issues, Aaa	4.58	4.60	4.60	4.37
Corporate seasoned bonds, Aaa	4.48	4.48	4.48	4.41
Municipal seasoned bonds, Aaa	3.16	3.16	3.17	2.94
FHA home mortgages, 30-year 3/	5.44	5.44	5.45	5.44
Common stocks S&P composit index 4/				
Prices, closing (1941-43=10)	85.25	85.18	90.10	83.06
Dividend yield (per cent)	3.07	3.07	3.15	2.89

	Change in June	Average change-- last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	5/ 38	52	2.9	5.8
Bank loans and investments:				
Total	3,100	2,200	9.7	10.1
Business loans	1,200	900	18.1	18.7
Other loans	2,100	1,300	14.1	11.8
U.S. Government securities	-900	-700	-13.4	-4.0
Other securities	700	600	19.0	15.7
Money and liquid assets:				
Demand dep. & currency	800	500	3.7	3.8
Time and savings dep.	1,600	1,300	12.0	15.2
Nonbank liquid assets	400	600	3.0	4.8

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending July 28.
3/ Latest figure indicated is for month of June. 4/ Data are for weekly closing prices. 5/ Change in July (preliminary).

U.S. BALANCE OF PAYMENTS

	1965			1964				1964
	June	May	Apr.	QII	QI	QIV	QIII	Year
	Seasonally adjusted annual rates, in billions of dollars							
Balance on regular transactions				(1.0)	- 2.9	- 6.2	- 2.4	- 3.1
Current account balance					5.3	8.0	8.0	7.7
Trade balance 1/	4.0	5.5	6.4	5.3	3.7	7.2	6.7	6.7
Exports 1/	25.8	26.9	28.2	27.0	22.4	26.8	25.5	25.3
Imports 1/	-21.8	-21.4	-21.8	-21.7	-18.7	-19.6	-18.8	-18.6
Services, etc., net					1.6	0.8	1.3	1.0
Capital account balance					- 7.8	-12.5	- 9.1	- 9.7
Govt. grants & capital 2/					- 3.3	- 4.1	- 3.7	- 3.6
U.S. private direct inv.					- 4.0	- 3.3	- 2.2	- 2.4
U.S. priv. long-term portfolio					- 2.7	- 3.3	- 2.4	- 2.0
U.S. priv. short-term					1.2	- 2.3	- 1.6	- 2.1
Foreign nonliquid					1.0	0.4	0.8	0.4
Errors and omissions					- 0.4	- 1.7	- 1.2	- 1.2
	Monthly averages, in millions of dollars							
Deficit on regular transactions (seas. adjusted)				(- 80)	244	517	198	259
Additional seasonal element				(- 17)	172	- 1	- 143	---
Financing (unadjusted)	- 65	- 60	- 140	- 63	72	518	340	259
Special receipts 3/	0	0	0	(25)	22	52	1	29
Liabilities increase								
Nonofficial 4/	61	- 193	- 50	- 61	57	217	187	129
Official 5/	216	- 38	- 328	- 50	- 287	300	129	86
Monetary reserves decrease	- 342	171	238	22	281	- 50	23	14
of which: Gold sales	(313)	(117)	(159)	(196)	(277)	(57)	(- 7)	(10)
[Memo: Official financing] 6/	(- 126)	(133)	(- 90)	(- 3)	(15)	(301)	(153)	(129)

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

Prices. Prices for basic commodities, particularly in markets for futures, rose moderately during the period of high-level U.S. consultations on increased military activity in Vietnam. Prices of copper, already in short supply, approached earlier highs in both the New York and London markets. Following the President's announcement of decisions, however, prices generally eased somewhat as the size of the increase in defense spending apparently was below the common expectations.

The general wholesale price index has edged down since mid-June following its rise of 1.5 per cent from mid-March. Foodstuffs, which account for most of this year's rise in the total, reached a peak in late June and then declined somewhat reflecting similar behavior on the part of livestock and meats. Industrial prices rose only 0.1 per cent from mid-May to mid-June, with producers' equipment up slightly further while consumer goods and industrial materials were unchanged. The index apparently edged up 0.1 per cent further to late July, and at 102.2 per cent of the 1957-59 average, it is now about 1.5 per cent higher than last summer.

The consumer price index rose 0.5 per cent further in June, and the increase through the second quarter -- from March -- amounted to 1.0 per cent. To an even greater extent than in April and May, the rise in June reflected increases for foods. Retail prices of meats rose sharply -- by 7 per cent. Fresh fruits and vegetables rose 6 per cent further, and the total for foods increased 2 per cent. All items less foods averaged unchanged as services increased only a little and nonfood commodities

declined slightly. The first price decreases attributable to the excise tax reductions appeared as new car prices fell 2.8 per cent and, owing mainly to elimination of the tax on air conditioners, the index for household durable goods declined 0.5 per cent.

Industrial production. The industrial production index, which rose 0.5 point further in June -- with the rise largely accounted for by an increase in materials -- apparently rose further in July. Limited data suggest that output of business and defense equipment increased while auto assemblies held close to the June annual rate of 9.5 million units, increasing dealer inventories further. Steel production showed much less than the usual seasonal decrease, and the seasonally adjusted index for steel was up appreciably from the second quarter level, with some output still going with inventory.

In the second quarter the pace of expansion in industrial output slowed to an annual rate of about 4 per cent, about half the rate in the preceding year and a quarter. Continued rapid expansion in output of equipment provided the main upward momentum. The increase in business equipment production in June was very small, but it followed a fairly large increase in May, and for the quarter as a whole, the earlier rate of increase was maintained. Prospects appear favorable for a sustained high level or further increase; both new and unfilled orders for machinery and equipment were up appreciably further in the second quarter. Production of ordnance and some other defense equipment apparently rose following a one-month bulge in new orders in April.

Output of consumer goods has shown little net change since early in the year. Auto assemblies in May and June were moderately

below the March peak and unchanged from the first quarter average. Production of appliances and some other home goods also was down from a March peak but about the same as in January and February. Apparel production was virtually stable through the first half of the year. Even production of consumer staples changed little through that period.

Output of materials rose further during the second quarter, mainly as a consequence of increases in equipment parts and steel. Production of such basic materials as textiles, paper, chemicals, petroleum products, and clay and glass products showed little change.

INDUSTRIAL PRODUCTION
(Seasonally adjusted)

	June 1965 1957-59 = 100	Per cent increase from March 1965	Per cent increase from June 1964
Total	141.9	1.0	7.8
Consumer goods	138.0	-0.9	4.9
Autos	187.1	-3.7	15.7
Home goods	150.9	-1.4	9.5
Apparel	130.0	-1.1	5.3
Staples	131.6	-1.1	2.1
Business equipment	153.7	2.7	10.6
Materials	143.7	1.7	9.0

Personal income and spending. Personal income rose $4 billion in June to a seasonally adjusted annual rate of $524 billion, 7 per cent higher than a year earlier. A further moderately large gain in wages and salaries and sharp rises in farm proprietors' income and corporate dividend payments accounted for nearly all of the June advance.

Half of the June rise was in wages and salaries, with increases widespread. Farm proprietors' income rose sharply to the highest level since 1952, reflecting mainly a rapid rise in livestock prices. The jump in dividends was due mainly to an extra dividend payment by a major auto producer.

Retail sales declined slightly in June despite the substantial rise in personal income. The decline was primarily at general merchandise stores; dollar sales at food stores increased, partly because of higher prices.

In the second quarter personal consumption expenditures rose only $5 billion following an unusually large increase of $11.6 billion in the first quarter. Spending for nondurable goods and services increased somewhat more than in the first quarter, but spending for autos and parts fell short of the first quarter total as automobile buying declined from the phenomenal first quarter rate. Consumption expenditures rose less than disposable personal income and the spending rate declined from the unexpectedly high 93.3 per cent rate of the first quarter to a more usual rate of 92.9 per cent.

In July retail sales rose about 1-1/2 per cent to a new high, according to a preliminary estimate based on data for four weeks. Sales at nondurable goods stores on balance were up a little with moderate gains for most types of stores. Sales at durable goods stores were up about 2 per cent, with automotive stores and furniture and appliance stores showing unusual strength.

Auto sales and stocks. Sales of new domestic autos in the first 20 days of July were equal to a month earlier, after allowance for normal seasonal decline, and 16 per cent above a year ago. If this pace continued through the month, July's seasonal adjusted rate was about 8.3 million cars per annum, down from 8.8 million in June but equal to the average monthly rate to date in the current model year and moderately above the April and May rates. In the last 10 days of June sales were boosted by terminating dealer contests.

Dealer inventories of new cars on July 20 were 5 per cent higher than at the end of June and 10 per cent above a year ago. They represent 56 days' supply at the July selling rate, an unusually high level. The model changeover, now in progress, will be longer this year allowing more chance to liquidate stocks.

New car prices, which normally decline moderately in this season, dropped 2.8 per cent in June to a level 3.4 per cent below June 1964 as the excise tax was cut from 10 to 7 per cent of wholesale value. Used car prices rose 1.3 per cent over May to their level a year ago.

Consumer credit. Despite some slowing in June, instalment credit expanded at a little faster rate in the second quarter than in the first. The June increase was $602 million, an annual rate of $7.2 billion. The rate for the second quarter as a whole was $8.1 billion, up from $7.8 billion in the first quarter.

NET CHANGES IN INSTALMENT CREDIT
(Seasonally adjusted annual rates, in billions of dollars)

January	8.0
February	7.7
March	7.6
April	8.9
May	8.0
June	7.2
First quarter	7.8
Second quarter	8.1

The slower tempo for June as compared with May reflected changes in personal loans and nonauto goods credit. Auto credit was maintained by heavy sales of both new and used cars; also, the proportion of cars purchased on credit was somewhat larger than usual.

Personal loans in June were up $162 million, a sizable increase by most past standards but not so large an increase as occurred either in April, when there was heavy tax borrowing, or in May.

Noninstalment credit increased $122 million in June, with single payment loans accounting for more than half the rise. At the end of the month total consumer credit outstanding had reached almost $80 billion, a level 11 per cent higher than a year earlier.

Orders for durable goods. New orders for durable goods stabilized in June after a 5 per cent drop in May. The May decline reflected large decreases for steel and defense products. In June, new orders for defense products declined moderately further but steel orders rose -- at least temporarily -- from the low May level and new orders for most other durable goods changed little.

Unfilled orders for durable goods continued to expand in June, with most of the rise for the month representing further growth in machinery backlogs. Unfilled orders for durable goods are now somewhat higher relative to shipments than they were a year ago.

New orders for defense products bulged in April -- taking the total for durable goods up to a new peak -- and, despite a large decline after April, the second quarter defense total was considerably above the first quarter. This large rise in defense orders -- and a more moderate further gain in new orders for machinery and equipment -- offset a sharp drop in steel orders, and total new orders for durable goods in the second quarter were unchanged from the first quarter.

	Per cent change in new orders from 1st to 2nd quarter
Durable goods, total	0
Iron and steel	-19
Defense products	10
Machinery and equipment	3
All other	0

Manufacturers' inventories. Inventory accumulation by manufacturers was somewhat larger in June than in earlier months this year. The June book value increase totaled $340 million as compared with increments averaging $265 million a month from January through May.

This moderate step-up came from a sizable increase in the rate of accumulation by durable goods producers, chiefly of work-in-process stocks. Accumulation of steel stocks by steel users slowed further, and the book value of durable materials and supplies -- which had

increased sharply over the period of rapid accumulation of steel stocks -- showed little change in June. At steel mills, finished steel stocks recovered moderately further from their sharply reduced April level -- steel mills had shipped out everything they could lay their hands on just before the May 1 strike deadline.

For the second quarter, the book value of manufacturers' inventory accumulation totaled $900 million, up from $765 million in the first quarter. Durable goods producers accounted for all that accumulation in the second quarter and for 3/4 of the first quarter rise; and accumulation of steel stocks -- now coming to an end -- was a major factor in both quarters.

Residential building. Seasonally adjusted private housing starts, which had dipped in May, turned slightly upward again in June. At 1.53 million, including farm starts, the annual rate was the same as for the second quarter as a whole. This was 4 per cent above the recent low reached in the first quarter and just under the average for all of 1964.

While starts in the North Central states accounted for most of the second quarter rise, starts in the Northeast and South also showed some increase and the rate in the strategically important West was unchanged after more than a year of continuing decline.

In the nation as a whole, seasonally adjusted building permits changed little in June from the upward revised rate for May. Permits for single family buildings declined somewhat, but multifamily permits

recovered further and, while still well below earlier highs, were up appreciably from the recent low of last December.

PRIVATE HOUSING STARTS AND PERMITS

	June (thousands of units) 1/	Per cent change from	
		Month ago	Year ago
Starts (total)	1,531	1	-6
Permits (total)	1,241	--	-5
1 -family	702	-3	-3
2-or-more-family	539	4	-7

1/ Seasonally adjusted annual rate; preliminary.

Rental vacancies edged down in the second quarter of the year to 7.5 per cent of units available and fit for use. The average was only slightly higher than a year earlier and compared with a post-war peak of 8.1 per cent in the second quarter of 1961. The second quarter dip reflected mainly a decline within metropolitan areas to nearly the year earlier average -- 7.2 per cent. Outside such areas, the average rose, but the rise appeared to be less than seasonal.

Within individual regions, shifts from the first to second quarter tended in part to reflect seasonal influences. However, average vacancy rates in the Northeast and particularly the West continued unusually high in relation to earlier levels for those regions. In the South and North Central states, on the other hand, the second quarter rates were the lowest in recent years.

Last week, the $7.5 billion omnibus housing bill was sent to the President. The bill extends for four years all basic FHA programs

and introduces a number of innovations, including a new land-development loan program, a new veterans' preference program for cold war dischargees and a rent subsidy program for those eligible for public housing. It will probably be some time before the impact of these innovations on housing developments will be felt directly.

Labor market. Employment in nonfarm establishments increased substantially further in June, and at 60.3 million, seasonally adjusted, was 2.2 million higher than a year earlier. An increase of 200,000 in June followed a rise of about the same amount in May. Manufacturing accounted for nearly half of the rise and the increase there was again largely concentrated in the metals and metal-using industries. In addition, the usual large gains occurred in services and State and local government.

The increase in nonfarm jobs since December has been substantial -- in excess of a million. Factory jobs increased nearly 400,000, more than twice as much as in the first six months of last year, to 18.0 million. The sharper rise reflected stronger demands for consumer durables -- mainly automobiles -- and for capital equipment. Employment in defense industries also showed an increase, in contrast to the cutback in the first half of last year. Nondurable goods employment increased moderately both this year and last.

Outside manufacturing, trade and State and local government employment advanced more sharply this year. In construction, on the other hand, employment in June was 30,000 below year-end, whereas it had risen

in the comparable period a year earlier. Construction employment in June was nevertheless 100,000 above the level a year ago.

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

	Dec. 1964 to June 1965	Dec. 1963 to June 1964	June 1964 to June 1965
Total	1,100	813	2,202
Manufacturing	383	170	720
Metal-using 1/	283	90	505
Other durables	31	19	71
Nondurables	69	61	144
Construction	- 29	116	109
Other industrial 2/	47	-25	100
Trade	285	237	460
Service and finance	194	182	371
Government	220	133	442

1/ Includes ordnance, primary and fabricated metals, the machinery industries, and transportation equipment.
2/ Other industrial includes mining, transportation and public utilities.

Labor costs. Labor costs per unit of output in manufacturing edged up again in June and the second quarter average was a little above the initial quarter; it was still slightly below a year ago. The small first to second quarter increase in costs primarily reflected continuing increases in total compensation per man-hour in a period of less rapid increase in manufacturing output and productivity.

Labor market areas. In June, 7 of the 150 major labor market areas were shifted to lower unemployment-rate categories, reflecting recent gains in employment, especially in durable goods. Four of these

areas moved into the 1.5 to 2.9 per cent unemployment rate class, bringing the number of major markets in this category to 40, the largest number since July 1957 and double the number a year earlier.

Major areas with 6 per cent or more of the labor force unemployed numbered 21 in June, 16 fewer than a year earlier and less than at any other time since early 1957. The 19 areas still classified in the 6 to 9 per cent unemployed category include 7 primarily coal mining areas in Appalachia, 4 chiefly textile areas in Massachusetts, 5 mainly defense areas in California, and 3 other widely dispersed areas. Two areas in Puerto Rico remained in the very substantial labor surplus category with unemployment rates of more than 12 per cent.

Gross national product. Gross national product rose $9 billion in the second quarter to a seasonally adjusted annual rate of $658 billion, according to Commerce preliminary estimates. In terms of constant prices this was 4.5 per cent higher than a year earlier. The second quarter rise, although substantially less than the $14 billion increase in the first quarter, was larger than had been generally expected.

A notable feature of the second quarter was a $1.6 billion increase reported for Federal Government purchases of goods and services, after three quarters of decline. This rise stemmed largely from an estimated $1 billion advance in the rate of defense spending -- partly reflecting Vietnam, particularly in June -- and from an increase in CCC spending.

Total private domestic investment was little changed. Residential construction outlays were unchanged from the first quarter, while business spending for construction was up sharply because of increased industrial and commercial building. Outlays for producers' durable equipment were off slightly due to reduced automobile buying by businesses. The reported increase in business inventories -- at a $5.7 billion annual rate, with farm stocks down slightly -- was substantial but about $1 billion less than in the first quarter.

Personal consumption expenditures, as already noted were up only about $5 billion in the second quarter; they were at a rate $27 billion or 7 per cent above the second quarter of last year.

Net exports, rebounding from the effects of the dock strike in the first quarter, were estimated to be $2 billion higher in the second quarter. State and local government outlays for goods and services increased only moderately.

Farm income. Rising prices received for meat animals in April, May, and June raised farm income prospects for 1965. Realized net income for the second quarter was estimated at a seasonally adjusted annual rate of $15.0 billion, up $2.4 billion from the first quarter and $2.0 billion from the second quarter a year ago. The increase in gross receipts outpaced that in production expenses. With prospects for continued strength in meat animal prices and for relatively stable crop prices and a harvest larger than in 1964, realized net farm income in 1965 may turn out to be the highest since the $13.7 billion of 1953. In the last 4 years realized net income has ranged from $12.5 to $12.9 billion.

In the second quarter, increases in cash receipts and government payments both contributed to a 7 per cent gain in gross realized income over a year earlier. Gains in cash receipts from sales of livestock and products reflected higher prices. Meat animal prices were a fifth above the low second quarter prices of 1964 while meat production was 6 per cent less. Dairy and poultry product prices were moderately higher even though marketings were also a little higher. For crops, prices in the second quarter were about equal to a year ago and volume of marketings was 6 per cent larger. Larger government payments reflected increased participation in the feed grain and cotton acreage retirement programs and an increase in the proportion of the price support on wheat that is made through payments.

Production expenses in the second quarter were somewhat higher than a year earlier. Feed prices were up a little and purchased livestock prices were sharply higher than a year ago. The long-run uptrend in overhead costs continued.

Livestock situation. Cattle feeding turned up in May and June in response to the profitable feeding margins this year following two unprofitable years. Placements of cattle on feed during the second quarter a fourth larger than a year earlier brought the inventory of cattle on feed to 7.5 million head, 9 per cent more than in mid-1964. Production of fed beef is expected to stay above year-earlier levels through out the remainder of 1965. Prices are also likely to be well above year-earlier levels reflecting income gains, population growth, and smaller pork supplies.

All evidence points to a continuation this fall of the decline in hog production underway since the spring of 1964. The combined spring and fall pig crops of 1965 are indicated to be 9 per cent below 1964 and 15 per cent below 1963. Pork production during the remainder of 1965 will probably be 10 per cent below year-earlier levels. Hog prices are expected to decline seasonally this fall but only to levels well above those of last fall. If producers respond to favorable price ratios as in the past, expansion in hog production may begin in 1966.

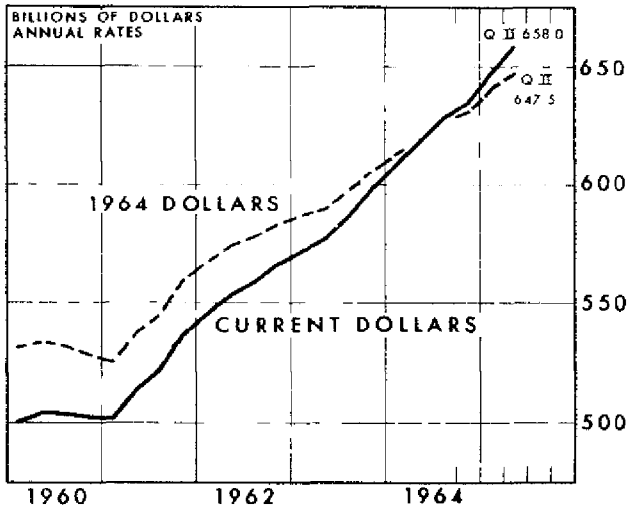
Broiler production has increased sharply in recent weeks. The very large expansion has prompted the Department of Agriculture to warn this industry against overexpansion.

Expansion in cattle feeding may be the major cause of a recent acceleration in short-term debt of farmers, following a year and a half of slackening rate of expansion. Outstanding loans of PCA's for the country have shown a more rapid rate of increase since March; in the Corn Belt acceleration began earlier and was larger.

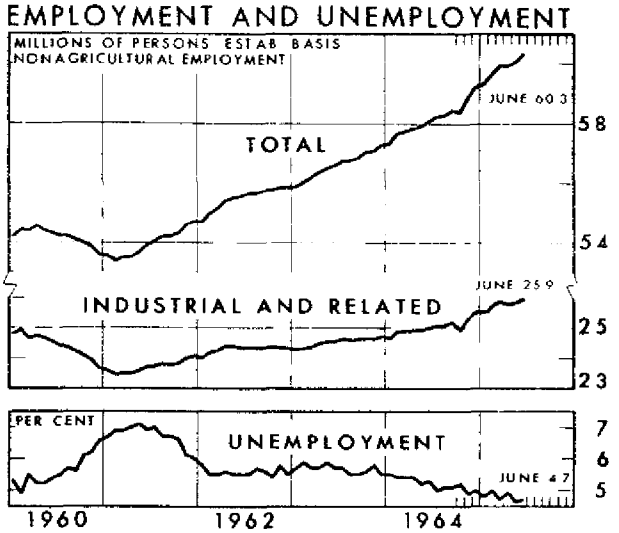
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

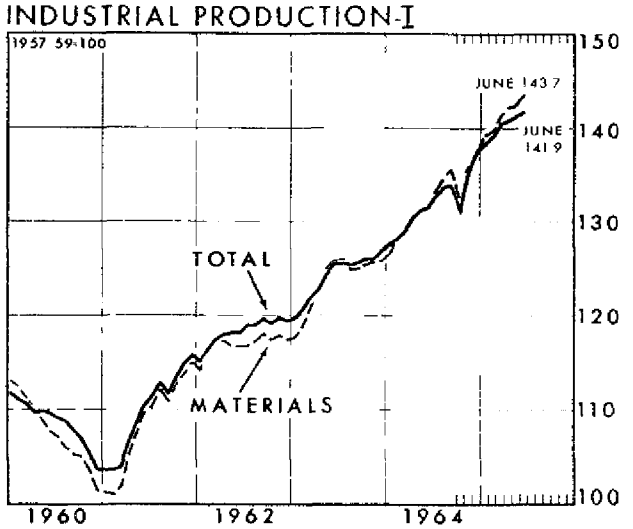
GROSS NATIONAL PRODUCT



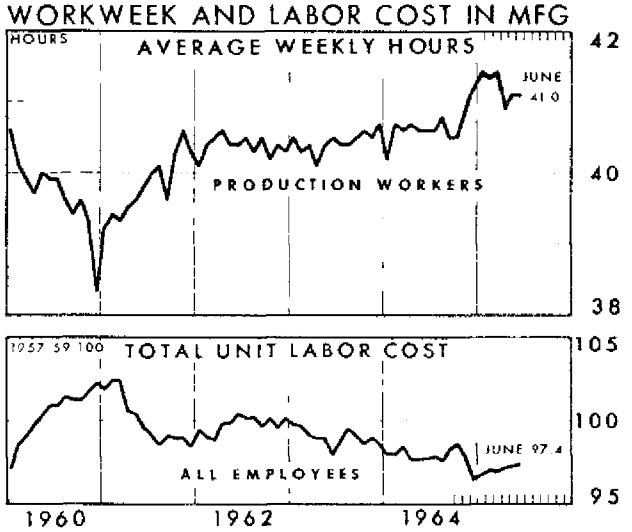
EMPLOYMENT AND UNEMPLOYMENT



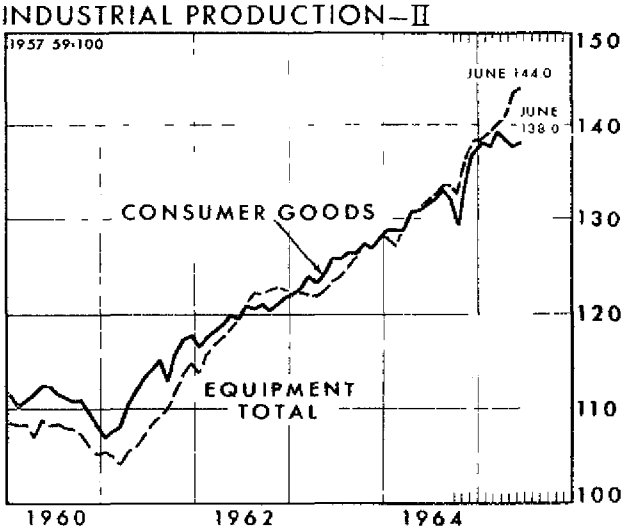
INDUSTRIAL PRODUCTION-I



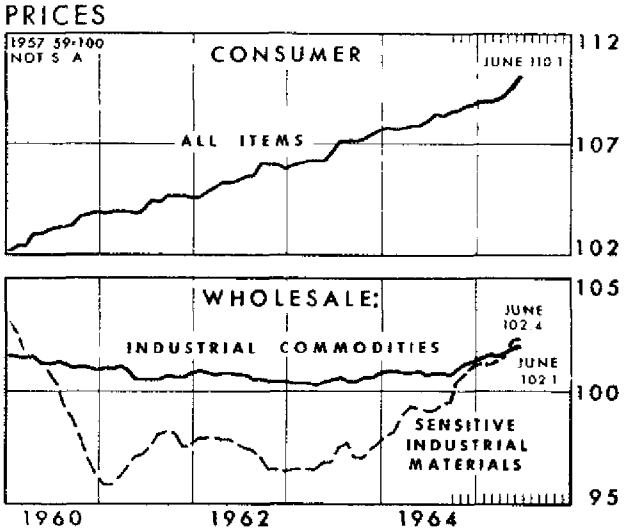
WORKWEEK AND LABOR COST IN MFG



INDUSTRIAL PRODUCTION—II



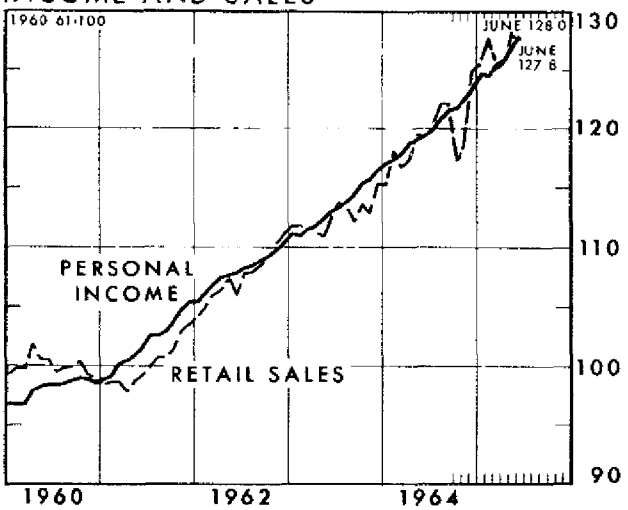
PRICES



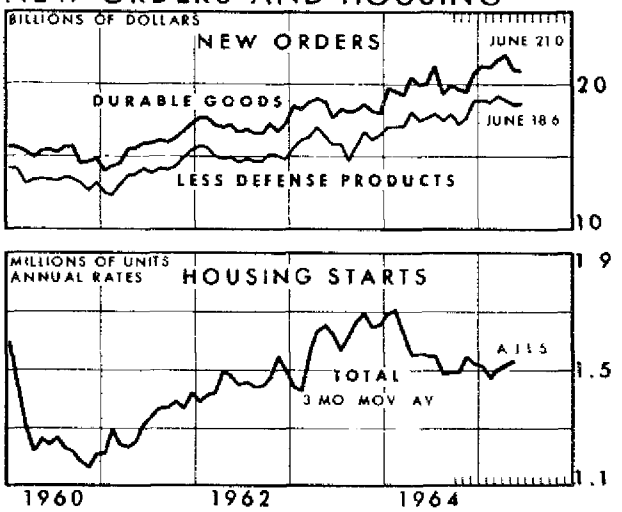
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

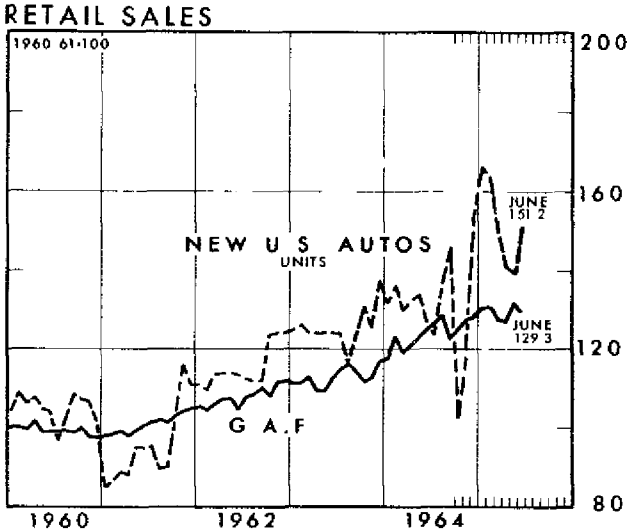
INCOME AND SALES



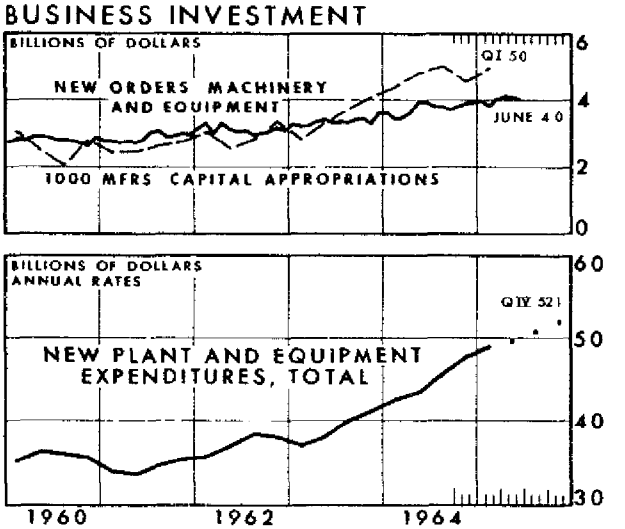
NEW ORDERS AND HOUSING



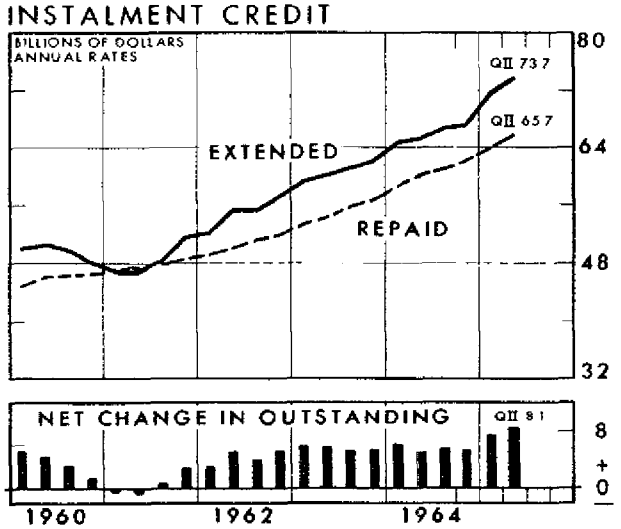
RETAIL SALES



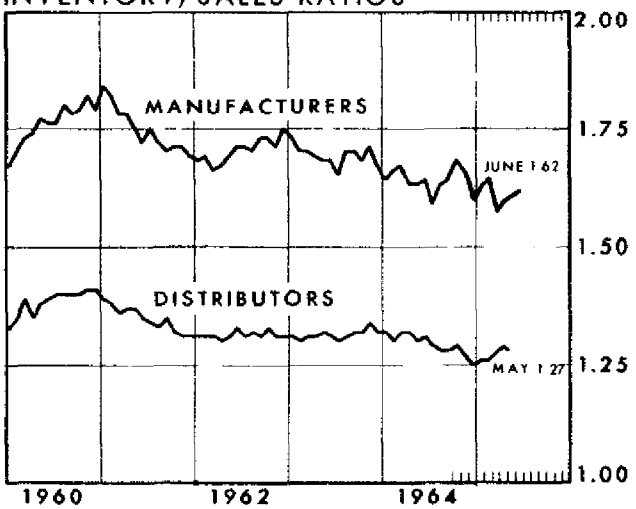
BUSINESS INVESTMENT



INSTALMENT CREDIT



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

Bank credit. A significant seasonally adjusted August expansion of bank credit seems in prospect, although the rise is likely to be less than the extraordinary increase of August a year ago. Loans and investments of weekly reporting member banks showed a contraseasonal rise of $550 million during the first two weeks of August.

Continued marked increases in loan portfolios were the chief feature of the credit expansion at reporting banks. Government security holdings declined, but total investments changed little -- as holdings of municipals and other securities registered an offsetting gain. (Purchases of other securities were heaviest at banks outside New York City, where savings accounts and other time deposits rose rapidly.) Though the growth of total loans over the two weeks was no larger than last year, it was substantially greater than in the comparable period of most earlier years.

As in other recent months, the major source of the rise in loan volume during early August was heavy business credit demands. Manufacturers of durable goods continued to add large amounts to their indebtedness to banks, and wholesale trade firms also were heavy borrowers. Increasing outlays for inventories and fixed capital, which have increased external financing requirements of firms in these industries throughout 1965, may thus be continuing in August.

In meeting demands for loan accommodation by business and other customers this year, banks have cut deeply into their portfolios

So far in July, most industrial categories of business loans have shown less than seasonal declines. As in June, however, loans to metal and metal products firms showed no particular strength and commodity dealer loans declined more than seasonally.

Real estate and consumer and other loans at weekly reporters during this period grew about the same as in the comparable period last year.

Over the first three weeks in July, nearly all of the relatively heavy liquidation of Treasury securities by reporting banks was accounted for by those outside of New York; these banks recently have had heavier business loan demands and a smaller runoff in financial loans. On the other hand, holdings of other securities continued to increase by about equal amounts in New York and other banks. There is some indication that the June-July increase, at least in New York, represents a temporary commitment of funds pending the anticipated increase in loan demand this fall.

Money supply and time deposits. Growth in the seasonally adjusted money stock moderated in July to an estimated annual rate of about 6 per cent. The July expansion brought the increase in the money stock since the first of the year to a seasonally adjusted annual rate of 3.1 per cent.

The July expansion in the privately held money stock did not receive significant support from the rundown in Treasury deposits, since this has been about seasonal since midyear. It is likely, however, that a further decline of Treasury balances will contribute to growth in the seasonally adjusted money stock in August.

Time deposit growth accelerated last month to an estimated annual rate of over 14 per cent, the highest since February. Most of the pickup probably occurred in deposits of individuals, since expansion of CD's at reporting banks was not as large as in other recent months. New York City banks, in particular, have recently been less aggressive in seeking such deposits and their outstandings have remained below their mid-June peak.

Banks outside of New York, facing heavier loan demand, increased their outstanding CD's by over $175 million the first three weeks of July. The level of CD's outstanding at these banks has grown $530 million since mid-June, after several months of stability. The greater success of outlying banks in the CD market probably reflects the slower pace of CD sales by New York City banks, a situation which could be reversed again if New York City banks become more aggressive CD issuers in the fall.

Bank reserves. During July, weekly net borrowed reserves of member banks fluctuated over a wider range than in June but averaged about the same--a little under $180 million.[1/] Borrowings and excess reserves both averaged about the same as in June.

The effective rate on Federal funds was 4-1/8 per cent on 12 of the 19 trading days during the July reserve period, and 4 per cent on all but one of the remaining days.

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

Corporate and municipal bond markets. Congestion evident in corporate and municipal bond markets earlier this summer has eased in recent weeks. The yield series on new issues of corporate bonds, which had turned down slightly in late June, has since stabilized at a level about 2 basis points below its mid-June peak of 4.60 per cent. And yields on seasoned municipal bonds have edged off several basis points since early July.

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	4.60(6/11)	4.48(7/30)	3.17(7/8)	3.30(7/1)
Low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(2/11)
Week ending June 11	4.60	4.46	3.16	3.25
" " July 2	4.58 1/	4.47	3.17	3.30
" " July 30	4.58	4.48	3.16	3.25

1/ Week ending June 25.

The supply of new corporate bonds expected to reach the market in the weeks remaining to Labor Day is down substantially from the heavy volume of new offerings witnessed in the spring and early summer. But volume scheduled for August is still rather large for late summer, and investors have tended to resist buying new issues being reoffered at yields on the low side of prevailing averages. In instances where investor resistance has developed, underwriters have nevertheless

achieved ready distribution of their remaining holdings, by making only minor upward yield adjustments. Unsold syndicate balances are consequently quite moderate.

BOND OFFERINGS[1/]
(In millions of dollars)

	Corporate				State and local govt.	
	Public offerings		Private placements			
	1965[e/]	1964	1965[e/]	1964	1965[e/]	1964
Jan.-Aug. average	447	339	609	463	936	927
June	715	468	800	623	972	939
July	540	234	500	411	1,000	943
Aug.	300	183	500	433	700	799

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

In the municipal bond market easing of earlier congestion has reflected a sharp and partly seasonal cutback in the immediate volume of new offerings from the unusually large July total, and a moderate reduction in dealer's advertised inventories below the record early June level of $900 million. This latter liquidation was accomplished only after a substantial markup in yields on older issues, however, and inventories still total nearly $750 million.

Corporate profits. Corporate profits before taxes, which reached an all-time peak of $64.3 billion (seasonally adjusted annual rate) in the first quarter of this year, probably remained at just about this same rate in the second quarter, though total manufacturing earnings may have declined slightly.

Data now available on profits after taxes of over 600 large companies show moderate to large increases in almost every manufacturing industry. For manufacturing as a whole, after-tax profits appear to have been about 17 per cent larger than in the second quarter of last year. This follows a year-to-year rise of 22 per cent in the first quarter. One element in these increases, of course, is the further cut in Federal income tax rates this year.

A 17 per cent increase in after-tax profits of manufacturing companies would suggest a year-to-year rise of about 13 per cent in their before-tax profits. This is slightly smaller than the seasonally adjusted rise that had already occurred between the second quarter of last year and the first quarter of this year, but the implied decline from first to second quarter this year is much less than many had projected. Such data as are available suggest that the better-than-expected performance of manufacturing profits reflected some further increases in profit margins accompanying the larger-than-projected volume of business done.

Stock market developments. Stock prices during the past month have fluctuated in a narrow range, showing no significant net change. At Tuesday's close of 85.46, Standard and Poor's index of 500 stocks was about 6 per cent below its mid-May high and 4.5 per cent above the lowest point reached in the June decline. Trading activity on the New York Stock Exchange was light to moderate during July with an average of 4 million shares traded per day.

Total stock market credit as reported by the New York Exchange and weekly reporting member banks showed no change in June, remaining at $7.1 billion despite the sharp break in market prices. Data provided by the Stock Exchange Margin Panel, however, indicate a significant decline in debit balances in customers' margin accounts. This universe total (blown up from accounts of 245,000 customers at firms whose bookkeeping is processed by electronic equipment) is estimated at $4.6 billion for the end of June -- down $130 million during the month. Margin panel estimates of credit in margin accounts differ from total customer net debit balances reported by stock exchange firms -- which remained constant at $5.1 billion in June -- by excluding debt in subscription accounts and credit extended in connection with cash transactions to be settled within the usual three-day period. Transactions volume was heavy toward the end of June, which suggests that a temporary bulge in this latter type of credit was a major factor preventing a decline in reported stock market credit totals in that month.

Margin panel data also indicate the extent to which price declines in June increased the vulnerability of customer credit to margin calls. The table below shows the status of net debit balances in margin accounts distributed according to the customer's equity in his collateral.

STATUS OF NET DEBIT BALANCES IN MARGIN ACCOUNTS

Customer's per cent equity	Per cent of total balances		
	1963	1965	
	November	April	June
70 and over	15.5	36.1	26.0
60-69	13.5	25.5	28.9
50-59	28.0	20.6	19.7
Less than 50	43.0	17.8	25.4

After margins were raised to 70 per cent in November 1963, margin account debt was upgraded very sharply in the year and a half of continued price increases which followed. More recently, declining stock prices have produced some deterioration in margin status as can be seen by comparing the June and April distributions. With average prices falling 5.6 per cent between the end of April and the end of June, the share of debt most likely to become vulnerable to call -- that margined at less than 50 per cent -- rose moderately from 18 to 25 per cent. But for most stock market credit, customers' equities continue to provide substantially more buffer against maintenance margins (which range from 25-33 per cent at most firms) than in late 1963, when 43 per cent of net debt was margined below 50 per cent.

Mortgage markets. In June, the FHA-secondary market yield series, at 5.44 per cent, was little different from the average for the period since April 1963. Contract interest rates for conventional first mortgages on homes, as reported by the Federal Housing Administration, also remained about unchanged in June, at 5.80 per cent for new home loans and 5.85 per cent for loans on existing houses.

Loan-to-price ratios and maturities on conventional first mortgages for new homes in June were generally somewhat less liberal than in either the previous month or in June of 1964. Also, average loan amounts were only slightly higher than a year earlier. In the case of existing home loans, however, some further year-to-year liberalization was still continuing, as shown in the table.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASE

	May	June	Per cent increase in June 1965 from a year ago
New home loans			
Purchase price ($1,000)	24.7	24.0	+2
Loan/price (per cent)	74.4	73.9	-1
Maturity (years)	24.9	24.6	-3
Existing home loans			
Purchase price ($1,000)	19.7	20.0	+4
Loan/price (per cent)	71.9	72.1	+2
Maturity (years)	20.3	20.6	+2

Mortgage debt expansion in the second quarter of the year apparently moderated appreciably from the record rate reached a year earlier and, while still quite large, was below any second quarter since 1962. As in the first quarter of this year, the moderation reflected mainly a reduced rate of expansion in the holdings of savings and loan associations. But, unlike developments since early 1964, indications are that none of the other major financial institutions did more than match their year-earlier pace.

MORTGAGE DEBT OUTSTANDING BY TYPE OF HOLDER
(Billions of dollars without seasonal adjustment)

	Amount P 6/30/65	Increase in second quarter of 1965 p	1964 p	1963
All holders	325.1	$7.7	$8.6	$8.1
Financial institutions	251.5	5.9	6.5	6.9
Commercial banks	46.0	1.4	1.4	1.7
Mutual savings banks	42.4	.9	1.0	.9
Savings and loan assoc.	105.7	2.6	3.0	3.5
Life insurance companies	57.3	1.0	1.0	.8
Federal agencies	11.7	.1	--	-.7
FNMA	4.4	-.1	-.1	-.6
Individuals and others	62.0	1.6	2.1	1.8

A factor in the reduced rate of mortgage debt expansion has been the lower level of residential -- especially multifamily -- starts this year. Also, net savings inflows to major lending institutions have tended to fall below year-earlier levels in recent months, and pressure on lenders to follow more selective loan-originating policies has increased.

On a seasonally adjusted basis, expansion in mortgage debt approximated an annual rate of $28 billion in the second quarter of the year, compared with a record $31.5 billion reached in the second quarter of last year. Then expansion in home debt had already begun to moderate somewhat, but the rate of net additions to debt on multifamily and commercial properties was still rising. Since then, both types of debt have grown less rapidly.

U. S. Government securities market. The Treasury announced the terms of its August refinancing on July 28 and early market reaction pointed to a successful operation. The Treasury is offering two issues in exchange for $7.3 billion of maturing notes, of which $3.2 billion are held by the public. The exchange options include a new 18-month note priced to yield 4.10 per cent and the reopened 4's of February 1969 priced to yield 4.17 per cent. While attrition in the refunding is expected to be minimal in view of the attractive pricing of the new issues, the participation of the dealers in the refunding was restrained by their sizable holdings of intermediate-term bonds and the absence of significant investor demand for such bonds in recent weeks.

Yields on outstanding Treasury notes and bonds edged up in late July, as developments in Vietnam served to introduce a note of caution in

the market. The reopening of a 3-1/2 year bond in the August refunding also contributed to some upward yield adjustments in the intermediate-term area. In addition, investors were small net sellers of over-five-year bonds during the second half of July, as some institutional investors sold Governments to take advantage of recent increases in corporate bond yields. Given their sizable holdings of longer-term bonds, dealers tended to resist adding to their positions in these issues by marking down their prices and expanding their offerings. In recent days the market has steadied following sizable Treasury investment account purchases of August refunding rights and intermediate-term issues.

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	4.22
Lows	3.76	3.81	4.00	4.08	4.17	4.17
1965						
June 30	3.81	3.85	4.06	4.14	4.20	4.20
July 13	3.88	3.94	4.09	4.15	4.21	4.21
July 26	3.80	3.88	4.09	4.15	4.20	4.21
August 3	3.85	3.94	4.13	4.18	4.21	4.22

Treasury bill rates declined in mid-July but turned up in late July and early August. The decline reflected sizable investment demand for bills from a variety of investors and an improving availability of funds to finance dealer positions. More recently, investment demand for bills has tapered off and dealers have been particularly disappointed over the modest demand

from sellers of "rights" to the August refunding. As a result, some dealers have expanded their offerings of bills at rising yields in an effort to reduce sizable holdings built up in anticipation of demand related to the August refunding. Some reduction in these holdings occurred in the first week of August, following System purchases of nearly $275 million of bills in the market and the cautious dealer bidding in the August 2 weekly auction which resulted in the lightest dealer awards of the year.

Treasury finance. The cash deficit for fiscal 1965 was $2.7 billion. As can be seen from Table 1, Federal revenues totaled $119.7 billion in fiscal 1965, an increase of $4.2 billion over 1964. In spite of the reduction in tax rates, corporate profits tax collections were nearly $2.0 billion higher -- and even individual income tax collections after refunds were $100 million higher -- than in fiscal 1964. Cash expenditures totaled $122.4 billion, somewhat higher than anticipated earlier due to increased spending in June. The overall increase in expenditures from fiscal 1964 to fiscal 1965 amounted to $2.0 billion. Although there were sizable increases in expenditures in several areas, these were largely offset by a $3.7 billion decline in defense expenditures. Defense expenditures were $2.0 billion below even the level estimated last January.

Defense expenditures for fiscal 1966 are currently estimated at $53.3 billion, only $800 million above the amount estimated in the January Budget Document, an amount added to the defense budget to cover the military pay increase expected to go into effect October 1. The cost-cutting programs instituted by the Defense Department over the past two years were more successful than anticipated even last January and largely account

for the reduction in fiscal 1965 defense expenditures below the Document. The success of these programs was expected to continue to hold Defense expenditures (in fiscal 1966) about $2 billion below the amount estimated in the Document. However, as a result of Vietnam, the situation is changing. An increase in authorizations of $1.7 billion was requested August 4 and further additions may be requested later. Implicit in the $53.3 billion figure shown in the table for fiscal 1966 is an increase of $2 billion in actual expenditures arising out of developments in Vietnam.

Increased civilian pay is expected to take effect at the same time as the increases in military pay and expenditures for housing and agricultural programs now are expected to be higher than projected in the Document. In total, Federal cash expenditures for fiscal 1966 are projected to be $130.1 billion. Federal revenues are now projected at $125.2 for fiscal 1966, which produces an estimated cash deficit of nearly $5 billion.

Social Security bill. The 1965 Social Security Amendments were signed into law July 30. The bill provides hospital insurance and voluntary medical insurance for all persons over 65, increases Social Security benefits by 7 per cent, liberalizes the eligibility requirements for recipients of Social Security benefits and expands public assistance programs, especially in provision of medical services.

The program is now expected to cost $6.5 billion a year when fully effective. However, the increase in expenditures has been phased out throughout the year with the expenditures for medical care not scheduled to begin until fiscal 1967. As a result, the cost of the total program

THE FEDERAL BUDGET PROJECTED
(Fiscal years, in billions of dollars)

	1964	1965		1966	
	Actual	Jan. Bud. Doc.	Actual	Jan. Bud. Doc. 1/	FRB 2/
Cash receipts	115.5	117.4	119.7	123.5	125.2
Cash payments	120.3	121.4	122.4	127.4	130.1
Surplus (+) or deficit (-)	- 4.8	- 4.0	- 2.7	- 3.9	- 4.9
Cash receipts	115.5	117.4	119.7	123.5	125.2
Withheld income taxes	39.3	36.2	36.8	38.4	39.9
Other individual inc. tax	15.3	15.3	16.8	14.9	15.5
Corp. income tax	24.3	26.4	26.1	28.4	28.0
Excise and highway tax	14.0	14.6	14.8	14.0	13.3
Soc. Sec. receipts	21.9	21.8	22.1	23.9	24.6
Repayments	1.7	1.9	2.1	1.9	1.9
Other receipts	6.2	6.9	7.0	8.4	8.4
Refunds	7.1	5.8	6.0	6.4	6.4
Cash payments	120.3	121.4	122.4	127.4	130.1
National defense	54.5	52.8	50.8	52.5	3/53.3
nternational affairs & finance	2.0	2.2	2.9	2.8	2.7
Space	4.2	4.9	5.1	5.1	5.1
Agriculture	7.3	6.1	7.1	5.5	6.5
Natural resources	2.6	2.8	2.7	2.9	2.9
Commerce & transportation	6.5	7.4	7.5	6.5	6.5
Housing & community develop.	1.7	- .2	.9	.7	1.2
Health, labor & welfare	27.3	28.9	28.3	34.1	34.2
Education	1.3	1.5	1.5	2.6	2.6
Veterans	6.1	6.0	6.1	5.1	5.1
Interest	8.0	8.5	8.7	8.8	8.8
Deposit fund accounts	- .6	- .1	- .2	*	--
Civil service	- 2.0	- 2.1	- 2.1	- 2.1	- 2.1
Clearing account	- .9	.2	.9	- .1	- .1
General Govt.	2.2	2.5	2.3	2.9	3.5

Income Assumptions -- Calendar Years (In billions of dollars)

	1963	1964	1965		1966 1st hf.
			Bud. Doc.	FRB	FRB
GNP	583.9	622.6	660.0	659.3	685.9
Corporate profits	51.3	57.2	61.0	62.3	65.0
Personal income	464.1	491.4	520.0	522.2	539.9

*Less than $50 million.

1/ Reflects President's original proposed reduction of $1.75 billion in excise taxes.

2/ Reflects President's recent proposed reduction of $4.0 billion in excise taxes.

3/ Includes $800 million for pay increase.

August 1965

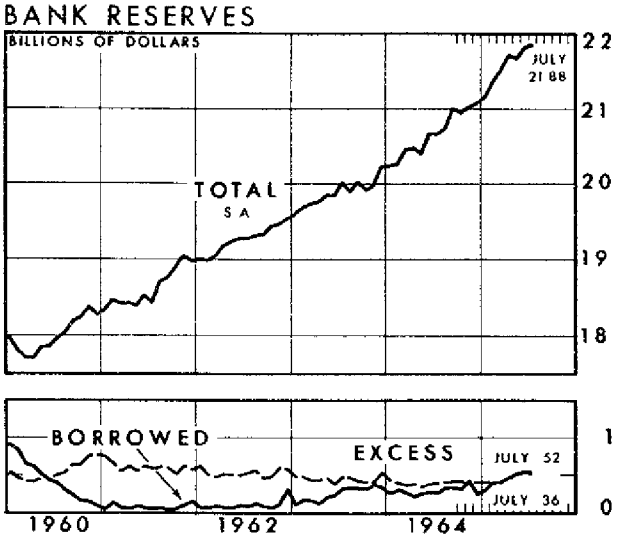
in fiscal 1966 is expected to be $3 billion, of which $800 million represents a lump-sum payment to Social Security beneficiaries to cover the retroactive (to January 1, 1965) increase in these benefits. Most of this lump-sum payment is expected to occur in September.

Increased payroll taxes have also been legislated to cover the cost of the program. As finally passed, the ceiling on wages and salaries has been raised from the first $4,800 to the first $6,600 of income and the combined tax rate from 7-1/2 to 8.4 per cent (one-half of the tax is paid by the employees; one-half by the employer). The tax on self-employed persons is 3/4 of the combined rate. The increased taxes are to be effective as of the first of the year and will increase tax liabilities about $6.0 billion in calendar 1966. In addition, the voluntary medical insurance is expected to yield $300 million ($600 million at annual rates) but it is not clear whether this will be handled as a receipt or treated as a negative expenditure since the $2 a month voluntary contribution can be deducted from social security benefit checks; nor is it clear when such contributions are to start. Not all of the increase in tax liability will be realized as cash receipts in calendar 1966 due to the lags in collection.

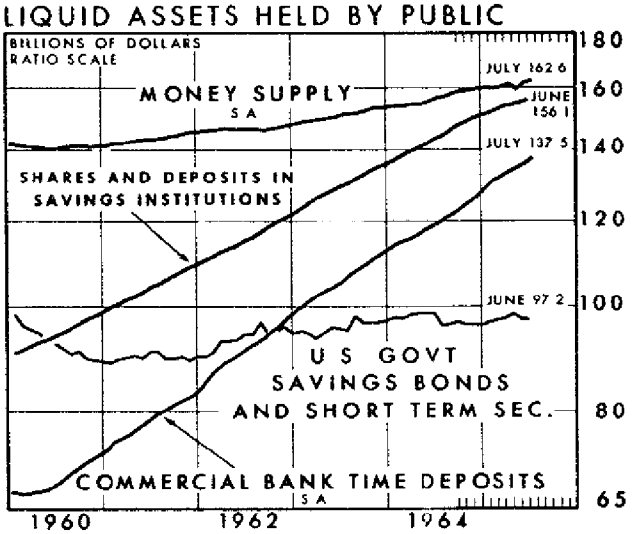
An additional increase in the tax rate from 8.4 to 8.8 per cent is scheduled for January 1, 1967. Further increases in the combined tax rate are scheduled for 1969 and at somewhat irregular intervals thereafter until 1987 when a rate of 11.3 per cent has been reached. In its final form, no future increases in the ceiling on the wages subject to tax were legislated.

FINANCIAL DEVELOPMENTS - UNITED STATES

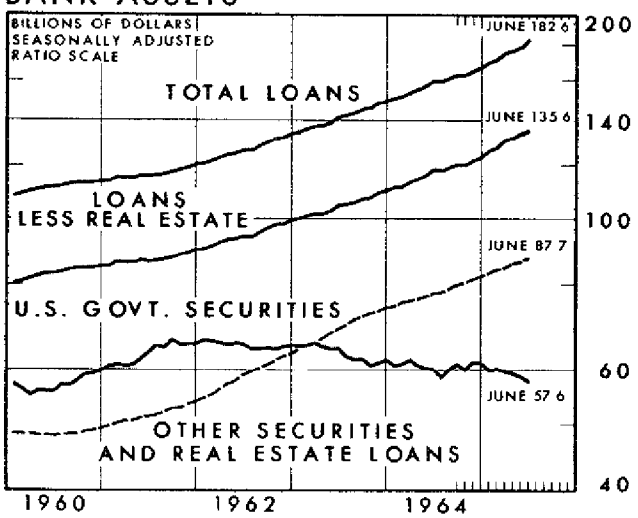
BANK RESERVES



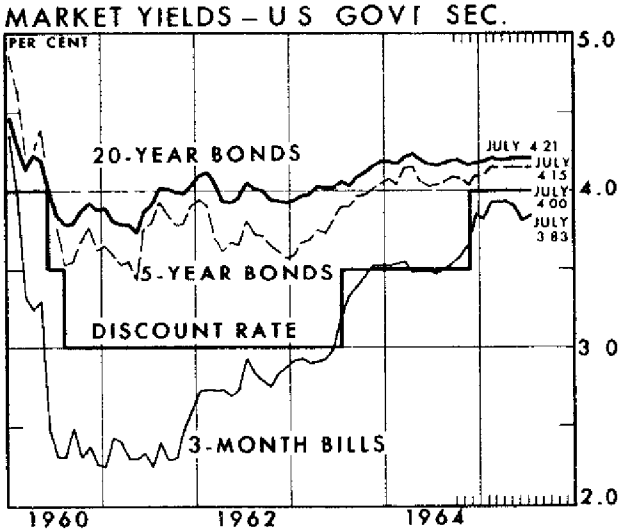
LIQUID ASSETS HELD BY PUBLIC



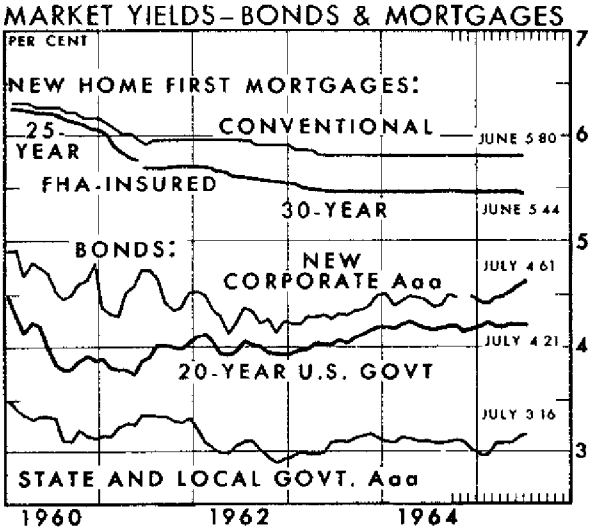
BANK ASSETS



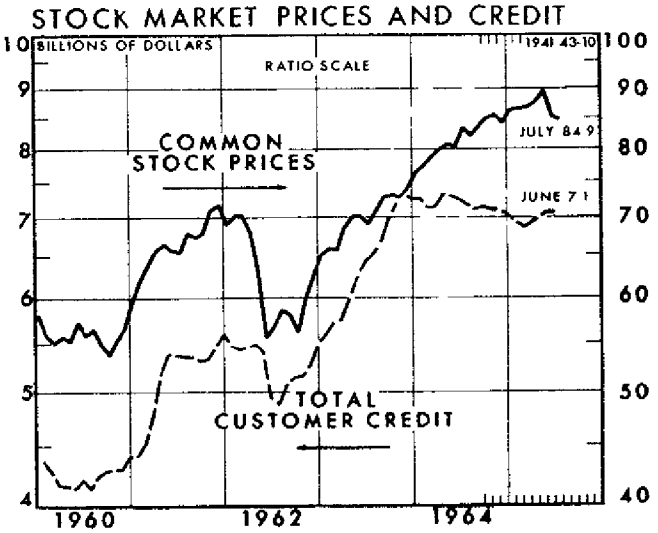
MARKET YIELDS – U S GOVT SEC.



MARKET YIELDS – BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. The surplus in U.S. international transactions appears to have continued in recent weeks. Partial data for July, a seasonally unfavorable month, suggest an unadjusted deficit on regular transactions smaller than would be expected on seasonal grounds. Changes in reserve assets and in liquid liabilities to foreigners during July reflected the special advance repayment of $179 million by France on its postwar debt to the U.S.

Revised data now show an over-all payments surplus for June of $65 million in place of the approximate balance indicated earlier. For the second quarter, after allowance for net special receipts of perhaps $75 million and for seasonal variation, the surplus on regular transactions may now be estimated at about $250 million, seasonally adjusted. On the official settlements basis, the surplus was much smaller. (Preliminary official estimates of the second quarter balance of payments will be released in mid-August.)

Merchandise imports in June remained at the high annual rate of $22 billion, while exports at an annual rate of $26 billion were down further from the March peak. By June any continued after-effects of the dock strike were probably small. As shown in the table below, exports in June were no higher than last autumn's level, and the average rate of exports from last December through June was about 2 per cent lower. Imports, on the other hand, were up sharply on both comparisons. Steel imports rose further in June, and the increase in these imports from last

autumn was close to $1 billion at an annual rate. The rise in other imports over this period was also very sharp, by more than 10 per cent in the aggregate, an increase more noteworthy since the value of food imports declined.

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

	1964 Aug-Oct.	Dec. '64-June '65	1965 June
Exports	26.0	25.4	26.2
Imports	18.7	20.2	22.0
Balance	7.3	5.2	4.2

Outstanding bank claims on foreigners covered by the VFCR decreased during the second quarter by $300 million. Included in this net decline are about $200 million of term loans sold by some banks, mainly to their foreign branches. Declines in outstanding short-term loans and acceptance credits account for much of the remaining net change in claims covered by the VFCR.

In U.S. balance of payments accounts, the net reflow, as reported by all U.S. banks, was about $370 million. This figure is based on reports from a wider group of institutions than those reporting under the VFCR and covers a slightly different grouping of assets. Of this total reflow, $70 million are likely to have reflected transactions by customers of banks.

Outstanding long-term bank loans declined throughout the quarter. Apart from the $200 million sell-offs, there was a seasonally adjusted net inflow of about $25 million, compared with a $70 million net outflow in the second quarter a year ago. The sell-offs accounted for the bulk

of the declines in long-term claims on Europe ($120 million) and Latin America ($80 million); there was a small rise in claims on Japan. Most, if not all, of the sell-offs absorbed Euro-dollars that would otherwise have been available in European credit markets; thus, these markets have been effectively refinancing the credits originally extended by U.S. banks.

New long-term loan commitments during the quarter to developed countries were principally to borrowers in Japan and Australia and totalled $200 million. Commitments to LDC's, principally Latin America and the Philippines, totaled $140 million. For the quarter as a whole new commitments were made at a monthly rate of probably $100 million per month, about half the monthly average for the year 1964.

Outstanding short-term loans and acceptance credits increased $30 million in June, following declines in April and May. For the quarter as a whole there was a seasonally adjusted net reflow of short-term bank credits of about $20 million. This reflow was composed of outflows to Latin America ($20 million) and Japan ($50 million) and a reflow from the rest of the world totaling about $90 million, a sizeable part of which reflected a special transaction with Canada.

Liquid funds abroad reported by banks declined in June by $80 million, to some extent reflecting seasonal influences. For the quarter as a whole, banks reported a net reflow of $140 million. Nonbanks reported a reflow of $120 million for April and May apart from a $90 million increase in foreign currency deposits, which is known to have represented funds in transit.

Trade of other industrial countries. The Common Market countries had a balanced trade position in the first five months of 1965, in contrast to their combined trade deficit in the corresponding months of 1964, which had been at an annual rate of over $500 million (imports valued c.i.f., exports f.o.b.). The change reflected a sharp drop in Italian imports (which ended in the summer of 1964), a considerable increase in French exports, and increases in Dutch and Belgian exports that exceeded the moderate import increases of these two countries. On the other hand, partly offsetting these factors making for a smaller aggregate deficit, Germany's imports rose nearly 25 per cent while its exports increased by 10 per cent.

Since the beginning of 1965, German imports have continued to rise (through June). The growth of German imports has been one of the principal expansive forces in world trade during this recent period, along with rising import demand in the United States and Canada. British imports were also substantially higher in the second quarter than in the first. While the rise in British imports included manufactures and materials, it also represented in part a rebound from an unusually low level of British food imports in the first quarter, probably due in part to the U.S. dock strike. Elsewhere in Europe recent import advances have been moderate -- even in Italy, where domestic recovery has been proceeding rapidly -- or nil, as in France. Outside Europe, the quarter-to-quarter rise in Japanese imports shown in the last two columns of the table largely reflected irregular monthly fluctuations rather than a real upswing. However, a sharp rise that occurred in June may mark the beginning of an upturn in Japanese imports.

IMPORTS
(Seasonally adjusted indexes, 1964-I=100)

	1964		1965	
	III	IV	I	II
U.K.	101	102	98	103
EEC	100	104	104	107 (Apr.-May)
Germany	111	117	122	128
France	99	103	99	97 (Apr.-May)
Italy	79	83	84	85 " "
Netherlands	104	105	102	108 " "
Belgium - Lux.	103	104	101	115 (Apr.)
Sweden	107	106	118	117 (Apr.-May)
Switzerland	101	104	101	103 " "
Japan	96	107	100	106
Canada	100	104	109	114 (Apr.-May)
Total OECD-Europe, by source:				
Intra	101	107	110	109 (Apr.)
From U.S., Canada	100	103	94 a/	111 " a/
From Non-OECD 1/	98	101	103	104 "

1/ Not including Japan.
a/ Distorted by U.S. port strike (as are also some other figures in the last two columns, in lesser degree).

The rise in imports of the European members of OECD since a year ago has been most marked for intra-European trade, as may be seen in the lower part of the table. Intra-EEC trade was further stimulated at the beginning of 1965 when a new 10 per cent tariff reduction became effective within EEC. Tariffs have now been reduced to 30 per cent of their original level. A similar reduction within EFTA also went into effect on January 1. In recent months, imports from nonindustrial countries both by the U.K. and by continental countries have been relatively flat, as the further expansion in import demand has been mainly for manufactured products rather than raw materials.

Imports by nonindustrial countries (not shown in the table) appear to have been still rising, in the aggregate, last spring, but sharp losses of reserves were being experienced by some -- in particular, by Australia and South Africa -- making it unlikely that the rise would continue.

In May and June a downturn in U.K. shipments to sterling area countries was a major factor in the sluggish performance of British export trade. With British imports up, especially in May when the cut in import surcharge on most non-food imports from 15 to 10 per cent took effect, the trade balance worsened again. In view of the continued precariousness of Britain's external position, the authorities on July 27 took further measures: (1) to limit central government and local authority financing; (2) to require permits for certain types of private construction and to restrain instalment buying; (3) to make export financing easier and import financing tighter; and (4) to tighten exchange controls by (a) not allowing prepayment of imports before shipment of the goods and (b) various measures affecting the financing of British direct investment subsidiaries abroad and of foreign direct investment subsidiaries in the United Kingdom.

Countries whose exports have been responding most vigorously in recent months to rising demand in world trade include France, Italy, the Netherlands, Switzerland, Japan, and Canada. The rise in French and Dutch exports, in particular, has owed a good deal to growing demand from Germany. Germany's own exports, after rising by 10 per cent from the first quarter of 1964 to the first quarter of 1965, appear to have flattened out in the second quarter.

EXPORTS

(Seasonally adjusted indexes, 1964-I=100)

	1964		1965	
	III	IV	I	II
U.K.	99	103	104	104
EEC	102	107	112	113(Apr.-May)
Germany	98	105	110	109
France	99	105	105	112(Apr.-May)
Italy	112	112	125	130 " "
Netherlands	107	110	113	117 " "
Belgium - Lux.	102	110	116	107(Apr.)
Sweden	98	111	118	110(Apr.-May)
Switzerland	105	107	111	117 " "
Japan	117	128	141	149
Canada	111	103	104	111(Apr.-May)
Total OECD-Europe, by destination:				
Intra	101	107	110	109(Apr.)
To U.S., Canada	102	108	110 a/	124 " a/
To Non-OECD 1/	103	109	111	114 "

1/ Not including Japan.
a/ Distorted by U.S. port strike (as are also some other figures in the last two columns, in lesser degree).

Long-term interest rates. Yields on Government bonds in major European countries have advanced further in the past two months. The June cut in Bank rate in Britain was offset by further tightening of bank credit. In Germany most bond yields are now above 7 per cent. The rise in long-term rates in these two countries over the past twelve months has exceeded one-half per cent.

LONG-TERM BOND YIELDS
(Per cent per annum[1/])

	July 1965	Change from: May	Feb.	July 1964
U.K. (Govt.)	6.83	+ .17	+ .38	+ .63
Germany (Fed. Rwy.)	6.92	+ .10	+ .43	+ .57
Netherlands (Govt.)	5.28	+ .16	+ .34	+ .26
Switzerland (Govt.)	3.91	---	- .09	- .16
Canada (Govt.)	5.27	+ .18	+ .24	+ .08
U.S. (Corp. Baa)	4.87	+ .06	+ .09	+ .04

1/ Averages of rates at weekly dates (July 1965 incomplete).

Euro-dollar rates. Quoted deposit rates in the London Euro-dollar market eased off further during July, following a decline in June for all but the shortest maturities. Rates for longer-term deposits held up quite firmly in July, and the 180-day rate averaged about 5/8 per cent higher than a year ago. Rates for shorter maturities fell sharply in the third week of July, when funds were moving out of sterling into dollars. The call rate was quoted at 4-1/16 per cent at the end of the month, only 3/16 per cent higher than a year earlier. The decline in Euro-dollar

rates during June and July was accompanied by an increase in liabilities of U.S. banks to their branches abroad. This suggests that some U.S. banks may have been using Euro-dollar money obtained by their branches not only to finance transfers of loan assets to the branches as already mentioned, but also to supplement their U.S. money market financing.

EURO-DOLLAR DEPOSIT RATES
AND SELECTED U.S. MONEY MARKET RATES
(Per cent per annum[1/])

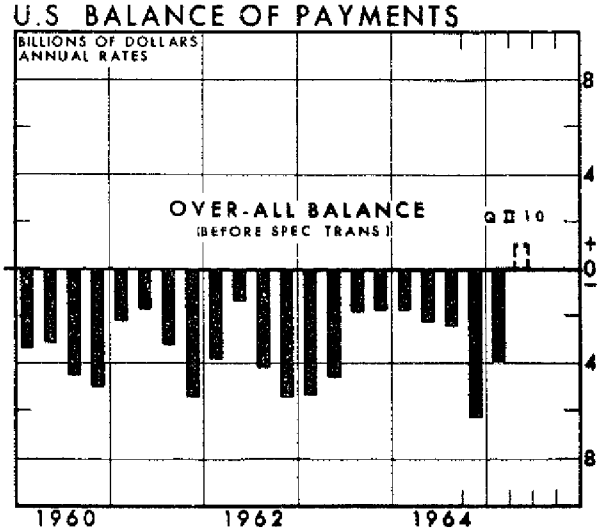
	July 1965	Change from: May	Feb.	July 1964
Euro-dollars:				
180-day	5.09	- .10	+ .48	+ .64
90-day	4.74	- .25	+ .21	+ .40
30-day	4.56	- .19	+ .22	+ .35
7-day	4.34	- .08	+ .11	+ .32
Call	4.21	- .10	+ .15	+ .31
U.S.:				
CD's (secondary)	4.30	- .02	+ .10	+ .44
Federal funds	4.09	- .02	+ .10	+ .66

1/ Averages of rates at weekly dates; except for Federal funds, which are daily averages.

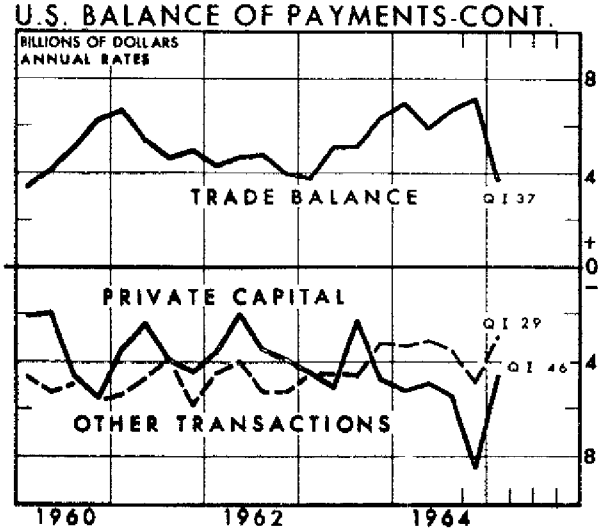
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

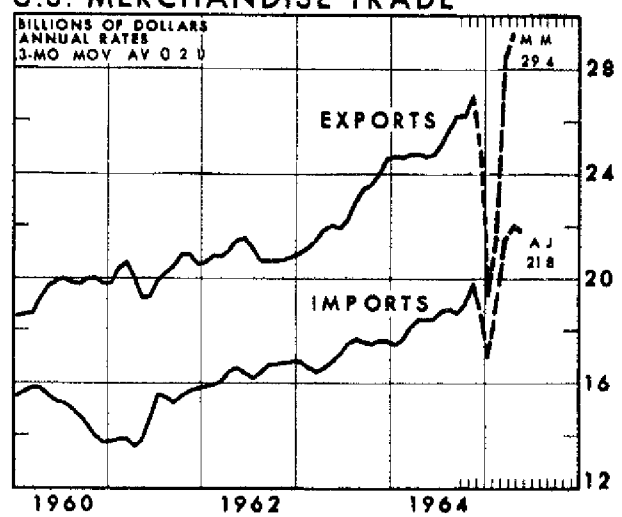
U.S BALANCE OF PAYMENTS



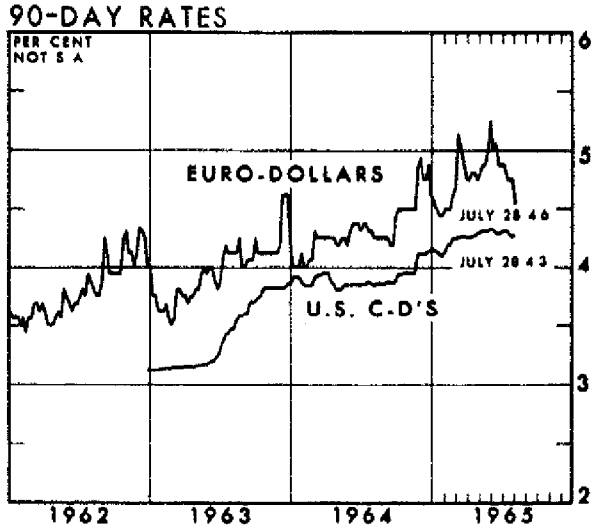
U.S. BALANCE OF PAYMENTS-CONT.



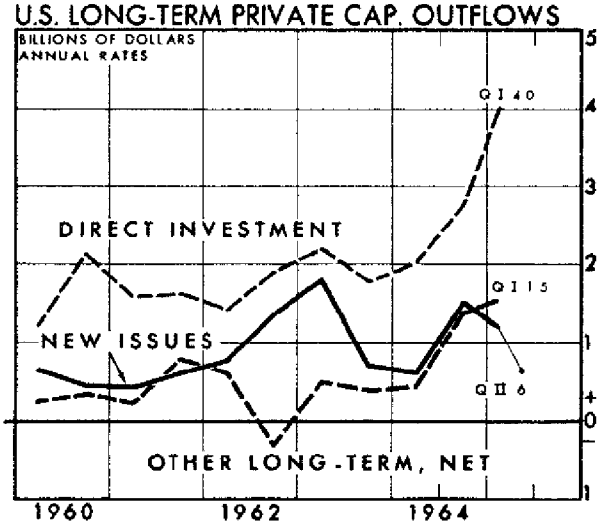
U.S. MERCHANDISE TRADE



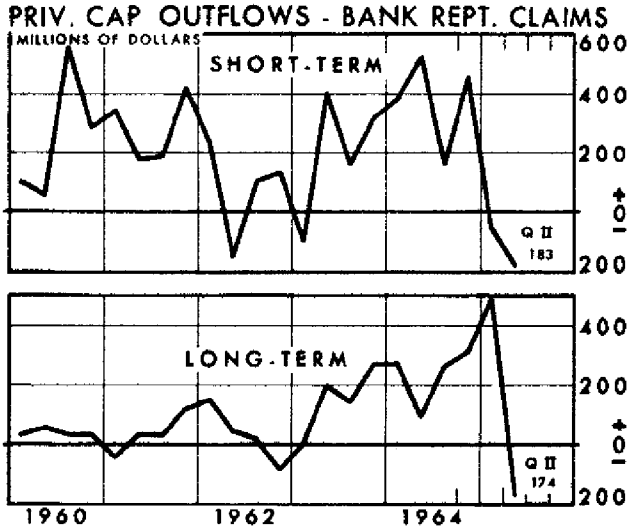
90-DAY RATES



U.S. LONG-TERM PRIVATE CAP. OUTFLOWS



PRIV. CAP OUTFLOWS - BANK REPT. CLAIMS



APPENDIX A: PROJECTION OF U.S. BALANCE OF PAYMENTS IN 1965

A revised projection of the U.S. balance of payments in 1965 recently made by the National Foreign Trade Council Balance of Payments Group was released on July 23, and is shown in the table below together with actual date for 1964. Explanatory footnotes have been added to define the content of some of the items shown.

U.S. Balance of Payments
(billions of dollars)

	1965 Est.	1964 Actual	Changes, as effect on balance
Goods: Exports	26.0	25.3	+0.7
Imports	20.4	18.6	-1.8
Balance	+5.6	+6.7	-1.1
Investment income receipts	+6.1	+5.5	+0.6
Other services, net (incl. military expenditures)	-4.1	-3.6	-0.5
Balance on goods and services	+7.6	+8.6	-1.0
Remittances and pensions	-0.9	-0.8	-0.1
Govt. grants and capital outflows 1/	-3.6	-3.6	0.0
U.S. private capital	-3.6	-6.5	+2.9
Foreign capital excl. U.S. liquid liabilities 2/	+0.3	+0.7	-0.4
Errors and omissions	-0.6	-1.2	+0.6
Balance financed by reserves and liquid liabilities including Roosa bonds 3/	-0.8	-2.8	+2.0
Memorandum:			
Balance on regular transactions	-1.2	-3.1	+1.9

1/ Net of advance debt repayments as well as scheduled payments, but without deduction of increase in U.S. liabilities associated with aid.

2/ Includes private capital, military export prepayments, U.S. liabilities associated with aid, and (in 1964) Roosa bonds sold to Canada in connection with Columbia River transactions ($0.2 billion).

3/ Other than those sold to Canada in 1964.

The projected deficit on regular transactions for 1965 of somewhat over $1 billion would represent an improvement of $2 billion over the actual outturn in 1964. The major changes projected between the two years are a $3 billion cut in private capital outflows partly offset by a $1 billion deterioration in the trade surplus. Estimates of both capital outflows and the trade surplus were lowered from those made by the NFTC Group last January.

The projected reduction of U.S. private capital outflows as compared with 1964 was thought of as follows: little or no reduction in the direct investment outflow from last year's $2.4 billion, though in the absence of the President's program the outflow might have grown further this year; perhaps a $1/2 billion reduction in other long-term outflows, mainly in bank loans; a reduction of $1 billion or more in short-term bank credit outflows; and a shift in the movement of non-bank liquid funds from an outflow of over $1/2 billion to an inflow of over $1/2 billion. Without this inflow of liquid funds, the deficit would be in the $1-1/2 to $2 billion range.

Imports were estimated at nearly 10 per cent above last year's average, as the high rate of imports in the first half of the year resulted in an upward revision of last January's estimate. Merchandise exports were projected at $26 billion, about 3 per cent above the 1964 total. Last January's export estimate was scaled down somewhat in the light of the rate of export shipments recorded thus far this year. A sizeable minority of the Group thought that the $26 billion estimate may still be somewhat too high.