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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**

June 22, 1966

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SUMMARY AND OUTLOOK

Outlook for GNP

Following the marked slowdown in the current quarter, a pick-up in the rate of growth in GNP is in prospect after midyear, but expansion over the last half of the year is not likely to be as rapid as in late 1965 and early 1966.

Given the large backlogs of defense orders, and with a military pay raise likely to become effective soon the increase in defense spending in the second half of the year could be about as large as in the first half, even without much further escalation of the war. Moreover, recent evidence on business plans, order backlogs, and the rate of capacity utilization supports the prospect of continued rapid increases in business fixed investment. In fact, expansion in capital expenditures may be unusually large in the third quarter, making up for a lag in the current quarter when strikes slowed the rise in business construction. On the other hand, considerable weakness is now apparent in residential construction, and further declines are in prospect.

Part of the explanation for the less expansive tone of consumption expenditures in the current quarter was the unexpectedly large rise in the Federal individual income tax take, which, together with a distinct slowing of the rise in personal income, has resulted in a small increase in disposable income. In the third quarter, consumer income is expected to rise considerably faster, in part because of

Medicare payments and the Federal pay increases, but consumption overall may lag the rise in income somewhat.

In the special case of new autos, the May sales rate was well below the level of underlying demands suggested by recent consumer buying surveys and industry estimates, and early June figures indicate some recovery beginning this month. Third quarter sales of new autos, which will be stimulated by strong industry pressures to move exceptionally large stocks of current models, are expected to be up substantially from the current quarter, although far from returning to the high first quarter rate. The run-off in auto stocks is likely to reduce the overall rate of inventory accumulation in the third quarter, just as the build-up has caused a spurt in inventory investment in the current quarter.

Prices and resource use

Pressures against resources remained strong through the second quarter and prospects are for continuation of high levels of resource utilization. Capacity utilization in manufacturing remains about 92 per cent and little change is in prospect. While the over-all unemployment rate has increased a little to 4 per cent, rates for primary labor force groups are very low and are likely to remain so.

Sustained pressure on resources points to continuation of price rises for manufactured materials and products at roughly the rates of recent months. If labor contracts in major industries are negotiated later this year and in early 1967 in an environment of strong

demands and high profits, increases in wage rates may accelerate, and rising labor costs per unit of output would exert additional upward pressures on prices of fabricated products. Prices of some materials, on the other hand, which contributed so much to the recent rise in industrial prices, are not likely to increase so rapidly in the period ahead, especially if the strikes and other interruptions to supplies of the past year can be avoided. Lumber prices have already turned down, and hide prices have soared into a range in which the elasticity of demand should limit further increases. Altogether, the rise in industrial prices should remain close to the recent annual rate of about 3.5 per cent.

Wholesale prices of foodstuffs showed some seasonal strengthening in June, but the decline may be resumed soon in response to expansion in supplies. With food prices declining, the total wholesale price index has been virtually stable since February, and the over-all consumer price index increased only 0.1 per cent further in May and was 2.7 per cent above a year earlier. Food prices declined while nonfood commodities and services rose further.

Bank credit and deposits

Bank credit expansion over the second half of June is likely to be quite strong. Loan growth is being spurred by business needs for funds to pay income taxes and also to finance accelerated payments of withheld individual income and social security taxes. Increased bank purchases of liquid assets for window dressing purposes for end of June

statements will further contribute to credit expansion, as will delivery of attractively priced agency and participation issues the final statement week of the month.

While many of these asset acquisitions are temporary and will be reversed in July, a relatively rapid growth in bank loans may continue. The maintenance of demands for funds for capital outlays and working capital -- in conjunction with apparently large reductions in corporate liquidity associated with tax payments in March, April, and June -- can be expected to be reflected in further strong business demands for bank credit over the summer.

In an effort to finance such loan demands, banks are likely to turn again to their security portfolios, and to increase their efforts to attract time deposits. It is not clear how strong an effort banks will make to attract consumer-type time deposits in view of the growing public concern over the effects of such competition on other savings institutions. Nor is it clear how successful banks would be in attracting increasing amounts of such funds in view of the intensified effort other savings institutions could make to ward off another experience like April. Banks could become more aggressive in the negotiable CD area, where in order to replace maturing negotiable CD's -- let alone increase outstandings -- they are likely to have to increase offering rates on shorter CD's.

Outlook for capital markets

With the volume of new offerings in bond markets scheduled to contract in the weeks immediately ahead, the general advance of bond yields underway since early April has recently showed signs of leveling off, and some yields have tended to decline. No appreciable upward pressures on long-term rates appear likely over the near term. However, any marked decline of corporate and municipal bond yields would very likely encourage borrowers to add to the new issue calendar -- to help meet their continuing large current and future financing requirements. Consequently, the leeway for declines in long-term yields at this juncture seems to be quite limited.

The slackening of prospective new issue volume, while partly seasonal, seems to extend to all sectors of the securities markets. For example, offerings of Federal agency issues and participation certificates, which recently have exerted such an important influence on interest rates, may drop in the third quarter to about half or less of their second quarter volume. Moreover, issues of publicly-offered corporate bonds thus far scheduled for July total only \$200 million, and the July calendar of municipal bond offerings also promises to be quite light at the current reading. An offsetting influence in markets to the relatively light calendar currently in prospect may be the need for banks to make further portfolio adjustments -- in addition to obtaining time deposits -- as loan demand continues.

The recent abatement of yield pressures in other sectors of the capital markets may also operate to reduce pressures on home mortgage markets to a limited extent. Credit conditions in the home mortgage sector, however, will be most strongly affected by the size of July net withdrawals from savings and loan associations.

Balance of payments

The merchandise trade surplus for April and May combined was at an annual rate of only \$3 billion, compared with \$4-1/2 billion in the first quarter and \$5 billion in the fourth quarter of 1965. Exports this year have been running below expectations, and little higher than late last year, while imports have been increasing at an annual rate of nearly 20 per cent.

The deterioration in trade in April-May would have produced an increase in the over-all deficit on the liquidity basis had it not been for shifts of funds by foreign official and international institutions from liquid to nonliquid U.S. assets. The deficit on the basis of official reserve transactions apparently did increase from the first quarter to April-May, though the amount of the increase is still uncertain.

Over the months ahead, the trade surplus is likely to recover somewhat from the unusually low April-May level as export expansion is resumed in response to strong demands abroad. But it may not rise above the January-May average annual rate of just under \$4 billion. For all other payments flows, taken together, the prospect is for some deterioration rather than improvement. Hence the liquidity

deficit seems likely to rise above the \$2-1/4 billion level of the first five months of the year.

Full balance of payments data are now available for the first quarter of 1966. They show that the net outflow of U.S. private capital remained at about the \$3-1/2 billion annual rate recorded in the second half of 1965. This is a low rate by historical standards, lower than in any calendar year since 1959. Some further reduction is possible, but it is not likely to be large as prospects are now viewed. Direct investment outflows during the remainder of 1966 seem likely to exceed the \$2-1/2 billion rate of the first quarter. And while net outflows into foreign securities have already declined from the first quarter rate of \$1-1/4 billion, which was swollen by a bulge in Canadian new issues, reflows of bank credit appear to have diminished, taking April and May together. Such reflows could increase again to the first quarter rate, but seem unlikely to increase more than that.

June 21, 1966.

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SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally Adjusted)

	Latest Period	Amount			Per cent change	
		Latest Period	Preceding Period	Year Ago	Year Ago*	2 years Ago*
Civilian labor force (mil.)	May '66	76.3	76.7	75.3	1.3	2.5
Unemployment (mil.)	"	3.0	2.9	3.5	-12.9	-20.7
Unemployment (per cent)	"	4.0	3.7	4.6	-	-
Nonfarm employment, payroll (mil.)	"	63.1	62.9	60.0	5.1	9.0
Manufacturing	"	18.9	18.9	17.8	6.1	10.1
Other industrial	"	8.1	8.1	7.8	3.0	6.2
Nonindustrial	"	36.1	36.0	34.3	5.4	9.2
Industrial production (57-59=100)	"	154.8	153.6	141.6	9.3	17.5
Final products	"	154.0	153.1	140.2	9.8	17.2
Materials	"	156.0	154.2	142.6	9.4	18.0
Wholesale prices (57-59=100) ^{1/}	"	105.5	105.5	102.1	3.3	5.4
Industrial commodities	"	104.2	103.9	102.0	2.2	3.3
Sensitive materials	"	106.9	106.4	102.3	4.5	7.8
Farm products and foods	"	107.8	108.7	101.1	6.6	11.4
Consumer prices (57-59=100) ^{1/}	Apr '66	112.5	112.0	109.3	2.9	4.4
Commodities except food	"	106.0	105.6	105.0	1.0	1.6
Food	"	114.0	113.9	107.3	6.2	7.9
Services	"	121.1	120.1	117.3	3.2	5.5
Hourly earnings, mfg. (\$)	May '66	2.69	2.69	2.60	3.5	6.7
Weekly earnings, mfg. (\$)	"	111.60	111.69	107.10	4.2	8.8
Personal income (\$ bil.) ^{2/}	"	565.5	563.1	525.0	7.7	15.1
Retail sales, total (\$ bil.)	"	24.4	25.0	23.3	4.7	12.5
Autos (million units) ^{2/}	"	7.3	7.9	8.1	-10.4	-6.8
GAF (\$ bil.)	"	5.8	5.8	5.3	8.7	16.7
Selected leading indicators:						
Housing starts, pvt. (thous.) ^{2/}	"	1,306	1,499	1,516	-13.9	-14.0
Factory workweek (hours)	"	41.4	41.5	41.1	0.7	2.0
New orders, dur. goods (\$ bil.)	"	24.1	24.2	21.0	14.8	20.9
New orders, nonel. mach. (\$ bil.)	"	3.5	3.6	3.1	13.4	19.2
Common stock prices (1941-43=10)	"	86.78	91.60	89.28	- 2.8	7.5
Inventories, book val. (\$ bil.)	Mar '66	122.7	121.9	113.0	8.5	15.7
Manufacturers	Apr '66	70.3	69.6	64.0	9.8	16.1
Gross national product (\$ bil.) ^{2/}	QI-66	713.9	697.2	657.6	8.6	16.3
Real GNP (\$ bil., 1958 prices) ^{2/}	"	633.6	624.4	597.7	6.0	11.7

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

June 21, 1966

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SELECTED DOMESTIC FINANCIAL DATA

	Week ended	Four-Week	Last six months	
	June 17	Average	High	Low
<u>Money Market</u> <u>1/</u> (N.S.A.)				
Federal funds rate (per cent)	5.13	4.90	5.13	1.00
U.S. Treas. bills, 3-mo., yield (per cent)	4.52	4.58	4.70	4.12
Net free reserves <u>2/</u> (mil. \$)	- 341	- 347	98	- 387
Member bank borrowings <u>2/</u> (mil. \$)	788	700	812	218
<u>Security Markets</u> (N.S.A.)				
Market yields <u>1/</u> (per cent)				
5-year U.S. Treas. bonds	4.92	4.96	5.03	4.51
20-year U.S. Treas. bonds	4.74	4.73	4.81	4.44
Corporate new bond issues, Aaa	5.43	5.43	5.43	4.82
Corporate seasoned bonds, Aaa	5.06	5.05	5.07	4.73
Municipal seasoned bonds, Aaa	3.59	3.59	3.63	3.39
FHA home mortgages, 30-year <u>3/</u>	6.32	6.32	6.32	5.51
Common stocks S&P composite index <u>4/</u>				
Prices closing (1941-43=10)	86.72	86.27	94.06	83.63
Dividend yield (per cent)	3.32	3.34	3.39	3.01
	Change in May	Average change Last 3 mos.	Annual rate of change (%) 3 mos. 1 year	
<u>Banking</u> (S.A., mil. \$)				
Total	- 76	107	5.7	4.7
Bank loans and investments:				
Total	1300	2300	9.1	8.9
Business loans	1200	1000	16.3	10.9
Other loans	300	1400	13.2	10.4
U.S. Government securities	- 1300	- 600	- 13.4	- 6.3
Other securities	1100	600	14.9	14.3
Money and liquid assets:				
Demand dep. & currency	- 1600	500	3.6	5.9
Time and savings dep.	1300	1400	11.0	13.6
Nonbank liquid assets	100	1000	4.5	6.2

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 June 15.3/ Latest figure indicated is for month of May. 4/ Data are for weekly closing prices.

U. S. BALANCE OF PAYMENTS
(In millions of dollars)

	1 9 6 6				1 9 6 5			1965
	Apr.	Mar.	Feb.	QI	QIV	QIII	QII	Year
	(billions)							
	Seasonally adjusted							
Current account balance				1,269	1,290	1,527	1,761	6.0
Trade balance <u>1/</u>	200	450	330	1,118	1,271	1,231	1,317	4.8
Exports <u>1/</u>	2,300	2,550	2,290	7,121	7,027	6,826	6,798	26.3
Imports <u>1/ 2/</u>	-2,100	-2,100	-1,960	-6,003	-5,756	-5,595	-5,481	-21.5
Services, etc., net				151	19	296	444	1.2
Capital account balance				-1,604	-1,560	-1,821	-1,426	-6.9
Govt. grants & capital <u>3/</u>				-955	-881	-743	-949	-3.4
U.S. private direct investment				-630	-731	-569	-859	-3.4
U.S. priv. long-term portfolio				-244	-154	-363	101	-1.1
U.S. priv. short-term				-14	-27	105	412	0.8
Foreign nonliquid				239	233	-251	-131	0.2
Errors and omissions				-228	-80	-240	-109	-0.4
	Balances, with and without seasonal adjustment (- = deficit)							
Liquidity bal., S.A.				-563	-350	-534	226	-1.4
Seasonal component				485	-3	-472	-37	--
Balance, N.S.A.	-233	-36	28	-78	-353	-1,006	189	-1.4
Official settlements bal., S.A.				-245	-1,158	236	238	-1.3
Seasonal component				625	33	-508	-184	--
Balance, N.S.A. <u>4/</u>	-175	-100	175	380	-1,125	-272	54	-1.3
Memo items:								
Monetary reserves (decrease -)	-110	64	-263	-424	-271	-41	-68	-1.2
Gold purchases or sales (-)	-70	-73	--	-68	-119	-124	-590	-1.7

1/ Balance of payments basis which differs a little from Census basis.

2/ Monthly figures tentatively adjusted for changes in carry-over of import documents.

3/ Net of associated liabilities and of loan repayments.

4/ Differs from liquidity balance by counting as receipts (+) increase in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increase in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. We are now estimating GNP at a \$725 billion rate in the second quarter and \$739 billion in the third. The \$14 billion increase projected for the third quarter represents a pick-up from the \$11 billion rise indicated for the current quarter but remains below the exceptionally large increases of late 1965 and early 1966. In current dollars, the third quarter rise equals the average quarterly increase during 1965, but with price increases projected to be larger, the real rate of gain is lower. The rise in the GNP deflator in the third quarter will be larger than in the present quarter, in part, because of the way in which the cost of Federal pay increases enters the national accounts; as a result the increase in real GNP in the third quarter is estimated at an annual rate of 4 per cent, as compared with a gain of 5-1/2 per cent for 1965 as a whole and 6 per cent in the first quarter of 1966.

The slowing in the second quarter came primarily from a marked drop in the expansion in consumer spending. Total consumption expenditures increased an estimated \$4.5 billion as compared with nearly \$11 billion in the first quarter. The main feature was a sharp decline in new auto sales. While there were presumably special influences in the auto sales decline--such as the safety issue and the possibility of a let-down after the record buying in the first quarter--the slower increase in consumer spending also was associated with

retardation in the rate of expansion in disposable income. Although the rise in personal income slowed appreciably, there was an unexpectedly large increase in the Federal individual income tax take, which further limited the rise in disposable income. The ratio of spending to disposable income was only a little below the high first quarter level.

Additional factors contributing to the second quarter slowdown in over-all economic expansion were: a decline in residential construction activity; somewhat less rapid expansion in business fixed investment owing in part to strikes which limited the rise in business construction; and a smaller rise in defense spending. Business inventory investment, on the other hand, is estimated to have increased considerably in the second quarter, because auto production was not cut nearly as sharply as sales.

In the third quarter, growth in income is expected to accelerate considerably, owing in part to Medicare payments and Federal pay increases, and the rise in consumption expenditures is projected at over \$9 billion--double the second quarter increase but still below the exceptionally large first quarter increase.

In the case of new autos, May sales appeared to be well below the level of underlying demands as suggested by recent consumer buying surveys and industry estimates, and partial recovery was indicated in early June. Moreover, third quarter unit sales will be stimulated by strong industry efforts to move the exceptionally

large dealer stocks. Sales of new domestic autos are projected at an annual rate of 8.5 million units in the third quarter as compared with an estimated 7.8 million in the second quarter and 9.3 million in the first quarter.

Strong further expansion in business fixed investment is anticipated for the third quarter, in line with recent surveys of business plans and with rising orders and backlogs through May. Short of any official information, we are estimating that, because of the military pay raise defense purchases of goods and services will rise in the third quarter somewhat more than in the second quarter.

Limiting the rise in GNP in the third quarter is an expected substantial further decline in residential construction activity, in line with the sharp drop in housing starts to a 1.3 million rate in May, which also is assumed for the third quarter. And business inventory accumulation is tentatively projected at a lower rate in the third quarter, in large part because of the expected large run-off of new auto inventories.

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

	1964	1965	1966					
			1965			Projected		
			II	III	IV	I	II	III
Gross National Product	628.7	676.3	668.8	681.5	697.2	713.9	725.0	739.0
Final sales	623.9	668.1	662.4	673.9	687.1	705.8	715.0	731.0
Personal consumption expenditures	398.9	428.7	424.5	432.5	441.0	451.8	456.4	465.7
Durable goods	58.7	65.0	63.5	65.4	66.4	68.7	65.9	67.5
Nondurable goods	177.5	189.0	187.9	190.5	195.0	200.1	203.8	207.5
Services	162.6	174.7	173.1	176.7	179.6	183.0	186.7	190.7
Gross private domestic investment	92.9	105.7	102.8	106.2	110.3	111.7	115.0	115.3
Residential construction	27.5	27.6	28.0	27.7	27.2	28.2	27.7	27.0
Business fixed investment	60.5	69.8	68.4	70.9	73.0	75.5	77.3	80.3
Changes in business inventories	4.8	8.2	6.4	7.6	10.1	8.1	10.0	8.0
Nonfarm	5.4	7.9	6.6	7.0	8.9	7.4	9.5	8.0
Net exports	8.6	7.1	8.0	7.4	6.9	6.4	5.7	5.7
Gov. purchases of goods and services	128.4	134.8	133.5	135.4	139.0	144.0	147.9	152.3
Federal	65.3	66.6	65.7	66.5	69.2	72.5	74.7	77.9
Defense	49.9	49.9	49.2	49.8	52.0	55.0	57.0	59.5
Other	15.4	16.7	16.5	16.7	17.2	17.5	17.7	18.4
State and local	63.1	68.2	67.8	68.9	69.8	71.5	73.2	74.4
Gross National Product in constant (1958) dollars	577.6	609.6	603.5	613.0	624.4	633.6	638.8	645.4
GNP Implicit deflator (1958=100)	108.9	110.9	110.8	111.2	111.7	112.7	113.5	114.5
Personal income	495.0	530.7	524.7	536.0	546.0	557.1	566.0	580.0
Wages and salaries	333.5	357.4	353.6	359.0	368.1	377.0	384.0	392.9
Transfer payments	36.6	39.2	37.5	41.2	39.7	41.7	41.8	45.7
Personal contributions for social insurance (deduction)	12.4	13.2	13.0	13.3	13.6	16.8	17.0	17.8
Disposable personal income	435.8	465.3	458.5	471.2	480.3	488.7	494.6	506.9
Personal saving	26.3	24.9	22.4	26.8	27.1	24.4	25.3	28.4
Saving rate (per cent)	6.0	5.4	4.9	5.7	5.6	5.0	5.1	5.5
Total labor force (millions)	77.0	78.4	78.1	78.5	79.0	79.4	79.7	80.1
Armed forces	2.7	2.7	2.7	2.7	2.8	2.9	3.0	3.1
Civilian labor force	74.2	75.6	75.4	75.8	76.2	76.5	76.7	77.0
Employed	70.4	72.2	71.9	72.4	73.0	73.6	73.9	74.3
Unemployed	3.9	3.5	3.6	3.4	3.2	2.9	2.8	2.7
Unemployment rate (per cent)	5.2	4.6	4.7	4.5	4.2	3.8	3.7	3.5

Industrial production. Industrial production increased in May to 154.8 per cent of the 1957-59 average, nearly 1 per cent above the upward revised April figure of 153.6 and 9 per cent above a year earlier. Production of autos and parts declined, but output of most other final products and materials advanced. This year, both industrial production and the manufacturing component have increased at an average annual rate of 10 per cent, with the rise slower in April and May than earlier.

In May, auto assemblies, in response to the sharp decline in sales, were reduced 7 per cent to an annual rate of 8.6 million units. While some assembly plants have already closed down for model changeover, scheduled output for June is at about the May rate.

Deliveries of new domestic cars declined sharply further in May to an annual rate of 7.3 million units--down 20 per cent from the high first quarter rate and 10 per cent below May 1965. In early June, deliveries partially recovered to the 8.0 to 8.5 million range. Inventories of new cars changed little in early June and on June 10, at 1.7 million units, were 27 per cent above a year earlier.

Output of furniture, television sets, and some other home goods increased in May. Both output and sales were about one-tenth above a year earlier.

Production of business and defense equipment continued to advance rapidly in May and were 17 and 27 per cent, respectively, above a year ago. New orders for machinery and equipment rose further and the backlog of unfilled orders was 25 per cent above May 1965.

Production of nondurable materials rose sharply in May while output of durable materials as a whole showed little change, as declines in output of parts for new cars and also in output of construction materials offset increases in output of iron and steel and other durable materials. Part of the sharp rise in output of nondurable materials reflected resumption of work at coal mines where output had been curtailed in April by a strike, but gains in other nondurable goods lines were widespread.

Personal income. Personal income in May, at a seasonally adjusted annual rate of \$565.5 billion, was up about \$2.5 billion from April and \$4 billion from March. The increase from March to May was at an annual rate of about 4 per cent, well below the very rapid rates of late 1965 and early 1966. Nevertheless, the May level was about 8 per cent above a year earlier.

In April and May, expansion in private wage and salary disbursements slowed considerably as employment gains slackened, in part because of strikes; farm proprietors' income declined moderately following fairly steady increases earlier; dividend payments showed little further rise; and transfer payments--which had increased substantially last autumn and winter--were a trifle lower.

Retail sales. According to the advance monthly figure, retail sales declined 2.5 per cent in May, bringing the total decrease to 4.5 per cent from the March high. The May level was the lowest

since last October and was only 5 per cent above May 1965. The dramatic upsurge in the winter months reflected in part the rise in food prices.

The decline from March to May was concentrated in durable goods stores with virtually the entire April decline at auto dealers. In May, while a further decrease in auto sales accounted for the major part of the drop, sales of other durable goods also fell off and the total for all durable goods stores was 2 per cent below a year earlier. Sales of nondurable goods were up slightly over the two-month period, and the May level was 8 per cent above a year earlier.

Fragmentary indications for early June suggest moderate recovery in sales of autos and other durable goods and some further increase for nondurable goods. In the week ending June 11, total retail sales were up 8 per cent from the corresponding year-earlier week, with durables up 2 per cent and nondurables up 10 per cent.

Consumer credit. The slowing in consumer credit expansion in recent months apparently continued in May, judging by data from commercial banks. If bank-held credit accounts for about the same proportion of the total as in other recent months, a seasonally adjusted May increase of only around \$500 million in total consumer instalment credit is indicated. The average monthly increase in 1965 was \$670 million.

Commercial bank delinquency rates are only modestly above levels of two and three years ago, and are down from last autumn.

Latest ABA figures show that a usual seasonal reduction took place this spring.

This week major New York banks raised most of their consumer loan rates by one-half a percentage point. Increases of a half a percentage point also were announced by a Boston bank, to become effective July 1. The quoted rate in New York is now 4.75 per cent for direct auto loans (without credit life insurance), and 5.25 per cent for most other secured consumer loans. Purchased auto paper and personal loans (unsecured) were raised earlier this year, and were not affected by the current change.

Consumer expectations. According to the May survey conducted by the Survey Research Center of the University of Michigan, consumer optimism has weakened significantly over the past six months. Their Index of Consumer Sentiment, which was at a record level of 102 or 103 (Fall 1956=100) throughout 1965, declined to about 100 in February 1966 and 96 in May. This index is based on answers to several questions relating to short-term and long-term expectations about business conditions, to past and expected trends in personal finances, and to buying intentions. According to the Center, "all five components of the Index have fallen significantly since November 1965." For instance, there was a large decline in the proportion of consumers expecting to be "better off" financially a year hence. The Center found that awareness of higher prices and expectations of further price increases over the coming year were a major influence on the deterioration in consumer "sentiment."

A number of this survey's findings contradict the findings of the Census mid-April survey of consumer buying intentions, and partly in view of the much larger Census sample, the Survey Research Center's findings are subject to some question. Thus, Census reported large increases in the proportion of households with incomes above a year earlier and with expectations of larger incomes a year hence. Moreover, Census found buying intentions for major household durable goods unusually strong, while the Center reported a very sharp drop in such intentions. The Center found a collapse in used car buying plans, while in the Census report they were holding close to year-earlier levels. The magnitude of the declines indicated by the Center in household durable and used car buying plans alone makes them suspect. Both surveys seemed to agree on a sustained high level of buying intentions for new cars.

Orders for durable goods. New orders for durable goods in May remained at the April level which was about 3 per cent below the March peak. Shipments rose moderately in May, although not quite back to their March high. Unfilled orders increased substantially further but not so rapidly as in other recent months.

New orders for steel rose sharply in May, to about the highest level reached in the steel inventory build-up period in late 1964 and early 1965. This large increase was surprising in view of recent cutbacks in steel consumption by the auto industry and apparently reflected strong nonautomotive demand. New orders for machinery and

equipment, which had shown an unusually large increase in April, edged up further in May. On the other hand, defense ordering dropped sharply from the very high rates prevailing in the first four months of the year.

The May rise in unfilled orders was mainly in machinery and equipment--continuing the earlier rapid increase--and in steel. The defense order backlog held at the sharply advanced April level.

Business inventories. Business inventory accumulation is expected to increase appreciably in the current quarter, owing largely to the sharp but involuntary build-up in auto stocks. Book value figures are now available only through April, when the value of retail inventories increased about \$180 million, little different from the first quarter rate. Two-thirds of the increase was at auto dealers, where stocks had been showing little change for some months.

Manufacturers' inventories increased \$625 million in April compared with an average monthly rise of \$545 million in the first quarter. The direction of change ran counter to manufacturers' anticipations for the second quarter as a whole, when, according to the May Commerce Department survey, producers anticipated an average monthly increase of only \$435 million. These anticipation surveys have seriously underestimated actual inventory changes since mid-1965, and it is quite likely that in the current quarter accumulation will be at or above the first quarter rate. In April accumulation of work-in-process stocks in defense and business equipment industries

continued to be important and it has apparently continued to expand since then. Accumulation of stocks of materials by durable goods producers picked up in April, following some months of little change--reflecting in part the end of liquidation of steel stocks.

Construction activity. Seasonally adjusted new construction outlays in May changed little from the revised (downward) April level at an annual rate of \$76.2 billion, they were 2 per cent below the record reached last March but 6 per cent above a year earlier. These estimates are very preliminary.

For residential construction, starts in May suggest a definite weakening. Seasonally adjusted private housing starts dropped sharply further to the lowest rate since January 1963. On a three-month moving average basis, the rate was 1.46 million, about the same as the recent low reached in the third quarter of last year. Even allowing for the extreme volatility of the series, moreover, indications now are that the indicated drop to a 1.3 million rate in May reflects further declines in advance commitments built up earlier and increased lender constraints on construction and related loans stemming from the still tightening mortgage market. At best, this would suggest a second quarter rate no higher than 1.40 million as compared with the first quarter rate of 1.52 million.

PRIVATE HOUSING STARTS AND PERMITS

		May <u>1</u> / (thousands of units)	Per cent change from	
			April	Year ago
Starts	(total)	1,306	-13	-14
Permits	(total)	1,091	- 7	-12
1	family	601	- 6	-17
2-or-more	family	490	- 7	- 5
Northeast		199	-18	-17
North Central		279	- 4	-14
South		388	- 4	- 3
West		225	- 3	-17

1/ Seasonally adjusted annual rates; preliminary.

Building permits also dropped further in May and were the lowest since early 1961, with the year-to-year decline for single family units particularly marked. Regionally, the declines were widespread for both starts and permits and they were most pronounced in the Northeast.

While the relatively high rate of starts in April had raised the possibility that a marked turn in this series might be delayed until after midyear, the May shift was not entirely unexpected. Apart from evidence of underlying mortgage market conditions, shown in the recent Federal Reserve survey, an independent survey by the National Association of Home Builders suggested that 6 out of 10 builders have made significant downward revisions in their plans since last fall and particularly since March, owing mainly to the altered mortgage market environment. Four out of ten builders also stressed increases in labor and material costs as a limiting factor. In addition, there have been

reports of increased numbers of would-be sellers of existing homes withdrawing from the market because of the large discounts now involved in sales transactions.

Labor market. Nonfarm payroll employment, after changing little in April mainly because of strike curtailments, advanced 166,000 in May. Gains continued strongest in Government and manufacturing. Employment returned to or increased from March levels in most other industries, but declined further in construction.

CHANGES IN NONFARM EMPLOYMENT
(Seasonally adjusted, in thousands)

	Jan. 1966 to March 1966	March 1966 to May 1966
Total nonfarm	770	180
Manufacturing	260	140
Durable	190	100
Nondurable	70	40
Construction	80	-145
Transportation and public utilities	15	20
Trade	105	- 5
Finance & service	130	30
Government	180	150
Federal	50	50
State & local	130	100

Employment gains since March have generally slowed reflecting strikes in some industries, the less rapid rate of growth in over-all demands. In some sectors the slowing has been substantial as compared with the pace of the preceding 2-month period. No further increase has occurred in trade and there has been very little expansion in finance and service. In construction, employment has declined 145,000 from its March peak, largely reflecting strike activity during April and May. The less rapid expansion in manufacturing employment since March has been specially marked in automotive-oriented and building material industries; in the capital goods and defense-related industries gains have continued strong.

The workweek in manufacturing edged down in May to 41.4 hours from 41.5 in the preceding two months, largely reflecting reductions in the automobile industry where the workweek was almost an hour shorter. Generally, however, extensive use of overtime continued, with factory workers averaging over 4 hours a week of overtime. This amount of overtime was about the same as in other months this year and well above a year ago.

Unemployment. Unemployment rose in May to 4.0 per cent from 3.7 per cent in April. Women and youths accounted for most of the rise; for adult men (25 and over) the rate remained at the April low of 2.1 per cent.

Most of the May rise in teenage unemployment was among 14-17 year old students, many of whom entered the labor force in search

of summer employment comparatively early and in greater numbers this year. The jobless rate of this group rose sharply, to a level higher than a year ago. By comparison, the rate for 18-19 year olds was unchanged, and well below a year earlier. The increased unemployment of both teenagers and women was primarily of short-term duration. Long-term unemployment (15 weeks or over) declined further to a level a fourth below a year ago.

Prior to March, differences in unemployment rates among age-sex groups had been narrowing. Since then, however, differences have been widening.

SPREAD IN UNEMPLOYMENT RATES
(Seasonally adjusted)

	Unemployment rates		Difference (percentage points) between adult male rate and:		
	Total	Men 25 years & over	Teenagers	Adult women	Nonwhites
1965 Oct.	4.3	2.6	10.6	1.6	5.3
Nov.	4.2	2.5	9.8	1.8	5.6
Dec.	4.1	2.3	10.6	1.7	5.2
1966 Jan.	4.0	2.5	9.5	1.3	4.5
Feb.	3.7	2.3	8.6	1.3	4.7
Mar.	3.8	2.3	9.4	1.3	4.9
Apr.	3.7	2.1	9.9	1.5	4.9
May	4.0	2.1	11.3	1.9	5.5

Collective bargaining. Labor-management contract settlements negotiated in the first quarter of 1966 provided for larger wage increases than those negotiated last year and indications are that in the second quarter the average wage increase in new contract settlements will

widen further from a year ago. The proportion of all workers negotiating contracts in any quarter is, of course, quite small. Consequently, the effect on average hourly earnings will tend to appear as the current pattern is extended to settlements later this year and next.

In the first quarter, wage increases averaged 10-cents an hour or 3.7 per cent per year over the life of the contract, compared with an average rate of 3.3 per cent during 1965. In addition, contracts in both years provided for improved fringe benefits.

So far in the second quarter, contract settlements appear to have provided wage increases of 4 per cent or better. Recently, Western Union, the Pacific Northwest lumber industry and Railway Express Agency all signed contracts which provided for more than a 4 per cent wage increase. And in construction, recent settlements seem to have been in the 5-6 per cent range.

Rising consumer prices are becoming an important factor in collective bargaining. The higher than guidepost settlements in recent months frequently have included provisions for some method of adjusting for rising consumer prices. A number of recent contracts specifically have provided for wage reopening whenever the CPI rises by a stated percentage, as in the women's coat and suit industry. There is also renewed interest in cost-of-living clauses. The electrical workers are demanding reinstatement of such an escalator clause as a major goal in their upcoming negotiations with GE and Westinghouse.

Workers now covered by escalator clauses--in auto, aerospace and meat packing--will have received by midyear 6 to 7 cents in cost-of-living adjustments this year, the largest since 1958. However, only 2 million workers are covered by such clauses, about half the number covered in 1958.

Hourly earnings in a selected group of nonmanufacturing industries--union and nonunion, high and low wage--have been averaging about 4.5 per cent above a year ago. In manufacturing, hourly earnings in May averaged 3.5 per cent above a year earlier. For both broad sectors, the increases over the past 12 months have been moderately greater than in the preceding 12-month period.

WAGES IN SELECTED INDUSTRIES

	Average Hourly Earnings May 1966	Per Cent Increase May '65 to May '66
Manufacturing	\$2.70	3.5
Construction	3.81	4.4
Mining	3.04	4.5
Finance	2.49	4.6
Retail trade	1.90	4.4
Laundries	1.58	5.3

Wholesale prices. The industrial commodity price index has continued to rise steadily at an annual rate of about 3.5 per cent. From mid-April to mid-May it rose 0.3 per cent for the fourth consecutive month, reaching a level 104.2 per cent of the 1957-59 average. Estimates indicate a continuation of this rate of increase into late June. Average prices of foodstuffs have continued to decline from the February peak, and as a consequence, the estimated total wholesale price index has changed little since then.

Average prices of machinery and equipment, reflecting strong demand for capital goods, rose 0.4 per cent from April to May, and increased about 2 per cent during the first five months of this year. Prices of construction materials, also rising rapidly, increased 0.8 per cent in May and over 3-1/2 per cent during the first five months of the year. Lumber rose again in May primarily because of the lingering effects of the boxcar shortage and the anticipation of a strike; since then, however, prices have declined. Prices of fabricated metal products are continuing to rise, reflecting large unfilled orders and increasing material costs.

Prices of a number of synthetic fibers are continuing to fall sharply, reflecting significant economies of scale, and the average for man-made fiber textile products in May was down about 6 per cent from a year ago. This decline has about offset increases in other textile products, and consequently, the average for the entire textile group has changed little during the past 12 months. Also

prices of both color and black-and-white television receivers recently have been reduced by up to 10 per cent.

Average prices of foodstuffs are continuing to decline, reinforced by seasonal reductions in fresh fruits and vegetables, and by mid-June are estimated to be nearly 3 per cent below the February peak. Livestock prices which were the major influence on the rise in foodstuffs have remained on downward trends, although the reduction in average prices was temporarily slowed by a seasonal increase in hogs last month. Wheat prices in the past month have risen sharply primarily because of deterioration in the crop of winter wheat, new commitments to India, and rising commercial export demand.

WHOLESALE PRICE INDEXES
1957-59=100

	Index May 1966	Per cent change to May 1966 from		
		April 1966	February 1966	September 1964
Total index	105.5	0	.1	4.8
Industrial commodities	104.2	.3	.9	3.5
Industrial materials	103.9	.4	1.2	4.2
Industrial products	104.5	.4	.7	2.7
Consumer nonfood	103.0	.2	.6	2.4
Producer	107.5	.6	.9	3.4
Foodstuffs	109.3	-.6	-2.0	8.9
Federal Reserve groupings.				

Consumer prices. The consumer price index rose 0.1 per cent from mid-April to mid-May and was 2.7 per cent above May 1965. The rise was the smallest monthly increase since early last summer as foods declined for the first time in 9 months. Prices of beef, pork, poultry, eggs, and fresh fruits and vegetables fell, resulting in a 0.6 per cent decline in food purchased in grocery stores and a 0.4 per cent decline in the total for food which includes restaurant meals. In May, meat prices were still 15 per cent above a year earlier, but further declines are expected.

Average prices of services rose 0.3 per cent to a level 3.4 per cent above a year earlier. Medical care services continue to show large increases, rising 0.5 per cent from April and 4.4 per cent from May 1965. Mortgage interest rates, house repairs, and personal services also contributed to the rise.

Nonfood commodity prices rose 0.3 per cent largely as a result of further increases in apparel and footwear. Prices of new cars declined about seasonally, and used cars rose less than seasonally.

Agricultural conditions. The only surprising development revealed in the June 1 survey of crop conditions was deterioration in the winter wheat crop prospects. For spring-planted crops, planting delays and slow development were reported in some areas, but the effects on output prospects were not considered serious. Pasture conditions were normal over most of the country but exceedingly dry weather prevailed in Kansas and adjacent states, the center of the winter wheat area.

The June 1 estimate of the winter wheat crop was 975 million bushels, 11 per cent less than the May 1 forecast but only 5 per cent less than the 1965 crop. Drought and frost caused most of the damage. Since June 1, rains have benefited yields in some areas but have impeded harvest in others. The spring wheat crop was estimated at 259 million bushels. For all wheat, a crop of 1,235 million bushels is in prospect.

Supplies of spring vegetables for fresh market are 4 per cent larger than last year and producers plan a 9 per cent expansion in acreage of vegetables for processing. More potatoes are in prospect in all growing areas and prospects for most deciduous fruits are better than last year. The citrus crop, now largely harvested, is substantially larger than last year and prospects for 1966-67 are generally favorable.

Commercial output of pork and beef in May was about 4 per cent larger than April, on a seasonally adjusted basis, and 10 per cent above the very low level of last May. However, output of milk and eggs in May was still running below year earlier levels. Reduced milk production--below year earlier levels for the past 7 months--is reflected primarily in reduced volume of CCC price support purchases; domestic sales of fluid milk products, cheese, and frozen dairy products are larger than a year earlier. Egg production is rising and in the third quarter is likely to equal a year earlier and in the fourth quarter to be significantly above a year ago.

Commodity market developments. Tightening supplies and uncertain new-crop conditions revealed by the crop report released on June 10 set off a wave of buying of future contracts, mostly wheat and soybeans, but other grains as well, by exporters, speculators, and commercial traders. Later, likelihood of damage to the wheat crop by storms in harvest areas exerted further pressure on demand. An additional fillip was given to the futures markets by the June 20 announcement by Canada of a sale to Russia of a large amount of wheat for delivery over the next three years.

Underlying the active trading in futures markets is a shift in the supply position of most of the major commodities from one of chronic surplus to one of closer balance with demand. In recent years reductions in production by means of acreage diversion programs and large exports have greatly reduced stocks of wheat and feed grains held by the Commodity Credit Corporation. Soybeans, the one crop with yields little improved from 20 years ago, has experienced spectacular increases in domestic and export demand, and acreage has expanded rapidly. In 1965, acreage in soybeans was exceeded only by those in wheat and corn. The USDA has encouraged further expansion in acreage in 1966.

The pinch in wheat supplies in prospect during 1966-67 marketing season stems mainly from the commitment of large supplies to India. Big exports, three-fourths of them aid-financed, have been the major draft on wheat supplies and if continued in the volume attained

in 1965-66 could reduce the July 1, 1967 carry-over below the 450-500 million bushel reserve considered desirable.

SUPPLY AND DISTRIBUTION OF WHEAT
 Year beginning July 1
 (millions of bushels)

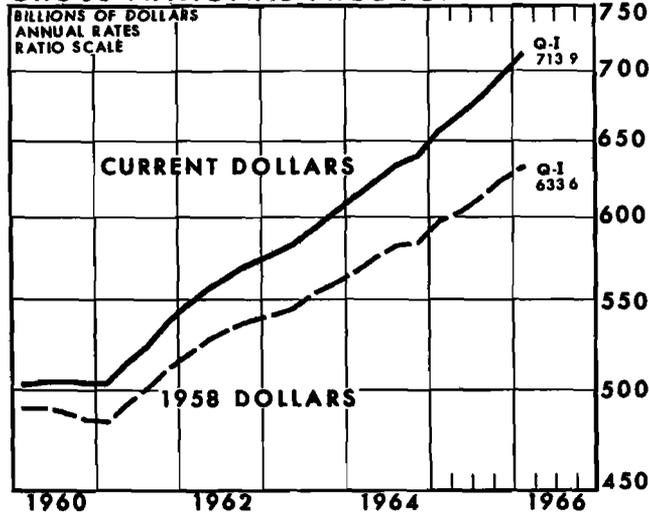
	1964	1965	1966
Supply	2,194	2,147	1,793
Beginning carry-over	901	818	555
Production	1,291	1,327	1,235 ^e
Import	2	2	3
Utilization	1,374	1,592	1,430 - 1,530
Food	519	525	525
Livestock feed	62	156	80
Seed	65	61	75
Export	728	850	750 - 850
Ending Carry-over	818	555	363 - 263

Action was taken by the USDA in early May to increase wheat production in 1967 by increasing acreage allotments 15 per cent. More recently, the USDA has announced that the size of P.L. 480 shipments in the coming year will be gauged by supply prospects, mainly farmers' plantings of winter wheat in response to increased acreage allotments, and by weather conditions. Winter wheat normally makes up three-fourths of the U.S. crop.

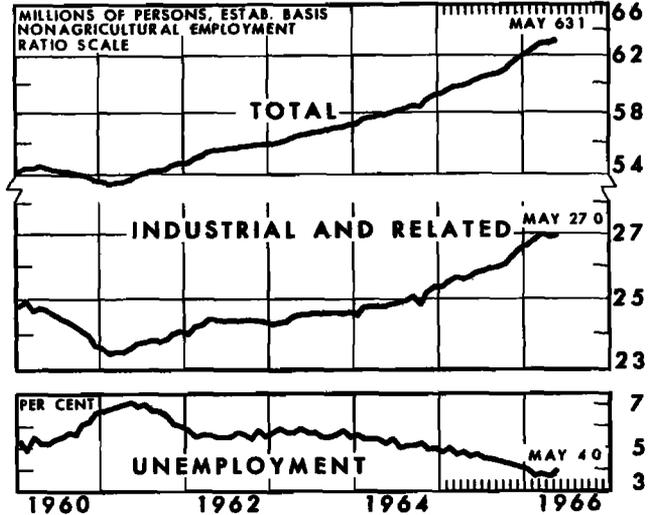
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

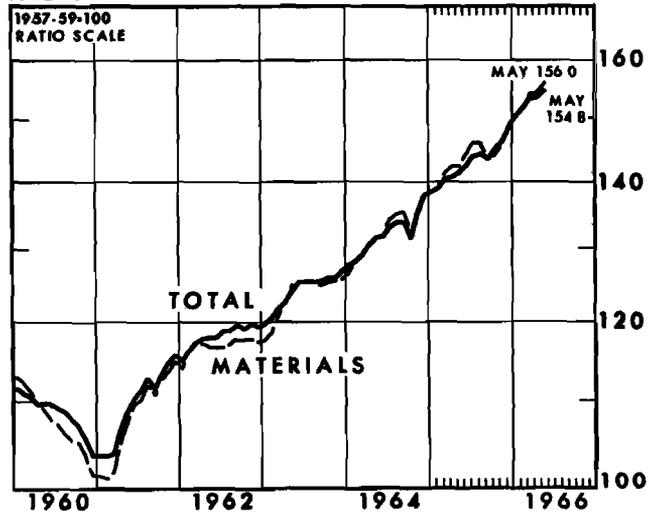
GROSS NATIONAL PRODUCT



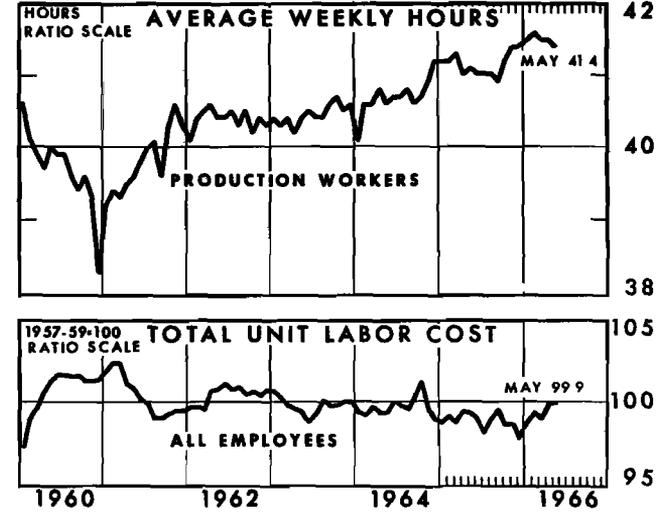
EMPLOYMENT AND UNEMPLOYMENT



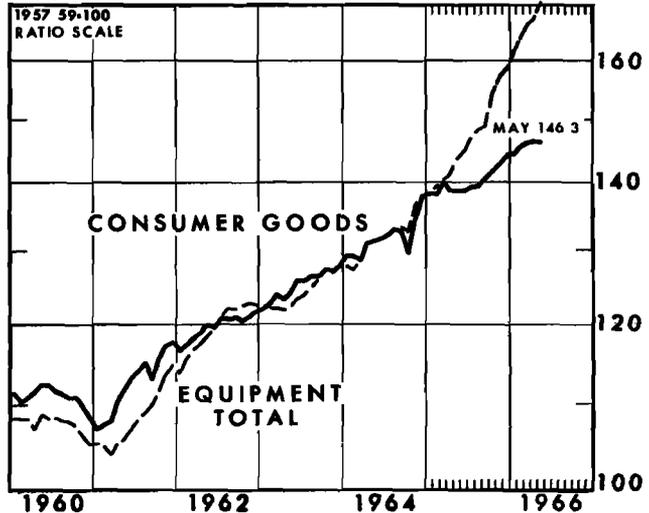
INDUSTRIAL PRODUCTION-I



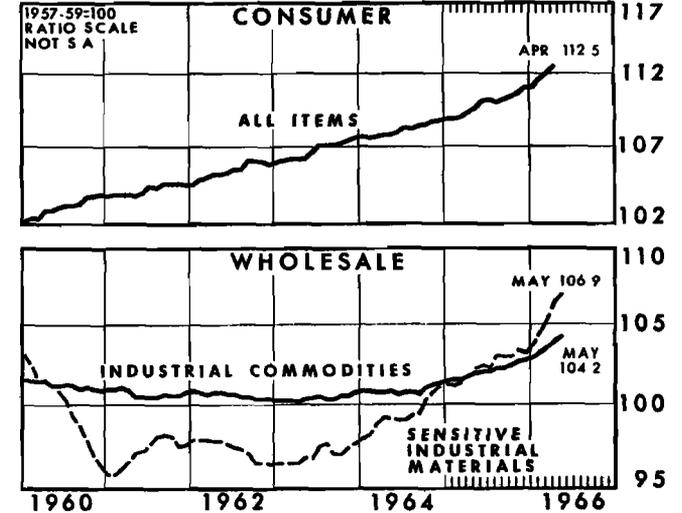
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



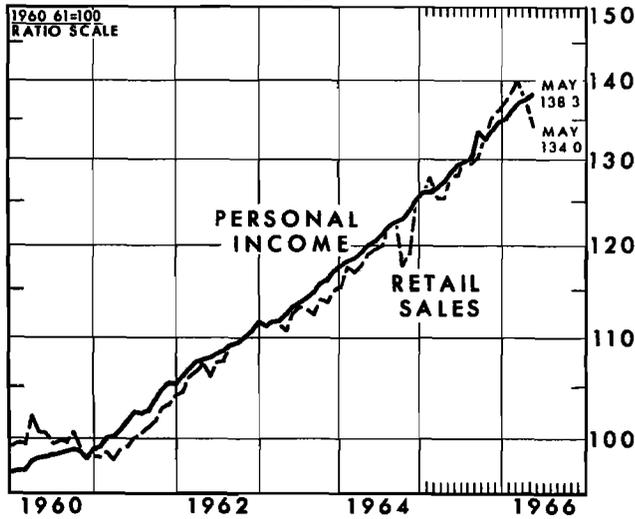
PRICES



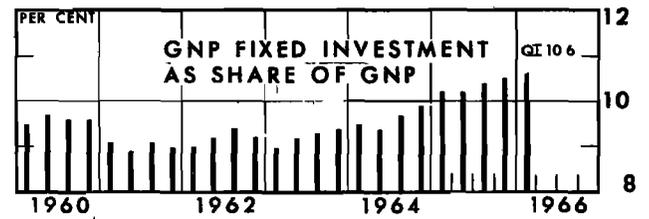
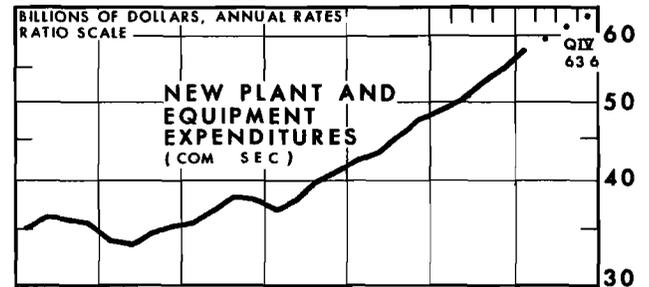
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

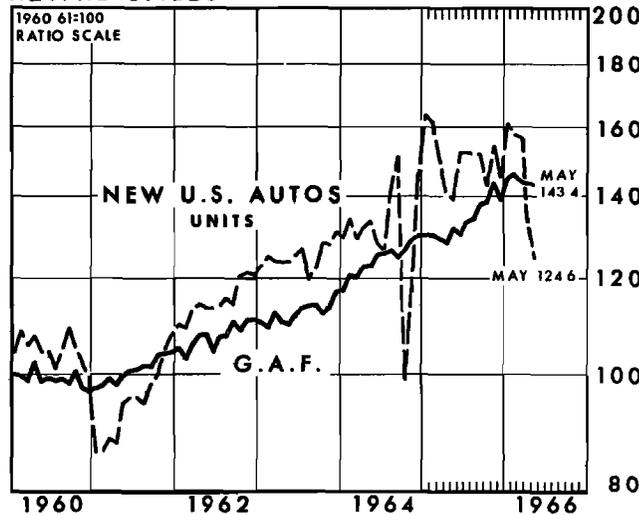
INCOME AND SALES



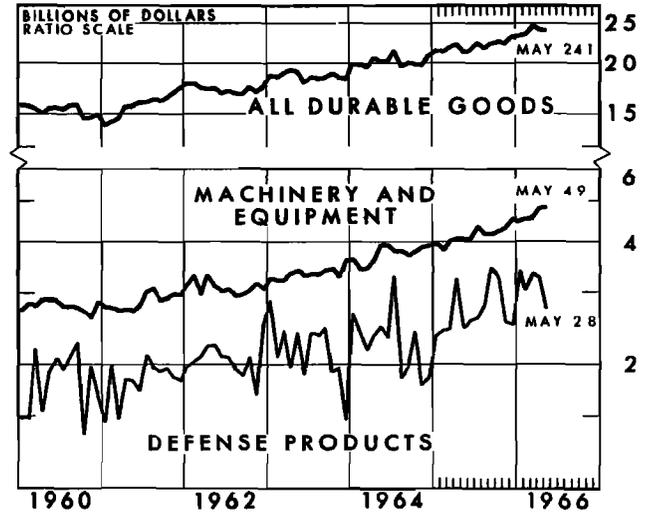
BUSINESS INVESTMENT



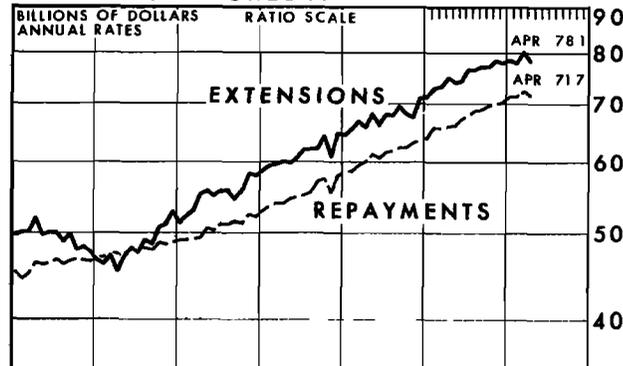
RETAIL SALES



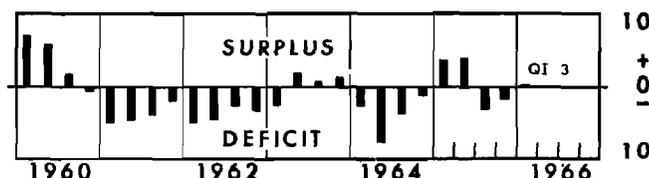
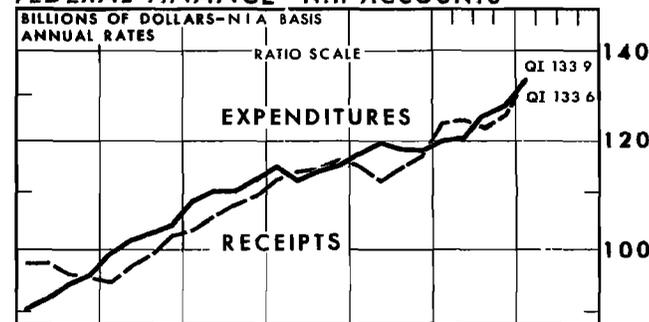
MANUFACTURERS' NEW ORDERS



INSTALMENT CREDIT



FEDERAL FINANCE-N.I.A. ACCOUNTS



DOMESTIC FINANCIAL SITUATION

Bank credit. In the two weeks prior to the June tax and dividend dates, bank credit at weekly reporting banks declined contra-seasonally -- mainly because of reductions in loans to government security dealers and in banks own holdings of Treasury bills. Most of the latter liquidation is thought to be centered at dealer banks. The decline in these bank assets reflects the reduced inventories of Government security dealers in the face of a large demand for the already curtailed market supply of bills.

At New York City banks in the week ended June 15, however, tax and dividend pressures were partially reflected in an increase in bank credit of \$1.5 billion -- about \$500 million more than last year. Loan demands were strong by finance companies -- who had to finance maturing paper -- and by nonfinancial businesses. Continued demand for bills by the public -- even in light of tax and dividend pressures -- and a generally reduced inventory position kept Government security dealer bank loan demands quite modest, although the New York banks absorbed about \$350 million of bills, mainly for their own account. Part of this increase, however, may have reflected acquisitions by banks for midyear statement purposes rather than to accommodate customers in need of funds for tax and dividend payments. The earlier than usual purchases of bills for such purposes may be caused by the fact that several large New York banks had reduced their bill portfolios to, or close to, zero.

Business loan expansion was stronger than usual the first half of June -- particularly in metals, petroleum and textile industries, and by miscellaneous manufacturing firms. However, the increase was moderate in the week ended June 15 if one takes into account the extent to which corporate tax liabilities were not provided for by tax bills or maturing CD's and RP's. Tax liabilities not funded in this manner were estimated to amount to \$4.9 billion, or \$1.3 billion greater than last year, yet business loans at New York banks during the week ended June 15 increased by only \$67 million more than the expansion at the same time in 1965.

Several factors seem to have been at work tending to moderate business loan expansion at New York City banks that week -- at least one of which is a statistical quirk. Comparable statement weeks in recent years have ended a day or so past the tax date, while this year the statement week ended on June 15. Some large firms evidently borrow for tax purposes on June 16 which provides them with the needed funds by the time their tax checks are cleared. Thus, the increase in business loans during the week ended June 15 tends to understate tax borrowing by some unknown -- but possibly appreciable -- amount.

The recent expansion of business loans was perhaps also tempered by corporate build up of liquid assets for tax payments, in part from funds obtained through the capital markets. Liquidation of such assets were reflected in large in areas in finance company borrowing at banks and quite large net declines in CD's around the tax

date. Stress may have been placed on asset liquidation in view of the tight situation at many banks; particularly in New York City. All of these factors suggest that a clearer picture of the extent of tax period borrowing must await data for the statement week ending June 22, and also of course from the non-New York weekly reporters for the week of June 15.

Deposits and money stock. Private demand deposits increased sharply in the first half of June, in large part because of more than seasonal reductions in Treasury deposits. In the second half of the month, the buildup in U.S. Government balances will tend to moderate increases in private demand deposits, but for the month as a whole such deposits are expected to expand at a 14.5 per cent seasonally adjusted annual rate, and the money stock is likely to increase at a 12 per cent annual rate. If realized, this would indicate an increase in the money stock for the first half of 1966 at a 4.5 per cent rate, as compared to 4.8 per cent for all of 1965.

Time and savings deposits continue to expand at a rate slightly below the 10 per cent rate of May. The pattern at weekly reporting banks in evidence since mid-March of reductions in pass-book savings accounts and increases in time deposits other than negotiable CD's has continued.

Growth in outstanding CD's moderated sharply in June, reflecting dividend payments and the needs of firms to prepare for tax payments. Despite about the same quantity of CD's maturing at the tax date as

last year, the larger tax liabilities led to a very sharp \$428 million decline in outstanding CD's at New York City banks -- \$260 million more than last year. Quite scattered and modest increases in offering rates on CD's in the most recent weekly report suggest that no strong effort was made by banks to replace their maturing paper. This decision evidently reflects on both the feeling by banks that corporate CD demand would be so thin until after tax payments are completed as to make strong efforts to replace maturing certificates not worthwhile, plus a relatively comfortable position on the result of redeposits of tax funds in Treasury deposits in New York banks.

All of the major New York banks recently have reported rates at 5.50 per cent on 6-month and over CD's and most have only little leeway below Q ceilings in the 3- to 6-month area. However, according to posted rates, New York banks have considerable room (25 to 50 basis points) to increase rates on CD's maturing in less than 90 days. Most other large banks also report offering rates 25 to 50 basis points below Q ceilings in the under 90-day market and almost half of these banks report offering rates below 5.50 on long CD's. However, our survey also suggests that a good portion of these reported rates are below rates at which banks are willing to negotiate for large blocks of funds. This factor, plus sporadic reports of higher CD offering rates, suggest that attempts of banks to accelerate CD inflows will entail -- at present Regulation Q limits -- use of shorter CD's at higher rates. A few banks have already started to use less than 90-day

maturities at rates above 5.25, and by June 22 at least three major New York City banks were offering 5.50 per cent on CD's maturing in 60 to 89 days.

U.S. Government securities market. Yields have declined in all maturity sectors of the U.S. Government securities market since early June and bill rates currently are at, or very close to, their lows for the year. In the note and bond area, a modest amount of net investment demand developed earlier in the month for issues due within 5 years and this demand was supplemented by System purchases totaling about \$45 million. More recently, dealers have been net buyers of coupon issues in all maturity areas and their positions in bonds due after 5 years have risen above \$100 million for the first time since early April. The general strength of the note and bond market in the recent period has thus appeared to reflect mainly a turn to a somewhat more bullish psychology among market professionals with respect to the near-term outlook for banks. This attitude has been influenced in part by recurrent rumors as to peace prospects in Vietnam and by such economic indicators as the slower pace of auto sales. In addition, the good receptions accorded recent corporate and Agency issues also provided a tonic to the market.

Yields on Federal Agency issues have edged off their recent peaks, as many previously hesitant investors apparently have decided to commit funds at prevailing yield levels. Prospects of lesser supplies of new issues in coming weeks have contributed to the firmer tone in this market.

YIELDS ON U.S. GOVERNMENT SECURITIES
(Per cent)

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
<u>1959-1961</u>						
Highs	4.68	5.15	5.17	5.11	4.90	4.51
Lows	2.05	2.33	3.08	3.30	3.63	3.70
<u>1966</u>						
Highs	4.70	4.90	5.12	5.03	5.02	4.81
Lows	4.43	4.57	4.78	4.76	4.56	4.49
<u>1965-1966</u>						
Dec. 3	4.12	4.26	4.54	4.52	4.52	4.44
Feb. 28	4.64	4.84	5.06	5.03	5.02	4.81
June 1	4.63	4.78	5.09	4.98	4.80	4.73
June 7	4.60	4.76	5.08	4.97	4.82	4.74
June 21	4.47	4.57	4.97	4.89	4.77	4.69

Treasury bill yields have moved sharply lower since early June, with the 3-month Treasury bill currently yielding 4.46 per cent.* The decline in bill yields, which has averaged about 17 basis points throughout the list since the beginning of June, is in part a seasonal phenomenon. Treasury bill yields reach a seasonal low for the year towards the end of June, reflecting a decreased market supply of bills at the same time demands are strong.

The supply of bills outstanding will decline with the maturity of \$4.5 billion of June tax bills, some \$2.0 billion of which are estimated to be turned in for cash rather than utilized to pay taxes. Moreover, the market supply situation has been currently aggravated by the very low level to which dealer trading positions in bills have fallen. As of

* On June 22 the 3-month bill closed at 4.40 per cent.

June 20, such positions totaled only \$587 million, and this has largely divorced the bill market from any upward yield pressures that might have resulted from the currently high financing costs to dealers.

The tax date itself passed with scarcely a ripple in the bill market, as the small reported selling of bills was more than offset by buying of bills for future delivery from holders of the maturing tax bill. In addition, bill demand has been buttressed by reported purchases by state and local governments who have temporarily reinvested proceeds of recent security issues. Moreover, since early June the System has been a net buyer of nearly \$1/2 billion of bills in the market.

Yields on competing short-term debt issues, including CD's, remained generally unchanged over the tax date and indeed are unchanged since early June.

SELECTED SHORT-TERM INTEREST RATES 1/

	1965	1966	
	Dec. 3	June 1	June 17
Commercial paper 4-6 months	4.375	5.50	5.50
Finance company paper 30-89 days	4.375	5.375	5.375
Bankers' Acceptances 1-90 days	4.25	5.375	5.375
Certificates of deposit (prime NYC)			
Most often quoted new issue:			
3-months	4.50	5.25	5.25
6-months	4.50	5.50	5.50
Highest quoted new issue:			
3-months	4.50	5.47	5.40
6-months	4.50	5.58	5.50
Federal Agencies:			
3-months	4.34	5.15	5.09
6-months	4.49	5.39	5.41
9-months	4.58	5.56	5.54
Prime Municipals 1-year	2.65	3.30	3.40

1/ Rates are quoted on offered side of market; rates on commercial paper, finance company paper, and bankers' acceptances are quoted on a bank discount basis while rates on the other instruments are on an investment yield basis.

Corporate and municipal bond markets. As in markets for Treasury and Federal agency securities, the tone of markets for other types of bonds has improved recently. Yields on municipal bonds, after rising in May and early June to within a few basis points of their 1966 highs, have since turned down slightly. While yields on new corporate bonds have continued to advance in recent weeks to the highest levels of the year, market participants are expecting some easing of pressures in this market too once the current week's offerings -- which represent nearly half of the June supply -- are out of the way.

BOND YIELDS
(Per cent per annum)

	Corporate		State and local Government	
	Aaa		Moody's	Bond buyer
	New	Seasoned	Aaa	(mixed qualities)
<u>Previous Postwar High</u>	5.13(9/18/59)	4.61(1/29/60)	3.56(9/24/59)	3.81(9/17/59)
1965 low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(2/11)
<u>Weeks ending:</u>				
Dec. 3	4.79	4.60	3.37	3.50
Mar. 4(high)	5.38	4.85	3.63	3.83
Apr. 8(low)	4.90	4.98	3.44	3.55
June 3	5.36	5.04	3.60	3.78
June 10	5.34	5.06	3.60	3.78
June 17	5.43	5.06	3.59	3.74

The corporate bond market appears to be in a good technical position to absorb this week's \$410 million volume of new issues. Only one small recently offered utility issue is still in syndicate, and a

number of other issues have recently sold out quickly, moving to premium prices in the secondary market. With the volume of new offerings scheduled to contract considerably in the weeks immediately ahead, investors are expected to show an active interest in the current week's supply of new corporate issues as well as in the new \$175 million World Bank offering.

For the month of June, publicly offered corporate bonds are now estimated to aggregate about \$850 million. This will represent the largest monthly volume of such offerings in over four years. When combined with anticipated private placements and corporate stock offerings, it amounts to a record breaking total of almost \$2.7 billion gross corporate security offerings.

Corporate bonds scheduled for public offering in July, on the other hand, now amount to only \$200 million. While this volume will, of course, be augmented as the month progresses, it may ultimately total no more than the relatively moderate May calendar, but about the same as the seasonally large July calendar a year ago. Looking beyond July, issues with offering dates set for August already aggregate more than \$400 million (including the \$250 million AT&T debenture) -- larger than the final August total a year earlier. Moreover, any significant easing of yields in the corporate bond market at this point might elicit further additions to the near-term calendar.

CORPORATE SECURITY OFFERINGS 1/
(In millions of dollars)

	Bonds				Stocks	
	Public Offerings <u>2/</u>		Private Placements		1966	1965
	1966	1965	1966	1965		
1st Qtr.	1,773	.905	2,586	1,673	734	429
2nd Qtr.	1,968 <u>e/</u>	1,864	2,454 <u>e/</u>	2,258	1,009 <u>e/</u>	920
April	628	422	754	648	209	162
May	490 <u>e/</u>	694	700 <u>e/</u>	630	100 <u>e/</u>	449
June	850 <u>e/</u>	748	1,000 <u>e/</u>	980	700 <u>e/</u>	309
July	500 <u>e/</u>	542	800 <u>e/</u>	780	100 <u>e/</u>	122

1/ Data are gross proceeds.

2/ Includes refundings.

In the State and local government bond market, June volume is expected to exceed that of June a year ago, but with both the California and Public Housing issues now out of the way, the remaining June supply is rather evenly distributed over the rest of the month, and as yet offerings scheduled for July are quite light. At the same time, dealers have succeeded in reducing their advertised inventories to less than \$500 million.

STATE AND LOCAL GOVERNMENT BOND OFFERINGS
(In millions of dollars) 1/

	1966	1965
1st Quarter	2.881	2.851
2nd Quarter	3,300 <u>e/</u>	3,046
April	1,150 <u>e/</u>	994
May	900 <u>e/</u>	987
June	1,250 <u>e/</u>	1,065
July	800 <u>e/</u>	995

1/ Data are for principal amounts of new issues.

Mortgage markets. Mortgage markets have tightened further in recent weeks as lender uncertainty about the direction and magnitude of net flows of loanable funds has continued. Further information now available for May (some of which is described in Appendix A) tends to confirm the picture of conditions reported in the recent Federal Reserve Bank reports on mortgage markets.

The rate of increase in mortgage yields since September has been the sharpest in the postwar period and, by May, the structure of yields was at a record high. For conventional first mortgages on new home purchases interest rates were up 5 basis points further in May, to 6.30 per cent. Except for a pause in January, such rates have advanced by 5 or more basis points each month since September. Rates on mortgages for existing homes have exhibited much the same pattern and, in May, averaged 6.35 per cent, at least 5 basis points above the earlier peak in late 1959 and early 1960.

Secondary market yields on 5-3/4 per cent, 30-year FHA-insured home mortgages reached 6.32 per cent in May. This was 32 basis points more than the average for comparable 5-1/2 per cent mortgages in March and 86 basis points above the plateau which had persisted through September of last year (when the contract maximum had been 5-1/4 per cent).

To keep its buying prices in line with the market, effective June 10, the Federal National Mortgage Association lowered prices paid to sellers of eligible home mortgages 2 percentage points further.

This reduction--equal to about 25 basis points on yield to the purchaser--was the second such adjustment since early April and the fifth (including three of 1 percentage point each) since early December. Reflecting these and other adjustments (including the April limitation on mortgages eligible for purchase to those with an unpaid balance of \$15,000), the volume of offerings of mortgages by private holders to FNMA has declined from earlier peaks. But in May the volume was still more than five times as large as a year earlier. To assure continuance of FNMA's support to the market, bills now before Congress would permit an addition to FNMA's present borrowing authority for this purpose of up to \$2 billion.

Corporate profitability. Financial data that have recently become available for manufacturing corporations suggest that the substantial rise in corporate profits in the first quarter reflected not only a higher level of activity but also a more rapid advance in prices than in costs. Increasingly favorable price-cost relationships have contributed significantly to the prolonged rise in profits since 1961, and the leveling off or worsening of these relationships, which occurred rather early in previous expansion periods, has been notably absent, at least through early 1966. In the first quarter, profits per dollar of sales, as well as rate of return on net worth, were the highest in many years.

The ratio of profits before taxes to sales for manufacturing corporations, which averaged about 9 per cent in 1964 and 9.5 per cent

in 1965, rose to 9.9 per cent (seasonally adjusted) in the first quarter of 1966. This is the highest rate since late 1955 and early 1956. The ratio of after-tax profits to stockholders' equity in the first quarter was just under 13 per cent (annual rate not seasonally adjusted). This is the highest rate of return for any first quarter since 1951. In these earlier years, of course, deductions for depreciation were relatively much smaller than they are today. If allowance is made for the liberalization of depreciation rules in recent years (i.e., if profits are taken before deducting depreciation), earnings per dollar of sales and per dollar of net worth were higher in the first quarter of this year than in any first quarter since 1948.

Sooner or later, some combination of factors will undoubtedly bring this persistent rise in profitability to an end. But thus far the assortment of factors which typically exerted downward pressure on profit margins as earlier postwar expansions progressed--substantial wage increases, bunching of start-up expenses on new plants, less rigorous control of various administrative expenses, increasing inability to pass on cost increases in price advances--appear to have been relatively unimportant for manufacturers as a whole. It seems likely, given the moderation of economic expansion this spring and the developing pressure on wages that profit margins will rise less than seasonally in the current quarter.

Stock prices. Common stock prices have fluctuated indecisively since the Memorial Day holiday, at levels somewhat above the yearly lows reached in mid-May. On June 20, Standard and Poor's composite index of 500 stocks was 86.48, 3-1/2 per cent higher than on May 17. But the index was still 8 per cent below the record high of February 9.

The slower pace of stock-trading--which began after the April market break--has continued into June. For the first three weeks this month, trading activity on the New York Stock Exchange averaged about 6.2 million shares per day, considerably below April and May in which trading averaged 9.3 and 8.2 million shares per day respectively. More recently, however, there has been some pick-up in trading of the speculative issues so favored by investors during the winter and early spring months.

The general weakening in stock prices and the dampening of speculative psychology during May were accompanied by a decline in the use of stock market credit. Customers' net debit balances were reduced by \$67 million and purpose loans at banks were cut another \$19 million. Moreover, a still preliminary tabulation of accounts in the New York Stock Exchange margin panel shows a May decline in margin credit amounting to \$150 million.

Estimated budget results for fiscal 1966. Federal receipts and expenditures, based on actual data through May have risen sharply on all budget bases in fiscal 1966. National accounts expenditures rose almost

\$12 billion, which more than matched the growth in receipts and led to a slight deficit for the fiscal year. On a cash basis, payments grew even more relative to receipts, and the deficit nearly doubled to an estimated \$5.4 billion.

The full employment budget moved in an expansionary direction over the year. The surplus declined sharply between the first and second halves of calendar 1965, primarily because of the sharp growth in expenditures in the second half of the year. In the first half of 1966, the surplus remained at this very low level with further increases in taxes and expenditures being about offsetting.

While most major expenditure categories are substantially on target in relation to projections in the January 1966 Document, defense expenditures have been running moderately higher than projected. And on a cash budget basis, the government sponsored corporations--namely the Federal Home Loan Banks and the three agricultural lending corporations--are spending far in excess of their Budget projections. As a result cash payments will be considerably higher than predicted in January.

On the revenue side, all receipt figures are above Budget projections primarily because of a higher than anticipated level of GNP. The increase in cash and Administrative budget receipts is further accentuated by the speed-up in payments of social security taxes which was not explicitly planned in the January Document.

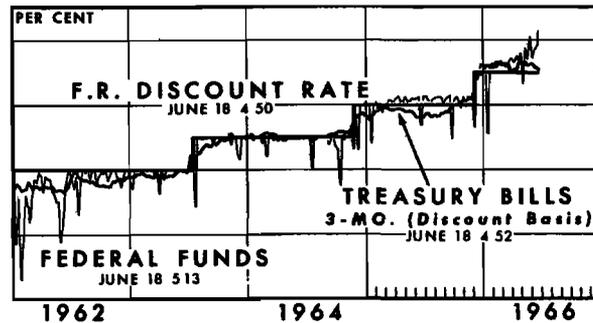
Federal Budgets
(In billions of dollars)

	By Half-Years				By Fiscal Years			
	July - Dec. 1964	Jan. - June 1965	July - Dec. 1965	Jan. - June 1966 p/	1964	1965	1966 p/	Jan. 1966 Budget Document FY'66
Quarterly Totals, not seasonally adjusted								
Administrative Budget								
Receipts	39.6	53.5	43.2	60.3	89.5	93.1	103.5	100.0
Expenditures	48.1	48.4	53.0	54.0	97.7	96.5	107.0	106.4
Deficit (-)	- 8.5	5.2	- 9.9	6.3	- 8.2	- 3.4	- 3.5	- 6.4
Cash Budget								
Receipts	51.3	68.4	55.0	78.0	115.5	119.7	133.0	128.2
Payments	61.5	60.9	67.1	71.3	120.3	122.4	138.4	135.0
Deficit (-)	- 10.2	7.5	- 12.0	6.7	- 4.8	- 2.7	- 5.4	- 6.9
Annual Rates, seasonally adjusted								
National Income Budget								
Receipts	115.7	124.1	124.0	136.0	115.1	119.6	130.0	128.8
Expenditures	118.1	120.4	126.3	135.2	117.1	119.2	130.8	131.0
Deficit (-)	- 2.4	3.7	- 2.3	.8	- 1.9	.3	.8	- 2.2
Full Employment Budget								
Receipts	120.8	128.5	127.0	136.2	120.8	124.7	131.6	
Expenditures	117.6	120.0	126.0	135.2	116.0	118.8	130.6	
Surplus (+)	3.2	8.5	1.0	1.0	4.8	5.9	1.0	

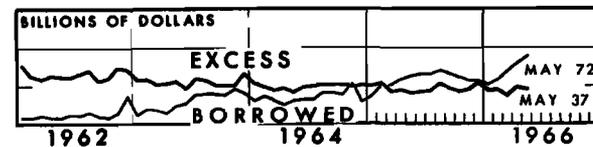
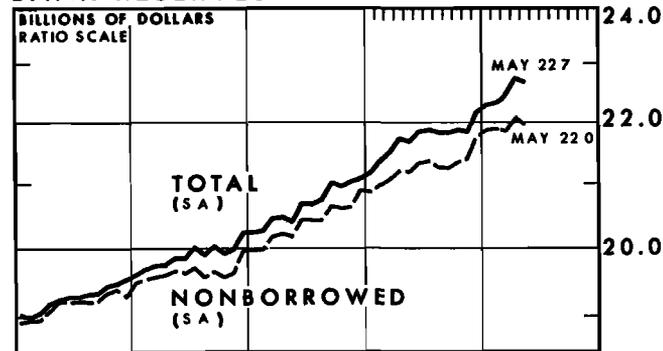
p -- Projected.

FINANCIAL DEVELOPMENTS - UNITED STATES

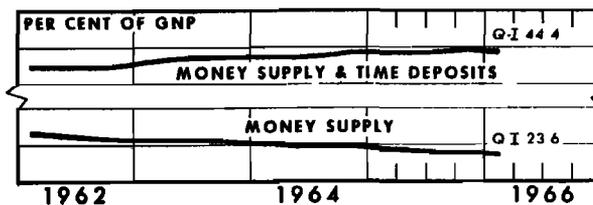
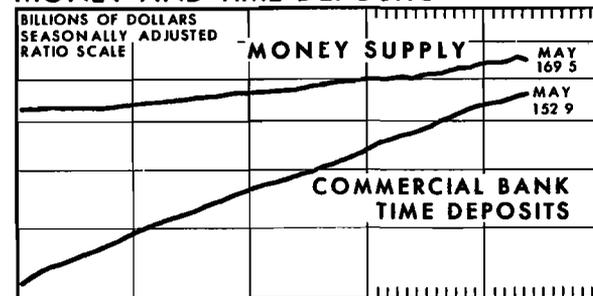
FREE RESERVES AND COSTS



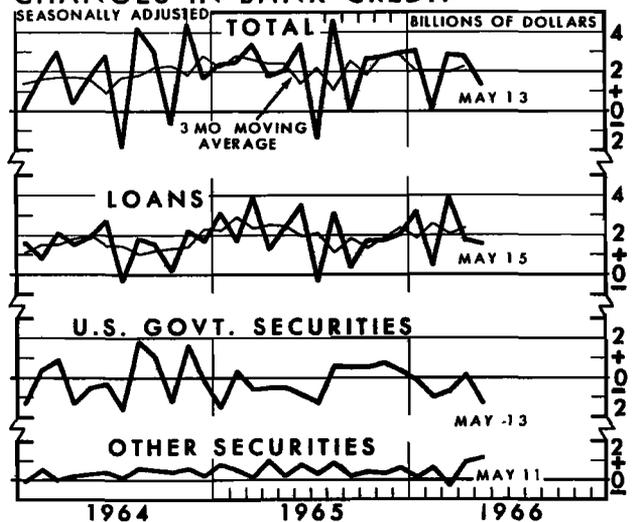
BANK RESERVES



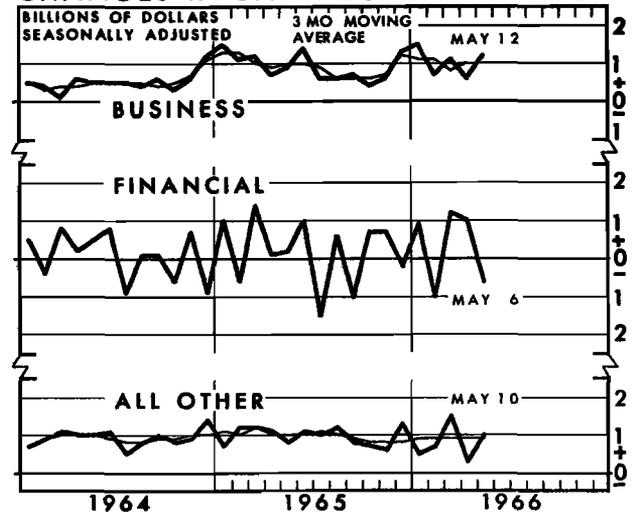
MONEY AND TIME DEPOSITS



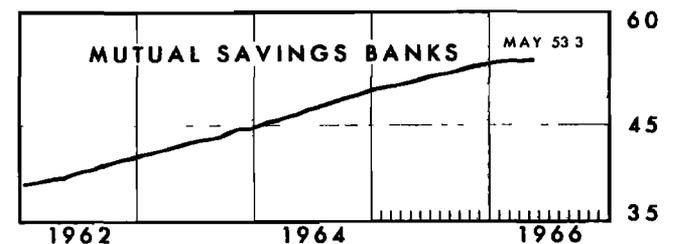
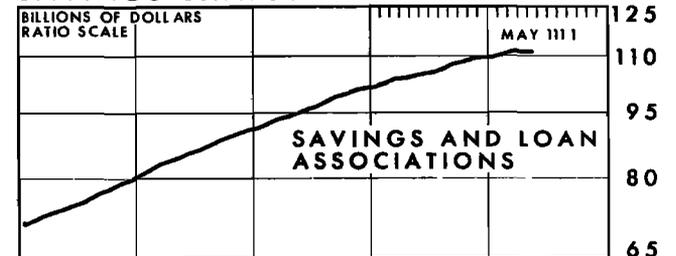
CHANGES IN BANK CREDIT



CHANGES IN BANK LOANS-BY TYPE

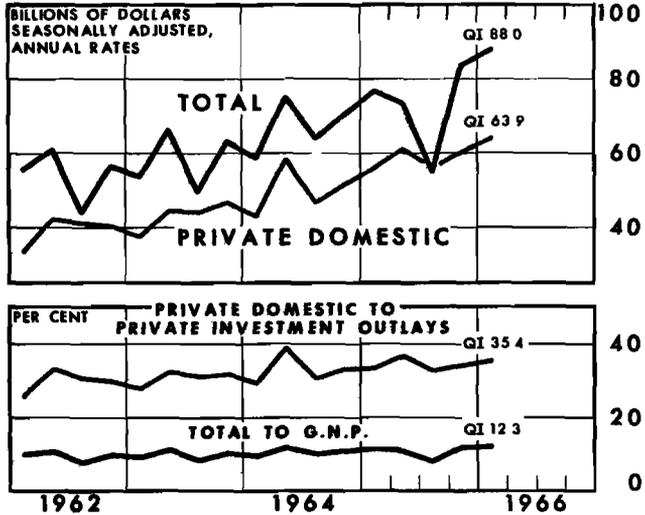


SAVINGS SHARES AND DEPOSITS

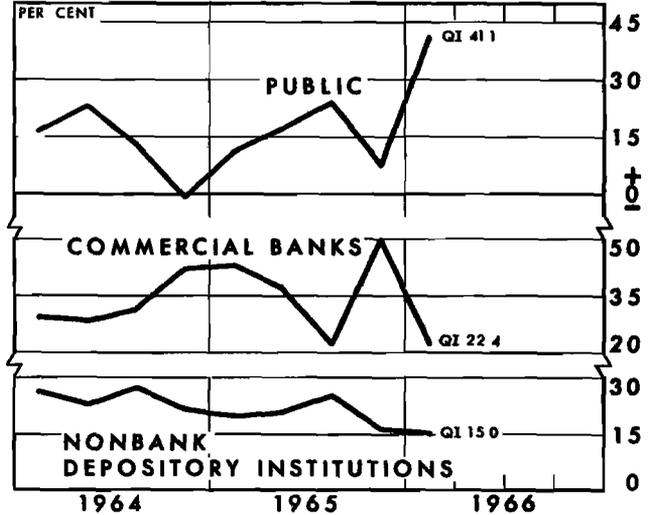


FINANCIAL DEVELOPMENTS - UNITED STATES

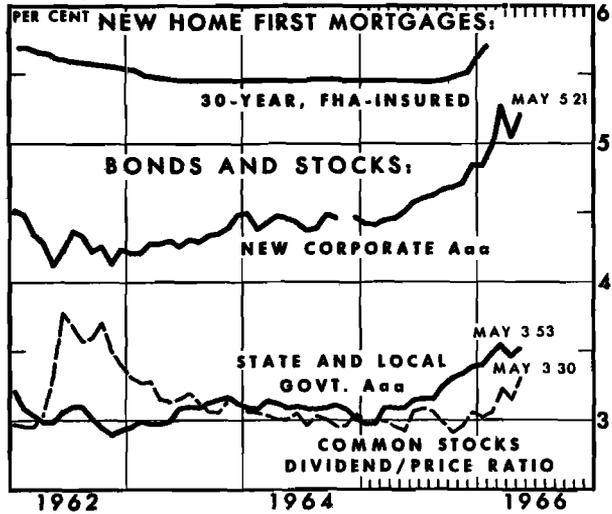
NET FUNDS RAISED - NONFINANCIAL SECTORS



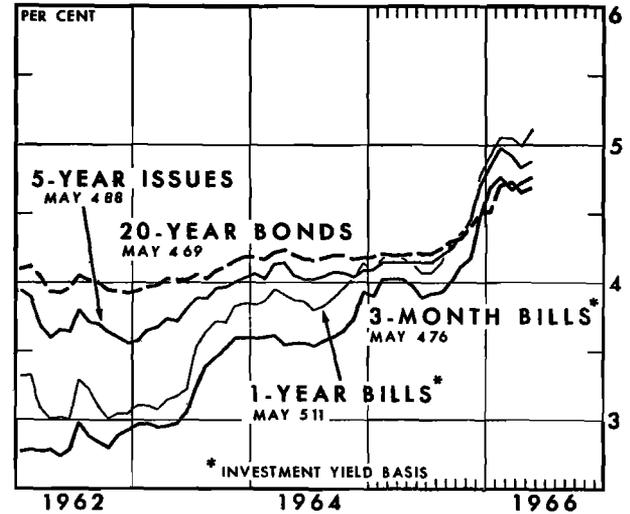
SHARES IN TOTAL CREDIT



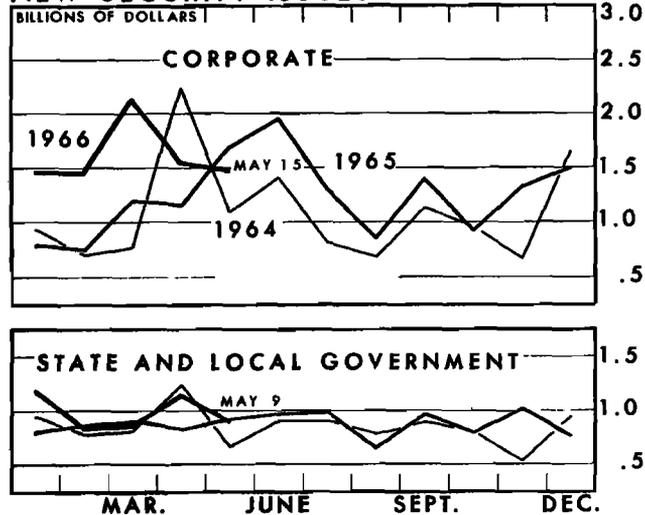
MARKET YIELDS



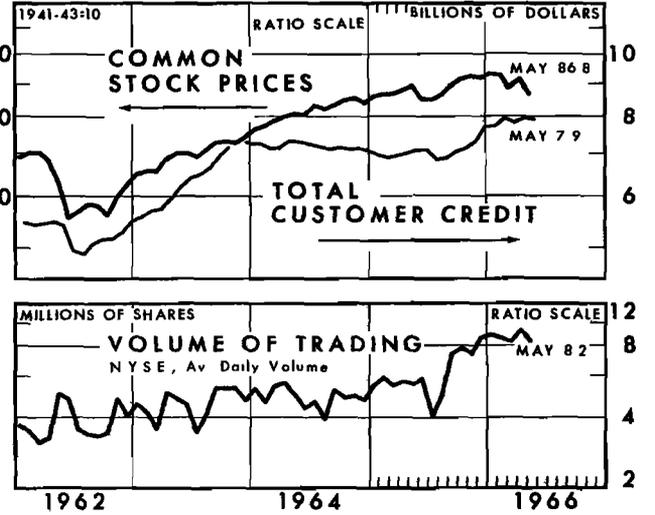
MARKET YIELDS - U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. For the month of May, reserve changes and the changes in liquid liabilities reported by a sample of large banks show a deficit on the liquidity basis of a little less than \$100 million (not seasonally adjusted). For April-May combined and after rough allowance for seasonal factors, the rate of deficit appears to be not greatly changed from the first quarter (\$2-1/4 billion, annual rate). No report for the May deficit on the official settlements balance is yet available.

The liquidity deficit was held down in April and May by substantial shifts, amounting to more than \$350 million, of funds of foreign central banks and international institutions into time deposits with maturities of more than 365 days and into securities of certain Federal agencies. Had it not been for these asset shifts the April-May liquidity deficit rate would have been substantially above the first quarter, when similar shifts amounted to about \$150 million.

The merchandise trade balance in April-May was at an annual rate of only about \$3 billion, compared with \$4.5 billion in the first quarter. Although May exports were slightly larger than those of April, while imports were down slightly in May, the underlying trends measured by moving averages remained unfavorable.

Exports this year have been below expectations, despite further strengthening of demand conditions abroad. Merchandise exports in the first five months of 1966 averaged only about 2 per cent above

the average for the second half of 1965, making an annual rate of increase of 4 per cent over this interval. Imports, on the other hand, had risen at an annual rate of 16 per cent.

New issues of foreign securities fell sharply in May and are expected to rise only moderately in June. For the second quarter, seasonally adjusted purchases of foreign securities -- almost wholly Canadian -- are expected to be at an annual rate of about \$900 million, compared with the \$1.5 billion average rate for the preceding two quarters.

Detailed balance-of-payments data for the first quarter of 1966, together with revised data for earlier periods, will be published in the June Survey of Current Business. As will be seen from the table below, the deterioration in merchandise trade from the fourth quarter to the first, and also a deterioration in military transactions and in "other services" (mainly in travel), was approximately offset by a sharp recovery in net receipts of income from investments. Hence, the surplus on all goods and services remained at an annual rate of about \$6 billion. (Published GNP data, which now show net exports somewhat larger than this, will be corrected in July.)

U.S. BALANCE ON GOODS AND SERVICES^{1/}
(In billions of dollars, at seasonally adjusted annual rates)

Item	Year	1965		1966	
		Q-III	Q-IV	Q-I(p)	Apr-May(e)
Merchandise, ex. military	4.8	4.9	5.1	4.5	3
Military transactions	-2.0	-2.2	-2.2	-2.6	...
Investment income ^{2/}	4.3	4.2	3.2	4.4	...
Other services ^{3/}	-0.0	.1	.1	-0.3	...
Total ^{1/}	7.0	7.1	6.1	6.0	5

(p) Preliminary.

(e) Estimated.

^{1/} Excludes transfers under military grants.

^{2/} Excludes undistributed earnings of subsidiaries.

^{3/} Transportation, travel, fees and royalties, and miscellaneous.

There was a small increase in net outflows of U.S. Government grants and capital in the first quarter, and also an increase in net unidentified payments--the "errors and omissions" item.

The net outflow of U.S. private capital was at a rate of slightly over \$3-1/2 billion in the first quarter, little changed from the second half of 1965 or the year 1965 as a whole. This figure includes the placing abroad of funds raised abroad through sales of bonds by U.S. corporations. Such bond sales were at an annual rate of nearly \$3/4 billion in the first quarter; they are counted in the balance of payments under inflows of foreign nonliquid capital. The net outflow of U.S. capital less these foreign borrowings was at a rate slightly under \$3 billion in the first quarter. The proceeds of the bonds will ultimately be used to finance direct investments abroad, but only a small part was so used during the first quarter. The remainder largely accounts for the outflow ("reported by others") shown on the last line of the table below.

NET U. S. PRIVATE CAPITAL FLOWS
(In billions of dollars, at seasonally adjusted annual rates)

Item	1965			1966	
	Year	Q-III	Q-IV	Q-I(p)	Apr-May(e)
Direct investments <u>1/</u>	-3.4	-2.3	-2.9	-2.5	...
Foreign securities	-.8	-1.1	-.8	-1.3	-1
Other: reported by banks	.1	-.0	.9	1.0	0
reported by others	<u>.3</u>	<u>.1</u>	<u>-.8</u>	<u>-.8</u>	<u>...</u>
Total	<u>-3.7</u>	<u>-3.3</u>	<u>-3.6</u>	<u>-3.6</u>	<u>...</u>

(p) Preliminary. (e) Estimated.
1/ Excludes undistributed earnings of subsidiaries.

Prices and wages in industrial countries. In the first several months of 1966, pressures of demand upon supply capacities continued to be reflected in substantial price and wage advances in other industrial countries. Only in France and Italy, where there still exists some slack, were increases in consumer prices in the twelve months from April 1965 to April 1966 below 3 per cent.

CONSUMER PRICE INCREASES
(per cent change from a year earlier)

	Non-food			Total including food		
	Apr. 1966	Q-I 1966	Q-I 1965	Apr. 1966	Q-I 1966	Q-I 1965
United Kingdom	+4.7	+4.2	+3.5	+3.5	+4.3	+4.6
Germany	+4.1 _{a/}	+3.8	+2.8	+4.2 _{a/}	+4.2	+2.4
Netherlands	+3.4	+6.1	+4.6	+7.4	+7.0	+4.5
Belgium	n.a.	n.a.	n.a.	+5.5	+4.4	+4.1
France	+2.7	+2.8	+2.0	+2.8	+2.6	+2.4
Italy	+2.3	+2.3	+5.3	+2.7	+2.9	+5.5
Japan	+7.3	+7.0	+4.8	+4.6	+6.2	+7.4

a/ March.

Part of the upward impetus on consumer prices was provided by special factors: food prices rose substantially because of poor 1965 harvests, increases in world market prices for a number of raw materials worked themselves through to the final product stage, and in a number of countries indirect taxes and charges for public services were increased as part of general anti-inflation programs. Wholesale prices for manufactured products, perhaps a better indicator of demand pressure, rose less than did consumer prices in several major

countries. However, in most countries -- Britain being the chief exception -- the rate of rise in wholesale prices of manufactures has tended to accelerate since late last year.

INCREASES IN WHOLESALE PRICES OF MANUFACTURES
(per cent change from a year earlier)

	Apr. 1966	Q-1 1966	Q-IV 1965	Q-I 1965
United Kingdom ^{1/}	+2.3	+2.3	+3.4	+4.1
Germany	+2.3 ^{a/}	+2.3	+2.0	+1.4
Netherlands	n. a.	+5.4 ^{b/}	+2.7	+3.7
Belgium	+2.7	+2.7	+1.0	+2.5
France	+3.5	+2.0	0.0	+1.4
Italy ^{2/}	+2.5 ^{a/}	+2.3	+1.7	+1.2
Japan	+2.1	+1.4	+0.3	-0.1

^{1/} Excludes food.

^{2/} General wholesale price index.

^{a/} March.

^{b/} February.

A number of countries are supplementing their anti-inflationary financial policies with attempts to control prices and wages directly, either by regulation (France, and recently Belgium and the Netherlands) or by suasion (United Kingdom). Voluntary postponement of certain price increases in Britain seems, however, to be building up latent price pressures. In France, where the system of price ceilings imposed in 1964 has been gradually modified, recent price advances may be partly a reaction after the earlier repression, rather than solely a response to current demand conditions.

Unit labor costs have continued to increase virtually everywhere. The labor market situation has remained extremely tight in

Europe, except in France and Italy; strong wage rises have outpaced productivity gains. Only in Italy did unit labor costs actually fall, as productivity rose sharply during the first year and a half of the recovery (which began in late 1964). Wage increases in most countries moderated somewhat in the summer and autumn of 1965. In the United Kingdom, however, though average weekly earnings rose less rapidly than before, basic wage rates advanced at an accelerating pace last year and have continued to do so in 1966.

HOURLY WAGE RATE INCREASES
(per cent change from a year earlier)

	Apr. 1966	Q-I 1966	Q-IV 1965	Q-I 1965
United Kingdom	+7.3	+6.9	+6.9	+4.8
Germany	n.a.	+7.7 ^{a/}	+6.4	+8.4
Netherlands	+5.7	+6.4	+9.5	+13.0
Belgium	n.a.	+7.2	+7.5	+9.4
France	+6.0	+5.8	+5.7	+6.4
Italy	+3.9	+4.3	+5.7	+12.6
Japan ^{1/}	+10.4	+8.6	+7.5	+11.8

^{1/} Average monthly earnings.

^{a/} January.

United Kingdom. The efforts of the British authorities to moderate the upward movement of prices and wages with "incomes policy" have had only slight success. The National Institute of Economic and Social Research estimated recently that moral suasion efforts kept prices about 1/2 percentage point below what they otherwise would have been. No such estimates are available with regard to wages.

Wage increases continue to outpace productivity gains by considerable margins, and this is reflected in the continuing rise in wholesale prices and in non-food consumer prices. In early June reports from industrial buyers of increases in prices they pay kept mounting, indicating that the period of voluntary restraint may be coming to an end. When the payroll tax becomes effective in the autumn, a further acceleration in the upward pace of consumer prices is to be expected.

Wage settlements in 1966 have generally been well above the Government's 3 to 3.5 per cent "guiding light," and average hourly basic rates have been rising at more than twice the suggested maximum. Recent awards obtained by the railwaymen and by the road-haulage workers amounted to 6.5 and 7 per cent respectively.

Germany. Despite the leveling off since mid-1965 in domestic new orders and the slowing of growth in output, particularly in the capital equipment field, the upward movement of German prices and wages has continued this year. As in other countries, a large part of the increase in consumer prices has been due to higher prices for food and services, particularly rent. However, the fact that wholesale prices have been rising a little faster in recent months than before supports other evidence that the period of slowing in expansion of demand may be coming to an end.

The tight labor market situation and the continued upward movement of prices have been encouraging further demands for wage increases. Average hourly wage rates rose sharply between October and

January, and were then 7.7 per cent higher than in January 1965. Since January, however, wage settlements have generally been fairly well in line with the 6 per cent recommended by the Council of Economic Experts. But they still exceed the expected growth in productivity, which is estimated at about 4.4 per cent between the years 1965 and 1966.

The Netherlands and Belgium. Continued inflationary pressures led the Dutch and Belgian Governments this spring to impose direct controls on prices and wages. In both countries the pace of price increases had accelerated noticeably during the first four months of 1966. Although price movements were influenced in both countries by increases in indirect taxes and higher charges for public services, the acceleration was cause for concern since it appeared likely to lead to wage increases, particularly in Belgium where most wage contracts have an escalation clause.

In Belgium, a general price freeze was imposed for three months starting May 6th. In addition, the Government will attempt to roll back prices for certain major consumer goods; beef and pork prices are already being reduced under the program. Furthermore, customs duties and turnover taxes for certain consumer goods will also be reduced and certain import quotas will be raised.

In the Netherlands, effective May 24th, wage increases are not allowed to be passed on to consumers unless failure to do so would prevent an efficient firm from earning a normal return on capital. Until the end of 1966, price increases for goods sold domestically must be reported to the Government with a detailed explanation of the

increase (before this decree price increases were reported on a voluntary basis).

No new collective wage agreements will be authorized in the Netherlands before July 15 (under the current system all contracts are subject to approval by the authorities); thereafter, new wage contracts may not provide for increases in excess of 7 per cent. Average increases in some 80 contracts approved thus far in 1966 amounted to 7.5 per cent, those awaiting approval or disapproval averaged 10.6 per cent.

France and Italy. Resumption of economic growth in these countries last year was coupled with large productivity increases typical of the early stages of a recovery. Consequently, cost pressures have not yet developed. In Italy unit labor costs have actually declined; with unemployment still relatively large, wage increases have been notably less than in preceding years, as the table on page IV - 6 shows. In France, where the margin of unused resources is somewhat smaller, wages have begun to move up a bit faster.

Similarly, the rate of rise in Italian consumer prices has been unusually low, by comparison both with Italian price changes in earlier years and with prices in other European countries. In France, a slight quickening of the tempo has become noticeable, particularly on the wholesale level.

Japan. Renewal of expansion in economic activity after mid-1965 was accompanied by some acceleration in the pace of increase in non-food consumer prices. But since food prices at the consumer

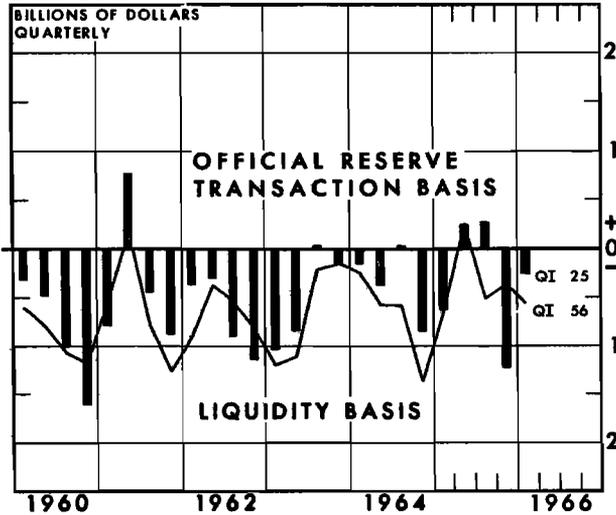
level have not risen much for about a year (after extremely sharp advances in the autumn and winter of 1964-65), total consumer prices have continued to show what is for Japan a relatively moderate rate of rise -- 4-1/2 per cent from April 1965 to April 1966, as compared with 7-1/2 per cent from early 1964 to early 1965.

Wholesale prices of manufactures have been rising less in Japan, during 1964, 1965, and so far in 1966, than in most other industrial countries. Important factors in a temporarily sharp rise in the Japanese index between November 1965 and February 1966 were increases for nonferrous metals, wood products, and rice. (Rice prices are government-fixed.)

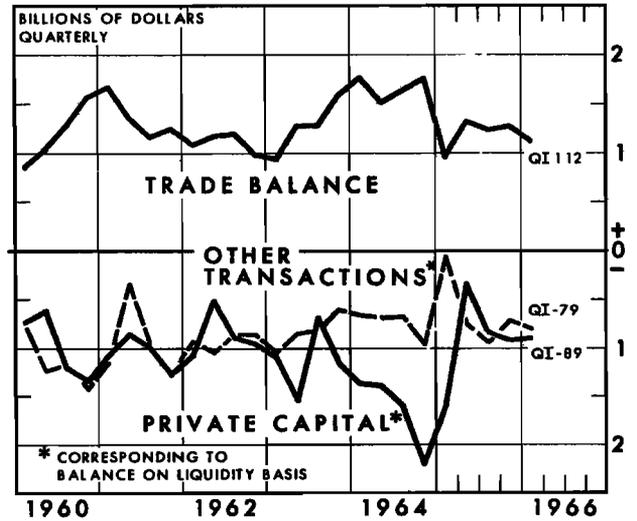
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

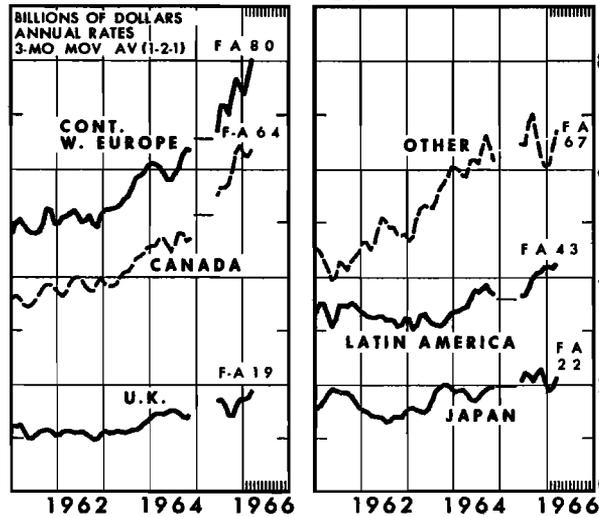
U.S. BALANCE OF PAYMENTS



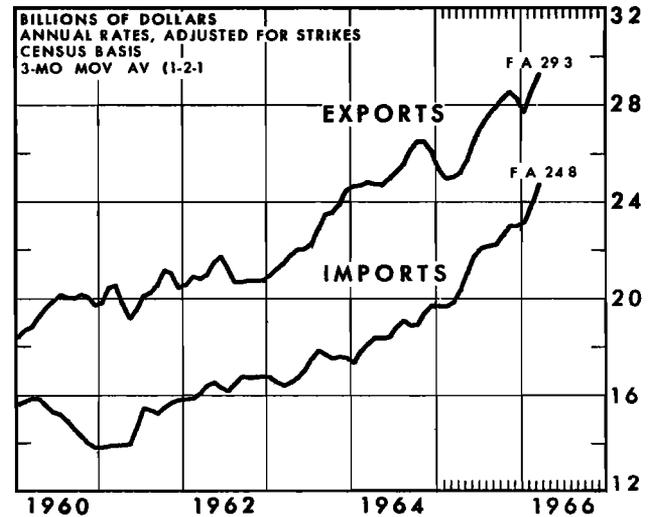
U.S. BALANCE OF PAYMENTS - CONT.



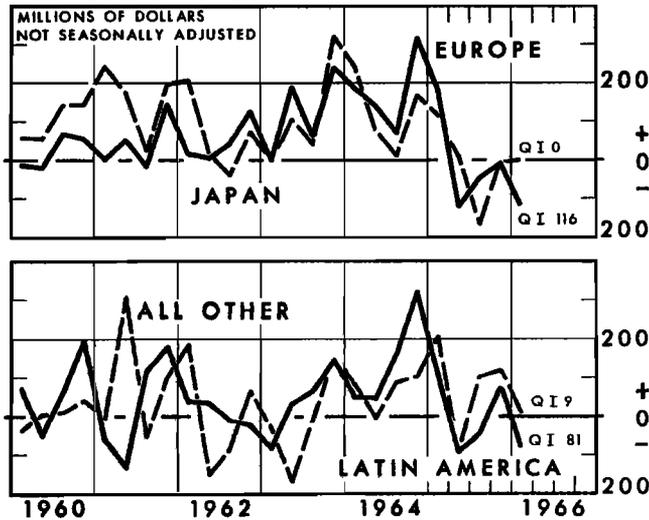
U.S. EXPORTS BY AREA



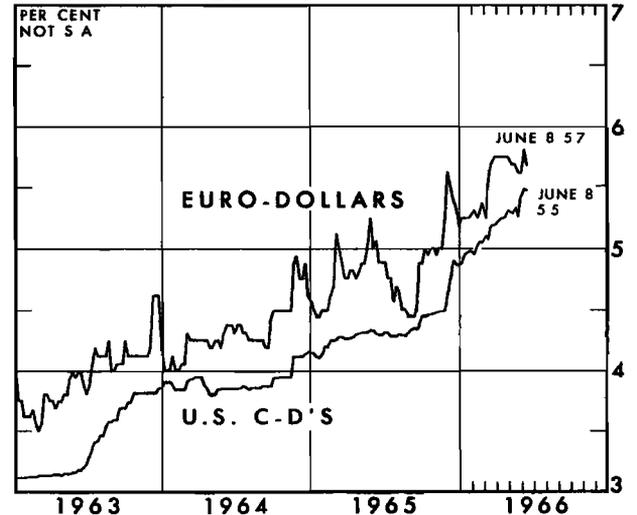
U.S. MERCHANDISE TRADE



U.S. BANK CREDIT OUTFLOWS



90-DAY RATES



**APPENDIX A:
FLOWS TO NON-BANK FINANCIAL INTERMEDIARIES**

Preliminary data indicate that savings and loan associations and mutual savings banks gained funds on balance during May and the first half of June -- showing some of the usual seasonal tendency for their net savings positions to improve relative to April. At both types of institutions, however, the magnitude of recent net inflows has continued to be much smaller than in comparable periods of other recent years. This year-to-year shrinkage has continued to center in California for the savings and loans, and in New York for the mutual savings banks, as the bottom panels of Tables 1 and 2 show.

The savings and loan industry is presently bracing itself for a large net outflow of funds in July. This outlook reflects a general presumption that the usual pattern of heavy gross withdrawals (following termination of both quarterly and semi-annual interest accrual periods at the end of June) will be accentuated as in April by the diversion of funds to higher yielding marketable securities and savings instruments at commercial banks. Since net withdrawals from the S & L's during July last year greatly exceeded those for April, the basis for present apprehension in the industry is clear.

In view of the special circumstances surrounding this year's \$750 million April net outflow at S & L's, there is considerable uncertainty in the industry whether continuing competitive interest rate pressures will combine with the usual seasonal patterns of larger gross withdrawals to produce a significantly larger net outflow in July. Some analysts believe that the present fear of possible attrition in excess of \$1 billion at S & L's is being exaggerated. They argue: (1) that the bulk of the interest-sensitive money held in large accounts at S & L's with quarterly interest accrual periods may already have switched in April; (2) that S & L's with semi-annual accrual periods have fewer large interest-sensitive accounts and are generally located in geographic areas where interest rate competition from commercial banks has been less intense and where holders are less aware of opportunities for investment in marketable securities; (3) that the commercial banks at which rates on savings instruments have been advanced since April are less important and will probably have a much smaller impact on shifts in savings flows than those which had already raised rates before or during April; (4) that the recent Home Loan Bank ruling providing increased leeway for S & L's to respond to rate competition (and still stay eligible for advances

* Prepared by: Robert King, Economist, Capital Markets Section, Division of Research and Statistics.

Table 1

NET SAVINGS FLOWS
AT SAVINGS AND LOAN ASSOCIATIONS
(in millions of dollars)

All Associations			
	<u>1966</u>	<u>1965</u>	<u>1964</u>
First Quarter (Mo. avg.)	433	629	779
April	-748	-93	329
May		792	994
June <u>1/</u>	455 <u>p/</u>	1,603	1,751
July		432	33
Per cent Change in Savings Capital First Five Months	0.9	2.5	4.0

California State Chartered Associations ^{1/}			
	<u>1966</u>	<u>1965</u>	<u>1964</u>
First Quarter (Mo. avg.)	115	151	307
April	-296	-115	1
May	-74	119	169
June <u>1/</u>	53 <u>3/</u>	195	251
July		30	150
Percent Change in Savings Capital, First Five Months	-0.2	8.0	7.4

p/ Preliminary

1/ June figures include interest credited.

2/ These associations accounted for 13% of savings capital at all associations at the end of 1965.

3/ This figure is for the first 17 days of June and does not include interest credited. Comparable data are not available for earlier years.

Table II

NET SAVINGS FLOWS
AT MUTUAL SAVINGS BANKS
(in millions of dollars)

	All Banks		
	<u>1966</u>	<u>1965</u>	<u>1964</u>
First Quarter (Mo. avg.)	262	361	367
April	-341	-22	87
May	105 <u>p/</u>	188	270
June <u>1/</u>		436	478
July		212	284
Percent Change in Savings Deposits, First Five Months	1.1	2.6	3.3

	New York State Banks ^{2/}		
	<u>1966</u>	<u>1965</u>	<u>1964</u>
First Quarter (Mo. avg.)	51	134	151
April	-301	-72	11
May	77	105	158
June <u>1/</u>	51 <u>3/</u>	61 <u>3/</u>	65 <u>3/</u>
July		105	151
Percent Change in Savings Deposits, First Five Months	0.2	1.5	2.4

p/ Preliminary

1/ June figures include interest credited.

2/ These banks account for 57% of the savings deposits at all MSB's.

3/ This figure is for the first 15 days of June for the 15 largest MSB's in New York City.

at Home Loan Banks) will help to limit further attrition in S & L savings capital; and (5) that pressure for further leeway of this type may soon develop if the 5-1/4 per cent pass-book rate already announced by a few West Coast associations should spread more generally to other associations.

Other analysts are considerably less sanguine about the July outlook. They note that because the general public typically responds with a substantial lag to opportunities for profitable substitution created by changed interest rate spreads, there are probably many shareholders who failed to switch in April and are now alerted to the opportunity they missed. The widespread publicity given to recent increases in market yields, particularly those on short-term Federal agency debt and participation certificates, adds emphasis to this point. Moreover, there is some concern that favorable corporate earnings reports for the second quarter will stimulate renewed incentives to buy stocks at just the point when share-holders in S & L's become free to switch without sacrificing accrued interest. Finally, there is some underlying concern that the recent spotlighting of S & L hardships might trigger loss of confidence in the industry, leading to large withdrawals of funds particularly from West Coast institutions.

To prepare for the expected July increase in S&L demands for advances, the Home Loan Bank System has just raised \$400 million of new money in the market. This, together with its present holdings of Treasury securities, gives the System total loan resources of nearly \$1.5 billion. In the event that this lending power should seem insufficient, industry representatives have been assured that the Home Loan Banks would have access to other funds and that there would be no shortage of money for advances.

As Table 3 and the chart show, the volume of advances already supplied by the Home Loan Banks this year has been much larger than in other recent years. Not only did member associations lag behind previous years in reducing outstanding advances during the first quarter, but new borrowing since mid-March has been more than double that of a year ago.

TABLE III

CHANGE IN HOME LOAN BANK ADVANCES

(In millions of dollars)

All Home Loan Banks

	1966	1965	1964
Jan. 1 - Mar. 15	-473	-727	-764
Mar. 15 - June 15	\$1,118	596	348
June 15 - Sept. 15		571	467

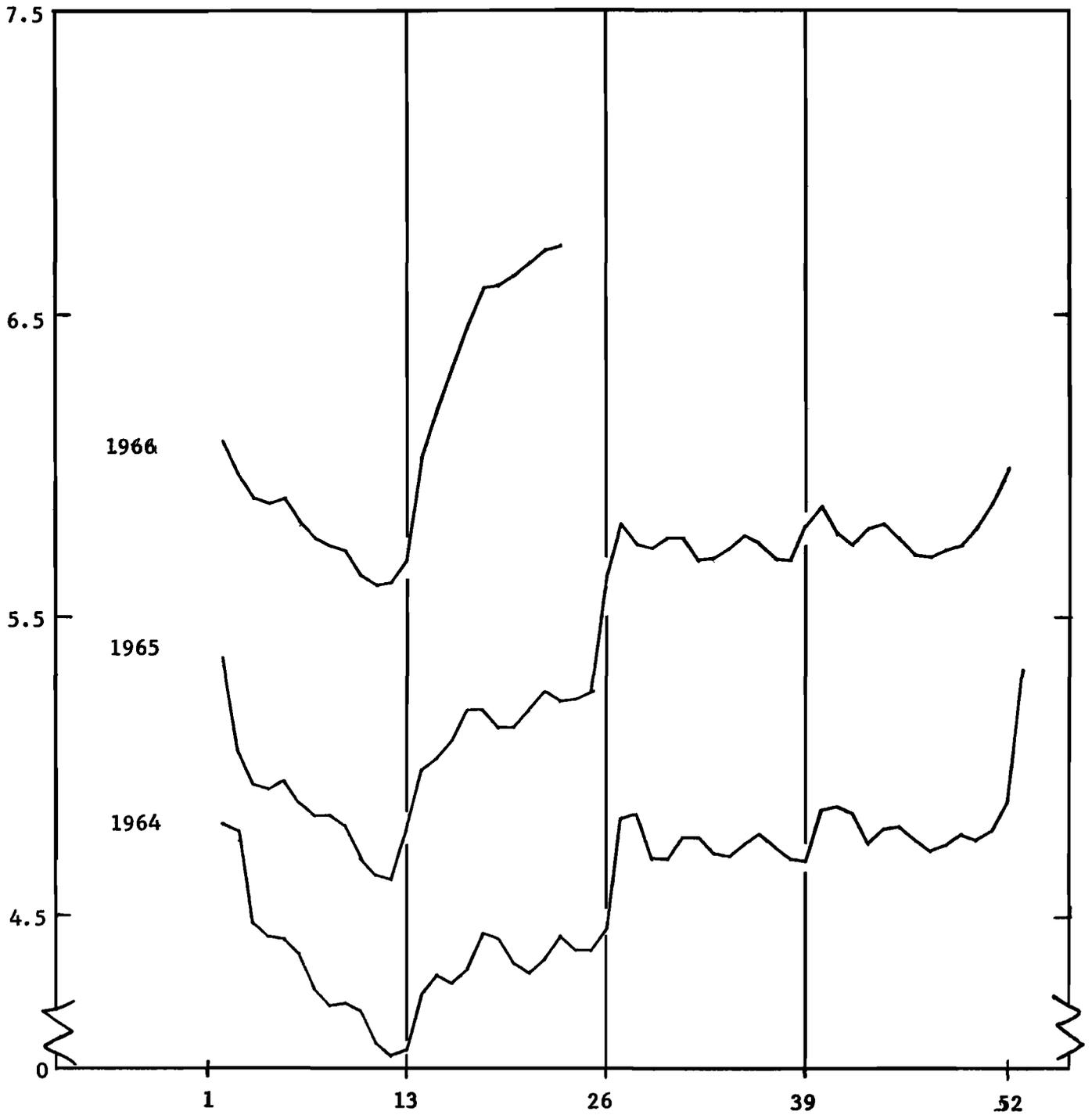
San Francisco Home Loan Bank*

	1966	1965	1964
Jan. 1 - Mar. 15	\$-157	-172	-308
Mar. 15 - June 15	739	358	108
June 15 - Sept. 30		26	204

* This district accounted for 39 per cent of all outstanding advances at the end of 1965.

FEDERAL HOME LOAN BANK ADVANCES OUTSTANDING
(Weekly)

Billions



Traditionally, savings and loan associations have relied heavily on advances from the Home Loan Banks as a source of liquidity. But as shown by the table below, they have also typically held liquid assets in excess of the 7 per cent of savings capital (recently reduced to 6 per cent) required by regulation. Even California associations, where gross liquidity positions are among the lowest in the country, showed a gross liquidity ratio of nearly 9 per cent at the end of April.

TABLE IV
RATIO OF LIQUID ASSETS TO SAVINGS CAPITAL
(End of April)

	1966	1965	1964
All insured S&L's	9.6	10.3	10.8
Calif. insured S&L's	8.9	9.3	9.7

With all savings and loan associations holding \$110 billion of savings capital at the end of April, the Bank Board's recent temporary liberalization in the required liquidity ratio (from 7 to 6 per cent) has the effect of adding \$1.1 billion of liquidity for withdrawals to the more than \$3 billion of excess liquid assets already available to S&L's throughout the nation. This excess liquidity is particularly important now, since the reduction in required liquidity ratios also requires associations to meet withdrawals by reducing liquidity at least one per cent before associations can secure advances from their Home Loan Banks.

The combination of (1) liberal loan commitments in the first quarter -- despite slower net growth of savings capital, (2) unexpectedly large net withdrawals in April, and (3) fear of even larger net withdrawals during July has led savings and loan associations to curtail new loan commitments drastically since April. The sharpness of this adjustment has been accentuated by the April change in Home Loan Bank policy on advances. This change directed member associations to limit outstanding commitments "...to levels not exceeding the total of the previous calendar four months loan repayments plus or minus their realized savings gains or losses for the same past four months." Since both April and the expected July experience enter into estimates currently affecting S&L loan policy, it is not surprising that in the face of the great uncertainties with respect to the July withdrawals -- new loan commitments have been drastically reduced.

A recent survey by the U.S. Savings and Loan League revealed that the 143 responding associations cut back their new loan commitments by nearly 50 per cent in May, relative to May a year ago. This change reflected a year-to-year decline of 70 per cent in commitments for purchases of existing homes, multifamily structures, and for the refinancing of existing homes; a decline of 45 per cent in construction loan commitments; and a drop of 30 per cent in loan commitments for the purchase of new homes.

While no continuing series on new loan commitments of S&L's is available, comparison of the total backlog of outstanding commitments at the end of April (latest date available) with repayments and net savings capital flows for the January-April period suggests that new loan commitments would become more readily available (given the new Bank Board ruling on advances) if the July attrition in savings capital should prove to be less extreme than some fear.

Table V

OUTSTANDING LOAN COMMITMENTS AT S & L's
vs LOAN REPAYMENTS AND NET SAVINGS
FLOWS FOR PRECEDING FOUR MONTHS
(End of April)

All Insured Associations			
	<u>1966</u>	<u>1965</u>	<u>1964</u>
<u>Outstanding Commitments</u> (April 30)	3,172	3,226	3,058
<u>Aggregate Jan-April Flows</u>			
Mortgage Repayments	4,533	4,649	4,514
Net Savings Flow	549	1,755	2,588
Total	<u>5,082</u>	<u>6,404</u>	<u>7,102</u>
California Insured Associations			
	<u>1966</u>	<u>1965</u>	<u>1964</u>
<u>Outstanding Commitments</u> (April 30)	774	1,175	1,560
<u>Aggregate Jan-April Flows</u>			
Mortgage Repayments	952	1,117	1,179
Net Savings Flow	-66	336	847
Total	<u>886</u>	<u>1,454</u>	<u>2,026</u>