Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

---

[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optical character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Content last modified 6/05/2009.

CONFIDENTIAL (FR)

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

July 7, 1965

IN BROAD REVIEW

The latest information available, mainly for June, continues to suggest expansion in activity but at a slower pace than in the first quarter. Some statistical measures have been stronger than in the preceding two months but some have been weaker. Retail sales in June appear to have been maintained, or possibly to have bettered, the record May level. Unit auto sales experienced an upsurge to a level well above April and May. Industrial production is tentatively indicated to have remained at, or possibly to have exceeded somewhat, the May level. The labor market remained strong in June and the unemployment rate was essentially unchanged from the reduced May rate.

New orders for durable goods declined in May but the reductions were mainly centered in steel, where an adjustment to more sustainable levels has been generally expected, and in defense products following a sharp run-up in April. Business inventory accumulation in May was reported down considerably from the high April rate.

Attention recently has focused more on commodity markets where both wholesale and consumer prices have increased further. The rise in wholesale prices has been attributable in large measure to reduced supplies of livestock and meats and of some fresh fruits and vegetables. Industrial prices through June continued to edge up at about their earlier slow pace, with the increase for the first half year totaling 0.7 per cent. The consumer price index rose again in May and is likely to show a further advance in June, largely reflecting higher food prices.

Stock market gyrations since mid-May have occupied center stage in recent business and financial attention. Very recently, common stock prices have recovered a portion of the earlier decline and trading activity has returned to more nearly normal levels. The recent stock price readjustment may be no more than a temporary market set-back but it conceivably could be an early warning of a possible later decline in business activity. The stock market, however, is hardly an unambiguous leading indicator.

Bank credit expansion in June was very large with midmonth borrowing for tax and dividend purposes and end-of-month borrowing for window dressing purposes major influences. Both total credit and business loan expansions, however, were less in the second quarter as a whole than in the first. The money supply rose substantially in June following a decline in late April and May. Growth in time deposits at commercial banks also accelerated from the reduced May rate.

In other credit and debt markets, corporate bond yields have eased slightly from quite advanced levels. Municipal security yields, however, have remained under upward pressure. Mortgage yields have continued unchanged. U. S. Government intermediate- and long-term yields have held in a narrow range while bill rates turned up in late June and early July, after weeks of downward pressure; the 3-month bill yield on July 6 was 3.87 per cent.

The U. S. balance of payments was in surplus on regular transactions by about $200 million in the second quarter. Payments transactions appear to have been in approximate balance in June. The nearly $1 billion improvement in the payments position between the first and second quarters was due in large part to the shift from large outflows to inflows of bank credit. Renewed net bank credit outflows, though on a moderate scale, would appear the likeliest possibility over the balance of the year. Other apparently nonrecurring factors behind the second quarter improvement included a probably reduction in outflows of direct investment capital from the accelerated rate of the first quarter and a rebound in the trade surplus from the strike depressed levels of the early months of the year. Trade figures for May suggest, however, that exports may have fallen off from the advanced levels of last autumn.

Credit and capital market conditions abroad have shown diverse developments in recent months. There have been marked increases in long-term interest rates in countries where governmental policy has been focused on resisting inflation (Germany and the Netherlands) or where the balance of payments is a matter of serious concern (the United Kingdom). Credit conditions have been greatly eased in Italy and Japan, where policy is aiming at stimulation of domestic activity.

July 6. 1965

I -- T - 1

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per cent change: Year Ago*	Per cent change: 2 Yrs Ago*
Civilian labor force (mil.)	June '65	75.7	75.4	74.3	1.8	3.9
Unemployment (mil.)	"	3.6	3.5	4.0	-10.2	-13.6
Unemployment (per cent)	"	4.7	4.6	5.3	-	-
Nonfarm employment, payroll (mil.)	May '65	60.1	59.9	57.9	3.7	6.3
Manufacturing	"	17.9	17.9	17.2	3.8	5.0
Other industrial	"	7.9	7.9	7.7	2.7	5.0
Nonindustrial	"	34.3	34.2	33.0	3.8	7.3
Industrial production (57-59=100)	"	141.3	140.8	131.3	7.6	13.6
Final products	"	140.2	139.1	131.1	6.9	13.3
Materials	"	142.4	142.3	131.3	8.5	13.7
Wholesale prices (57-59=100)1/	"	102.1	101.7	100.1	2.0	2.1
Industrial commodities	"	102.0	101.8	100.9	1.1	1.6
Sensitive materials	"	102.4	101.6	99.2	3.2	5.8
Farm products and foods	"	101.1	100.2	96.8	4.4	2.7
Consumer prices (57-59=100)1/	"	109.6	109.3	107.8	1.7	3.2
Commodities except food	"	105.2	105.0	104.3	0.9	2.1
Food	"	107.9	107.3	105.5	2.3	3.6
Services	"	117.5	117.3	114.9	2.3	4.4
Hourly earnings, mfg. ($)	"	2.61	2.59	2.53	3.2	6.5
Weekly earnings, mfg. ($)	"	107.10	105.93	102.56	4.4	8.4
Personal income ($ bil.)2/	"	517.0	515.0	487.8	6.0	12.3
Retail sales, total ($ bil.)	"	23.4	22.9	21.8	7.3	15.7
Autos (million units)2/	"	8.1	8.2	7.8	4.0	12.4
GAF ($ bil.)	"	5.3	5.1	5.0	7.7	21.1
Selected leading indicators						
Housing starts, pvt. (thous.)2/	"	1,484	1,546	1,518	-2.2	-13.1
Factory workweek (hours)	"	41.1	40.9	40.6	1.2	1.7
New orders, dur. goods ($ bil.)	"	21.0	22.0	19.9	5.3	12.1
New orders, nonel. mach. ($ bil.)	"	3.1	3.1	3.0	5.4	19.0
Common stock prices (1941-43=10)1/	June'65	85.04	89.28	80.24	6.0	21.3
Inventories, book val. ($ bil.)	Apr.'65	112.0	111.3	106.4	5.3	10.5
Gross national product ($ bil.)2/	Q1-65	648.8	634.6	608.8	6.6	13.5
Real GNP ($ bil. 1964 prices)2/	"	641.5	630.6	612.9	4.7	9.3

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended July 2	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	5/ 3.68	4.00	4.13	2.00
U.S. Treas. bills, 3-mo. yield (per cent)	5/ 3.78	3.81	4.00	3.76
Net free reserves 2/ (mil. $)	-144	-174	163	-212
Member bank borrowings 2/ (mil. $)	486	539	611	203
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	5/ 4.13	4.15	4.18	4.08
20-year U.S. Treas. bonds	5/ 4.20	4.21	4.22	4.17
Corporate new bond issues, Aaa	--	4.58	4.60	4.33
Corporate seasoned bonds, Aaa	4.46	4.47	4.47	4.41
Municipal seasoned bonds, Aaa	3.17	3.17	3.17	2.94
FHA home mortgages, 30-year 3/	5.45	5.45	5.45	5.45
Common stocks S&P composit index 4/				
Prices, closing (1941-43=10)	85.16	84.67	90.10	83.06
Dividend yield (per cent)	3.07	3.09	3.15	2.89

	Change in May	Average change-- last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	6/ 161	109	6.0	5.5
Bank loans and investments:				
Total	1,800	2,300	10.3	10.1
Business loans	900	900	18.4	17.6
Other loans	1,300	1,500	16.6	12.1
U.S. Government securities	-600	-600	-11.3	-3.0
Other securities	200	200	13.0	15.0
Money and liquid assets:				
Demand dep. & currency	6/7/1,700	500	3.5	4.0
Time and savings dep.	6/7/1,400	1,300	11.8	14.8
Nonbank liquid assets	-900	800	3.7	5.0

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending June 30.
3/ Latest figure indicated is for month of May. 4/ Data are for weekly closing prices. 5/ Week ending June 25. 6/ Change in June. 7/ Based on preliminary revised data; not for publication.

U.S. BALANCE OF PAYMENTS

	1965 May	1965 Apr.	1965 Mar.	1965 QI	1964 QIV	1964 QIII	1964 QII	1964 Year
	Seasonally adjusted annual rates, in billions of dollars							
Balance on regular transactions				- 2.9	- 6.2	- 2.4	- 2.2	- 3.1
Current account balance				5.3	8.0	8.0	6.9	7.7
Trade balance 1/	5.5	6.4	10.4	3.7	7.2	6.7	5.9	6.7
Exports 1/	26.9	28.2	32.6	22.4	26.8	25.5	24.3	25.3
Imports 1/	-21.4	-21.8	-22.2	-18.7	-19.6	-18.8	-18.4	-18.6
Services, etc., net				1.6	.8	1.3	1.0	1.0
Capital account balance				- 7.8	-12.5	- 9.1	- 8.6	- 9.7
Govt. grants & capital 2/				- 3.3	- 4.1	- 3.7	- 3.6	- 3.6
U.S. private direct inv.				- 4.0	- 3.3	- 2.2	- 2.2	- 2.4
U.S. priv. long-term portfolio				- 2.7	- 3.3	- 2.4	- 1.0	- 2.0
U.S. priv. short-term				+ 1.2	- 2.3	- 1.6	- 2.2	- 2.1
Foreign nonliquid				1.0	0.4	0.8	0.4	0.4
Errors and omissions				- 0.4	- 1.7	- 1.2	- 0.6	- 1.2
	Monthly averages, in millions of dollars							
Deficit on regular transactions (seas. adjusted)				244	517	198	182	259
Additional seasonal element				172	- 1	- 143	- 17	---
Financing (unadjusted)	- 56	- 143	- 528	72	518	340	198	259
Special receipts 3/	0	0	0	22	52	1	- 10	29
Liabilities increase								
Nonofficial 4/	- 186	- 49	- 330	57	217	187	38	129
Official 5/	- 41	- 332	- 363	- 287	300	129	69	86
Monetary reserves decrease	171	238	165	281	- 50	23	101	14
of which: Gold sales	(117)	(159)	(354)	(277)	(57)	(- 7)	(- 24)	(10)
Memo: Official financing 6/	(130)	(- 94)	(- 198)	(15)	(301)	(153)	(160)	(129)

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

THE DOMESTIC ECONOMY

Industrial production. Industrial production in June probably equaled or was somewhat above the preliminary May level of 141.3 per cent. Available weekly production data, while not indicating any decline in output, do not suggest any strong upward movement. Output apparently advanced further for business equipment but changed little for consumer goods. Overall output of materials is likely to have increased slightly.

Auto assemblies were at a seasonally adjusted annual rate of about 9.5 million units, the same as in May. July production schedules are also set at this rate. Output of home appliances, furniture, television and other home goods, rose about 10 per cent from September to March and then dropped somewhat in April and May and possibly June.

Steel ingot production increased in June as uncertainty continued regarding a peaceful settlement of the wage contract negotiations. In June, output of petroleum products and coal increased and output of paperboard and electric power was maintained.

The following table shows quarterly indexes for the total index of industrial production and major groupings beginning with the first quarter of 1964.

INDUSTRIAL PRODUCTION
(Seasonally adjusted, quarterly averages)
1957-59 = 100

	1964				1965	
	I	II	III	IV	I	II*
Total	128.3	131.1	133.6	134.6	139.3	141.1
Consumer goods	128.8	131.1	132.4	133.3	138.3	138.6
Consumer goods, excluding automotive products	127.0	128.9	130.3	132.7	135.1	135.4
Business equipment	133.0	139.0	141.1	145.1	148.9	151.8
Materials	128.0	131.2	134.6	135.2	140.0	142.4
Materials, excluding iron and steel	129.7	131.8	135.1	135.4	140.2	142.5

*April-May average.

Consumer demands. Retail sales in June remained at about the record May level, according to available weekly data. Personal income in June apparently showed another sizable increase, with the rise again mainly attributable to gains in employment and higher wages and salaries.

For the second quarter as a whole, the rise in consumer purchases of goods and services is now estimated at some $4 billion, annual rate--not quite so large as the increase in personal disposable income. The saving rate, however, apparently was up only slightly from 6.7 per cent in the first quarter.

A feature of consumer spending in the second quarter was the large rise in purchases of nondurable goods--an increase of about $4 billion in the annual rate. Retail sales at nondurable goods stores were up more than 2 per cent from the first quarter, with most types of stores participating in the advance although apparel and department stores changed little. Much of the large increase in sales at food stores represented higher retail prices. Altogether, consumer purchases of nondurable goods were about 7 per cent higher than in the spring of 1964.

The increase in purchases of nondurable goods was in part offset by a decline in auto purchases in the second quarter. As compared with a year earlier, consumer purchases of durable goods as a whole were up about 5 per cent, however.

Sales of new domestic automobiles rose sharply in June to a seasonally adjusted annual rate of 8.8 million vehicles, compared with 8.2 and 8.1 in April and May. The average rate of sales in the second quarter was 8.4 million, down from 9.3 million in the first quarter. Some purchases may have been postponed from May to June by uncertainty about excise taxes. Sales contests also helped boost sales in June.

Dealer new car inventories as of June 20 were 7 per cent above the end of May and represented 49 days' supply, well above average for this season. Industry sources anticipate that inventories will remain unusually high this summer.

<u>Consumer credit.</u> Instalment borrowing slowed after a sharp spurt in April, but consumers continued to use more instalment credit for automobiles and especially for GAF purchases than they had in the first quarter of the year.

Officers of the two largest finance companies and the three major trade associations in the consumer credit field met with Board members and senior staff June 23 to discuss current credit quality and collection experience. The industry spokesmen reported that consumers are making payments about as promptly today as at any time in recent years. A degree of uncertainty was suggested, however, about the trend in portfolio quality of some of the small lenders.

CONSUMER INSTALMENT CREDIT

	Change in outstandings	Extensions	Repayments	Repayments as a per cent of disposable income
	(In billions, seasonally adjusted annual rate)			
1964 - Year	$5.7	$66.1	$60.4	$14.0
1965 - 1Q	7.8	71.7	63.9	14.3
2Q(2 mos.)	8.5	73.8	65.3	14.4
April	8.9	74.2	65.3	n.a
May	8.0	73.2	65.2	n.a.

Construction activity. Construction expenditures rose slightly in June to a seasonally adjusted annual rate of $67.7 billion. This was a new high, taking account of seasonal and other revisions back to 1962. For the first half-year as a whole, construction activity averaged 2 per cent more than a year earlier; both private residential and public expenditures changed little on average from a year earlier while business expenditures were up more than a tenth.

Seasonally adjusted housing starts, which--on the basis of revised figures--had advanced 7 per cent in the previous three months, declined in May. For April and May combined, the annual rate averaged 1.51 million. This was moderately above the first quarter low but still somewhat below the average for the year 1964.

Seasonally adjusted residential building permits, unlike starts, recovered somewhat in May after a drop in April. The May increase was concentrated in single family units, for which permits had tended downward in recent months. Permits for multifamily units in May reached a new low for the year, but were still above the reduced rate of last December.

PRIVATE HOUSING STARTS AND PERMITS

	May (thousands of units) 1/	Per cent change from	
		Month ago	Year ago
Starts (total)	1,484	-4	- 2
Permits (total)	1,220	+3	- 5
1 -family	722	+7	+ 1
2-4 -family	88	+2	-12
5-or more family	410	-3	-12

1/ Seasonally adjusted annual rate; preliminary.

A factor in the May increase in permits for single family homes may have been the improved inventory position reported by merchant builders. While stocks of unsold homes have changed very little since last August, they were lower in April both absolutely and in relation to unit sales than a year earlier. Also, buying intentions for both new and existing houses in April were about as high or higher than at this time in other recent years, according to the Census Bureau. A survey made this spring by the National Association of Real Estate Boards indicated that inquiries by prospective purchasers about existing houses of good quality have tended to exceed available listings and that, except for poorly located properties, values have remained stable.

Orders for durable goods. New orders for durable goods declined 5 per cent in May because of large decreases for steel and defense products. Steel orders have fallen steadily since February when ordering in anticipation of a strike was at a peak and the May level was the lowest since December 1963. Defense orders had spurted sharply in April, taking total durable new orders up to a new peak; in May new defense orders reverted to about the level prevailing in the first 3 months of the year and were also about unchanged from a year earlier.

New orders for machinery and equipment were maintained in May at a level moderately above the first quarter average and the year-earlier level. For the remaining durable goods, new orders have changed little in recent months at a level well above a year ago.

NEW ORDERS FOR DURABLE GOODS

	May (In millions -- seasonally adjusted)	Per cent change to May from:		
		April	1st quarter	May 1964
Total	$21,011	- 5	- 2	5
Iron and steel	1,636	-13	-25	-5
Defense products	2,452	-24	1	-1
Machinery & equipment	4,085	0	4	4
All other	12,838	0	0	9

Total shipments of durable goods declined moderately in May as steel shipments dropped nearly a fifth from the record April level. Shipments remained below new orders and the durable goods order backlog rose further despite a drop in the steel industry.

Unfilled orders for steel have declined 13 per cent since February but are still well above a year ago. Unfilled orders for all other durable goods combined rose 4-1/2 per cent between February and May and the total durable backlog increased 3 per cent, to a level 15 per cent above May 1964.

Business inventories. Preliminary figures indicate a substantial decline in the rate of business inventory accumulation in May: the book value increase totaled about $400 million as compared with an April increase of over $800 million (revised upward substantially from the preliminary $680 million). With the present May showing, the average monthly gain during the first 2 months of the second quarter was moderately smaller than the first quarter average.

The May decline in the rate of accumulation was primarily concentrated in trade. At retail, auto dealer stocks continued to rise sharply but at most other types of stores inventories generally changed little or declined moderately and the total book value increase was much lower than in earlier months of the year. The rate of accumulation also dropped sharply at wholesalers.

Inventory accumulation by manufacturers in May continued at about the moderate pace of the first four months of the year -- around $260 million per month -- and in May as in earlier months the bulk of the accumulation was in the durable goods sector.

Accumulation of steel stocks in May continued to dominate the durable total, but there was a pronounced slowdown in accumulation by steel consumers and a step-up at steel mills. In April, steel mills had drawn heavily on their finished stocks to permit what may have been record accumulation by consumers (nearly 1.5 million tons). In May, accumulation by consumers dropped sharply to 400,000 tons -- the smallest monthly amount since last September -- while steel mills restored part of the sharp April cut in their finished steel holdings.

Stocks of steel in the hands of consumers totaled 15.5 million tons at the end of May. This was well above the level of around 12 million tons reached at the peaks of both the 1962 and 1963 steel build-ups, but consumption is also up sharply and the inventory-consumption ratio of 2.7 in May was about the same as at those two earlier peaks.

With the tapering off in accumulation of steel by consumers, the earlier large rise in book value of stocks of materials and supplies held by durable goods producers slowed considerably in May. On the other hand, durable stocks of finished goods, which in April were somewhat below the end-of-1964 level, rose appreciably in May, with much of the increase at steel mills.

CHANGE IN MANUFACTURERS' INVENTORIES
(Seasonally adjusted book values, in millions of dollars)

	May 1965	Average per month Jan.-April
Total	257	264
Durable sector	216	205
Materials and supplies	84	180
Work-in-process	45	45
Finished goods	87	-20
Nondurable sector	41	60
Addendum:		
Consumers' steel inventories (mil. tons)1/	.4	1.0

1/ Based on figures, without seasonal adjustment, from special Census Survey of "Inventories of Steel Mill Shapes."

Labor market. The job situation remained relatively strong in June. Employment advanced moderately. The unemployment rate was 4.7 per cent, little changed from the 4.6 per cent in May and down from the 5.3

per cent of a year earlier. For most groups changes in unemployment were largely seasonal. The rate continued low among married men -- 2.4 per cent -- and there was little improvement for teenagers -- 14 per cent. Among women, however, the unemployment rate rose in June following a decline in May.

The number of youths who entered the work force in June was smaller than expected and the seasonally adjusted teenage labor force declined by 230,000. The unusual circumstance that the survey week in June -- the week including the 12th -- was the earliest possible in the month and many schools were still in session, probably resulted in a smaller increase in both labor force and in unemployment of young people than if the survey had been taken later in the month. Because of this, the July data may show a more than seasonal rise in unemployment.

Employment of women in June increased more than seasonally and accounted for a large part of the total employment gain over the month. The early survey week also resulted in a larger than usual number of school teachers counted as employed in June. Usually many teachers leave the labor market for the summer after school sessions end.

Of interest is the rise in June for the second consecutive month in the number of workers on part time for economic reasons. This is one of the most cyclically sensitive of the household survey series and in the past has responded to movements in economic conditions somewhat earlier than the overall employment and unemployment series. In June there were 2 million workers on involuntary part time. This was about 200,000 above the April low, indicating some easing in work-time schedules. However, the number was still 300,000 fewer than in June 1964.

Based on the first half averages, the total labor force expanded by 1.1 million from 1964 to 1965. This is almost 300,000 less than called for in the official labor force projections. The deficiency was mainly among youths. Total employment expanded by about 1.5 million in the same period. For adult men and women employment gains substantially exceeded labor force increases and unemployment declined. For youths, employment gains about matched those in the labor force and unemployment showed little change over the year.

Hours and earnings. The average workweek in manufacturing has become slightly shorter than earlier this year, although a considerable amount of overtime work has continued. Weekly hours are estimated to average 41.0 hours in the second quarter, down from the postwar record of 41.4 in the first quarter. In the second quarter of 1964, the workweek averaged 40.6 hours.

Average hourly earnings in manufacturing continued to increase in the second quarter at about the same rate as in the preceding two years. At $2.61 in the second quarter, hourly earnings were 8 cents or approximately 3.5 per cent higher than in the second quarter of 1964. A rise of 8 cents was also reported in the preceding year. Although hourly rates continued to rise, weekly earnings, seasonally adjusted, fell slightly in the second quarter, marking the first quarterly reduction since 1960. Over the past year, however, weekly earnings have risen a little more than hourly earnings because of the longer workweek and increased overtime pay. At over $107 in the second quarter, weekly earnings were 4 per cent above a year earlier.

Prices. The wholesale commodity price index continued to rise through June. The estimate for the last week of the month, 102.7 per cent of the 1957-59 average, was up 0.6 per cent from the monthly index for mid-May and 2 per cent from the end of 1964. Rising prices of foodstuffs continued to account for most of the increase; the end-of-June estimate for foodstuffs was up more than 2 per cent from mid-May and 6 per cent from December. The index for industrial commodities, which had risen 0.2 per cent in May, edged up another 0.1 per cent in June. The increase through the first half of the year amounted to 0.7 per cent--almost the same as the rise in the fourth quarter of last year. At an estimated 102.1 per cent of the 1957-59 average, industrial commodities are up nearly 2 per cent from a low in early 1963 but only 0.5 per cent from the high in early 1960.

The rise in prices of livestock and meats--reflecting a considerably greater-than-seasonal decline in marketings of meat animals--accelerated in May and early June. On a seasonally adjusted basis, production of red meat in the second quarter was down more than a tenth from the fourth quarter of last year. At mid-year, livestock prices were up a third and meat prices a fifth from last December, and they were not far below the peak levels attained in the spring of 1958 when a cycle of livestock marketings reached a low. At these high levels, prices are likely to encounter growing resistance from both meat packers and consumers. Supplies of many spring and summer vegetables also have been smaller than usual, chiefly because harvesting was delayed by unfavorable weather.

Among industrial commodities, the comprehensive monthly figures for mid-May show that the previously reported increases for copper and aluminum products raised the nonferrous metals group about 2 per cent further, to a point almost a fifth above the low in early 1963. Recently, indicators of market conditions for nonferrous metals have presented conflicting evidence. Prices of scrap generally are higher than a month ago. However, London prices for refined copper and lead have fallen, copper futures have declined in New York, and tin prices have dropped from a very high level. (Although down from recent highs, copper on the New York and London exchanges is still substantially above the price maintained by the primary producers.) In this country, the approaching termination of inventory accumulation for tinplate--which accounts for 40 per cent of U.S. consumption of tin--and for galvanized steel products may be easing demands for tin and zinc. Steel scrap prices have already declined appreciably in anticipation of a curtailment in steel production.

In May, prices of hides and skins increased a tenth, mainly reflecting the reduction in marketings of livestock. Gasoline rose substantially, and the petroleum products group--at 95.4 per cent of the 1957-59 average--was up 6 per cent from the low of last September. Tires rose moderately, as previously reported, and filter-tip cigarettes increased. Following negotiation of a new labor contract in the can industry, prices of metal containers went up 2.5 per cent. Scattered additional increases for machinery and equipment raised the group average .1 per cent further. Prices of nonmetallic minerals, lumber, industrial chemical, motor vehicles, furniture, and other household durable goods generally were stable.

The consumer price index in May rose to 109.6 per cent of the 1957-59 average, 0.3 per cent above April and 0.6 per cent above March. This stepped-up rate of increase is attributable to the developments in markets for foodstuffs described above. Prices of fruits and vegetables showed a seasonal rise that was greater than usual. At the same time retail prices of meats, rather than declining to a seasonal low, edged up. The recent large increases in wholesale meat prices will be reflected in the consumer indexes for June.

Nonfood commodities rose 0.2 per cent in May, with increases for apparel, gasoline and cigarettes only partly offset by very small decreases for some durable goods. Services also rose 0.2 per cent.

Reflecting chiefly the recent changes for foods, the year-over-year increase in the total CPI widened to 1.7 per cent from 1.1 per cent in the first quarter. Foods were 2.3 per cent above a year earlier, with fresh fruits and vegetables up more than 10 per cent. Nonfood commodities were 0.9 per cent higher and services were up 2.3 per cent.

Agriculture. Supplies of foodstuffs in mid-1965 are considerably smaller than a year ago. Upward pressure on prices from reduced supplies of pork, lamb, beef, potatoes, and fresh vegetables is being accentuated by rising consumer incomes. Prices received by farmers in June averaged 10 per cent above a year ago, principally because of higher prices for hogs and beef cattle. Prices received are more favorable relative to prices paid by farmers than a year ago: the parity ratio on June 15 was 79 (1910-14 = 100) compared with 74 a year earlier.

On the demand side, consumer spending for food has increased. Per capita expenditures in the first quarter were 4.5 per cent above a year earlier, and the increase probably was larger in the second quarter. Exports of farm products, at an annual rate of $6.1 billion in the July-April period, were about equal to a year earlier, although the commodity mix was different. Despite higher retail prices of meats and vegetables, the Department of Agriculture has recently estimated that the average family will spend only 18.3 per cent of its disposable income on food in 1965 as compared with 18.5 per cent in 1964 and 20.0 per cent in 1960.

On the supply side, per capita supplies of pork and lamb were 9 per cent below year-earlier levels in June and beef was 7 per cent less than the extremely large production in June last year. Broiler production, currently up a little from a year ago, is expanding rapidly and may exceed year-earlier levels by 8 to 10 per cent in the third quarter. Carryover stocks of potatoes from the small 1964 crop are being supplemented by new crop supplies and lettuce, quite short in April and May, is now in ample supply.

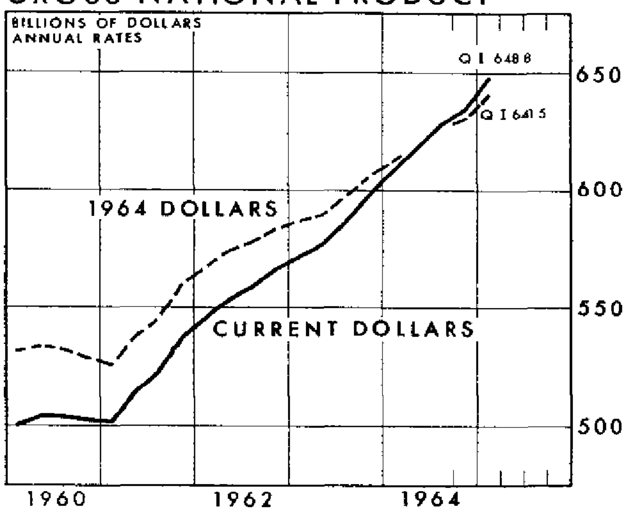
In the third quarter, supplies of fresh vegetables and potatoes are expected to be more plentiful than a year ago when serious drought reduced yields. Because of depleted stocks, however, it will probably be some time before potato prices work down. Pork supplies will be down at least 10 per cent from a year earlier; the decrease would be still larger if producers should start withholding hogs for breeding. USDA experts are tentatively projecting third and fourth quarter cattle slaughter at year-ago levels.

Stocks of feed grains and soybeans are below a year ago, largely because of the lower yields of 1964. Because of tight supplies of "free corn, the CCC has been able to sell two-thirds more corn in the domestic market than last year. The wheat carryover is the same as last year and cotton stocks are up 1.3 million bales bringing the cotton carryover to 13.4 million bales, an amount equal to one year's normal disappearance. Through May, the CCC had reduced holdings of farm products under price support to $6.8 billion from $7.4 billion in May 1964.

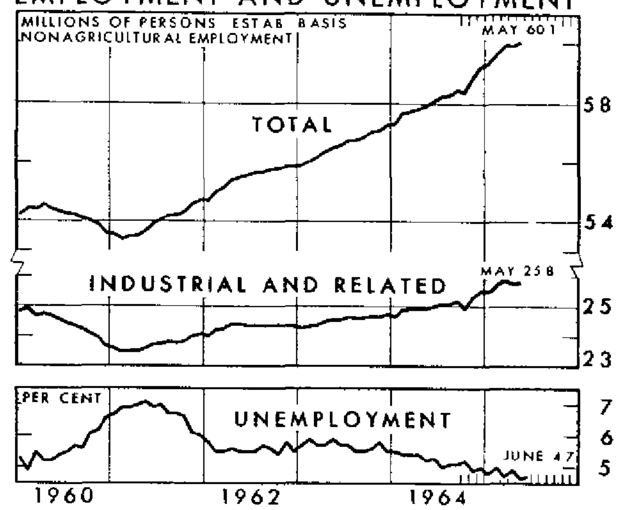
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

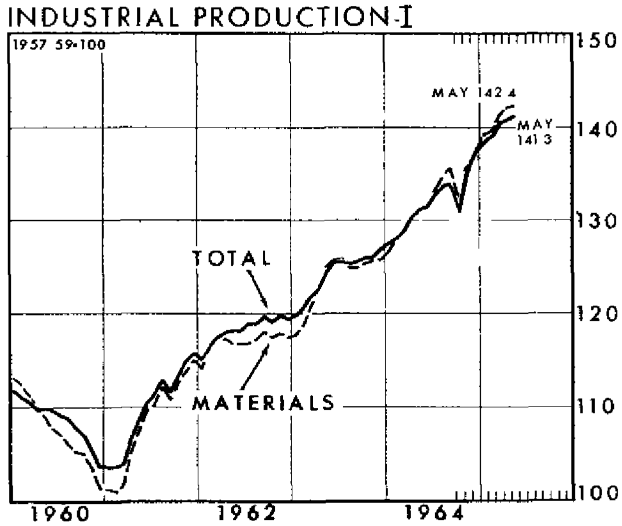
GROSS NATIONAL PRODUCT



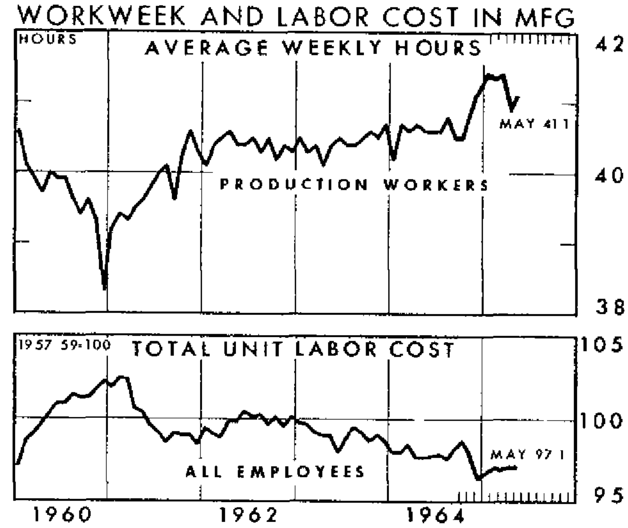
EMPLOYMENT AND UNEMPLOYMENT



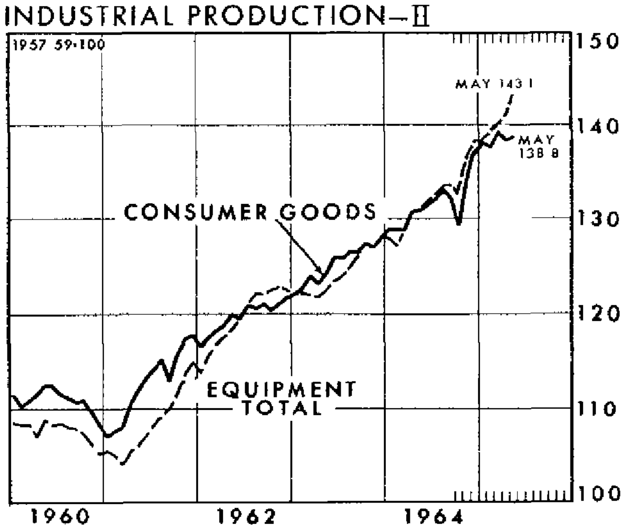
INDUSTRIAL PRODUCTION-I



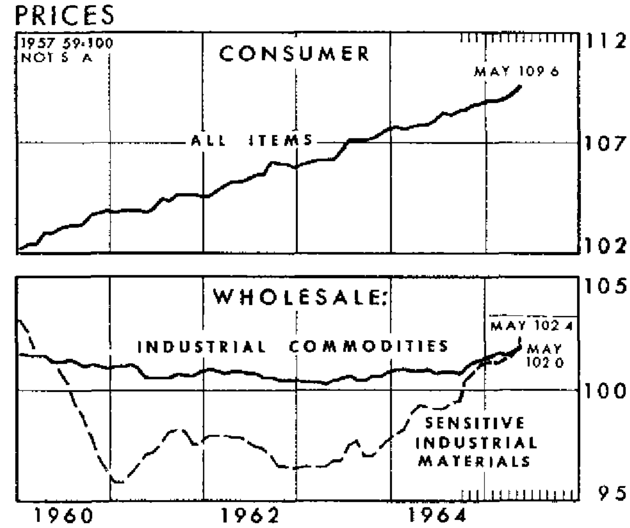
WORKWEEK AND LABOR COST IN MFG



INDUSTRIAL PRODUCTION-II



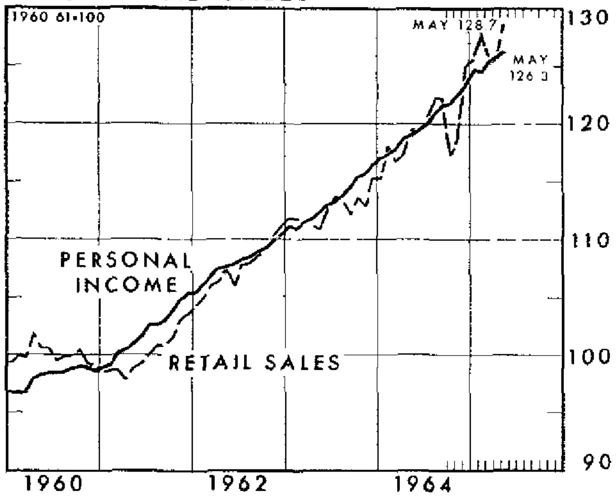
PRICES



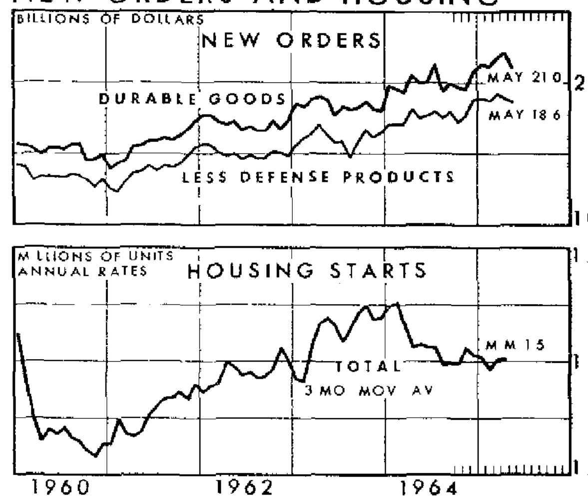
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

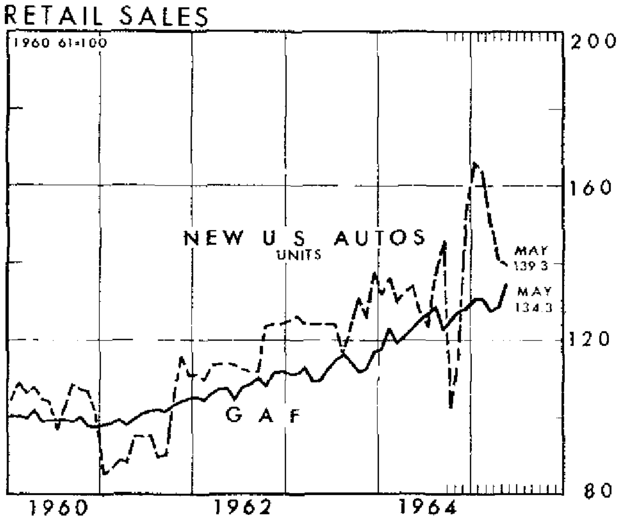
INCOME AND SALES



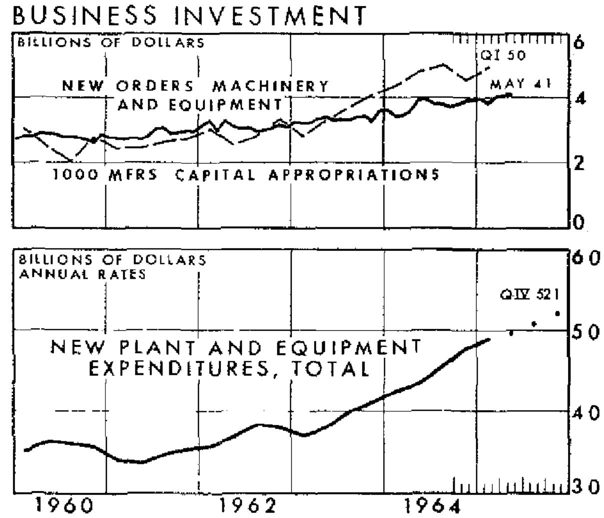
NEW ORDERS AND HOUSING



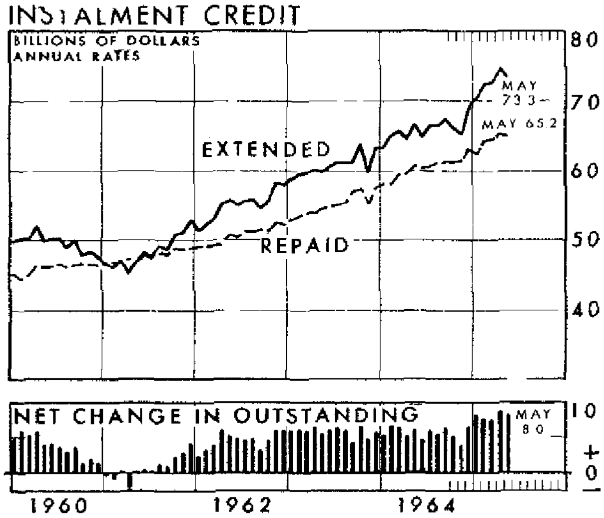
RETAIL SALES



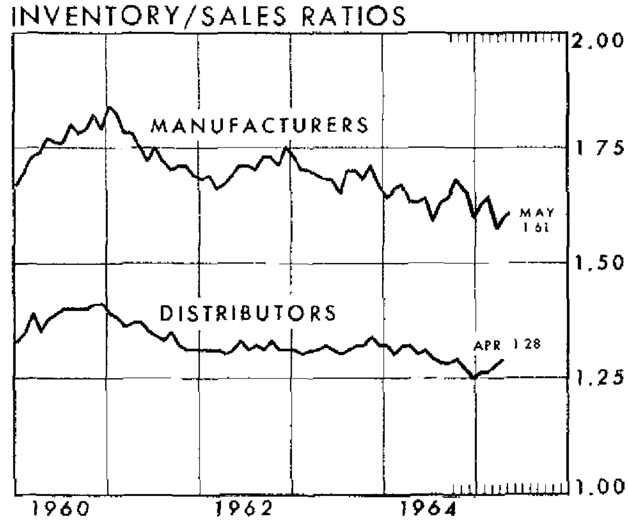
BUSINESS INVESTMENT



INSTALMENT CREDIT



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

Bank credit. Seasonally adjusted bank credit rose by about $3.5 billion in June according to preliminary estimates. This would be over twice the rate of increase of April-May and more than the very large expansion of March, and reflects, in part, heavy tax and dividend borrowing at midmonth and window dressing at month end. For the second quarter as a whole, however, the increase in bank credit was about 11 per cent, annual rate, and was somewhat below the advanced first quarter rate.

A $2.7 billion increase in loans at weekly reporting banks during the one week that encompassed the tax and dividend dates this year was 40 per cent larger than the increase in loans for the two weeks that covered the same dates last year; the increase in business loans was almost twice as large. Corporate tax payments this June were only $300 million larger than last year and there was a larger volume of maturing CD's and tax bills outstanding. These comparisons suggest that the continuing strong demand for external financing may be reflecting a shortfall of business liquid assets relative to the demand for them at the higher pace of business activity.

Seasonally adjusted business loans, for the whole month of June, increased at an estimated annual rate of about 25 per cent--again larger than April-May but slightly less than the unusual first quarter rate. While borrowing was particularly heavy in the petroleum and chemicals, miscellaneous manufacturing and mining, and public utility groups, most industry categories increased their bank borrowing in June, as is typical around quarterly tax dates. Commodity dealers, however, continued to reduce their loans more than seasonally from levels reached during the dock strike. In addition, the metals and metal products group showed only a normal seasonal increase in bank borrowing, perhaps suggesting a deceleration in the rate of steel accumulation.

Business loans accounted for less of the increase in bank credit in June than in previous months this year; a larger share was attributable to expansion in loans to security dealers and finance companies. These latter borrowers traditionally increase their bank financing in June in order to absorb purchases of securities and maturing notes and RP's liquidated by business and others to provide funds for tax payments. This year, however, such loans increased more than seasonally. Loans to security dealers also rose quite sharply late in the month, presumably as the result of heavy maturities of June 30 corporate RP's based on Treasury and agency issues. Businesses, for window dressing purposes, prefer to show money balances rather than RP's on their balance sheets.

Commercial banks reduced their holdings of Treasury issues in June by about $600 million (seasonally adjusted), but this was more than-offset by purchases of other securities. At city banks, most of the decline in Governments during the first four weeks of June was in bills, but bank bill purchases increased at the end of the month, most likely for window dressing purposes. The large increase in other securities was due in part to the delivery of two Federal agency issues earlier in the month.

Money supply and time deposits. After declining sharply in late April and May, when there was an unusually large build-up in U. S. Government deposits, the seasonally adjusted money stock rose by $1.7 billion in June. A considerable part of this increase occurred in the first two weeks of the month as Treasury deposits were reduced. During the last week of June, the money stock again declined as Treasury deposits rose to a record high at midyear of $11.5 billion. The June expansion brought the increase in the seasonally adjusted money stock during the first half of the year to an annual rate of 2.5 per cent.

Time deposit growth also accelerated in June from the reduced May rate. In June, both savings and other time deposits grew more rapidly than last year. Outstanding CD's, as expected, declined about $325 million at the tax date, but then began to increase again. At month-end CD's outstanding at banks outside New York were at the highest level since early March, after over three months of sidewise movement. Outstandings at New York City banks, however, had not fully regained their pre-tax period level. New York banks appear to have been less aggressive in their CD offerings recently.

Even with the acceleration of time deposit growth in June, the rate of growth of such deposits in the second quarter was below that of both the first quarter and the average for all of 1964. This lower rate of expansion may reflect, in part, the competition from larger market offerings of new security issues during the second quarter, the heavy individual income tax payments in April, and the high cost and possibly Regulation Q impediments to issuing CD's, as well as the normal reaction to the surge of time deposit growth early in the year.

Bank reserves. Average net borrowed reserves of member banks increased from $159 million in May to $177 million in June.[1/] Borrowings

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

by member banks increased $44 million, on the average, to $534 million in June, while average excess reserves increased $26 million to $537 million. The effective rate on Federal funds was at 4-1/8 per cent on 20 of the 24 trading days in June.

Corporate and municipal bond markets. Average yields on new corporate bonds appear to have peaked around mid-June at the time of the large Chase Manhattan Bank offering. Since then they have decreased little, as the volume of new corporate offerings in immediate prospect has contracted and as underwriters' unsold balances of older issues have been reduced substantially. In the municipal bond market, on the other hand, congestion continues--despite some reduction in advertised inventories from the $900 million record reached earlier in June--and upward pressures on yields have been maintained.

At current levels average yields on new corporate bonds are higher than they have been since late 1961 and are about 1/4 of a percentage point above the 4.35 level prevailing early in the year. And municipal bond yields (Moody's Aaa series) are within one basis point of the three-year peak reached in late 1963. Since yields on Treasury bonds have remained generally stable, the spread between new corporate bonds and Treasury issues has widened to more than 40 basis points for the first time in three years. Similarly, the margin by which Treasury issues exceed tax except yields--at about 95 basis points--is currently the narrowest since late 1962.

BOND YIELDS

	Corporate Aaa		State and local government	
	New	Seasoned	Moody's Aaa	Bond buyer (mixed qualities)
1964				
High	4.53	4.45	3.16	3.32
Low	4.30	4.35	2.99	3.12
1965				
High	4.60(6/11)	4.48(6/18)	3.17(7/1)	3.30(7/1)
Low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(2/11)
Week ending May 25	4.55	4.44	3.09	3.19
" " June 11	4.60	4.46	3.16	3.25
" " July 2	4.58 1/	4.47	3.17	3.30

1/ Week ending June 25.

July offerings of corporate bonds are expected to remain large, declining less than seasonally at this time of year. With a smaller currently scheduled supply of public offerings, upward pressures on yields are likely to be less intense than in May and June. Factors that complicate supply forecasts at this time include the possibility of additional public offerings of capital notes or debentures by large banks in the period immediately ahead and uncertainties over the magnitude of additional bond financing by the Bell System.

In the municipal bond market, July offerings are expected to about equal those in May and June. If commercial bank interest in such offerings continues at a reduced level, upward pressures recently in evidence on municipal bond yields may persist.

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

	Corporate				State and local govt.	
	Public offerings		Private placements			
	1965 e/	1964	1965 e/	1964	1965 e/	1964
Jan.-July average	465	362	607	467	923	946
May	710	470	500	537	900	709
June	715	468	800	623	900	939
July	500	234	500	411	900	943

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

Stock market. In late June, stock prices experienced a further sharp decline after stabilizing in light trading at a level about 6 per cent below their mid-May peak. By June 28, Standard and Poor's index of 500 stocks was down about 10 per cent from the high. This drop, however, was followed by an equally sharp recovery--both on very heavy trading volume (10.5 million shares on June 29). At the July 6 close of 84.99, about a third of the total loss had been erased. Indications are that institutional buyers re-entered the market, particularly for blue chip issues, suggesting confidence in the basic strengrh of both the economy and the stock market.

Financial intermediaries. In late June the Federal Home Loan Bank Board brought further pressure on savings and loan associations that had raised rates since the first of the year. Those which have not cut back by July 1 to the rates prevailing at the end of 1964, will be denied the additional lending authority provided in the Housing Act of 1964. Even after a roll-back, loans to these associations for expansion purposes will be denied for a number of months. Early this year, some West Coast associations which had been using high rates to attract savings capital from other sections of the country, experienced a sharp contraction in inflows after the increase in interest rates paid by commercial banks. When some associations raised rates to maintain their differential, the FHLBB began a series of restrictive actions, denying these associations loans to expand their lending activities. At no time, however, have they been denied funds to meet withdrawals.

During the first five months of this year, net savings flows to depositary-type institutions totaled a record $12.6 billion, one-tenth larger than the corresponding period of 1964. All of this year-over-year growth, however, was concentrated in the first quarter and occurred in time and savings deposits at commercial banks where rates were raised at the start of the year; gains in both savings capital at savings and loan associations and in regular deposits at mutual savings banks were smaller than in early 1964. In April, when tax payments were larger than usual, withdrawals of savings by individuals at all three types of institutions were also larger than usual. Since then, inflows at both savings and loan associations and mutual savings banks have continued to lag 1964 while second quarter inflows to commercial banks have not been sustained at their earlier high level.

Home mortgage markets. Lender competition for mortgages has continued active this year, although savings inflows to the specialized mortgage-lending institutions have remained below year-earlier levels. In May, secondary yields on FHA-insured mortgages held at 5.45 per cent, an average which has prevailed with virtually no change for more than two years. Contract interest rates for conventional first mortgages on homes have also been maintained at the rates prevailing since early 1963, according to the Federal Housing Administration. For new home loans, the average was 5.80 per cent; for loans on existing homes, 5.85 per cent. Trade expectations generally are that these rates will continue.

Loan-to-price ratios and maturities on conventional first mortgages in May generally changed little from April as well as from a year earlier. Average loan amounts continued appreciably higher than a year earlier, reflecting upgrading by home purchasers and higher prices. In the case of new home loans, over the first five months of this year as a whole, loan-to-price ratios have tended to be less liberal than a year earlier and maturities have been liberalized only fractionally further.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASE

	April	May	Per cent increase in May 1965 from a year ago
New home loans			
Purchase price ($1,000)	24.9	24.7	+6
Loan amount ($1,000)	18.1	18.2	+7
Loan/price (per cent)	73.7	74.4	+1
Maturity (years)	24.9	24.9	+1
Existing home loans			
Purchase price ($1,000)	19.6	19.7	+6
Loan amount ($1,000)	14.0	14.1	+7
Loan/price (per cent)	71.8	71.9	+1
Maturity (years)	20.4	20.3	+3

Nonfarm mortgage foreclosures (mainly on homes) in the first quarter were 10 per cent more numerous than a year earlier. This increase compares with an average increase of just over 10 per cent in 1964 as a whole. Unlike other recent years, foreclosures on conventional mortgages apparently accounted for most of the year-to-year rise.

NONFARM MORTGAGE FORECLOSURES

	Thousands 1/	Rate per thousand mortgaged homes
1965 First quarter	111.4	4.7
1964 " "	101.4	4.5
1963 " "	94.0	4.4
1962 " "	83.7	4.1
1961 " "	67.6	3.4
1960 " "	45.6	2.4

1/ Annual rate

Activity by the Federal National Mortgage Association in the secondary market has continued relatively limited in recent months. However, public offering this June for delivery on July 1 of $525 million of participation certificates backed by a pool of mortgages held jointly by FNMA and the VA was very well received. FNMA plans to offer another $750 million of such certificates in the new fiscal year.

U. S. Government securities market. Yields on intermediate- and long-term Treasury securities have continued to fluctuate in a narrow range in recent weeks. Yields on Treasury bills and other short-term Treasury issues, however, turned up in late June and early July, after several weeks of persistent downward pressure.

YIELDS ON U. S. GOVERNMENT SECURITIES

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1965						
Highs	4.00	4.05	4.16	4.18	4.24	4.22
Lows	3.76	3.81	4.00	4.08	4.17	4.17
1965						
June 1	3.88	3.93	4.11	4.15	4.23	4.22
June 15	3.80	3.86	4.09	4.15	4.21	4.21
June 24	3.77	3.81	4.02	4.12	4.19	4.20
July 6	3.87	3.90	4.08	4.15	4.21	4.22

The Treasury bond market displayed some signs of strength around mid-June, although price gains were limited and they reflected improved professional demand and System buying rather than any pick-up in investment demand. Contributing to the market improvement at that time, were the working off of congestion in the corporate bond market and a Treasury official's speech which highlighted the relatively moderate Treasury financing job in the second half of 1965. In late June and early July, however, Treasury bond prices again drifted lower, mainly reflecting profit-taking by dealers in a market atmosphere characterized by continued light investment demand.

In recent weeks, dealers have made net purchases of coupon issues from private investors, although their positions in longer-term bonds were reduced somewhat as the System bought more than offsetting amounts of this market supply. During June the dealers bought, net, nearly $150 million of over-5-year bonds from private investors while selling $210 million to the System. These transactions reduced dealer holdings of longer-term bonds to about $650 million on July 6.

Including all maturities, the System purchased nearly $400 million of coupon issues during June, one of the largest monthly totals in recent years. Such purchases in conjunction with sizeable purchases of bills from foreign accounts and the insertion of reserves through repurchase agreements and through a large foreign currency swap transaction permitted the Desk to provide large amounts of needed reserves after mid-June and early July without buying bills directly from dealers.

The absence of the System from the dealer bill market in recent weeks was an important factor which tended to put upward pressure on bill rates. The dealers stockpiled bills in anticipation of substantial System purchases. When these purchases failed to materialize, dealers made efforts to lighten their holdings. With net bill demand from the public also reduced, yields rose. In the auction held Friday July 2, the 3-month bill was issued at 3.85 per cent, up 7 basis points from the previous weekly bill auction. Meanwhile, other money market rates have generally held in a narrow range, although dealer loan rates in New York City firmed in late June and early July.

Treasury finance. The Treasury ended the fiscal year with a large cash operating balance of $11.5 billion, more than $1 billion above a year ago, but only about $1/4 billion above the end of fiscal 1963. In the latter year, however, the Treasury had undertaken some anticipatory borrowing in June. The mid-1965 cash balance reflects a larger than expected increase in tax receipts, especially in the second quarter of this year, which served to reduce the fiscal 1965 cash budget deficit to about $2 billion. The cash deficit in fiscal 1964 had been almost $5 billion.

In the second half of calendar 1965 the cash deficit is expected to be in the neighborhood of $10 billion, but in view of the existing size of the cash balance, net cash borrowing by the Treasury may be held to $4 or $5 billion, as compared with $6.7 billion in the second half of 1964. This projection takes into account the recent excise tax cut and social security legislation expected to be passed by Congress shortly.

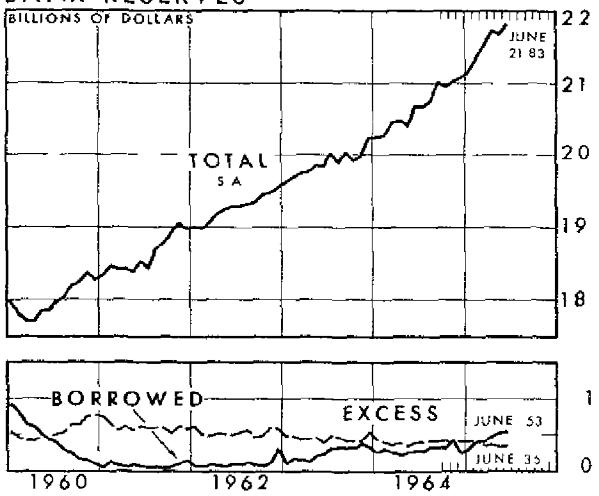
While the provisions of the social security bill that will finally be passed by the Congress are still in part uncertain (as explained in more detail in Appendix A), the expansive effect of the program will be concentrated in the second half of 1965, with a one-time retroactive payment of about $700 million and a 7 per cent increase in monthly benefits of about $1.4 billion at an annual rate. An increase in social security taxes, including those for medicare, in the neighborhood of $6 billion (with the exact size depending on the bill finally agreed to) is scheduled to become effective January 1, 1966. Medicare payments are scheduled to begin July 1, 1966.

The lower excises became effective June 22 (with cuts on two items retroactive to mid-May). The bill provides for reductions totaling $4.8 billion over a three and a half year period. This total is about $800 million larger than the Administration request, with the additional reductions to take effect in 1967 and after. In the second half of 1965, receipts from excises will be lowered by about $700 million. (The schedule of excise tax cuts is shown in Table 1 of Appendix B).

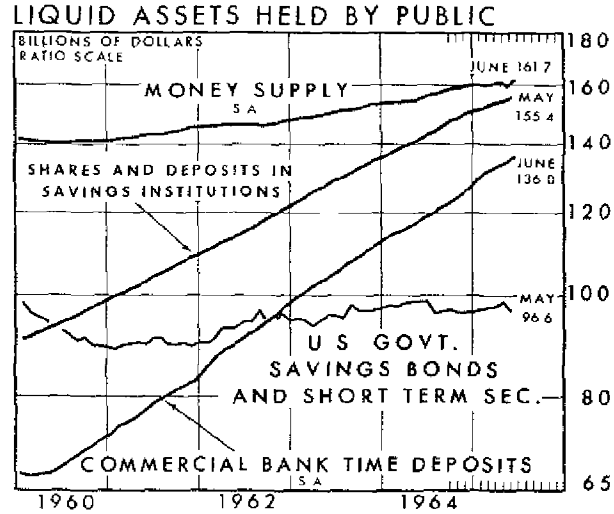
The net effect of these programs on the various Federal budgets -- cash, national income, and full employment -- is shown quarterly in Table 2 of Appendix B. These results are about the same as earlier projections in that they show a turn to a more expansive fiscal policy in the second half of 1965, as measured by the lower full employment surplus in the third and fourth quarters. Thiss full-employment surplus rises again in the first half of 1966 but to a level below that of the first half of this year.

FINANCIAL DEVELOPMENTS - UNITED STATES

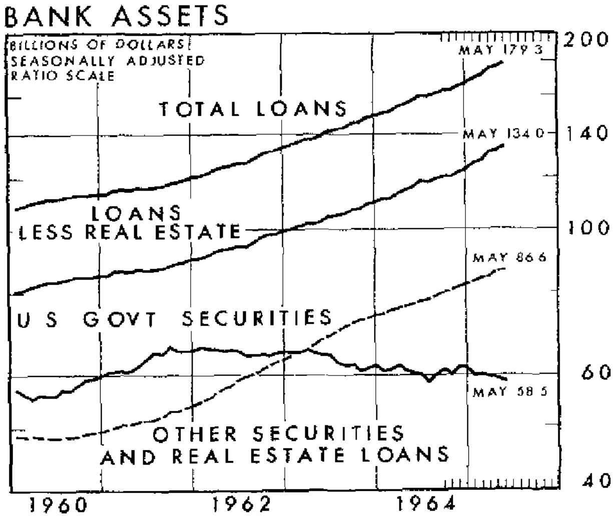
BANK RESERVES



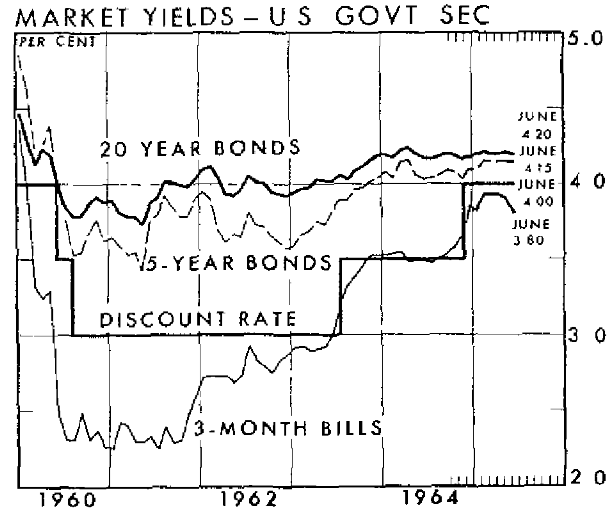
LIQUID ASSETS HELD BY PUBLIC



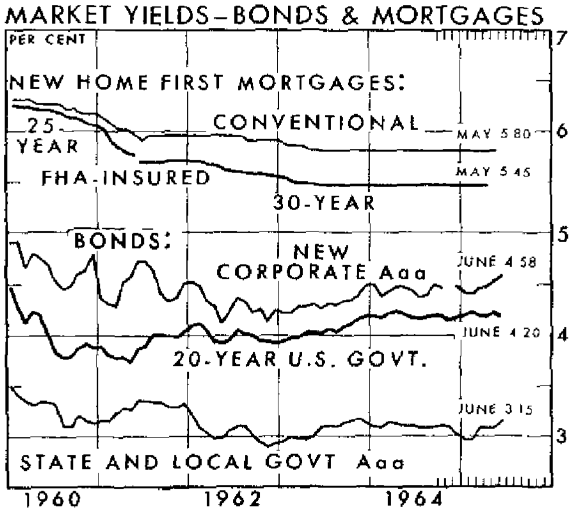
BANK ASSETS



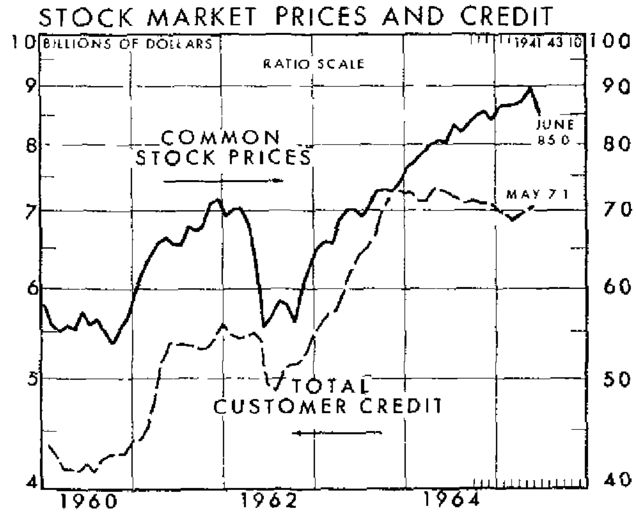
MARKET YIELDS – U S GOVT SEC



MARKET YIELDS–BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. International payments transactions of the United States were in approximate balance in June, according to preliminary indicators, following surpluses in the three preceding months. A less favorable outcome in June would be expected on seasonal grounds. For the second quarter as a whole, the balance on regular transactions may be estimated as a surplus of around $200 million, seasonally adjusted. This would compare with a seasonally adjusted deficit of $733 million in the first quarter. Official settlements in the second quarter apparently showed a modest surplus.

The $900 million seasonally adjusted improvement in the balance on regular transactions between the first and the second quarters reflected the initial impact of the President's program which was on a scale not likely to be sustained in the rest of the year. A major factor was a reversal of outflows of bank credit. In the first quarter net outflows of long- and short-term bank loans and acceptance credits to foreigners totaled about $600 million. In April and May, by contrast, there were inflows in the form of net repayments on such credits totaling $260 million. In these two months, claims covered by the VFCR guidelines declined by about $230 million. At the end of May, banks under the VFCR program were in a position to increase their loans and other claims on foreigners by $300 million during the remainder of the year without exceeding their combined target.

Some of the improvement in the over-all payments position in the second quarter probably reflected lower direct investment outflows. Recently published balance of payments estimates for the first quarter show an outflow of direct investment capital of $1 billion, seasonally adjusted. This outflow was at a rate perhaps half again as large as might have been expected on the basis of earlier trends and of known plans for capital expenditures by foreign affiliates of U.S. companies. The size of the outflow suggests that funds were transferred early in the year in anticipation of new government measures to deal with the balance of payments. The transferred funds were probably earmarked for capital expenditures to be made in the course of the year, and therefore, a marked slowing down in outflows of direct investment capital could be expected to have occurred following announcement of the President's program. The quarterly rate of these outflows in the second and succeeding quarters may have been cut by as much as $1/2 billion, as compared with the first quarter.

Among other capital movements in the second quarter, reflows of liquid funds out of deposits and short-term investments abroad appear on the basis of incomplete data for April and May to have been smaller than in the first quarter. Exceptionally large reflows of such funds had occurred in March. Also, preliminary figures on U.S. purchases of new foreign security issues in the period April-June show little change from the preceding three months after seasonal adjustment.

Data on foreign trade are now available through May, but underlying trends in exports and imports in recent months still remain obscured by distortions introduced by the dock strike. Both exports and imports in May continued to reflect the catching up of strike-delayed shipments, though both fell off further from the peak reached in March, the first full month after the end of the strike. The effect of these irregular trade movements on the payments position is difficult to assess. Compared with the depressed $1 billion rate of trade surplus in the first quarter, the surplus on merchandise trade movements in April-May averaged more than $500 million higher at a quarterly rate. Actual net receipts from trade probably did not show such a large improvement between these two periods.

For the six months December through May, exports averaged slightly above $25 billion at an annual rate and imports nearly $20 billion. Compared with the months immediately preceding this period, exports were lower by around $1 billion and imports were higher by about $1-1/2 billion at an annual rate. The reduced foreign demands behind the falling off in exports suggested by this comparison are hard to pinpoint. Besides the dock strike distortions, data on the destination of exports over this period are affected by statistical reclassifications. Making crude allowances for these effects, however, it would appear that while exports to Canada have continued to expand, there was some slackening of demands for U.S. exports from other industrial countries and a more marked reduction in purchases by the nonindustrial countries from the peak rates reached last autumn.

Although recent trends are difficult to interpret, about one-fourth of the apparent sharp rise in imports since last fall seems to have resulted from longer imports of steel ordered in anticipation of a steel strike. Steel imports in the six months, November-April, averaged 640 thousand tons a month, more than 40 per cent higher than in the corresponding period a year earlier. Steel imports in April were at a much higher rate.

Credit conditions and interest rates in Europe. During the first half of 1965, long-term bond yields rose in a number of European countries -- markedly in Germany, Britain, and the Netherlands; and to a lesser degree in France. Demand for long-term funds on the Continent has been strong, by public authorities as well as private borrowers. Upward movements in rates, there and also in Britain, have been regarded as generally consistent with national policies concerned with resisting inflation or restoring payments equilibrium. In Germany, earlier efforts to restrain the rise in bond yields had to be given up in May.

In Italy, where national policy since mid-1964 has been strongly oriented toward revival of economic activity, long-term interest rates declined further in the first half of 1965. In Belgium, yields have been steady, at a much higher level than two years ago. In Switzerland, bond yields eased early in 1965; a rising tendency later was successfully resisted by the authorities.

Among the factors contributing to stiffening of short-term as well as long-term interest rates on the Continent may have been the slackening of previously accelerated flows of U.S. direct investment funds and of U.S. bank credit, and withdrawals of U.S. liquid funds from the Euro-dollar market (largely via Canada). However, outflows of commercial bank funds from Italy to the Euro-dollar market, encouraged by the Bank of Italy, tended to exert a stabilizing effect on Euro-dollar rates.

Credit conditions in Britain tightened during the first half of the year, as the Government placed increasing emphasis on monetary policy in dealing with the U.K. balance-of-payments problem. Bond yields rose throughout the period.

Bank credit outstanding, seasonally adjusted, was sharply reduced in May and was then slightly below the end-of-1964 level. Whatever effect the November rise in bank lending rates (accompanying the rise in Bank Rate at that time) may have had on bank credit expansion was supplemented by the imposition in late April of special deposit requirements for commercial banks; and in early May the Bank of England requested the banks and other financial institutions to limit to 5 per cent the growth of their loans over the 12 months from March 1965. Consumer credit was made tighter in early June when minimum downpayments on hire-purchase contracts were raised 5 percentage points.

Short-term interest rates moved down after March, as the discount houses bid actively for a diminished stock of Treasury bills outstanding, and as local authorities pulled out of the market and borrowed heavily from the Public Works Loan Board at the start of the new fiscal year. Rates were reduced further when Bank Rate was cut from 7 to 6 per cent on June 3. Three-month rate reductions from

December 30 to June 30 were from 6.41 to 5.39 per cent on Treasury bills; from 7-3/4 to 6-5/8 per cent on hire-purchase paper; and from 7-3/4 to 6-1/4 per cent on local authority deposits.

Bond yields advanced during January-April, as investors held back. The rise accelerated in late May and June, partly, it seems, in reflection of uncertainties about coverage of the new capital gains tax, which has not yet been enacted. Yields on selected government bonds rose by between 29 and 40 basis points from late December to late June, the yield on War Loan rising from 6.47 per cent on December 31 to 6.80 per cent on June 25.

In Germany, the bond market came under increasing pressure this spring because of a heavier volume of new issues and rising short-term rates; the U.S. balance-of-payments program may also have been a factor. Earlier, the Bundesbank raised its discount rate on January 22 from 3 to 3-1/2 per cent, after money market rates had for some time been above the discount rate. Since then the rate for 90-day interbank loans has moved up further by 1/2 of 1 per cent.

Various public authorities had been supporting the bond market ever since March 1964, when the 25 per cent withholding tax on interest paid to foreigners was first proposed, but during 1965 the support prices were progressively lowered in the face of market sales. The composite yield on 6 per cent public authority bonds accordingly moved up from 6.43 per cent at the end of December to 6.70 per cent on May 4. On May 5, market pressures became so great that it was decided to suspend support operations; since then yields have moved to 7.3 per cent, where they appear to have stabilized. New issues, carrying a 7 per cent coupon for the first time since 1958 and priced to yield 7.2 per cent, are currently readily absorbed by the market.

In the Netherlands, interest rates have been under upward pressure ever since the central bank began to take restrictive actions to counter the "wage explosion" of the fall of 1963. Short-term rates, as reflected by 3-month Treasury bill yields, moved up further from an average of 3.68 per cent in December 1964 to 4.13 per cent in mid-June.

Tightening of financial conditions pushed yields on perpetual Government bonds from 4.98 per cent last December to 5.24 per cent in mid-June. Coupons of new loans by private issuers, which at 6 per cent had already been unusually high, moved to 6-1/4 per cent. The capital market is expected to tighten further as the Central Government and local authorities seek additional funds.

In France, the authorities have acted to lower money market rates and the cost of bank credit, but bond yields have risen. New bond issues in January-April ran 11 per cent above a year earlier, mainly because of heavier offerings by the public credit institutions and the nationalized enterprises. Yields on public sector bonds rose gradually by 10 basis points to 5.80 per cent in mid-June; corporate yields were steady in the first quarter but have since advanced 20 basis points to 6.45 per cent in mid-June. (These yields are net of a 10 per cent withholding tax.)

In view of the year-long sluggishness in domestic economic activity, on April 8 the Bank of France reduced the basis discount rate from 4 to 3-1/2 per cent and the first penalty rate from 5 to 4-1/2 per cent, and money market rates fell to an average of 4 per cent in April, as compared to 4.4 per cent in March. A rise to about 4.5 per cent in June was largely seasonal. To offset seasonal tightness in May-June, bank liquid asset requirements were eased. The minimum lending rates applicable to the various types of bank credit were reduced by 0.15 to 0.25 percentage points in January and by a further 0.10 to 0.35 percentage points in April.

On June 23, consumer credit regulations were eased in a further move to stimulate the economy. The fixed limit of 10 per cent per year on bank credit expansion was removed on July 1, but no early upsurge in credit extension is expected.

In Italy, in sharp contrast with Britain and Germany, a decline in bond yields dating from June 1964 continued in the first four months of 1965. Bank credit remained in abundant supply.

The composite yield on bonds of corporations and the public credit institutions dropped sharply from 6.90 per cent in December (monthly average) to 6.76 per cent in January, and declined slightly further to 6.71 per cent in May. (Yields in May were 7.26 per cent on corporate bonds; 6.89 per cent on bonds of public credit institutions which finance industry and public works; and 6.18 per cent on bonds of public credit institutions which extend real estate and farm credit.) Yields on government bonds, of which the amount outstanding is small relative to other types, dropped from 5.62 per cent in December to

5.35 per cent in January, held steady in February-March, and rose to 5.49 per cent in May.

The decline in bond yields since mid-1964 reflects a high degree of liquidity in the Italian banking system, occasioned mainly by the surplus position of the balance of payments and also by rising Bank of Italy credit to the Treasury. The banks have employed additional reserve funds to retire credit from the central bank, to decrease their net liabilities to the Euro-dollar market, and to build up free reserves. They have also increased their loans somewhat, and they have added substantially to bond holdings.

Money market conditions in Switzerland early in the year were described as very easy because of the large foreign exchange inflows of late 1964 associated with the sterling crisis. The decline in the 3-month deposit rate from 3.70 to 3.06 per cent during January was sharper than usual. (To mop up liquidity, in January the Swiss National Bank swapped $110 million of foreign exchange to Swiss commercial banks.) After the marked tightening of the Euro-dollar market in March, Swiss banks apparently moved funds into that market. Also, U.S. corporation subsidiaries began to seek more credit from Swiss banks. Developments such as these raised the 3-month deposit rate to 3.44 per cent on May 21, and preparations for mid-year window dressing were an added factor in a further increase to 3.69 per cent on June 18.

The bond market came under pressure in May and June as the volume of new flotations continued to mount. After a rise of about 4 basis points in government bonds in early May, the Swiss National Bank reportedly bagan to intervene to stabilize the market. To avoid upward pressure on rates, the Treasury decided to redeem in cash part of a long-term issue maturing in June, and a portion of its refinancing was done with medium-term notes.

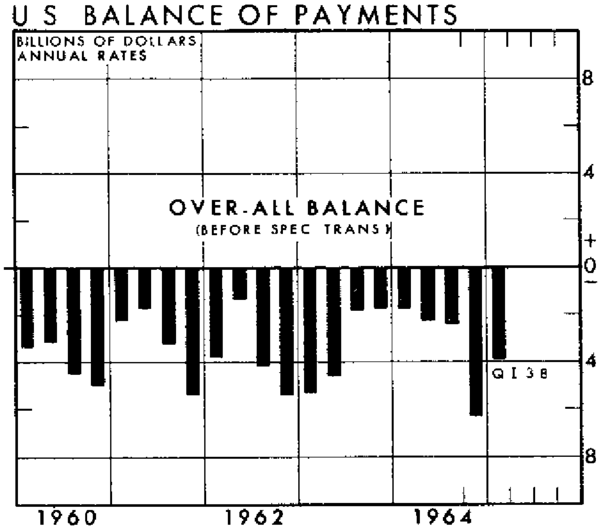
Credit conditions in Japan. With the aim of stimulating domestic economic activity, the Bank of Japan reduced its discount rate to 5.48 per cent on June 26, the lowest it has been since October 1951. Successive reductions since last December have been accompanied by actions to make reserve funds more readily available to the banks and to relax previous restrictions on bank lending policies, but the banks appear to have been acting cautiously in their lending operations. The discount rate has now been lowered by more than 1 percentage point since December, and the call loan rate has been brought down from 11.3 per cent to 6.6 per cent.

Continued weakness in the Japanese stock market and a persisting overhang of inventories of finished goods have contributed to lack of confidence in the domestic economic outlook. The trade balance has been an element of strength in the balance of payments. The rapid rise in exports that began early in 1964 has continued in recent months, helped by active selling efforts of Japanese producers. Despite net outflows of long-term capital in March and April, and a moderate loss of reserves in the second quarter, the Japanese authorities describe the payments position as relatively satisfactory.

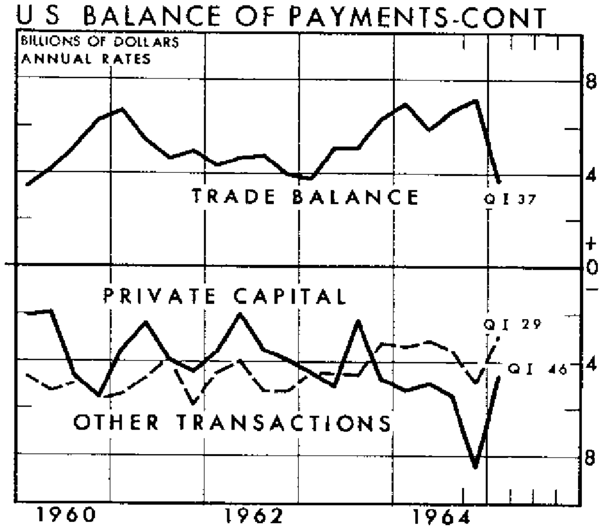
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

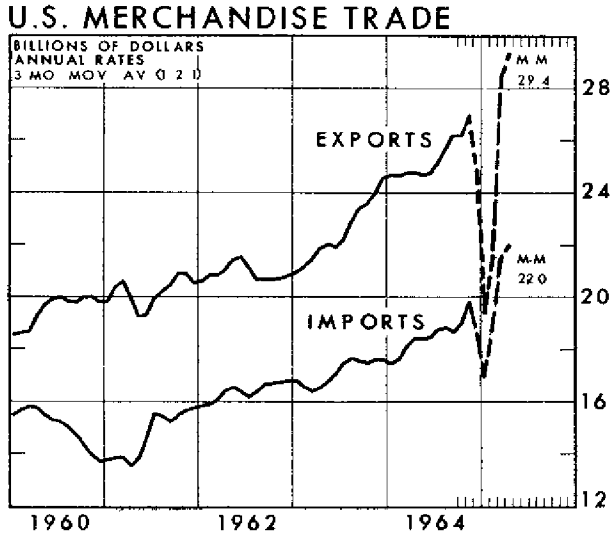
U S BALANCE OF PAYMENTS



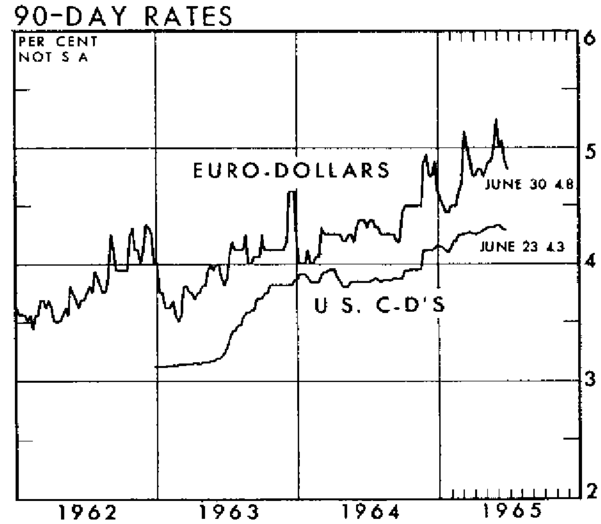
U S BALANCE OF PAYMENTS-CONT



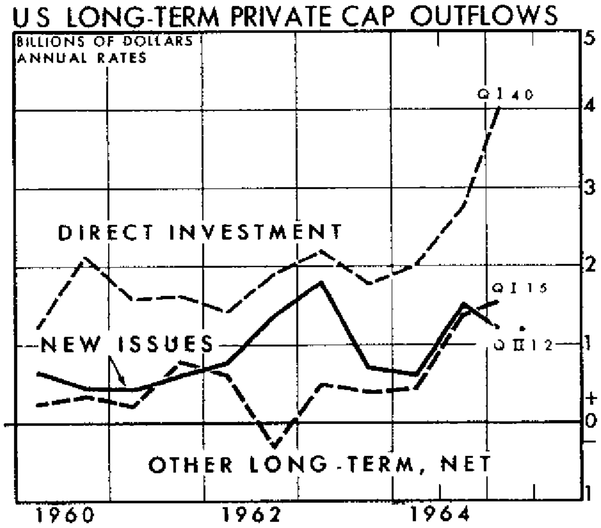
U.S. MERCHANDISE TRADE



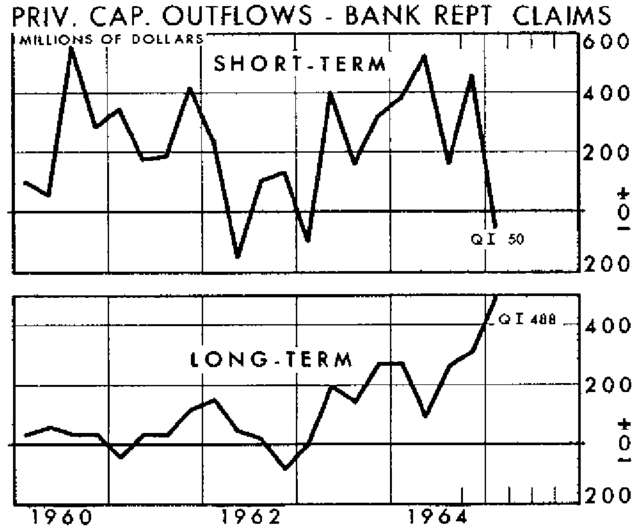
90-DAY RATES



U S LONG-TERM PRIVATE CAP OUTFLOWS



PRIV. CAP. OUTFLOWS - BANK REPT CLAIMS



APPENDIX A: PRESENT STATE OF THE 1965 SOCIAL SECURITY AMENDMENTS*

The Senate Finance Committee reported out the 1965 Social Security Amendments on June 28. The Committee report was released on June 30 and it is expected that the Senate will take up the bill during the week of July 9. It is also expected that the Senate will pass the bill with only very minor changes from the way it was reported out.

The bill as passed by the House and as reported by the Senate Finance Committee provides for medicare for the aged, increased social security benefits and increased social security taxes. However, there are two major differences (and numerous smaller ones) between the House and Senate versions. Consequently, the bill will have to go to conference but final passage is expected around July 15.

The estimated cost of the program is shown in Table 1 and the estimated timing of the increased expenditures by calendar and fiscal years is shown in Table 2. The increase in social security benefits is to be effective immediately. However, benefits under medicare are not to become effective until July 1, 1966.

Table 1

Increases in Social Security Expenditures: (Billions of dollars)	Annual Cost
Medicare for the aged	2.4
Voluntary major medical	1.1
7 per cent increase in benefits	1.5
Liberalization of regulations and eligibility	.6
Inclusion of Kerr-Mills plans in medicare	.2
House passed increase in expenditures	5.8
Cost of increased income ceiling	.6
Senate reported increase in expenditures	6.4

Table 2

Increases in Social Security Expenditures
(Billions of dollars)

	Calendar Years			Fiscal Years	
	1965	1966	1967	1966	1967
Medicare		1.2	2.4		2.4
Major medical		.5	1.1		1.1
Increased benefits	.7	1.5	1.5	1.5	1.5
Retroactive benefits	.7			.7	
Liberalization regulations etc.	.3	.6	.6	.6	.6
Kerr-Mills		.2	.2	.1	.2
Increased income ceiling	.4	.6	.6	.6	.6
	2.0	4.6	6.4	3.5	6.4

* Prepared by Nancy Teeters, Economist, Division of Research and Statistics.

The Kerr-Mills plans which established, several years ago, separate Federal-State aid programs for meeting the medical expenses of the needy are to be absorbed into the general Medicare program, resulting in somewhat higher expenditures under these programs. Inclusion of these plans was not requested by the Administration but was included by both Houses.

The major difference between the House and Senate versions with respect to expenditures is that the Senate bill raises the ceiling on the amount a person can earn without reducing benefits from $1,200 a year to $1,800.

The increased expenditures are to be financed by increased social security taxes to be effective January 1, 1966. The House passed a tax increase which consists of raising the ceiling on the amount of wages and salaries subject to tax from the present $4,800 to $5,600 and raising the combined employer-employee tax rate from the current 7.25 per cent to 8.7 per cent. The bill reported by the Senate Finance Committee increases the wage ceiling to $6,600 and raises the rate to 8.35 per cent. The House bill has a future increase in the wage ceiling built into it and both have preplanned increases in the tax rate as can be seen in Table 3.

Table 3

Past and Future Increases in Social Security Tax Rate and Base

Effective: Jan. 1	1959	1960	1962	1963	1966	1967	1968	1969	1971	1973
Current Law:										
Maximum Salary Subject to Tax	4800	4800	4800	4800	4800		4800			
Combined Rate	5.0%	6.0%	6.25%	7.25%	8.25%		9.25%			
House passed bill:										
Maximum Salary Subject to Tax					5600	5600		5600	6600	6600
Tax Rate					8.7%	9.0%		9.8%	9.8%	10.7%
Senate Bill:										
Maximum Salary Subject to Tax					6600	6600		6600	6600	6600
Tax Rate					8.35%	8.7%		9.9%	10.0%	11.0%

Suposedly the alternate tax plans would yield the same increase in revenue--an estimated $5.4 billion at annual rates. Of this $5.4 billion, a $2.2 billion increase in social security taxes had been previously legislated to be effective January 1966. The new base and higher rate would add, at least, an additional $3.2 billion in revenue. It appears likely, however, that if the Senate's tax program is the one finally passed, the $6,600 wage ceiling and 8.35 per cent tax rate would yield larger revenues--by about $600 million--than the smaller base and higher rate. The inrease in taxes being scheduled for January 1 is, therefore, somewhere between $5.4 and $6.0 billion, depending on which tax program is enacted.

APPENDIX B: SCHEDULED EXCISE TAX CUTS AND BUDGETARY OUTLOOK*

As indicated in Table 1, most of the excise tax cuts take place in fiscal 1966. About $1.8 billion of such reductions (at an annual rate) have already taken place, including a 3 percentage point reduction in auto excises. A further $1.7 billion is scheduled for January 1, 1966, which includes 1 percentage point further on autos together with elimination of taxes on auto parts; also telephone taxes are substantially reduced. Subsequent excise reductions represent the gradual elimination of telephone and auto taxes (except for a residual 1 per cent retained on autos).

Table 2 shows the effect of the excise tax cut, together with the new social security program described in Appendix A, on various measures of the Federal budget. As these programs take effect in the third quarter of this year, all budgets are projected to be in deficit, while the full employment surplus drops to just under $1 billion, the lowest level since the first stage of the recent income tax cut in the second quarter of 1964. Relatively little change, seasonally adjusted, is projected for the fourth quarter, but the budgets become less expansionary in the first half of 1966 when new social security taxes become effective.

---

* Prepared by Government Finance Section, Division of Research and Statistics.

Excise Tax Reduction
(In millions of dollars at annual rates)

I.	June 19, 1965		
	A. Retail excises	550	
	B. Manufacturers	608	
	C. Regulatory	20	
	D. Automobile 1/	570	
	Effect of June 22 effective date	30	
			-1,778
II.	January 1, 1966		
	A. Admissions	187	
	B. Communications 2/	801	
	C. Automobile and related	498	
	D. Light bulbs and doc. stamps	200	
			-1,726
III.	January 1, 1967		
	A. Communications	91	
	B. Automobile	380	
			- 471
IV.	January 1, 1968		
	A. Communications	91	
	B. Automobile	380	
			- 471
V.	January 1, 1969		
	A. Communications	91	
	B. Automobile	190	
			- 281
			-4,727

1/ Automobile rate reduction schedule is as follows:
From 10% to 7% -- June 1965
6% -- January 1, 1966
4% -- January 1, 1967
2% -- January 1, 1968
1% -- January 1, 1969

2/ Tax on telephone service rate reduction schedule is as follows:
From 10% to 3% -- January 1, 1966
2% -- January 1, 1967
1% -- January 1, 1968
0 -- January 1, 1969

Various Federal Budgets by Quarters
(In billions of dollars)

	1964				1965				1966		Calendar Years	
	I	II	III	IV	I	IIp	III	IV	I	II	1964	1965
					Quarterly Totals							
Cash Budget												
Receipts	30.3	33.4	27.0	24.3	30.7	37.6	28.6	25.7	31.1	39.3	115.0	122.6
Payments	28.7	30.1	30.9	30.6	28.3	31.8	32.0	32.3	31.1	32.3	120.3	124.4
Deficit/Surplus	1.6	3.3	- 3.9	- 6.3	2.4	5.7	- 3.4	- 6.6	--	7.0	- 5.2	- 1.8
Cash Budget, Seasonally Adj.												
Receipts	29.5	28.6	28.2	28.7	29.8	32.2	29.9	30.5	30.4	33.9	115.0	122.6
Payments	30.5	29.7	30.2	29.8	30.1	31.5	31.2	31.4	33.1	32.0	120.4	124.4
Deficit/Surplus	- 1.1	- 1.1	- 2.0	- 1.1	- .3	.7	- 1.3	- .9	- 2.7	1.9	- 5.4	- 1.8
National Income Seasonally Adj.												
Receipts	28.7	28.1	28.5	28.8	30.1	30.5	30.4	30.6	31.6	32.0	114.1	121.6
Expenditures	29.3	30.1	29.8	30.0	30.3	30.2	31.3	31.6	32.2	32.8	119.2	123.1
Deficit/Surplus	- .6	- 2.0	- 1.3	- 1.2	- .1	.3	- 1.1	- 1.0	- .6	- .8	- 5.1	- 1.5
					At Annual Rates							
Nattional Income, Seasonally Adj.												
Receipts	114.8	112.3	114.0	115.2	120.3	121.9	121.6	122.2	126.4	128.1	114.1	121.6
Expenditures	117.2	120.2	119.2	120.1	120.3	120.6	125.2	126.4	128.8	131.2	119.2	123.1
Deficit/Surplus	- 2.4	- 7.8	- 5.2	- 5.0	--	1.3	- 3.6	- 4.2	- 2.4	- 3.1	- 5.1	- 1.5
Full-Employment, Seasonally Adj.												
Revenue	124.4	120.2	121.9	123.9	125.1	126.9	125.5	127.1	132.9	134.8	122.6	126.2
Expenditures	116.5	119.6	118.7	119.8	119.8	120.1	124.7	125.9	128.3	130.7	118.7	122.6
Deficit/Surplus	7.9	.6	3.2	3.8	5.3	6.8	.8	1.2	4.6	4.1	3.9	3.6

p - preliminary

APPENDIX C: PRICE CHANGES DURING THE CURRENT BUSINESS EXPANSION*

The all-commodity index of wholesale prices has risen 2 per cent since last summer after 7 years of stability. (Chart 1.)# More than half the rise is accounted for by sharp increases in prices of foodstuffs in response to curtailed supplies, but the increase in the index for industrial commodities, although slow-paced, has been persistent. (Chart 2.) Over the 9 months since the third quarter of last year, the industrial index has increased 1.3 per cent. As the attached table shows, this index had increased only 0.5 per cent over the preceding year and a half, from the first quarter of 1963 to the third quarter of last year, and had declined 0.7 per cent in the first 2 years of this business expansion.

Sharp increases in prices of foodstuffs, to a point 5 per cent higher than last summer, reflect delays in harvesting vegetables because of unfavorable weather and, more importantly, reduced marketings of livestock in response to low prices last year. Government surveys of farmers' production plans indicate that reduced output and higher prices for livestock will continue for some months to come. The last comparable shift in the livestock situation occurred in 1957, and prices rose sharply to a peak in the spring of 1958 when the recession in business activity reached its low. (The last Chart, numbered 14.)

Increases in food prices contributed to raising the consumer price index 0.6 per cent from March to May, and further increases are likely. As a consequence, wages will be pushed up in those industries that have cost-of-living clauses in their labor contracts. About 2 million workers presently are covered by such clauses--about half as many as the high at the end of 1958.

Prices of foodstuffs tend to be dominated by changes in supplies--reflecting variations in the weather or swings in the livestock production cycles--and are much less sensitive to cyclical changes in incomes and demands. In time, moreover, the supply and price changes tend to be self-correcting. This memorandum, therefore, will focus on markets for industrial commodities.

---

* Prepared by Murray Altmann, Senior Economist, Division of Research and Statistics.

The charts, numbered in the lower right corner of the page, are assembled in numerical sequence but there are no charts numbered 5, 11, and 13. Latest figures shown are for May 1965, with the exception of June estimates for the wholesale indexes on charts 1, 2, and 14.

Early 1961 to early 1963

In the first 2 years of this expansion period, downward pressure was maintained on prices in many markets for industrial commodities as the pace of expansion was not rapid enough to significantly raise rates of resource utilization and alter competitive conditions. In the spring and summer of 1962, moreover, expectations were dampened by the Government-industry conflict over steel prices and by the sharp drop in common stock prices.

A rise in prices of sensitive industrial materials, which had begun promptly with the upturn in activity in early 1961, proved to be short-lived. By early 1963, prior to the renewed expansion in industrial output, the sensitive index had backed down almost to the low of early 1961. (Chart 4.) Prices of nonferrous metals and mill products were a little lower than in early 1961.

For industrial materials other than the sensitive, the index declined 1.5 per cent over the first 2 years of the current business expansion. Decreases were fairly widespread, as the table shows, and in some instances they were sizeable. Even steel mill products declined slightly. To some extent, decreases in this period may have reflected downward adjustments of list or published prices to the level at which transactions had actually been occurring for some time--to the level, in other words, of prices after discounts and special concessions. One price increase among these materials was for metal containers. Even at the recession low at the beginning of 1961, container prices had been raised 2 per cent.

Price reductions were widespread among finished products also. Most consumer durable goods--television sets, appliances, floor coverings, and autos--declined by significant amounts. On the other hand, household furniture rose 2 per cent in that 2-year period. The possibility of a measurement problem for furniture is suggested by an almost steady rise since 1958 at an average annual rate of 1 per cent. The largest increase among finished goods was shown by nonalcoholic beverages.

An alternative and often useful way of grouping industrial commodities, also shown in the table and in the chart numbered 10, combines all metals and machinery in one group and all other industrial commodities into a second group. In the first 2 years of the expansion, both of these groups declined slightly.

Early 1963 to the summer of 1964

In early 1963, expansion in new orders for and production of business equipment and other durable goods was resumed, and the rise in production in other industrial countries accelerated. Consequently, prices of metals and machinery turned up. The sensitive group for nonferrous metals and mill products rose nearly a tenth in the year and a half from the first quarter of 1963 to the third quarter of 1964. (Chart 12.) In 1963, prices of most steel mill products were raised, and the aggregate index for mill products rose 1.5 per cent. With costs of these basic metal products rising, prices of brass plumbing fixtures and of structural metal products also increased, and metal containers were raised again. Altogether, the index for metals and machinery rose nearly 2 per cent.

Industrial commodities other than metals and machinery on balance declined slightly further in this period and provided a partial offset. (Chart 10 and table.) A sharp further decrease in petroleum products was an important part of the offset, and prices of industrial chemicals continued to decline.

Meanwhile, woodpulp prices recovered to their early 1961 level, although they remained about 5 per cent lower than in 1959-60, and prices rose for some paper products but declined further for others. Millwork prices remained at the high reached in early 1964--6.5 per cent above a year earlier.

Among the sensitive materials, lumber and plywood rose, but the increase of 4 per cent was not especially large for these commodities. (Charts 6, 7, and 8.) In the upswing from the recession low in early 1958, for example, they rose about a tenth. Moreover, a decline in their prices was underway in the summer of 1964 in response to a weakening in residential construction activity.

Among finished consumer products, price changes during this period continued to be mixed, as the table shows. Television sets, appliances, and autos declined further. Prices of floor coverings and apparel were increased appreciably when prices of raw wool went up. The large increase shown for nonalcoholic beverages, 8.5 per cent, was provoked in 1963 by soaring prices for sugar.

Since the summer of 1964

From the third quarter of last year to June, the industrial index increased 1.3 per cent, or an annual rate of 1.75 per cent. Metals and machinery increased 1.6 per cent further--an annual rate of 2 per cent compared with a rate of 1.25 per cent in the preceding period. At the same time, offsetting decrease in prices were fewer than before. In particular, prices of petroleum products recovered much of their earlier decline, and the aggregate for industrial commodities other than metals and machinery also increased in this period in contrast with its slight decreases in the two earlier periods. (Chart 10.)

The nonferrous metals group has risen as much since last summer, as it had in the preceding year and a half, and was again the major influence behind a 3 per cent rise in the index for sensitive materials. Apparently with competitive positions in mind, producers of copper had held prices down earlier in 1964 despite strikes and other interruptions to supplies and large increases in prices on the London and New York exchanges. But last autumn and again this spring, producers responded to pressures from both the markets and the Chilean Government by raising prices a total of more than 10 per cent, and increases for mill products followed. Also, in this period, demands for aluminum products expanded sufficiently so that attempts to increase prices from reduced levels, after having failed several times before, finally succeeded. Higher prices for copper and aluminum were reflected in further increases for plumbing fixtures and structural metal products.

The sensitive textile group changed little in this period, but in a sense prices of textile mill products are inflated. (Chart 7.) Market prices of natural fibers are down sharply from a year ago, mainly as a result of a 7.5 per cent reduction last year in Federal price-supports for cotton. In addition, enactment of "one price cotton" legislation further reduced the cost of cotton for domestic use by about a fifth. Prices of cotton textile mill products have increased somewhat since last summer, however, and are only slightly below their levels prior to the reduction in the cost of raw cotton. Demands for cotton textiles have been strong, and while employment costs have increased, profit margins have widened appreciably.

In the recent period, the index for industrial materials other than the sensitive rose 1 per cent, in contrast with no change in the preceding period and a decrease in the first 2 years of expansion. Petroleum products rose 5 per cent, after having fallen 12 per cent from early 1961, and this partial recovery exerted an important influence on the aggregate index for nonsensitive materials--and also on the index for consumer nonfood products. The decline in industrial chemicals was arrested, and woodpulp rose further but paper products changed little. Increases were effected for selected steel mill products, but prices were stable for most mill products and the increase in the average was small. Prices of metal containers were raised once again, and producers attributed the action to increased labor costs.

Among finished products, the further rise in machinery and equipment and partial recovery in trucks and in tires and tubes shown in the table are probably attributable to the strength of demands. Meanwhile, televison sets and appliances continued downward, and accompanying a decrease in raw wool, floor coverings declined somewhat. On balance, wholesale prices of consumer nonfood products increased slightly. (Chart 9.)

Comparing the latest figures for the groups of industrial commodities with their levels in early 1960, prior to the last recession, only the producers' equipment is up by a statistically significant amount. It is possible that a part of the 3 per cent rise in that 5-year period reflected improvements in efficiency of equipment not fully allowed for in the figures.

Most groups of industrial materials remain below their early 1960 levels, as the table shows, with nonferrous metals and metal containers the principal exceptions. Labor costs per unit of manufacturing output (including output of both industrial products and industrial materials) are down 3 per cent from 5 years ago.

Among consumer goods, the large increases are for beverages and tobacco. Furniture is also higher, and apparel and footwear are up about 2 per cent. But most other groups of consumer goods are lower than they were 5 years ago, and appliances and television sets are down substantially.

For the most part, price increases during the current business expansion are a consequence of strong demands. The rise in prices of nonferrous metals and mill products alone accounts directly for two-fifths of the increase in the total industrial index since early 1963, and prices of these demand-sensitive commodities typically show large cyclical swings. Increases in machinery prices also are attributable mainly to strong demands and an accumulation of order backlogs. Hourly employment costs in some machinery industries, according to industry comments, have exceeded gains in output per manhour, in part because of overtime operations. But if labor costs have increased for these industries, costs probably have declined for others since total labor costs per unit of output in manufacturing have drifted downward.

For some products, upward pressure on prices has arisen from the cost of materials. The rise in nonferrous metals increased manufacturing costs for batteries, plumbing fixtures, and some other products. Prices of nonalcoholic beverages were raised sharply when sugar prices soared, although the beverages have not come down again despite the retreat in sugar prices. Prices of apparel and floor coverings were raised when prices for wool went up. Increases in costs arising from wages and purchased materials have been selective, however, rather than pervasive, and therefore they have not been part of a cumulative interaction of prices and costs. It is significant that prices of steel mill products currently are only 1 per cent higher than in early 1960; from the end of 1953 through 1958, steel prices were raised a third.

That upward pressure have not been diffused through the structure of prices and costs is a fact that has favorable implications for future price developments, assuming that the pace of expansion in demands does not soon again accelerate to a rapid rate. Current or prospective increases in supplies of goods and in capacity to produce combined with only moderate expansion in demands--or contraction in those instances where temporary inventory demands have been important--might serve to moderate such price pressures as have existed. A downturn in economic activity probably would be accompanied promptly by a reversal in the direction of the industrial price index, in contrast with experience in the 1957-58 recession, since the substantial rise in prices of nonferrous metals and mill products would be quickly liquidated, prices of textiles and other sensitive materials probably would decline, and the structure of costs does not appear to have been raised generally.

C - T-1

WHOLESALE COMMODITY PRICES

(Per Cent Increase)

Commodity Group	1961-Q1 to 1963-Q1	1963-Q1 to 1964-Q3	1964-Q3 to 1965-May	1960-Q1 to 1965-May
All Commodities	-0.8	0.3	2.1#	1.9#
Foodstuffs	-1.2	-0.2	4.8#	6.8#
Livestock & Prod.	-4.5	-0.6	7.6#	6.2#
Crops & Prod.	2.7	0	2.3#	7.4#
Industrials	-0.7	0.5	1.3#	0.6#
Materials	-1.1	0.6	1.6	-0.2
Sensitive	0.6	2.9	3.1	0
Other	-1.5	-0.1	1.1	-0.2
Products	-0.3	0.2	0.9	1.1
Consumer Nonfoods	-0.7	-0.2	0.7	0.4
Producers' Equipment	0.5	1.2	1.1	2.7
Industrials--Alternative Groupings				
Metals & Machinery	-0.6	1.9	1.6	2.1
Other	-0.8	-0.5	0.9	-0.8

* * * * * * *

Sensitive Industrial Materials				
Nonferrous Metals	-2.2	9.3	8.7	7.6
Textiles	2.0	-0.7	0	-2.7
Lumber & Plywood	1.7	4.3	-0.2	-3.7
Rubber	-3.5	-9.1	4.9	-32.5
Hides & Leather	1.5	1.5	3.5	-1.2

Other Industrial Materials				
Steel Mill Prod.	-0.7	1.5	0.5	0.9
Structural Metal Prod.	-1.7	1.4	1.5	-0.5
Metal Containers	2.5	1.1	2.7	8.0
Plumbing Fixtures	-2.1	2.4	1.8	-0.4
Heating Equip.	-1.8	-0.8	0	-7.2
Nonmetallic Minerals	-0.3	0.2	0.2	0.3
Millwork	-0.9	6.5	-1.1	2.5

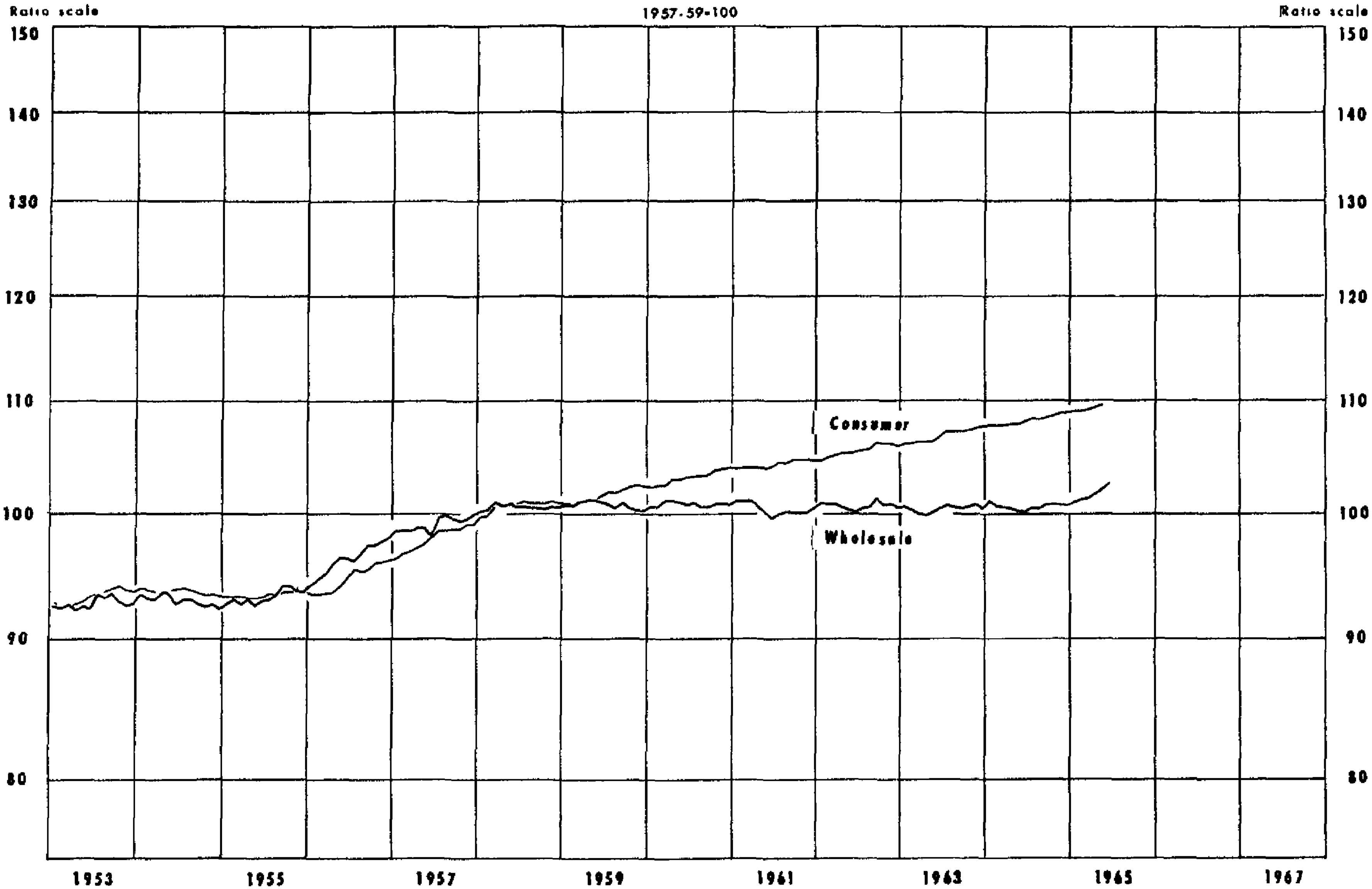
(Per Cent Increase)

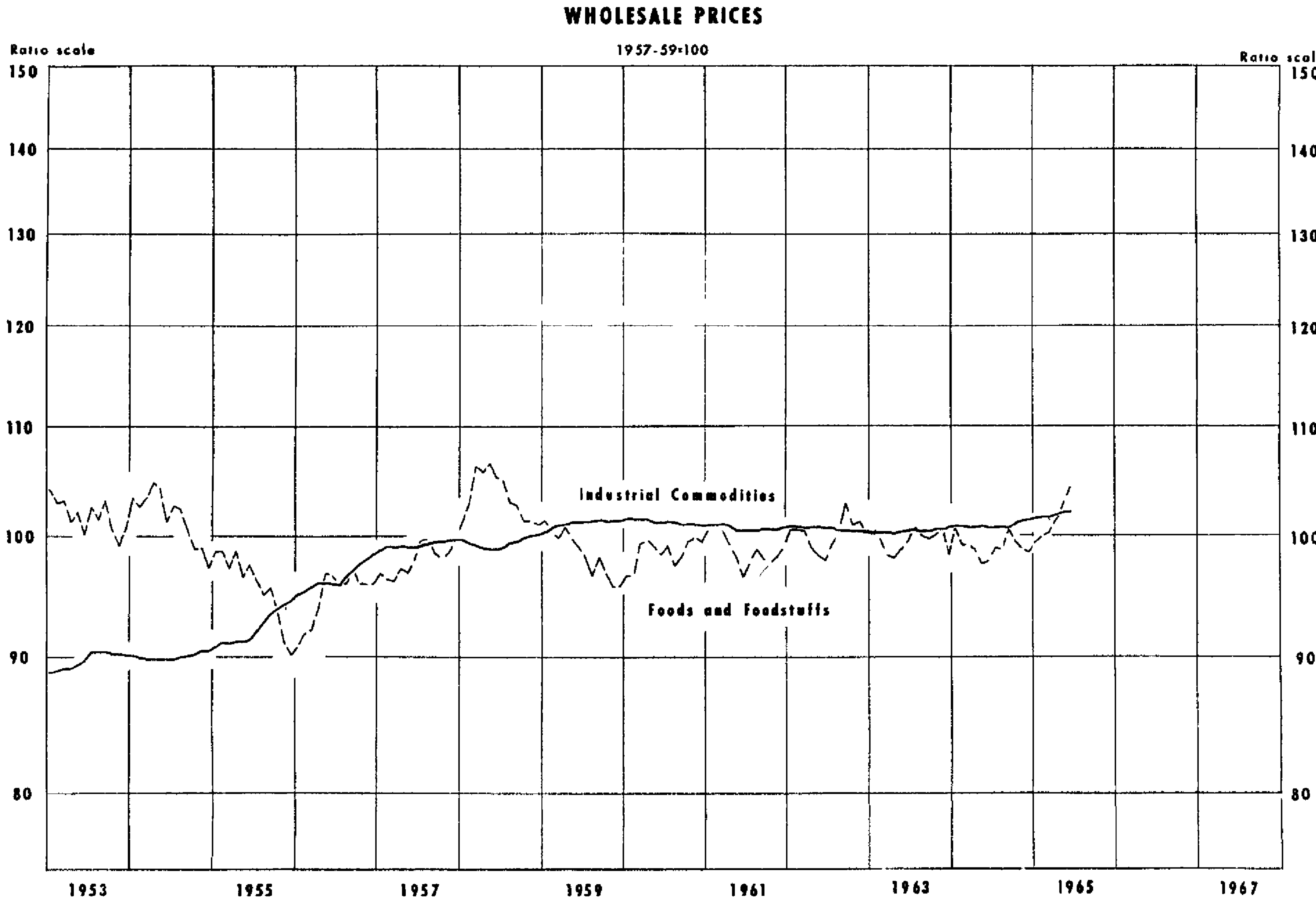
Commodity Group	1961-Q_1 to 1963 Q_1	1963-Q_1 to 1964-Q_3	1964-Q_3 to 1965 May	1960-Q_1 to 1965-May
Woodpulp	-6.0	6.8	2.7	-2.6
Paper	0	1.5	0.3	2.5
Paperboard	-1.9	2.4	-0.1	-3.5
Paper boxes	-2.1	-3.2	0.5	-4.7
Building Paper & Board	-6.3	-0.9	-1.6	-9.4
Industrial Chemicals	-4.1	-1.6	0.6	-5.9
Petroleum Products*	-4.8	-6.9	4.7	0.7
Electric Power*	0.2	-1.3	-0.4	-0.5
<u>Industrial Products</u>				
Machinery & Equip.	-0.4	1.0	1.1	1.5
Trucks	-1.3	-0.8	1.3	-1.0
Commercial Furniture	0.7	0.9	0.4	1.8
Passenger Cars	-1.5	-0.9	-0.2	-3.4
Tires and Tubes	-3.4	-1.1	1.9	-1.3
Household Furniture	2.0	0.8	0.7	4.6
Floor Coverings	-3.1	3.1	-1.3	-2.5
Household Appliances	-3.3	-1.2	-2.0	-9.2
TV, Radios, etc.	-6.9	-2.9	-1.6	-12.2
Apparel	0.5	1.9	-0.1	2.1
Footwear	1.4	0	1.3	1.6
Drugs & Pharmaceuticals	-3.9	-0.5	0.2	-5.1
Paper Products-Consumer	-1.3	-0.2	0.3	-2.0
Tobacco Prods.	0.3	3.7	1.3	5.4
Nonalcoholic Beverages	6.2	8.5	0.5	16.2
Toys, Sporting Goods, Etc.	0.7	0.1	1.1	2.4
Jewelry, Watches, Etc.	0.7	-0.2	0	1.2

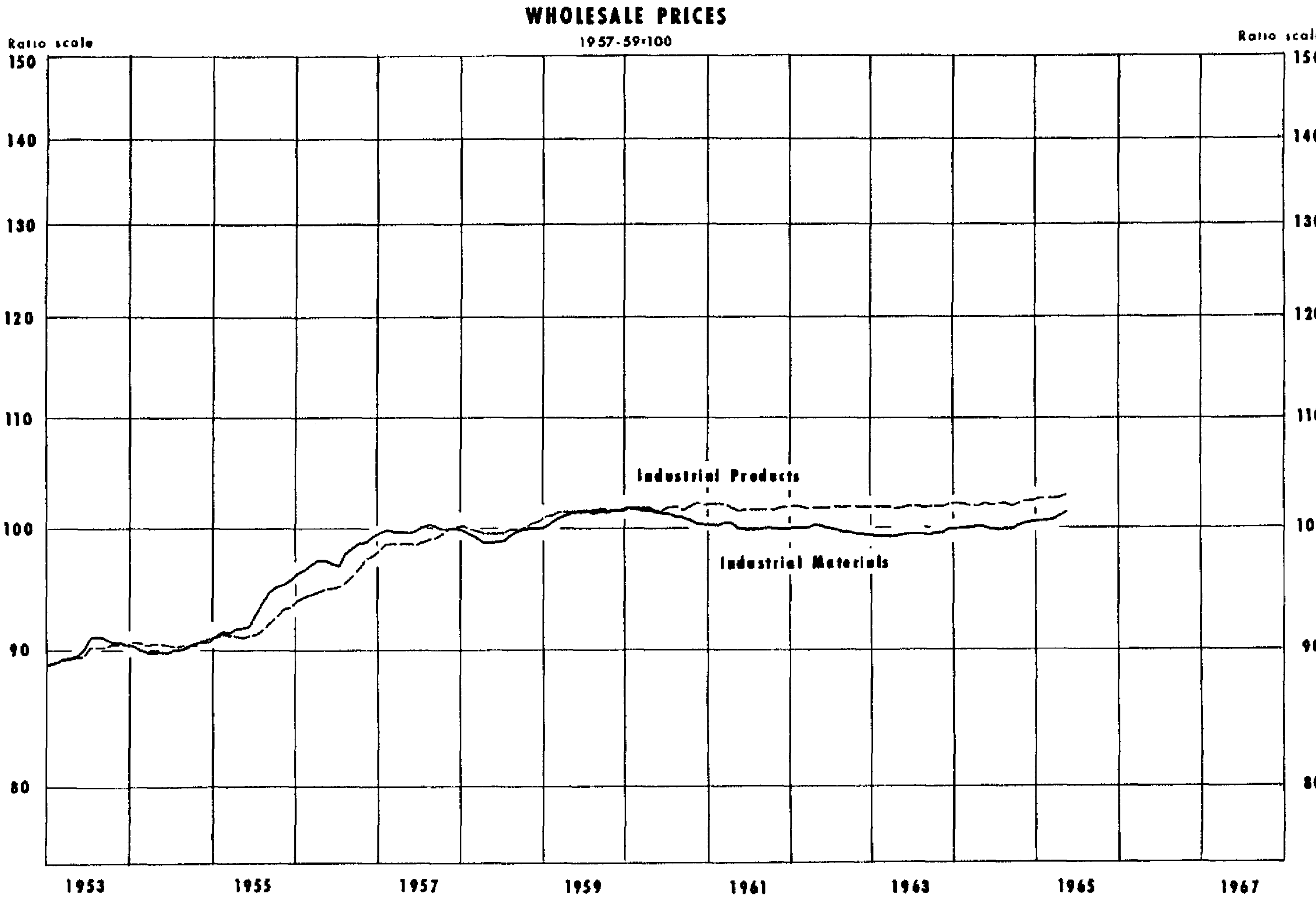
Per Cent change based on an estimate for June 1965 rather than the preliminary figure for May.

* Petroleum products and electricity are represented in the industrial products group--consumer nonfoods--as well as in the industrial materials group.

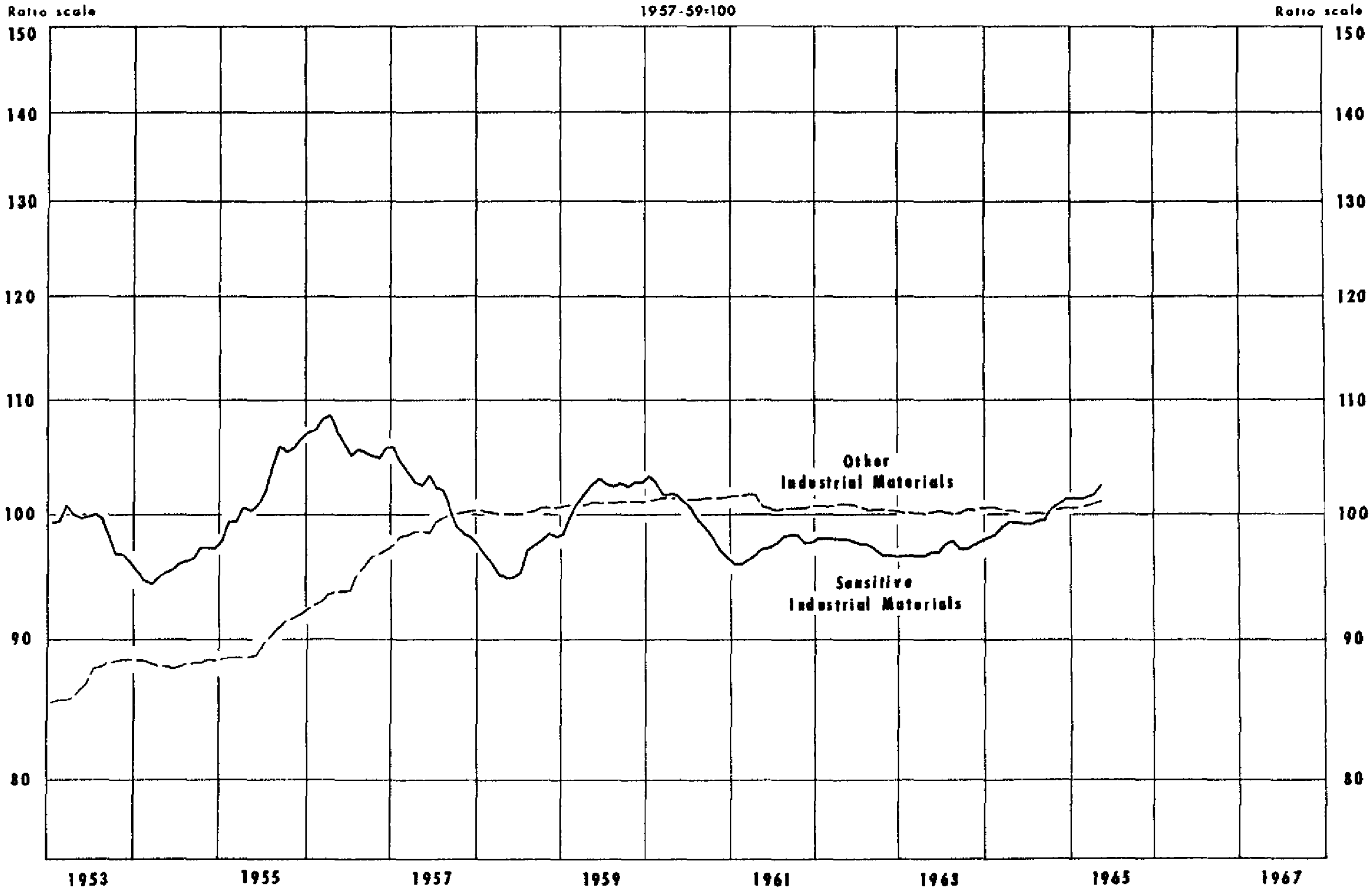
PRICES


Ratio scale
1957-59=100
Ratio scale
150
140
130
120
110
100
90
80
Consumer
Wholesale
1953
1955
1957
1959
1961
1963
1965
1967


WHOLESALE PRICES
1957-59=100
Ratio scale
Ratio scale
150
140
130
120
110
100
90
80
Industrial Commodities
Foods and Foodstuffs
1953
1955
1957
1959
1961
1963
1965
1967

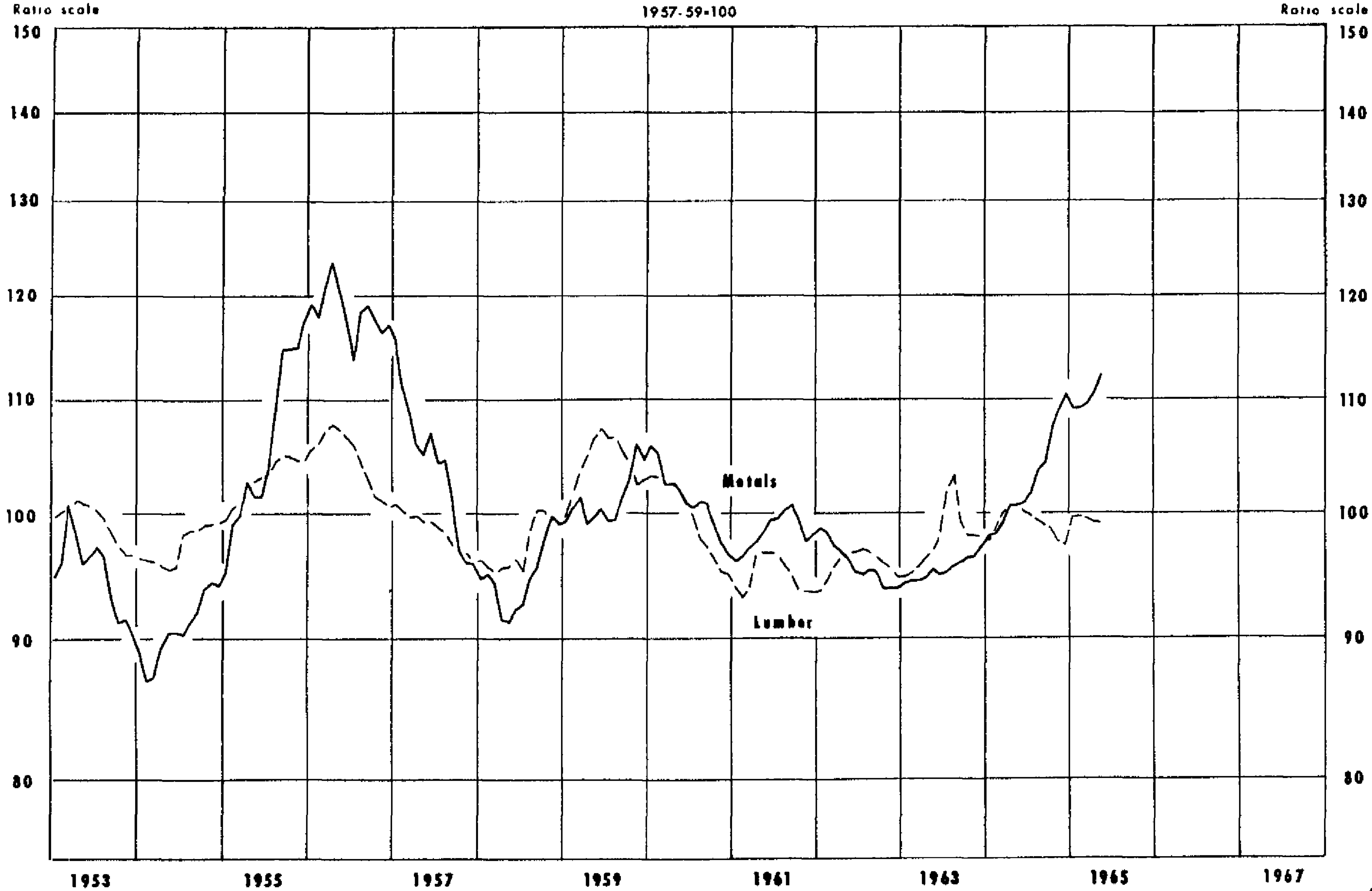

WHOLESALE PRICES
1957-59=100
Ratio scale
Ratio scale
150
140
130
120
110
100
90
80
Industrial Products
Industrial Materials
1953
1955
1957
1959
1961
1963
1965
1967

WHOLESALE PRICES

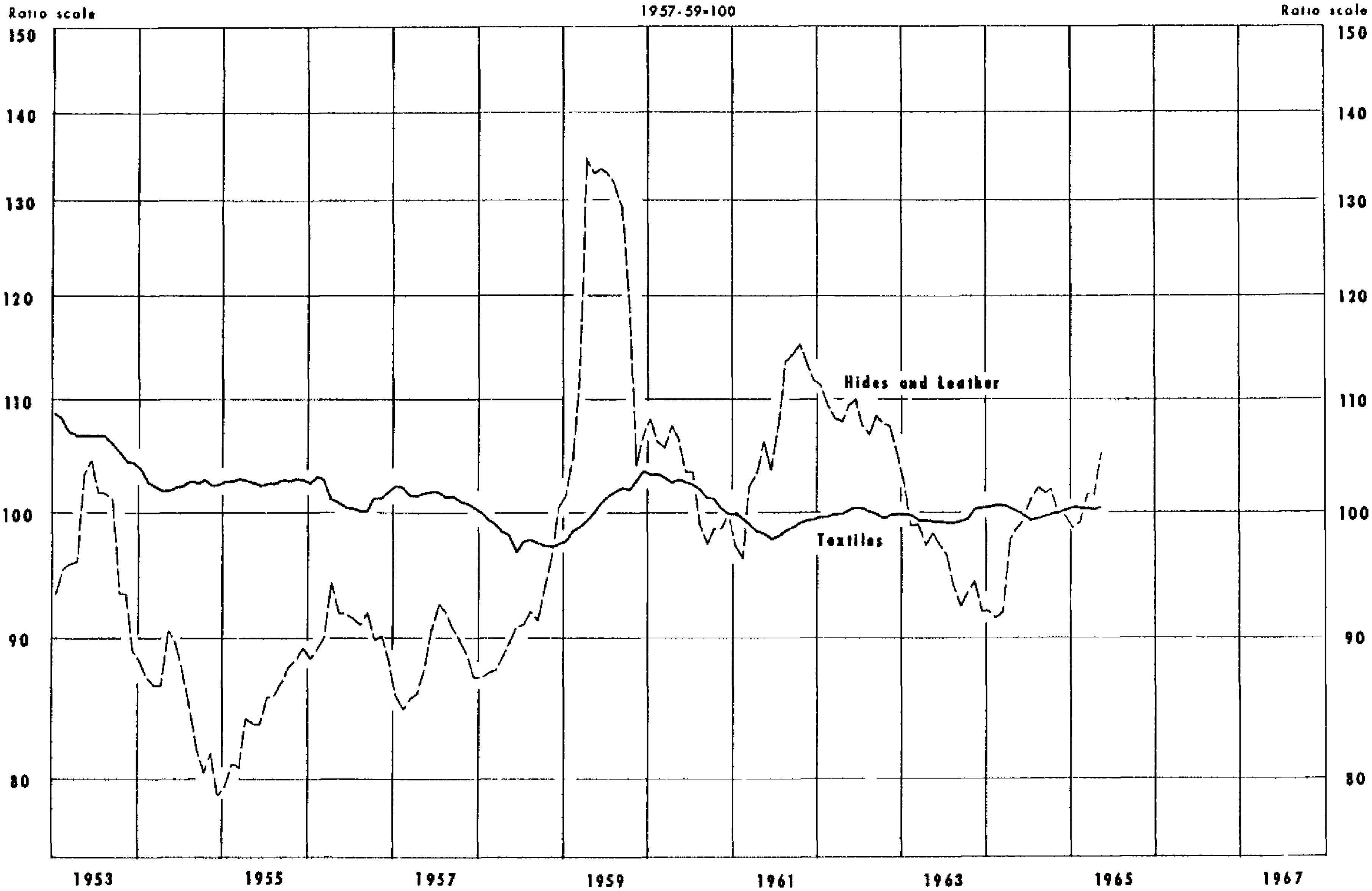


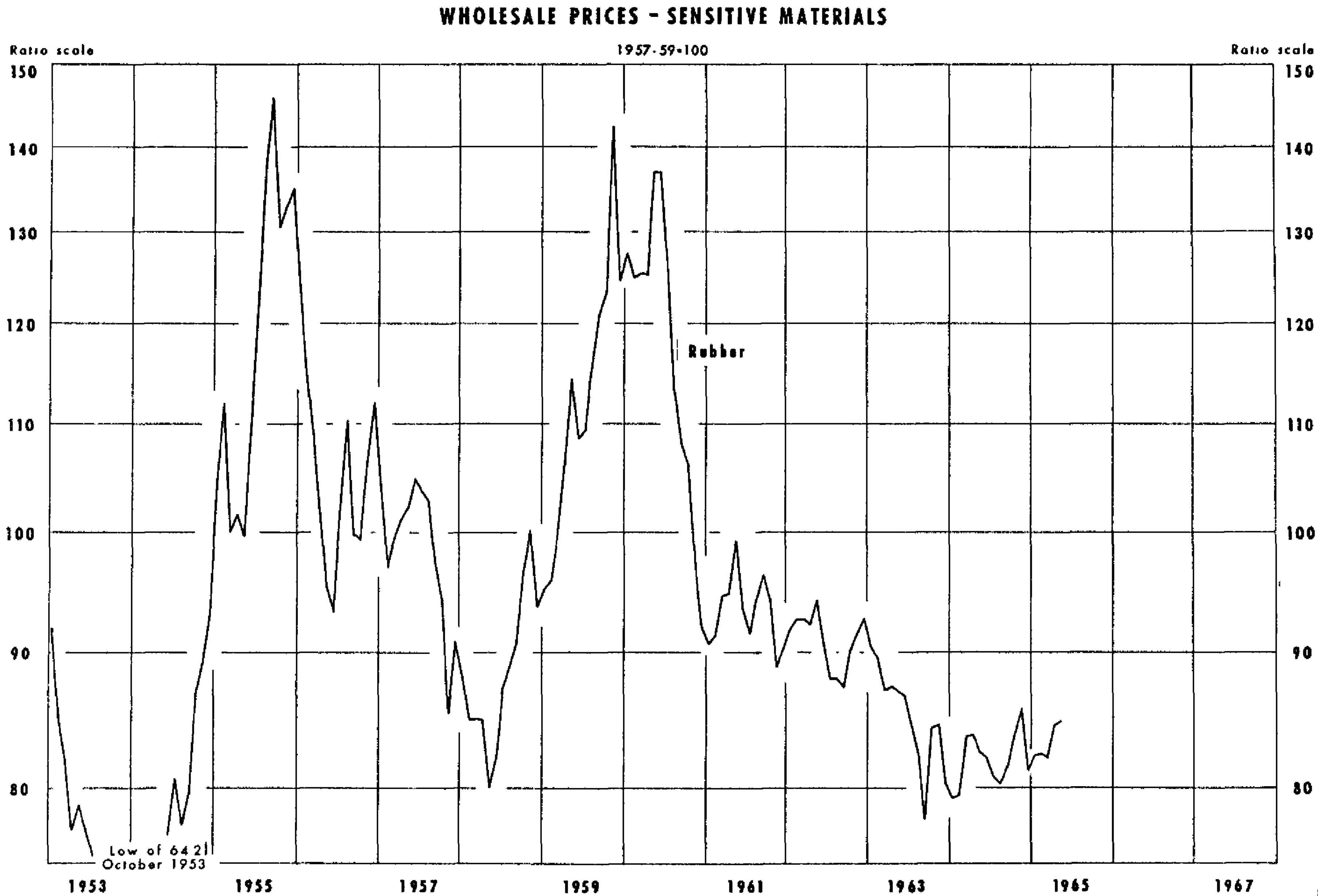
WHOLESALE PRICES - SENSITIVE MATERIALS

1957-59=100



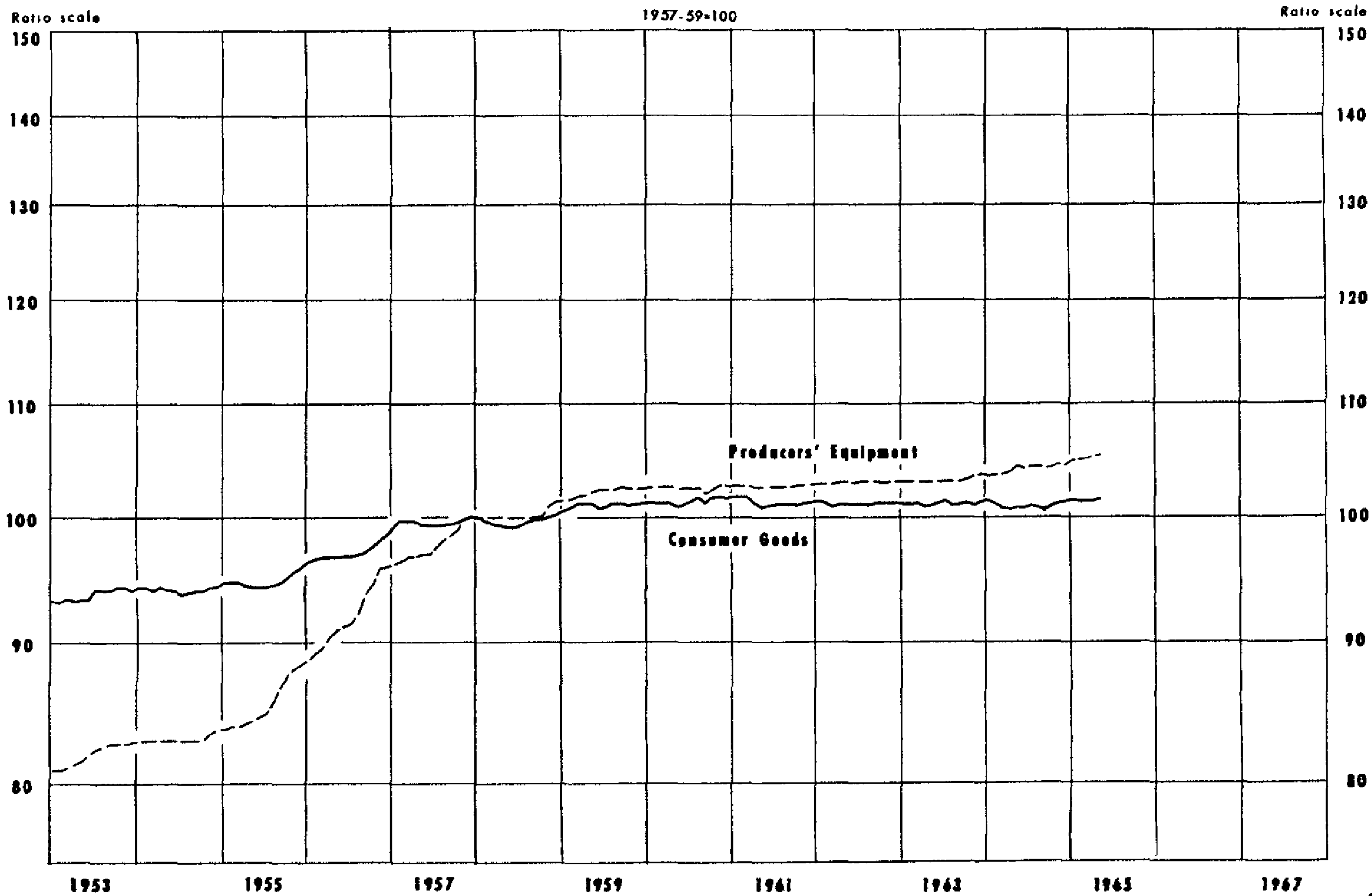
WHOLESALE PRICES - SENSITIVE MATERIALS



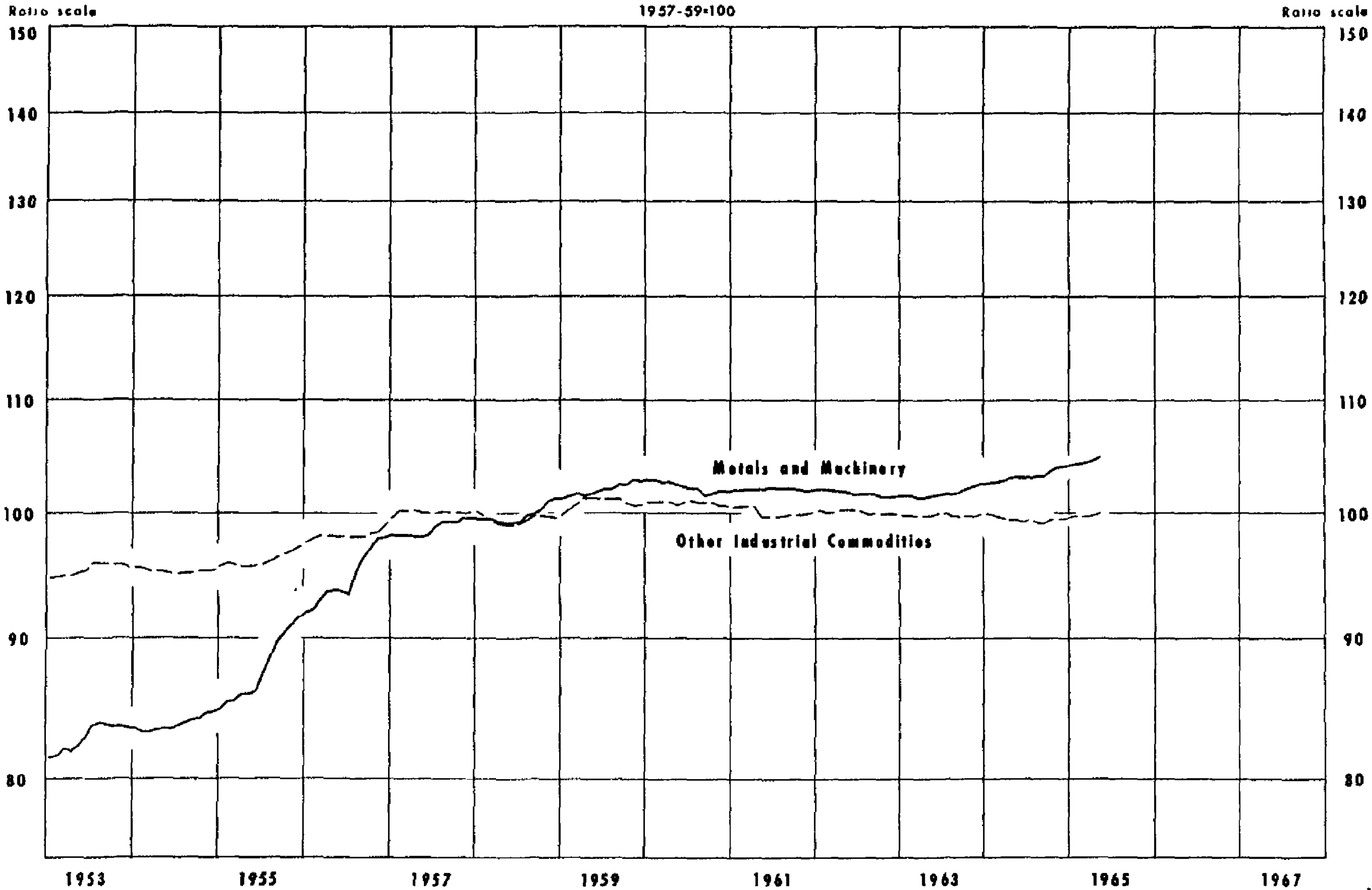


WHOLESALE PRICES - SENSITIVE MATERIALS
Ratio scale
1957-59=100
Ratio scale
150
140
130
120
110
100
90
80
Rubber
Low of 64.2
October 1953
1953
1955
1957
1959
1961
1963
1965
1967

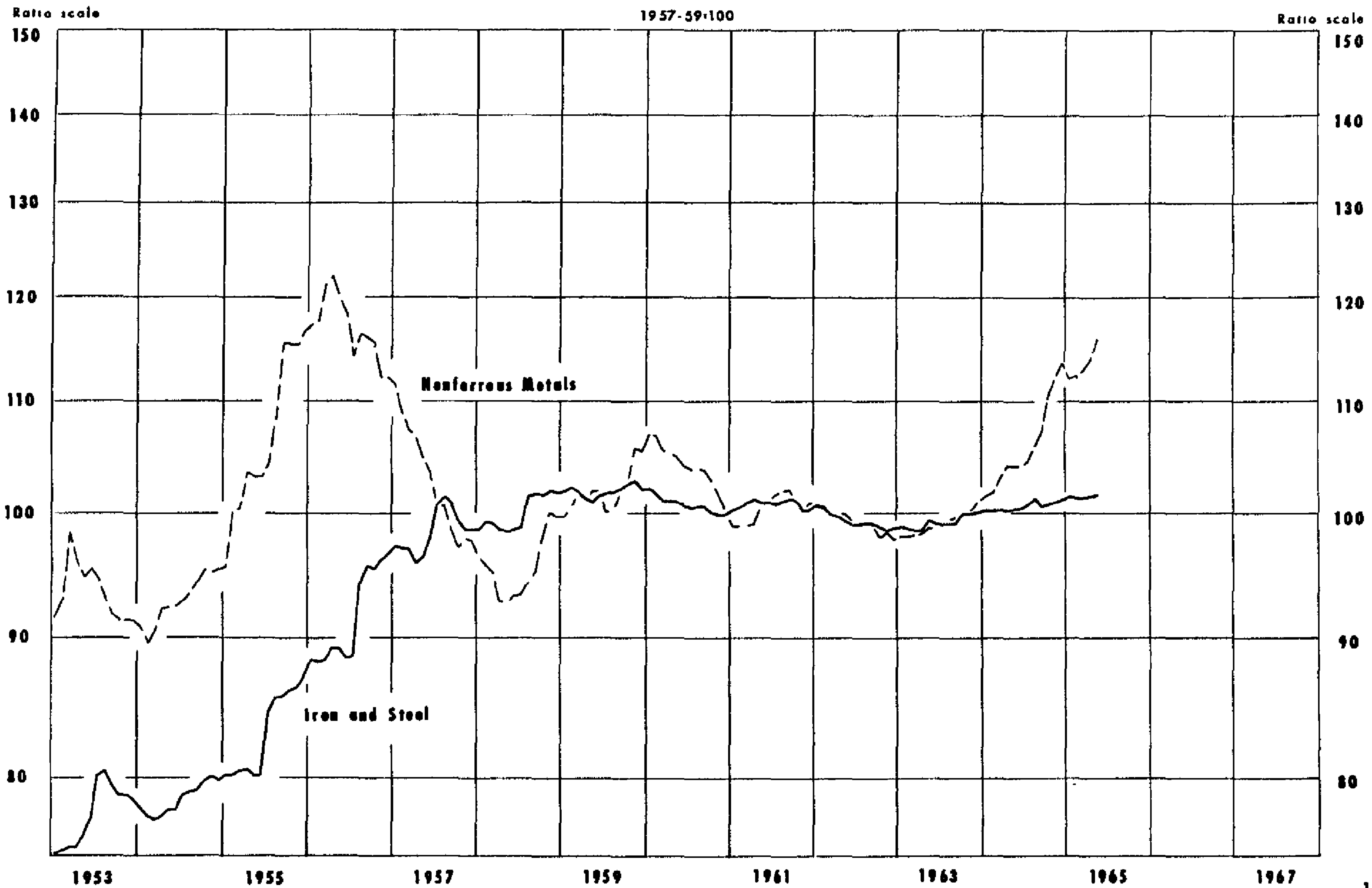
WHOLESALE PRICES - INDUSTRIAL PRODUCTS

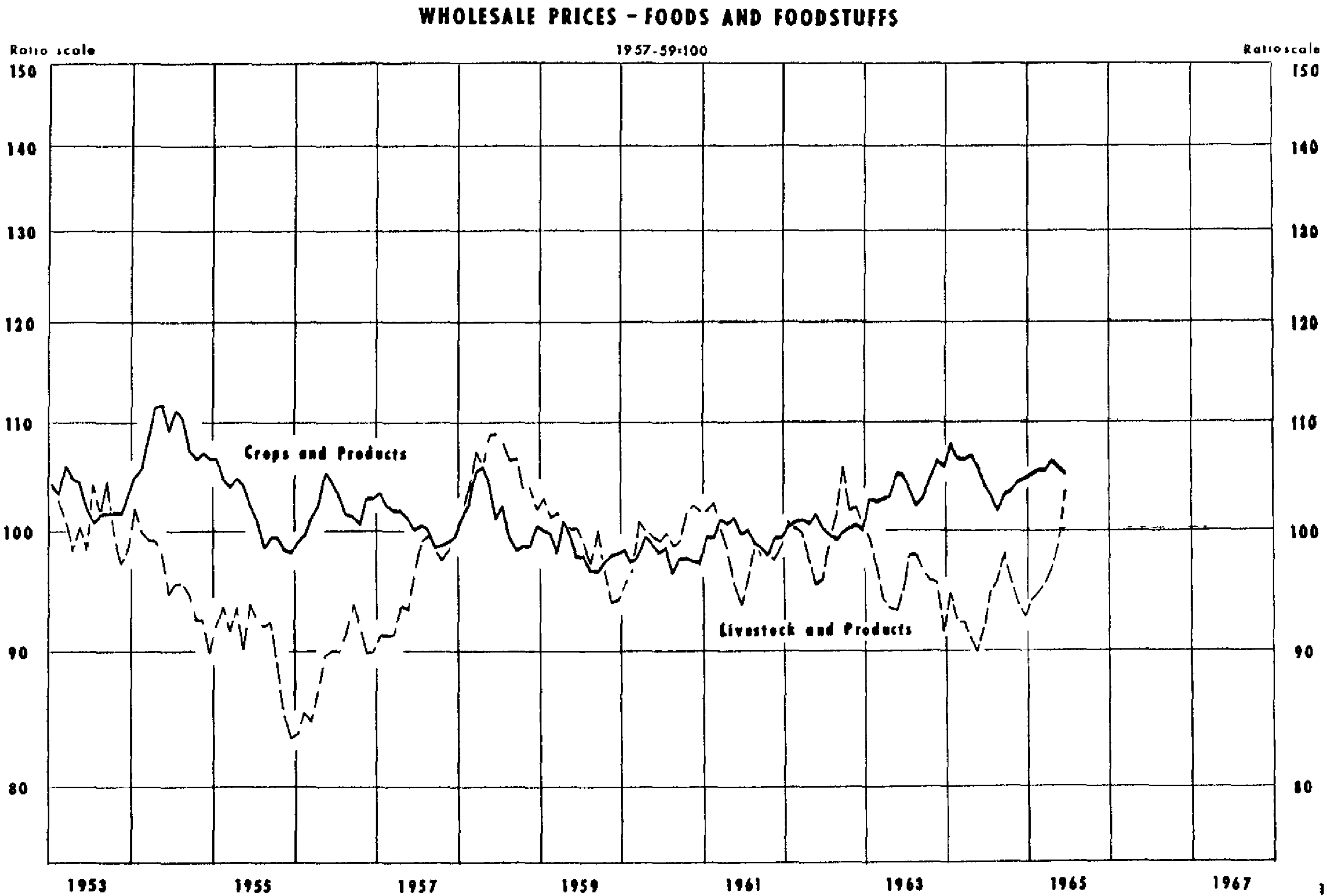


WHOLESALE PRICES



WHOLESALE PRICES




WHOLESALE PRICES - FOODS AND FOODSTUFFS
Ratio scale
1957-59=100
Ratio scale
150
140
130
120
110
100
90
80
Crops and Products
Livestock and Products
1953
1955
1957
1959
1961
1963
1965
1967