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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**

April 7, 1965

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IN BROAD REVIEW

Performance of the domestic economy in the first quarter appears in some respects to have exceeded even the unusually favorable earlier expectations. In terms of aggregate demand, a GNP level of \$650 billion seems to have been reached, up about \$15 billion from the fourth quarter. Significantly, the rise in final demands was especially strong and broadly distributed, while inventory accumulation, judging by January and February data, continued large but not much higher than in the preceding quarter. The build-up of steel inventories continued, but rates of accumulation apparently have been restrained somewhat by the very large final takings of steel products, including new autos. Unfilled orders for durable goods rose further in February as new orders continued to exceed sales. Construction activity continued to edge higher. Industrial production rose further in March--now tentatively indexed at around 140.

The labor market strengthened materially in the first quarter, with employment registering marked improvement, and unemployment, both in number and in composition, reflecting more strength than anticipated. The unemployment rate dropped in March to 4.7 per cent, the lowest since 1957. Nevertheless, productivity gains have continued to equal or exceed wage increases, and unit labor costs in manufacturing have been essentially stable.

In commodity markets, industrial prices have shown little change this year, following a rise of 3/4 of 1 per cent last fall. Among sensitive prices, however, some upward pressures have been in

evidence recently. Consumer prices were unchanged in February at a level 1.2 per cent above a year earlier. Stock market prices have held within a narrow range below their February highs.

Bank credit expanded substantially further in March, with the increase for the month probably amounting to around \$3.5 billion. For the first quarter as a whole, the annual rate of growth approximated 13 per cent as compared with 7 per cent in the fourth quarter. Loan expansion was very large in March with business borrowing heavy in most categories and especially so for metal and metal-using firms.

The money supply increased \$700 million in March. This rise, however, merely offset a corresponding decline in February and for the first quarter, the annual rate of growth was only 1 per cent as compared with 3.5 per cent in the preceding quarter. Growth in time and savings deposits slackened markedly in March to about the average monthly increase in the second half of 1964. For the quarter expansion in the money supply and time and savings deposits combined was at an annual rate of 8.8 per cent, about the same as in the fourth quarter. The increase in public holdings of total liquid assets also was at a rate about equal to that of late 1964.

Bank reserve availability has come under somewhat more pressure recently and in the two weeks ending April 7 net borrowed reserves averaged around \$115 million and member bank borrowings from the Reserve Banks, \$540 million.

In corporate, municipal, and U. S. Government security markets, somewhat greater uncertainty has developed in recent weeks.

The British budget announcement imparted a somewhat firmer tone to markets, but a residue of caution apparently remains as investors await further clarification of sterling's position and attempt to reappraise prospects for U. S. monetary action. Bond yields generally have moved up a little but remained below earlier highs for this year and below the highs reached in the sterling crisis period in late 1964. The yield on the 3-month Treasury bill increased somewhat in late March and early April to 3.94 per cent.

The balance of payments showed a substantial but partly seasonal surplus in March according to very preliminary indications. The result was a first-quarter deficit at a seasonally adjusted annual rate of roughly \$2-1/2 billion. The March surplus may have reflected a bigger than usual reflux of U. S. corporate funds, and perhaps also a catching up of exports in the wake of the port strike. The March surplus was reflected in a decline in balances held here by commercial banks located abroad, rather than in net official settlements.

In Europe, financial policies have remained generally restrictive, except in Italy where fiscal policy measures were announced in March to supplement last summer's easing of credit policy. A marked turn toward easier monetary policy took place in Japan at the beginning of April.

SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest Period	Amount		Year Ago	Per cent change	
		Latest Period	Precedg Period		Year Ago*	2Yrs. Ago*
Civilian labor force (mil.)	Mar. '65	74.9	75.1	73.8	1.6	3.3
Unemployment (mil.)	"	3.5	3.7	4.0	-12.1	-14.7
Unemployment (per cent)	"	4.7	5.0	5.4	--	--
Nonfarm employment, payroll (mil.)	Feb. '65	59.6	59.3	57.7	3.3	6.3
Manufacturing	"	17.8	17.7	17.2	3.4	5.1
Other industrial	"	7.9	7.8	7.7	2.1	5.9
Nonindustrial	"	33.9	33.8	32.8	3.4	7.0
Industrial production (57-59=100)	"	138.8	138.1	128.2	8.3	15.1
Final products	"	138.5	137.3	128.1	8.1	13.0
Materials	"	139.5	138.6	128.1	8.9	17.5
Wholesale prices (57-59=100) ^{1/}	"	101.2	101.0	100.5	0.7	1.0
Industrial commodities	"	101.5	101.5	100.9	0.6	1.2
Sensitive materials	"	101.1	101.3	98.2	3.0	4.8
Farm products and foods	"	98.7	98.1	98.1	0.6	0.0
Consumer prices (57-59=100) ^{1/}	"	108.9	108.9	107.6	1.2	2.6
Commodities except food	"	104.7	104.9	104.1	0.6	1.9
Food	"	106.6	106.6	106.0	0.6	1.5
Services	"	116.9	116.6	114.3	2.3	4.3
Hourly earnings, mfg. (\$)	"	2.59	2.57	2.51	3.2	6.6
Weekly earnings, mfg. (\$)	"	107.05	106.78	101.97	5.0	9.3
Personal income (\$ bil.) ^{2/}	"	510.7	510.2	480.5	6.3	12.5
Retail sales, total (\$ bil.)	"	23.4	22.9	21.5	8.8	15.0
Autos (million units) ^{2/}	"	9.6	9.7	7.9	20.3	29.8
GAF (\$ bil.)	"	5.2	5.3	5.0	5.7	16.7
Selected leading indicators						
Housing starts, pvt. (thous.) ^{2/}	"	1,422	1,466	1,657	-14.2	-1.6
Factory workweek (hours)	"	41.4	41.4	40.7	1.7	2.7
New orders, dur. goods (\$ bil.)	"	21.2	21.3	19.5	8.7	16.2
New orders, nonel. mach. (\$ bil.)	"	3.0	3.1	2.8	9.8	20.8
Common stock prices (1941-43=10) ^{1/}	Mar. '65	86.83	86.75	78.80	10.2	32.2
Inventories, book val. (\$ bil.)	Feb. '65	110.3	110.0	105.4	4.7	9.5
Gross national product (\$ bil.) ^{2/}	Q4 - '64	634.6	628.4	599.0	5.9	12.0
Real GNP (\$ bil., 1964 prices) ^{2/}	"	630.6	626.6	606.2	4.0	8.1

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended April 2	Four-Week Average	Last six months	
			High	Low
<u>Money Market</u> <u>1/</u> (N.S.A.)				
Federal funds rate (per cent)	4.05	4.05	4.12	1.00
U.S. Treas. bills, 3-mo., yield (per cent)	3.92	3.92	4.00	3.55
Net free reserves <u>2/</u> (mil. \$)	-109	-46	256	-109
Member bank borrowings <u>2/</u> (mil. \$)	487	426	590	122
<u>Security Markets</u> (N.S.A.)				
Market yields <u>1/</u> (per cent)				
5-year U.S. Treas. bonds	4.14	4.14	4.18	3.99
20-year U.S. Treas. bonds	4.20	4.20	4.22	4.14
Corporate new bond issues, Aaa	4.43	4.43	4.53	4.33
Corporate seasoned bonds, Aaa	4.42	4.42	4.45	4.41
Municipal seasoned bonds, Aaa	3.09	3.09	3.12	2.94
FHA home mortgages, 30-year <u>3/</u>	5.45	5.45	5.46	5.45
Common stocks S&P composite index <u>4/</u>				
Prices, closing (1941-43=10)	86.53	86.70	87.56	83.66
Dividend yield (per cent)	3.01	3.00	2.94	3.04
	Change in Feb.	Average change last 3 mos.	Annual rate of change (%)	
			3 mos.	1 year
<u>Banking</u> (S.A., mil. \$)				
Total reserves	<u>5/</u> 154	142	7.9	5.1
Bank loans and investments:				
Total	2,400	2,100	9.4	9.1
Business loans	1,100	1,200	25.4	14.2
Other loans	600	900	10.3	12.4
U.S. Government securities	100	-600	-11.1	-2.6
Other securities	600	500	15.6	12.7
Money and liquid assets:				
Demand dep. & currency	<u>5/</u> 700	100	1.0	3.6
Time and savings dep.	<u>5/</u> 1,300	2,000	18.7	14.4
Nonbank liquid assets	1,600	1,200	6.0	5.9

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted.

1/ Average of daily figures. 2/ Averages for statement week ending March 31.3/ Latest figure indicated is for month of February. 4/ Data are for weekly closing prices. 5/ Latest figure indicated is for month of March.

U.S. BALANCE OF PAYMENTS

	1965		Dec.	1964				1964
	Feb.	Jan.		QIVp	QIIIr	QIIr	QIr	YEARp
Seasonally adjusted annual rates, in billions of dollars								
Balance on regular transactions				- 6.0	- 2.6	- 2.5	- 1.1	- 3.1
Current account balance				7.6	7.6	6.4	7.9	7.4
Trade balance <u>1/</u>	- 0.3	.0	9.3	7.1	6.6	5.8	6.7	6.6
Exports <u>1/</u>	18.7	14.2	28.8	26.7	25.5	24.2	24.4	25.2
Imports <u>1/</u>	-19.0	-14.2	-19.5	-19.6	-18.9	-18.4	-17.7	-18.6
Services, etc., net				.5	1.0	.6	1.2	.8
Capital account balance				-11.7	- 9.2	- 8.7	- 8.4	- 9.6
Govt. grants & capital <u>2/</u>				- 4.1	- 3.7	- 3.6	- 3.1	- 3.7
U.S. private direct inv.				- 2.6	- 2.3	- 2.3	- 2.1	- 2.3
U.S. priv. long-term portfolio				- 3.4	- 2.4	- 1.1	- .9	- 2.0
U.S. priv. short-term				- 2.1	- 1.6	- 2.2	- 2.4	- 2.1
Foreign nonliquid				.5	.8	.5	.1	.5
Errors and omissions				- 1.9	- 1.0	- .1	- .6	- .9

Monthly averages, in millions of dollars

Deficit on regular transactions (seas. adjusted)				502	220	207	89	254
Additional seasonal element				- 6	- 118	12	112	---
Financing (unadjusted)	474	202	261	508	337	196	- 23	254
Special receipts <u>3/</u>	0	0	0	51	1	- 10	68	27
Liabilities increase								
Nonofficial <u>4/</u>	- 26	523	- 594	207	184	36	78	126
Official <u>5/</u>	152	- 650	512	299	129	69	- 151	86
Monetary reserves decrease	348	329	343	- 50	23	101	- 17	14
of which: Gold sales	(215)	(263)	(95)	(57)(-	7)(-	24)	(15)	(10)
[Memo: Official financing] <u>6/</u>	(500)(-	321)	(855)	(300)	(153)	(159)(-	101)	(128)

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

2/ Net of associated liabilities and of scheduled loan repayments.

3/ Advance repayments on U.S. Govt. loans and advance payments for military exports: assumed zero in absence of information.

4/ Includes international institutions (except IMF), commercial banks and private nonbank.

5/ Includes nonmarketable bonds.

6/ Decrease in monetary reserves, increase in liabilities to foreign official institutions, and special receipts.

 THE DOMESTIC ECONOMY

Industrial production. Industrial production in March is estimated to have risen further to about 140 per cent of the 1957-59 average--at least one point above the preliminary February index of 138.8. The indicated gains in production appear to have been widespread, judging by incomplete data. The indexes of final products and materials both apparently showed further increases.

In March, as in February, industrial production was 8 per cent above a year earlier with the rise in the total index in the six months ending February not so large as in the preceding six months. However, excluding steel and autos, growth was about the same in the two periods. An increase in output of household durable goods as rapid as 8 per cent, shown below for the latest six-month period, often occurs in recovery from recession but is unusual after a long period of expansion.

 INDUSTRIAL PRODUCTION
 Per cent increase

	February 1965 from August 1964	August 1964 from February 1964
Total	3.7	4.4
Iron and steel	4.7	15.5
Automotive	4.1	5.2
Total excluding steel and automotive	3.6	3.8
Household goods	8.1	2.0
Apparel	3.1	3.5
Consumer staples	2.5	3.0
Business equipment	5.0	7.4
Materials, excluding iron and steel	3.4	4.1

Among final products, auto assemblies in March were at a record seasonally adjusted annual rate of 9.9 million units compared with 9.1 million in February. Output in the first seven months of the 1965 model year, including the two strike months, was at an annual rate of 8.1 million units as compared with 7.9 million during the comparable 1964 model year period--up 3 per cent. Production schedules for the second quarter of this year are set at about a 9.5 million rate--the same as in the first quarter. The March rise in auto output along with a rebound in truck production and an estimated increase in output of automotive parts is equivalent to a rise of close to half a point in the total index.

Available weekly data on output of television sets indicate a further increase in March. Output of color television sets has been increasing rapidly and currently is about 35 per cent greater than that of black and white console sets and is 20 per cent of total television production.

Further increases in output of business equipment and some other metal products are indicated by the preliminary information on March manhours of work.

Among materials, output of steel ingots increased slightly further and production of crude oil, refined oil products, and paper-board continued at advanced levels. Some further increases in other materials-producing industries, including paper and chemicals, also may have occurred.

Retail sales. Retail sales in March (based on four full weeks) appear to have declined moderately from their advanced February level, after allowances for the usual seasonal influences and the changing date of Easter. Owing to less than seasonal increases at automotive and furniture and appliance outlets, sales at durable goods stores appear to have declined appreciably from their February high. Sales at nondurable goods outlets, which also reached a new high in February, may have declined fractionally.

Total retail sales in the first quarter sparked by large increases at automotive outlets, appear to have advanced 4.5 per cent from the reduced fourth quarter, about 3.5 per cent from the preceding high reached in the third quarter 1964, and 8 per cent from the first quarter of last year.

The current figures for January and February are considerably higher than those first reported. The advance February total has been revised upward almost 2 per cent, reflecting significant upward revisions for both durable and nondurable goods. A month ago the advance January figures were also revised upward about 2 per cent.

Autos. Sales of new domestic autos, already at a very high rate in February, rose further in March, setting a monthly record of 30,000 units per trading day. Dealers, moreover, reported that sales were limited by supply bottlenecks for the newly popular sports and luxury models. Total inventories of new cars increased further but were still low relative to sales. Strong as the market for cars was, sales showed less than usual large seasonal rise in March and seasonally

adjusted rates declined 8 per cent to an annual rate of 8.8 million. This may be compared with the 7.7 million new domestic cars sold during the 1964 model year.

Consumer credit. Credit buying continued at a fast pace in February, reflecting in part unusually strong demands for autos, color television sets, and selected appliances. Instalment credit rose \$641 million after seasonal adjustment, second only to the \$670 million rise reported for January. The pace apparently slowed a little in March, but in dollar amount the expansion indicated for the first quarter should establish a record. In percentage terms, however, the first quarter is expected to rank well behind gains in the peak quarters of 1955 and 1959.

The recent rise in instalment debt has been distinguished by very sizable increases in the auto component, which averaged more than \$300 million a month in January and February as compared with \$170 million a month in the second half of 1964.

At least part of the rise in auto debt (and for that matter, total instalment debt) in January was due to a temporary dip in repayments. The upward trend was resumed in February with seasonally adjusted repayments up \$168 million.

Construction activity. Seasonally adjusted new construction expenditures edged up further in March to a new high. Residential activity declined through most of last year but has tended upward in recent months and rose again in March. Most other types of private and public activity also advanced last month, with expansion in industrial construction expenditures continuing marked.

In the first quarter as a whole, construction activity reached an annual rate of \$67.2 billion, up 1 per cent from the previous peak in the third quarter of last year.

Business inventories. The seasonally adjusted book value of business inventories increased only \$325 million in February, according to preliminary figures. But, following the experience of other recent months, the preliminary January figures have been revised substantially upward. The increase for January is now estimated to total almost \$1 billion, as compared with less than \$700 million reported a month ago. Thus, accumulation now shown for the first two months of the quarter totaled \$1.3 billion, or an annual rate of \$7.8 billion. The November-December rate was \$10 billion.

Inventory holding of manufacturers increased only \$135 million in February. This was the smallest increase since last July. With an increase of \$400 million now reported for the first two months of the year, accumulation by manufacturers in the first quarter may turn out to be close to the \$700 million indicated by the February quarterly survey of manufacturers' expectations. The actual increase in the fourth quarter was \$1.9 billion.

The February increase in factory stocks was concentrated in durable goods. At steel mills, inventories declined somewhat following a sharp run-up in the fourth quarter, while outside of the steel industry accumulation of steel continued at about the rapid pace of other recent months.

Three-fifths of the February increase in total business inventories, and an even larger proportion of the January increase, occurred at distributors. (The bulk of the upward revision in January was at distributors.) This is in marked contrast with the fourth quarter when manufacturers accounted for the entire rise and distributors' inventories declined somewhat. For January-February combined, distributors' inventories increased \$900 million while manufacturers' stocks rose only less than half that amount.

On the basis of these new figures, stocks of wholesalers have shown a sharp spurt, rising nearly \$400 million in the first two months of the year. Retail stocks rose about \$500 million over the recent two-month period, and virtually all the rise was at durable goods stores, with nearly two-thirds of that increase at auto dealers.

Labor market. Widespread improvement in the labor market continued in March. The seasonally adjusted unemployment rate declined to 4.7 per cent from 5 per cent in February, the lowest monthly rate in more than seven years. The unemployment rate averaged 4.8 per cent for the first quarter, down from 5 per cent in the fourth quarter. This was the fifth consecutive quarter to show a decline.

Nearly all of the March decline in unemployment was among adult men and women, with employment unchanged while the adult labor force declined. Teenagers experienced a rise in employment but their labor force also increased and there was little significant change in their unemployment rate. Long-term unemployment (15 weeks or more) declined significantly further in March to a level 300,000 below

a year earlier and was the lowest for the month in eight years. Moreover, the decline was greater for the very long-term unemployed (27 weeks or more) than for those out of work for shorter periods.

The labor force in March was only 1.1 million larger than a year earlier; this was less than the projected increase. Total employment (household data) was more than 1.6 million higher and the number unemployed was about one-half million less than a year earlier.

More than half the decline in unemployment over the past year occurred among adult men. The jobless rate for this group was 3.3 per cent in March, compared to 4.0 per cent a year earlier. The rate for adult women was one percentage point below a year earlier and, except for January, the lowest in five years. The teenage unemployment rate showed little significant change over the year.

Steel negotiations. The steel workers presented their economic demands to the steel industry at the end of March leaving only one month for negotiating a contract before strike deadline. The list of demands, as expected, is extensive and the cost is higher than the 3-1/2 per cent package increase negotiated in the can company settlement. The demands include 25 cents--in two annual increases of 12-1/2 cents--in basic wage rates. For nonincentive employees a 10 per cent increase is called for over a 3-year period. In addition, the union is asking the steel companies for increases in premiums for overtime, holidays, and night-shift work; a cost-of-living escalator clause is also included in the package, but this demand was dropped in the can

company negotiations. A supplemental monthly payment of \$100 for early retirement is the same as in the can contracts, but substantially less than received in autos. The steel union is placing greater emphasis on higher regular pension payment than on earlier retirement. The demand for an increase in the duration of supplementary unemployment benefits is not yet specific, although the demand for an increase in the percentage of normal pay covered by the benefits is less than in the can contract.

Prices. While the industrial commodity price index has continued stable this year following its rise of three-fourths of a per cent last autumn, prices of some sensitive commodities have resumed their advance and there have been increases reported for some other industrial products. The current index level is equal to the peak reached about 5 years ago.

Wholesale prices of foodstuffs have increased this year reflecting mainly a greater-than-seasonal decrease in marketings of hogs--as a result of relatively low prices last year--and sustained expansion in demand for meats. Prices of foodstuffs remain within their range of fluctuation through the past five years, and they are more than 5 per cent below the level reached in early 1958 when livestock marketings fell to one of their cyclical lows.

While the over-all industrial index has been stable, the daily index for 13 raw industrial commodities has regained its high of last autumn. Prices of copper (in the 'free' markets), tin, and

rubber have increased appreciably. The increases may reflect primarily speculative reactions to events in Vietnam and Indonesia and to renewed attacks on sterling. All the hard news, as one journal put it, has been bearish: legislation has been enacted to release substantial amounts of copper, lead, and zinc from the stockpile; the strike against copper facilities in Zambia has ended; and the strike in Australia appears close to a settlement. Most recently, copper strikes have threatened again in South America. Domestic users of tin continue to be adequately supplied by releases from the stockpile.

Producers of aluminum sheet for use in cans have announced price increases of up to 3 per cent, and can companies announced that prices will be raised following negotiation of a new labor contract estimated to increase hourly labor costs at an annual rate of 3-1/2 per cent. Earlier, price increases had been announced for some glass and paper containers. Packaging markets, nevertheless, continue to be characterized by innovations and intense competition.

The consumer price index was unchanged in February. Foods were stable while nonfood commodities declined and services continued their steady upward trend. New car prices declined about seasonally and used car prices also went down. Increases in prices were noted for such items as property taxes, home and auto insurance premiums, auto repairs, local transit fares, and medical care services.

Agriculture. The March survey of farmers' planting plans for 1965 indicates that the total acreage will be only a little larger than the 306 million acres planted last year but that there will be substantial shifts among crops. Expanded acreages are planned for soybeans, grain sorghums, hay, potatoes, and dry beans and reduced plantings for oats, barley, corn, cotton, tobacco, spring wheat, and sugar beets.

The Crop Reporting Board estimates that the 1 per cent smaller acreage of corn, the major feed grain, may produce a crop equal to the record of 1963. Such a crop combined with the planned increase in grain sorghum acreage would result in a build-up in feed grain stocks, reversing the downtrend of the past two seasons. A 1.3 billion bushel wheat crop is now in prospect, 1 per cent above last year's outturn. Cotton acreage is expected to be down 4 per cent and tobacco 15 per cent, reflecting for the most part changes in allotment programs.

The original sign-up period for the 1965 Feed Grain, Spring Wheat, and Cotton Acreage Diversion Programs ended on March 26. Through March 25, farmers had signed contracts retiring 42 million acres from production. Sign-ups under the Wheat and Feed Grain Programs are somewhat larger than last year. Only 800,000 acres have been signed up for retirement in the Cotton Program out of a total allotment of 16 million acres. As a result the sign-up period has been extended for two weeks. Apparently, many large cotton producers prefer to grow full allotments at 29.0 cents per pound rather than

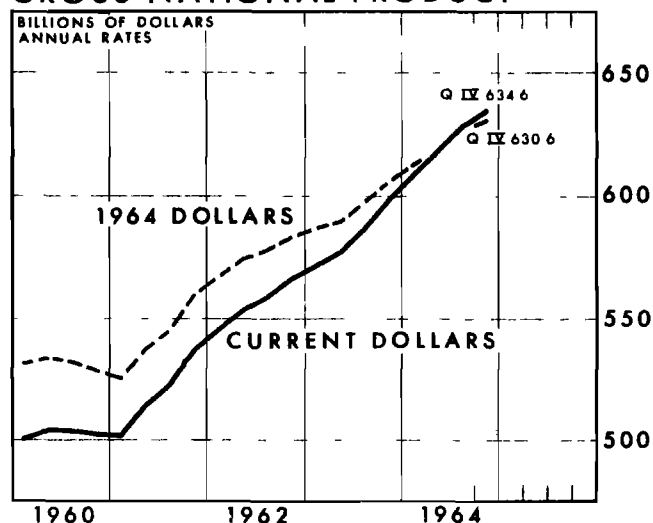
to cut plantings 35 per cent in return for price support loans at 29.0 cents per pound on their actual production and price support payments of 4.35 cents per pound on normal yield of their acreage planted for harvest. Producers with allotments of 15 acres or less are eligible for price support loans and payments without signing up.

Reports on livestock inventories and producers' plans indicate that throughout 1965 pork supplies will be substantially below 1964 levels and that beef supplies may be somewhat larger than the record supplies of 1964. Less of the beef will be from fed cattle. Per capita consumption of red meat in 1965 has been estimated by the Department of Agriculture at 170 pounds, 2 per cent below the unusually large volume of 1964, with pork down 8 per cent and beef up 2 per cent. If these estimates should be realized, per capita red meat consumption for this year would be 5 per cent higher than in 1960-62, reflecting chiefly a rise of 16 per cent for beef, a decline of 5 per cent for pork.

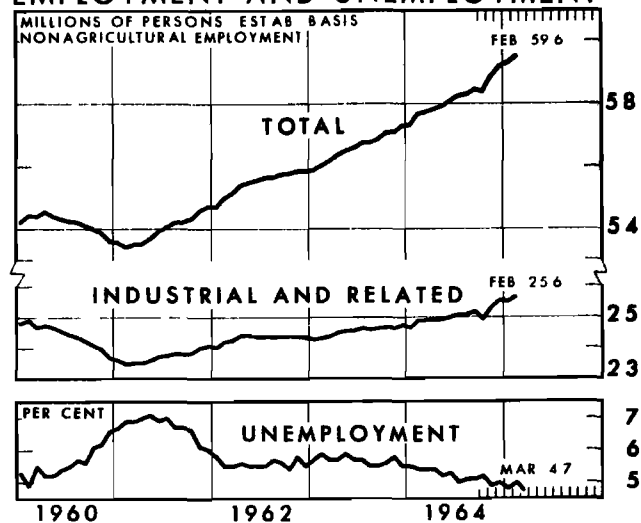
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

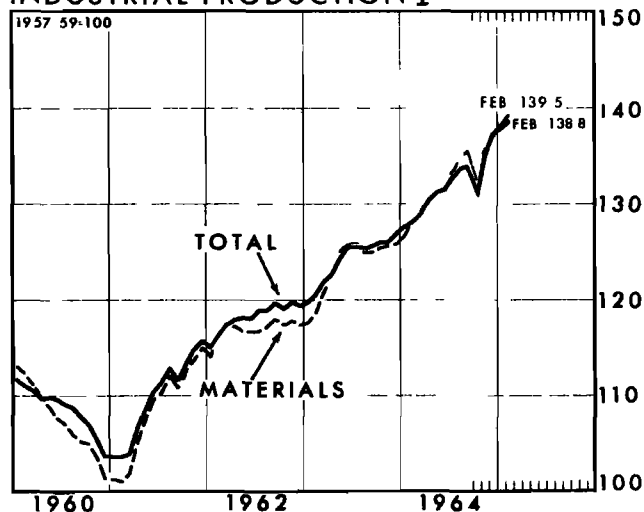
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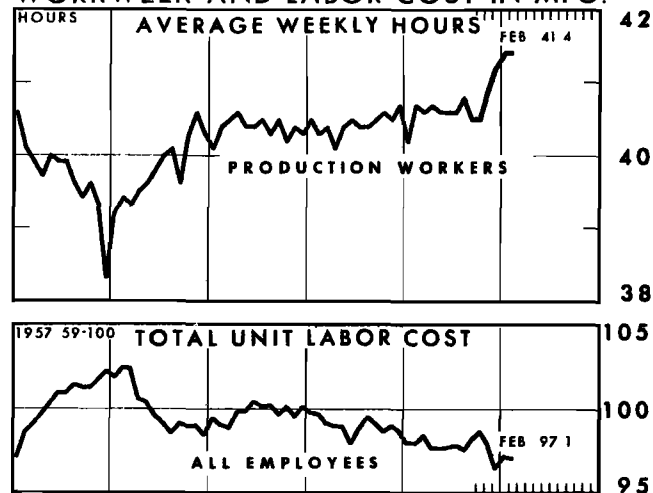
EMPLOYMENT AND UNEMPLOYMENT



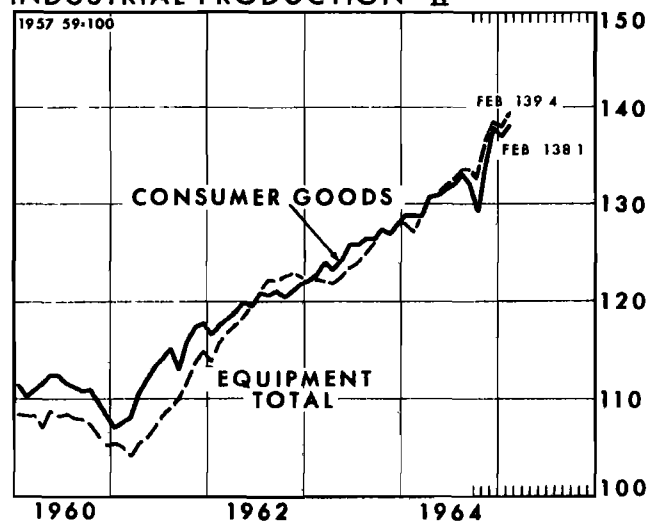
INDUSTRIAL PRODUCTION-I



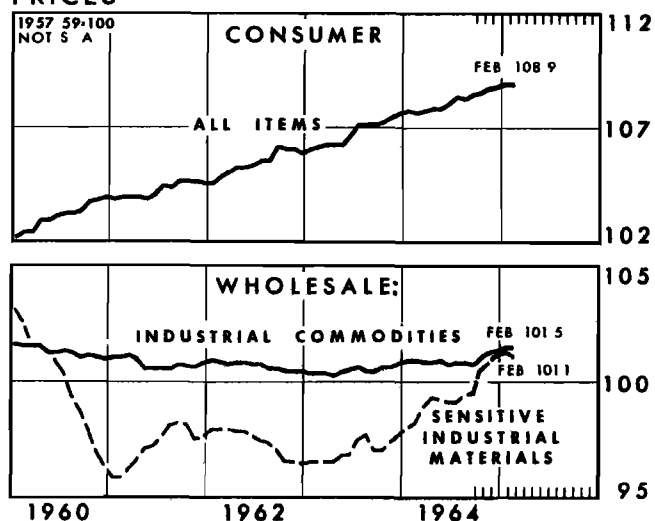
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



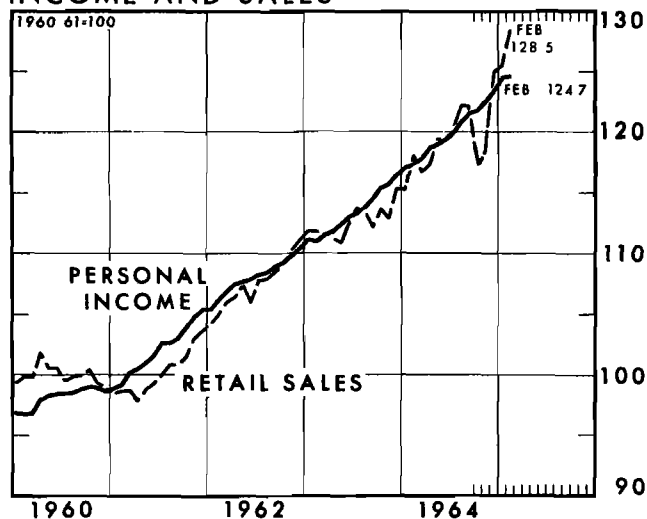
PRICES



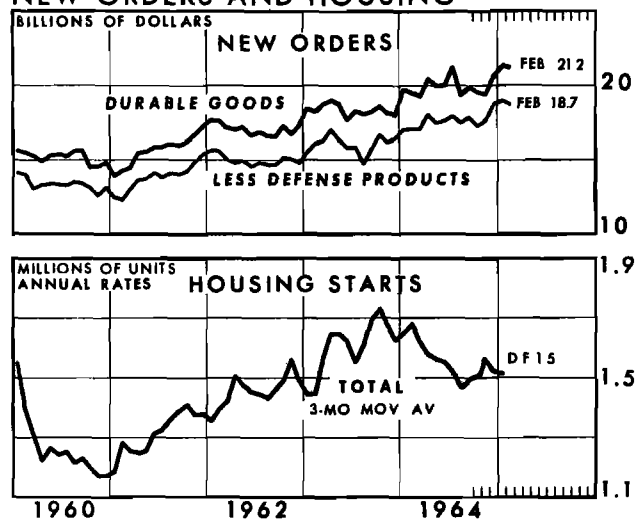
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

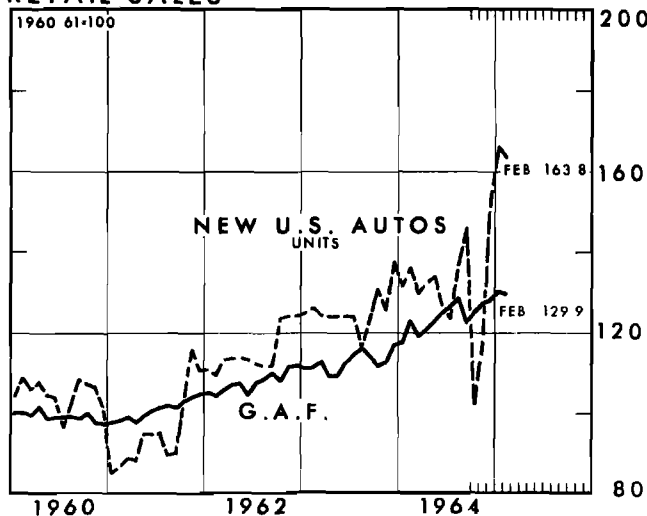
INCOME AND SALES



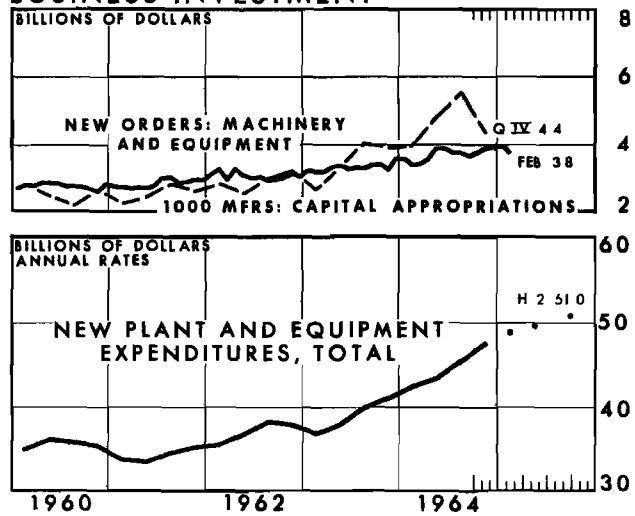
NEW ORDERS AND HOUSING



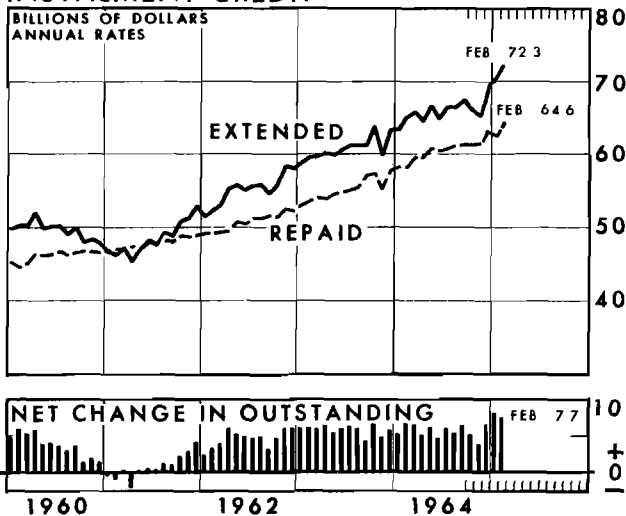
RETAIL SALES



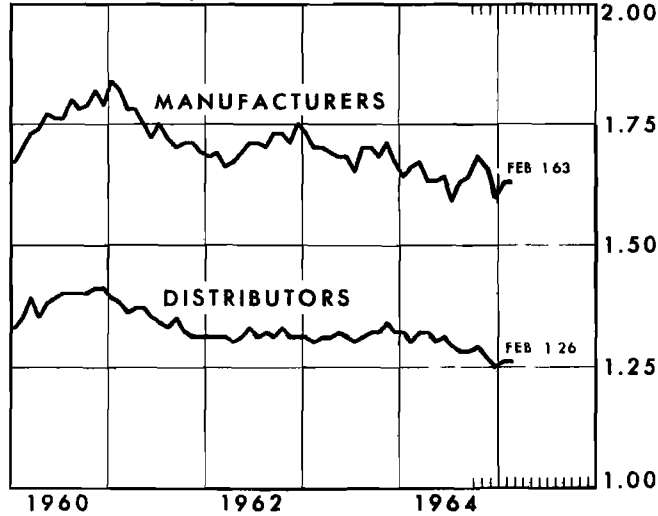
BUSINESS INVESTMENT



INSTALMENT CREDIT



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

U.S. Government securities market. Yields on U.S. Government securities turned up in late March and the first few days of April after drifting down during most of the preceding month. The more cautious tone in the Treasury bond market was related mainly to renewed concern over the course of sterling, but the market firmed in early reaction to the British budget presented on April 6. While the market was primarily looking to international developments, the domestic situation, including publication of net borrowed reserves above \$100 million, a lower unemployment rate, and continued strength in bank loans did impart a minor note of caution.

Trading in longer-term issues was generally light in the late March-early April period. Still, some selling by dealers and other temporary holders was more than offset by small net demand from investors and the System, and dealer holdings of bonds due in more than 5 years declined from \$300 million on March 24 to about \$210 million on April 5; these holdings were concentrated in the over 20-year maturity area. System purchases of over 5-year bonds totaled \$42 million in this period, while purchases of 1-5 year issues amounted to \$25 million.

Treasury bill rates--which had earlier moved down in contrast to the firmness of other money market rates--edged up in late March and early April. Pressure on bill rates was maintained from the supply side. One source of bill supplies recently has been various foreign and international accounts, which reduced their holdings of bills in

the custody of the New York Reserve Bank by nearly \$500 million between March 10 and March 31. In addition, the Treasury maintained recent weekly auctions at \$2.2 billion while only \$2.0 billion or \$2.1 billion of bills were maturing. Dealers have generally been cautious bidders in these auctions, receiving smaller awards than earlier this year.

Net market demand, as indicated by dealers' net sales to the public, had tapered off in the last two statement weeks in March, although it improved in early April. Meanwhile, dealers continued to have to finance bill inventories at relatively high rates, reflecting in part continued pressure on bank reserve positions, but most recently financing has been available at the discount rate through System repurchase agreements.

YIELDS ON U.S. GOVERNMENT SECURITIES

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
<u>1964-65</u>						
Highs	4.00	4.05	4.22	4.21	4.26	4.26
Lows	3.42	3.50	3.92	3.99	4.12	4.14
<u>1964-65</u>						
December 31	3.82	3.92	4.06	4.12	4.21	4.21
February 25	4.00	4.05	4.12	4.15	4.21	4.21
March 25	3.89	3.97	4.11	4.13	4.19	4.19
April 6	3.94	3.99	4.12	4.15	4.20	4.20

Treasury financing outlook. The small amounts of new cash obtained by the Treasury in recent weeks have further enhanced its relatively comfortable cash position. At the end of March the cash operating balance had risen to \$8.2 billion, as compared with

\$7.9 billion last year at the same time. The cash balance has been built up during the first quarter with tax collections coming in a bit higher than patterns implicit in the January budget document, particularly withheld income and social security taxes. On the expenditure side, cash payments appear to be running about in track with, or perhaps somewhat lower than, budget document projections; military expenditures are coming in below projections, but other cash outlays, especially agricultural programs and Federal Home Loan Bank lending, might well turn out above anticipations.

With a cash surplus of about \$4.5 billion anticipated for the second quarter, the Treasury can retire the \$3.3 billion of June tax bills and add further to its cash balance without raising any new cash in the market until summer, when it has to begin financing the July-December deficit. The second half deficit is expected to be in the \$11.5-\$12 billion range. Net cash borrowing of around \$8 billion may be required, compared with \$7.3 billion in July-December 1964, with the mid-year cash balance being utilized to finance perhaps about one-third of the deficit.

The next regularly scheduled financing will be in May, when the Treasury refunds \$4.1 billion of publicly held securities. Terms will be announced toward the end of April.

Corporate and municipal bond markets. Corporate and municipal markets have recently reflected increased investor uncertainty about the course of bond yields over the near-term future. This more cautious tone, like that in the Government market, has been attributable

largely to the situation in sterling, to further signs of strength in the domestic economy, and to evidence of tautness in the money market.

In the corporate bond market, investors have resisted acceptance of new offerings at yields about 5 basis points below the year's high reached in early March. As a result, underwriters have accumulated a sizable unsold inventory of new issues. Yields on municipal bonds also reached a high for the year in early March, and have since stabilized at or slightly below that level. However, retail demand has been relatively weak for many recent offerings.

BOND YIELDS
(Weekly averages - per cent per annum)

	Corporate		State and local government	
	Aaa		Moody's	Bond Buyer
	New	Seasoned	Aaa	(mixed qualities)
<u>1964</u>				
Sterling crisis high	4.47 ^{1/2}	4.45	3.09	3.21
<u>1965</u>				
Low	4.33 (1/29)	4.41 (3/12)	2.94 (2/11)	3.04 (2/4)
High	4.48 (3/12)	4.44 (1/8)	3.09 (4/1)	3.20 (3/4)
Latest week	4.43	4.42	3.09	3.16
<u>1/</u> Week ending December 4.				

The over-all volume of new corporate bonds reaching the public during the past several weeks has been considerably smaller than the volume early in March. For all of April, the calendar of public offerings scheduled thus far is about one-third below March. Almost all of the decline is accounted for by convertible bonds, however, so that the effects of the smaller over-all volume on bond

yields may be relatively small. Also, the April volume is about the same as a year earlier, close to the experience for the year to date.

BOND OFFERINGS 1/
(Millions of dollars)

	Corporate				State & local govt.	
	Public offerings		Private placements			
	1965 e/	1964	1965 e/	1964	1965 e/	1964
Jan.-Apr. avg.	321	338	513	423	856	1,005
March	550	361	500	343	950	860
April	380	383	500	480	750	1,293

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

In the municipal bond market too, the recent supply of new offerings has declined substantially from early March and the volume of new offerings estimated for April is the smallest monthly total since November. But investor enthusiasm for new municipal issues has not risen so far in anticipation of this cut-back in current and prospective offerings. Commercial banks in particular appear to have been less active buyers of municipals, presumably because of a continued strong loan demand, some slackening of savings inflow, and somewhat more restrictive reserve availability. As a result, dealers have found it difficult to reduce their advertised inventories of unsold securities much below \$750 million for any sustained period of time.

Stock market. Common stock prices, as measured by Standard and Poor's index of 500 stocks, have continued to fluctuate within a narrow range below the record high of 87.58 reached in early February. Since late February, this sideways price movement has been accompanied

by a sharply lower trading volume. In the week ending April 2 trading averaged 4.7 million shares per day, substantially below the unusually high 6.4 million daily average reached in the last week of February, and the smallest average daily volume for any week since December.

The recent lack of direction in the popular stock price averages seems to reflect a number of cross currents. On the one hand news reports directly related to the current state of the economy have continued good. At the same time, however, uncertainties arising from the Vietnam situation, the approaching deadline of steel labor negotiations, and the state of the British pound have acted as market depressants. Furthermore, funds available for stock market purchases on the Exchanges have recently been reduced by the Federal Government's public sale of \$343 million in General Aniline stock and by an unusually heavy volume of new convertible debentures, which have more appeal for stock investors than nonconvertible bond offerings. Finally, secondary stock offerings--led by the sizable liquidation of DuPont holdings in General Motors--have been unusually large recently; and selling pressure has been reported on the Exchanges stemming from investors' needs for funds to meet April income tax liabilities.

Mortgage markets. Lender competition for mortgages has continued through the first quarter of the year as mortgage funds generally have remained ample. While still not particularly high, purchasing activity in the secondary market by the Federal National Mortgage Association has been at a more advanced level in recent months than in most of the past two years. According to FNMA, this, however,

has reflected broadened activity in mortgages owed by rural and moderate income families rather than a general shift in private investor demands.

In the market for conventional mortgages on homes, interest rates remained stable in February according to the Federal Home Loan Bank Board. While loan amounts and other nonrate terms were generally more liberal than a year ago, they continued somewhat less liberal than more recently. A similar pattern prevailed for loans on existing homes, except in the case of loan-to-price ratios which moved to a new high in February.

Savings and loan dividend rates. At the end of March, a number of savings and loan associations in the Los Angeles area raised dividend rates about 10 basis points to levels that provide effective annual returns of slightly more than 5 per cent. For the most part the increases were initiated by relatively small State-chartered stock companies. Since real estate markets in the Los Angeles area have weakened in recent months, the rate advances were probably largely defensive. During January and February net inflows of savings to all associations in California were only half as large as in the same period of 1964, and there is some concern that the short-fall will be even greater in April as tax payers attempt to adjust for earlier underwithholding on Federal income tax liabilities.

In an effort to head off a possible general advance in savings and loan dividend rates, the Federal Home Loan Bank Board recently requested Home Loan Banks to refuse expansion credit (advances

for purposes other than coverage of withdrawals) to member associations that have raised dividend rates since the end of last year. This prohibition is not applicable, however, to associations where the increased rate is no higher than 4-1/4 per cent or the prevailing rate for the region at the end of 1964. The Bank Board also disclosed that it recently ordered 35 insured associations to cut dividend rates unless their reserves against risk assets were brought up to Board requirements by the end of March.

Bank credit. Reflecting continued strong loan demand, bank credit rose substantially further in March. Early estimates for seasonally adjusted credit at all commercial banks indicate that growth may have been somewhat larger than in either January or February--probably around \$3.5 billion. Over the first quarter as a whole the annual rate of growth may approximate 13 per cent compared with about 7 per cent in the fourth quarter of 1964.

Loans probably will show a record postwar seasonally adjusted rise of more than \$3.5 billion in March, reflecting heavy borrowing in most major loan categories. Holdings of municipal and agency issues, however, showed little change after a sharp decline in the rate of acquisitions in February. Holdings in March, however, were influenced by a large temporary run-off of New York State tax anticipation notes at the month-end. To meet loan demand in the context of reduced reserve availability and reduced time deposit inflows, banks not only curtailed the rate of acquisition of municipal and agency issues, but also made large reductions in their holdings of U.S. Government securities, mainly in Treasury bills.

Following some slackening in late February and early March, business loan demand at city banks strengthened again beginning around the mid-March tax date. Borrowing was unusually heavy during the tax week and again in the week of March 31. At all commercial banks the seasonally adjusted rise was probably close to the February increase of \$1.1 billion, more than twice the monthly average rise over the year 1964.

A substantial part of the business loan rise continued to reflect borrowing by metals companies, for which the increase in March was about the same as in March 1960 but less than in March 1956--two earlier periods of substantial steel inventory accumulation. But strong loan demand was evident in most other major loan categories as well, including food processors, trade, textiles, petroleum and chemicals, and miscellaneous manufacturing and mining. On the other hand, loans to commodity dealers, which had been increasing contraseasonally during the dock strike, dropped off more than usual in March and loans to construction firms rose less than usual.

"Other" loans (including those to consumers) rose by an unusually large amount in March. Most of the increase occurred late in the month and presumably was associated in part with the continued high level of auto-sales but there have also been reports of more borrowing than usual by individuals to meet April 15 income taxes. Security loans rose contraseasonally reflecting substantial borrowing for purchasing and carrying non-Government issues. Loans to nonbank financial institutions are also expected to show a seasonally adjusted

increase in March due in part to temporary end-of-month borrowing. City bank acquisitions of real estate mortgages continued in March about one-third below the year earlier pace, as they have since the beginning of the year.

Money supply and time deposits. The seasonally adjusted money supply increased \$700 million in March following a decline of similar amount in February. Substantial growth in the first half of March, when U.S. Government deposits declined much more than usual, was followed by a small reduction in the second half associated in part with a subsequent sharp build-up in Treasury balances. Over the first quarter, growth in the money supply was at an annual rate of 1 per cent compared with 3.5 per cent in the fourth quarter of 1964.

Growth in time and savings deposits slackened markedly in March to a seasonally adjusted rate of \$1.3 billion, over \$1 billion below the unusually sharp January-February expansion but the same as the average monthly rise in the second half of 1964. At city banks, savings deposits growth has continued large, while other time deposits, excluding negotiable CD's, rose by less than half the January-February rate. Outstanding CD's increased somewhat further over the four weeks ending March 24 as heavy sales early in the month and again in the post-tax week more than offset record tax and dividend period maturities. By March 31, CD's at banks in New York City had more than regained their peak March 10 level, while at Chicago banks they were still a little below and at other banks considerably below earlier highs.

Following the rate increases in early 1957 and 1962, the initial surge of time and savings deposit inflows continued through the first

quarter. This was followed by a sharp temporary drop in the growth rate for a month or two, after which it rose and leveled off about one-third below the first quarter level. This year, the reaction to the initial surge appears to have occurred somewhat sooner than in 1957 and 1962. Factors accounting for this earlier slowdown were: (1) the concentration of rate increases on January 1 this year in contrast with a more extended transition to higher rates in these earlier periods, (2) heavy needs for funds this year to participate in large secondary distributions of General Aniline and General Motors stock, and (3) the marked slackening after January in the inflow of time deposits from corporations, which were less important levelers of such deposits in these earlier periods.

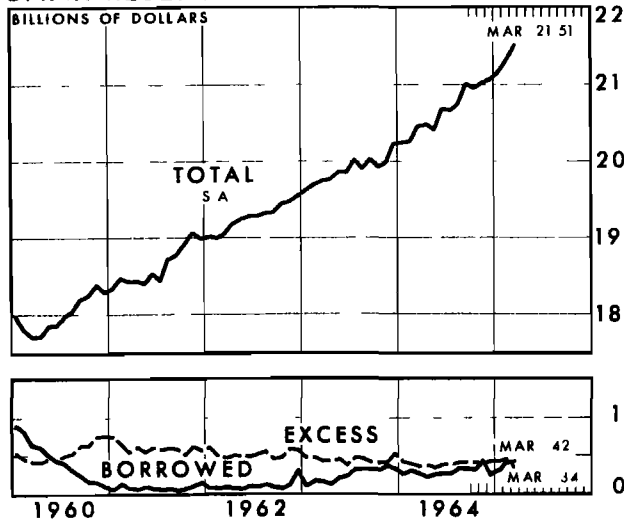
Over the first quarter, growth in money supply plus time and savings deposits at commercial banks combined grew at an annual rate of 8.8 per cent, about the same as in the fourth quarter. Moreover, a more comprehensive figure for total liquid asset holdings by the public continued to rise in January and February at about the \$3 billion per month rate which has prevailed over the past three years.

Bank reserves. Net borrowed reserves rose in late March and early April after averaging about \$30 million over the first four weeks of March. The increase largely reflected a higher level of borrowings, although this rise was associated in part with seasonal borrowing by Chicago banks in connection with the April 1 personal property tax assessment date. The effective rate on Federal funds was above 4 per cent on 11 days between February 25 and April 6 and never

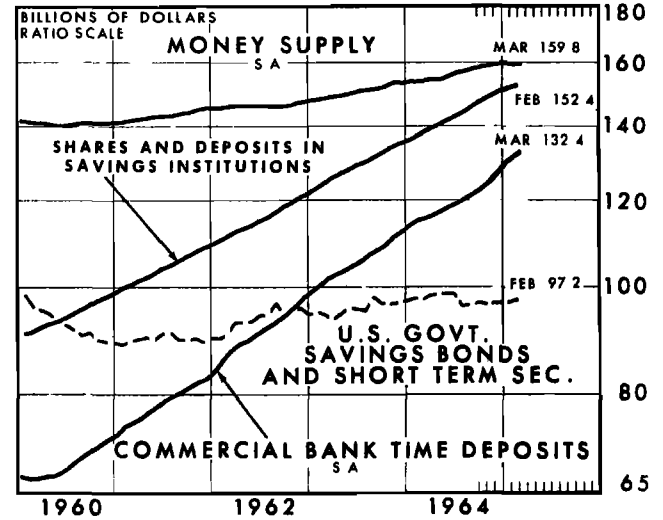
below that level. Transactions took place generally in the 4-4-1/8 per cent range and at lower rates on only 6 days.

FINANCIAL DEVELOPMENTS - UNITED STATES

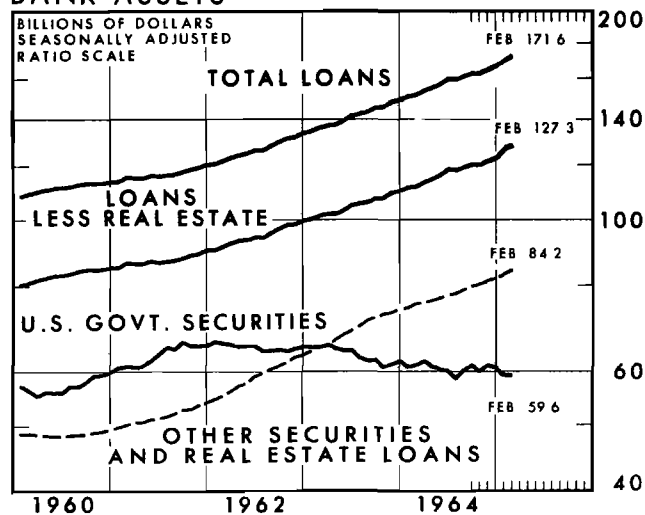
BANK RESERVES



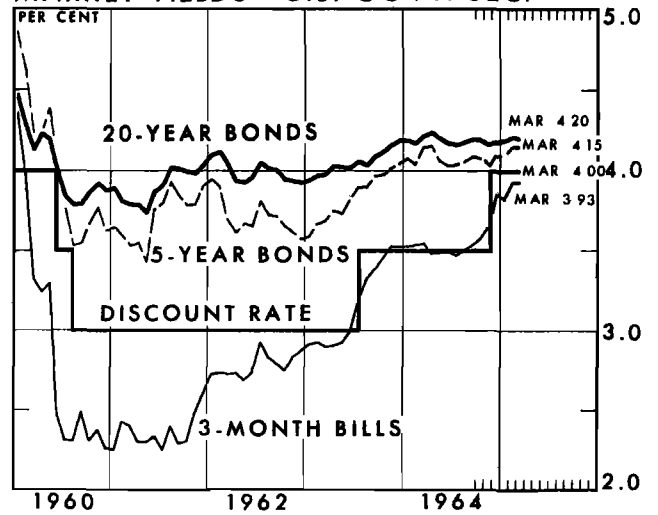
LIQUID ASSETS HELD BY PUBLIC



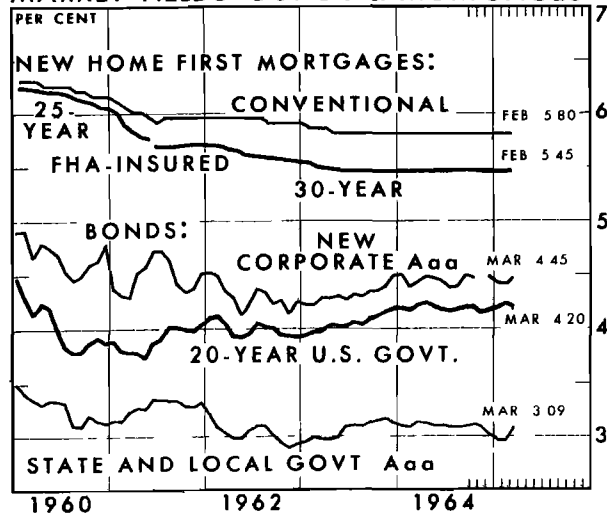
BANK ASSETS



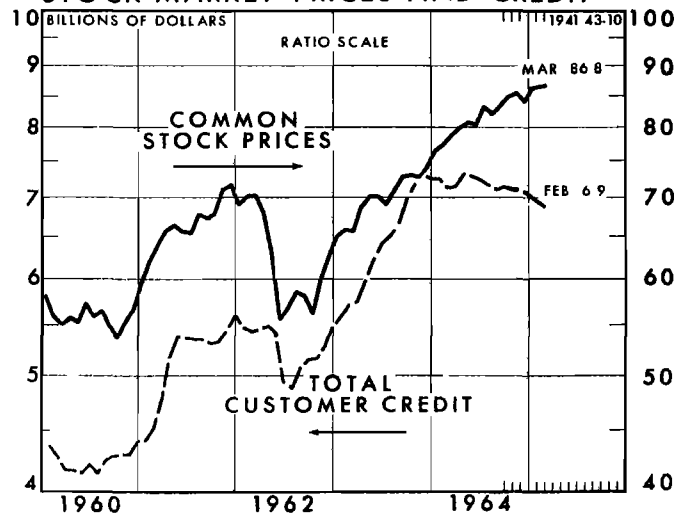
MARKET YIELDS - U.S. GOVT. SEC.



MARKET YIELDS - BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. An over-all payments deficit in the first quarter of about \$300 million is tentatively indicated by the incomplete data now available. This quarterly total includes an estimated surplus for March of around \$500 million, which may require substantial revision when fuller figures become available around the middle of the month. Seasonal factors are favorable in the first quarter by an amount greater than \$300 million. Thus after adjustment for seasonal influences, the first quarter deficit would appear to have been something over \$600 million or, roughly, \$2-1/2 billion at an annual rate. This would be about the same as in the second and third quarters of 1964, and less than half the rate in the fourth quarter.

The deficit in the first quarter appears to have been very largely financed by "official settlements" -- changes in U.S. reserve assets and in liabilities to foreign official institutions together with receipts from special transactions. In the past, the first quarter has usually seen a seasonal reconstitution of foreign commercial bank balances here tending to reduce dollar accruals to foreign monetary authorities. Making a crude allowance for this seasonal behavior, the adjusted deficit in the first quarter calculated on the "official settlements" basis would appear to have been very large, and about as large as in the last three months of 1964.

Comparing the development of the payments deficit during the first quarter of this year with that of a year earlier, there was a very large deficit in February as compared with a negligible deficit in February 1964, and a surplus in March perhaps about twice as large as that recorded a year earlier. Statistics helping to explain these

U.S. BALANCE OF PAYMENTS DEFICIT
(in millions of dollars)

	1965		1964	
	Total	Official	Total	Official
Jan.	200	-320	140	-265
Feb.	575	600	60	30
Mar.	-500?	- 50?	-270	- 70
Total	275?	230?	- 70	-305
Seasonal adjustment	340?	n. a.	340	n. a.
Adjusted Total	615?	n. a.	270	n. a.

Monthly data on changes in liquid liabilities to foreigners and in U.S. reserve assets have been supplemented by estimates of special receipts from prepayments on U.S. Government loans and advance payments on military sales. All figures rounded.

differential movements are almost wholly lacking. However, the large February deficit presumably reflected among other things the reportedly heavy outflows of long-term bank loans early in the month prior to the President's balance of payments message. Part of the surplus registered in March was the result of the pattern observable last year of U.S. corporations investing funds at short-term abroad and repatriating them prior to the quarterly tax date. But the larger size of the March surplus than a year ago may indicate a bigger than usual reflux of such funds, possibly influenced by the balance of payments program. The March surplus was reflected principally in a decline in balances held here by commercial banks abroad (including U.S. bank branches).

One uncertainty in any appraisal of recent developments in the payments position has been the impact of the dock strike on the flow of external payments and receipts. Recorded movements of both exports and imports were cut sharply in January. While imports in February rebounded to about the fourth quarter average rate, exports recovered much less to a rate still about 30 per cent below the fourth quarter average. The better recovery of imports may have been due to priority being assigned to the unloading of inbound ships and to the clearance of their cargo from the docks before export shipments were handled. Despite the delays in shipments, it may be presumed that most payments for exports and imports were effected on schedule; to the extent, however, that payments were disrupted as well, the result would have been to enlarge the deficit in January and February with a possible compensatory diminution of the deficit in March.

Substantial progress has reportedly been made in the past month in clearing the docks but partial embargoes on rail shipments to ports apparently are continuing. Until normal schedules are restored, current trends in exports and imports will be obscured.

One indicator of demands for U.S. exports is provided by monthly data on new export orders for durable goods excluding autos, covering about one-third of total exports. These orders increased sharply at the end of 1963 and remained at an advanced level (above sales) throughout 1964 and in January this year. Unfilled export orders increased from \$2.6 billion in December 1963 to \$3.2 billion a year later. Half of this increase was for aircraft. Order books for other durables appear not to have lengthened since the middle of last year.

Credit conditions abroad. Monetary and credit policies in Europe remained generally restrictive during the first quarter of 1965, except in Italy. Between December and March, long-term bond yields rose considerably in Germany, eased slightly in Belgium, the Netherlands Switzerland and -- at least through January -- declined further in Italy. In the short-term area, money rates eased more than seasonally in Switzerland, and tightened in the Euro-dollar market.

LONG-TERM GOVERNMENT BOND YIELDS^{a/}
(per cent per annum)

	March _{b/} 1965	Changes		
		Dec. 1964 to Mar. 1965	July 1964 to Dec. 1964	June 1963 to July 1964
E. E. C. :				
Germany	6.63	+ .21	+ .08	+ .28
France	5.79	+ .10	+ .01	+ .30
Belgium	5.33 _{b/}	- .09 _{b/}	--	+ .59
Netherlands	4.95 _{b/}	- .05	- .02	+ .71
Italy	5.35 _{b/}	- .27 _{b/}	+ .57	+ .76
Switzerland	3.94	- .12	- .02	+ .97
United Kingdom	6.53	+ .06	+ .23	+ .70
Canada	5.10	+ .07	- .17	+ .29
United States	4.16	- .05	+ .04	+ .14

a/ Yields at end of month for representative long-term issues for all countries except Belgium and France, for which data shown are a composite yield of public sector securities, and except Italy for which the data are monthly averages of composite yields.

b/ Early or mid-March data for all countries except Belgium (end of February), Italy (January 1965 average), and U.S. (end of March).

The initial impact of the U.S. balance of payments program on financial markets abroad was most clearly evident in the Euro-dollar market, where rates moved up abruptly from February 10 to new highs on March 10. In addition, it was clear that the U.S. program would produce further demands on domestic credit supplies in European countries as U.S.

subsidiaries and other European residents turned to local sources for financing in place of U.S. bank loans and parent company funds.

A particularly large influx of loan applications from U.S. subsidiaries was reported in Belgium. As part of the anti-inflationary program, credit guidelines (in terms of recommended maximum annual increases in outstanding bank loans) are still in effect in Belgium, but the central bank has reportedly advised Belgian banks that borrowing by U.S. subsidiaries from local sources occasioned by our program may be exempted from the credit guidelines. Reportedly, more than half the financing of the new General Motors plant in Antwerp -- the cost of which is currently estimated at over \$80 million -- will be provided by local banks, with the remainder coming from undistributed profits. From Stockholm, it is reported that some Swedish banks, which normally finance in New York a considerable amount of Swedish trade with Latin America, may have to resort to inter-bank borrowing within Sweden at an added cost of 1 per cent.

Such pressures as these could eventually be reflected in higher interest rates in many European national markets unless offset by modifications in central bank policies. Also, high rates in the Euro-dollar market may tend to attract liquid funds from national markets; linkage of rates with those in the Euro-dollar market has been particularly noticeable in the U.K. local authority deposit market. But evidence thus far of tendencies for rates to harden in Continental centers is limited.

Ease in the Swiss money market since the turn of the year has probably been a consequence of the heavy movements out of sterling that occurred in late 1964. With inflows to Switzerland apparently reduced,

especially since the U.S. program was announced, the decline in the Swiss franc exchange rate during the first quarter has reflected the continuing current account deficit and possibly also outflows of Swiss bank funds attracted by high Euro-dollar interest rates.

Euro-dollar interest rates have eased off somewhat since March 10, but early this week remained about 1/2 of 1 per cent above year-ago levels. The spread of the 90-day Euro-dollar rate over U.S. CD's is wider by about 1/8 of 1 per cent than a year ago.

SHORT-TERM INTEREST RATES
(monthly averages of Friday market rates, per cent per annum)

	March 1965	Changes	
		From March 1964 to March 1965	From March 1963 to March 1964
Deposit rates (90-day):			
Euro-dollar (London)	4.88	+ .61	+ .62
U.K. local authorities	7.77	+2.65	+ .72
Switzerland	3.06	- .13	+ .54
Interbank loans (3-month):			
Germany	4.04	+ .58	+ .01
Treasury bills (3-month):			
U.K.	6.29	+2.13	+ .69
Canada	3.61	- .16	+ .13
U.S.	3.90	+ .38	+ .63

United Kingdom. The generally restrictive tone of British financial markets was not significantly altered during the first quarter. In the money market, tight conditions continued unabated. In January, it appeared that effects of the 7 per cent Bank rate and the general shortage of funds might spread beyond the bank loan market; building societies raised mortgage rates generally by 1/2 to 3/4 of 1 per cent. Following

a temporary pause in early February, markets tightened again as a reduced supply of loan funds forced local authorities to compete actively in the deposit market. After the U.S. balance of payments program was announced on February 10, local authority deposit rates -- then about 7.2 per cent -- rose dramatically further along with Euro-dollar rates.

In contrast, U.K. Treasury bill yields moved down a little during the first quarter. A much reduced supply of bills at the weekly tenders reflecting the customary seasonal revenue surplus, together with recurrent rumors of a Bank rate decrease, led the discount houses to raise bid prices. In order to discourage rumors regarding Bank rate action and to moderate the decline in the bill yield, the Bank of England forced the discount houses to borrow at Bank rate intermittently in February and March. On March 19, after a few days of heavy borrowing, the discount houses lowered their bid to such an extent that the market yield rose 15 basis points to 6.35 per cent, marginally above the average February level. On April 2 the bill yield was unchanged at 6.35 per cent.

France. The Paris money market was easy during most of the first quarter, in part because of the balance of payments surplus. The authorities raised the banks' required liquid assets ratio to 36 per cent in January, following temporary reductions toward the end of 1964, but this was clearly a technical adjustment to seasonal requirements. Except for customary end-of month tightness, the rate for day-to-day money has been close to the Bank of France's basic discount rate of 4 per cent, which tends to act as a floor to market rates.

Despite the recession in economic activity that set in last autumn, the authorities have maintained the 10 per cent per annum ceiling

on bank credit expansion. It is not clear whether credit expansion is still continuing to press against the ceiling. The ease in the money market -- which is exclusively an interbank market -- gives no adequate clue, since restraint may be imposed by the ceiling regulation consistently with quite a wide range of conditions in the money market. Government bond yields have registered only negligible changes during the quarter, while yields on corporate fixed interest securities have shown a flat trend.

Virtually the only notable financial development occurred in the Paris gold market, where gold coins have held at greatly advanced prices throughout the quarter because French purchases of gold, together with President de Gaulle's pronouncements on the gold standard, created new doubts about maintenance of the U.S. official price for gold. For example, the price of the "Napoleon" 20-franc piece, which averaged 41.28 francs last December, climbed to 42.80 francs on January 8 and to 44.30 francs -- its highest level since 1952 -- on March 10. The price receded to 43.70 francs on March 26.

Germany. German financial markets last month were dominated by the approach of the important March 15 tax date. Cessation of an abnormal pre-February 10 inflow of U.S. capital and credit to Germany, noted in market reports, may have contributed to the seasonal rise in rates. Day-to-day money rates moved up by a rather significant margin, from about 3 per cent in mid-February to roughly 4 per cent in the first half of March.

To help meet seasonal requirements, German commercial banks let their holdings of U.S. Treasury bills under the preferential swap arrangement with the Bundesbank decline by about \$90 million from March 10 to March 24.

However, the substantial rise in the premium on the three-month forward DM in the second week of March, reversing the February decline, may suggest that German banks were placing funds in the Euro-dollar market, where they can earn more than by holding U.S. Treasury bills under the preferential arrangement.

Since the turn of the year German bond prices have been weakening. This tendency, apparent even before the German discount rate increase of January 22, was reinforced by this indication of the authorities' determination to maintain a restrictive policy. Yields on a representative long-term bond moved up from 6.42 per cent at year-end to 6.63 per cent in mid-March.

Italy. Italy provides the single important exception to the generally restrictive posture of monetary and credit policy in Europe. A shift in monetary policy occurred last August, and since then bank loans and investments have increased significantly.

The cutback in economic activity caused by the 1964-64 stabilization program apparently came to an end by late 1964 but, in the absence of clear evidence of a definite upturn, the Italian authorities have recently moved to spur lagging output, especially in the building sector. A decree law approved by the Cabinet on March 13 provides a program of loans for various public works (agriculture, schools, housing, roads and ports) to be financed from the proceeds of bond issues by the Credit Consortium for Public Works, which will be authorized to borrow \$400 million equivalent in Italy and abroad. In addition, the Postal Savings Fund will lend \$600 million equivalent, over an unspecified period of time,

to local authorities; some of the funds for these loans will almost certainly be obtained indirectly from the Bank of Italy. These stepped-up financing programs indicate that the Italian authorities have decided that the time has come to use fiscal as well as monetary measures to stimulate demand.

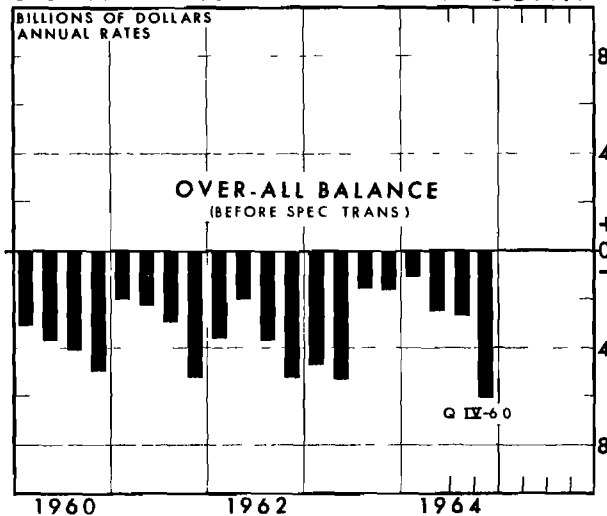
Japan. The Bank of Japan's basic discount rate was reduced effective April 3 to 5.84 per cent, the level at which it stood before the tightening of monetary policy in December 1963. Quarterly credit expansion quotas for the large city banks have been sharply liberalized.

While the authorities do not want to encourage a new over-expansion of investment based on bank credit, they wish to reduce the pressures that have contributed to numerous recent bankruptcies and financial reorganizations of business companies. Industrial production has stabilized at a high level since last autumn. The trade balance in January-February was sharply improved from November-December, with exports up and imports down. However, wholesale and consumer prices continued to rise through February; the wholesale index in that month was 1.2 per cent above last year's low in June.

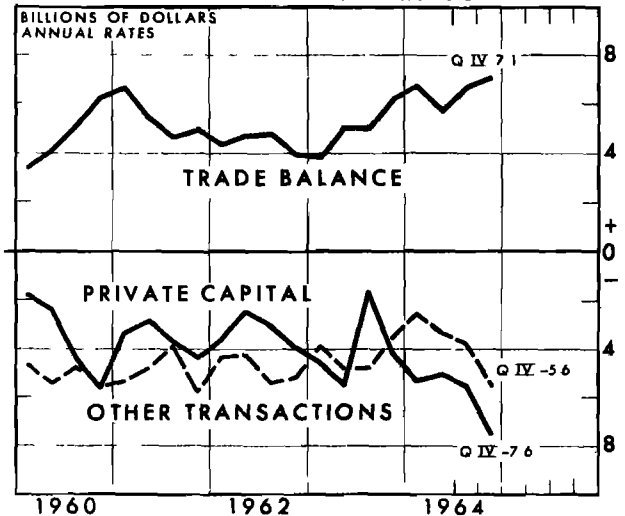
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

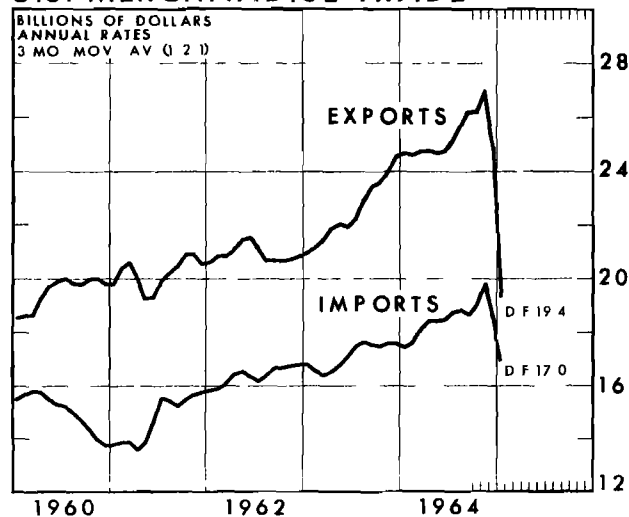
U.S. BALANCE OF PAYMENTS-CONT.



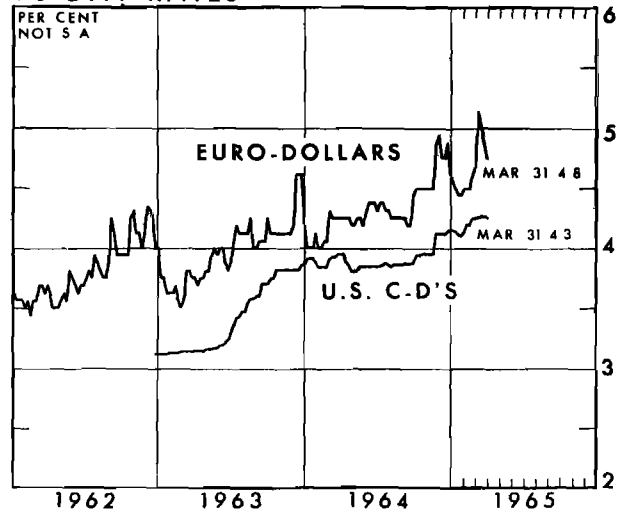
U.S. BALANCE OF PAYMENTS



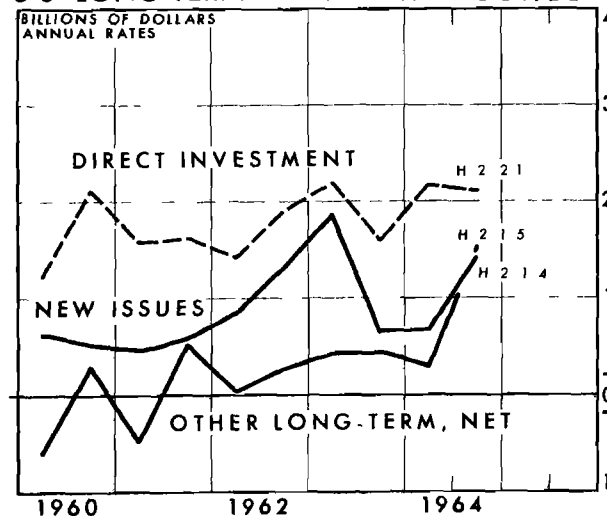
U.S. MERCHANDISE TRADE



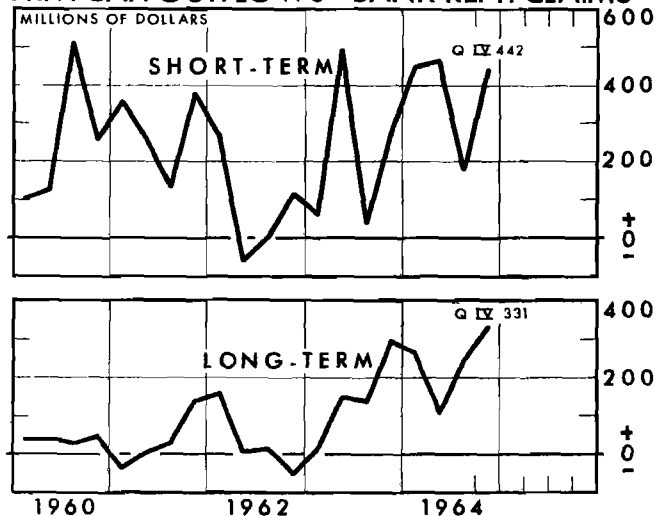
90-DAY RATES



U.S. LONG-TERM PRIVATE CAP OUTFLOWS



PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



APPENDIX A: MARCH LENDING PRACTICES SURVEY

The results of the third quarterly survey of changes in bank lending practices conducted as of March 15, 1965 are summarized in the following paragraphs and accompanying table. Reports were received from the 81 banks that report in the quarterly interest rate survey.

Most of the banks experienced continued strength in loan demand. Well over half of the banks (45 out of 81) reported that demand for commercial and industrial loans had strengthened in the first quarter, and half of these had also indicated increased loan demand in the December survey. Another 14 per cent (11 banks) reported stronger loan demand in December with no change in March, making a total of seven-tenths of the banks where loan demand had strengthened in one of the two quarters. Factors reported to account for the increased demand included the dock strike, steel stockpiling and tax payments. One bank stated that the demand was principally for future commitments, mainly for capital expenditures.

The most striking changes reported in lending practices were in interest rates and compensating balance requirements for business borrowers. Forty-six banks (nearly three-fifths of the total) indicated that they had firmed policy in the first quarter with respect to interest rates charged and over half of these (25 banks) had also tightened policies on size of compensating balances. Another four banks showed firmer policies on compensating balances but no change in interest rates. Looking at both the December and March surveys, two-thirds of the banks had firmer policies on interest rates and about half on compensating balances in one or both of the surveys. Firmer policies in both surveys were reported by one-third of the banks for interest rates, and by more than one-fourth for compensating balances.

The reason most often given for firmer policies on interest rates and compensating balances was the need to improve gross income to offset higher rates paid on time deposits. Another reason for the firming of lending practices often was the individual bank's high loan-deposit ratio.

The proportions of banks reporting firmer policies in March on other terms and conditions of loans to business borrowers were considerably smaller than in the case of interest rates and compensating balances. About one-fifth of the banks had firmer policies on standards of credit worthiness of the borrower, about 12 per cent with respect to type and amount of collateral required and 11 per cent with respect to maturity of loan. Most of the banks with firmer policies in these areas had reported increased loan demand in December or March or in both surveys. Only rarely did a bank that indicated no change in loan demand on both surveys report any change in these terms and conditions of credit.

Aggressiveness in seeking new business loans appeared to be inversely related to strength of loan demand. Fifteen banks reported greater aggressiveness in seeking new business loans in the first quarter and most of these were banks that reported no change or weaker loan demand in this period. By contrast, nine banks in the March survey reported less aggressiveness in seeking new loans and all but one of these indicated increased loan demand in the first quarter.

With respect to term loans, nine banks indicated less willingness to make such loans while only three were more willing. Also, only three banks in the March survey indicated willingness to make term loans with longer maximum maturities than before. However, all of these were banks which reported increased loan demand. Competition both from other banks and nonbank financial institutions coupled with substantial growth in time deposits were given as reasons for this change.

In extending credit to new business borrowers as well as to nonlocal service area customers, less than three-tenths of the banks reported firmer policies in the March survey, a slightly lower proportion than in December. As in earlier surveys, very few banks reported firmer policies for established and for local service area customers.

Banks stating that the applicant's value as a depositor was more important than three months earlier represented three-tenths of the total, also a smaller proportion than in earlier surveys. The use of the proceeds of the loan was considered more important at about one-fourth of the banks, a slightly higher proportion than in December.

Practices in lending to finance companies also firmed in March but to a lesser extent than for nonfinancial businesses. Thirteen banks (16 per cent of the total) reported firmer policies on interest rates charged and 9 banks (11 per cent of the total) on compensating balance requirements. Five of the 13 reporting firmer interest rates also had firmed policies on compensating balances, with the remaining banks firming interest rates only. The proportion of banks reporting firmer policies in these areas has increased in each of the last three surveys and in March for the first time, two large New York City banks reported firmer policies. With respect to enforcement of balance requirements and establishing new or larger credit lines for finance companies, somewhat more than one-fifth of the banks reported firmer policies in March, about the same as in other surveys.

The firming of interest rate policies on loans to nonfinancial businesses indicated in the March lending practices survey contrasts with a slight decline in the average rate reported on short-term business loans by the same banks in the quarterly interest rate survey. Only loans in the smallest size class--less than \$10,000 in amount--showed an increase from December to March, with rates on loans of larger size

remaining the same or declining slightly. A major factor contributing to the decline was the increased dollar volume of loans made at the prime rate, which reached the unusually high proportion of 58 per cent in the March Survey.

While a further explanation for the apparent disparity between the two surveys must await further investigation, one contributing factor may have been a change in loan mix between December and March, probably in part of a seasonal nature. In four out of the past five years, average rates on short-term business loans declined in the first quarter. Moreover, the increased proportion of loans made at the prime rate in March, at a time when banks indicate that they have been trying to reduce the number of customers eligible for that rate, suggests that the composition of demand had shifted toward prime customers. Changes in the average size of loan did not appear to be an important factor affecting the change in rates from December to March.

Quarterly Survey of Changes in Banking Lending Practices*
December 1964 - March 1965
(Numbers of banks)

Lending to Nonfinancial Businesses

	<u>Stronger</u>	<u>Weaker</u>	<u>Unchanged</u>
1. Strength of loan demand	45	8	28
	<u>Greater</u>	<u>Less</u>	<u>Unchanged</u>
2. Aggressiveness of bank in seeking new loans	15	9	55
3. Factors considered in deciding whether to approve credit requests:			
	<u>More important</u>	<u>Less important</u>	<u>Essentially unchanged</u>
Applicant's value to the bank as a depositor or source of collateral business	24	-	57
Applicant's intended use of loan proceeds	20	-	61

* The survey covers 81 city banks regularly reporting in the Quarterly Survey of Interest Rates on Business Loans.

4. Practices with respect to reviewing lines of credit or loan applications of:

	<u>Firmer</u>	<u>Easier</u>	<u>Essentially unchanged</u>
Established customers	5	1	75
New customers	22	3	56
Local service area customers	5	2	74
Nonlocal service area customers	17	2	60

5. Terms and conditions of loans:

	<u>Firmer</u>	<u>Easier</u>	<u>Essentially unchanged</u>
Interest rates	46	-	35
Compensating or supporting balances	29	-	52
Standards of credit-worthiness	16	1	64
Type and amount of collateral	10	-	71
Maturity	9	4	67

6. Term loans

	<u>More willing</u>	<u>Less willing</u>	<u>Unchanged</u>
Willingness to make	3	9	69
	<u>Longer</u>	<u>Shorter</u>	<u>Unchanged</u>
Maximum maturity bank will approve	3	1	75

<u>Years</u>	<u>Number of banks</u>
3	7
5	34
6	1
7	12
8	5
10	5
n.a.	17

Lending to Finance Companies

	<u>Firmer</u>	<u>Easier</u>	<u>Essentially unchanged</u>
Interest rates	13	-	68
Size of compensating or supporting balances required	9	2	70
Enforcement of balance requirements	18	1	62
Establishing new or larger credit lines	19	6	55