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CONFIDENTIAL (FR)

# CURRENT ECONOMIC
# and
# FINANCIAL CONDITIONS

**Prepared for the**
**Federal Open Market Committee**

*By the Staff*

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

January 26, 1966

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# CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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## SUMMARY AND OUTLOOK

### Outlook for GNP

The increase in GNP in the current quarter is expected by the Board's staff to be at least as large, and possibly larger, than the sharp rise reported for the fourth quarter of last year. Federal spending continues to be a very expansive influence. The Budget Message* suggests a sharp rise is underway in total Federal spending; on a national income basis, the rise in total spending is slated to amount to over $9 billion, annual rate, from the fourth quarter 1965 to the second quarter 1966. Less than half of the rise will be in defense spending; transfer payments (a component of personal income) and grants-in-aid are also slated to rise rapidly.

Continued rapid expansion in business fixed investment is still indicated. Incentives to invest are strong, with utilization of manufacturing capacity in December 1965 now estimated at over 91 per cent of capacity. New orders for machinery and equipment continued well above shipments in December and order backlog rose further to a level substantially above a year earlier.

Pressures for inventory accumulation also are strong, particularly in business equipment and defense industries. Despite steel inventory liquidation at a rate twice that after both the 1962 and 1963 steel settlements, business inventories were increasing in

* An analysis of the Budget will appear in the Greenbook Supplement, January 28.

the fourth quarter at a rate close to the high third quarter level. In the current quarter, with steel liquidation ending, a step-up in the rate of nonfarm inventory accumulation is likely.

Employment gains are expected to be as rapid in the current as in the fourth quarter and an anticipated large rise in wage and salary income will be supplemented by a large increase in Federal transfer payments. Thus, a sizable further gain in personal income is in prospect and, despite the boost in social security taxes, consumption expenditures may show only a moderately smaller rise than in the fourth quarter.

Resource utilization and prices

The surge in production and employment in late 1965 carried rates of resource utilization to high levels. Through most of last year manufacturing output was between 90 and 91 per cent of capacity but by December it was estimated at 91.5 per cent, the highest in a decade. The unemployment rate dropped further to 4.1 per cent in December as additions to the armed forces and increases in the number of trainees under anti-poverty programs supplemented strong private demands for labor.

As yet, pressure on resources has not been reflected in an acceleration of the rise in the industrial price index, which has continued to creep upward at an annual rate of about 1.5 per cent. Manufacturing wages have continued to rise at about the same rate as productivity and labor costs per unit of output have been slightly below the levels of the preceding two years.

In some industries, however--notably in nonferrous metals, paper, textile, and machinery--pressures on capacity are strong. Demands for these products are continuing to rise as a result of high private activity and rising defense spending.

There is likely to be a substantial drain on available manpower resources in coming months. Labor markets are already showing signs of tightening, with increased indications of anticipatory hirings and job-shifting of the type associated with industrial boom conditions. Even with an estimated growth of two million (annual rate) in the total labor force, the latest target strength for the armed forces and the prospective rapid increase in civilian employment are likely to bring the unemployment rate down to 3.5 per cent or lower by midyear. Shortages of skilled workers undoubtedly will also increase further.

Under such conditions, upward price pressures may become stronger and more pervasive than in 1965. So far, however, there has not been much upward cost and price thrust from major industries which contributed importantly to the inflations of the Korean War period and the mid-1950's.

Business credit demands

Expanded business demands for external financing from banks and security markets are likely to contribute to further upward pressures in long-term interest rates as the spring progresses. Capital expenditures on plant and equipment and inventories are expected to continue to grow more than flows of funds to corporations from undistributed profits and capital consumption allowances. Businesses anticipate spending 7 per cent more on plant and equipment in the second quarter than they spent in the fourth quarter of last year, and the rate of inventory accumulation is expected to turn up in the first part of the year. At the same time, undistributed profits will probably increase only slowly, since it seems likely that much of the rise in after-tax profits will be absorbed by higher dividend payments.

The continued squeeze on corporate financial positions is likely to manifest itself in several ways. Corporate security flotations are likely to be substantial. Moreover, business demands for bank credit will probably also remain active. Expansion in business loans was very heavy in December and appears to have been relatively strong the end of the year.

As credit demand builds, upward interest rate pressures in long-term markets are likely to become more pervasive, as businesses compete for funds in security markets and as banks undertake further portfolio adjustments. In order to accommodate business customers in a period when deposit funds are more difficult and more costly to obtain than in the past, banks may cut back on their acquisitions of municipal bonds and mortgages. In addition, they are likely to firm lending terms further, including a reduction in term loans, which will be a factor pending to enlarge business capital market demands. Such adjustments would tend to transmit existing pressures on banks to longer-term markets.

Bank deposits

Time and savings deposit growth at commercial banks has been at a reduced rate since November of last year. Although there has been some pickup in CD inflows in recent days, it does not appear likely, in the current financial environment, that time and savings deposit inflows will climb back to the high rates of last year. Regulation Q ceilings on savings deposits, the recent shortening of CD maturities at New York banks, and increased cash needs of business would all seem to work against such a development. Instead, it can be expected that net inflows of time and savings deposits may continue at, or possibly somewhat above, the pace of the past two months.

The smaller inflow since November of time and savings deposits has been offset in part by larger increases in demand deposits. Private demand deposit increased sharply in the second half of December, and Government deposits in January. Continued transactions demand for funds should contribute to further growth in private demand deposits and in the money supply.

A reduced demand for CD's and other interest-bearing bank deposits relative to demand deposits would, of course, tend to slow bank credit growth unless the Federal Reserve made deliberate efforts to offset it. The lower public demand for bank time and savings deposits reflects not only the relatively attractive rates on market securities but also apparently a reduced demand for financial assets generally in a period of rising expenditures. Under such circumstances, banks having to liquidate securities to meet loan demands may not find willing buyers at current market rates.

Balance of payments

A group of Government analysts has been meeting to consider the balance of payments outlook for 1966. One of their tentative conclusions is that little net improvement on capital account is to be expected this year, despite the impact of tightening credit conditions here and the voluntary restraint programs. Also, a rise in military expenditures abroad is likely to match net gains in investment income. Accordingly, any significant reduction in the "liquidity" deficit from last year's $1.3 billion would require a further increase in the merchandise trade surplus from the fourth quarter 1965 level. If, for example, exports were to increase by 10 per cent over the year to the fourth quarter of 1966, and imports by only 5 per cent, the 1966 deficit might be less than $1/2 billion. If, on the other hand, as seemed more likely to the group, imports and exports were each to rise about 7-1/2 per cent over the year, the deficit might be about the same in 1966 as in 1965.

Current and prospective business developments abroad carry some unfavorable and some favorable implications for U.S. trade. Taking one of the unfavorable elements first, it is increasingly evident that the steady and rapid rise in British prices and costs will necessitate additional actions this year to restrain the growth of demand in Britain. Since Britain is the world's second largest international trader, U.S. exports would not escape the direct and indirect effects of such actions.

On the favorable side, the upswings in domestic activity that got under way in Italy and France in 1965 have been continuing. In both countries imports have already risen appreciably and are expected to go on rising. A rise in Japanese imports seems also to be developing. In Germany, aggregate demand from domestic and foreign sources has continued to press on available resources, and there are no signs yet of slackening in the rapid rise of German imports. The Canadian economy, and Canadian imports, are booming. It is clear that expansionary influences on world trade will predominate, and opportunities will be open for rapid expansion of U.S. exports.

The question is whether pressures of domestic demand will limit export growth and boost imports so much as to prevent a net balance of payments gain. In the fourth quarter of 1965, imports approached 3.3 per cent of GNP, the highest ratio since late 1959, as a result of marked expansion in imports both of industrial supplies and of finished manufactures. A net payments gain in 1966 seems to require that imports now advance a little less rapidly than GNP, with the ratio between the two subsiding towards the average 1965 level of 3.1 per cent.

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.) | Dec'65 | 76.5 | 76.1 | 74.7 | 2.4 | 4.3 |
| Unemployment (mil.) | " | 3.1 | 3.2 | 3.7 | -15.7 | -22.9 |
| Unemployment (per cent) | " | 4.1 | 4.2 | 5.0 | -- | -- |
| Nonfarm employment, payroll (mil.) | " | 61.8 | 61.4 | 59.2 | 4.5 | 8.0 |
| Manufacturing | " | 18.4 | 18.3 | 17.6 | 4.9 | 7.9 |
| Other industrial | " | 8.1 | 8.0 | 7.8 | 3.7 | 7.5 |
| Nonindustrial | " | 35.3 | 35.1 | 33.8 | 4.4 | 8.2 |
| Industrial production (57-59=100) | " | 148.3 | 146.3 | 138.1 | 7.4 | 16.8 |
| Final products | " | 148.1 | 147.3 | 138.1 | 7.2 | 15.7 |
| Materials | " | 148.6 | 145.8 | 138.0 | 7.7 | 18.0 |
| Wholesale prices (57-59=100)1/ | " | 104.1 | 103.5 | 100.7 | 3.4 | 3.8 |
| Industrial commodities | " | 102.8 | 102.7 | 101.4 | 1.4 | 2.0 |
| Sensitive materials | " | 103.2 | 103.4 | 101.2 | 2.0 | 5.6 |
| Farm products and foods | " | 106.5 | 104.3 | 97.2 | 9.6 | 9.6 |
| Consumer prices (57-59=100)1/ | Nov'65 | 110.6 | 110.4 | 108.7 | 1.7 | 3.0 |
| Commodities except food | " | 105.6 | 105.3 | 104.8 | 0.8 | 1.1 |
| Food | " | 109.7 | 109.7 | 106.8 | 2.7 | 4.4 |
| Services | " | 119.0 | 118.7 | 116.0 | 2.6 | 4.5 |
| Hourly earnings, mfg. ($) | Dec'65 | 2.65 | 2.65 | 2.57 | 3.1 | 6.0 |
| Weekly earnings, mfg. ($) | " | 109.50 | 109.71 | 105.70 | 3.6 | 8.1 |
| Personal income ($ bil.)2/ | " | 550.5 | 546.1 | 512.0 | 7.5 | 15.0 |
| Retail sales, total ($ bil.) | " | 24.3 | 24.0 | 22.8 | 6.7 | 15.6 |
| Autos (million units)2/ | " | 8.5 | 9.0 | 8.5 | -0.6 | 10.9 |
| GAF ($ bil.) | " | 5.5 | 5.6 | 5.2 | 6.2 | 16.5 |
| Selected leading indicators: | | | | | | |
| Housing starts, pvt. (thous.)2/ | " | 1,746 | 1,537 | 1,610 | 8.4 | 11.9 |
| Factory workweek (hours) | " | 41.4 | 41.4 | 41.2 | 0.5 | 2.0 |
| New orders, dur. goods ($ bil.) | " | 22.5 | 22.4 | 20.7 | 8.6 | 25.2 |
| New orders, nonel. mach. ($ bil.) | " | 3.3 | 3.4 | 3.1 | 5.6 | 19.4 |
| Common stock prices (1941-43=10)1/ | " | 91.73 | 92.15 | 83.96 | 9.3 | 23.7 |
| Inventories, book val. ($ bil.) | Nov'65 | 118.3 | 117.7 | 109.3 | 8.2 | 13.2 |
| Gross national product ($ bil.)2/ | QIV'65 | 694.6 | 681.5 | 641.1 | 8.3 | 15.1 |
| Real GNP ($ bil., 1958 prices)2/ | " | 621.7 | 613.0 | 584.7 | 6.3 | 11.0 |

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

SELECTED DOMESTIC FINANCIAL DATA

| | Week ended Jan. 21 | Four-Week Average | Last six months High | Last six months Low |
|---|---|---|---|---|
| Money Market 1/ (N.S.A.) | | | | |
| Federal funds rate (per cent) | 3.55 | 4.34 | 4.63 | 1.00 |
| U.S. Treas. bills, 3-mo., yield (per cent) | 4.61 | 4.55 | 4.63 | 3.80 |
| Net free reserves 2/ (mil. $) | -21 | -62 | 100 | -246 |
| Member bank borrowings 2/ (mil. $) | 218 | 479 | 627 | 218 |
| Security Markets (N.S.A.) | | | | |
| Market yields 1/ (per cent) | | | | |
| 5-year U.S. Treas. bonds | 4.82 | 4.83 | 4.89 | 4.14 |
| 20-year U.S. Treas. bonds | 4.50 | 4.50 | 4.52 | 4.20 |
| Corporate new bond issues, Aaa | 4.84 | 4.85 | 4.89 | 4.56 |
| Corporate seasoned bonds, Aaa | 4.74 | 4.74 | 4.74 | 4.51 |
| Municipal seasoned bonds, Aaa | 3.39 | 3.40 | 3.40 | 3.15 |
| FHA home mortgages, 30-year 3/ | 5.62 | 5.62 | 5.62 | 5.44 |
| Common stocks S&P composite index 4/ | | | | |
| Prices, closing (1941-43=10) | 93.65 | 92.90 | 93.95 | 83.85 |
| Dividend yield (per cent) | 3.01 | 3.03 | 3.11 | 2.88 |

| | Change in Dec. | Average change last 3 mos. | Annual rate of change (%) 3 mos. | Annual rate of change (%) 1 year |
|---|---|---|---|---|
| Banking (S.A., mil. $) | | | | |
| Total reserves | 333 | 115 | 6.3 | 5.1 |
| Bank loans and investments: | | | | |
| Total | 2,500 | 2,400 | 10.9 | 10.0 |
| Business loans | 1,400 | 900 | 15.5 | 19.4 |
| Other loans | 600 | 1,000 | 10.1 | 10.2 |
| U.S. Government securities | 0 | 400 | 7.8 | -6.2 |
| Other securities | 500 | 400 | 10.1 | 15.2 |
| Money and liquid assets: | | | | |
| Demand dep. & currency | 1,700 | 1,000 | 7.5 | 4.8 |
| Time and savings dep. | 1,500 | 1,800 | 15.3 | 16.1 |
| Nonbank liquid assets | 600 | 1,200 | 5.6 | 6.2 |

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending January 19.
3/ Latest figure indicated is for month of December. 4/ Data are for weekly closing prices.

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

| | 1965 | | | | | | 1964 | |
|---|---|---|---|---|---|---|---|---|
| | Dec. | Nov. | Oct. | QIII | QII | QI | QIV | Year (billions) |
| | Seasonally adjusted | | | | | | | |
| Current account balance | | | | 1,615 | 1,705 | 1,284 | 2,005 | 7.7 |
| Trade balance 1/ | | 470 | 460 | 1,285 | 1,279 | 923 | 1,789 | 6.7 |
| Exports 1/ | | 2,370 | 2,320 | 6,806 | 6,748 | 5,586 | 6,690 | 25.3 |
| Imports 1/ 2/ | | -1,900 | -1,860 | -5,521 | -5,469 | -4,663 | -4,901 | -18.6 |
| Services, etc., net | | | | 330 | 426 | 361 | 216 | 1.0 |
| Capital account balance (regular transactions) | | | | -1,975 | -1,528 | -2,070 | -3,126 | -9.7 |
| Govt. grants & capital 3/ | | | | -943 | -974 | -803 | -1,014 | -3.6 |
| U.S. private direct investment | | | | -515 | -891 | -1,159 | -821 | -2.4 |
| U.S. priv. long-term portfolio | | | | -356 | 100 | -679 | -833 | -2.0 |
| U.S. priv. short-term | | | | 49 | 424 | 297 | -568 | -2.1 |
| Foreign nonliquid | | | | -210 | -187 | 274 | 110 | 0.4 |
| Errors and omissions | | | | -284 | -77 | -3 | -430 | -1.2 |
| | Balances, with and without seasonal adjustment (- = deficit) | | | | | | | |
| Bal. on regular transactions, S.A. | | | | -644 | 100 | -789 | -1,551 | -3.1 |
| Seasonal component | | | | -490 | -42 | 529 | -3 | -- |
| Balance, N.S.A. | 2 | -91 | -319 | -1,134 | 58 | -260 | -1,554 | -3.1 |
| Liquidity bal., S.A. | | | | -491 | 242 | -709 | -1,366 | -2.8 |
| Seasonal component | | | | -490 | -42 | 529 | -3 | -- |
| Balance, N.S.A. 4/ | 87 | -16 | -319 | -981 | 200 | -180 | -1,369 | -2.8 |
| Official settlements bal., S.A. | | | | 259 | 207 | -643 | -782 | -1.2 |
| Seasonal component | | | | -552 | -166 | 661 | 35 | -- |
| Balance, N.S.A. 5/ | | -351 | -98 | -293 | 41 | 18 | -747 | -1.2 |
| Memo items: | | | | | | | | |
| Monetary reserves (decrease -) | -101 | -91 | -82 | -40 | -68 | -842 | 151 | -.2 |
| Gold purchases or sales (-) | -72 | -58 | 12 | -124 | -590 | -832 | -172 | -.1 |

1/ Balance of payments basis which differs a little from Census basis.
2/ Figures for October-November tentatively adjusted for changes in carry-over of import documents. Third-quarter imports not adjusted by months.
3/ Net of associated liabilities and of scheduled loan repayments.
4/ Differs from balance on regular transactions by counting as receipts (+) debt prepayments, advances on military exports, and net sales of non-convertible Roosa bonds.
5/ Differs from liquidity balance by counting as receipts (+) increase in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increase in certain nonliquid liabilities to foreign official institutions.

# THE ECONOMIC PICTURE IN DETAIL

## The Nonfinancial Scene

Gross national product. GNP is now estimated by Commerce at a seasonally adjusted annual rate of $694.6 billion for the fourth quarter, up $13 billion from the third quarter. The Board's staff is now projecting a further rise of over $14 billion to $709 billion for the first quarter.

This slight acceleration in the rise in GNP now projected for the current quarter, however, may prove to be illusory if the fourth quarter figures are revised up moderately. The present official fourth quarter estimate is based on incomplete or preliminary monthly figures, and new evidence has already become available suggesting that a few major components -- and possibly the total -- may be subject to moderate upward revision. For one thing, the recently announced sharp -- and probably temporary -- spurt in housing starts in December will raise the residential construction activity estimate. For another thing, given the large rise in personal income now shown for the quarter, the estimate for consumption expenditures may be too low. (In the present consumption estimate preliminary retail sales figures have been used, pending an imminent revision by Census of recent monthly figures on the basis of a broadened and up-dated sample.) Finally, business inventory accumulation on a book value basis in October and November (preliminary) slightly exceeded the third quarter rate, and this suggests that the present estimate of nonfarm business inventory accumulation is too low for the fourth quarter.

In the current quarter, the Federal government continues to be a strongly expansive force. On the basis of fiscal year Budget estimates, Federal defense spending is now estimated at $54.5 billion, annual rate, $1.8 billion higher than the staff projected three weeks ago, and total Federal purchases show almost as much rise in the current quarter ($2.8 billion) as in the fourth quarter ($3.2 billion) when they were augmented by the military and civilian pay raises.

The large rise in business fixed investment projected for the quarter is in line with findings of the latest Commerce-SEC survey. The first quarter level of business fixed investment represents 10.6 per cent of GNP, up from 10.2 per cent a year ago, and as high as at the peak of the 1956-57 investment boom. In the 1956-57 period, the high rate of business fixed investment proved to be unsustainable, but at the present time and in view of increased defense needs, the immediate prospect is for further expansion in business investment. The rise in residential construction activity results from the unexpected upturn in housing starts in late 1965. In view of the especially favorable weather conditions the sharp December rise in housing starts will probably prove to be temporary. The general outlook for residential construction activity continues to be one of relative stability at the reduced rates reached in the latter part of 1965.

A rise in nonfarm business inventory accumulation is posited on the assumption that the rate of accumulation was limited by steel liquidation in the fourth quarter and that this liquidation will end in the current quarter. Apart from steel, business inventory accumulation has been running at a relatively high rate -- pressures for accumulation are particularly strong in business equipment and defense industries in the durable goods sector.

Perhaps the only moderating influence from the demand side in the current quarter may be the large boost in social security taxes and its effect on limiting the rise in personal income and possibly consumption expenditures. Disposable personal income is projected to rise about $2.5 billion less in the current quarter than in the fourth quarter, and with the spending rate likely to hold close to the fourth quarter rate (94.3 as compared with 94.2) consumption expenditures are expected to rise somewhat less in the current quarter. But if personal income, as in the fourth quarter, continues to be more strongly expansive than originally estimated and also if renewed escalation of war in Vietnam tends to stimulate consumer buying propensities, we may now be underestimating possible consumption expenditures in the current quarter.

In real terms, projected first quarter GNP is 5.7 per cent above a year ago. This would moderately exceed the rapid rate of growth for the year 1965.

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

| | 1964 | 1965 1/ | 1965 I | 1965 II | 1965 III | 1965 IV 1/ | 1966 I Proj. |
|---|---|---|---|---|---|---|---|
| Gross National Product | 628.7 | 675.6 | 657.6 | 668.8 | 681.5 | 694.6 | 709.0 |
| | | | | | | | |
| Personal consumption expenditures | 398.9 | 428.5 | 416.9 | 424.5 | 432.5 | 440.1 | 446.7 |
| Durable goods | 58.7 | 64.8 | 64.6 | 63.5 | 65.4 | 65.7 | 66.0 |
| Nondurable goods | 177.5 | 189.0 | 182.8 | 187.9 | 190.5 | 194.8 | 198.3 |
| Services | 162.6 | 174.7 | 169.5 | 173.1 | 176.7 | 179.6 | 182.4 |
| | | | | | | | |
| Gross private domestic investment | 92.9 | 104.9 | 103.4 | 102.8 | 106.2 | 107.5 | 110.6 |
| Residential construction | 27.5 | 27.6 | 27.7 | 28.0 | 27.7 | 27.2 | 27.9 |
| Business fixed investment | 60.5 | 69.8 | 66.9 | 68.4 | 70.9 | 73.2 | 75.2 |
| Change in business inventories | 4.8 | 7.4 | 8.8 | 6.4 | 7.6 | 7.0 | 7.3 |
| Nonfarm | 5.4 | 7.1 | 9.2 | 6.6 | 7.0 | 5.8 | 6.5 |
| | | | | | | | |
| Net exports | 8.6 | 7.2 | 6.0 | 8.0 | 7.4 | 7.4 | 7.9 |
| | | | | | | | |
| Gov. purchases of goods and services | 128.4 | 135.0 | 131.3 | 133.5 | 135.4 | 139.6 | 143.8 |
| Federal | 65.3 | 66.7 | 64.9 | 65.7 | 66.5 | 69.7 | 72.5 |
| Defense | 49.9 | 49.9 | 48.8 | 49.2 | 49.8 | 52.0 | 54.5 |
| Other | 15.4 | 16.8 | 16.1 | 16.5 | 16.7 | 17.7 | 18.0 |
| State and local | 63.1 | 68.2 | 66.4 | 67.8 | 68.9 | 69.9 | 71.3 |
| | | | | | | | |
| Gross National Product in Constant (1958) Dollars | 577.6 | 609.0 | 597.7 | 603.5 | 613.0 | 621.7 | 631.6 |
| | | | | | | | |
| Personal income | 495.0 | 530.7 | 516.2 | 524.7 | 536.0 | 546.0 | 554.0 |
| Wages and salaries | 333.5 | 357.4 | 348.9 | 353.6 | 359.0 | 368.1 | 375.7 |
| | | | | | | | |
| Farm income | 12.0 | 14.3 | 12.0 | 14.5 | 15.0 | 15.5 | 15.5 |
| Personal contributions for social insurance (deduction) | 12.4 | 13.2 | 12.9 | 13.0 | 13.3 | 13.6 | 16.6 |
| | | | | | | | |
| Disposable personal income | 435.8 | 465.3 | 451.4 | 458.5 | 471.2 | 480.3 | 487.0 |
| Personal saving | 26.3 | 25.1 | 23.3 | 22.4 | 26.8 | 28.0 | 27.9 |
| Saving rate (per cent) | 6.0 | 5.4 | 5.2 | 4.9 | 5.7 | 5.8 | 5.7 |
| | | | | | | | |
| Total labor force (millions) | 77.0 | 78.4 | 77.7 | 78.2 | 78.5 | 78.9 | 79.5 |
| Armed forces " | 2.7 | 2.7 | 2.7 | 2.7 | 2.7 | 2.8 | 2.9 |
| Civilian labor force " | 74.2 | 75.6 | 75.0 | 75.5 | 75.8 | 76.1 | 76.6 |
| Employed " | 70.4 | 72.2 | 71.3 | 71.9 | 72.4 | 72.9 | 73.7 |
| Unemployed " | 3.9 | 3.5 | 3.6 | 3.6 | 3.4 | 3.2 | 2.9 |
| | | | | | | | |
| Unemployment rate (per cent) | 5.2 | 4.6 | 4.8 | 4.7 | 4.4 | 4.2 | 3.8 |

1/ Income and product figures are Department of Commerce preliminary estimates.

Industrial production. In December, industrial production rose to 148.3 per cent of the 1957-59 average, 1.4 per cent above November and 7.4 per cent above a year earlier. For the year as a whole the index was 8 per cent above 1964. The large December rise in output reflected primarily a sharp increase in production of industrial materials, up 2 per cent. Output of final products rose one-half per cent.

Auto assemblies were maintained at an annual rate of 9.3 million units, and in January, production continued at the same advanced rate. Output of most other consumer goods-appliances, television sets, furniture, and staples -- continued to expand in December. Production of aircraft and commercial and defense equipment rose further and output of industrial and farm machinery, as well as trucks, was maintained at record levels.

Iron and steel output rose more than 5 per cent in December from the November low, but was still about 15 per cent below the levels of last spring and summer. In January, steel ingot production increased further. By the end of November, inventories of steel mill products at manufacturing consumers had declined 17 per cent from the August peak and totaled 14.2 million tons -- equivalent to about a 2-1/2 months' supply at 1965 consumption rates. In December, production of most other materials, both durable and nondurable, also advanced.

The increase in industrial production since last September, when output declined due to the sharp curtailment in steel production and strikes in several industries, has been large and at a rate usually associated with the early phase of recovery from a recession low. The total index rose 3.3 per cent in the final three months and the total excluding steel rose 3.7 per cent, to a level 8.5 per cent above December 1964.

Retail sales. Retail sales rose 1 per cent in December after showing little change in November and data for the first two weeks of January suggest a further rise this month. Both durable and nondurable goods have shared in the recent rise, with durables showing the largest increase.

Despite a moderate decline in unit sales of autos, dollar sales of auto dealers were up in December and total durable goods store sales rose 2 per cent to exceed the previous high reached last February. December sales of auto dealers were still 4 per cent below the record February 1965 level, while all other durable goods combined were up 10 per cent.

The small rise in nondurable goods sales in December reflected mainly a pronounced gain at food stores as most other lines showed little change or declined somewhat. December nondurable goods sales were up 5-1/2 per cent from last February.

Unit sales of domestic autos in the first 20 days of January were well above a month earlier, and even somewhat exceeded the very high rate a year ago. The seasonally adjusted annual rate for the month as a whole may be close to the record 9.6 million units set a year ago, when sales were raised sharply by backlog demand following auto strikes.

Consumer credit. Demands for consumer credit continued strong in December, according to a preliminary tabulation of commercial bank data and scattered reports for other lenders. At commercial banks, instalment debt outstanding increased sharply further by about $325 million, following the large rise of $353 million in November.

Borrowing to buy new cars slackened a bit at the banks in December, but this probably reflected the slight downturn in new car sales rather than any unseasonable shift from credit to cash purchases. The volume of auto credit also depends on the size of the contract, but here changes from one month to the next are usually small. Over a longer period, however, the average size of auto contracts has been creeping up by about $50 to $100 a year.

The seasonally adjusted increase in total instalment debt in December probably amounted to about $675 million, about the same increase as in November. Such a pace would result in a fourth quarter rate of rise about in line with the third quarter but down a little from earlier in the year.

Delinquency rates on consumer loans made by commercial banks, as reported by the ABA, have shown a slight but persistent updrift during most of the past year. Nonetheless in perspective, the rates are still not high: 1 per cent for direct auto loans and well under 2 per cent for most other types of loans.

Orders for durable goods. New orders for durable goods in December remained at the record October-November level, while shipments edged up further and the backlog of unfilled orders continued to expand. The ratio of unfilled orders to shipments at 2.84, was unchanged from the two preceding months but was up from 2.62 a year earlier.

New orders for defense products receded further from the exceptionally high September-October level and about equalled shipments, so that unfilled orders were unchanged. However, the defense order backlog has increased 13 per cent since mid-1965 and 22 per cent over the past year, as compared with increases in shipments of 4 and 9 per cent, respectively.

New orders for steel increased substantially further in December, moderately exceeding shipments, which also rose, and unfilled orders showed a small pick-up following 9 months of decline. New orders for machinery and equipment were about unchanged and well above shipments, and the order backlog showed a sizable further rise to a level 18 per cent above a year earlier; shipments rose about 10 per cent over the year.

Business inventories. Overall inventory accumulation in the fourth quarter appears to have been about as large as in the third quarter despite the rapid liquidation of steel stocks. The November increase in book value of business inventories was about as large as in October and the two months' average slightly exceeded the third quarter rate. Accumulation by durable goods manufacturers was down from the high third quarter rate, but rising inventory requirements for business equipment and defense industries kept overall durable goods accumulation unexpectedly large. Nondurable goods stocks rose much more rapidly than in the third quarter. Trade inventory accumulation in October and November was stepped-up considerably from the unusually low third quarter rate although it was down sharply from the pace in the first half of the year when auto inventory accumulation was especially large.

MONTHLY AVERAGE CHANGE IN BOOK VALUE
OF BUSINESS INVENTORIES
(Seasonally adjusted; millions of dollars)

| | 1965 | | |
|---|---|---|---|
| | First half | Third quarter | Oct.-Nov. |
| TOTAL | 752 | 639 | 665 |
| Manufacturing | 280 | 547 | 406 |
| Durable goods | 257 | 450 | 254 |
| Nondurable goods | 24 | 98 | 153 |
| Wholesale & retail trade | 472 | 92 | 259 |

Residential construction. Seasonally adjusted housing starts rose sharply further in December to a rate nearly a fourth above the reduced October level. The fourth quarter average was the highest of the year. Even so, the total for the year, 1.5 million, was down 3 per cent from 1964, the same amount as from 1963 to 1964.

The further rise in starts in December may have reflected, in part at least, more than usual difficulties of seasonal and other statistical measurement. By region, there was no consistent pattern in the movement of starts even in terms of direction of change. Much of the rise was concentrated in the North Central states, which benefited from exceptionally favorable weather conditions. While seasonally adjusted starts also continued to increase in the South, they declined in the North East and reached a new low for recent years in the West.

Building permits also rose in December. (Partly because of an adjustment for working days, this series is somewhat less volatile than starts.) All types of structures shared in the increase, but, as in the case of starts, regional differences were marked.

PRIVATE HOUSING STARTS AND PERMITS

| | December 1/ (thousands of units) | Per cent change from: Month ago | Year ago |
|---|---|---|---|
| Starts (total) | 1,746 | +14 | + 8 |
| Permits (total) | 1,319 | + 3 | +10 |
| 1- family | 745 | + 1 | + 3 |
| 2-or-more family | 574 | + 5 | +21 |
| North East | 232 | -18 | - 6 |
| North Central | 432 | +41 | +57 |
| South | 447 | +11 | +19 |
| West | 208 | -28 | -30 |

1/ Seasonally adjusted annual rate; preliminary.

Personal income. Personal income in December increased $4.4 billion to a seasonally adjusted annual rate of $550.5 billion, a level $38.5 billion or 7.5 per cent above a year earlier.

The December increase was centered in wage and salaries which rose sharply, mainly because of higher employment. The December payroll rise -- $3 billion -- although not quite so large as in the two preceding months, was much larger than in any earlier month of 1965.

For 1965 as a whole, personal income totaled $530.7 billion, 7.2 per cent more than in 1964. Wage and salary disbursements also increased 7.2 per cent, with manufacturing payrolls up 7.7 per cent. Transfer payments rose $2.6 billion, or 7.1 per cent, with about half of the rise resulting from liberalization of old-age and survivors insurance benefits. Farm income rose exceptionally sharply -- by $2.3 billion, or 19 per cent -- mainly because of higher prices for hogs and cattle and for some field crops and vegetables.

Employment and labor force. Expansion in nonfarm employment in December, as in November, was very large -- about double the amount in earlier months in 1965. Confirmation of the sharp acceleration in demands for workers at year-end was apparent in almost all labor market data. Total employment from the household survey showed an average increase of 450,000 per month in the two-month period, while nonfarm establishment employment averaged 400,000 higher. The sharp expansion in labor force, the decline in unemployment of primary workers, record help-wanted advertising and rising turnover in manufacturing, also indicate a sharp step-up in manpower demands and a growing stringency in labor supply.

In part, recent high demands reflect the addition of growing defense activity to already rising consumer and business outlays. However, with gains in employment so large and widespread among industries, some anticipatory hiring also may have been taking place, to assure that adequate labor will be on hand to meet expected further increases in private and defense output. Changed expectations may be seen in the shift in employers' attitudes toward hiring and paying the additional costs for new workers. Earlier, employers resisted adding inexperienced workers because of possible future layoffs, high built-in fringe benefits and training expenses -- in many instances, the workweek was extended to limit new additions to the work force. Now, employers' efforts seem to be directed toward hiring new workers about as rapidly as they become available.

CHANGES IN NONFARM EMPLOYMENT, 1965
(Seasonally adjusted, thousands of persons)

| Industry | Average Monthly Change, 1965 | | | |
|---|---|---|---|---|
| | July & Aug. | Sept. & Oct. | Nov. & Dec. | Year |
| Total nonfarm 1/ | 166 | 190 | 398 | 188 |
| Manufacturing | 65 | 46 | 133 | 60 |
| Durables | 66 | 24 | 88 | 47 |
| Nondurables | 0 | 22 | 45 | 13 |
| | | | | |
| Nonmanufacturing 1/ | 101 | 145 | 266 | 128 |
| Construction | - 3 | 6 | 91 | 13 |
| Trade | 10 | 42 | 62 | 37 |
| Finance & service | 51 | 45 | 42 | 34 |
| Government | 36 | 43 | 63 | 36 |
| Federal | 12 | 4 | 12 | 1 |
| State and local | 24 | 40 | 51 | 35 |

1/ Employment in mining, transportation and public utilities which changed little are not shown separately.

An important feature of the November-December employment rise was its wide dispersion among industries. The magnitude of some increases may represent especially favorable weather conditions or unusual seasonal holiday requirements coinciding with the availability of a large number of part-time workers. But the widespread nature of the expansion in employment suggests that rising output and expectations of possible future labor shortages were also important influences. Highlighting the sharp overall rise was a sizable gain in construction employment following a period of relative stability during most of 1965. Trade and Government employment also rose more rapidly than earlier, while services maintained high rates of increase.

In manufacturing, gains were general but notable increases occurred in rubber, chemicals, textiles, apparel and food -- industries which had shown little change after the first quarter of 1965. Even though steel employment was reduced because of inventory liquidation in November and December, total durable goods employment increased faster than at any time since the first quarter of 1965 and was well above the average monthly increase for the year. The workweek was maintained at the postwar high level of 41.4 hours.

LABOR TURNOVER IN MANUFACTURING
(Rate per 1,000 employees, seasonally adjusted)

| | Accessions | | Voluntary quits | Layoffs |
|---|---|---|---|---|
| | Total | New hires | | |
| 1965, November | 50 | 37 | 22 | 12 |
| 1964 " | 41 | 28 | 15 | 15 |
| 1959 " | 42 | 24 | 15 | 25 |
| 1956 " | 43 | 28 | 19 | 16 |
| 1951 " | 53 | 38 | 26 | 18 |

A positive test of heightened pressure in the labor market is a high and rising rate of factory turnover, especially voluntary quit rates. The pull of increased job openings at higher grades and better pay tends to lift the rate of quits among employees, while for employers it implies increased hiring of employed workers in occupational categories which may not be readily found among the unemployed or new entrants. These indicators of manpower demands are close to those experienced during the Korean War.

In November (latest data available) voluntary quits jumped to 22 per 1,000, well above last year and most earlier expansionary periods and only moderately below 1951 rates. At the same time, layoff rates, as might be expected, have declined -- to even lower rates than in the early 1950's. Meanwhile hiring rates have increased substantially both to expand employment and offset voluntary and involuntary separations. Rising quit rates have two major effects: on the one hand, it increases mobility and affords more efficient utlization of available skills; on the other, it represents increased pressure on wages as employers attempt to prevent employees from quitting, or to induce other workers to leave their current jobs.

Most of the increase in employment in the past two months has come from the larger-than-expected influx of youth and women into the labor force in response to expanded demands. The 900,000 rise in total employment and the 80,000 additions to the armed forces in November and December were accounted for by an increase of more than 800,000 in the labor force and a reduction in unemployment of 150,000.

The overall unemployment rate in December was down to 4.1 per cent with the rate for adult men falling to 2.3 per cent and for married men to 1.8 per cent. Thus, although the overall unemployment rate is now about the same as in the expansion period of 1956 and early 1957, the increased demand for experienced workers has brought the rates for adult men down to about the levels in the Korean period of early 1952 -- the overall rate then was about 3 per cent. The greater number of young people who are in the labor force currently, many of whom are apparently having difficulty finding jobs because of inexperience, account for most of the difference in the two periods. In addition, the build-up of the armed forces was larger and more rapid in the earlier period -- about 1-3/4 million men were added to the armed forces within one year after the outbreak of hostilities resulting in a sharp drop in unemployment among youth. The armed forces had a strength of almost 3.7 million at the Korean peak in the spring of 1952.

In August of 1965, the planned size of the armed forces was increased by over 300,000 to 2,980,000. By December more than 150,000 men had been added to existing strength. Recently the Secretary of Defense proposed increasing the armed forces by an additional 113,000 or by a total of over 400,000 since the start of Vietnam hostilities. It is expected that this new goal will be attained by about midyear 1966. This would imply a rise of 250,000 between December 1965 and the summer of 1966 -- a monthly rate of about 40,000, approximately the same as in November and December. Apparently the new goal can be attained with draft calls remaining at 30,000 to 40,000 a month, if voluntary enlistments remain as high as in recent months.

Wages and labor costs. Relative stability in unit labor costs in manufacturing has continued to be an important influence in limiting advances in industrial prices. Outside of manufacturing, wage gains also reflected increased demands and reduced labor supplies, with wage increases generally above the guideposts.

AVERAGE HOURLY EARNINGS

| Industry | Per cent increase Nov. 1965 from Nov. 1964 |
|---|---|
| Manufacturing | 3.1* |
| Contract construction | 4.5 |
| Telephone | 3.8 |
| Banking | 3.8 |
| Electric & gas utilities | 3.9 |
| Retail trade 1/ | 4.5 |
| Hotels & motels | 4.5 |
| Laundries | 4.8 |

*Based on December data.
1/ Revised series, includes eating and drinking places.

Average hourly earnings in factories at $2.66 in December were 3.1 per cent above the same month last year. This is about in line with the average rise for 1965. While productivity advances in manufacturing were at a slightly slower pace in 1965 -- 3.6 per cent compared with over 4 per cent in 1964 -- nevertheless, they were above gains in hourly compensation and unit labor costs showed a small downtrend during the year. (Recent revision in the unit labor cost index both because of higher output figures and a small downward revision in wage and salary compensation have lowered the index. In the fourth quarter it was 98.3, and the annual average for 1965 was 98.9. Comparable figures for 1964 were 99.9 and 99.6.)

Most nonmanufacturing industries for which hourly earnings data are available continue to show above guidepost trend productivity gains in November (latest data available) and apparently were exerting upward pressure on prices in retail trade and services.

Wage contracts in 1966. Wage increases stemming from major collective bargaining contracts in manufacturing should continue to be rather limited in 1966. A smaller number of workers are covered by contracts that terminate or provide for a wage reopening than in 1965, and about four-fifths of the workers covered by contract expirations will not be subject to wage changes until midyear or after. Major nationwide negotiations will take place in electrical equipment in October. In addition scattered contract terminations are scheduled in construction in the spring and summer and in printing, apparel, shoes and textiles in the fall. Considerable bargaining activity may also result from possible wage reopenings for operating railroad workers, bitumunous coal and telephone workers early in 1966.

Another factor helping to stabilize wage negotiations is the large number of workers (4.3 million, of which 2.1 million are in manufacturing) who will receive automatic wage increases based on earlier contracts. In almost all instances the amount of increase provided for in 1966 will be within the guidepost or close to it. Automobile, steel, aerospace, nonelectrical machinery, nonoperating railroad employees, and truckers will receive increases in compensation ranging from 3.0 to 3.5 per cent per hour in 1966. In construction, however, 750,000 workers are scheduled to receive automatic wage increases larger than those in most other major industries.

About 2 million workers are covered under cost-of-living escalator clauses in 1966, about the same number as in the previous two years but well below the 4.0 million total in 1959. These clauses are now mainly restricted to workers in the automobile, aerospace, meatpacking and trucking industries, although some workers in chemicals, retail trade and public transit also have their wages tied to change in the consumer price index.

The Administration intends to maintain the wage guidepost at 3.2 per cent although calculation of the 5-year productivity factor now comes to 3.6 per cent (an additional .2 from upward revisions in private GNP and .2 from dropping 1960 and substituting 1965 in the 5-year average). The Council contends that the last 5 years is temporarily high and no longer a reasonable approximation of a true productivity trend, since it was due mainly to increased operating rates rather than from more efficient utilization of equipment and manpower.

Wholesale prices. The industrial commodity price index rose .1 per cent further from mid-November to mid-December, and estimates indicate an additional .1 per cent rise into late January to 102.9 per cent of the 1957-59 average. Since September 1964, the industrial index has increased at a relatively even pace of about 1.5 per cent per year. Average prices of foodstuffs continued to rise in December and January chiefly because of sharp additional increases in livestock and meats, and the total wholesale price index rose 1 per cent further.

Some types of nonelectrical machinery continued to rise in December while electrical machinery remained stable, and the average for machinery and equipment increased .1 per cent further. Prices of metal working and other nonelectrical machinery have increased substantially since early 1963, when the rapid rise in capital spending began, and the average for all machinery and equipment has increased about 3 per cent during the three years. Some part of these increases is attributable to unmeasured quality improvement.

Hides and leather prices rose sharply further in December and January. The prolonged drought in Argentina -- a major world hide supplier -- and the spreading of hoof and mouth disease out of the Ukraine into western Europe have been major influences in addition to strong world demand.

The price index for steel mill products rose slightly in December, reflecting the previously announced increases in tinplate, and prices of tin cans were raised. The index for nonferrous metals declined somewhat primarily as a result of the rollback in copper prices. In the "free" markets, copper prices have reached new highs, and the rise in average prices paid may account for scattered price increases in plumbing equipment in December.

The Government last week applied a virtual embargo on the export of domestically produced copper in both ore and semirefined form, and also placed strict quotas on the export of other copper products. The policy grew out of the 14 per cent differential between domestic and foreign producer prices and the continuing worldwide shortage of the metal. Further releases of copper from the strategic stockpile -- either through Congressional legislation or Presidential emergency directive -- are expected this spring. Domestic stocks of other major nonferrous metals remain low, but production continues to expand in line with consumption. Moreover, large amounts of these metals in the stockpile have been declared by the Office of Emergency Planning to be in excess of national security needs, and consequently are available in the event of shortages.

The sharp rise in prices of foodstuffs over the past year is attributable mainly to a reduction in marketings of hogs. Hog prices are about 75 per cent above a year ago and at a 17-year high. In the next several months marketings are expected to remain below and prices above the levels of a year ago. By the second half of 1966, however, expanded production of hogs induced by current high prices is expected to result in increased marketings and consequently in price declines.

WHOLESALE PRICE INDEXES
1957-59 = 100

| Commodity group | Per cent increase to December 1965 from | | | Index December 1965 |
|---|---|---|---|---|
| | Jan. 1960 | Sept. 1964 | June 1965 | |
| | (71 months) | (15 months) | (6 months) | |
| Total index | 3.6 | 3.4 | 1.3 | 104.1 |
| Industrial commodities | 1.2 | 2.1 | 0.7 | 102.8 |
| Industrial materials | 0.5 | 2.4 | 0.7 | 102.1 |
| Industrial products | 1.8 | 1.7 | 0.7 | 103.5 |
| Consumer nonfood | 1.1 | 1.7 | 0.7 | 102.3 |
| Producer goods | 3.3 | 1.7 | 0.6 | 105.9 |
| Foodstuffs | 11.5 | 7.4 | 3.0 | 107.8 |
| Industrial commodities | | | | |
| Less metals and machinery | 0.1 | 1.9 | 0.8 | 100.9 |
| Metals and machinery | 2.6 | 2.2 | 0.5 | 105.4 |
| Nonferrous metals | 9.8 | 9.5 | 0.9 | 117.2 |

Farm land values. The rise in prices of farm land continued in the year ending on November 1, 1965. In that 12-month period, the national average index rose 6.6 per cent to 145 (1957-59-100), according to confidential figures of the Department of Agriculture, compared with 6.2 per cent in the preceding year and 5.8 per cent in the year ending November 1, 1963.

Values rose in each Federal Reserve District in the latest period with increases ranging from about 5.5 per cent in the Cleveland, Richmond and San Francisco Districts up to 8.2 per cent in the Atlanta District. In the Dallas District, values continued to fluctuate sharply in response to drought and to other factors; they increased only 2 per cent in the latest year following an increase of 10 per cent in the preceding year.

Undoubtedly the generally improved farm incomes of 1965 and the favorable prospects in view for further improvement in income in 1966 are reflected in the sustained strength of land values nationally, and in the accelerated rise in values in the great feed grain and livestock areas of the Midwest and the Northern Plains. Rates of increase in the year ending on November 1, 1965 accelerated in the Chicago, Minneapolis, Kansas City, and Boston Districts, where increases in gross farm incomes during 1965 were sharpest. Values in these districts, except Kansas City, had tended to lag behind the national average in earlier years.

The largest increases in recent years (since 1957-59) have been in the Atlanta, Dallas, and San Francisco Districts--areas experiencing rapid growth in population and urbanization and technological changes in farming. The smallest increases have been in Chicago, Cleveland, Minneapolis Districts--established agricultural areas where land values are more nearly related to purely agricultural uses.

Meat and poultry supplies. Per capita meat supplies in the current quarter will probably fall short of year-ago supplies because of continued shortages of pork. Hog slaughter is estimated to be down 13 to 15 per cent. In the second quarter, it will be only about 5 per cent under the low for last year. In the second half of the year, a gradual expansion is in prospect up to 6 per cent above a year earlier by the fourth quarter.

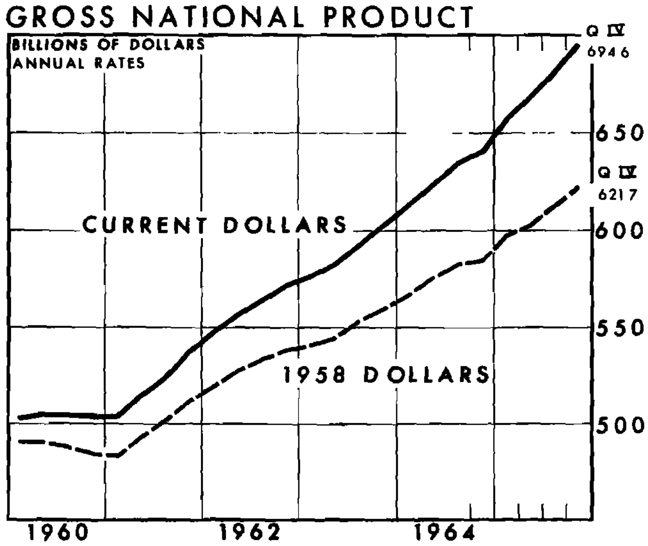
Supplies of both beef and poultry meat are expected to be larger in the current quarter than a year ago. The number and weights of cattle on feed on January 1 point to marketing of fed beef throughout the first half of the year at levels above those of 1965. Broiler production is now 13 per cent above a year ago and further increases are in prospect; broiler prices are expected to decline from current high levels.

Altogether, the shortage of meats should ease by the autumn of this year. In fact, USDA analysts are concerned about possible over-expansion of broiler production in the fall of 1966 and of pork in late 1967. If the peak in the cattle numbers cycle was passed in 1965 as balance sheet data indicate, cattle available for feeding and herd replacement may be somewhat smaller in 1967 and for sometime thereafter.

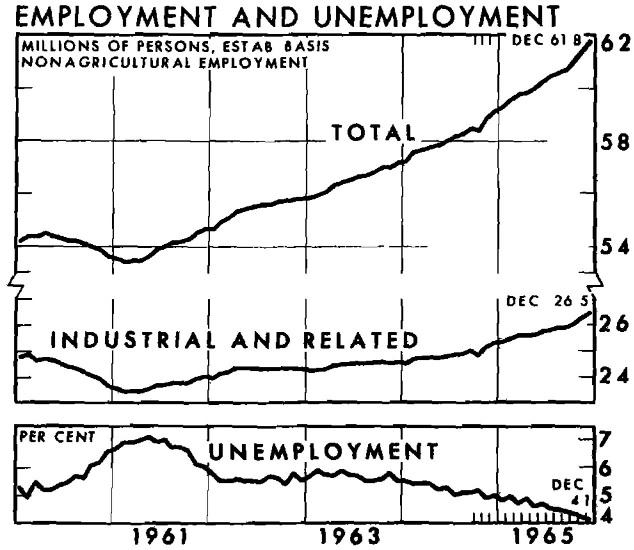
# ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

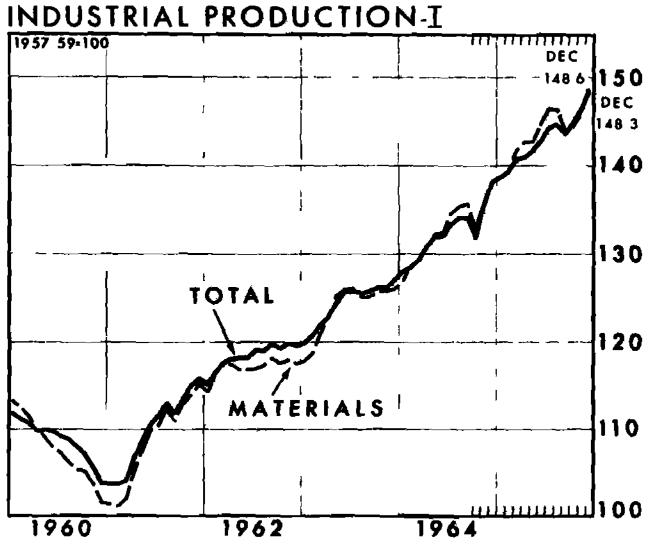
## GROSS NATIONAL PRODUCT



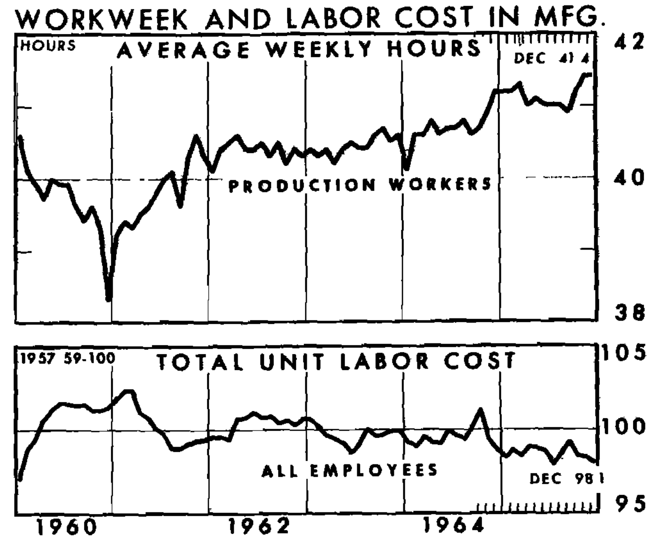

## EMPLOYMENT AND UNEMPLOYMENT



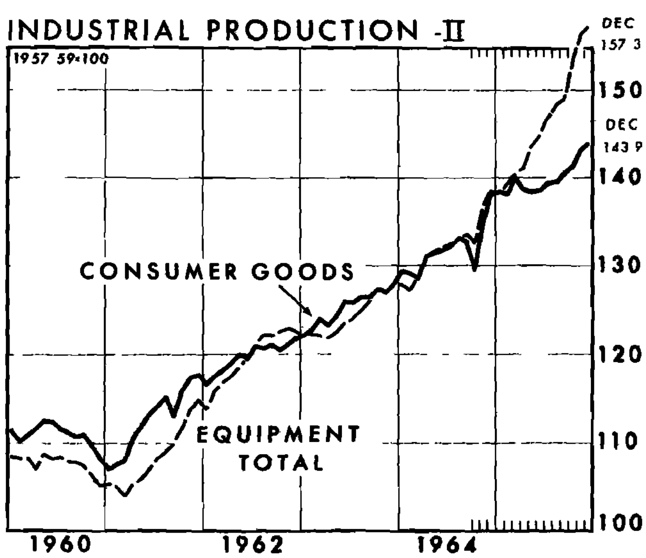

## INDUSTRIAL PRODUCTION-I



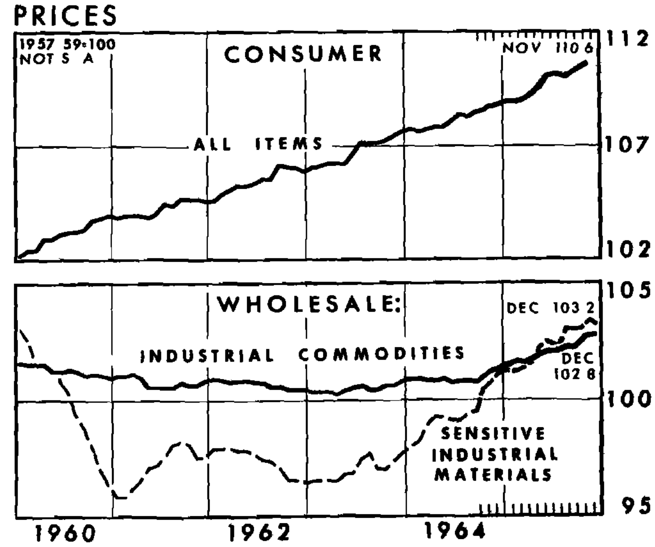

## WORKWEEK AND LABOR COST IN MFG.




## INDUSTRIAL PRODUCTION -II



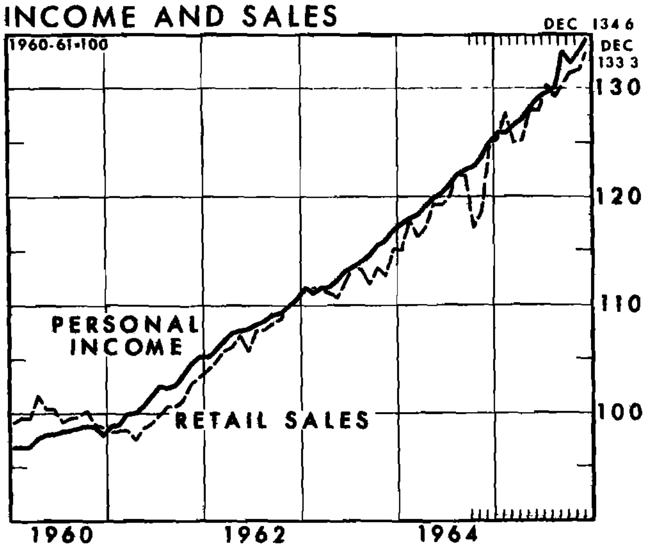

## PRICES



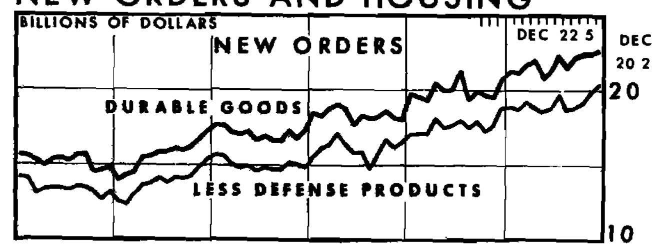
# ECONOMIC DEVELOPMENTS - UNITED STATES

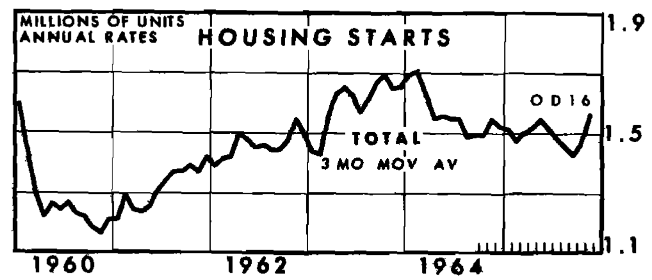
SEASONALLY ADJUSTED

## INCOME AND SALES

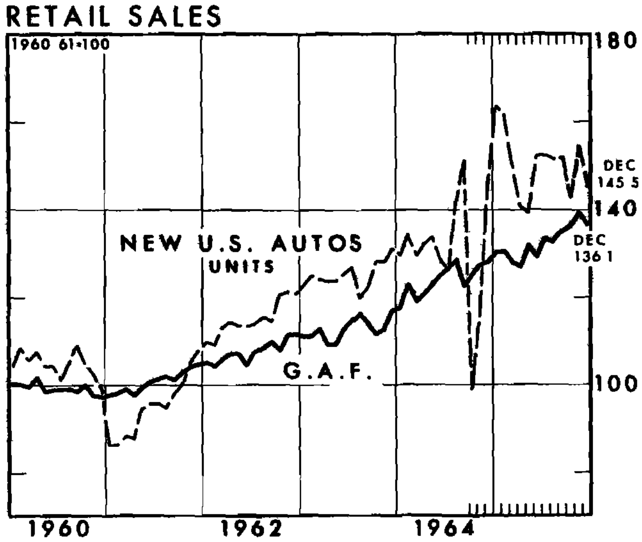



## NEW ORDERS AND HOUSING

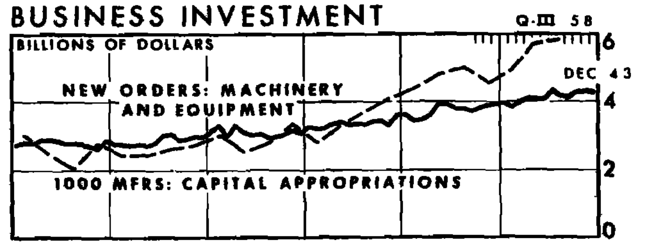


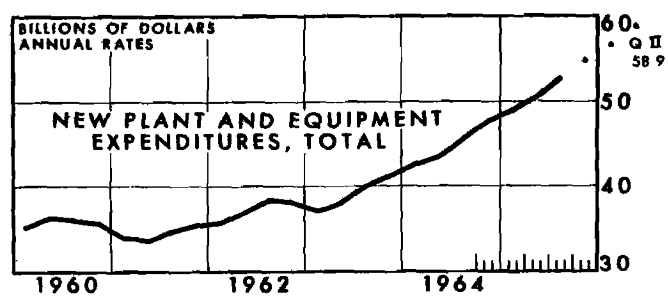




## RETAIL SALES

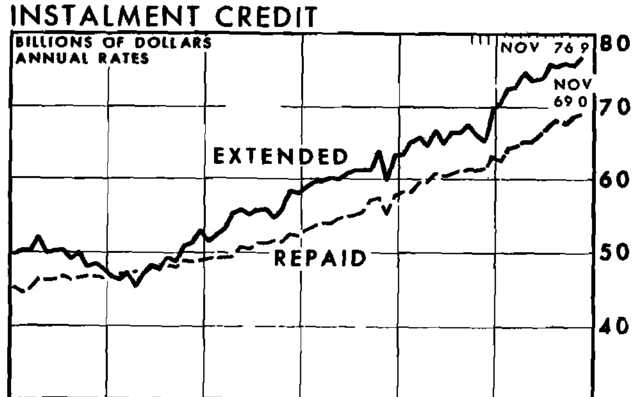


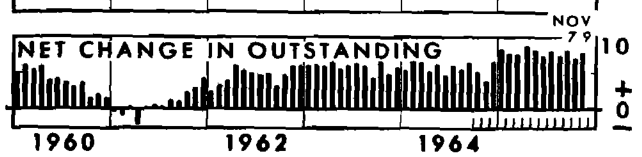

## BUSINESS INVESTMENT



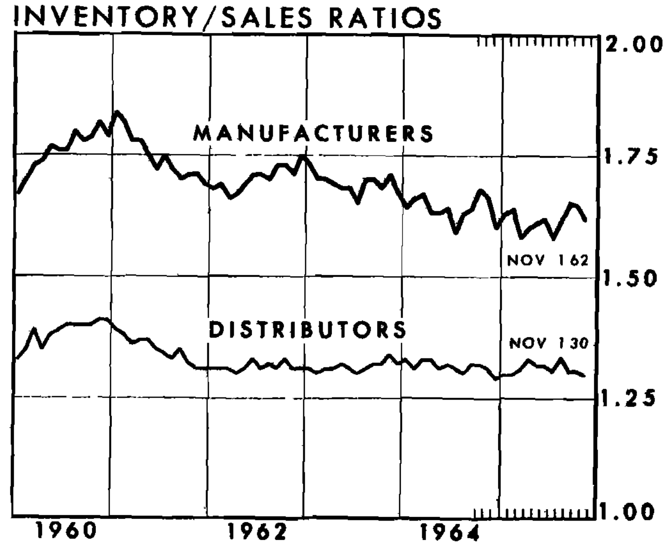




## INSTALMENT CREDIT




## INVENTORY/SALES RATIOS



## DOMESTIC FINANCIAL SITUATION

Bank credit. From late December to mid-January, total loans and investments of weekly reporting banks declined more than usual, despite delivery this month of $1 billion of bills carrying full tax and loan credit. Strong pressures on bank liquidity apparently have led to rapid secondary distribution of new Treasury issues and a relatively prompt distribution of the $1.5 billion of certificates delivered last week also seems likely. Further indications of the relatively tight position of these banks are provided by their much larger than usual liquidation of municipal and agency securities over recent weeks.

Total loans since the latter part of December also have declined more than a year earlier, mainly because of large reductions in security loans. Pay-downs by Government security dealers were sizable, reflecting reductions in their portfolios of bills. Business loans, however, continue to expand markedly--particularly in New York. Our tentative estimate of business loan expansion in January is for a seasonally adjusted increase of about $1 billion, or about as much as the average monthly expansion of 1965. Such an increase will follow a near record rise in business loans in December.

Bank deposits and the money supply. In sharp contrast to the experience after previous changes in Regulation Q, increased returns available on time deposits and market securities have not yet had much impact on the growth rate of money balances, mainly because the public's demand for money has been increased significantly by the buoyant pace of economic activity. As a result, the money stock is likely to show a seasonally adjusted annual rate of growth of around 10 per cent in January, only moderately below last month's 12.3 per cent rate. Most of the January rise reflects the high level of money balances carried over from the end of December, but higher yields have not caused these balances to be converted into other financial assets. At the same time, time and savings deposit growth has slowed rather than accelerated; January expansion appears likely to be only a little more than one-half of the December rate of 12.4 per cent. In January 1965, following the previous change in Regulation Q, time and savings deposits grew at an annual rate of 21 per cent and the money stock declined slightly.

The difficulty and cost of attracting a larger inflow of time and savings deposits this year have been major factors in maintaining pressure on bank loans and investments. Over the first two weeks of January, time and savings deposits at weekly reporting banks expanded only one-fifth as much as in the same period last year, and New York City banks actually suffered declines. Both savings deposits and negotiable CD's contracted at all weekly reporting banks--especially those in New York--compared with rapid expansion at this time last year. Time deposits other than negotiable CD's, on the other hand, expanded quite sharply in early January at banks outside of New York City.

CHANGES IN TIME AND SAVINGS DEPOSITS
FIRST TWO REPORTING WEEKS IN JANUARY
WEEKLY REPORTING MEMBER BANKS
(Millions of dollars)

| | 1965 | 1966 |
|---|---|---|
| | Total | |
| Total | +1,369 | +292 |
| Savings deposits | + 348 | -110 |
| Time deposits other than negotiable CD's | + 342 | +475 |
| Negotiable CD's | + 679 | - 73 |
| | New York City | |
| Total | + 352 | - 54 |
| Savings deposits | + 38 | - 82 |
| Time deposits other than negotiable CD's | + 191 | + 73 |
| Negotiable CD's | + 123 | - 45 |
| | All Other | |
| Total | +1,017 | +346 |
| Savings deposits | + 310 | - 28 |
| Time deposits other than negotiable CD's | + 287 | +402 |
| Negotiable CD's | + 420 | - 28 |

The chief element in the slowdown of time and savings deposit expansion early in 1966 has been the decline in CD's outstanding (see accompanying table). Despite increases in rates paid by banks, CD yields have not risen as rapidly as those on bills. In addition, the state of business liquidity relative to short-term spending plans may have reduced the pool of funds available for banks to tap. Both the strength of business loan demands and the marked further increase in money balances these past two months suggest a continued rapid expansion in business expenditures for goods and services. This may be generating an unusual strain on business liquidity positions, preventing banks from increasing their outstanding CD's even while paying rates of 5 per cent or more.

The 4 per cent ceiling on savings deposit rates may also have limited the ability of banks to compete for these balances. Banks outside of New York City apparently have made up part, but not all, of the difference by issuance of non-negotiable certificates under the new rate ceilings.

The resulting pressure on banks from the slowdown of time and savings deposit inflow in the first two weeks of January had been particularly severe in New York City, where both CD's and savings deposits declined and time deposits other than negotiable CD's grew by less than last year. However, these banks were able to increase their outstanding CD's by $127 million during the last reporting week, and very large net inflows in the last few days have also been reported. This increased inflow of negotiable CD's to New York City banks probably reflects both the recent decline in bill yields and the appearance of what may be only a temporary availability of investment funds. The need of New York banks to obtain funds whenever the market is favorable is especially great since they face large maturities in coming weeks due to their emphasis on shorter-term CD's in the last month or so.

U.S. Government securities market. Yields on Treasury notes and bonds have moved up recently after declining earlier in January while Treasury bill rates have turned down very recently after rising through mid-January. The seesaw movement of Treasury bond yields in recent weeks appears to have reflected the immediate technical condition of the market rather than any change in the market's outlook for long-term yields. Dealers have had net short positions in coupon issues due in more than 1-year since early January but recently they have built up their holdings of bonds due in over 20-years as a consequence of net investor selling in that maturity area. Apart from this selling, the Treasury bond market has been influenced recently by fading prospects for peace in Vietnam and continuing signs of strength in the domestic economy. Many market participants have also directed their attention to the higher spending figures and larger financial asset sales contained in the Federal Budget rather than to the smaller Administrative Budget deficit or the small Cash Budget surplus indicated for fiscal 1967.

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

| Date (closing bids) | 3-month bills | 6-month bills | 3 years | 5 years | 10 years | 20 years |
|---|---|---|---|---|---|---|
| 1959-1961 | | | | | | |
| Highs | 4.68 | 5.15 | 5.17 | 5.11 | 4.90 | 4.51 |
| Lows | 2.05 | 2.33 | 3.08 | 3.30 | 3.63 | 3.70 |
| 1965-1966 | | | | | | |
| Highs | 4.66 | 4.75 | 5.00 | 4.89 | 4.67 | 4.53 |
| Lows | 3.76 | 3.81 | 4.00 | 4.08 | 4.17 | 4.17 |
| 1965-1966 | | | | | | |
| Dec. 3 | 4.12 | 4.26 | 4.54 | 4.52 | 4.52 | 4.44 |
| 10 | 4.33 | 4.48 | 4.70 | 4.69 | 4.60 | 4.50 |
| Jan. 4 | 4.56 | 4.73 | 5.00 | 4.89 | 4.65 | 4.52 |
| 12 | 4.61 | 4.73 | 4.82 | 4.77 | 4.56 | 4.49 |
| 18 | 4.66 | 4.75 | 4.88 | 4.83 | 4.61 | 4.50 |
| 25 | 4.60 | 4.67 | 4.91 | 4.89 | 4.61 | 4.52 |

Treasury bill rates extended their earlier advance through mid-January but have since declined somewhat. After being auctioned at a record high average rate of 4.673 per cent on January 17, the 3-month bill fell back to an average of 4.596 per cent in the January 24 auction. The recent decline in bill rates has reflected the strong cumulative demand for bills, the resulting reduction in dealer inventories, and the emergence of more comfortable conditions in the central money markets which have been accompanied by a decline in dealer financing costs.

Yields on most other short-term debt instruments have continued to rise in recent weeks:

SELECTED SHORT-TERM INTEREST RATES[1/]
1965-66

| | Dec. 3 | Dec. 31 | Jan. 24 |
|---|---|---|---|
| Commercial paper 4-6 months | 4.38 | 4.75 | 4.88 |
| Finance company paper 30-89 days | 4.38 | 4.75 | 4.88 |
| Bankers' Acceptances 1-90 days | 4.25 | 4.75 | 4.75 |
| Certificates of deposit (prime NYC) | | | |
| Most often quoted new issue | | | |
| 3-months | 4.50 | 4.75 | 4.90 |
| 6-months | 4.50 | 4.75 | 5.00 |
| Secondary market: | | | |
| 3-months | 4.49 | 4.90 | 5.00 |
| 6-months | 4.57 | 5.00 | 5.12 |
| Municipal Note 1-year | 2.70 | 2.85 | 2.85 |
| Federal Intermediate Credit Bank 9-month | 4.58 | 4.88 | 4.96 |

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

Treasury refunding. The Treasury is expected to announce the terms of its February refunding after the market's close on Wednesday, January 26.

Corporate and municipal bond markets. Despite an unseasonably large January supply of new offerings, yields on corporate and municipal bonds have not risen above the levels reached in December following the discount rate action. In fact, municipal bond yields declined slightly through the third week of January. Reoffering yields on new corporate bonds in early January were below those in December, but investor reaction was lukewarm. Subsequently, when syndicates on several of these issues were broken, their yields rose 4 to 7 basis points in the secondary market about to the highs for recently offered issues reached at mid-December. The further yield advance on seasoned corporate bonds through December carried the Aaa-rated average on these securities to the highest levels since the early 1930's.

BOND YIELDS
(Per cent per annum)

| | Corporate Aaa | | State and local Government | |
|---|---|---|---|---|
| | New | Seasoned | Moody's Aaa | Bond buyer (mixed qualities) |
| Previous Postwar High | 5.13(9/18/59) | 4.61(1/29/60) | 3.65(9/24/59) | 3.81(9/17/59) |
| 1965 Low | 4.33(1/29) | 4.41(3/12) | 2.94(2/11) | 3.04(2/11) |
| Weeks ending: | | | | |
| Nov. 26 | 4.78 | 4.61 | 3.37 | 3.47 |
| Dec. 17 | 4.86 | 4.68 | 3.40 | 3.55 |
| Jan. 14 | 4.82 1/ | 4.74 | 3.40 | 3.52 |
| Jan. 21 | 4.84 | 4.74 | 3.39 | 3.51 |

1/ Average for week of Jan. 7; average in week of Jan. 14 was not representative.

Public offerings of corporate issues in January will probably total about $430 million, slightly less than previously estimated but still the largest January volume in eight years. Moreover, offerings in February are now projected to rise to $500 million, as opposed to $187 million in February a year ago. With the announcement of the new $250 million AT&T offering for March, the calendar for that month already totals $400 million, suggesting that that month too is likely to exceed the year earlier volume--a relatively heavy $557 million.

BOND OFFERINGS 1/
(In millions of dollars)

| | Corporate | | | | State & local govt. | |
|---|---|---|---|---|---|---|
| | Public Offerings | | Private placements | | | |
| | 1965-66 | 1964-65 | 1965-66e/ | 1964-65 | 1965-66e/ | 1964-65 |
| 1965 | | | | | | |
| Yearly | | | | | | |
| Average | 474 | 300 | 707 | 604 | 938 | 904 |
| October | 280 | 181 | 700 | 642 | 800 | 852 |
| November | 630 | 30 | 700 | 645 | 950 | 578 |
| December | 310 | 320 | 1,300 | 1,342 | 800 | 1,078 |
| 1966 | | | | | | |
| January | 430 | 161 | 700 | 565 | 1,200 | 849 |
| February | 500 | 187 | 700 | 450 | 1,000 | 966 |

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

The tendency for yields on municipal bonds to edge lower during the first three weeks of January apparently reflected seasonal demand. Although the flow of new offerings remained large, dealers' advertised inventories rose less than $50 million from the relatively low level of $450 million reached late in 1965. Strength of demand for municipals was surprising in view of indications that large city banks are allowing some of their municipal holdings to run-off without replacement, in order to improve their liquidity positions.

Announcement of the $250 million financing by New York City for the current week raised the total January volume of municipal offerings to nearly $1.2 billion. Since the February calendar promises to be nearly as large, the municipal bond market is about to experience a testing of current yield levels.

Mortgage markets. In January, adjustments in mortgage yields were apparently continuing in response to the general advice of other capital market rates in December and the intensified competition for savings flows which has followed the Regulation Q action. In December, secondary market yields on 30-year, 5-1/4 per cent FHA-insured mortgages advanced 11 basis points further after a 7 basis point rise during the previous four months. The average of 5.62 per cent was the highest since May of 1962. Even so, the advance was matched by the rise in yields on offerings of new corporate bonds, adjusted to an Aaa basis, so that the already narrow spread in favor of mortgages was no more than maintained.

In response to continued demand pressures on its own resources, effective January 18, FNMA announced a further reduction of one percentage point for eligible home mortgages offered for purchase under its secondary market operations. The reduction--equivalent to about 12 basis points on yield--was the second such adjustment in less than six weeks. FNMA also raised the issue price of common stock required to be bought by those selling it mortgages under its secondary market operations. And further to stem what has been a record volume of offerings, it also indicated that it would limit its purchases to mortgages offered within four months after underwriting by FHA or VA. According to testimony of the FHA commissioner, an increase in the current 5-1/4 per cent contract rate on FHA-insured mortgages is under consideration.

In the market for conventional mortgages, contract interest rates also advanced further in December, based on reports from the Federal Housing Administration. Rates for loans for new homes reached 6.00 per cent, 10 basis points above the November average and 15 basis points above the earlier level which had continued for more than two years. Loans on existing homes showed a similar pattern of increase, reaching 6.05 per cent in December.

In November, adjustments in nonrate terms for conventional mortgages had moved counter to contract rates, according to the Federal Home Loan Bank Board survey. However, during December, both maturities and loan-to-value ratios on loans for new homes tightened somewhat again. Comparable terms for loans on existing properties were liberalized further, but this appeared to be largely seasonal.

AVERAGE NONRATE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASES

| | November | December | Per cent increase in December 1965 from a year ago |
|---|---|---|---|
| New home loans | | | |
| Loan amount ($1,000) | 18.5 | 18.4 | 3 |
| Loan/price (per cent) | 74.9 | 74.0 | -- |
| Maturity (years) | 25.0 | 24.8 | -2 |
| Existing home loans | | | |
| Loan amount ($1,000) | 13.9 | 14.5 | 6 |
| Loan/price (per cent) | 72.0 | 72.4 | 1 |
| Maturity (years) | 20.4 | 20.6 | 2 |

Stock market. Trading activity on the New York Stock Exchange during January has continued at the very high level of last fall while common stock prices have posted further gains. The volume of daily transactions during the first three weeks of January averaged somewhat above the 8.7 million shares daily for December, the peak month in the history of the Exchange. And on January 25, the Standard and Poor's composite price index closed at 93.85, almost 4 per cent above last May's peak.

Recent evidence of continued economic expansion, further upward adjustments in forecasts of future economic growth, a growing presumption that Federal spending may exceed totals announced in the new budget, and favorable year-end reports of corporate earnings and dividends have all contributed to the further advance of stock prices. At the same time, however, uncertainties about the war in Vietnam--both as to the possibilities of peace and whether further escalation would lead to new taxes on corporate income--have acted as a brake on price advances. In addition, profit-taking at the start of the new tax year seems to have been larger than usual, possibly reflecting questions being raised about the sustainability of present stock prices as the Dow-Jones industrial average has pressed toward the unprecedented 1000 mark.

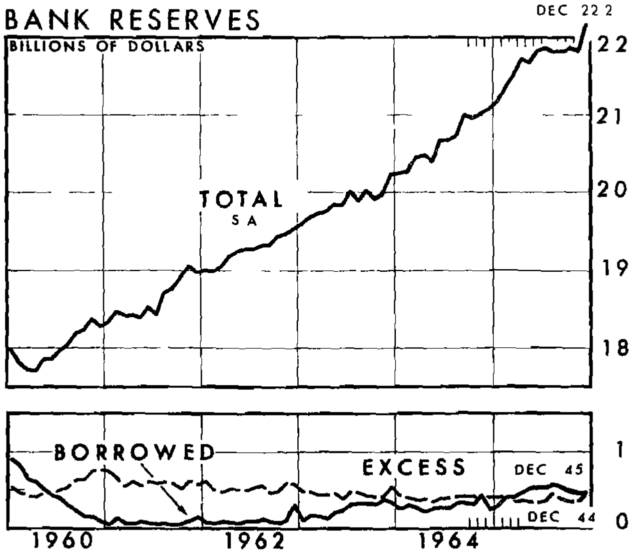
Customer credit provided by banks and brokers in the stock market rose $400 million during December to a total of $7.7 billion. Most of this increase was attributable to a $312 million expansion in customers' net debit balances on securities other than Governments.

Since July net debit balances have risen $660 million or 13-1/2 per cent, nearly offsetting all of the decline which occurred in this form of stock market credit from the November 1963 change in margin requirements through July 1965. While a part of this recent credit growth reflects increases in clearing balances associated with the greatly enlarged volume of trading activity, the bulk of the change represents expanded margin buying.

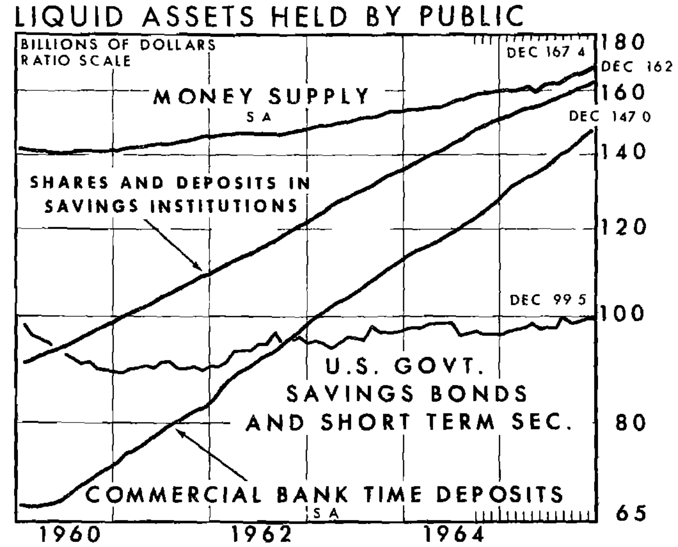
1/25/66

# FINANCIAL DEVELOPMENTS - UNITED STATES

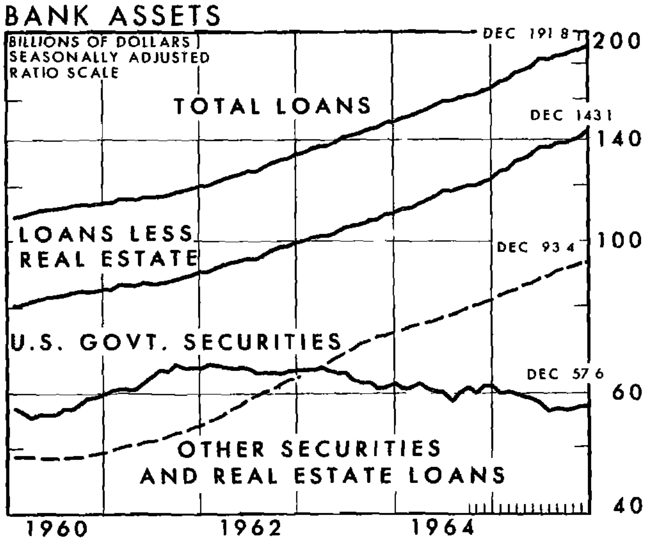
BANK RESERVES



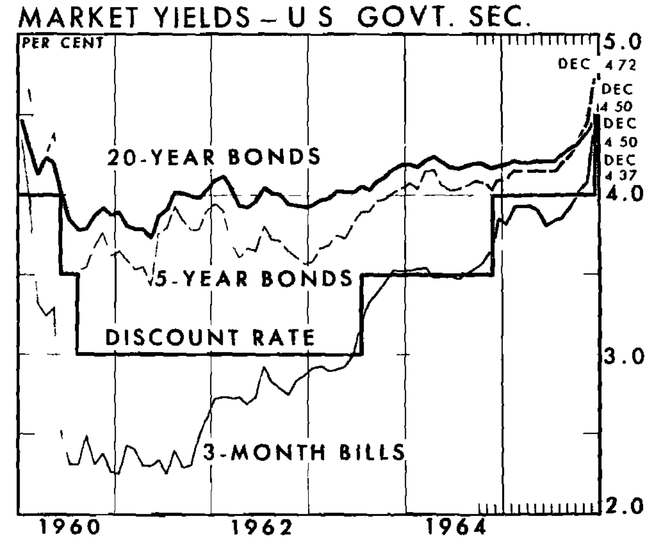

LIQUID ASSETS HELD BY PUBLIC



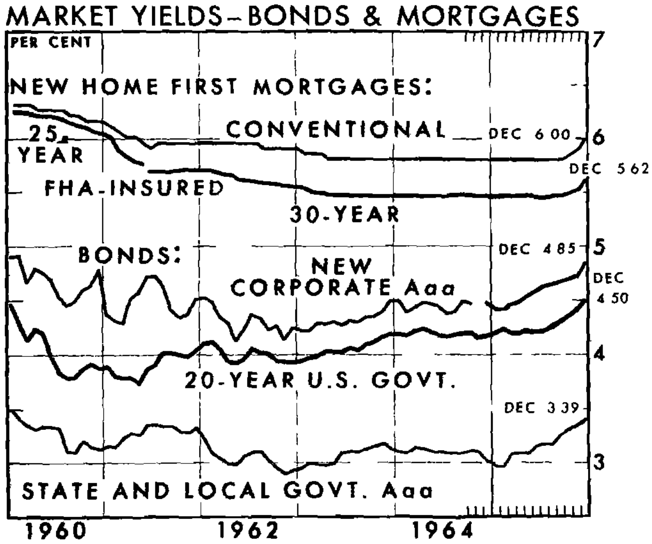

BANK ASSETS



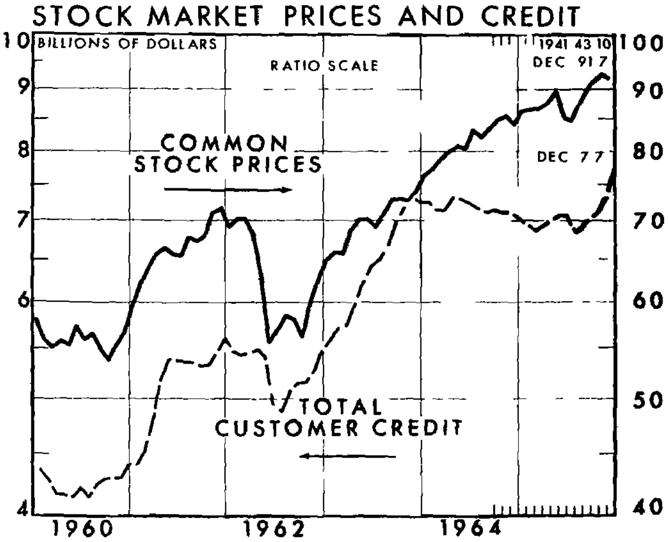

MARKET YIELDS – U S GOVT. SEC.




MARKET YIELDS–BONDS & MORTGAGES




STOCK MARKET PRICES AND CREDIT



## INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. As measured on the liquidity basis, the fourth quarter balance of payments deficit is now estimated at $350 million, revised upward from earlier estimates as a result of a very small deficit for December instead of the surplus that had been suggested by preliminary indicators. The deficit for the year of $1.3 billion was financed almost entirely by a reduction in U.S. monetary reserves; U.S. liquid liabilities to foreigners increased less than $100 million. Foreign gold purchases were $1.3 billion, and in addition the U.S. gold stock was reduced during the year by sales of $117 million to industry and by the gold subscription payment of $259 million to the IMF for the increase in the U.S. quota. There was a $95 million increase in the U.S. gold tranche position in the IMF, and a $350 million rise in holdings of convertible currencies. On a year-to-year comparison, the deficit was reduced by about $1-1/2 billion on the liquidity basis (and also on regular transactions).

On official settlements, the fourth quarter deficit is now estimated at $1.1 billion. This figure is sharply higher than earlier estimates primarily because of the substantial rise in December in liquid liabilities to foreign official institutions; however, it has also been increased by $160 million reflecting a decision by a technical committee on the balance of payments to include among the items measuring the deficit on official settlements non-convertible dollar Roosa bonds. For the year, the deficit on official settlements was $1.3 billion, compared to $1.2 billion in 1964. In 1965 the official settlements deficit was financed primarily through reductions in U.S. monetary reserve assets, whereas in 1964 it had been financed largely by increases in foreign official dollar holdings.

So far this year there appear to have been heavy weekly deficits on the liquidity basis, partly reflecting the resumption of Canadian borrowing which had been delayed in the fourth quarter. Total new issues of Canadian securities are expected to be close to $200 million in January, almost as much as the outflow in the whole fourth quarter.

With respect to credit transactions under the VFCR, partial data for December show an increase of about $150 million in foreign assets held by U.S. banks under the program. Seasonal increases in bank loans and acceptance credits in past Decembers have amounted to upwards of $200 million. While the VFCR ceilings for 1965 would have permitted an outflow of up to $475 million, it now appears that the total net outflow for the year may have been as low as $50 to $100 million under the program. Total claims on foreigners reported by banks in the United States (including claims reported for customer account and claims by branches and agencies of foreign banks) showed a net reflow through November (not adjusted for seasonal influences); for the year 1965 they may well show a smaller net outflow than reported under the VFCR, primarily reflecting the net reduction in customers' claims.

Foreign trade statistics for December just released by Census again require adjustment for statistical distortions. The adjustments remove the impression of a sharp rise in imports in that month, but total fourth-quarter imports (on the balance of payments basis, adjusted) were up 5 per cent from the third quarter, to an annual rate of over $23 billion. Exports (balance of payments basis) rose 4 per cent from the third to the fourth quarter, and exceeded $28 billion at an annual rate.

Exports to Canada continued to show extraordinary strength last autumn, reaching a seasonally adjusted annual rate of $6 billion in September-November, up 6 per cent from June-August. Exports to continental Europe appear to have picked up in October and November, and the three-month weighted moving average used in the chart to even out some of the month-to-month fluctuations rose to $7.4 billion in September-November, 3 per cent above its average level in the preceding three months. Exports to Latin America also looked a little more

in October and November than they did earlier in the year, but exports to other less-developed countries were down quite sharply.

Business conditions abroad. Rising consumer expenditure has been a common feature of economic developments in all the leading industrial countries in recent months. Private investment expenditure has been rising in some countries but declining in others. In Italy and Japan the contribution of export sales to growth of total demand was somewhat less last autumn than it had previously been, but this may have been only a temporary development. In virtually all industrial countries, except Britain, imports have been increasing as a result of rising domestic demands.

Advances in industrial production from the fourth quarter of 1964 to October 1965 appear to have been about 7 per cent in Canada and Italy and about 4 per cent in France; if measured from the first-quarter-1965 low, the rise in France was comparable in terms of annual rate to the other two. In Japan there are still only few indications of recovery; industrial output in October-November was up only 1 per cent from 1964-IV. In Britain and Germany, where demand remained strong, severe shortages of skilled labor kept output increases to 1 per cent and 4 per cent respectively; measured from the first-quarter average, there was little or no increase in either of these two countries.

INDUSTRIAL PRODUCTION[1/]
(1960 = 100)

| | 1964 | 1965 | | | | |
|---|---|---|---|---|---|---|
| | IV | I | II | III | Oct. | Nov. (p.) |
| Canada | 131 | 134 | 135 | 138 | 140 | ... |
| Italy | 133 | 134 | 138 | 141 | ... | ... |
| France | 127 | 125 | 127 | 126 | 132[a/] | 132 |
| Japan | 172 | 172 | 171 | 173 | 173 | 174 |
| Germany | 128 | 132 | 132 | 130 | 134 | 132 |
| United Kingdom | 115 | 116 | 116 | 116 | 116 | 116 |

1/ Excluding construction.
a/ Dip reflects inadequate seasonal adjustment.

In Canada, increases in aggregate demand appear to be broadly based. Total investment outlays in 1965 were expected to be 19 per cent higher than in 1964. The growth in consumer spending within the year 1965 was unusually strong. Third-quarter retail sales were 6 per cent above those of the first quarter, and sales moved up further in October.

Unemployment averaged only 3.4 per cent of the labor force in October-December. With domestic resources under mounting strain, advances in domestic prices and wages accelerated. In December, the consumer price index was 2.9 per cent above December 1964. On the wage front, average hourly earnings in manufacturing by September had moved up nearly 6 per cent from a year earlier.

Sustained economic expansion also brought a large increase in imports last year. In September-October imports were about one-fifth higher than a year earlier. For the first ten months of 1965, imports averaged 13 per cent higher than in the corresponding months of 1964, and this was the principal factor in dissipation of the previous year's strength in the Canadian balance of payments.

The Italian recovery faltered a little during the summer; monthly industrial production showed no net advance from June to September. An important factor was a decline in exports. Following a rise of over 40 per cent in the two years to April-June 1965, Italian exports fell off 2 per cent between then and September-October. Automobile and steel production, both of which had risen swiftly during the first half of 1965, declined in the summer.

Italian imports, on the other hand, showed an accelerating rise during the summer, and by September-October were one-sixth above their low level of the second half of 1964. Underlying this recovery in imports was a continuing advance in consumption. Italian analysts estimate that fixed investment outlays had not yet turned up last autumn, and the trend of construction activity appeared to be still downward last summer. Government expenditures have probably been rising.

Price and wage rate increases in Italy, though large by recent North American standards, have continued to be much more moderate than in the three previous years. Year-to-year increases are: wholesale prices, 2.0 per cent (as of September); consumer prices, 3.6 per cent, and hourly wage rates in manufacturing, 7.2 per cent (as of October).

In France, the advance in business activity, renewed early last year, gained added momentum in September from the good reception given new French auto models in both the domestic and export markets, and also from further gains in consumer spending on apparel. Businesses increasingly regarded their inventories as low, and stepped up orders. The moderate relaxation of instalment credit regulations at the end of June proved helpful. Consumer incomes have been rising, though less rapidly than before mid-1964; hourly wage rates at the beginning of October were about 6 per cent above their level a year earlier. The average work week held at the level to which it had risen in the second quarter. By October and November seasonally adjusted unemployment was showing its first decline since early 1964.

New orders for machinery and equipment stayed at a relatively depressed level in September-October. Construction activity, however, continued at advanced levels. While private residential building prospects for next spring are considered rather weak, public works outlays have apparently been maintaining an upward trend.

Exports in the fourth quarter were up 7 per cent from the second quarter. Nevertheless, France's trade balance (exports f.o.b., imports c.i.f.) moved into deficit again, as fourth-quarter imports were 12 per cent above their second-quarter rate. Despite this evidence of stiffening demand, price advances for manufactured products continued minimal at both wholesale and retail levels. Prices of foodstuffs and of services, however, were rising, and the over-all consumer price index in September-October was up 2.4 per cent in a year.

Japanese industrial production, after beginning to rise a little last summer, stabilized again in October-November. The earlier upturn reflected continuing advance in output of consumer nondurables and also beginning of recovery for consumer durables after a year and a half of decline. Recovery seemed evident also in new orders for machinery, but ouput of machinery stayed on the plateau it reached at the end of 1964. Interruption of the over-all advance after September appears to have reflected a 7 per cent drop in exports from the third to the fourth quarter, which was particularly marked in exports of steel to the United States. This downturn in exports followed a rise of about 60 per cent since mid-1963.

Japanese imports, which had shown no net advance from the fourth quarter of 1964 to the third quarter of 1965, moved up in November-December; in the fourth quarter they averaged 4 per cent higher than in the third. December price levels were up from a year earlier by 1.6 per cent at wholesale, while the consumer price index was up 6 per cent.

The current economic situation of Germany differs from those of Italy, France and Japan in that the pressures of demand have been continuously severe throughout the past two years. During 1965 a precarious balance was maintained between demand and supply, with domestic new orders on a plateau, with export orders and shipments also relatively level, and with imports rising sharply -- by more than 40 per cent from the last quarter of 1963 to the last quarter of 1965. Labor shortages have been the primary limitation on domestic output growth. In some industries, especially steel, the combination of competition from imports and slackened domestic demand for inventories has resulted in some underutilization of plant capacity.

New orders for finished goods (both consumer and investment goods) stepped up in September, and industrial output rose appreciably in October, but this advance was not wholly sustained in November.

Average hourly earnings in industry were 10.6 per cent higher in July than a year earlier, and this trend probably continued later in the year. The cost of living index, however, rose a little less than 4 per cent in the twelve months to November, and wholesale prices of industrial products rose only 1.8 per cent. To moderate inflationary pressures in 1966, monetary policy remains very tight and efforts are being made to restrain the growth of government expenditures. At the federal level the budget for 1966, calling for expenditures about 5 per cent above actual outlays in 1965 (and about 10 per cent above those originally budgeted for 1965) will be voted on in the near future.

In Britain, productivity gains appear to have been smaller than in Germany and price advances have been greater. Wholesale prices of manufactures in December were 3.4 per cent above their position a year earlier. Retail prices (all items) were up 4.5 per cent.

While total industrial production in Britain was virtually level from February through November, automobile output dropped sharply during the first half year. Production of textiles and apparel, on the other hand, tended to rise on into the third quarter. These developments corresponded to changes in consumer buying. Auto buying, curtailed by credit tightness, stabilized after April on a level about one-fourth below its high at the beginning of 1965. Retail sales (excluding autos), on the other hand, were 3 per cent higher in volume and 5 per cent higher at current prices in November than at the beginning of the year.

Inventory investment, which had slackened off during the second half of 1964 and early 1965, increased in the second and again in the third quarter. Residential construction contracts declined further at that time, but inflows of savings to building associations during the summer led to a sharp expansion of mortgage lending in the fourth quarter. Fixed capital outlays by manufacturing companies fell off in the second quarter but picked up a little again in the third. Surveys of investment intentions taken in November-December suggested little change in plans for machinery expenditure in the near future.

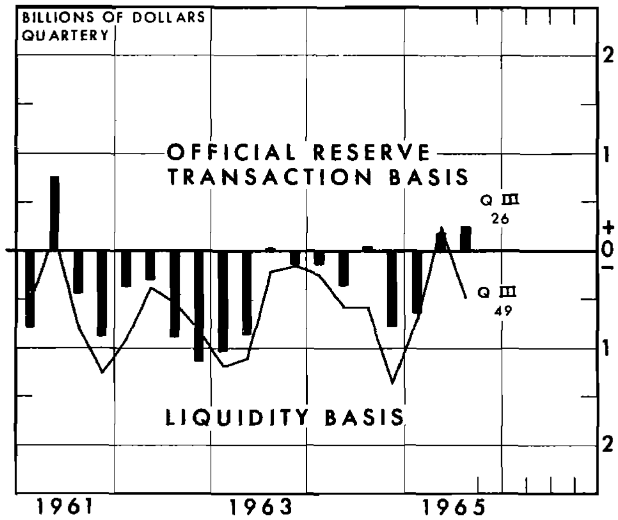
Exports, which had risen encouragingly last summer, increased further in the fourth quarter and were 7 per cent above the fourth quarter of 1964. The gains reflected, among other things, final deliveries on some industrial equipment contracts that had been in the pipeline for 12 to 18 months. New export orders for machinery and equipment were on a somewhat lower level in 1965 than in 1964.

British imports leveled off after May. In November-December they were 2 per cent higher than a year earlier.

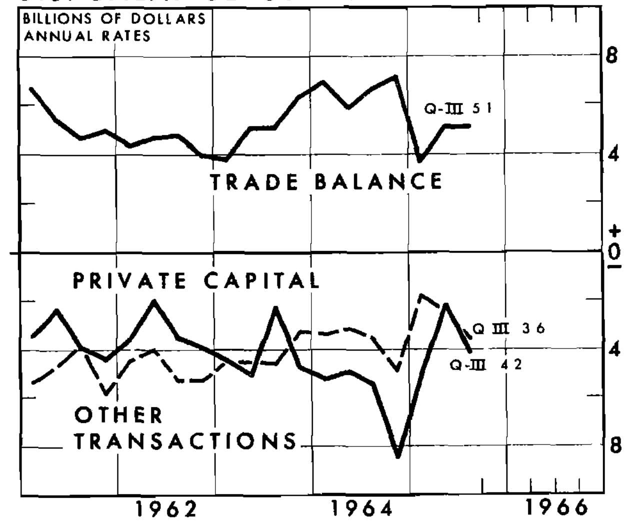
# U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

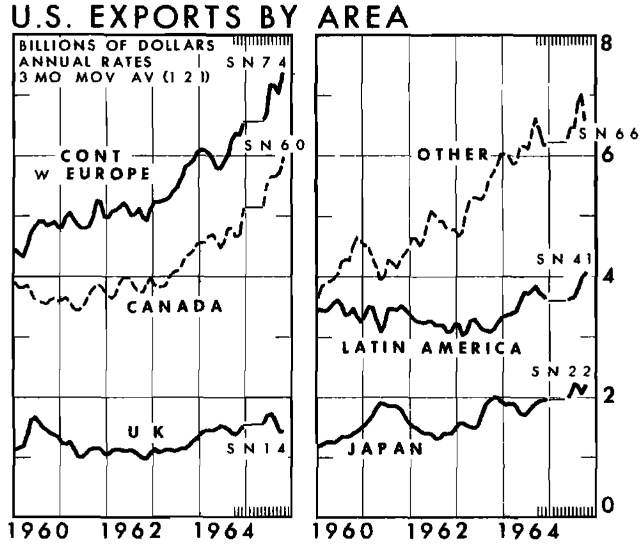
## U.S. BALANCE OF PAYMENTS



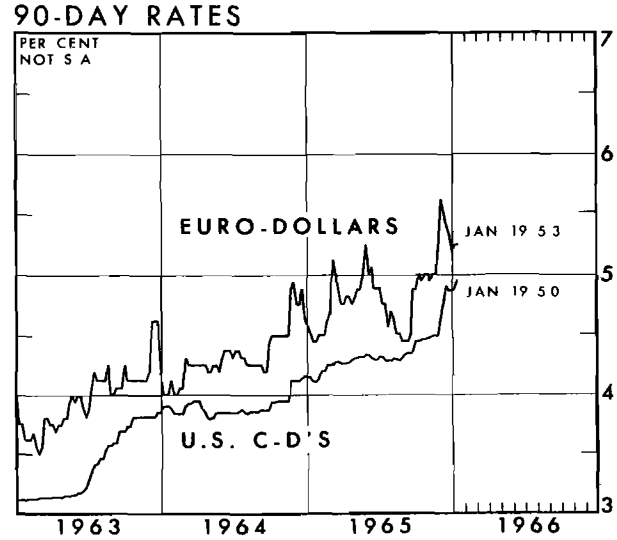

## U.S. BALANCE OF PAYMENTS-CONT.



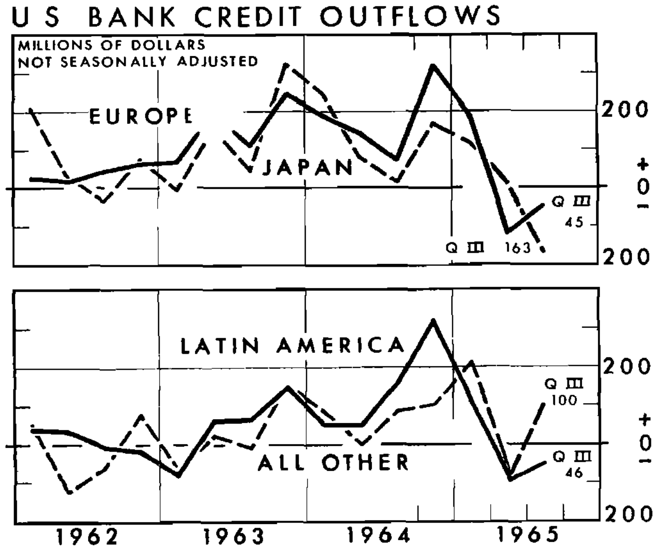

## U.S. EXPORTS BY AREA



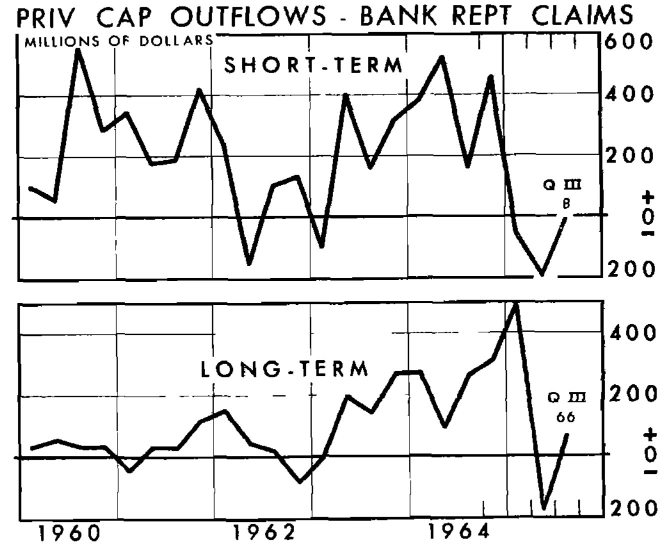

## 90-DAY RATES




## U S BANK CREDIT OUTFLOWS




## PRIV CAP OUTFLOWS - BANK REPT CLAIMS



## APPENDIX A: PROPOSED NEW SPEED-UP OF CORPORATE TAX PAYMENTS

The President's proposal in his State of the Union Message to further accelerate corporation tax payments to a pay-as-you-go basis is set forth in the attached tables. It is designed to bring corporations to a full current tax payment basis in the spring of 1967--three years earlier than under present law. The resulting non-recurring gain in revenues is demonstrated in Table 1 where it is shown that the acceleration will bring forward an additional 16 per cent of corporate taxes in fiscal year 1966 and an additional 26 per cent in fiscal year 1967 as compared with 100. In other words, corporations will be paying 116 per cent of tax liabilities in 1966 and 126 per cent in 1967. As compared with existing law, this new plan pulls forward an additional 6 per cent in fiscal year 1966 and an additional 16 per cent in fiscal year 1967.

In terms of actual revenue, the new plan is estimated to pull forward in April-June 1966, a total of $4.4 billion compared with $3.3 billion estimated under existing law. In April-June 1967, the new figure is estimated at $8.5 billion instead of $5.3 billion.

The new proposal does not alter existing regulations relating to taxes exempt from acceleration. These include among other provisions (1) the first $100,000 of tax liability and/or (2) 30 per cent of total liability. Thus, even at completion in the spring of 1967 of the move to a full pay-as-you-go basis, corporations will still have left to pay in March and June of the year following the accrual of liability roughly 42 per cent of their total liability for the preceding year. This is shown for 1968 in the next to last column of the middle tier of Table 2. After paying during 1967 58.4 per cent of estimated 1967 liabilities, corporations in the following March 1968--when they will file the final return for calendar year 1967--are scheduled to pay half of the remaining tax due, with the remaining half to be paid in June, the table shows that such 1967 taxes paid in 1968 will come to 41.6 per cent of total 1967 liabilities.

The bottom tier of Table 2 shows the heavy concentration of tax payments in the April--June quarter which will result from this speed-up plan.

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

Table 1

Corporation Tax Collections Under Proposed 1/ Speed-Up Plan
(In Per Cent)

| | Calendar Year of Payment | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1963 | | 1964 | | 1965 | | 1966 | | 1967 1/ | | 1968 1/ | |
| | Calendar Year of Liability | | | | | | | | | | | |
| | 1962 | 1963 | 1963 | 1964 | 1964 | 1965 | 1965 | 1966 1/ | 1966 | 1967 | 1967 | 1968 |
| | Per Cent Due of Calendar Year Liability | | | | | | | | | | | |
| March | 25 | | 25 | | 24 | | 21 | | 13 | | | |
| April | | | | 1 | | 4 | | 12 | | 25 | 0 | 25 |
| June | 25 | | 25 | 1 | 24 | 4 | 21 | 12 | 13 | 25 | 0 | 25 |
| Sept. | | 25 | | 25 | | 25 | | 25 | | 25 | 0 | 25 |
| Dec. | | 25 | | 25 | | 25 | | 25 | | 25 | 0 | 25 |
| Total | 50 | 50 | 50 | 52 | 48 | 58 | 42 | 74 | 26 | 100 | 0 | 100 |
| Calendar year | 100 | | 102 | | 106 | | 116 | | 126 | | 100 | |
| Fiscal year | 100 | | 102 | | 106 | | 116 | | 126 | | 100 | |

1/ Proposed by the President in the State of the Union Message.

Table 2

Corporation Tax Collections Under Proposed Speed-Up Plan
(In billions of dollars and in per cent)

| | Calendar Year | | | | |
|---|---|---|---|---|---|
| | 1964 | 1965 | 1966 | 1967 | 1968 |
| Tax liability | $25.1 | $26.9 | $28.5 | $29.5 | $ 30.5 |

| | Liability Year | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1963 | 1964 | 1964 | 1965 | 1965 | 1966 | 1966 | 1967 | 1967 | 1968 |
| Jan.--Mar. | 7.7 | -- | 7.8 | -- | 7.7 | -- | 7.1 | -- | 5.6 | -- |
| Apr.--June | 6.9 | .4 | 6.9 | 1.4 | 6.8 | 4.5 | 6.2 | 8.6 | 4.9 | 8.9 |
| July--Sept. | 1.8 | 3.2 | 1.7 | 3.8 | 1.6 | 3.7 | 1.5 | 3.9 | 1.2 | 4.0 |
| Oct.--Dec. | .7 | 4.2 | .8 | 4.8 | .8 | 4.7 | .7 | 4.7 | .6 | 4.9 |
| Total | 17.1 | 7.9 | 17.2 | 9.9 | 17.0 | 13.0 | 15.6 | 17.2 | 12.3 | 17.8 |
| Calendar year | 25.0 | | 27.2 | | 30.0 | | 32.8 | | 30.1 | |
| Fiscal year | 24.3 | | 26.1 | | 30.1 | | 32.9 | | 30.2 | |

| | Per Cent of Calendar Year Liability Collected in Period | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Jan--Mar. | 31.6 | -- | 31.2 | -- | 28.7 | -- | 24.9 | -- | 19.0 | -- |
| Apr.--June | 28.4 | 1.7 | 27.6 | 5.1 | 25.4 | 15.8 | 21.9 | 29.2 | 16.6 | 29.2 |
| July--Sept. | 7.4 | 12.9 | 6.7 | 14.0 | 6.1 | 13.2 | 5.3 | 13.2 | 4.1 | 13.2 |
| Oct.--Dec. | 3.1 | 16.8 | 3.1 | 17.8 | 2.9 | 16.6 | 2.3 | 16.0 | 2.0 | 16.0 |
| Total | 70.5 | 31.4 | 68.6 | 36.9 | 63.1 | 45.6 | 54.4 | 58.4 | 41.6 | 58.4 |

| | Per Cent of Total Collected in Calendar Year | | | | |
|---|---|---|---|---|---|
| Jan.--Mar. | 30.7 | 28.9 | 25.8 | 21.7 | 18.6 |
| Apr.--June | 29.4 | 30.6 | 37.8 | 45.3 | 45.8 |
| July--Sept. | 20.0 | 20.0 | 18.1 | 16.4 | 17.3 |
| Oct.--Dec. | 19.9 | 20.5 | 18.3 | 16.6 | 18.3 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

## APPENDIX B: CORPORATE FINANCING IN 1965*

The article on "Financing Corporate Investment" which appeared in the December issue of the Bulletin was based in large part on preliminary Flow-of-Funds statistics through the third quarter of last year. Similar estimates, which take account of revisions in relevant components of GNP, firmer statistics for the third quarter, and preliminary data for the fourth quarter, are now available for the full year 1965 and are shown in the attached table. These estimates will appear in the Economic Report of the President in a table that replaces the usual Department of Commerce estimates of corporate sources and uses of funds, which have been discontinued.

As may be seen from the table, internal funds are currently estimated to have been $6 billion larger and capital expenditures over $9 billion larger than in 1964. This development, together with increases in other uses of funds, was reflected in a large increase in the volume of funds obtained in credit and capital markets. Borrowing at commercial banks accounted for most of the increase in such external financing. Thus the new data do not change the general conclusions presented in the Bulletin article.

There are also attached updated versions of two of the charts that appeared in the Bulletin article. As Chart 1 shows, financing in credit and capital markets continued through the fourth quarter to represent an unusually large proportion of total corporate funds obtained from all sources (other than open-book trade credit). However, availability of estimates for each of the quarters of last year changes somewhat our previous impressions of trends during the year. Security market financing, which had increased both in dollar volume and relative to total funds in each of the first three quarters, declined in the fourth quarter while expansion in bank loans, which had moderated in the third quarter, accelerated again in the fourth quarter.

The 1965 figures plotted in Chart 2 not only show a continued rise in both capital outlays and internal funds from the third to the fourth quarter but also indicate that for the year as a whole capital outlays were larger relative to internal funds than had been apparent previously. The latter change reflects primarily the recent Department of Commerce upward revisions in nonresidential business fixed investment and downward revisions in undistributed corporate profits.

Though financing activities of corporations and changes in their overall financial position reflect all the uses to which corporations put funds and all the sources they tap, it is convenient.

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* Prepared by Eleanor Stockwell, Senior Economist, Capital Markets Section, Division of Research and Statistics.

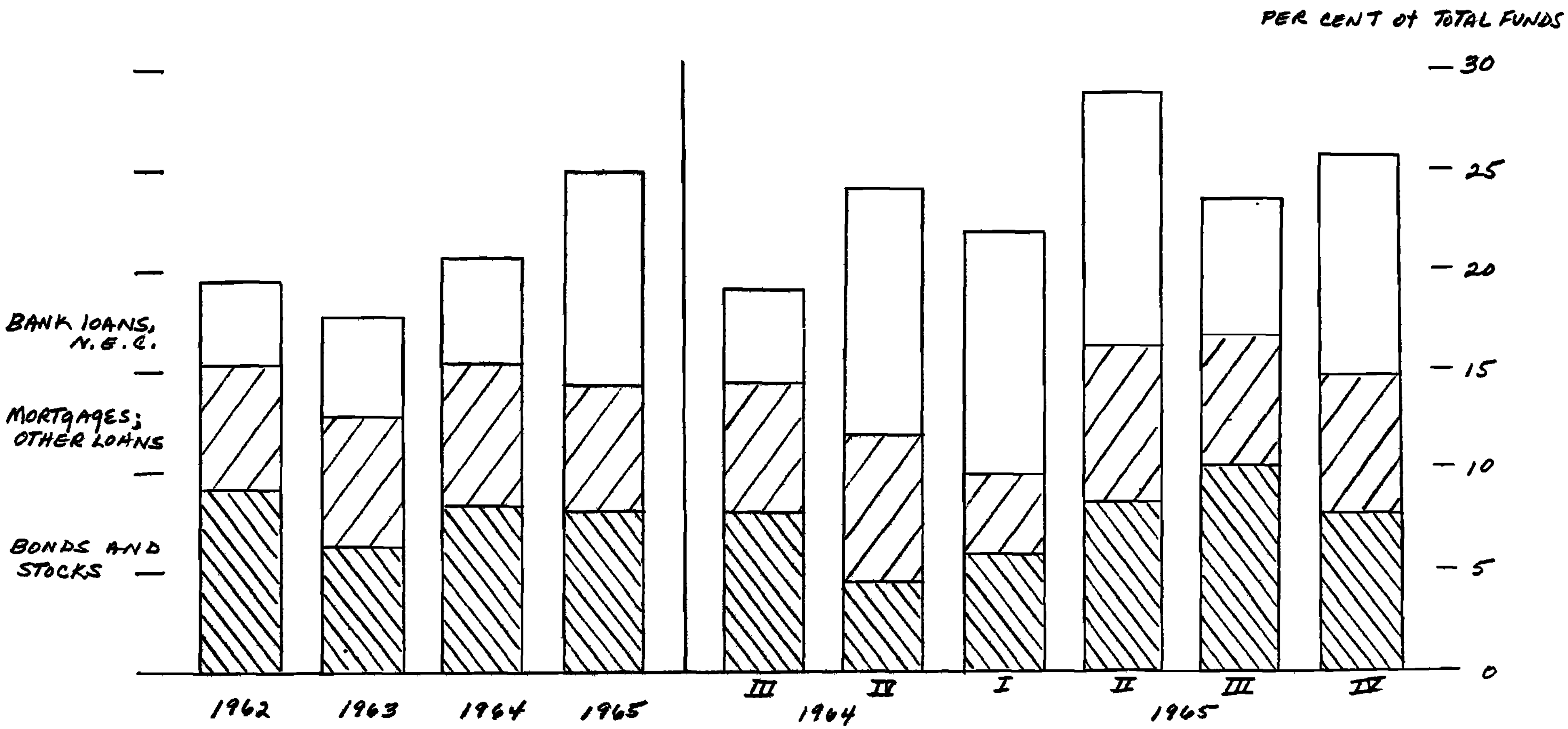
and often revealing to focus the analysis on selected major uses and their relation to selected major sources. The approach used in the *Bulletin* article, of appraising the growth in corporate borrowing last year in terms of the course of capital outlays vs. internal funds, is just one of several ways of summarizing corporate investment and financing. Another approach is to compare borrowing with that part of capital outlays not covered by capital consumption allowances. Using this approach makes the increase in credit and capital market financing last year seem not very striking; "net" capital outlays rose 43 per cent and credit and capital market financing 50 per cent. Or, expressed another way, such financing represented about 81 per cent of "net" outlays in 1963 and 1964 and 85 per cent in 1965. Thus, the volume of borrowing last year, while substantial, was only moderately larger than might have been expected given the sharp rise in corporate investment in physical assets.

SOURCES AND USES OF FUNDS
CORPORATE NONFINANCIAL BUSINESS
(In billions of dollars)

| | 1964 | 1965 |
|---|---|---|
| Net savings | 16.5 | 20.5 |
| Capital consumption | 32.9 | 34.9 |
| Gross saving | 49.4 | 55.4 |
| | | |
| Gross investment | 45.9 | 50.4 |
| Capital expenditures | 49.6 | 58.7 |
| Fixed investment | 45.0 | 52.7 |
| Plant and equipment | 41.3 | 49.1 |
| Residential construction | 3.7 | 3.6 |
| Change in inventories | 4.6 | 6.0 |
| | | |
| Net financial investment | - 3.7 | - 8.2 |
| Net acquis. of finan. assets | 14.9 | 23.0 |
| Liquid assets | - 1.0 | - 0.1 |
| Demand deposits and currency | - 2.6 | - 3.6 |
| Time deposits | 3.2 | 5.0 |
| U.S. Govt. securities | - 1.5 | - 1.5 |
| Open-market paper | 1.4 | 0.8 |
| Consumer credit | 1.0 | 1.0 |
| Trade credit | 8.9 | 11.3 |
| Other financial assets | 4.5 | 10.0 |
| | | |
| Net increase in liabilities | 18.6 | 31.2 |
| Credit mkt. instruments | 13.5 | 20.2 |
| Corporate bonds | 4.0 | 6.3 |
| Corporate stock | 1.4 | 0.2 |
| Mortgages | 3.4 | 3.6 |
| Bank loans n.e.c. | 3.4 | 8.6 |
| Other loans | 1.3 | 1.5 |
| Profit tax liability | 0.2 | 1.6 |
| Trade debt | 2.4 | 5.7 |
| Other liabilities | 2.5 | 3.7 |
| | | |
| Discrepancy | 3.5 | 5.0 |

CHART 1

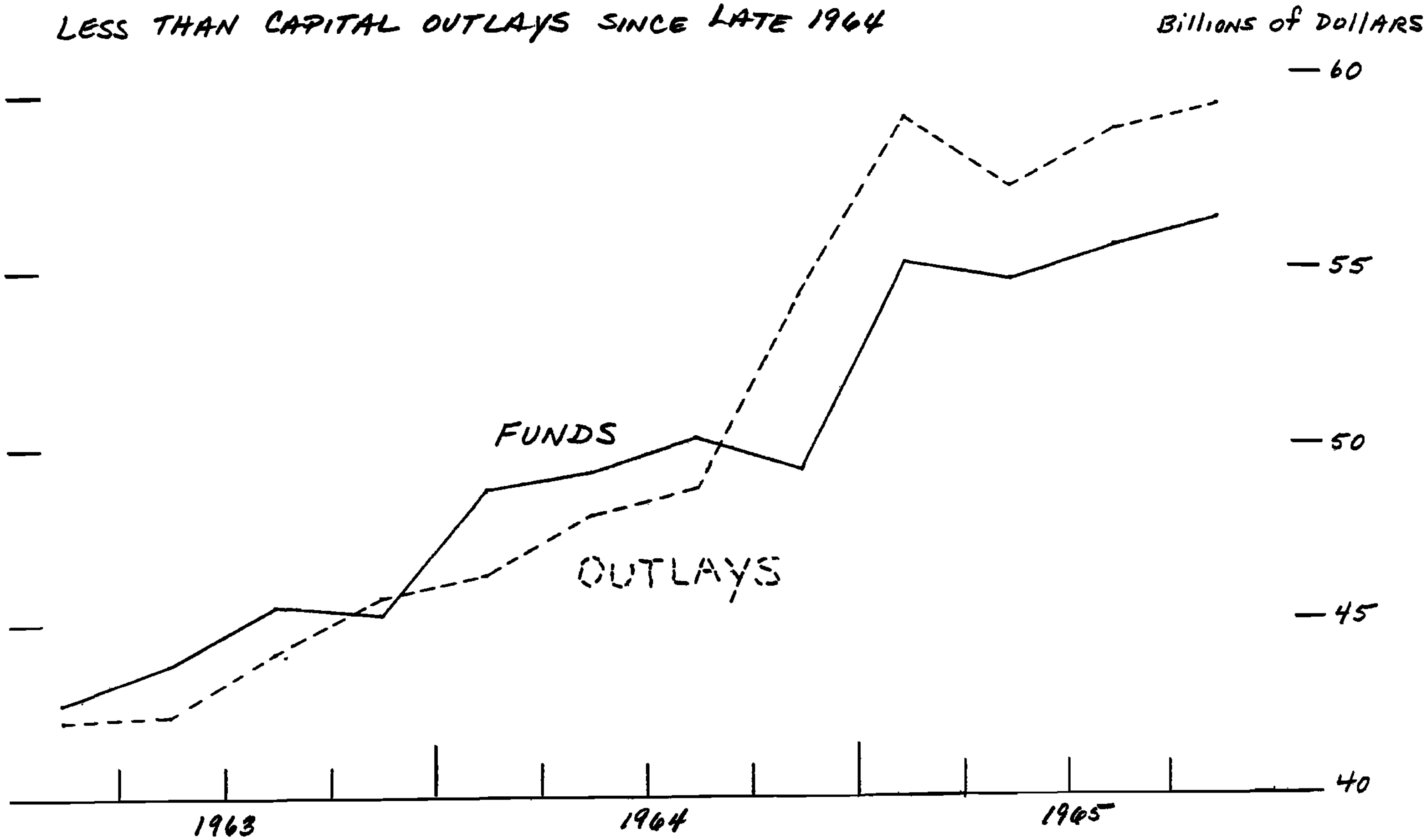
RELIANCE ON EXTERNAL FUNDS INCREASES




NOTE.— FLOW OF FUNDS DATA FOR NONFINANCIAL CORPORATE BUSINESS. EXTERNAL SOURCES SHOWN ARE EXPRESSED AS PERCENTAGES OF TOTAL FUND SOURCES (EXCLUDING TRADE DEBT). QUARTERLY PERCENTAGES COMPUTED FROM SEASONALLY ADJUSTED DATA FIGURES FOR FOURTH QUARTER 1965 PRELIMINARY.

CHART 2

INTERNAL FUNDS GROW, but
LESS THAN CAPITAL OUTLAYS SINCE LATE 1964




NOTE.— FLOW of FUNDS DATA FOR NONFINANCIAL CORPORATE BUSINESS. QUARTERLY TOTALS, AT SEASONALLY ADJUSTED ANNUAL RATES. OUTLAYS COMPRISE INVESTMENT IN FIXED ASSETS AND INVENTORIES. FOURTH QUARTER 1965 PRELIMINARY.