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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

December 7, 1966

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SUMMARY AND OUTLOOK

Outlook for economic activity

An increase of $12 billion in GNP is now indicated for the current quarter and a slightly smaller increase for the first quarter 1967. In real terms, these projected increases are at an annual rate of about 3.5 per cent. The fourth-quarter increase is somewhat smaller than we projected 3 weeks ago, mainly because the recent Commerce/SEC survey indicated a smaller rise in business plant and equipment outlays and because the most recent housing starts figures suggest a deeper decline in residential construction.

The marked slowing of the pace of expansion in business investment in plant and equipment is beginning sooner than the large build-up in equipment order backlogs would seem to have warranted. Fixed capital spending was somewhat lower in the third quarter than indicated earlier, and spending programs for the current quarter have been lowered appreciably. The survey also indicates a progressive tapering off of expansion in the first half of 1967.

Auto sales continue to lag both third quarter and year-earlier levels, and future buying intentions for both autos and household durable goods were reported relatively weak in mid-October. Despite further gains in nondurable goods, total retail sales remained stable through November, in marked contrast to the sharp rise in the autumn of 1965. Increases in total consumer spending in the current quarter and those projected for early 1967 are smaller than in the third quarter.

Meanwhile, employment and incomes continued to expand at a rapid rate through November. The strength exhibited in these series contrasts with other evidence indicating slackening in consumer demands as well as some slowing in growth of the economy as a whole. The projections of consumer income and spending imply a sizable increase in the saving rate through the first quarter from the low third-quarter figure; this would not be inconsistent with the recent slackening in consumer credit expansion.

Residential construction is clearly down sharply further in the current quarter, but the rate of decline is likely to moderate appreciably in the first quarter. Tapering off of the decline in construction activities would help support expansion in total GNP. But slackening of the pace of increase in the business equipment sector can be expected to exert downward pressure on GNP, directly and through its influence on the rate of business inventory accumulation in the current and next quarters.

The current and future course of defense spending still remains uncertain. Prospects are for further sizable increases in such spending, but it seems unlikely that it will continue at the extraordinary third quarter rate. We are projecting progressively smaller increases in the fourth and first quarters, but it must be emphasized most strongly that this is conjecture and as such, should not be used publicly.

Prices and resource use

Reflecting a mixture of influences, the rise in industrial commodity prices--which was interrupted chiefly by declines in prices of some sensitive materials--probably has been resumed but at a lesser rate than earlier in the year. Wholesale prices of foodstuffs already have declined sharply in response to expansion in supplies, and they may not decline further. But the decreases had not yet been reflected at retail when foods were priced in early October for the latest consumer price index, and decreases in food prices are expected in indexes for subsequent months. Recent increases in retail prices for other goods have been mainly seasonal; e.g., auto prices rose with elimination of seasonal discounts on the old models but prices of new models are not significantly higher than a year ago. Service prices continue to rise at a rapid rate.

Capacity utilization in manufacturing may have eased a bit from the 91 per cent rate of the third quarter. The rise in output of business and defense equipment probably has been limited by capacity or labor supply, but slackening in demand has resulted in actual cutbacks in production of autos and announced reductions in output of some household durable goods. The demands of these industries for steel and other materials--including some nondurables--consequently has been or will be curtailed, and demands for some building materials and supplies are being reduced by the decline in residential construction. In some of those industries experiencing an easing in demands for their products, prices may be held in check even if wage increases push up unit labor costs.

Although press reports point to occasional elimination of overtime and selective layoffs in consumer durable goods industries, the November statistics showed a substantial further expansion in employment in manufacturing as well as most nonmanufacturing lines. The unemployment rate fell back to the low of 3.7 per cent touched earlier this year, and the average factory workweek was unchanged from October.

Bank credit and deposits

The outlook for the commercial banking system continues to be dominated by the interaction of investor demands for CD's with the need for banks to accommodate financing needs of their business customers. After tapering off in late summer and early fall, business loan expansion slowed further last month, most notably at banks outside New York. Business loan growth is likely to be more rapid than in December, but still considerably below the pace of the first half of the year. Although corporate tax payments are estimated to be about $1.3 billion higher this year than last, a good part of the added tax need may be financed by using funds from maturing CD's. Meanwhile, non-tax financing demands of business could be relatively moderate, assuming the rate of business inventory accumulation does not show any pick-up during the last few weeks of the year.

If business loan expansion does not accelerate sharply this month, there may still be pressure on banks from a short-term spurt in other bank loans and from CD runoffs. Government security dealers may have greater recourse to banks as repurchase agreements with corporations mature around the dividend and tax dates. And sales finance companies are likely to draw on bank credit lines as their outstanding market paper matures.

With respect to CD's, even with present rate relationships, the December runoff could well be larger than the estimated $400 million in November. Preliminary estimates indicate that CD maturities in December have risen to a record $5.5 billion. Moreover, it normally takes several weeks for banks to regain the large amounts of funds lost over the December dividend and tax dates. Meanwhile, U.S. Government deposits will be drawn down on average during the month. Although such deposits will begin to rise in the latter part of the month, they will remain at relatively low levels by year-end, so that many banks will find themselves with considerably less Government deposits than they normally have at this time of year.

Thus, unless there is a marked resumed expansion in bank reserves, pressures on banks could be generally sustained over the weeks immediately ahead, although they probably will be less intense than in early fall and may ease off further in the early weeks of the new year.

Outlook for capital markets

In corporate and municipal bond markets, upward pressures on interest rates recently moderated, as evidence of less restraint in money markets has been widely interpreted as a modest shift in Federal Reserve policy. The market appears now to be awaiting the specifics of the new Federal budget. Meanwhile, the heavy weight of current and prospective new issue volume--particularly in the corporate market--might inhibit any significant decline in long-term interest rates in the period immediately ahead; and some rate pressures are possible as the process of market digestion of the new securities continues.

The apparent decline in business spending plans, however, may lead to a tendency for capital market rates to decline over the longer run. Such a tendency could be offset in some degree by sizable Treasury offerings of participation certificates; at least a modest offering appears possible before year-end. In a favorable atmosphere, businesses and State and local governments, which earlier had been discouraged from financing by tight market conditions, might also be encouraged to come back to market. It is difficult to quantify the likely volume of such offerings, however, and the pressure they exert on market generally will depend not only on the outlook for capital spending at the time but also on the nature of bank and other investor portfolio adjustments.

With respect to banks, the analysis of the preceding section suggests little if any support to capital markets in the period immediately ahead, but banks could become more of a positive factor after the new year. Meanwhile, net inflows of funds to savings and loan associations are likely to remain sluggish over the rest of this year. It is difficult to evaluate their likely loss experience in January after the interest-crediting period, but drastic losses are likely to be avoided given prospective market conditions.

With only gradual easing in the position of institutional investors likely, mortgage funds probably will remain relatively limited for a while longer. The mortgage market will be aided to some extent as Federal Home Loan Banks resume expansion advances, but a rapid reversal of tight mortgage conditions is likely to be dependent mostly on a significant and sustained decline in interest rates on market securities. Finally, it should be noted that the rather low levels to which commitments have fallen in mortgage markets may make the volume of new forward commitments quite sensitive to even a modest pick-up in new savings flows.

Balance of payments

The deficit on the liquidity basis in October and November was almost as large as in the corresponding months two years ago when outflows of U.S. capital swelled in anticipation of new governmental restraints. However, regular year-end receipts (possibly including British debt service payments, which were waived in 1964 and 1965), together with an expected large receipt from Germany under the military offset agreement, could still bring the liquidity deficit for the fourth quarter down below $3/4 billion, making the published total for the year about $1-1/2 billion.

The balance on the basis of official reserve transactions, also a deficit in October and November, will continue to depend heavily upon developments in the Euro-dollar market and related changes in the liabilities of U.S. banks to their foreign branches. These liabilities showed only a modest net increase in November. If they decline toward year-end, as in earlier years, this would enlarge the official settlements deficit for the quarter, and leave the balance for the year near zero.

Merchandise trade figures for October are consistent with earlier expectations of a turnaround in the trade balance and the current account. Exports rose sharply further, imports advanced only moderately, and the balance improved. Given the current prospects for domestic demand, further slackening of the advance in imports is to be expected in the months ahead. Strength in exports is hoped for, but the repercussions of developing weakness in the internal economies of Britain, Germany, and Canada may make the export trend less buoyant than in recent months.

Bank-reported flows of U.S. capital were negligible in October, and November-December outflows may be smaller than seasonal. Some renewed outflow in 1967, however, is to be expected if U.S. credit conditions ease, and would not be prevented by compliance with the voluntary program for 1967, to be announced this week.

Direct investment outflows diminished in the third quarter, but the large liquidity deficit in October-November may reflect a new increase. The direct investment restraint program for 1967 will attempt to hold outflows below the 1966 level, but will probably have difficulty doing so unless U.S. corporations not only seek foreign financing aggressively but also scale down their spending plans abroad.

Both current and capital transactions have been greatly influenced by temporary factors this year. The year's liquidity deficit may prove fairly representative of the longer-term underlying trend, with the temporary swelling of merchandise imports as a result of excess domestic demand roughly offsetting temporary inflows of foreign nonliquid capital and of U.S. bank credit.

On the other hand, the official settlements balance has been unusually favorable this year, because of the large inflow of foreign liquid funds. Cessation and partial reversal of that flow could produce a large official settlements deficit in 1967 even if the liquidity deficit does not change much.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per cent change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 years Ago*
Civilian labor force (mil.)	Nov'66	77.9	77.1	76.1	2.4	4.6
Unemployment (mil.)	"	2.9	3.0	3.2	-10.8	-21.7
Unemployment (per cent)	"	3.7	3.9	4.2	--	--
Nonfarm employment, payroll (mil.)	"	64.7	64.4	61.9	4.6	9.4
Manufacturing	"	19.4	19.3	18.4	5.5	10.8
Other industrial	"	8.0	8.0	7.9	0.6	3.5
Nonindustrial	"	37.3	37.1	35.5	5.0	10.1
Industrial production (57-59=100)	Oct'66	158.6	158.1	145.5	9.0	20.4
Final products	"	158.2	156.7	145.7	8.6	21.1
Materials	"	159.2	159.6	145.3	9.6	20.1
Wholesale prices (57-59=100)1/	"	106.2	106.8	103.1	3.0	5.4
Industrial commodities	"	104.5	104.4	102.5	2.0	3.4
Sensitive materials	"	102.6	103.1	103.0	- 0.4	2.2
Farm products and foods	"	108.8	111.5	103.6	5.0	10.8
Consumer prices (57-59=100)1/	"	114.5	114.1	110.4	3.7	5.5
Commodities except food	"	107.6	107.0	105.3	2.2	2.9
Food	"	115.6	115.6	109.7	5.4	8.1
Services	"	124.1	123.5	118.7	4.5	7.3
Hourly earnings, mfg. ($)	Nov'66	2.76	2.76	2.65	4.2	8.2
Weekly earnings, mfg. ($)	"	113.88	113.74	109.60	3.9	9.3
Personal income ($ bil.)2/	Oct'66	594.6	590.0	547.2	8.7	18.1
Corporate profits before tax ($ bil.)	QIII'66	82.1	82.8	75.0	9.5	21.1
Retail sales, total ($ bil.)	Oct'66	25.7	25.7	24.2	6.1	19.8
Autos (million units)2/	"	8.0	8.6	8.4	- 3.8	38.7
GAF ($ bil.)	"	6.1	6.1	5.6	9.4	19.6
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	848	1,070	1,411	-39.9	-44.3
Factory workweek (hours)	Nov'66	41.3	41.3	41.4	- 0.2	1.0
New orders, dur. goods ($ bil.)	Oct'66	24.1	25.3	22.4	7.4	22.8
New orders, nonel. mach. ($ bil.)	"	3.6	3.7	3.3	7.0	19.7
Common stock prices (1941-43=10)	Nov'66	81.49	77.13	92.15	-11.6	- 4.6
Manufacturers' Inventories, book val. ($ bil.)	Oct'66	75.7	74.9	66.6	13.6	22.5
Gross national product ($ bil.)2/	QIII'66	744.6	732.3	686.5	8.5	16.7
Real GNP ($ bil., 1958 prices)2/	"	649.3	643.5	618.2	5.0	11.0

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Dec. 2	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	5.55	5.65	6.25	3.00
U.S. Treas. bills, 3-mo., yield (per cent)	5.17	5.30	5.59	4.33
Net free reserves 2/ (mil. $)	- 207	- 227	- 94	- 583
Member bank borrowings 2/ (mil. $)	636	608	928	439
Security Markets (N.S.A.)				
Market yeilds 1/ (per cent)				
5-year U.S. Treas. bonds	5.28	5.36	5.89	4.88
20-year U.S. Treas. bonds	4.87	4.88	5.12	4.68
Corporate new bond issues, Aaa	5.86	5.75	5.98	5.32
Corporate seasoned bonds, Aaa	5.37	5.36	5.53	4.93
Municipal seasoned bonds, Aaa	3.89	3.82	4.04	3.59
FHA home mortgages, 30-year 3/	6.63	6.63	6.63	6.32
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	80.36	80.95	87.45	73.20
Dividend yield (per cent)	3.69	3.66	3.89	3.31

	Change in Oct.	Average change last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $) 5/				
Total reserves 6/	- 44	- 37	- 1.9	2.2
Bank loans and investments:				
Total	- 600	- 400	- 1.4	6.3
Business loans	700	400	6.7	16.7
Other loans	500	- 100	- 1.2	7.4
U.S. Government securities	-1,800	- 600	-14.0	- 9.1
Other securities	100	0	- 0.8	7.3
Money and liquid assets:				
Demand dep. & currency 6/	- 300	- 100	- 0.7	2.2
Time and savings dep. 6/	100	100	0.5	8.6
Nonbank liquid assets	2,900	2,100	9.5	5.5

N.S.A.--not seasonally adjusted. S.A.--Seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending November 30.
3/ Lates figure indicated is for month of September. 4/ Data are for weekly closing prices. 5/ Where necessary, comparisons shown below have been adjusted for definitional changes in June and July. 6/ Change in November.

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

	1966 Oct.	1966 Sept.	1966 QIII	1966 QII	1966 QI	1965 QIV	1965 QIII	1965 Year (billions
				Seasonally adjusted				
Current account balance				1,084	1,348	1,290	1,527	6.0
Trade balance 1/	360	235	725	853	1,168	1,271	1,231	4.8
Exports 1/	2,620	2,490	7,405	7,111	7,171	7,027	6,826	26.3
Imports 1/ 2/	-2,260	-2,255	-6,680	-6,258	-6,003	-5,756	-5,595	-21.5
Services, etc., net				231	180	19	296	1.2
Capital account balance				-1,175	-1,586	-1,542	-1,821	-6.9
Govt. grants & capital 3/				-961	-948	-881	-743	-3.4
U.S. private direct investment				-957	-687	-731	-569	-3.4
U.S. priv. long-term portfolio				-94	-219	-154	-363	-1.1
U.S. priv. short-term				-53	-2	-27	105	0.8
Foreign nonliquid				890	270	251	-251	0.2
Errors and omissions				-66	-268	-80	-240	-0.4
Balances, with and without seasonal adjustment (- = deficit)								
Liquidity bal., S.A.			-217	-125	-536	-332	-534	-1.3
Seasonal component			-495	-27	488	-3	-472	--
Balance, N.S.A.	-764	112	-712	-152	-48	-335	-1,006	-1.3
Official settlements bal.,			993	-198	-226	-1,158	232	-1.3
Seasonal component			-521	-182	628	33	-508	--
Balance, N.S.A. 4/	-213	312	472	-380	402	-1,125	-276	-1.3
Memo items:								
Monetary reserves (decrease -)	4	-139	-82	-68	-424	-271	-41	-1.2
Gold purchases or sales (-)	-45	37	-173	-209	-68	-119	-124	-1.7

1/ Balance of payments basis which differs a little from Census basis.
2/ Monthly figures tentatively adjusted for changes in carry-over of import documents
3/ Net of loan repayments.
4/ Differs from liquidity balance by counting as receipts (+) increases in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increase in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. We have again lowered our sights on the amount of rise in prospect for GNP in the current quarter. We are now estimating an increase of $12 billion--to a seasonally adjusted annual rate of $756.5 billion--and in the first quarter of 1967 we are projecting continued expansion at close to this rate. These dollar gains are little different from the increase now shown for the third quarter, and in real terms, growth over the period from midyear through winter holds at an estimated annual rate of about 3.5 per cent.

A major new demand development has been the finding, in the latest Commerce-SEC quarterly survey, that business has reduced its fixed capital spending in the last half of this year. Actual outlays for new plant and equipment were apparently somewhat lower than estimated earlier in the third quarter, and spending planned for the current quarter has been reduced appreciably. This is the first significant downward revision in the surveys since 1963.

The increase now programmed for plant and equipment outlays from the second to the fourth quarter is at an annual rate of 8-1/2 per cent--down from 11-1/2 per cent projected last summer (and the 17 per cent rate realized between the fourth quarter 1965 and the second quarter of this year). Progressive further slowing of expansion is indicated in the first half of next year--to an annual rate of only 4-1/2 per cent--and, in view of the marked tapering off of expansion indicated by this government survey to midyear and the small increases projected for the whole year 1967 by recent private surveys, business fixed investment outlays could well level off or decline in the second half of 1967. The recent weakening of business fixed investment plans undoubtedly reflects businessmen's re-appraisal of the economic outlook and the limited availability of funds for financing capital spending as well as their reactions to suspension of the 7 per cent investment tax credit and of accelerated depreciation allowances on newly acquired structures.

Residential construction also has contributed to the smaller rise now anticipated for GNP in the current quarter. Housing starts showed an unexpectedly large drop in October and, as a result, the fourth quarter estimate of residential building has been reduced further. Meanwhile revised figures indicate a somewhat higher level for the third quarter. The decline from the third to fourth quarter is now estimated at $2.8 billion, the same as from the second to the third quarter. It now appears probable that little further decline is likely in early 1967. A tapering off of the decline in this sector, which has been a major downdrag in the last half of this year, would provide an offsetting influence in terms of total GNP to further slackening of expansion foreseen in other sectors of the economy.

The rise in consumption expenditures estimated for the current quarter remains about as projected three weeks ago--and smaller than in the third quarter. Some further slackening in the rise is projected for the first quarter. The outlook for sales of autos and household durable goods remains relatively uncertain--sales have been lagging recently and near-term buying intentions in mid-October were reported by Census to be down significantly from year-earlier levels. Total dollar purchases of consumer durable goods are projected as holding at the third quarter level in the current and following quarter; in line with recent retail sales trends, expenditures on nondurable goods continue to rise and services maintain their rapid rate of expansion.

In contrast to evidence of slackening in the rise in consumer spending since the summer, expansion in personal income has speeded up. Payroll employment and personal income rose rapidly in October and November, and the increases in both total personal and disposable income estimated for the fourth quarter are considerably larger than their third quarter gains. As a result of this indicated upward divergence of expansion in consumer incomes from spending, the saving rate is estimated as recovering in the current quarter from the large decline in the third quarter (when consumer spending bulged sharply). A further increase in the saving rate is projected for the first quarter--to a more normal level close to the average in 1964 and 1965.

The rate of inventory accumulation, which showed a sizable decline in the third quarter from the exceptionally high second quarter rate, is estimated as declining further in the current and following quarter. The projected decline in the rate of accumulation is expected to result from slackening of expansion in final sales and output of consumer goods and business equipment, as well as from the sharp curtailment in construction activity. The extent of the decline over this period will depend, to an important degree, on the speed with which output curtailments are instituted in response to lagging sales. In the auto and appliance industries such output curtailments are now being instituted, and in the business equipment industries output increases have been slowing in recent months.

The Vietnam War and defense spending remain, by all indications, major expansive influences on the economy. A $3.5 billion rise in defense spending is still being estimated for the current quarter--below the third quarter increase largely because the latter included the special military and civilian pay increases. Although there is little evidence on which to base such an estimate, a rise of $2.5 billion is projected for the first quarter.

Industrial production. Industrial production in November is tentatively estimated to rise by only about 0.2 per cent and thus to remain at 159 rounded. This was the same level as in October and about 0.5 per cent above the August-September level. Output of steel and autos declined but output of most other durable goods is expected to have shown some increase. Auto assemblies in November did not reach earlier posted schedules. Output declined 6 per cent from October and was 9 per cent below a year earlier.

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

	1964	1965	1966 Proj.	1966 I	1966 II	1966 III*	Projected IV	1967 Projected I
Gross National Product	631.7	681.2	738.6	721.2	732.3	744.5*	756.5	768.0
Final sales	627.0	672.1	728.6	712.3	720.0	734.6*	747.5	760.2
Personal consumption expenditures	401.4	431.5	466.0	455.6	460.1	469.9	478.3	485.7
Durable goods	59.4	66.1	69.5	70.3	67.1	70.2	70.2	70.2
Nondurable goods	178.9	190.6	206.9	201.9	205.6	208.1	212.1	215.5
Services	163.1	174.8	189.6	183.4	187.4	191.5	186.0	200.0
Gross private domestic investment	93.0	106.6	115.2	114.5	118.5	114.9*	112.7	112.1
Residential construction	27.6	27.8	26.1	28.6	28.0	25.2*	22.4	22.0
Business fixed investment	60.7	69.7	79.1	77.0	78.2	79.8*	81.3	82.3
Change in business inventories	4.7	9.1	10.0	8.9	12.3	9.9	9.0	7.8
Nonfarm	5.3	8.1	10.1	8.5	12.1	10.4	9.5	8.0
Net exports	8.5	7.0	4.8	6.0	4.7	4.2	4.5	4.8
Gov't purchases of goods & services	128.9	136.2	152.6	145.0	149.0	155.5	161.0	165.4
Federal	65.2	66.8	76.5	71.9	74.0	78.3	82.0	84.6**
Defense	50.0	50.1	59.4	54.6	57.1	61.3	64.8	67.3**
Other	15.2	16.7	17.1	17.4	16.9	17.0	17.2	17.3**
State & local	63.7	69.4	76.1	73.1	75.0	77.2	79.0	80.8
Gross National Product in constant (1958) dollars	580.0	614.4	647.0	640.5	643.5	649.1*	655.0	660.4
GNP Implicit deflator(1958=100)	108.9	110.9	114.2	112.6	113.8	114.7	115.5	116.3
Per cent change, annual rate								
GNP current dollars	7.0	7.8	8.4	9.5	6.2	6.7	6.4	6.1
GNP constant dollars	5.3	5.9	5.3	5.9	1.9	3.5	3.6	3.3
Implicit deflator	1.6	1.8	3.0	3.6	4.3	3.2	2.8	2.8
Personal income	496.0	535.1	580.6	564.6	573.5	585.2	599.0	611.0
Wage and salaries	333.6	358.4	392.4	380.0	387.4	396.7	405.5	413.0
Disposable income	436.6	469.1	505.4	495.1	499.9	507.8	518.9	530.0
Personal saving	24.5	25.7	26.2	26.7	26.6	24.5	26.8	30.2
Saving rate (per cent)	5.6	5.5	5.2	5.4	5.3	4.8	5.2	5.7
Total labor force (millions)	77.0	78.4	80.1	79.4	79.7	80.4	80.9	81.3
Armed forces "	2.7	2.7	3.1	2.9	3.1	3.2	3.3	3.4
Civilian labor force "	74.2	75.6	77.0	76.5	76.7	77.2	77.5	77.9
Unemployment rate (per cent)	5.2	4.6	3.8	3.8	3.9	3.9	3.8	3.8
Nonfarm payroll employment (millions)	58.3	60.8	63.8	62.8	63.6	64.1	64.7	65.3

* Incorporates changes in published figures because of revisions in data underlying GNP estimates.

** Not to be used externally, but also harmful if swallowed.

Steel ingot production declined about 2 per cent further. In October, total output of iron and steel mill products was already down 5 per cent from the record summer level but was still relatively high. Two factors have contributed to the high rate of mill operations: consumption of steel in consuming industries has been at record levels and, according to trade reports, the steel mills themselves have been increasing inventories. November manhour data suggest further gains in output in many metal consuming industries, i.e., fabricated metal products, electrical and nonelectrical machinery, aircraft, and ordnance.

Preliminary November data for the nondurable industries suggest a continuation of the recent pattern of little change. Output of apparel, paper, and textiles, has edged downwards since midsummer.

Demand for household appliances has been softening. The output index for this group, while fluctuating from month to month, has remained at an advanced level since last April, but at the end of November and in early December, some producers announced cutbacks in output. Trade reports are ambiguous regarding the reasons for the cutbacks, but it no doubt reflects in part the sharply reduced volume of residential construction.

Production of construction materials also has been cut back. The rise in output of these materials accelerated in the last quarter of 1965 and by March 1966 output was at a new high. Since then it has declined and by October was down 5 per cent. Lumber production in late

1965 and early 1966 was stimulated by the escalation of the war in Vietnam and the threat of a strike. With peaceful settlement of the labor contract and with the sharp decline in residential construction, an oversupply quickly developed and by September lumber production had declined 15 per cent. However, output of most other major construction materials--concrete, structural metal parts, flat glass--has remained at advanced levels reflecting the continued relatively high rate of total public and private nonresidential construction.

Autos. Sales of new domestic automobiles were at a seasonally adjusted rate of 8.4 million units in November. While this was 4 per cent above October, it was slightly below the third quarter average, and was 7 per cent below the unusually high 9 million rate a year ago. Whether the apparent strengthening in sales from October to November can be taken as a favorable indication of the future sales outlook for the industry remains questionable.

Dealer inventories on November 30, at approximately 1.3 million units, are expected to remain unchanged in December as the industry adjusts production schedules down from an annual rate of 9.1 million units in October to 8.5 million units in November and possibly to a lower rate in December.

Consumer credit. Consumers added $380 million to their instalment debt in October. Excluding the auto strike period in the fall of 1964, this was the smallest monthly increase in four years. In September, the increase had amounted to $475 million, but that, too, was the smallest for a long time.

The instalment credit expansion has been at a relatively slow pace most of the year, and even assuming some pick-up in the final two months, the increase in outstandings for the year as a whole is not likely to reach $7 billion, as compared with a rise of $8 billion in 1965.

Recent weakness in consumer credit has affected all major credit lines--autos, home goods, home improvements, and personal loans. New extensions declined in October for the second month in a row in each of these categories. Meanwhile, repayments have continued to move up, although at a slightly slower pace than a year earlier.

Credit grantors are continuing to pursue restrictive lending policies. As would-be borrowers are screened more carefully, a higher proportion of applicants is being rejected than at this time last year. The trade press recently has reported elimination by some retailers of the option under which a customer who settles his account in 90 days pays no interest. This practice had been particularly prevalent among furniture and apparel stores.

Auto terms have been becoming more restrictive, too. The proportion of new car contracts written for 36 months was rising steadily by 2 or 3 points a year from 1961 to 1965, but during 1966 the proportion has tended down slightly. The typical new car contract still calls for a 36-month maturity, but apparently somewhat fewer applicants are now being rated sufficiently credit-worthy to obtain such favorable terms.

NEW CAR LOANS AT SALES FINANCE COMPANIES
(Proportion of contracts written for 36 months)

	Per cent
1961	70.5
1962	74.2
1963	76.3
1964	78.9
1965	79.5
1966 QI	80.6
Q2	80.1
Q3	80.0

Note: Quarterly data are seasonally adjusted.

Consumer buying plans. In mid-October, according to the Census quarterly survey of consumer buying intentions, the proportion of households reporting intentions to buy autos and major household durable goods within 6 months was significantly below a year earlier, and the number reporting intentions to buy either a new or previously occupied house within 12 months was down considerably.

For new cars, the proportion of households reporting intentions to buy within 6 months was 4.8 per cent, well below a year earlier (5.5 per cent) and the lowest since 1963. On the other hand, 12-month buying intentions held up much better, amounting to 10.4 per cent of households as compared with the record October 1965 figure of 10.6 per cent. Current uncertainties, such as availability of credit, draft status and perhaps safety considerations, appear to be affecting intentions to buy in the near term, although spending propensities over the longer term still seem relatively strong.

Intentions to buy used cars are down considerably, both on a 6-month basis (4.1 per cent as compared with the year-ago 4.5 per cent) and on a 12-month basis (7.5 per cent _versus_ 8.2 per cent). The mid-October 12-month buying plan figure is the lowest since this quarterly survey began in 1959.

The decline from a year ago in 6-month buying intentions for household durable goods--to 18 per cent from 19 per cent, for one or more of the 7 major items covered in the survey--followed a sequence of unusually strong gains in the three preceding surveys taken this year. The recent decline from a year-ago reflected primarily lower purchase plans for washing machines, refrigerators, and television sets, although, as compared with the earlier surveys in 1966, demands for other household equipment also appear to be not so strong.

The proportion of households reporting current incomes above a year earlier was down from the October 1965 survey, but consumers' income expectations over the coming year remained relatively strong.

Orders for durable goods. New orders for durable goods declined nearly 5 per cent in October, following a 7 per cent increase in September. Unfilled orders continued to expand in October, although at a reduced pace.

Most of the large September-October changes in new orders reflected fluctuations in defense products, which declined about 30 per cent in October after spurting nearly 50 per cent in September.

While the rate of inventory accumulation was speeding up during the spring and summer, manufacturers' shipments were showing little change and stock-sales ratios increased appreciably. But the ratio has levelled off this fall. In September, and also in October, the total book value of factory stocks represented 1.70 months' shipments, as compared with an average ratio of 1.61 in 1965 and early 1966.

CHANGES IN MANUFACTURERS' INVENTORIES, 1966
(Book value; seasonally adjusted; $ millions)

	I Q	II Q (monthly averages)	III Q	OCTOBER
Total	544	767	978	822
Durable goods	316	577	855	729
Motor vehicles	-31	2	85	-21
Other consumer durables	63	82	67	111
Machinery & Equipment & Defense products	194	324	459	367
Construction materials	6	40	35	102
Other durables	84	129	208	170
Nondurable goods	228	190	123	93

Moderate liquidation of stocks continued in the auto industry in October (the unusual build-up shown for the third quarter was concentrated in July and August). Another major factor contributing to the smaller increase in October than in the third quarter was the slackening of the pace of increase in the business and defense equipment sector, where earlier this year inventory accumulation had

The October level for defense products, while down sharply from the extraordinary September peak, was only a little below the average for the first eight months of the year and resulted in an appreciable further increase in the order backlog for this sector.

Apart from defense products, new orders on balance rose somewhat in October owing mainly to sharp recovery in the auto industry from reduced summer levels. New orders for steel showed a sizable decline. Orders for machinery and equipment, which had shown only a small further rise during the summer decreased in October although order backlogs in these industries continued to expand. The October level of new orders for the total of all durable goods except defense products was little changed from the average level prevailing during the first three quarters of the year, with October new orders for machinery and equipment and autos and other consumer durables moderately above early 1966 and orders for steel and construction materials down.

Manufacturers' inventories. The rate of accumulation of inventories by manufacturers, which had accelerated sharply from February through August, slowed considerably in September and, in October, held at about the September rate. The book value increase for September has been revised upward to $774 million (from the preliminary showing of a $695 million increase) and the October rise totaled $822 million; these increases are almost one-third smaller than the August rise of $1,152 million. The October inventory increase may still be on the high side as an indicator of the possible average monthly rise during the fourth quarter.

accelerated sharply. While one month's figure should not be taken to indicate a trend, some moderating tendency would appear to be in order in this sector, in line with the lag in new orders and slower growth of output of business equipment in recent months and the prospective slowdown in the rate of increase in final takings--especially for business equipment but perhaps also for defense products.

In contrast to lower rates of accumulation elsewhere, inventory accumulation in October was above third quarter--and earlier--rates for consumer durables other than autos and for construction materials. This step-up was probably temporary. Both sectors are subject to downward pressures from slack in final demands. Since October, output curtailments have been announced for some appliances, and output of construction materials has been trending downward.

Construction activity. Data on housing starts and permits for November and possible revisions for October are not yet available. Analysis of the decline in the seasonally adjusted annual rate of starts in October to 848,000 suggests the probability, however, that the October reading may appreciably overstate the extent of decline that will eventually be reported for the fourth quarter as a whole.

While starts reached a 20-year low in October, a large part of the drop was anticipated because, in a period when starts are under as abnormal downward pressure as at present, usual seasonal movements can hardly be expected to prevail, and in October unadjusted starts are normally expected to turn temporarily higher by about an implied

10 per cent. Given the fact that the seasonal adjustment factors decline sharply in the late fall and winter months, the seasonally adjusted starts series seems likely to rise in these months to rates significantly above the October level. At best, however, the rate for the fourth quarter as a whole is projected to average no more than 1 million, and this would still be down at least 8 per cent further from the reduced third quarter average.

Partly because of seasonal adjustment considerations, staff projections of starts are currently for little or no change in the first quarter of 1967 from the fourth quarter of this year. However, a further drop in the starts rate seems quite likely during the second quarter. Normally, unadjusted starts rise more than 50 per cent in the second quarter, but in view of the presently restricted flow of funds, the low level of commitments, and the relatively limited--though augmented--help currently being made available from FNMA and the Federal Home Loan Banks, a spring rise of this magnitude now appears to be more than can be expected. Further easing of mortgage funds during the second quarter would exert its major impact on starts in subsequent quarters because of lags between loan commitments and starts.

In the case of new construction expenditures, indications are that the present quarter will show a further downtrend, owing mainly to the drop in private residential outlays. In October, the latest month for which data are available, total expenditures were running below their third quarter average. While the trend for the private nonresidential and public components appeared to be relatively favorable, both types of activity remained below the peaks reached in the first quarter of the year.

NEW CONSTRUCTION PUT IN PLACE

	October 1966 (billions) 1/	Per cent change from	
		1st Q 1966	3rd Q 1966
Total	71.8	- 9	-2
Private	48.1	-11	-3
Residential	21.8	-21	-8
Nonresidential	26.3	- 2	+2
Public	23.8	- 3	--

1/ Seasonally adjusted annual rates; preliminary.

Total new construction outlays will probably decline further in the first quarter of next year even though some slowing in the rate of decline in residential construction expenditures is expected. Nonresidential construction expenditures, like public expenditures, are still unusually high and construction contracts and other information confirm the possibility of some further slackening from earlier peaks, owing to tax, cost, and other considerations. In the case of public construction expenditures, further attempts by the Administration is likely to limit such activity further.

Plant and equipment expenditures. Business outlays for new plant and equipment will continue rising but at sharply reduced rates in the first two quarters of 1967, according to the Commerce-SEC Survey conducted in late October and November. Moreover, the estimates for the third and fourth quarters of 1966 and the year as a whole have been reduced.

In the second quarter of 1967 such outlays are now indicated to be only 2.3 per cent more than estimated for the fourth quarter and 6.6 per cent more than in the second quarter of 1966. Quarterly increases in plant and equipment spending have become progressively smaller since the beginning of this year.

NEW PLANT AND EQUIPMENT SPENDING

	1965		1966				1967 Anticipated	
	III	IV	I	II	III	IV	I	II
	(Billions of dollars, seasonally adjusted annual rates)							
All industries	52.75	55.35	58.00	60.10	61.25	62.60	63.45	64.05
Manufacturing	23.00	24.15	25.60	26.80	27.55	27.80	27.85	28.45
Durable goods	11.75	12.45	13.15	13.85	14.35	14.65	14.70	15.10
Nondurable goods	11.25	11.70	12.45	12.95	13.20	13.15	13.15	13.35
Nonmanufacturing	29.75	31.20	32.40	33.30	33.70	34.75	35.60	35.60
	(Quarter-to-quarter annual rates of increase, per cent)							
All industries	19.1	19.7	19.2	14.5	7.7	8.8	5.4	3.8
Manufacturing	26.9	20.0	24.0	18.8	11.2	3.6	.7	8.6
Durable goods	35.2	23.8	22.5	21.3	14.4	8.4	1.4	10.9
Nondurable goods	20.6	16.0	25.6	16.1	7.7	- 1.5	0.0	6.1
Nonmanufacturing	13.2	19.5	15.4	11.1	4.8	12.5	9.8	0.0

According to this survey, third quarter outlays were $400 million (annual rate) less than reported in the August survey and plans for the fourth quarter have been reduced nearly $1 billion (annual rate). For the year, outlays are now estimated at $60.6 billion, up 16.5 per cent from 1965, as compared with a gain of 17.1 per cent shown by the August survey.

The Commerce-SEC survey findings for the first two quarters, coupled with the earlier McGraw-Hill survey for the whole year suggest a levelling off or a decline in spending after mid-1967. In recent years of vigorously expanding activity early plans were revised up as the year progressed. However, current prospects of more moderate growth in activity next year, together with scheduled termination at the beginning of 1968 of the suspensions of the investment tax credit and the accelerated depreciation allowances, may well limit upward revisions in 1967 spending plans, or even result in downward revisions.

Cutbacks from earlier plans in the third and fourth quarters of 1966, as reported in the latest survey, are the first of significance since 1963. Plans were lowered by producers of motor vehicles and parts, all major nondurable goods industries except petroleum products, transportation industries, and the communication-commercial sector. Several industries, however, raised planned outlays, including: primary metals, machinery, transportation equipment other than motor vehicles, petroleum products, and mining and public utilities.

Manufacturers' capital appropriations. Manufacturers approved new capital appropriations of $6 billion, seasonally adjusted, in the third quarter of this year, according to the latest NICB survey. This represented a 15 per cent decline from the second quarter and was only 3 per cent above a year earlier. An advance estimate (confidential) suggests some recovery in the fourth quarter. This series is highly volatile but the third quarter decline--although it followed a 12 per cent rise in the second quarter--was considerably larger than the usual range of fluctuations in this series. The bulk of the third quarter decline was in nondurable goods industries--down 28 per cent, as compared with a decline of only 4 per cent in durable goods industries.

The backlog of unspent appropriations edged up further in the third quarter despite the decline in newly approved appropriations. This rise in backlogs was the smallest since early 1963.

Labor market. Demands for labor were stronger in November than had been anticipated. The rise in nonfarm employment so far in the fourth quarter has been at a faster rate than in the third quarter, and the unemployment rate has declined to 3.7 per cent. The average workweek in manufacturing--one of the most sensitive indicators in a tight labor market--continued at a high average of 41.3 hours, unchanged over the month and only slightly lower than the postwar peak reached in earlier months this year.

Unemployment. Much of the advance in employment in recent months has been accounted for by sharp growth in the labor force of adult women in response to expanding demands. But, in addition, some further inroads in unemployment appear to have been made among most groups in November. The rate for adult men continued close to frictional levels, with the rate for married men declining to 1.7 per cent, the lowest this year. The rate for adult women decreased to 3.5 per cent from 4.0 per cent in October. But the unemployment situation among teenagers and nonwhite workers also showed some slight improvement but their rates continued relatively high. The teenage rate in November was at a new low for the year. The unemployment rate for nonwhite workers, at 7.4 per cent, has also been reduced somewhat from the summer months and a year earlier. It remained, however, 2-1/3 times as high as for white workers.

Nonfarm employment. Nonfarm payroll employment rose by 270,000 a more rapid advance than the average over the past year. Gains were widespread, with State and local government, services and manufacturing again leading, while construction employment continued to decline. The unemployment rate in the construction industry rose slightly further to 9.3 per cent, well above the 7.4 per cent rate prevailing in March.

In manufacturing, employment rose substantially. Moreover, the increase in durable goods employment was limited in part by strikes against G.E. and Westinghouse. A lack of increase in the transportation equipment industry resulted from reductions in auto production and a strike of 10,000 workers at West Coast shipyards. Almost all nondurable goods industries added to their work forces in November.

CHANGES IN NONFARM EMPLOYMENT
(Seasonally adjusted, in 000's)

	November from October 1966	Monthly average, year ending November
Total	271	236
Manufacturing	93	85
Durables	37	65
Nondurables	56	19
Construction	- 12	- 4
Other industrial 1/	15	7
Trade	24	40
Finance and service	69	46
Government	82	62
Federal	19	17
State and local	63	45

1/ Mining, transportation, and public utilities.

Wages and unit labor costs. Average hourly earnings of production workers in manufacturing industries rose to $2.76 and were 4.2 per cent higher than a year earlier. Year-to-year increases of more than 4 per cent have been maintained in recent months, compared with a 3.5 per cent average gain in the first half of this year. Added pressure on hourly earnings in December will come from the October rise in the Consumer Price Index. Over a million workers in the automobile and parts, aerospace, construction and farm equipment industries received a 3-cent cost-of-living increase early in December. All of these workers have now received 11 cents an hour in cost-of-living adjustments for 1966 compared with 4 cents in 1965.

Wage increases in manufacturing have been exceeding gains in productivity and have been reflected in reported increases in unit labor costs. Newly revised figures have become available which incorporate more recent estimates of supplements to wages and utilize improved computation procedures. These data show that unit labor costs, which had been holding relatively stable for several years, began to rise toward the end of last year, and in the past few months have been averaging more than 2 per cent higher than a year earlier; the previous series had shown an increase over the year of only about one per cent. The revised series appears to be more in line with recent trends in earnings. Average hourly earnings in manufacturing have been rising steadily throughout 1966, reflecting upward pressure on wages from higher contract settlements--which have recently been in the 5 per cent range--as well as the highest cost-of-living wage adjustments in many years.

CHANGES IN UNIT LABOR COST FOR ALL EMPLOYEES
IN MANUFACTURING, SEASONALLY ADJUSTED
(Per cent change from a year earlier)

	Unit labor cost		Unit labor cost
January 1966	0.7	July 1966	1.7
February 1966	1.0	August 1966	2.1
March 1966	1.1	September 1966	2.2
April 1966	1.7	October 1966	2.5
May 1966	1.4		
June 1966	1.6		

<u>Price developments</u>. The latest indexes available probably do not provide very reliable indicators of the most recent behavior of prices. The BLS weekly estimates of the wholesale index for industrial commodities shows no change from October, but the comprehensive monthly index probably will show an increase; and the October increase in the consumer price index was as large as the average increase over the preceding four months, but the November increase is not likely to be so large.

The BLS weekly estimates for industrial commodities are overweighted with sensitive materials, and they have been relatively stable since mid-October following an appreciable decline from the spring peak. The BLS daily index of 13 basic industrials also has leveled out since mid-October after declining 15 per cent from its March peak. However, price increases to take effect in November and December have been announced for agricultural machinery, commercial and home air-conditioners, and other electrical equipment. Some chemicals and fuels also have increased.

Wholesale prices of foodstuffs declined further in late October and then turned relatively stable in November at an average level about 1.5 per cent lower than the index for mid-October. Livestock and meats, accounting for most of the decline, fell about 5 per cent further to the lowest levels in more than a year.

Retail prices of meats still had not shown much decline by early October, the pricing period for the latest consumer price index; they were down only 0.5 per cent from September and were still about 5 per cent higher than in the autumn a year ago. The October decrease in prices of foods for home consumption consequently was small and the total for foods including restaurant meals was unchanged. A decline in food prices is expected in November.

With foods not providing any offset to increases in prices of other commodities and services, the total consumer price index showed another large increase in October (see table below). Services (not including rent) rose another 0.5 per cent, with medical care continuing to lead the way with an increase of nearly 1 per cent. The reported rise in rent has picked up slightly; in the four months from June to October the index rose 0.7 per cent or as much as in the first half of the year.

The increase in nonfood commodities was seasonal. Furniture and some household supplies increased, but apparel and fuels rose less than seasonally, and although new cars rose considerably more than seasonally, they did so mainly because of the earlier introduction of 1967 models which resulted in the sales mix having a higher proportion of new models than had been typical for October. BLS also reported that while suggested retail prices for the 1967 models averaged $55 or 2.1 per cent higher than for the 1966 models, all but 0.2 per cent of the increase was accounted for by quality improvements.

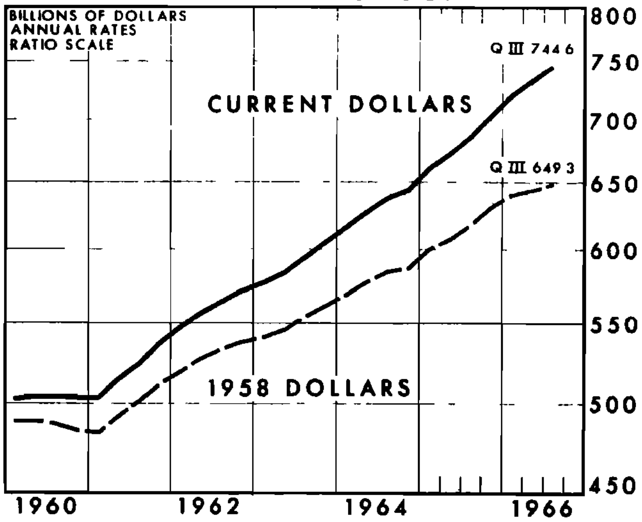
CONSUMER PRICE INDEX

	Index 1957-59 = 100	Per cent change to October 1966 from: Sept. 1966	Oct. 1965	Oct. 1964
All items	114.5	.4	3.7	5.5
Food	115.6	0	5.4	8.1
At home	113.8	-.2	5.6	8.1
Away from home	125.2	.5	5.0	8.2
Commodities less food	107.6	.6	2.2	2.9
Apparel	110.4	.6	3.3	4.7
Other nondurables	111.2	.2	2.3	4.6
New cars	98.4	4.2	.7	-2.9
Used cars	120.8	.6	1.2	- .9
Household durables	97.4	.1	1.5	- .6
Rent	110.0	.3	1.6	2.6
Other services	127.1	.5	5.0	8.1
Medical	137.4	.9	7.3	10.8
Transportation	125.9	.3	4.3	9.2
Household	123.5	.4	4.7	7.0
Miscellaneous	128.2	.5	4.4	7.5

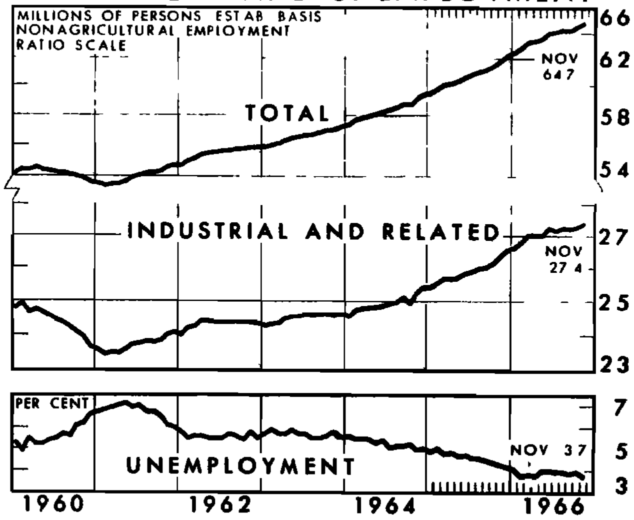
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

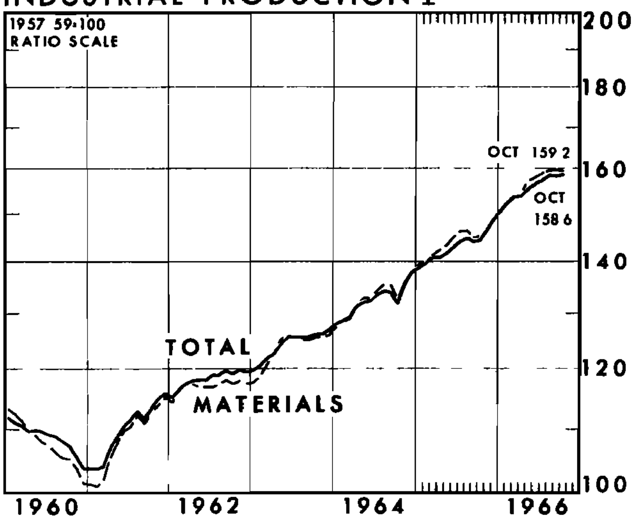
GROSS NATIONAL PRODUCT



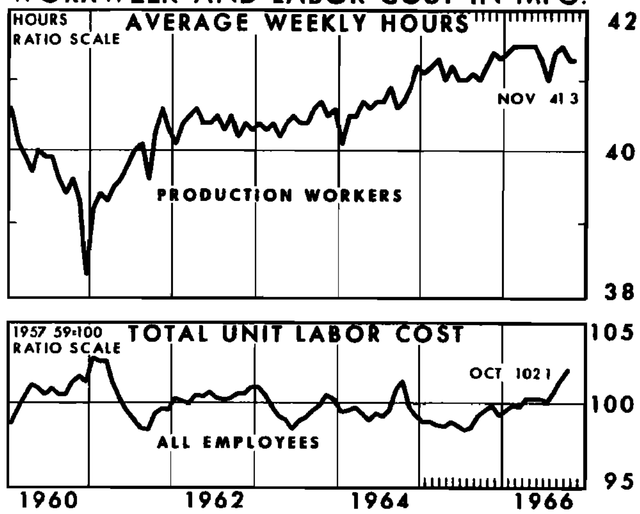
EMPLOYMENT AND UNEMPLOYMENT



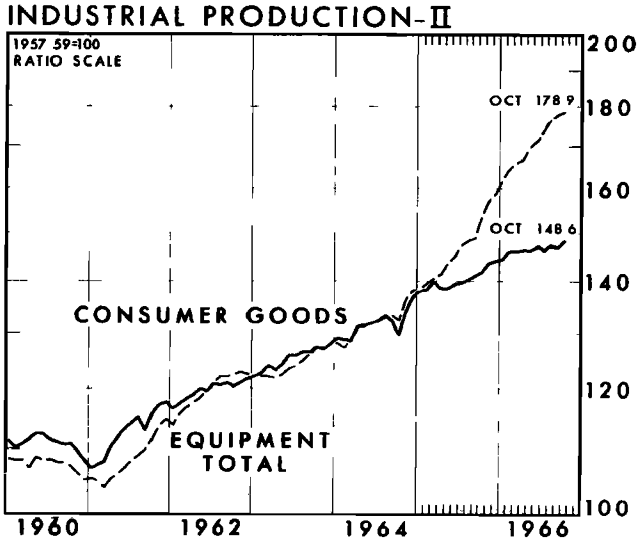
INDUSTRIAL PRODUCTION-I



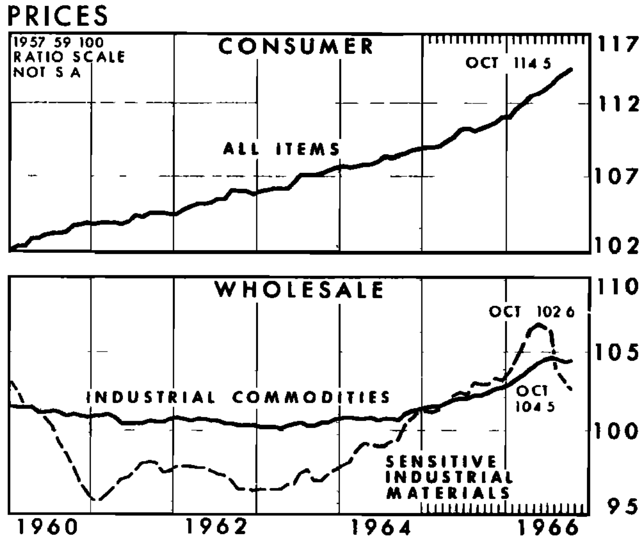
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



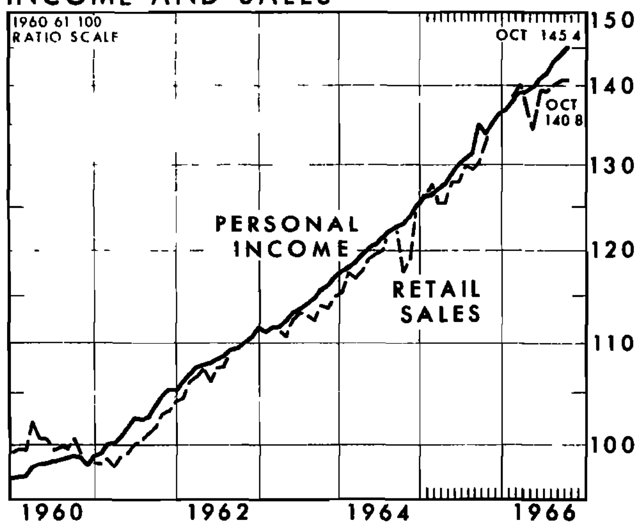
PRICES



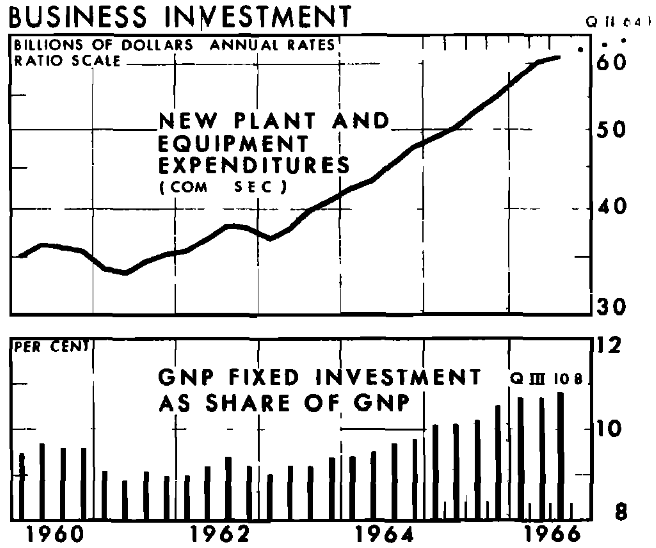
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

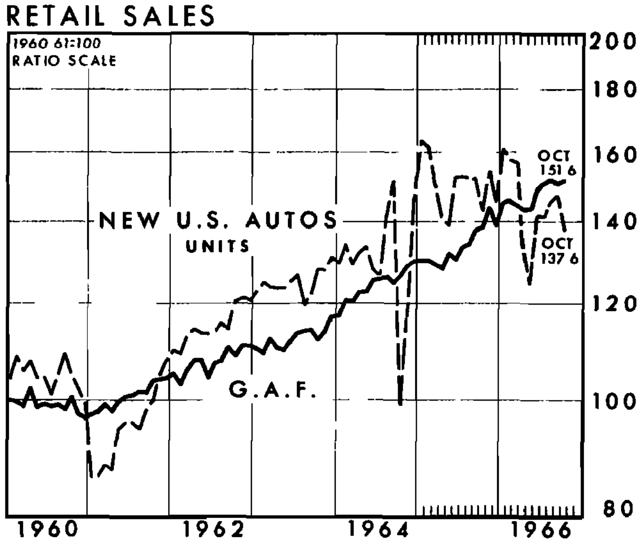
INCOME AND SALES



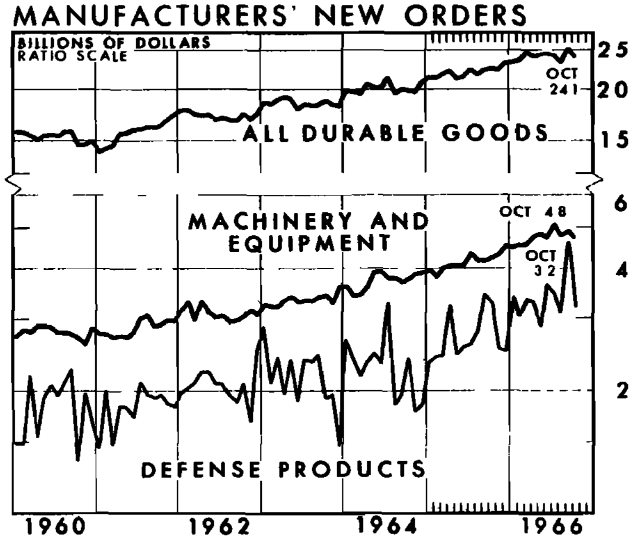
BUSINESS INVESTMENT



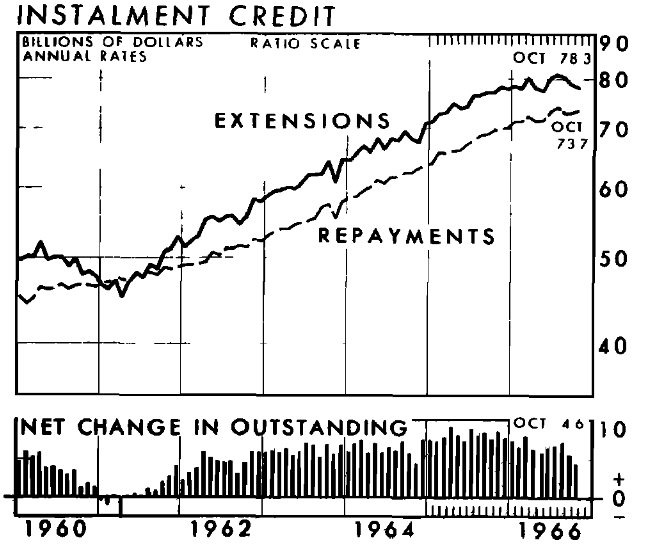
RETAIL SALES



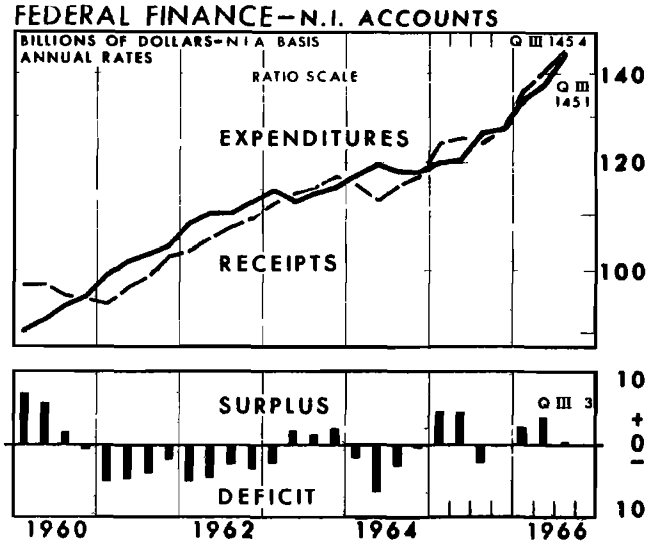
MANUFACTURERS' NEW ORDERS



INSTALMENT CREDIT



FEDERAL FINANCE—N.I. ACCOUNTS



DOMESTIC FINANCIAL SITUATION

Bank credit. Commercial bank credit is estimated to have increased by $600 million in November, or at an annual rate of 2.3 per cent following declines in October and September at annual rates of 2.3 per cent and 8.5 per cent. However, the late November Treasury bill issue of $1.2 billion, payable by full tax and loan credit, accounted for about one-third of the November increase, since banks purchased essentially all of this issue, a good part of which they still retained at month-end. For the three months, September-November, bank credit declined at a 2.7 per cent annual rate, in sharp contrast to the 8.4 per cent rate of increase recorded for the first 8 months of the year.

CHANGES IN COMMERCIAL BANK CREDIT 1/
(Annual rate - per cent)

	1966			1965
	November 2/	September-November 2/	January-August	Year
Total loans & investments	2.3	- 2.7	8.4	10.2
U.S. Govt. securities	4.6	-25.0	-4.7	-5.2
Other securities	-2.5	1.7	6.7	15.8
Loans	2.9	2.3	12.7	14.7
Business loans	6.1	8.2	18.4	18.5

1/ Annual rates of change have been adjusted for definitional shifts of participation certificates and balances accumulated for payment of personal loans.

2/ Preliminary.

Pressures on the banking system remained severe in November, even though loan expansion was much more moderate than in October, primarily because of further reductions in both private and U.S. Government demand deposits. City banks also continued to lose time deposits. As a result, banks liquidated $100 million of municipal and Federal agency securities, and--despite the late November financing--added only $200 million to their holdings of Treasury issues.

More banks--especially large ones--apparently have found it necessary to obtain funds by relying more heavily on sales of other securities. This was particularly noticeable at weekly reporting banks during the 4 weeks ending November 23. In that period such banks liquidated $900 million of municipal and agency securities and nearly $200 million of U.S. Treasury issues, while their total loans declined $20 million.

The increase of only $500 million in total loans at all banks in November reflected a slowing in business loan expansion, following the October spurt, and a continuing small increase in real estate and consumer loans. All other loans in the aggregate showed little net change. Limited availability of bank funds probably was the major factor in the small increases in real estate loans, while weakness in sales of new autos apparently contributed to the slowing of consumer loan expansion. Security loans showed little change; while financing needs of government security dealers moderated somewhat as the month progressed--because of heavy System buying and strong investment demand from public authorities and nonfinancial corporations--they rose again at month-end to accommodate dealer positions in the new bills.

Business loans rose only $400 million in the month, somewhat below the reduced rates of the 2 preceding months. The continuing slowdown is associated evidently with both the limited supply of bank funds and some reduction in business demand for bank credit. On the supply side, deposit losses have compelled banks to enforce more stringent lending standards. On the other hand, the fact that moderation in loan expansion is quite widespread among industries, with transport equipment a notable exception, suggests that slowing of demand may also have been a factor. Of particular interest is the weakness in trade loans, since these loans are closely related to trade inventories.

Bank response to recent Federal Reserve efforts to encourage curtailment of business loan expansion has varied. Among weekly reporters, business loans at New York City banks--although expanding less rapidly than in 1965--have been cut back much less than at weekly reporters outside New York City, as shown in line 5 of the table following. As a result, New York City banks' share of the increase in these loans from mid-August to late November amounted to about 60 per cent, compared with around 40 per cent for comparable periods of earlier years.

Since New York City banks experienced about two-thirds of the $3 billion CD runoff over this period (line 10), they had to make sharp reductions in their nonbusiness loans (line 6) and in their holdings of other securities (line 3) in order to maintain their business loans. They also made substantial use of Euro-dollars (line 11). While banks outside of New York cut back relatively more on their business loans, they also relied heavily on liquidation of other loans and other securities to meet deposit losses. Since business loans are relatively more important to New York City banks than to all other weekly reporters--as measured as a percentage of total loans and investments--these data suggest that New York bank attached higher priority to accommodating business loan demands than outside banks and paid a much higher price to meet those demands. It might be noted that New York City banks hold only about one-third of the business loans of all weekly reporting banks.

RECENT CHANGES IN SELECTED ASSETS AND LIABILITIES1/
Weekly Reporting Banks
(in millions of dollars, not seasonally adjusted)

	New York City banks			Outside banks		
	1966	1965	1964	1966	1965	1964
(1) Loans and investments	-1191	919	574	- 176	3118	3484
(2) U.S. Govt. securities	2	301	150	370	932	1183
(3) Other securities	- 587	-422	21	- 551	- 91	351
(4) Total loans	- 606	1040	403	5	2277	1950
(5) Business loans	500	828	657	448	1121	976
(6) All other loans	-1206	212	-254	- 443	1156	984
(7) Demand deposits	578	449	1392	625	1929	2500
(8) U.S. Govt.	- 61	-843	-157	- 366	-1254	-470
(9) Time deposits	-1963	611	564	-1147	1708	885
(10) CD's	-1903	257	359	-1154	339	179
Memo:2/						
(11) Use of Euro-dollars	773			579		

1/ Fourteen weeks beginning August 17, 1966, August 18, 1965, and August 19, 1964.

2/ Includes data for 12 banks, 8 in New York City, 2 in Chicago, and 1 each in San Francisco and Boston, and American Express.

<u>Bank deposits</u>. Time and savings deposits at commercial banks rose only $100 million during November, an annual rate of less than one per cent. While this increase partially offsets October's 2.3 per cent annual rate of decline, it fell far short of the 11 per cent rate of increase in the first eight months of the year. Country banks--having less interest sensitive customers--continue to do relatively well in the time deposit market. Over the past 3 months time deposit growth at these banks--though moderating somewhat--was still running at a 9 per cent annual rate; at reserve city banks, however, time deposits have declined at a 10 per cent annual rate, reflecting in large part CD run-offs at New York and Chicago banks.

As shown in the table, weekly reporting banks continued to lose total time and savings deposits in November, although at a somewhat reduced pace, especially after taking account of the normal seasonal decline in time deposits other than CD's. With interest rates on short-term Treasury bills falling below the 5-1/2 per cent ceiling, the runoff of CD's in the four weeks ending November 23 slackened to $400 million, less than 40 per cent of the September-October loss. New York City banks, which have highly interest-sensitive depositors, accounted for nearly all of this loss, as other city banks were better able to replace most of their maturities. Indeed, since November 2, weekly reporters outside of New York have actually increased their outstanding CD's by $40 million.

CHANGES IN TIME AND SAVINGS DEPOSITS
Weekly Reporting Banks
(In millions of dollars, not seasonally adjusted)

	November 1/		October 2/		September 3/		1st 8 months 4/	
	1966	1965	1966	1965	1966	1965	1966	1965
Total time & savings	-837	230	-1,212	1,188	-879	573	6,081	8,822
Savings deposits	- 51	329	-215	400	9	540	-3,443	3,081
Time deposits	-786	-99	-997	788	-888	33	9,524	5,741
CD's	-390	223	-1,077	470	-1,201	-260	1,547	3,594
Time other than CD's	-396	-332	80	318	313	293	7,977	2,147
Savings deposits and time other than CD's	-477	7	135	718	322	833	4,534	5,228

1/ Four weeks ending November 23, 1966, and November 24, 1965.
2/ Four weeks ending October 26, 1966, and October 27, 1965.
3/ Four weeks ending September 28, 1966, and September 29, 1965.
4/ Thirty-four weeks ending August 31, 1966, and September 1, 1965.

The outflow of savings deposits at city banks during November continued to be more moderate than it had been following the March and June interest crediting periods. This presumably reflected the smaller residual of interest-sensitive funds remaining in passbook accounts and the reduced attractiveness of time deposits in some areas following the rate rollback. However, the decline in time deposits other than CD's--a decline seasonally associated with Christmas Club maturities--was larger than usual this year. Part of the runoffs in State and local funds and in consumer-type time deposits, other than Christmas Club accounts, were associated with continued transfer of funds to market securities. The 5 per cent ceiling on time deposits with denominations under $100,000 was evidently a contributory factor in some cases. A discussion of time deposit behavior of those banks paying above 5 per cent on consumer-type time deposits prior to late September, as well as those banks which have been important issuers of CD's, can be found in Appendix A.

The money stock declined $400 million further in November--or at an annual rate of minus 2.8 per cent. Since March, the money stock has remained virtually unchanged even though the volume of transactions, as reflected by the volume of debits to demand deposit accounts, increased at an annual rate of approximately 12 per cent at 224 Standard Metropolitan Statistical Areas (excluding New York) between March and October. However, since mid-summer both the volume of debits to demand deposit accounts and demand deposit turnover at these areas declined slightly, while the money stock was unchanged.

With Government expenditures continuing to expand and with the legal debt limit imposing restrictions on new Treasury borrowing, seasonally adjusted U.S. Government deposits at banks declined by $600 million in November, to their lowest level of the year.

With city banks continuing to lose total private deposits, and with Government deposits down sharply, large banks obtained net $125 million of funds in the Euro-dollar market in November. However, the flow of funds from this source was sharply reversed in the last 3 weeks, due, in part, to some window dressing operations by foreign banks.

<u>Corporate and municipal bond markets</u>. Yields on new corporate and seasoned municipal bonds rose as much as 25 basis points during

November--erasing roughly half of their sharp September-October declines. Reeently, however, most new issues have been received quite well, in some cases at lower yields, and yields on recently offered issues also have edged lower in secondary markets. These tendencies developed even though most of the heavy December calendar was yet to come. The stronger tone among other things reflected recent money market evidence of reduced Federal Reserve restraint.

BOND YIELDS
(Per cent per annum)

	Corporate Aaa			State and local Government	
	New		Seasoned		
	With call protection	Without call protection		Moody's Aaa	Bond buyer's (mixed qualities)
1965					
Low	4.33(1/29)1/		4.41(3/12)	2.95(2/11)	3.05(2/11)
1966					
Low	4.79(1/7)	4.84(1/7)	4.73(1/7)	3.39(1/21)	3.51(1/21)
Weeks ending					
July 29	5.47	5.65	5.22	3.78	3.96
Sept. 2	5.98*	--	5.44	4.02	4.24
Nov. 4	5.60	5.87	5.35	3.72	3.74
Nov. 18	5.85	--	5.36	3.81	3.93
Dec. 2	5.80	6.10	5.37	3.89	4.02

1/ Issues with and without call protection averaged together.
* Includes issues with 10-year call protection.

In the municipal bond market late additions to the new issue calendar boosted November volume nearly to the $1 billion total of a year ago, and for December the estimated volume is $200 million larger than last year--due chiefly to the Oklahoma Turnpike issue which was marketed last week following several months of postponements.

While more than $50 million of smaller issues were deferred because of high interest costs within the past two weeks, the Oklahoma Turnpike issue sold out quickly and distribution of other recent offerings has been quite successful. Strengthening of the municipal market apparently reflects a presumption in market circles that the recent moderation of monetary restraint will maintain the improved competitive position of large bank CD's relative to Treasury bills, and thus make banks a more positive factor in the demand for municipal bonds during the months ahead.

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

	1966-67	1965-66
1st Quarter	2,963	2,851
2nd Quarter	3,255	3,046
3rd Quarter	2,463	2,781
4th Quarter	2,675e	2,651
Total	11,356e	11,329
October	725e	844
November	950e	1,043
December	975e	764
January	850-950e	1,219

1/ Data re for principal amounts of new issues.

In the corporate bond market, issues scheduled for public offering in the current week aggregate nearly $500 million. Another

$260 million is scheduled for offering next week; and for all of December the estimated volume totals $1.1 billion--about the same as the record August total. The December volume includes $215 million of intermediate term notes and $175 million of convertible bonds, as compared with $300 million of convertibles in August.

Corporate issues planned for public offering in January 1967 already total $590 million, more than the $460 million issued in January 1966. Of this year's total $400 million is accounted for by the AT&T and Bethlehem Steel issues. Advance announcements for the February calendar amount to about $200 million.

CORPORATE SECURITY OFFERINGS 1/
(In millions of dollars)

	Bonds					
	Public offerings 2/		Private placements		Stocks	
	1966-67	1965-66	1966-67	1965-66	1966-67	1965-66
1st Qtr.	1,774	905	2,586	1,673	734	429
2nd Qtr.	1,941	1,864	2,083	2,259	1,090	920
3rd Qtr.	2,256	1,575	1,627	1,955	314	383
4th Qtr.	*2,195	1,226	1,800e	2,264	445e	540
October	520e	287	450e	574	120e	124
November	550e	6 613	450e	529	125e	257
December	*1,125e	326	900e	1,161	100e	159
January	700e	460	450e	692	n.a.	n.a.

1/ Data are gross proceeds.
2/ Includes refundings.
* Includes Pennzoil $215 million short-maturity notes.

Some of the influences accounting for the enlarged calendar in the face of indicated slowing of corporate spending seem clear. Most important, corporate outlays for types of investments typically financed with security issues have continued to grow, whereas external financing available to finance such outlays from other than public offerings--such as term loans at banks and private placements with institutional investors--have continued to shrink. In addition, the forward calendar of new issues may have been augmented to some extent recently by corporations seeking to anticipate heavy cash needs in the second quarter of 1967. In that quarter advance payments due on corporate income taxes will rise to 50 per cent of estimated 1967 liabilities from the 24 per cent rate applicable (to 1966 liabilities) in the second quarter of this year.

Among these influences continued increases in outlays on fixed investment has probably had the greatest impact on financing. While over-all corporate investment expenditures have been cut back since mid-year, the decline has been concentrated in outlays for inventories and multifamily and commercial construction which are more likely to be financed with bank loans and mortgages than with security issues. Plant and equipment outlays have continued to rise and are expected to rise a little further in the first half of 1967. At the same time, corporate internal funds have failed to grow (with further expansion of capital consumption allowances about offsetting a down-trend in retained earnings). Hence, it is not surprising that fixed investment outlays have continued to require a large volume of security market financing.

Stock market. Common stock prices--as measured by Standard and Poor's composite index--have declined slightly in each of the past three weeks. At 80.84 on December 6, the "500" index was almost 2 per cent below its mid-November level, but remained 10 per cent above its 1966 low (October 7). In general, the whole period since late October has been marked by moderate day-to-day price fluctuations within a narrow range, reflecting prevailing cross-currents of uncertainty about the business outlook, corporate profits, Federal spending and taxes.

In recent weeks, the volume of trading has been heavy, averaging about 7.5 million shares daily, with the most active trading tending to accompany price advances. Activity has been augmented by year-end tax swapping. But November was nevertheless the third successive month in which trading activity fell behind the 1965 pace.

The use of stock market credit by margin customers declined slightly ($7 million) in October or measured by the NYSE margin panel. While customers' net debit balances with NYSE member firms were down considerably more--$186 million to less than $5.2 billion--this was due chiefly to the technical influence of start selling. Record short-selling in both September and October created a large volume of credit entries of a bookkeeping nature which offset an equal amount of debit balances.

Mortgage market developments. Fragmentary trade and press reports during recent weeks suggest that there may have been some slight improvement in the availability of mortgage funds, along with some lessening of pressures to tighten loan terms. Comprehensive data on mortgage flows and credit conditions are available only through October, however, and these do not indicate any significant market turn.

The number of offerings of Government-backed loans to the Federal National Mortgage Association for purchase under its secondary market operations did ease off somewhat in November, due partly to a slowdown during Thanksgiving week. And the FNMA also announced on November 29 that it stands ready to issue $250 million in advance mortgage commitments under the added $1 billion special assistance authorization approved last fall. Under these commitments, FNMA will agree to buy, at prices well above the current market, certain FHA and VA 6 per cent mortgages on yet-to-be-started homes.

Coming at a time when home mortgage debt has been expanding at a seasonally adjusted rate of around $2-1/2 billion per quarter, infusion of an additional $250 million in FNMA's new commitments promises a modest degree of near-term market support. Further support will be provided by the just announced release of $500 million in Federal Home Loan Bank funds to finance expansion of residential lending by savings and loan associations. Together, however, these FNMA and FHLB support actions could finance no more than 40,000 homes which would probably be started over roughly the next 90 to 180 days, depending on the speed that builders with developed land and construction plans can complete the details of their financing arrangements.

In October, the cumulative effects of months of tight credit on conventional home mortgage lending showed up in further year-over-year reductions in average maturities, according to the FHLBB-FDIC series. Average loan-to-price ratios were also lower, as loan amounts increased less since last year than prices of new and existing homes being financed. The tendency to ration available loans in favor of better-quality collateral and lower-risk borrowers is suggested by the fact that implied cash downpayments (purchase price less first-mortgage loan) remained at or close to record amounts for this 4-year-old series.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASES

	1966		Per cent change from a year ago in October
	September	October	
New home loans			
Purchase price ($1,000)	27.0	27.3	9
Loan amount ($1,000)	19.0	19.2	5
Loan/price (per cent)	71.1	71.0	-4
Maturity (years)	24.3	23.6	-5
Existing home loans			
Purchase price ($1,000)	20.4	20.4	4
Loan amount ($1,000)	14.0	14.1	1
Loan/price (per cent)	69.5	69.5	-3
Maturity (years)	19.4	19.2	-4

Source: Federal Home Loan Bank Board and FDIC.

Flows to intermediaries: Final data for October indicate that net flows to savings and loan associations and mutual savings banks were less favorable than preliminary reports had suggested. At all insured associations (representing 96 per cent of industry assets) there was a small net contraction of share capital rather than a net gain as initially indicated. While this loss was considerably smaller than many in the industry had feared, the algebraic difference between October net flows this year and those of 1965 (see table) was nearly as large as the difference in April, and nearly two-thirds as large as in July following the semi-annual interest crediting date.

Net flows to mutual savings banks in October were also below preliminary estimates which had been based on results for the New York State banks alone. But when allowance is made for seasonal influences, savings bank deposits grew at nearly a 7 per cent annual rate in October, as compared with about a 5 per cent rate in August-September, and a 4 per cent rate in the preceding seven months.

FLOWS TO DEPOSITARY-TYPE FINANCIAL INTERMEDIARIES
(In millions of dollars)

	Total	Savings and Loans Associations	Mutual Savings Banks	Commercial Banks 1/
October				
1966	542	- 60	131	471
1965	2,295	582	170	1,543
10 months				
1966	13,648	1,274	1,643	10,731
1965	22,158	5,934	2,706	13,518

1/ Excludes negotiable CD's at weekly reporting banks.

Data on November savings flows at the S&L's and savings banks are still incomplete. But savings banks in New York State alone experienced a net deposit inflow of $185 million, slightly larger than in any other November. If savings banks outside New York continue to fare less favorably, it would appear that November inflows for the industry would total about $220 million, or 20 per cent less than in November 1965.

As for savings and loan associations, a somewhat larger than seasonal repayment of Home Loan Bank advances during November as well as a substantial contra-seasonal increase in association deposits at the Home Loan Banks indicate that the S&L's have experienced sufficient net inflows to make progress in repaying advances and adding to liquidity. Under recent FHLBB regulations, associations which have received advances to meet withdrawals must repay these advances out of any net expansion in share capital before making new loans; consequently many associations have been limited to repayment flows in acquiring new mortgages.

During October, in fact, the volume of new mortgage acquisitions by insured S&L's dropped virtually to the same level as repayment flows. At the least, this relationship suggests that mortgage funds available from S&L's will not shrink further, it is an industry "rule of thumb" that repayments are automatically reinvested in mortgages, and although further net drains of share capital are expected in the post-Christmas January reinvestment period (following quarterly and semi-annual interest crediting in December), these drains would be covered largely by FHLB advances.

FHLB funds provided to cover withdrawals in January would be in addition to the $500 million of Federal Home Loan Bank credit released this week for expansion purposes. These expansion advances will be made available over a two to three month period. But their availability will not alter existing policy requiring individual S&L's to repay promptly their outstanding withdrawal advances as savings capital grows.

Looking beyond January, industry analysts are hoping for some strengthening of the slight pick up in net savings flows which they believe has already been occurring in November and December. Their hopes reflect the fact that a sizeable number of associations (600 in October and November) are experimenting with various types of certificate plans which appear to have been successful in attracting funds. Also, they apparently hope that market rates will decline relative to S&L rates in the period ahead.

<u>U. S. Government securities market</u>. Yields on Treasury notes and bonds declined in late November and early December after rising on balance since late October. Currently, yields on short- and intermediate-term Government securities (including bills) are at, or close to, their lowest levels of the fall months, but yields on long-term bonds remain somewhat above their recent lows of late October.

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
1966						
Highs	5.59	5.98	6.22	5.89	5.51	5.12
Lows	4.33	4.46	4.78	4.76	4.56	4.49
1966						
Aug. 29	5.02	5.51	6.22	5.89	5.51	5.12
Sept.21	5.59	5.96	5.90	5.53	5.21	4.97
Oct. 25	5.23	5.51	5.40	5.24	4.94	4.72
Nov. 10	5.45	5.70	5.57	5.39	5.17	4.89
Nov. 25	5.27	5.47	5.56	5.39	5.23	4.91
Dec. 6	5.15	5.25	5.47	5.25	5.07	4.88

The recent declines in Treasury bond yields have occurred against a background of continued signs of moderation in the domestic economy and a growing feeling that monetary policy may have moved to a somewhat less restrictive posture. However, improvement in the longer-term issues has been restrained by the large corporate bond calendar and rumors of a possible offering of FNMA participation certificates late in 1966 or early in 1967.

There has been sizable market demand for Treasury coupon issues in recent weeks, as measured by the decline in dealer holdings. From their peak in early November, dealer positions in notes and bonds due after 1-year have been reduced by about $300 million to their current level of about $750 million. This demand has featured recent large purchases of the new 5-3/8's of November 1971 by a major New York City bank and by a turnpike authority.

Treasury bill rates declined sharply in the second half of November when strong bill demand from private investors was supplemented by large Desk purchases for System and foreign accounts. The dealers also were able to find an improved availability of financing from corporations, public funds, and banks around the country. New York banks continued to post relatively high dealer lending rates, although these rates declined from their peaks as November progressed. Additional financing was provided in late November and early December as the Desk made a sizable volume of repurchase agreements to meet seasonal reserve needs.

The bill market steadied in early December, as demand tapered off and dealers built up their inventories through large awards of newly auctioned bills. However, the smaller than expected size of the Treasury cash offering of June tax bills on December 6 ($800 million) injected a positive note in the market.

As bill rates declined in recent weeks, the spread between 3-month and 6-month bill rates narrowed considerably and fell to less than 10 basis points in late November. This spread compares with one ranging from 25 to 50 basis points since mid-summer, and apparently reflects market expectations of lessened pressures on bills rates in the months ahead.

Yields on short-term debt instruments other than bills have also been steady to slightly lower in recent weeks, as the table shows.

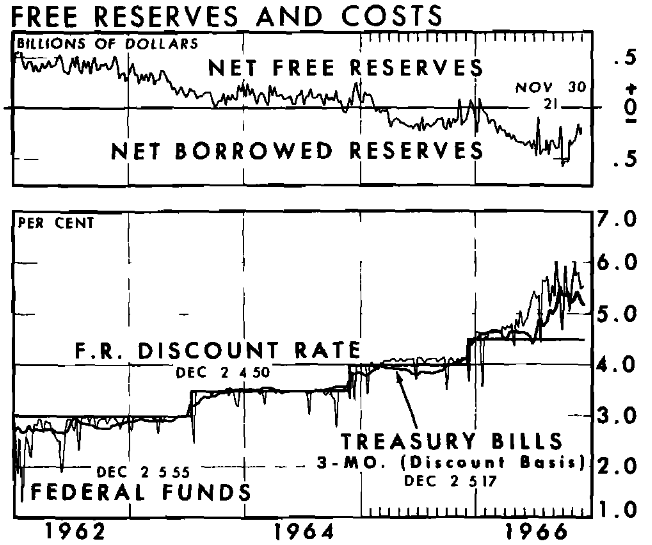
SELECTED SHORT-TERM INTEREST RATES1/

	1966			
	June 30	Sept. 23	Nov. 18	Dec. 2
Commercial paper 4-6 months	5.625	5.875	6.00	6.00
Finance company paper 30-89 days	5.50	5.625	5.875	5.875
Bankers' Acceptances 1-90 days	5.50	5.75	5.75	5.625
Certificates of deposit (prime NYC)				
Highest quoted new issue:				
3-months	5.50	5.50	5.50	5.50
6-months	5.50	5.50	5.50	5.50
Secondary market:				
3-months	5.55	5.90	5.75	5.75
6-months	5.60	6.30	5.90	5.80
Federal Agencies (secondary market):				
3-months	5.29	5.76	5.66	5.32
6-months	5.53	6.04	5.77	5.62
9-months	5.64	5.96	5.98	5.84
Prime Municipals 1-year	3.50	4.25	4.00	3.85

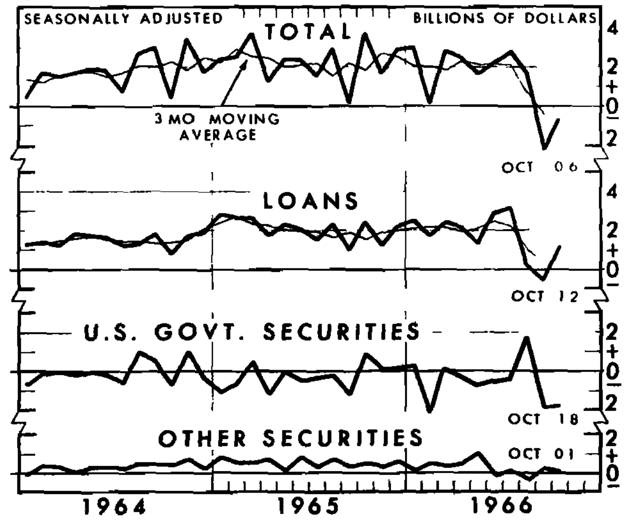
1/ Rates are quoted on the offered side of the market; rates on commercial paper, finance company paper, and bankers' acceptances are quoted on a bank discount basis while rates on the other instruments are on an investment yield basis.

FINANCIAL DEVELOPMENTS - UNITED STATES

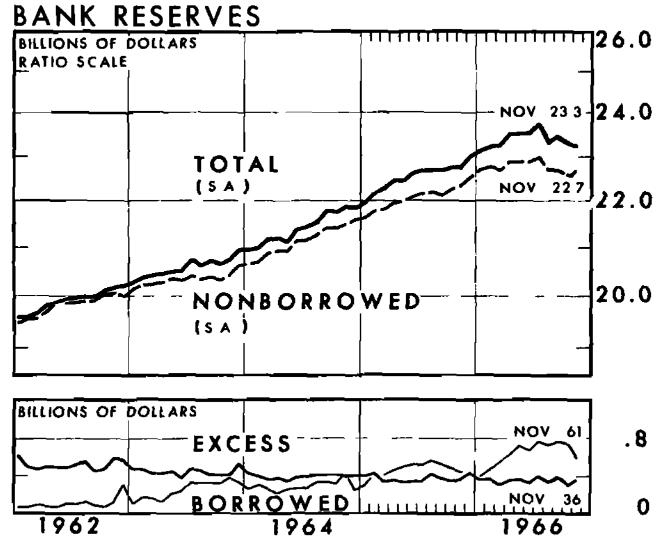
FREE RESERVES AND COSTS



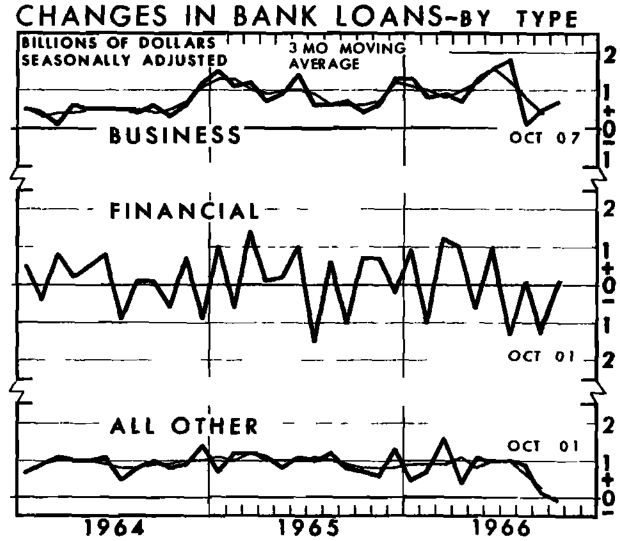
CHANGES IN BANK CREDIT



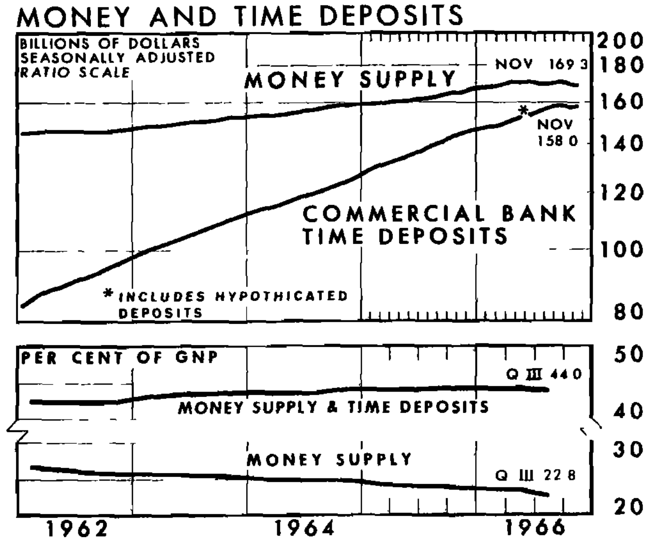
BANK RESERVES



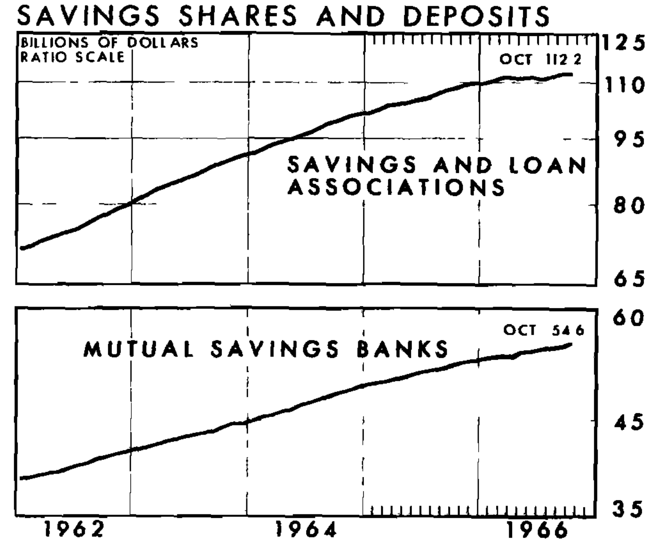
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

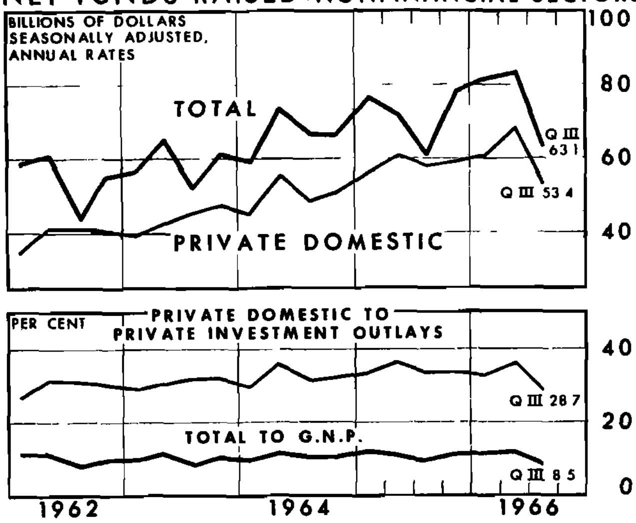


SAVINGS SHARES AND DEPOSITS

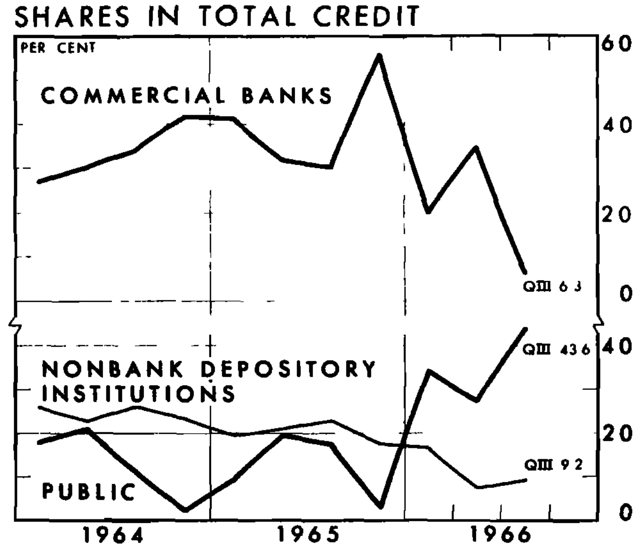


FINANCIAL DEVELOPMENTS - UNITED STATES

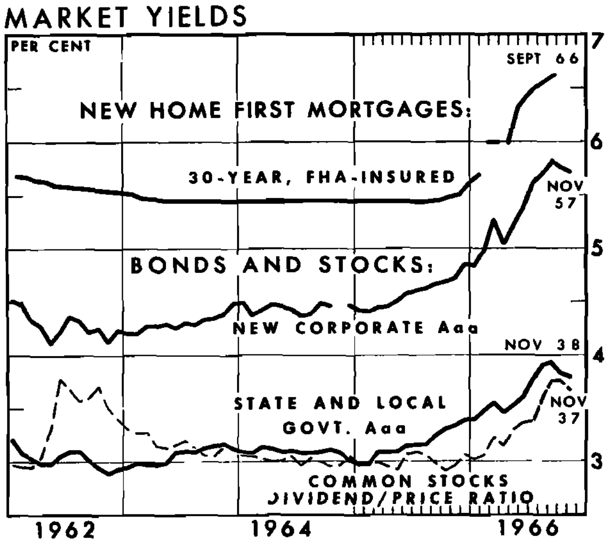
NET FUNDS RAISED-NONFINANCIAL SECTORS



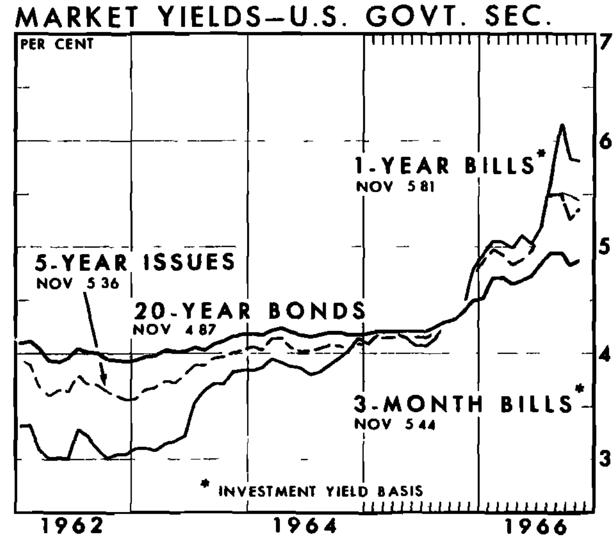
SHARES IN TOTAL CREDIT



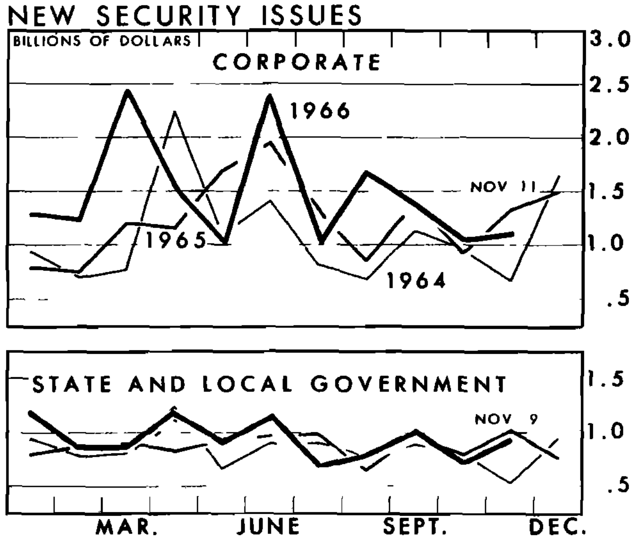
MARKET YIELDS



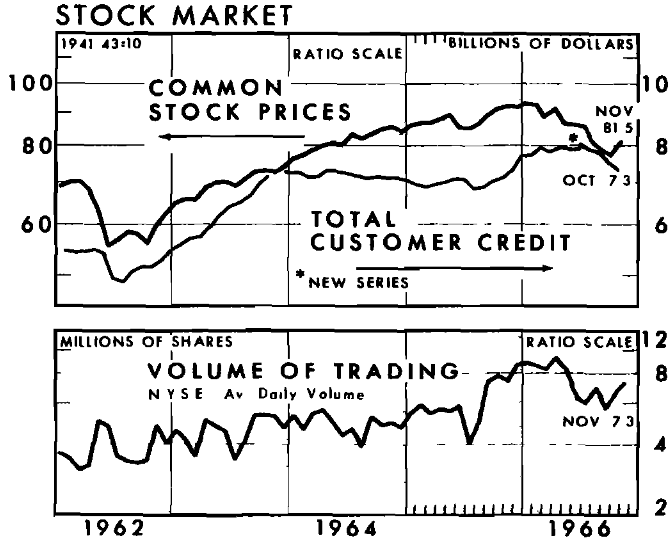
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. The October payments results were somewhat more unfavorable than had been expected. There was a deficit of $215 million on the official reserve transactions basis and a deficit of $765 million on the liquidity basis, both without seasonal adjustment. Weekly figures for November suggest a further small official reserve transactions deficit and a fairly substantial (perhaps $200 million) liquidity deficit in that month. Week-to-week payments swings during November were very large, making it more than usually difficult to estimate what the complete month-end statistics will show when they become available.

For the first eleven months of the year, seasonally unadjusted, there was a cumulative official settlements surplus of about $200 million; the liquidity deficit (on the basis on which it will be published) was probably somewhat more than $1-3/4 billion. There is still a large margin of uncertainty attached to forecasts of the full year's results. It is not yet known, for example, whether the U.K. Government will make or waive its year-end debt payment (about $140 million). It is uncertain whether a payment of $250 million expected in connection with the German Offset Agreement will be received before the end of the year. And it is not possible to predict with any accuracy the effect of year-end window-dressing operations by banks (net of official actions to moderate or offset these movements of funds). These transactions, together with the results of the first eleven months, probably imply a full-year liquidity deficit (published basis) in the range between $1-1/4 to $1-3/4 billion and an official settlements balance not far from zero.

Liabilities of U.S. banks to their overseas branches showed very large weekly fluctuations in November. For example, they rose by $280 million in the week ending November 23 (the day before Thanksgiving) but fell by $480 million in the week ending November 30. Probably part of this swing was due to very short-run loans of dollars by foreigners to the foreign branches over the long holiday weekend (the so-called "Thursday-Friday" transactions), and it is not impossible that U.S. lenders may have similarly advanced funds via the Euro-dollar market. Taking October and November together, the net increase in liabilities due to branches abroad appears to be about $400 million; for the eleven months the increase was $2-1/2 billion.

The trade balance recovered in October to a seasonally adjusted annual rate of about $4 billion after averaging just under $3 billion in the third quarter. Exports advanced sharply while imports rose at a relatively modest pace.

Exports rose by 9 per cent between the third quarter of 1965 and the third quarter of 1966, but in October alone they advanced by 5-1/2 per cent over the third quarter average. This expansion consisted entirely of non-agricultural commodities; agricultural exports had already risen sharply after mid-year and in October were not much changed. Little information is available about the components of non-agricultural exports on a seasonally adjusted basis, but about one-fifth of the increase appears to have consisted of new aircraft.

Imports, which had expanded by 20 per cent between the third quarters of 1965 and 1966, rose further by 1-1/2 per cent in October. Imports of petroleum, steel and sugar declined slightly from their third quarter levels. These commodities had accounted for more than one third of the rise in imports from the second to the third quarters.

Outstanding claims on foreigners reported by banks, seasonally unadjusted, were about unchanged in October: a small reflow of long-term credits was matched by a small outflow of short-term credits. Outflows of bank credit, particularly on short-term, tend to be seasonally high in the fourth quarter. New issues of foreign securities (less foreign participation) have been running in the fourth quarter at about the same level or a little less than in the third quarter (about $300 million seasonally adjusted). New issues for the full year are expected to be about $1.2 billion.

Industrial production abroad

Except in France, Italy, and Japan, a marked and widespread tendency is now evident for the expansion of industrial activity abroad to slacken or give place to contraction. Statistics of monthly production indicate that this change was occurring during the second and third quarters of 1966. Nevertheless, in monetary terms, GNP expenditures have still been increasing briskly in most countries. Even in Britain, where real GNP has been declining since midyear, current-value GNP may still have been rising a little.

In view of the 3-1/2 year length of the upswing in all industrial countries except Japan, France, and Italy, and in view of the very tight monetary policies that have been used to damp the inflationary pressures, it is not surprising that a common feature in the slowdowns that have occurred has been a slowing in growth, or even a decline, in private fixed capital and residential construction expenditures. (Inventory investment may also have slackened this summer and autumn, but relevant data are hard to come by.) Public investment outlays, on the other hand, continue to increase, though in Germany and the Netherlands their growth is limited by financing difficulties imposed by tight money and (in the Netherlands) by administrative regulations.

For the OECD European countries taken together, industrial production was at the same level in July-August as in the second quarter, and probably declined in September. Data for September are available for Germany, Britain, and France, with a combined weight of two-thirds of OECD European output. In September, German output declined for the third month in a row. British industrial production also dropped in September and other indicators suggest that it has declined further since then.

In several other countries, including Sweden, Austria, and Belgium, industrial production was below second-quarter averages in July-August (latest). This was the case also in the Netherlands, but other evidence suggests that in that country the third quarter as a whole may show no decline.

INDUSTRIAL PRODUCTION
(1960 = 100, seasonally adjusted)

	Wts. (1960)	1965		1966				Change (%) from one year earlier	
		Q-3	Q-4	Q-1	Q-2	July-Aug.	Aug.-Sept.	1st half 1966	Latest 2 months
OECD Europe	(39.0)	(128)	(130)	(132)	(133)	(133)	...	(+ 4.7)	(+ 4)
United Kingdom	10.7	116	117	118	117	118	117	+ 1.3	+ 2
EEC	(22.6)	(133)	(135)	(137)	(139)	(139)	...	(+ 5.7)	(+ 5)
Germany	10.7	131	133	135	136	134	131	+ 3.0	- 1
Netherlands	1.4	133	137	141	142	141	...	+ 7.2	+ 7
Belgium	1.3	131	135	134	134	132	...	+ 1.9	+ 1
France	5.2	130	133	134	136	140	140	+ 7.1	+ 8
Italy	3.9	142	145	149	155	156a/	...	+11.4	+10a/
Sweden	1.3	145	146	146	148	145	...	+ 3.5	+ 1
Austria	0.9	126	125	128	129	128	...	+ 3.2	+ 2
Canada	3.5	143	147	151	152	152	...	+ 9.2	+ 2
Japan	5.5	175	175	181	189	198	201	+ 7.2	+15
United States	52.0	133	135	140	143	145	146b/	+ 9.2	+10

a/ July
b/ Sept.-Oct.

Note: The 1960 weights relate to an OECD total of 100.

Of the European OECD countries, only France and Italy had further expansion in industrial production after midyear. French industrial production as presently adjusted for seasonality was unchanged in September, but with proper allowance for changing seasonals the index might have risen further. Outside Europe, rapid expansion has continued in Japan, while in Canada output remained last summer on the plateau reached in March.

In Britain, recent production and employment changes, taken with other evidence, indicate that the economy has moved into a period of recession. Seasonally adjusted unemployment increased in November for the sixth month in succession -- with sharper increases beginning in September than had occurred earlier. The seasonally adjusted number wholly unemployed in November (excluding school-leavers) was 423,000, up more than 50 per cent from the February-May low average of 277,000.

The September decline in industrial production, by 3 per cent, was especially marked in the engineering and allied industries. In October there was a further decline in passenger car output (which has been affected by strikes) and seasonally adjusted steel production also fell -- by 2.5 per cent, to a level about 5 per cent below October of last year.

Investment surveys by the Confederation of British Industry and the Board of Trade earlier this fall indicated substantial cutbacks in planned investment in 1967; the Board of Trade survey pointed to a 7 or 8 per cent decline from 1966 to 1967 in capital outlays by manufacturing industry valued at constant prices. Weakness persists in private residential construction. Activity in this field has been on a declining trend since late 1964 and is generally thought to be still falling, though seasonally adjusted statistics are not available beyond the second quarter (when there was a slight pick-up after the very sharp first-quarter drop). The government has predicted that its 1966 goal of 400,000 new dwelling units will not be met, and that total completions, private and public, will probably total 380,000 or the same as last year.

In Germany, signs of weaker domestic demand have been increasingly evident since about mid-year. By September industrial production had fallen 5 per cent below the March-June high. The decline was widespread among industries, affecting capital goods, consumer goods, and materials.

Total new orders received by manufacturers fell sharply between March and the third quarter. Since May new orders have been running below shipments, so that backlogs of unfilled orders are shrinking. Rapid increases in new foreign orders through the second quarter partly offset the decline in domestic demand. There was no further advance in the third quarter, but new foreign orders in that period were 12 per cent higher than a year earlier.

Unemployment remains very low in Germany, but has been rising since mid-year. A sharp increase occurred in November.

The German money market has been eased somewhat since mid-year by the improvement in bank liquidity arising from the favorable balance of payments, and indications are that the balance of payments will remain in surplus. However, the Bundesbank at the beginning of November expressed the view that its policy should continue to aim at countering inflationary dangers. Despite the new measures the Bundesbank took on December 1, its policy stance has not altered greatly over the past month.

The December 1 actions appear to have had two objectives. One is to induce the large German banks to hold more of their increasing liquid assets in domestic securities rather than abroad. To do this, the regulations affecting reserve requirements against the banks' foreign liabilities are being changed. The minimum ratios -- 20 per cent against time liabilities to foreigners and 30 per cent for demand liabilities -- are to apply next year to total foreign liabilities rather than only to net liabilities as at present. This will alter the incentives for placing funds abroad.

An initial effect of this action on the banks' _total_ liquidity (apart from the continuing effects of net acquisitions of foreign exchange by the central bank and commercial banks combined) is contractionary. The Bundesbank's second action had the purpose of offsetting at least in part this contractionary effect: the Bundesbank will keep in force after the year-end the cut of one-eleventh in the ordinary reserve requirements against domestic liabilities -- a cut which is presently in effect as a temporary seasonal measure for the month of December only.

Industrial production has leveled off in a number of the smaller European countries. In _Austria_, domestic demand conditions appear generally satisfactory but the rising share of imports in domestic sales and the scanty growth in export sales have been reflected in a loss of momentum for industrial output. In _Sweden_, the economy is still reacting to restrictive measures taken to moderate the severely overheated conditions of 1965 -- measures which helped to slow the expansion of industrial output from mid-1965 on. However, investment demand revived last spring, and demand for the highly specialized output of the export-oriented engineering branches has held up well. A sharp drop in residential construction this year has led to a decline in production of building materials.

In the Netherlands, industrial production in July-August was 7 per cent above the corresponding period in 1965, and it is not at all clear that its slight decline from the second quarter of this year marks a definite change of trend. Although domestic demand has been weakening somewhat, the inflow of new foreign orders has been strong enough to sustain the rising trend of total unfilled orders.

In Canada, industrial production has shown some signs of softness since the spring, and industrial output appears to have reached a plateau. The index peaked in April and declined for the next three months. Production turned up again in August, but this may reflect an earlier than usual start of new model auto production. The decline in production from April to July was concentrated in durables manufacturing and steel, and the development appears to have reflected weaker demand conditions especially for consumer household durables and automobiles. Output of machinery and heavy electrical equipment has no longer been increasing since February or March, but through August was off only slightly. Output of construction materials fell by 6 per cent from February through August.

In the general picture of more moderate production gains or of recessions, the three notable exceptions are Japan, Italy, France.

In Japan, industrial production continued to rise through September at a substantial pace. Output has been rising pretty steadily since a low was reached in October of last year, and the 11-month increase has been 17 per cent.

Comparing August-September with the corresponding period in 1965, the most rapid gains have been in output of intermediate goods (up 20 per cent) and of durable consumer goods (up 23 per cent). The increases for the other three sectors have been lower: non-durable consumer goods (9 per cent -- but in this field there had been no slowing in 1965); construction materials (12 per cent); and final-demand capital goods (11 per cent). The upturn in production of capital goods did not occur until May of this year; since then, advance has been rapid.

The level of outstanding orders for machinery, seasonally adjusted, has been rising since June 1965, and in August was 12 per cent higher than a year earlier. New orders received in September were 14 per cent higher than a year earlier.

In Italy, vigorous output expansion has been the rule this year in most sectors of industry. Construction activity has been depressed, but even in this sector demand has been moving up in 1966.

Italian industrial production in June-July was 11 per cent higher than a year earlier. Consumer goods production has been increasing rapidly, in response to both domestic and export demand. An increase of 6 per cent in "investment goods" output (including steel) would probably have been greater but for widespread work stoppages that plagued the metallurgical and engineering industries between February and July. The sharpest rise in the year to June-July was in "industrial materials," with a 14 per cent advance; this group includes petroleum refining, chemicals, and electricity, all having strong secular growth trends.

According to Italian officials, the recent flood damages will not significantly reduce the rate of economic growth next year; their estimate in September was that real GNP would increase from 1966 to 1967 by 5-1/2 per cent. Government expenditures for flood damage repairs are being financed in part by special tax increases.

In France, 1966 has seen a sustained advance in industrial production under the influence of rapidly rising domestic demand, despite some weakening in foreign demand for French exports. The rise in industrial production from the third quarter of 1965 to the third quarter of 1966 was 7 per cent.

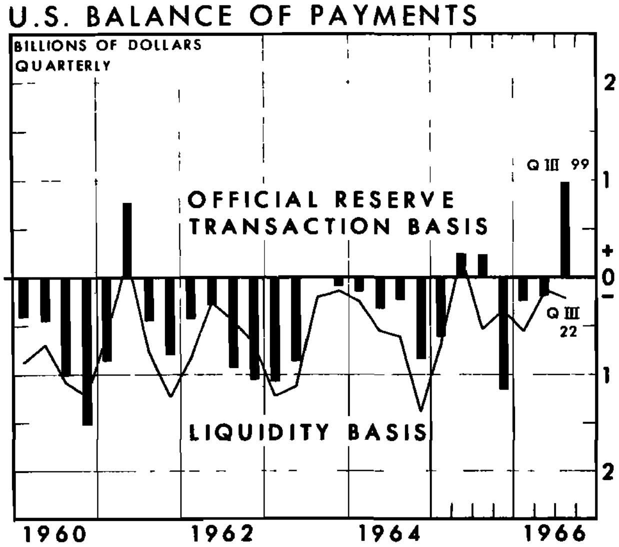
The pick-up in business fixed investment outlays has especially benefitted the equipment industries, as can be seen in the 7 per cent gain in output of the "metals transformation" branches, which, however, also include automobiles and some steel mill products in addition to equipment. Passenger car production rose rapidly in the autumn and winter of 1965-66, but then flattened out in the period February through September. A number of other consumer-oriented branches of industry have shown large output gains: in the third quarter, textile output was up 11 per cent from a year earlier, leather production by 9 per cent, paper output by 12 per cent, and printing-publishing by 17 per cent.

Weak sectors in French industrial production this year have been steel and construction materials, both showing very small changes since the third quarter of 1965.

U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

U.S. BALANCE OF PAYMENTS



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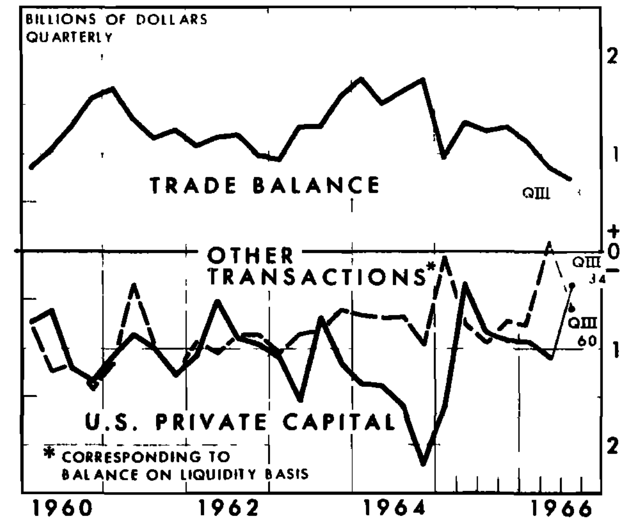

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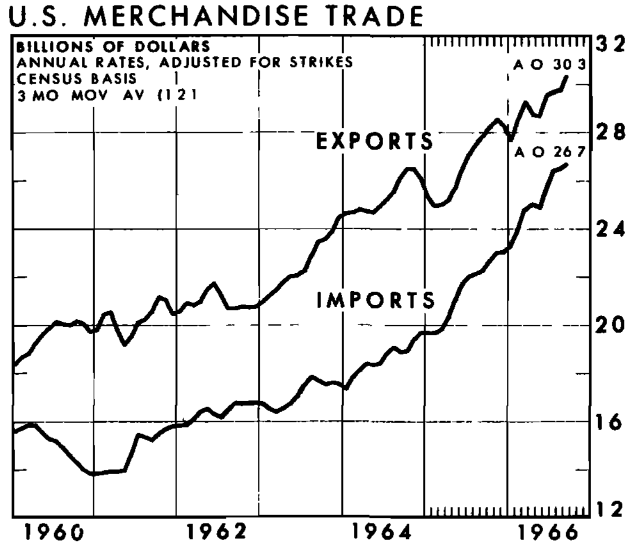
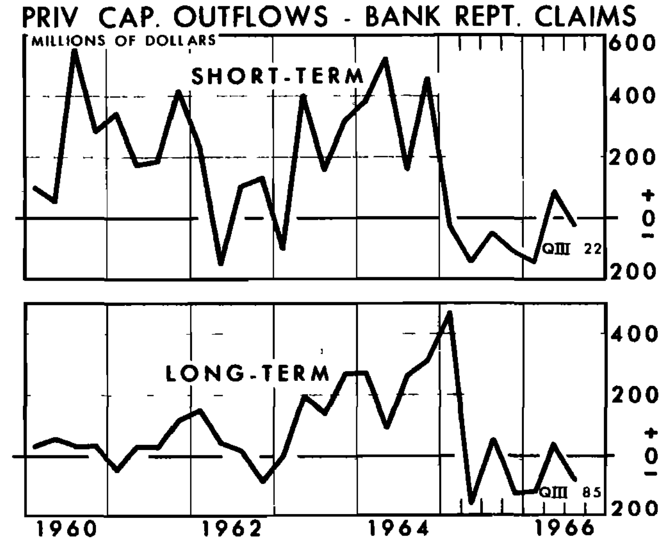
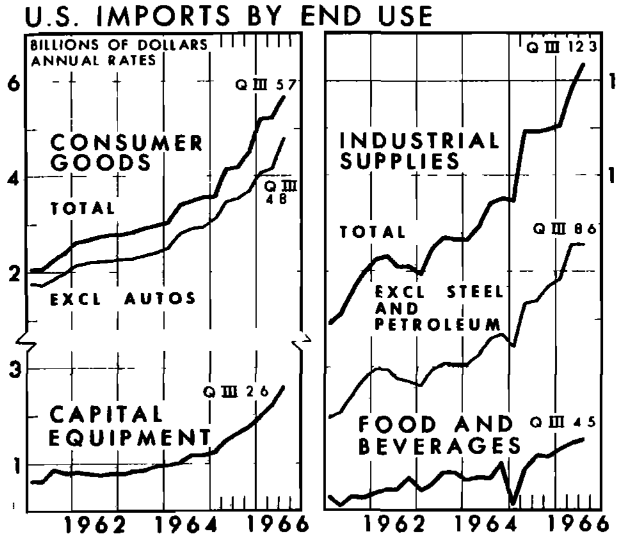


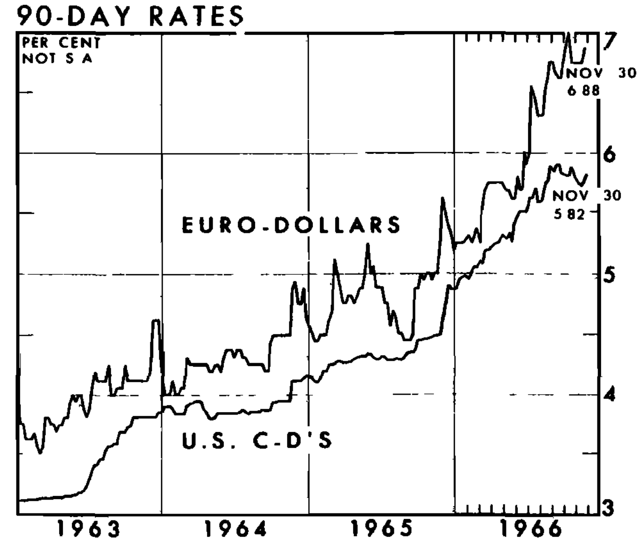
PRIV CAP. OUTFLOWS - BANK REPT. CLAIMS



U.S. IMPORTS BY END USE



90-DAY RATES



APPENDIX A: SURVEILLANCE PROGRAM OF BANKS MOST AFFECTED BY REGULATION Q CEILINGS*

In order to determine the effect of the September 21 rollback of the rate ceiling on time deposits of less than $100,000 and the general impact of higher market yields on large denomination negotiable certificates of deposit, the Division of Research and Statistics has initiated a special surveillance program. The 300 banks under review are those which were paying over 5 per cent on consumer time deposits at the time of the September 21 rollback and weekly reporters with outstanding large denomination CD's in excess of 10 per cent of total deposits as of the August CD maturity survey. Included in the consumer time deposit group are all banks showing rates above 5 per cent on such deposits in the May 11 survey plus 66 banks that were reported by Reserve Banks to have raised consumer time deposit rates above 5 per cent between May 11 and September 21.

Results thus far in the survey suggest the following:

1. Big bank losses of time deposits have been mainly caused by declines in large denomination CD's;

2. At small banks the effect of the rate rollback has been to halt the growth in time deposits for these banks. While the totals for these banks suggest no loss of time deposits, the lack of expansion of their deposits is in sharp contrast to the rapid expansion for these banks over the year ending June 1966;

3. The only noticeable portfolio change among banks in the surveillance is that banks losing CD's have sharply reduced holdings of U. S. Government and other securities.

Characteristics of Banks Reviewed

Over half the banks under review are located in the West--in the Kansas City, Dallas, and San Francisco Districts--with the remaining bulk in the Northeast and Chicago areas, as shown in Table 1. Of the 257 banks affected by the rollback, about two-thirds are small banks (having deposits of less than $100 million), and 72 of these

* Prepared by Lyn McWhirter, Research Assistant, Banking Section, Division of Research and Statistics.

have been chartered since the beginning of 1963. About 80 per cent of these newly chartered banks are in western districts, mainly in the States of California, Texas, Wyoming, and Colorado.

TABLE 1

DISTRICT DISTRIBUTION OF BANKS IN SURVEILLANCE
(Number of banks)

District	Total	Banks paying over 5 per cent on consumer time deposits: Banks with deposits of less than $100 mil: More than 4 years old	Banks with deposits of less than $100 mil: 4 years old of less	With deposits $100 mil. & over	CD/Total Deposit ratios more than 10% 1/
Boston	24	10	3	11	7 (7) 2/
New York	36	7	2	19	18 (10)
Philadelphia	8	0	1	5	3 (1)
Cleveland	8	0	1	4	5 (2)
Richmond	10	1	4	4	2 (1)
Atlanta	23	11	4	5	5 (2)
Chicago	32	13	0	14	8 (3)
St. Louis	5	1	0	3	3 (2)
Minneapolis	4	1	0	2	3 (2)
Kansas City	55	23	18	11	7 (5)
Dallas	35	6	10	7	15 (3)
San Francisco	61	15	29	12	7 (2)
Total	300	88	72	97	83 (40)

1/ As of the August CD Maturity Survey.
2/ Parenthesis shows the number of banks which are also paying over 5 per cent on consumer time deposits and are counted only once in total.

Approximately one-half of the 300 surveillance banks have deposits of less than $100 million and about one-tenth have deposits in excess of $1 billion, as shown in Table 2. More than one-fourth of the banks with high CD ratios have over $1 billion in deposits.

TABLE 2

SIZE DISTRIBUTION OF BANKS IN SURVEILLANCE
(Number of Banks)

Total deposits Dec. 31, 1965: (Millions of dollars)	Total	Banks paying over 5 per cent on consumer time deposits: Banks 4 years old or less	Banks more than 4 years old	CD/Total Dep. ratios more than 10% 1/
Under 50	127	68 2/	59	--
50-100	26	--	29	--
100-200	39	--	24	15
200-500	37	--	24	25
500-1,000	34	--	26	21
1,000 & over	33	--	23	22
Prime in NYC	7	--	4	7
Prime outside NYC	12	--	10	5
Nonprime	14	--	9	10
Total	296 2/	68	185	83 3/

1/ As of August CD Maturity Survey.
2/ Excludes four banks which entered System after Dec. 31, 1965.
3/ Banks which paid more than 5 per cent on consumer time deposits and also had CD-to-deposit ratios greater than 10 per cent are counted only once in the total.

Banks in the surveillance had been extremely successful in attracting time deposits between mid-1965 and mid-1966, as shown in Table 3. This was particularly true for the newly chartered banks, whose time deposits almost doubled over this period. In contrast, such deposits at all country banks rose only 12 per cent and those at older surveillance banks with deposits under $100 million rose 25 per cent.

TABLE 3

PER CENT INCREASES IN DEPOSITS
JUNE 1965 TO JUNE 1966

	Total Deposits	Time Deposits
Banks which paid over 5 per cent on consumer time deposits:		
With deposits of $100 million & over	18.9	30.4
With deposits of less than $100 million		
Banks 4 years old or less	59.9	98.1
Banks more than 4 years old	15.3	25.0
Banks with CD-to-Deposit Ratios greater than 10 per cent:	8.4	13.2
All commercial banks	n.a.	12.6
All member banks	7.2	12.4
Country	8.1	12.3
Reserve City	6.6	12.6
Weekly Reporters	4.6	12.3

Deposit and Portfolio Changes

As indicated in Table 4, the weekly reporting banks in the survey experienced sharp declines in total time and savings deposits during October and early November, while such deposits at the smaller, nonweekly reporting banks under review showed little change. Reductions at large banks, however, were mainly the result of CD run-offs, which is not surprising since the surveillance banks account for 90 per cent of all large negotiable CD's outstanding. Changes in other types of time deposits at weekly reporters in the survey differed little from those at other weekly reporting banks. Sizeable security liquidations accompanied CD run-offs, but the difference between changes in business loans at surveyed and other weekly reporters appears insignificant.

Nonweekly reporters in the survey showed little variation from all country banks--the most comparable control group--with one notable exception. Nonpassbook time deposits at small banks which had been paying in excess of 5 per cent on time deposits of less than $100,000 slowed while those at country banks continued to increase. This occurrence is a sharp reversal of the trend which had been established prior to the rollback, which suggests that many of the smaller banks surveyed had been able to attract deposits by paying relatively high rates and are failing to expand these deposits when forced to offer rates more in line with competitive institutions and below some market rates.

TABLE 4

PER CENT CHANGES IN DEPOSITS, LOANS AND SECURITIES
FOR BANKS UNDER SURVEILLANCE

	Weekly Reporters (Sept. 28 to Nov. 16)		
	Weekly Reporters in Surveillance	Other Weekly Reporters	All Weekly Reporters
Demand Deposits	2	7	3
Time & Savings Deposits	-3	0	-2
Savings	-1	0	-1
CD's	-9	3	-8
Other IPC	-1	1	-1
All other time	-3	-5	-4
Total Loans	0	1	0
C & I Loans	1	2	1
U.S. Govt. Securities	-5	1	-3
Other Securities	-5	-2	-4
Number of Banks	136	205	341

	Nonweekly Reporters (Sept. 28 to Nov. 9)			
	Banks in Surveillance	Country Banks	All Member Banks	All Commercial Banks
Demand Deposits	4	4	2	2
Time & Savings Deposits	0	0	-1	-1
Savings	0	0	0	n.a.
Time	0	2	-2	n.a.
Loans	2	1	0	0
U.S. Govt. Securities	0	1	-1	-1
Other Securities	1	0	-2	-2
Number of Banks	149*	5,982	6,174	14,297

* Fifteen nonweekly reporting banks are excluded from the surveillance because of reporting errors.

Reflecting their heavy concentrations of outstanding CD's, the New York, Chicago, and San Francisco Districts had the largest numbers of weekly reporting banks showing declines in total time and savings deposits over the period surveyed. Among nonweekly reporters, Atlanta and San Francisco ranked highest in the number of deposit-losing banks, and these banks were heavily concentrated in the States of Florida and California, where competition from nonbank savings institutions is intense.

Of the total of 127 deposit-losing banks, less than a fourth had decreases in excess of 5 per cent--19 weekly reporters and 10 nonweekly reporters. In the case of the weekly reporters, all but 4 had CD run-offs of 15 per cent or more. Among the 10 nonweekly reporters, the decreases in nonpassbook time deposits ranged between 7 and 47 per cent. Relative to the number of banks in the two surveillance groups, however, the proportion of the smaller nonweekly banks experiencing large time deposit declines was relatively small, suggesting that customers at these banks are much less interest-sensitive than those of larger banks.

Tabulations are in process on the borrowings of banks in the surveillance, and an analysis will be made available as soon as the data are completed.