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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

October 14, 1964

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IN BROAD REVIEW

Information becoming available in the past three weeks suggests that the rise in industrial production this autumn has been at least seasonal, despite a strike affecting half the automobile industry, and that gross national product has continued to rise, although not in all respects in accordance with expectations. In particular, business inventory holdings, seasonally adjusted, at the end of August were reported no higher than at the end of July--or June. Retail sales figures for August were revised upward and the preliminary figure for September, though down 1 per cent from August, remained slightly above the July level. Employment in mid-September showed some further increases and as in earlier months this year was about 1.6 million higher than a year ago. Wage settlements similar to those in the auto industry have been reached in the agricultural equipment industry, but it may be noted that here the same union was involved and that recent settlements with other unions--as in meat-packing--have involved less increases in wage costs. Industrial prices continue to be reported--through mid-October--as showing little change; the daily index of basic industrial materials has risen further reflecting additional increases for copper and tin.

Aggregate demands for funds, though still large, probably declined a little recently. Business needs for outside financing have tapered off, after a more than seasonal build-up over the September tax and dividend payment period. The autumn financing needs of the Treasury are also down a little from what had been expected earlier due to a somewhat better cash position. Financing demands of consumers and State and local governments continue large, though they do not appear to be rising.

Despite this recent apparent slackening in the demands for financing, the privately held money supply probably increased further in the first half of October, due in part to a larger than usual decline in Government balances with the commercial banks. Time and savings deposits continue to show substantial growth. Outstanding CD's have recovered part of their mid-September decline, but are still below their late summer high.

Interest rates on U.S. Government securities have recently been influenced by a cautious market attitude concerning the future course of the economy and of monetary policy. There were technical pressures in the Treasury bill market stemming mainly from large dealer positions and high financing costs for a time, and the 3-month bill was quoted briefly at 3.60 per cent bid. A small amount of Federal funds was purchased at 3-5/8 per cent--above the discount rate--but this reflected more an effort by one large bank to accustom the market to more flexibility in the rate rather than general money market tightness. Free reserves averaged a little lower, and member bank borrowings a little higher, in September and early October than in August.

In the capital markets, U.S. Government bond yields have risen a little since mid-September, while those on other bonds have remained generally stable. Stock prices have risen to new highs, reflecting the favorable business and profits outlook.

The balance of payments deficit now appears to have been somewhat lower in the third quarter than in the second. (Subject to revision on basis of later statistics to be available for Supplement.) The trade surplus in July-August was at about the second quarter rate, and outflows of U.S. capital were reduced.

In Continental Europe and Japan the trend towards more moderate domestic expansion and greater balance in external accounts continued. The pound sterling remained under pressure.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally Adjusted)

	Latest Period	Amount			Per cent change:	
		Latest Period	Preceding Period	Year Ago	Year ago	2 years ago
Civilian labor force (mil.)	Sept.'64	74.2	74.3	73.1	1.5	2.7
Unemployment (mil.)	"	3.8	3.8	4.0	-5.5	-6.1
Unemployment (per cent)	"	5.2	5.1	5.5	--	--
Nonfarm employment, payroll (mil.)	"	59.0	58.9	57.5	2.8	5.2
Manufacturing	"	17.5	17.4	17.1	2.2	3.1
Other industrial	"	7.8	7.8	7.7	1.5	3.7
Nonindustrial	"	33.8	33.7	32.7	3.3	6.6
Industrial production (57-59=100)	"	133.9	133.7	125.7	6.5	11.9
Final products	"	132.2	132.9	126.3	4.7	8.9
Materials	"	135.8	134.8	125.0	8.6	15.0
Wholesale prices (57-59=100)1/	Aug.'64	100.3	100.4	100.4	-0.1	-0.2
Industrial commodities	"	100.8	100.8	100.4	0.4	0.3
Sensitive materials	"	99.4	99.1	97.7	1.7	2.2
Farm products and foods	"	97.8	98.1	98.9	-1.1	-2.0
Consumer prices (57-59=100)1/	Aug.'64	108.2	108.3	107.1	1.0	2.6
Commodities except food	"	104.2	104.3	103.6	0.6	1.6
Food	"	106.9	107.2	106.0	0.8	3.0
Services	"	115.4	115.3	113.3	1.9	3.7
Hourly earnings, mfg. ($)	Sept.'64	2.58	2.55	2.48	4.0	7.5
Weekly earnings, mfg. ($)	"	104.25	103.59	100.83	3.4	6.9
Personal income ($ bil.)2/	Aug.'64	493.9	491.4	466.1	6.0	11.2
Retail sales, total ($ bil.)	Sept.'64	22.0	22.3	20.4	7.8	11.4
Autos (million units)2/	"	8.500	8.012	7.180	18.4	30.4
GAF ($ bil.)	"	4.9	5.2	4.6	6.2	10.0
Selected leading indicators						
Housing starts, pvt. (thous.)2/	Aug.'64	1,402	1,488	1,475	-5.0	-5.7
Factory workweek (hours)	Sept.'64	40.6	40.7	40.7	-0.2	-0.2
New orders, dur. goods ($ bil.)	Aug.'64	19.4	21.3	18.1	7.3	16.7
New orders, nonel. mach. ($ bil.)	"	3.0	2.9	2.5	16.9	28.1
Common stock prices (1941-43=10)	Sept.'64	83.41	82.00	72.85	14.5	43.8
Inventories, book val. ($ bil.)	Aug.'64	106.6	106.6	102.7	3.8	7.9
Gross national product ($ bil.)2/	QII '64	618.6	608.8	577.4	7.1	11.8
Real GNP ($ bil., 1963 prices)2/	"	608.5	601.3	578.5	5.2	8.1

1/ Not seasonally adjusted. 2/ Annual rate. 3/ Based on unrounded data.

SELECTED DOMESTIC FINANCIAL SERIES

	Week ended Oct. 9	Four-Week Average	Last six months High	Last six months Low
Money Market1/ (N.S.A.)				
Federal funds (per cent)	3.30	3.40	3.50	1.50
Treasury bills 3 mo., yield (per cent)	3.57	3.55	3.58	3.43
Net free reserves2/ (mil. $)	56	95	192	21
Member bank borrowings2/ (mil. $)	370	321	478	135
Security Markets (N.S.A.)				
Market yields 1/				
5-year Government securities(per cent)	4.06	4.06	4.16	4.00
20-year Government securities	4.20	4.20	4.25	4.15
Corporate new issues, Aaa (per cent)	4.44	4.47	4.53	4.37
Corporate seasoned, Aaa (per cent)	4.43	4.42	4.43	4.40
Municipal seasoned, Aaa (per cent)	3.11	3.11	3.11	3.07
FHA home mortgages-30-year (per cent)3/	5.46	5.46	5.46	5.45
Common stocks - S&P composite index4/				
Prices, closing (1941-43=10)	85.22	84.32	85.22	79.02
Dividend yield (per cent)	2.95	2.98	3.08	2.94

	Change in Sept.	Average change--last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	260	110	6.4	5.6
Bank loans and investments:				
Total	3,000	1,800	8.4	9.4
Business loans	700	500	10.3	13.1
Other loans	800	500	6.1	13.7
U.S. Government securities	1,000	400	8.0	-1.3
Other securities	500	400	13.2	11.6
Money and liquid assets:				
Demand dep. & currency	800	800	6.2	4.5
Time and savings dep.	1,100	1,067	10.8	13.6
Nonbank liquid assets 3/	3,100	1,000	5.2	6.1

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted. n.a.--not available
1/ Average of daily figures. 2/ Averages for statement week ending October 7.
3/ Data for month of August. 4/ Data are for weekly closing prices.

U.S. Balance of Payments

	1964					1963	1962
	Aug.	July	June	Q-II	Q-I	Year	Year
Seasonally adjusted annual rates, in billions of dollars							
Balance on regular trans.				- 2.7	- .9	- 3.3	- 3.6
Exports 1/	24.6	24.9	23.7	24.2	24.4	21.9	20.6
Imports 1/	-18.9	-18.9	-17.9	-18.3	-17.4	-16.9	-16.1
Trade balance 1/	5.7	6.0	5.8	5.9	7.0	5.0	4.4
Unadjusted monthly averages, in millions of dollars							
Balance on regular trans.	- 283	- 687	- 106	- 192	23	- 272	- 298
Trade balance 1/	388	411	419	567	587	416	361
Securities transactions		-62	-10	-64	-9	-69	-80
Bank-reported claims 2/	- 104	123	-351	-200	-211	-117	-39
Other		-1159	-164	-494	-344	-502	-540
Financing, total	283	687	106	192	-23	272	298
Special receipts 3/	0	0	0	-14	68	55	95
Liabilities increase							
To nonofficial 4/	146	551	- 348	37	77	49	16
To official	200	172	190	68	-151	136	59
Monetary reserves decrease	-63	-36	264	101	-17	32	128
of which: Gold sales	(-28)	(-6)	(70)	(-24)	(15)	(38)	(74)

1/ Balance of payments basis; differs a little from Census basis.
2/ Adjusted for changes in coverage and for long-term claims taken over from nonfinancial concerns.
3/ Other than nonmarketable bonds, which are included in liabilities to official. Advances on military exports are assumed as zero for individual months in absence of information.
4/ Including international institutions (except IMF), commercial banks and private nonbank.

THE DOMESTIC ECONOMY

Industrial production. Industrial production changed little in September as the General Motors' strike late in the month sharply curtailed auto production. In August and September, industrial production, at 134 per cent of the 1957-59 average, was 6 per cent higher than in the autumn of 1963, 30 per cent above the recession low of early 1961, and 22 per cent above the pre-recession high of 1960. (August revised to 133.7; September 133.9)

Auto assemblies in September were 572,000 units compared with a scheduled 675,000 units. The seasonally adjusted auto index declined to 146 per cent from 165 per cent in August. This decline along with the drop in truck production amounted to a loss of .4 of one point in the total index. Even if work is resumed at General Motors on Monday, October 19, output in October will total no more than about 600,000, compared with an original schedule of 875,000, and the seasonally adjusted auto index will decline to about 120--another .4 of one point loss in the total index.

In September, production of household furniture declined and output of television sets changed little while output of some other consumer goods increased further. In business equipment industries, industrial machinery rose further and output of commercial machinery remained at a high level. Steel ingot production rose and shipments of steel mill shapes and forms probably increased; heavy demands for steel for current use are being supplemented by inventory demands on the part of steel-users preparing for a possible strike next May.

<u>Construction activity</u>. Seasonally adjusted new construction put in place in September remained within 1 per cent of the peak reached in March and April and again in the early summer months of this year. Private residential activity edged downward further in September and was slightly below a year ago, but private nonresidential activity--already at a record rate--moved higher and public activity was unchanged after a two-month decline.

A conspicuous feature of developments since March, when residential activity passed its high, has been the continued upward movement in business and other private nonresidential construction generally. This has appreciably moderated the decline for the private sector as a whole and has been the main factor limiting the reduction in total construction activity. Meanwhile projections recently published by a number of trade sources suggest levels of construction expenditures in 1965 higher than those shown here for September, including, in the case of F. W. Dodge, a rise even for residential building.

CONSTRUCTION ACTIVITY

	September (billions) 1/	Per cent change from: Month ago	Per cent change from: March 1964
Total	$65.9	--	-1
Private	45.9	--	-2
Residential	26.1	-1	-7
Nonresidential	19.9	+1	+6
Business	14.1	+1	+6
Public	20.1	--	+2

1/ Seasonally adjusted annual rate; preliminary.

<u>Prices</u>. In the past three weeks, the wholesale price index for industrial commodities has remained stable, although prices for some nonferrous metals have increased further. Wholesale prices of foodstuffs have declined somewhat as the end of the farmers' strike and seasonal forces have combined to expand marketings of livestock.

Industrial price changes have continued to be selective, with strong upward pressures confined to a few nonferrous metals. Some steel producers have formally increased prices on reinforcing bars nearly 17 per cent, restoring prices to the level of early 1961. U.S. Steel reports that it is continuing to sell on a negotiated basis, but that prices have been higher recently. Since mid-September prices of tin have increased about 15 per cent further and prices of copper in the "free" markets about 20 per cent further. Chilean producers have raised prices 2-1/2 cents, to 35 cents a pound; other foreign producers have not followed. The domestic price for primary refined copper, now 34 cents, typically has been 1-1/2 cents above foreign prices because of the import duty.

The increases in tin and copper since mid-September account for a further rise of 3 per cent in the BLS daily index of 13 raw industrial commodities. Since September 1963, when the sustained rise began, this index has increased 18 per cent, reflecting chiefly increases in nonferrous metals.

The consumer price index declined .1 per cent in August. Prices of foods, apparel, autos, and some other goods showed small, seasonal declines while prices of services continued to rise slowly. Compared with a year ago, the total index was up 1.0 per cent.

Labor market. The employment situation continued relatively firm in September. Nonfarm employment (establishment series) advanced somewhat further and was 1.6 million larger than a year ago; this year-over-year differential has been maintained since early this year. For average hourly earnings, the increase in September was about the same as last year and the increase since the start of 1964 was about the same as in the first 9 months of 1963. The unemployment rate at 5.2 per cent in September was little changed from August and somewhat below the 5.5 per cent of September 1963.

Perhaps most noteworthy in September was the selective nature of the employment increase; gains in the metal-working and metal-using industries accounted for all the 60,000 rise in manufacturing. In nonmanufacturing industries almost all the rise was in State and local government employment, mainly reflecting the addition of new teachers as schools reopened with larger enrollments. Construction employment declined somewhat.

The volatile metals industries showed substantial increases between the second and third quarters of 1964, in contrast to little change a year earlier. Most other groups had somewhat slower employment increases in the third quarter this year than last year. Total nonfarm employment increased by about the same number as last year in the third quarter and also earlier in the year.

CHANGES IN NONFARM EMPLOYMENT
(In thousands)
2nd quarter to 3rd quarter

	1963	1964
Nonfarm	337	337
Manufacturing	2	86
Metals 1/	-3	80
Other	5	6
Construction	51	3
Trade & services	221	194
Government	30	12
Other	33	42

1/ Primary metals, fabricated metals, machinery, electrical machinery and transportation equipment.

Since May the unemployment rate appears to have leveled off at slightly above 5 per cent. The rates for most groups in the labor force have not changed significantly in recent months. Compared to a year ago, however, some groups have fared better than others. At 14.2 per cent in September, the unemployment rate of teenagers was only moderately lower than a year ago; expansion in the labor force of young workers has about kept pace with increases in employment. Unemployment rates of experienced wage and salary workers and of adult women have shown greater improvement. The jobless rate for married men has remained at about 3 per cent.

Hours and earnings. The average factory workweek in September, at 40.6 hours seasonally adjusted, continued at the high level maintained over the past year. A sharp lengthening of the workweek in primary metals industries to more than 43 hours and a further rise in transportation equipment to 42.6 hours offset declines in most other industries.

Average hourly earnings rose 4 cents to $2.56 in September; the rise was largely seasonal and a similar increase occurred last year. Over the past year hourly earnings have increased by 9 cents, or 3.6 per cent. Part of the advance has been due to the recent shift in employment towards the higher-paying, longer-workweek metal goods industries. If an adjustment is made for these inter-industry shifts, the advance in hourly earnings has been 3 per cent over the past year, about the same as in the previous 12 months. Weekly earnings advanced to about $104 in September, 3.4 per cent more than a year ago. Increased overtime in the metal industries contributed to the rise in weekly wages.

<u>Business inventories</u>. In August the book value of business inventories was unchanged for the second month, as accumulation at a stepped-up pace by manufacturers was offset by decumulation at distributors.

Factory stocks increased over $200 million in August and for July and August accumulation totaled $320 million. This rise compares with an increase of only $250 million for the entire first half of the year but nevertheless is not large and appears about in line with manufacturers' expectations. (According to the latest Commerce quarterly survey, a $400 million increase was anticipated for the third quarter--to be followed by a $700 million increase in the fourth quarter.)

Stocks held by durable goods manufacturers which had been rising in the second quarter, continued on up in the summer months; and inventories of nondurable goods, which had declined appreciably in June, stabilized in July and August.

Distributors' stocks declined $320 million in July and August after increasing $1.2 billion in the first half of the year. Autos accounted for an important part of the earlier run-up and for nearly half the July-August decline. Ample stocks permitted unusually large auto sales during the model change-over period. Some of the remainder of the summer decline in stocks--concentrated at retail outlets for other durable goods--may also have reflected unusually strong sales. A further decline in retail auto stocks appears in prospect for September, with sales up sharply further and General Motors out of production late in the month.

Retail sales. According to the advance report, seasonally adjusted retail sales in September were off 1 per cent from the record August level, but sales for the third quarter as a whole were 2 per cent above the second quarter. A revision raised the August figure by .7 per cent.

The September decline stemmed from a 2.5 per cent drop in nondurable goods sales, which had advanced steadily and by a substantial amount over the preceding seven months. The nondurable decline was centered in apparel and general merchandise stores and restaurants. In September a year ago, these same categories had declined, causing a similar decrease in total nondurable goods sales;

seasonal factors may need to be revised. As compared with last September, sales of nondurable goods were up about 6 per cent and for the third quarter as a whole the increase was also 6 per cent.

Total durable goods sales rose 2 per cent, bringing the two-month increase from July to September to 5.5 per cent. Owing mainly to sharply higher auto sales, durable goods sales in August and September were 12 per cent above a year earlier; nonauto durable goods sales were up 6 per cent.

In September, after revision of the month's adjustment factor to reflect earlier and more clustered new model introductions this year, seasonally adjusted new car sales showed a rise to an annual rate of 8.5 million units. This, the highest figure for any month of record is 6 per cent above August and 18 per cent above September a year ago. The General Motors' strike does not appear to have appreciably retarded sales by that company's distributors in September.

Consumer credit. Consumer instalment credit increased $435 million in August, or $5.2 billion seasonally adjusted annual rate. This rate, as shown in the table, was somewhat less than in July, about the same as in the second quarter. Increases for personal, nonauto, and repair and modernization paper were smaller than in July; auto credit moved up more than in July in response to the sharp rise in auto sales.

INSTALMENT CREDIT
Seasonally adjusted annual rates - Billions of dollars

	Extended	Repaid	Change in Outstandings
1964 -- 1st Quarter	64.7	58.6	6.1
2nd Quarter	65.3	60.2	5.1
July	66.4	60.7	5.7
August	66.3	61.1	5.2

Commercial banks and credit unions obtained a somewhat larger-than-usual share of the auto loan business in August, mainly at the expense of the sales finance companies. These companies held their share in the over-all totals, however, by increasing their lending on other goods.

Agriculture. Near-record farm output in 1964 is indicated by the October 1 crop report and the latest reports on livestock production. The October 1 index of crop output, although 3 per cent below 1963 is 9 per cent above the 1957-59 average. Production of livestock and products is estimated to be at a new high, 13 per cent above the 1957-59 average, reflecting large output of beef and poultry.

Except for some damage from tropical storms, September weather was favorable for crops in the South. The cotton crop improved 2 per cent and the current estimate nearly equals the 15.3 million bales of 1963. Rains in the East North Central and North and Middle Atlantic states were too little and too late to improve yields of corn and soybeans.

The 137 million ton production of feed grains now in prospect is considerably under utilization expected in 1964-65--close to the 149 million tons used last year--and stocks of feed grains are thus likely to be reduced substantially. With the increase in the cotton crop estimate, however, there is no longer the prospect of a reduction in the large cotton stocks on hand.

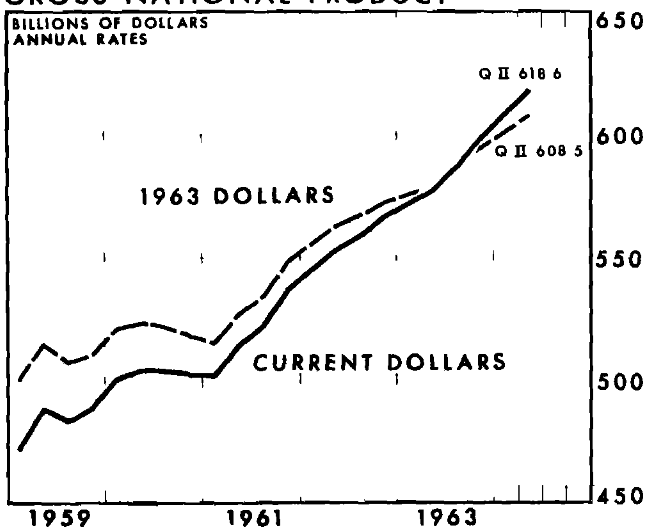
Pasture feed conditions continued short through September in many areas. Nationally, the October 1 condition was 69 per cent of normal for that date, 11 points below the 1958-62 average. September rains improved pasture feed prospects from Texas northward through most of the Corn Belt, but in the North and Middle Atlantic States, pastures deteriorated and many dairy herds were on supplemental roughage. Temporary emergency increases in milk prices of about 1/2 cent per quart have been granted in some areas, mostly in the South Central States and the lower Midwest.

The three government emergency assistance programs are being widely used by farmers in drought and storm damaged areas this year. Haying and grazing privileges on diverted cropland have been granted in 1,046 counties and parishes, twice as many as last year. CCC feed grain stocks are available to farmers in 336 counties (about the same as in 1963) at 75 per cent of the prevailing support price for feeding to dairy cattle and at the support price for other uses. Feed grains have been donated to the five Florida counties almost inundated by tropical storms and special funds have been allocated to Louisiana. Emergency operating credit is available to farmers in the drought and storm disaster areas at a 3 per cent interest rate for purposes essential to continuation of normal farming and ranching operations.

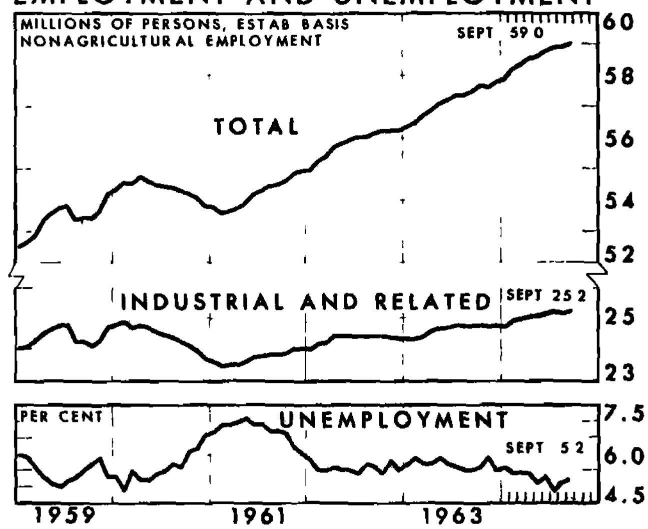
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

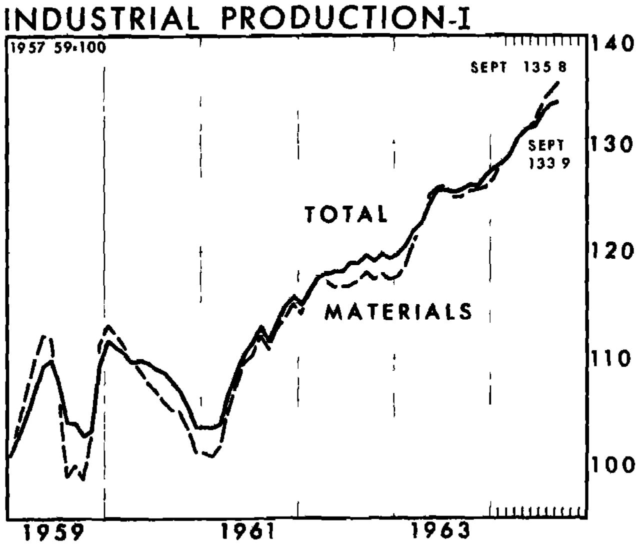
GROSS NATIONAL PRODUCT



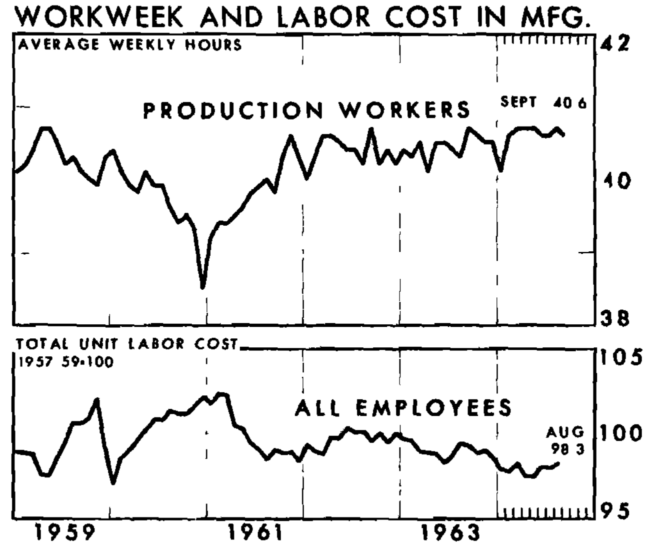
EMPLOYMENT AND UNEMPLOYMENT



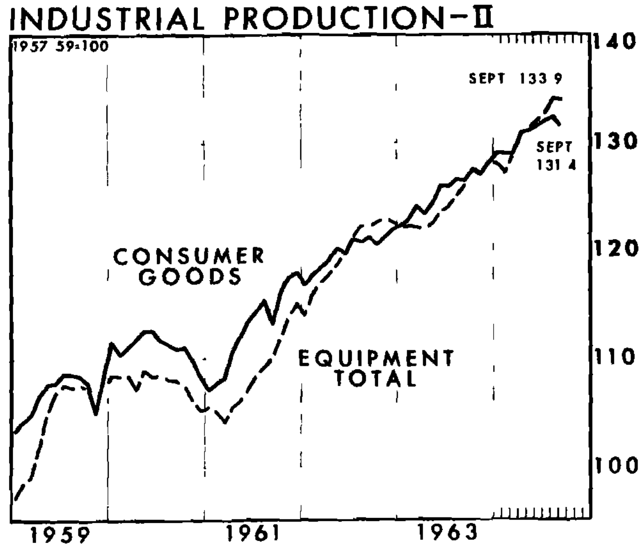
INDUSTRIAL PRODUCTION-I



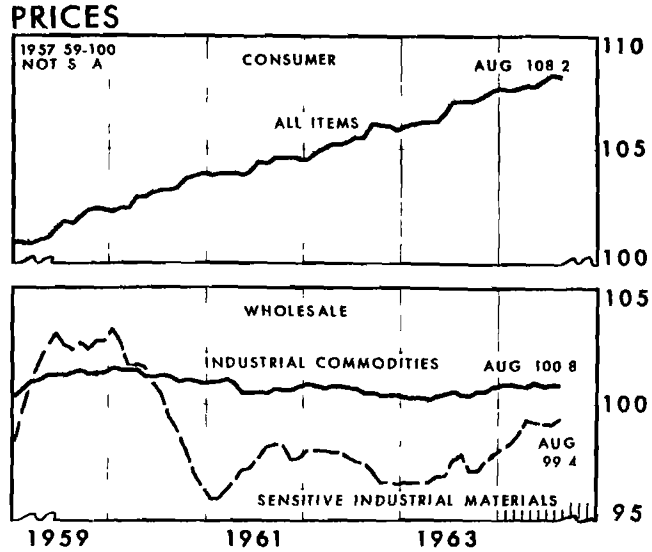
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



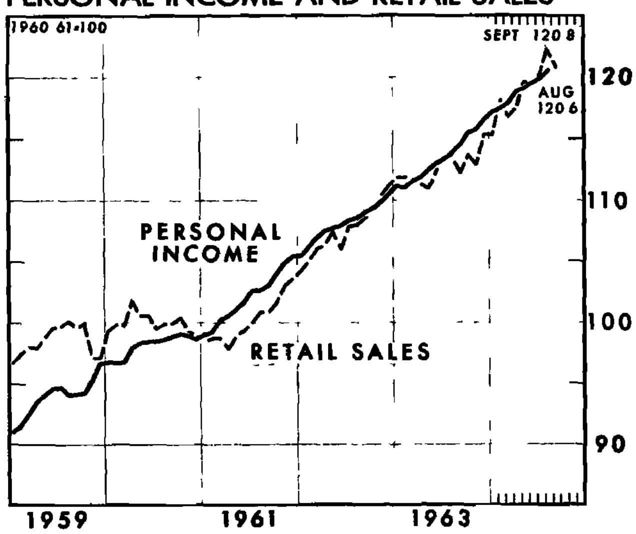
PRICES



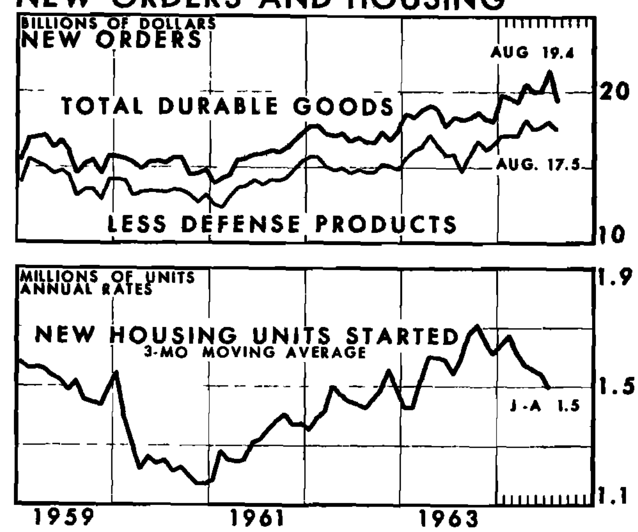
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

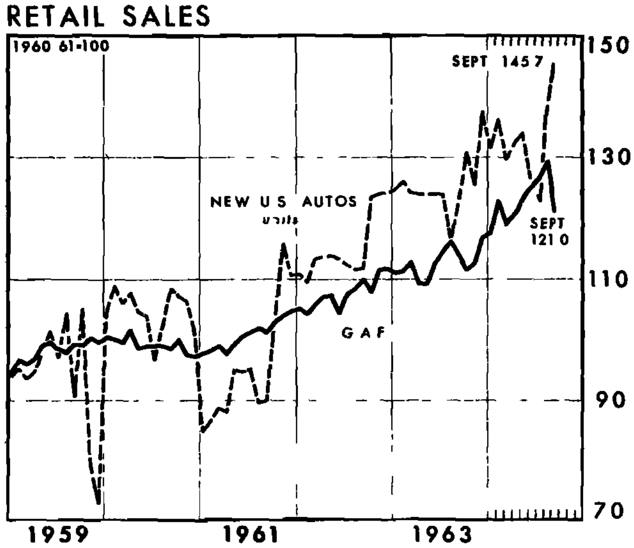
PERSONAL INCOME AND RETAIL SALES



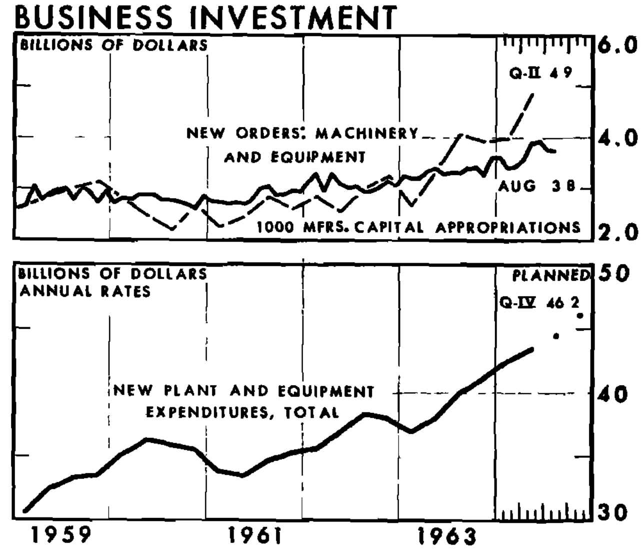
NEW ORDERS AND HOUSING



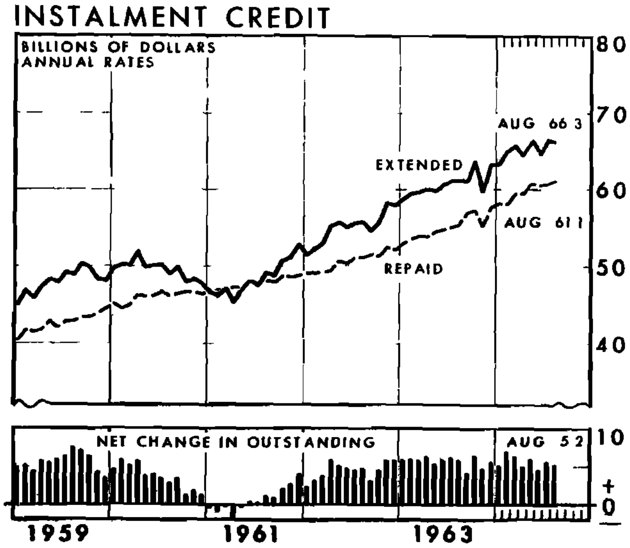
RETAIL SALES



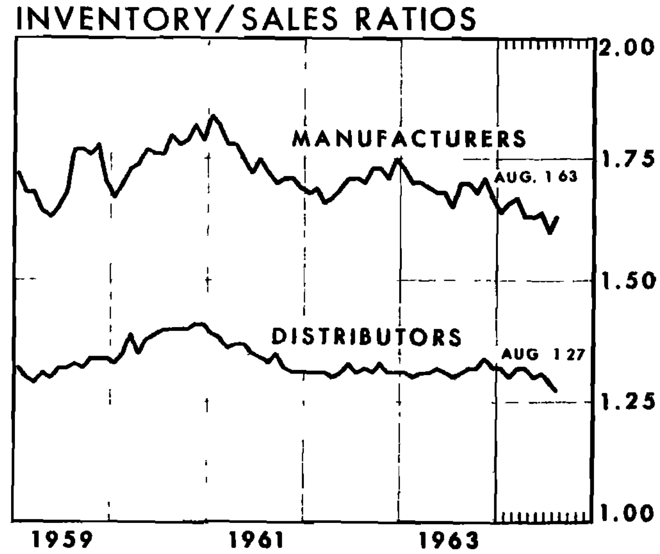
BUSINESS INVESTMENT



INSTALMENT CREDIT



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

U. S. Government finance. Although remaining in a narrow range, interest rates on U. S. Government securities edged slightly higher in the first half of October following their downdrift after mid-September. The more recent rate movements have reflected market caution over the possible course of monetary policy and continuing pressures on the money market. On October 6 the 3-month bill was briefly quoted at 3.60 per cent bid, equalling a 4-year high previously reached in late February of this year.

YIELDS ON U. S. GOVERNMENT SECURITIES
(Constant maturity series)

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1962						
December 31	2.92	2.96	3.40	3.56	3.85	3.92
1963						
December 31	3.51	3.64	4.05	4.06	4.14	4.19
1964						
June 30	3.47	3.52	3.95	4.01	4.15	4.15
September 15	3.54	3.69	4.05	4.10	4.22	4.22
September 29	3.55	3.70	4.00	4.05	4.18	4.19
October 13	3.58	3.72	4.04	4.07	4.19	4.20

Recent activity in the Treasury bond market has been dominated by trading among dealers and other market professionals, as investors have tended to remain on the sidelines while waiting for the interest rate outlook to clear. The market has searched speeches and statements by System and Treasury officials for policy hints, and the seemingly diverse hints they have found have triggered only minor price adjustments in both directions.

Dealers have continued to reduce their holdings of coupon issues. In a period of a little more than two weeks, ending October 9, holdings of issues maturing in over one year declined $235 million to a level of $355 million. About 75 per cent of this decline was accounted for on a net basis by System and Treasury purchases.

The most recent uptick in Treasury bill rates reflected dealer efforts to reduce heavy bill positions, on which financing costs were high. In the latter part of September and in early October dealers had to finance sizable residual needs at the New York City banks where borrowing costs often exceeded 4 per cent. By the second week of October dealers had made good progress in reducing their bill holdings, as a sizable market demand from public funds and other investors was supplemented by seasonally large System purchases of about $540 million. On the other hand, outright demand for bills by large corporations apparently has failed to pick up as much as expected following the mid-September tax and dividend dates. Most recently, dealers have rebuilt their declining inventories somewhat as a result of very aggressive bidding in the October 9 weekly auction. Dealer awards in this auction were a record $1.1 billion.

The recent advance in bill rates has extended to most other short-term debt instruments as may be seen in the accompanying table:

SHORT-TERM RATES

	Oct. 9	Sept. 13
	(per cent	per annum)
Certificates of deposit of large New York City banks		
3-months: most often quoted issuing rate	3.90	3.75
secondary market trading range	3.90-3.98	3.82-3.92
6-months: most often quoted issuing rate	4	3.95
secondary market trading range	3.98-4.10	3.93-4.00
Commercial paper (dealer rates)		
Prime 4 to 6 months (offered)	4	3-7/8
Finance company paper, directly placed		
30 to 89 days (offered)	3-3/4	3-5/8
Bankers' acceptances		
90 days or less (offered)	3-3/4	3-3/4

In addition, quotations on day-to-day money have also risen on some recent days to 4-year highs, with some Federal funds trading at 3-5/8 per cent and dealer loan rates posted by New York City banks as high as 4-1/4 per cent. It was reported that the bulk of Federal funds transactions at 3-5/8 per cent involved one major New York bank. This bank reportedly was not motivated by either an unusually tight money position or inability to borrow from the Federal Reserve. It apparently hopes to introduce greater rate flexibility into the Federal funds market, so that there would be a wider range within which funds could be both bought and sold to accommodate such temporary borrowers as dealers and correspondent banks.

The Treasury is expected to be in the market after mid-October to raise additional cash to meet seasonal drains. These cash requirements are likely to be somewhat smaller than projected earlier--by perhaps $1 billion--due to a continuing favorable cash position. Total cash financings of $4 to $4.5 billion are currently projected for the balance of 1964. The Treasury has indicated that it will raise this money in the short-term, probably the bill, area.

The Treasury's next regular refinancing of November 15 maturities will involve a relatively small $2-1/4 billion of publicly-held securities. It will announce the terms of this operation late this month. The market generally anticipates an 18-month issue to be offered in the refinancing, probably for cash.

Corporate and municipal bond markets. Yields on seasoned municipal bonds have remained generally stable since the third week in September. While the average yield on seasoned Aaa-rated corporate bonds has edged a little higher over the same period, that on newly issued corporate bonds has declined--virtually eliminating the 10 basis point spread which developed between seasoned and new issues in September. In general, current yields in both markets are appreciably above those prevailing at the end of the summer.

BOND YIELDS

	Corporate Aaa		State and local governments	
	New	Seasoned	Moody's Aaa	Bond Buyer (mixed qualities)
1964 - High	4.53(5/8)	4.43(10/9)	3.16(3/26)	3.32(4/21)
Low	4.30(2/21)	4.35(2/28)	3.07(7/16)	3.13(1/20)
Summer Low	4.37	4.40	3.07	3.16
September High	4.52	4.42	3.10	3.26
October 2	4.46	4.42	3.11	3.26
October 9	4.44	4.43	3.11	3.26

The recent mark-down of yields on new corporate bonds has reflected changes in the volume of public offerings being brought to market. From late August through much of September, an expanded calendar of public offerings had induced cautious bidding on the part of underwriters and led to a sharp run-up in new issue yields. Since then, with only a light supply of public offerings scheduled for October, underwriters have attempted to market new issues at lower yields. Investors have resisted these efforts, and most recent offerings of new corporate issues have received a slow reception. Underwriters' unsold syndicate balances have consequently grown, reportedly to around $100 million.

BOND OFFERINGS 1/
(Millions of dollars)

	Corporate				State & local govt.	
	Public offerings		Private placements			
	1964	1963	1964	1963	1964	1963
Jan.-June avg.	362	396	471	508	934	969
July	234	279	434	431	925e/	928
August	190p/	336	500p/	318	750e/	764
September	375e/	283	500e/	501	900e/	480
October	200e/	511	500e/	481	900e/	1,265

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

While public offerings of new corporate bonds definitely scheduled for October and beyond are at an unusually low level, press reports and insurance company commitment data both suggest that the volume of corporate financing being arranged through private placements has accelerated. Among the large private placements listed by the financial press in recent months have been offerings from several well-known manufacturing companies which on other occasions have borrowed in the public market. Similarly, several large placements have been listed recently for utility companies, although in the past such companies have been encouraged by regulatory agencies to place new bonds through competitive bidding.

Takedowns of corporate private placements in the first seven months of 1964 fell $250 million behind those for the like period of 1963, but preliminary data for August--a month in which public offerings were unusually low--show private placements of close to $500 million, $150 million more than a year ago. This change thus tends to confirm the general impression created by press reports, that the recent year-to-year short-fall in public offerings of corporate bonds is being at least partly offset by expanded private placements.

Yields on seasoned State and local government bonds have remained generally stable in recent weeks, notwithstanding further substantial new offerings, the continuing high level of dealer inventories at close to $700 million, and some further discussion of a possible shift to a less stimulative monetary policy. Good receptions accorded large new offerings of public housing and State of California bonds have helped to maintain this yield stability.

Stock market. Common stock prices, as measured by Standard and Poor's composite index of 500 stocks, have recently moved into new high ground on average daily trading of a little over 5 million shares. Closing at 84.96 on October 13, the index was nearly 1-1/2 per cent above the previous peak reached in mid-July. While the average of Dow-Jones industrial stock prices has shown only a slight further rise since late September, the broader Standard and Poor's index has moved steadily higher over most of the same period.

Strength in stock prices continues to reflect favorable profit expectations and the persistent buying of institutional investors. Discussion of inflationary possibilities in the period ahead has undoubtedly also stimulated some demand for stock recently, but little evidence of accelerated speculative interest has been reported, particularly on the part of small investors.

Mortgage market developments. Contract rates on conventional first mortgages were little changed in August, at 5.77 per cent for new home loans and 5.90 per cent for loans on existing houses, according to data from the Home Loan Bank Board. Maturities and loan-to-value ratios also remained at or near the more liberal levels reached earlier this year as active competition by lenders for mortgages has continued. Average prices paid for houses continued to move appreciably higher, however, and largely because of this, loan amounts in August averaged 6 per cent more than a year earlier--for loans on used as well as new houses.

Foreclosures on nonfarm real estate (mainly homes) increased further in the second quarter of the year and were appreciably higher than a year earlier, although not up so much as in other recent years. Increases in foreclosures were reported both for Government-underwritten and conventional mortgages.

NONFARM MORTGAGE FORECLOSURES

	Number at annual rate (thousands)	Rate per thousand mortgaged homes
Second quarter		
1960	49.7	2.6
1961	74.4	3.8
1962	86.7	4.2
1963	102.5	4.7
1964	113.5	5.0

Bank credit. Seasonally adjusted total loans and investments of all commercial banks rose $3.0 billion in September, as compared with $4.2 billion in August. The rise brought the average monthly increase in total credit for the third quarter to $1.8 billion, somewhat above the $1.6 billion average for the first half of the year. The annual rate of growth during the third quarter was 8.4 per cent, as compared with 8.0 per cent for the first half of the year.

NET CHANGES IN COMMERCIAL BANK CREDIT
(Seasonally adjusted)

	Net Change (billions of dollars)			Annual rate (per cent)		
	Sept. 1964	Average third qtr. of 1964	Average first 6 months of 1964	Third quarter of 1964	First 6 months of 1964	Last 5 months of 1963
Total loans & invest.	+3.0	+1.8	+1.6	+ 8.4	+ 8.0	+ 8.6
Total loans	+1.5	+1.0	+1.8	+ 7.5	+14.2	+11.4
U.S. Govt. securities	+1.0	+0.4	-0.4	+ 8.0	- 6.8	- 1.9
Other securities	+0.5	+0.4	+0.2	+13.2	+ 7.4	+16.1
Business loans	+0.7	+0.5	+0.4	+10.3	+ 8.4	+15.6
Loans (excl. security)	+1.1	+1.2	+1.5	+ 9.2	+12.5	+11.6

The September expansion, like that in August, was spread through all major loan and investment categories. Investments in U. S. Government and other securities, essentially municipal and agency issues, accounted for one-half of the expansion, although the increases in both investment groups were smaller than in August. At city banks, holdings of Treasury bills rose more than total holdings of Governments. Holdings of short-term notes and bonds also rose while those with maturities of more than one year declined. A substantial unwinding of the September rise occurred in the first week of October, when holdings of Governments at New York and Chicago banks declined more than they had increased in all of September.

The $1.5 billion increase in total loans in September was smaller than the increase in August, but exclusive of security loans the increase was substantially larger. For the third quarter as a whole, the annual rate of growth in both cases was less than in the first half.

The strong surge of business loan demand that developed during the mid-September tax and dividend period did not carry through the month. The seasonally adjusted increase of $700 million in September was about the same as in August, although higher than in other recent months.

In September, demands for commercial and industrial loans were quite strong in a number of major categories, particularly trade, metals, petroleum and chemicals, and public utilities. However, there was a large offset to the September rise in loans to public utilities and retail trade at New York City banks in the first week of October. The decline in loans to utilities may have been in large part in response to the large volume of capital market financing in September. In construction and textiles, loan demand weakened in September and bank holdings of acceptances also declined.

Since last spring, there has been a marked difference between business loan and business inventory developments. Prior to that time, the basic trends in business loans outstanding and in total business inventories had been quite parallel. This relationship was generally true over the preceding decade, and was strikingly close over the preceding two years. Since April, however, business loans have gone up much faster than total business inventories. From April through August, business loans rose $1.7 billion, compared with a rise of only $250 million in inventories. This development would seem to give further support to the view that general corporate needs for funds--for plant and equipment, inventories, and receivables--may have advanced more rapidly relative to internal cash flows than earlier, thereby generating a growing need for outside financing. With no immediate prospect for a slackening need for plant and equipment or receivables financing, and with some likelihood of a pick-up in inventory accumulation, a further acceleration in business loan expansion is possible in the months ahead.

Money supply, deposit turnover and time deposits. The seasonally adjusted money supply expanded $800 million in September to a level of $158.0 billion. Over the third quarter, the annual rate of growth was 6.2 per cent, double the 3.1 per cent rate prevailing in the first half of the year.

The annual rate of growth in the currency component of money supply slackened to 4.8 per cent in the third quarter, appreciably below the growth rates of 6.1-6.3 per cent in the preceding three quarters. New seasonally adjusted data on currency in circulation indicate that growth in the larger denomination currencies, particularly $50 and $100 bills, has slowed considerably this year from the 1963 rate. However, growth rates for $1 bills and coin have risen, possibly in part in response to hoarding of silver certificates and coin in view of the changed outlook for silver.

Seasonally adjusted time and savings deposits at commercial banks expanded $1.1 billion in September. This increase, comparable to that in August, brought the annual rate of growth for the third quarter to 10.8 per cent, slightly less than the 11.0 per cent rate prevailing in the first half of the year.

At city banks, savings deposits increased less in September than in the corresponding month of 1963 and 1962, and other time deposits, largely because of the decline in CD's over the tax period, fell more. Since mid-September, CD's have been regaining their pre-tax date level rapidly at New York City banks, but slowly elsewhere.

Turnover of demand deposits at 343 centers outside New York City rose to 35.5 (preliminary) in September, the same as in July but above the 35.0 average prevailing in August as well as in the first half of the year.

<u>Bank reserves</u>. Free reserves at all member banks averaged $82 million in September, below the $111 million average in August.[1/] Excess reserves averaged $423 million, about the same as in August, but borrowings, at $341 million, were $30 million higher.

During September the effective rate on Federal funds fell below 3.50 per cent on three days, with some transactions at a lower rate on seven days. In the first week of October, the effective rate fell

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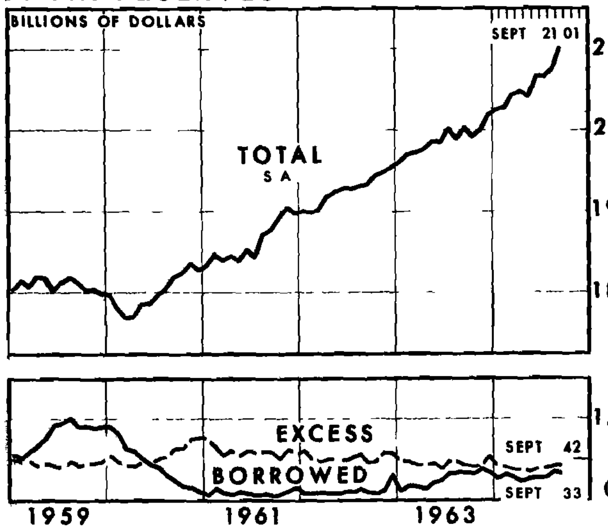
1/ Based on the average of daily figures for all of the reserve weeks ending in the month as used in the reserve memorandum to the FOMC, rather than an average of all days in the calendar month.

below 3.50 per cent on one day, but on two other days some purchases and sales took place at 3-5/8 per cent.

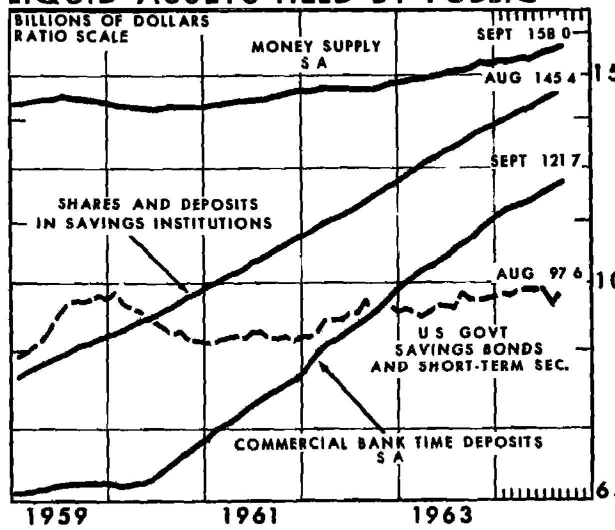
After rapid expansion in the first three weeks of September, seasonally adjusted reserves against private demand deposits declined substantially in the last two weeks, but the average for the month rose by over $100 million. Preliminary data for the first week of October again show a large expansion.

FINANCIAL DEVELOPMENTS - UNITED STATES

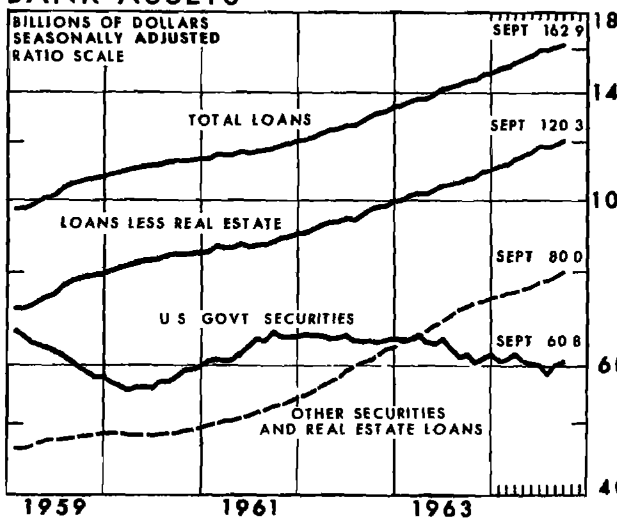
BANK RESERVES



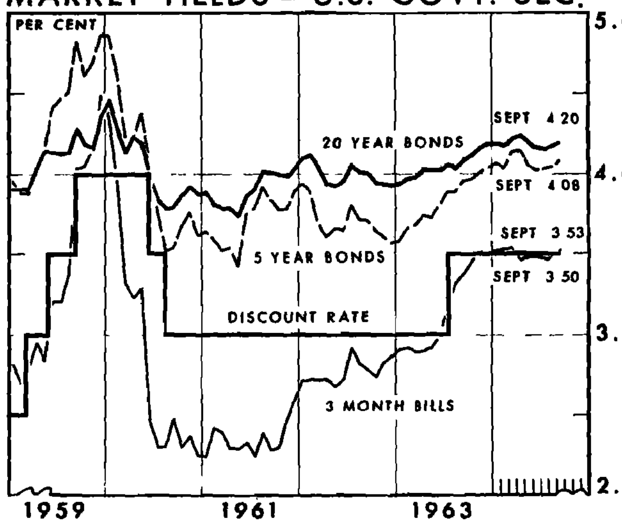
LIQUID ASSETS HELD BY PUBLIC



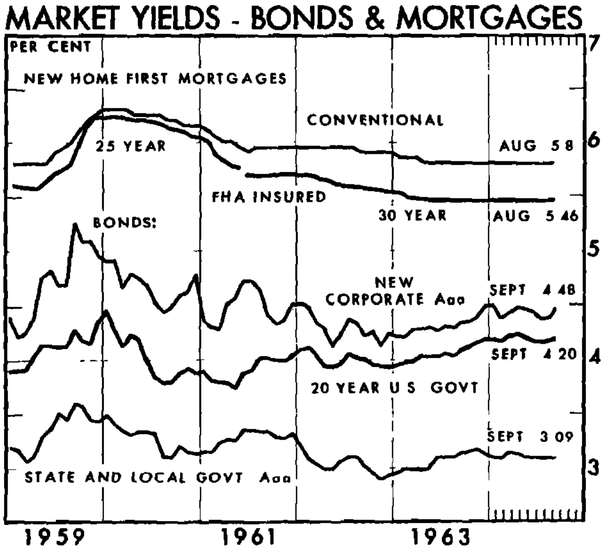
BANK ASSETS



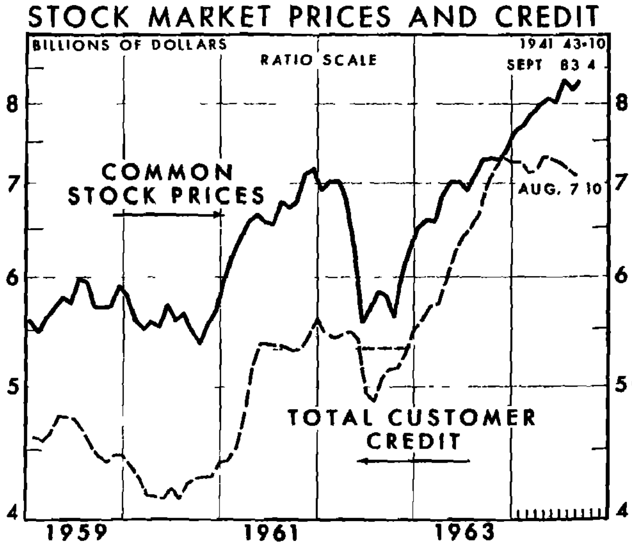
MARKET YIELDS - U.S. GOVT. SEC.



MARKET YIELDS - BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U. S. Balance of Payments. Preliminary weekly indicators show a large US payments deficit in early October, apparently repeating the pattern of recent quarters, when the deficit has occurred mainly in the first month of the quarter. Moreover, October often shows an increase in the payments deficit because of window-dressing by Canadian banks; most of them end their fiscal years this month.

The deficit on regular transactions for the third quarter (unadjusted) is now estimated at either $1100 million or $900 million, equivalent to seasonally adjusted annual rates near either $2-1/2 billion or $1-3/4 billion. The difference between the two estimates depends on whether a purchase by the Canadian Government of $204 million of non-marketable, nonconvertible U.S. securities is to be regarded as a "special transaction" or as a "regular" foreign long-term investment in the United States. If the lower rate of deficit is used, it will be important to recognize that the payment by U.S. power companies that produced the addition to Canadian Government holdings enabled British Columbia to relend in Canada the Canadian dollar proceeds. Some, at least, of this financing took the place of Canadian issues that might otherwise have been made in the United States. On the other hand, if the higher rate of deficit is used, it will have been temporarily swollen by the lumpiness of the Canadian transaction. Hence, the underlying rate of deficit in the third quarter is probably best thought of as lying between the two alternative figures.

U.S. capital outflows, so far as present data go, remained small in August. Long-term bank loans continued on the high plateau that has persisted since early 1963, but in August the principal borrowers were Mexico and the Philippines, whereas earlier Europe accounted for most of the outflow. Net short-term bank credits to foreigners were again negligible, as net repayments by Canada and Europe offset new credits to Latin America and Japan. U.S. banks reported small outflows of liquid funds in August, while there was a small inflow on securities transactions - reflecting continued US sales of foreign stocks, with no significant net flows on new issues or US corporate securities.

U.S. exports declined slightly in August from the July peak, while imports remained at advanced levels; the July/August trade surplus was about $6 billion at an annual rate, unchanged from the second quarter.

Business and financial developments abroad. On the Continet and in Japan the trend toward more moderate domestic expansion and greater balance in external accounts continued. The pound sterling remained under pressure and was supported by the Bank of England with the help of international credit facilities.

The British pound was under more or less continuous selling pressure during the latter part of September and the first part of October. Since September 14 support by the Bank of England has kept the spot rate from falling below 278.30, and more recently the rate has fluctuated around 278.34. Publication of September reserve losses of $45 million equivalent was accompanied by a Treasury statement disclosing that some use had been made during the month of the credit facilities made available by foreign central banks. These include the

$500 million swap arrangement with the Federal Reserve and newly entered into credit arrangements with the central banks of Belgium, Canada, France, Italy, the Netherlands, Switzerland and Germany.

The German industrial production index for August stayed at the high level attained in July so that the index for the two months combined rose 1.6 per cent from May-June. Some slackening in the pace of expansion may be indicated by downward fluctuation in incoming domestic orders in August together with a moderate rise of 3 per cent in foreign orders. For July and August combined the total orders index was 1 per cent below the March-April peak and only 1 per cent above the January-February level. Producer prices of industrial goods rose 0.3 per cent in August, the largest monthly increase in nearly a year, to a level 1.5 per cent above the year earlier. Productivity increases in the past year have been such as to prevent serious inflationary strains on the economy.

The German trade surplus was sharply reduced in July-August to an average of $63 million, as a result of declining exports and sharply rising imports, especially industrial imports. Since foreign aid and reparations outflows were largely unchanged, the reduced trade surplus, together with greater-than-seasonal outflows on account of tourism and over-all balance on capital account, combined to produce balance-of-payments deficits averaging over $30 million in the two months.

In France, despite the stabilization program, the rate of growth of real GNP from 1963 to 1964 is now officially forecast at 5.2 per cent, greater than the 4.2 per cent increase forecast a year ago; greater also than the actual rate of increase of 4.8 per cent from 1962 to 1963. Much of the 1964 rise had already occurred by the first half of the year. The forecast for 1965 shows a slackening of the years-over-year rate of growth to 4.3 per cent. Price indexes continue to rise at a slower rate than last year, due partly to price freezes and partly to tighter monetary and fiscal policy.

Official French reserve gains (adjusted for special transactions) came to $94 million in the third quarter, down sharply from the rise of over $300 million in the second quarter.

The Italian balance of payments continues to show favorable results: the over-all surplus was $151 million in July, and $160 million in August; and the rise in official reserves was $150 million in September. Though in 1963 there was a $112 million deficit, this quarter is normally a seasoanlly favorable period for Italy. Unadjusted for seasonality, the third quarter surplus may prove to be double that of the second quarter, despite reversal of the net flow of capital, which was heavily inward in the previous period. In addition to seasonally high inflows for tourism, the improvement in the third quarter was due to continuing reductions in payments for imports and further increases in receipts for exports, each by about 10 per cent compared with the second quarter.

Italian industry is, however, operating considerably below capacity; reportedly about half of all business enterprises are working at less than 30 hours a week, and the rest between 30 and 40 hours. Unemployment rose 18 per cent from April to July. The emphasis of monetary policy is therefore being shifted to greater ease; it is not yet certain what the direction of fiscal policy will be in 1965.

In Canada over-all industrial production did not change such in July; however a revival of economic activity is suggested by modest increases in July as compared with June in new orders, inventories, motor vehicle sales, retail trade, and housing starts. Price increases were quite moderate.

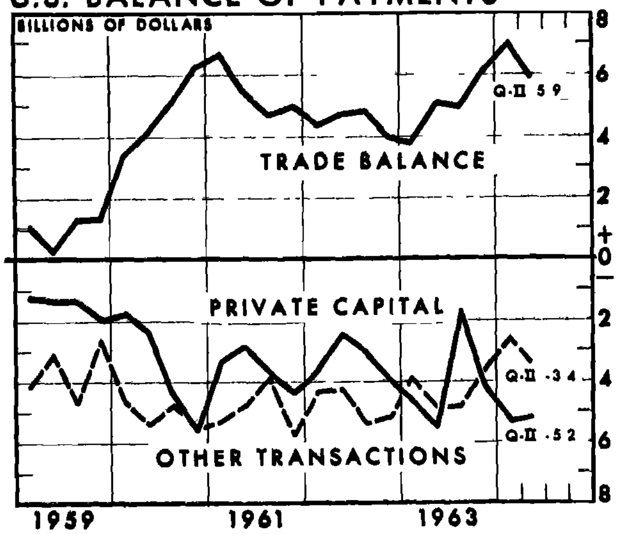
Japanese official reserve rose $12 million in both August and September, perhaps reversing a trend that has been generally downward for almost a year. These reserve gains probably reflect mainly a greatly reduced third quarter trade deficit, which, on an unadjusted basis, was less than one-third that of the second quarter. The capital account appears to have been in approximate balance in July and August.

The industrial production index leveled off in July and August after an upward surge in June. From the first of the year through August, industrial production rose 9 per cent, compared with a 13 per cent rise in the comparable period of 1963.

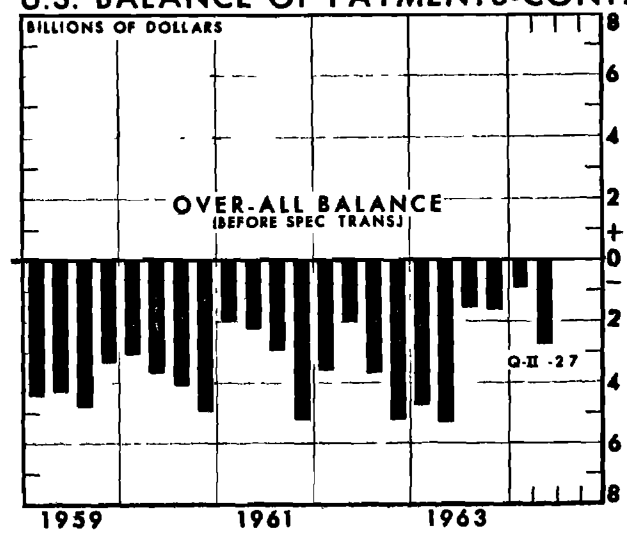
U.S. AND INTERNATIONAL - ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED, ANNUAL RATES

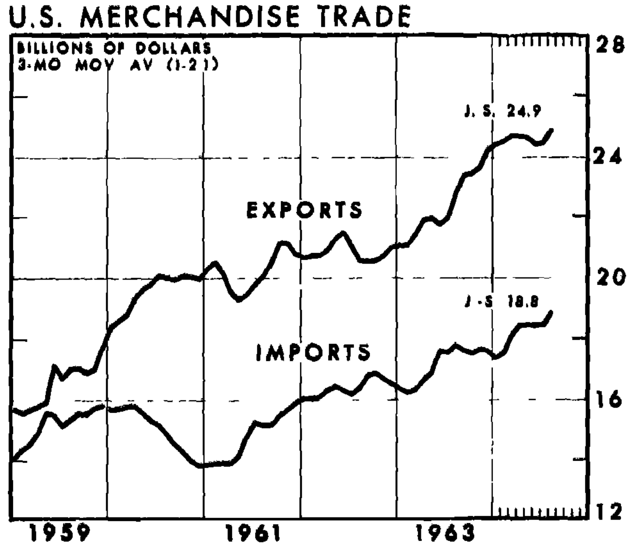
U.S. BALANCE OF PAYMENTS



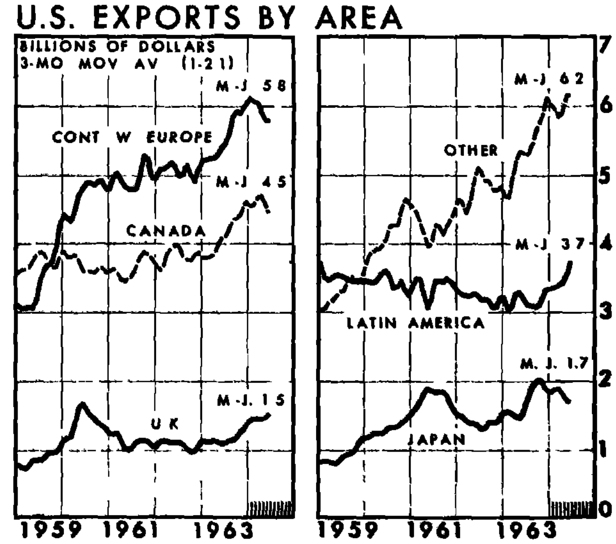
U.S. BALANCE OF PAYMENTS-CONT.



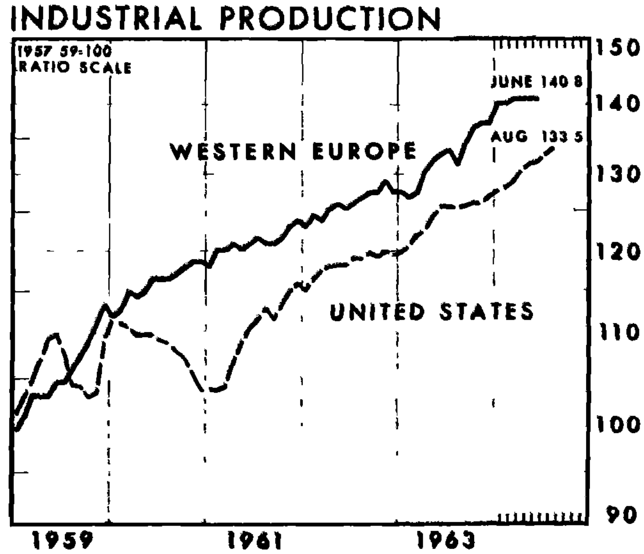
U.S. MERCHANDISE TRADE



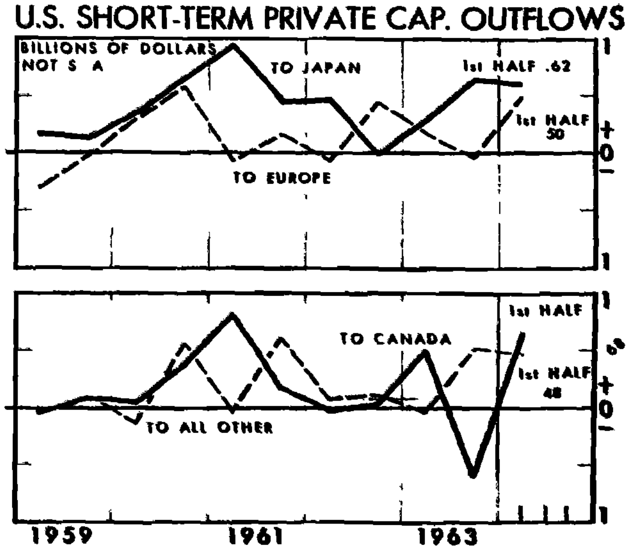
U.S. EXPORTS BY AREA



INDUSTRIAL PRODUCTION



U.S. SHORT-TERM PRIVATE CAP. OUTFLOWS



APPENDIX A: OUTPUT AND CAPACITY IN THE CURRENT EXPANSION

Over the expansion period so far--from early 1961 to the third quarter this year--output in manufacturing has risen 30 per cent while capacity has increased 15 per cent, resulting in an increase in the rate of capacity utilization from about 78 to about 88 per cent. During the same period, estimated capacity utilization for 17 major industrial materials has risen from around 69 to 88 per cent.

The significance of these figures for analysis of economic prospects is widely regarded as great, but there is wide disagreement as to what the significance is. In one view, for example, 88 per cent is far short of 100 per cent, and leaves plenty of room for further advance, even though 100 per cent is recognized to be unattainable by a considerable margin in an economy characterized by continually changing demands and production processes and by marked fluctuations in activity differently timed in different industries. In another view, an over-all rate of 88 per cent may be accompanied by enough evidence of extensions of delivery dates and upward price pressures to seriously threaten price stability. A third view is that 88 per cent is a moderate rate because it is below the 92 per cent average of rates "preferred" by businessmen the last time they were asked.

Uncertainties of interpretation are increased by the rough nature of the basic concept of capacity and of the measures that can be constructed to represent it. In the steel industry, for example, current operations are said by some industry people to be close to maximum because numerous finishing facilities are being fully used--even though output of ingots could be greatly increased from the current rate of 80 per cent or less. In aluminum, the situation is the other way around, with ingots being produced at full tilt while finishing capacity is more than ample to process all ingots available.

The rate of capacity use is important not only as it relates to price prospects but also as it relates to plans for capacity expansion; it was, in fact, primarily in connection with this subject that the index of capacity use for all manufacturing was developed at the Board. Earlier, the materials index had been developed at the Board chiefly as an aid to price analysis.

The purpose of this account of recent developments in capacity use is to provide background information that will be of some assistance in interpreting a broad range of developments relating to prices, capacity expansion, plant and equipment expenditures, production and employment.

Advance in capacity utilization since early 1961

The rise in the over-all utilization rate in manufacturing during this expansion has occurred in three periods, as is shown in Chart 1. In the initial advance from the recession low in early 1961 production increased much more rapidly than capacity--see Chart 4--and the utilization rate rose 7 percentage points in three quarters--to 85 per cent in the final quarter of 1961. In the next two years, except for the period of steel inventory accumulation in the second quarter of 1963, output rose less rapidly than in the initial stage and, with capacity expanding more rapidly, the utilization rate increased further by only one point--to 86 per cent in the fourth quarter of 1963.

From late last autumn to the third quarter of this year, manufacturing output expanded at an annual rate of nearly 8 per cent, outrunning the estimated 5.3 per cent annual rate of increase for capacity; as a result the utilization rate rose from 86 to 88 per cent. As indicated in Table 1, increases in utilization rates have occurred in two-thirds of the group of manufacturing industries, with the greatest rise, by far, in iron and steel. The run-up in the utilization rate for 17 major industrial materials--see Charts 1 and 3--was much more pronounced during this period--from 81 per cent to 88 per cent--largely due to the sharp rise in steel ingot production, which is much more important in the materials index than in the all-manufacturing index.

The 88 per cent level

In the light of past experience an 88 per cent rate of capacity utilization in manufacturing is not an extreme. During the Korean War period from mid-1950 to mid-1953, the rate was continuously above 88 per cent, and in the first half of 1953 it rose to a postwar peak of 96 per cent. In the next expansion period it peaked at 92 per cent, in the fourth quarter of 1955. Relative to rates in most recent periods, however, the current rate is relatively high; except for a single quarter in 1959, affected by an inventory build-up in anticipation of a steel strike, it is the highest since 1956.

Comparisons with the 1950's

The current situation differs from earlier postwar periods of high utilization rates in important respects. It is unlike the 1950-53 Korean period, because of differences both in the intensity and sources of demand and because of the controls on prices and materials use that were then in effect. It differs significantly from the 1955-56 period in respect to such features as the speed of expansion in production, the composition of demand and production and the nature of available resources of plant and equipment. A less rapid advance in production this time and greater reserves of capacity appear to have been important elements contributing not only

TABLE 1

OPERATING RATES AND PLANNED ADDITIONS TO CAPACITY
FOR MANUFACTURING INDUSTRIES
(McGraw-Hill Dept. of Economics) 1/

	Operating rates			Planned annual capacity increase (per cent) 1964	Estimated 2/ operating rate Aug. 1964	Change in rate Dec. 1963-Aug. 1964
	Dec. 1955	Dec. 1960	Dec. 1963			
Durables						
Iron and steel	98	50	70	2	85	+15
Nonf. met.	95	72	90	3	90	0
Machinery	87	70	82	4	87	+ 5
Elec. mach.	98	74	78	2	80	+ 2
Autos & trucks	96	80	89	3	92	+ 3
Trans. equip.	74	71	80	5	77	- 3
Fab. metal prod.	94	76	84	4	87	+ 3
Clay & glass	94	70	77	4	78	+ 1
Nondurables						
Chemicals	90	75	80	7	79	- 1
Paper & pulp	100	88	90	4	91	+ 1
Rubber	91	76	92	8	95	+ 3
Petroleum prod.	96	81	90	1	96	+ 6
Food & bev.	88	81	80	7	77	- 3
Textiles	93	82	95	4	96	+ 1
Misc. manuf.	95	83	88	7	88	0
Total	92	77	85			

1/ The McGraw-Hill utilization rate for total manufacturing is about 1 or 2 percentage points lower than the FRB measure shown in Charts 1 and 2.

2/ Estimate based on the Board's August industrial production index and three-fourths of the planned capacity increase.

to a long period of stability in industrial prices, shown in the lower panel of Chart 1, but also to the longer-sustained expansion in plant and equipment outlays shown on Chart 4.

Operating rates in durable and nondurable goods industries

One of the differences between the current situation and that in the mid-1950's is that this time production in industries producing durable manufactures has not been so high relative to capacity. The third quarter rate this year was 86 per cent as contrasted with 93 per cent in the second half of 1955. The figures are plotted in Chart 2.

Production of nondurable manufactures approached 90 per cent as early as mid-1961 and then showed little further change until the third quarter of this year when it moved up to 92 per cent, a level as high as was reached at any time in the mid-1950's. While some nondurable goods industries such as textiles show wide cyclical fluctuations, many--such as food products, petroleum products and paper and pulp--do not experience wide shifts in demand, and nondurable goods industries as a group characteristically have operated nearer to capacity over long periods than durables.

Among durable goods, as may be seen in the first and fifth columns of Table 1, estimated operating rates in August were below those in December 1955 for all groups except transportation equipment and nonelectrical machinery. The significance of differences in some groups such as iron and steel and nonferrous metals, however, may not be so great as the figures might suggest. Although the August rate shown for the iron and steel group is 85 per cent, many steel fabricating facilities were operating close to full capacity.

Within the group of nonferrous metals and products, output of copper refineries would have been higher except for strikes. With copper production in various other countries curtailed and world demands unusually strong, prices in free markets have skyrocketed and producer prices have advanced to 34 cents in the United States and 35 cents in Chile. Aluminum ingot production has been at capacity since February; prices, which had declined substantially between mid-1960 and mid-1963, have been raised moderately. Fabricating capacity has been ample, however, so that fabricating margins have narrowed. For lead and zinc, refining capacity has not limited supplies; it has been mining of ores that has not kept up with expanding demands, leading to repeated increases in prices from earlier reduced levels.

Advanced operating rates prevailing in various nondurable goods industries have not led to any general advance in prices in this area, although there has been considerable testing of markets and some price advances have held. Despite the high operating rate indicated for petroleum products, markets for these products have been weak most of the time and current prices are considerably below those of a year ago.

Demand, production, capacity, plant and equipment outlays and prices

From study of the behavior of capacity utilization rates for particular industries it is clear that the same utilization rate has different implications in different industries. Beyond that, considering the record for broad aggregates, it is clear that there is no "magic" capacity utilization number that automatically triggers price advances and that historical analogies with respect to capacity utilization should be drawn only with great care.

One reason that upward price pressures have not been greater and more widespread in this long expansion period since early 1961 is that increases in output--and particularly in new orders--have at no time been so sharp as in some other periods such as that from mid-1954 to the end of 1955. The increase in the rate of capacity expansion from 1961 to 1962 was less marked than that from 1954 to 1955 but capacity expansions in 1963 and 1964 have been fully as large as those in 1956 and 1957, taking account of the difference in levels of capacity. For the most part a balance between output and capacity has been maintained, almost as though "the importance of being on time" had been recognized and plans for capacity expansion fitted to realistic appraisals of prospects; one question now is how well additions to capacity already under way will take care of any further increases in demands for goods. So far demands have not been inflated by any inventory build-up of great significance and selective upward pressures on prices have reflected the strength of final demands, in some instances in combination with curtailment of supplies.

In the period ahead the cumulative sources of expansion could lead to further strengthening of final demands and also to an inventory build-up--as in steel, with a strike threat--which together would put additional pressure on capacity and set in motion the long-threatened general advance in prices--but such developments are not ordained. For example, growing conviction that the steel wage settlement will come relatively early and be relatively moderate could cause significant reappraisal of recently announced inventory policies of major steel consumers. Further increases in demand could then be of an orderly sort and be fairly readily accommodated by additional supplies coming from continuing increases in capacity. The extent of such capacity increases planned at the end of last year in various industries is indicated in Table 1. Actual supply-demand relationships and price developments will depend, additionally, on a variety of domestic and international influences affecting costs and competitive conditions--not discussed here. In this connection, one of the important questions is how far any increases in costs stemming from increases in wage rates will be offset by the lowering of costs through installation of new, more efficient equipment, either in capacity expansion or in modernization of existing facilities.

Description of capacity statistics cited

Statistics on capacity and its utilization are in a developmental stage, as their counterpart, the labor force and unemployment statistics were some thirty years ago. So necessarily the estimates used in this analysis are at best crude approximations with varying standards and definitions.

Federal Reserve Board major materials indexes

The Board's staff has developed indexes showing monthly production series and annual capacity levels for 17 major manufactured materials. These indexes are on a 1947-49 base period and use trade association and government data on physical volume capability as a capacity measure. The weights used for combining the various output and capacity indexes are based on value added data. The commodities included in this index account for slightly more than 10 per cent of total industrial production and for a somewhat greater share of its fluctuation. They may be regarded as of strategic importance during a period of near capacity operations, since their availability limits the potential output of a large share of the remaining production. They include, in addition to the textile, paper and primary metals series shown in Chart 3, series on petroleum and coal products, cement and a few chemicals.

In constructing these indexes, the definition of capacity is arbitrary to some extent, but full capacity usually refers to "normal" operations. The element of judgment involved in making these estimates relates principally to determining the level of capacity rather than the magnitude of change.

McGraw-Hill utilization rates

One of the questions included on the annual McGraw-Hill plant and equipment survey is: "How much of your capacity were you operating at the end of 19__?" These questionnaires are sent to a large number of manufacturing companies. The responses are grouped on a weighted basis into 15 (SIC 2-digit classification) industries and again weighted by FRB value added weights to estimate a total manufacturing operating rate.

Summaries of these responses are available by industry since 1954 and show reasonable patterns over the cycle. The lack of any definitition of capacity operation for respondents is a drawback, but the survey does indicate businessmen's impressions as to their operating rates.

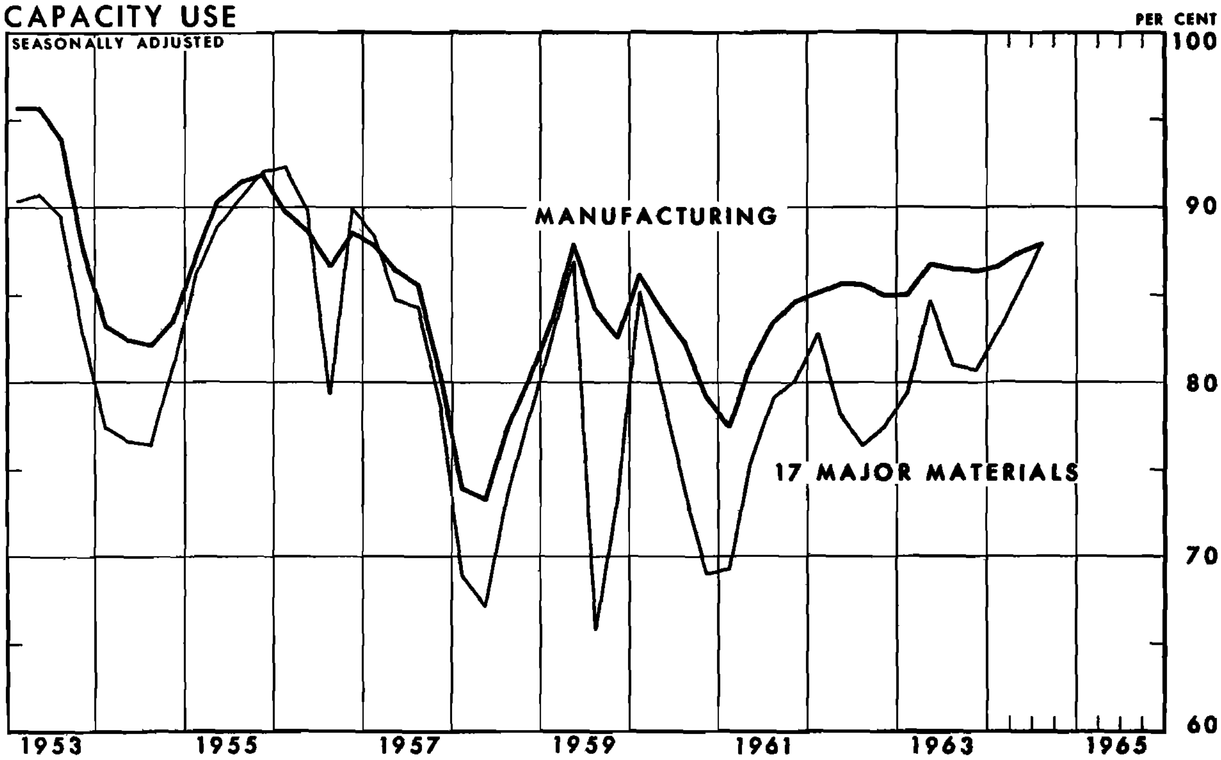
Changes in the operating rates for iron and steel for the past three years are calculated on the basis of estimated net additions to ingot capacity since 1960. No evaluation of over-all rolling mill capacity has been made.

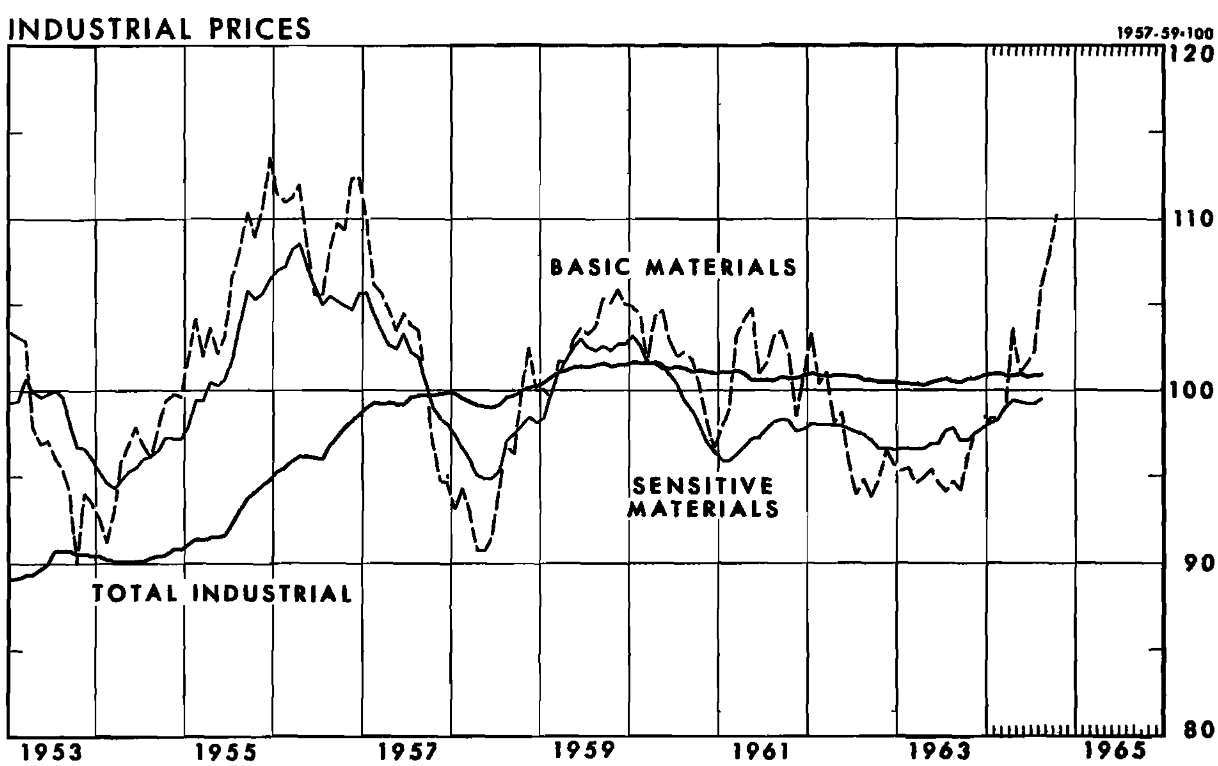
The combined FRB manufacturing measure

Capacity indexes (1957-59 output = 100) for total manufacturing and for the durable and nondurable goods components were designed for comparison with the manufacturing components of the FRB industrial production index. Each is based on three sets of data: (1) the McGraw-Hill capacity index (another question on the survey mentioned above asks for per cent increases in "capacity" for the year); (2) the U.S. Department of Commerce estimates of capital stock in manufacturing; and (3) the FRB output index divided by the McGraw-Hill utilization rate discussed above.

The course of each index is determined largely by (3) which is assumed to fluctuate without any pronounced bias over time. Both series (1) and (2) were assumed to have biases over time but, with allowance for these biases, were used mainly after 1953, to smooth out irregularities in (3). These measures are at best crude approximations of capacity and are subject to wider margins of error than most aggregate time-series commonly used in economic analysis.

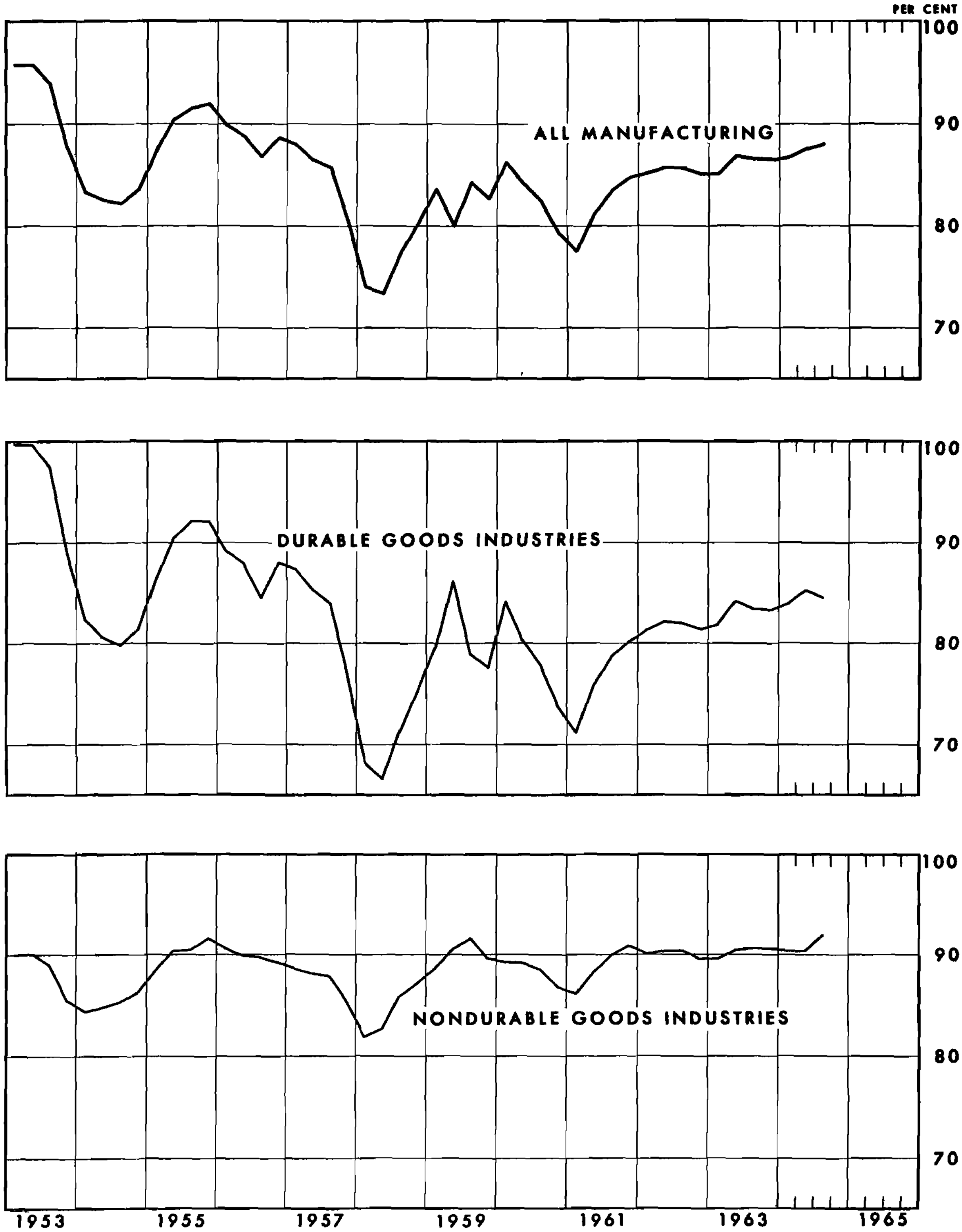
CAPACITY USE AND INDUSTRIAL PRICES





CAPACITY USE - MANUFACTURING

SEASONALLY ADJUSTED



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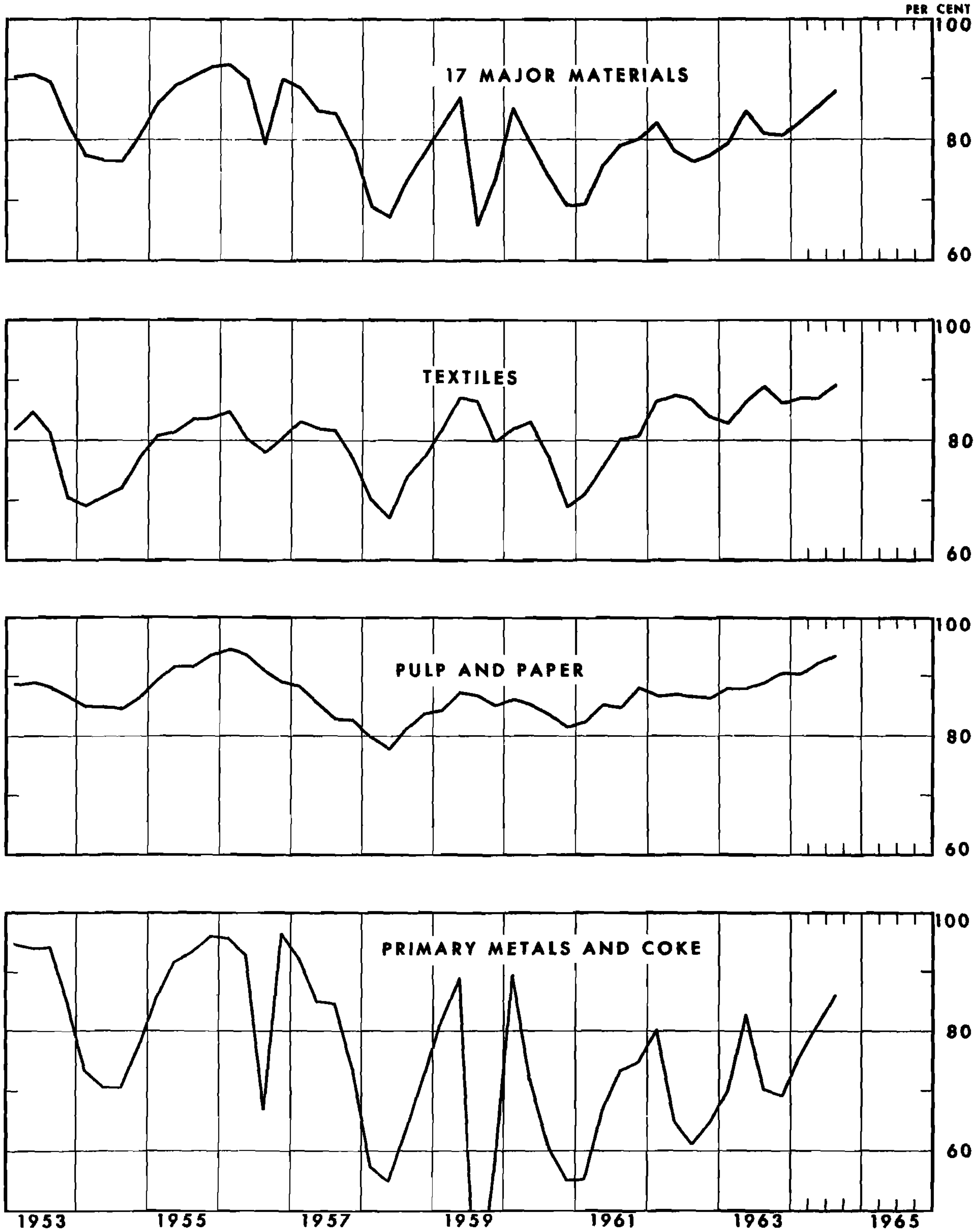
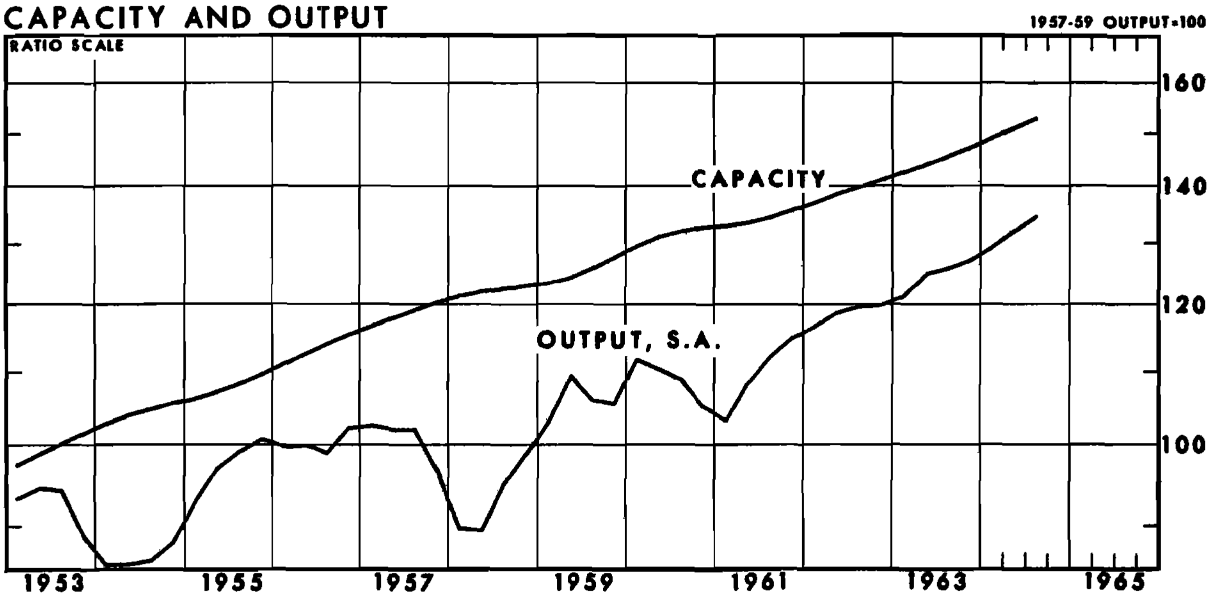
CAPACITY USE - MAJOR MATERIALS

SEASONALLY ADJUSTED

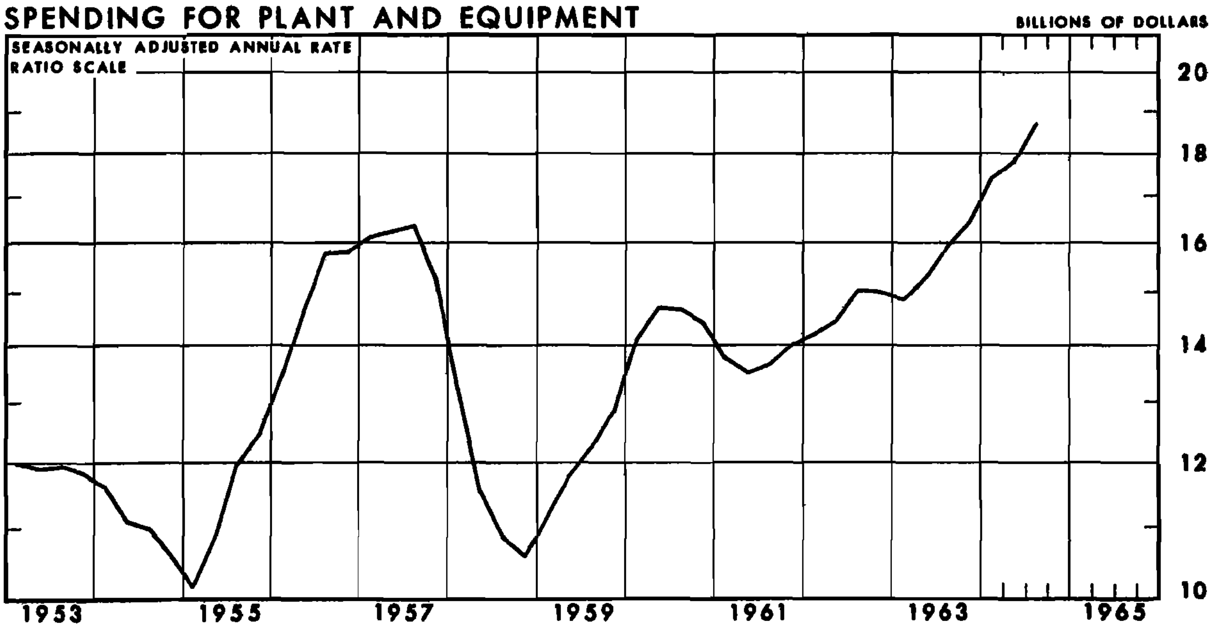


MANUFACTURING

CAPACITY AND OUTPUT



SPENDING FOR PLANT AND EQUIPMENT



CAPACITY INCREASE