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**CONFIDENTIAL (FR)**

# **CURRENT ECONOMIC and FINANCIAL CONDITIONS**

**Prepared for the  
Federal Open Market Committee**

*By the Staff*

**BOARD OF GOVERNORS  
OF THE FEDERAL RESERVE SYSTEM**

**January 27, 1965**

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IN BROAD REVIEW

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The domestic economy in late January still appeared to be heading upward on its broadly noninflationary course, but in the international area fourth quarter retrogression in the U. S. balance of payments has raised doubts about the adequacy of measures taken so far to reduce the payments deficit.

Some signs of domestic imbalance seemed more prominent than 3 weeks ago. The current pace of new auto sales to consumers--around a 10 million annual rate in January--is hardly sustainable for long. Similarly, the continuing rate of steel production--now close to 140 million tons a year and well above current advanced rates of use--cannot be maintained for many months. Possibly, an industrial stock average around the 900 level on the Dow-Jones scale is another indication of potential imbalance, although the recent stability, and more recently decline, in stock market credit points towards large cash demands for equities.

The official economic messages again reflect the stamp of modern-day fiscal theory which gained new support from the apparent success of the tax cut in 1964. Particularly noteworthy is the sharply stimulative fiscal policy indicated for the second half of this calendar year, when steel and auto output may well be considerably lower.

Information newly available since early January indicates a rise in the Board's production index although not nearly so sharp as in December. A further increase in retail sales from the record December level seems likely for January. Industrial commodity prices

were inching upward in mid-January at the very slow pace of the preceding month, and in free markets for copper earlier speculative enthusiasm was being dampened by increases in supplies.

In December, new housing starts rose considerably above their reduced November level to an annual rate of about 1.5 million units. New orders for durable goods and order backlogs rose further despite a decline in defense orders. Personal income increased appreciably further to well above \$500 billion, annual rate. Employment gains were large in December. Unemployment held at the 5 per cent level, but this represented considerable improvement from a year earlier. Unit labor costs in manufacturing, aided by rising productivity, were lower than in December 1963.

In financial markets, the large Treasury refunding was a notable success and so far appears to have had little effect on interest rates. Both U. S. Government and other long-term rates continued generally stable or moved a little lower, while the 3-month Treasury bill rate continued to fluctuate around the 3.80 per cent level.

City bank credit, after allowance for usual seasonal changes, has increased substantially thus far in January. Loans have declined much less than usual and banks participated heavily in the Government's recent financing operations.

The money supply increased \$800 million further in the first half of January following a rise of only \$300 million in the month of December and an average expansion of about \$500 million a month, or a 4 per cent annual rate, since August. Time and savings

deposits showed an unusually sharp increase in the first half of January, following very large increases in the final quarter of 1964.

The U. S. balance of payments deficit in 1964 now appears to have totaled \$3 billion. Very large outflows of short-term capital occurred in December, totaling \$500 million; these appear to have included some temporary loans and movements of funds to meet year-end pressures in the Euro-dollar market. Fragmentary data showing U. S. payments surpluses so far in January suggests a reversal of some of the December outflows.

In the past two weeks, foreign exchange markets have been relatively quiet. Early in the month, the announcement of the large gold purchase by France from the U. S. had produced some speculative activity and the London gold market was confronted with heavy demands. Pressures on sterling have eased since the publication of the foreign trade figures for December, which showed a smaller deficit than earlier.

SELECTED DOMESTIC NONFINANCIAL DATA  
(seasonally adjusted)

	Latest Period	Amount		Per cent change		
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Yrs. Ago*
Civilian labor force (mil.)	Dec. '64	74.7	74.4	73.4	1.8	3.5
Unemployment (mil.)	"	3.7	3.7	4.0	-8.5	-6.6
Unemployment (per cent)	"	5.0	4.9	5.5	-	-
Nonfarm employment, payroll (mil.)	"	59.1	58.9	57.3	3.2	5.8
Manufacturing	"	17.6	17.5	17.1	2.8	4.3
Other industrial	"	7.9	7.8	7.6	3.3	5.6
Nonindustrial	"	33.6	33.6	32.6	3.3	6.6
Industrial production (57-59=100)	"	137.0	134.8	127.0	7.9	14.7
Final products	"	137.3	134.7	128.0	7.3	12.5
Materials	"	136.8	135.4	125.9	8.7	16.5
Wholesale prices (57-59=100) <sup>1/</sup>	"	100.8	100.7	100.3	0.5	0.4
Industrial commodities	"	101.4	101.3	100.8	0.6	1.0
Sensitive materials	"	101.2	100.8	97.7	3.6	5.0
Farm products and foods	"	97.2	97.8	97.2	0.0	-2.1
Consumer prices (57-59=100) <sup>1/</sup>	Nov. '64	108.7	108.5	107.4	1.2	2.5
Commodities except food <sup>*</sup>	"	104.8	104.6	104.5	0.3	1.4
Food	"	106.8	106.9	105.1	1.6	2.6
Services	"	116.0	115.7	113.9	1.8	4.0
Hourly earnings, mfg. (\$)	Dec. '64	2.57	2.56	2.50	2.8	6.2
Weekly earnings, mfg. (\$)	"	105.39	104.70	101.54	3.8	8.4
Personal income (\$ bil.) <sup>2/</sup>	"	505.7	502.3	477.1	6.0	11.9
Retail sales, total (\$ bil.)	"	22.8	21.6	21.0	8.5	12.6
Autos (million units) <sup>2/</sup>	"	8.9	6.9	8.0	11.6	23.5
GAF (\$ bil.)	"	5.1	5.1	4.7	7.2	12.2
Selected leading indicators						
Housing starts pvt. (thous.) <sup>2/</sup>	"	1,541	1,430	1,570	-1.8	-1.3
Factory workweek (hours)	"	41.1	40.9	40.7	1.0	2.0
New orders, dur. goods (\$ bil.)	"	20.3	19.4	18.0	13.0	17.2
New orders, nonel. mach. (\$ bil.)	"	3.0	3.0	2.7	10.8	31.2
Common stock prices (1941-43=10) <sup>1/</sup>	"	83.96	85.44	74.17	13.2	34.0
Inventories book val. (\$ bil.)	Nov. '64	108.0	107.3	104.5	3.3	8.2
Gross national product (\$ bil.) <sup>2/</sup>	Q4 '64	633.5	628.4	599.0	5.8	11.8
Real GNP (\$ bil., 1963 prices) <sup>2/</sup>	"	617.6	614.9	594.7	3.9	7.9

\*Based on unrounded data. <sup>1/</sup> Not seasonally adjusted. <sup>2/</sup> Annual rates.

## SELECTED DOMESTIC FINANCIAL SERIES

	Week ended	Four-Week	Last six months	
	Jan. 22	Average	High	Low
<u>Money Market</u> <sup>1/</sup> (N.S.A.)				
Federal funds rate (per cent)	3.40	3.85	4.00	1.00
U.S. Treas. bills, 3-mo., yield (per cent)	3.81	3.80	3.87	3.42
Net free reserves <sup>2/</sup> (mil. \$)	65	80	256	-60
Member bank borrowings <sup>2/</sup> (mil. \$)	277	379	590	122
<u>Security Markets</u> (N.S.A.)				
Market yields <sup>1/</sup> (per cent)				
5-year U.S. Treas. bonds	p/4.10	p/4.10	p/4.13	p/4.00
20-year U.S. Treas. bonds	p/4.19	p/4.20	p/4.22	p/4.14
Corporate new bond issues, Aaa	4.39	4.46	4.53	4.37
Corporate seasoned bonds, Aaa	4.43	4.43	4.45	4.41
Municipal seasoned bonds, Aaa	2.96	2.98	3.12	2.96
FHA home mortgages, 30-years <sup>3/</sup>	5.45	5.45	5.46	5.45
Common stocks S&P composite index <sup>4/</sup>				
Prices, closing (1941-43=10)	86.74	85.77	86.74	81.99
Dividend yield (per cent)	2.97	3.00	3.05	2.94
	Change in Dec.	Average change last 3 mos.	Annual rate of change (%) 3 mos. 1 year	
<u>Banking</u> (S.A., mil. \$)				
Total reserves	53	25	1.4	4.2
Bank loans and investments:				
Total	1,100	1,400	6.6	7.9
Business loans	800	500	10.7	10.8
Other loans	700	700	8.2	12.0
U.S. Government securities	-400	-100	-2.0	-1.9
Other securities	-	300	9.6	9.7
Money and liquid assets:				
Demand dep. & currency	300	500	3.5	4.0
Time and savings dep.	1,400	1,600	15.8	12.6
Nonbank liquid assets	1,000	1,000	4.8	6.1

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted. p/--Preliminary.  
<sup>1/</sup> Average of daily figures. <sup>2/</sup> Averages for statement week ending January 20.  
<sup>3/</sup> Latest figure indicated is for month of December. <sup>4/</sup> Data are for weekly closing prices.



## U. S. BALANCE OF PAYMENTS

	1964					1963	
	Dec.	Nov.	Oct.	IIIQ	IIQ	IQ	Year
Seasonally adjusted annual rates, in billions of dollars							
Balance on regular trans.	< - - - 6.0 - - - >		- 2.3	- 2.8	- 1.0	- 3.3	
Current account balance			7.0	6.5	8.2	4.9	
Trade balance <u>1/</u>		5.6	6.6	6.5	5.8	6.9	5.0
Exports <u>1/</u>		25.8	25.2	25.4	24.1	24.4	22.0
Imports <u>1/</u>		-20.2	-18.6	-18.9	-18.3	-17.5	-17.0
Services, etc., net				0.5	0.7	1.2	- 0.1
Capital account balance				- 8.6	- 9.2	- 8.5	- 7.8
Govt. grants & loans <u>2/</u>				- 3.6	- 3.9	- 3.1	- 3.8
U.S. private direct inv.				- 2.1	- 2.3	- 2.1	- 1.9
U.S. priv. long-term portfolio				- 2.3	- 1.1	- 0.9	- 1.7
U.S. priv. short-term				- 1.2	- 2.5	- 2.5	- 0.7
Foreign nonliquid				0.6	0.5	0.1	0.3
Errors and omissions				- 0.7	- 0.2	- 0.7	- 0.3

## Monthly averages, in millions of dollars

Deficit on regular transactions (seas. adjusted)				189	231	81	272
Seasonal adjustment				150	- 35	- 104	-
Financing (unadjusted)	244	289	825	339	196	- 23	272
Special receipts <u>3/</u>	(0)	(0)	(0)	2	- 10	68	55
Liabilities increase							
Nonofficial <u>4/</u>	-586	540	678	187	36	77	49
Official <u>5/</u>	487	378	12	127	69	- 151	136
Monetary reserves decrease	343	- 629	135	23	101	- 17	32
of which: Gold sales	(95)	(40)	(37)	(-7)	(-24)	(15)	(38)
[Memo: Official financing] <u>6/</u>	(830)	(- 251)	(147)	(151)	(170)	(-169)	(168)

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

2/ Net of scheduled loan repayments.

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

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

5/ Includes nonmarketable bonds.

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

THE DOMESTIC ECONOMY

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Industrial production. Industrial production in December rose to 137 per cent of the 1957-59 average from 134.8 per cent in November. Much of the increase was accounted for by a sharp rise in output of autos, trucks, and automotive parts. Output of most other consumer goods, as well as of business equipment and materials also increased in December.

While some further increase in industrial production is anticipated in January it will not be nearly so large as the December rise. Auto output, which rose from a seasonally adjusted annual rate of 7.4 million units in November to a record 9.4 million rate in December, has changed little in January. Steel ingot production, which increased steadily in the previous three months, declined on a seasonally adjusted basis in January. Trade reports indicate that rolling mills are operating near capacity. Among other goods, there may be some cutbacks in production for export as railroads have embargoed transit of goods to East coast ports.

The increase in industrial production in 1964 for the third successive year was above the average rate of growth for the postwar period, 1947 to 1961, which included four recessions. As shown in the table, all three major market groupings showed above average increases in the latest three years, with the exception of equipment in 1963. The increases were especially large in 1962, following the 1961 recession.

GROWTH IN INDUSTRIAL PRODUCTION  
(in per cent)

	Average annual rate of change 1947-1961	Increase from previous year		
		1962	1963	1964
Total index	4.1	7.8	5.1	6.1
Consumer goods	3.9	6.3	4.6	4.8
Equipment, incl. defense	5.4	10.4	3.8	6.4
Materials	3.7	7.9	5.7	7.0

Retail sales. Retail sales in January, based on data for the first two weeks, appear to be up slightly from their record December level. Sales at both durable and nondurable goods outlets are showing gains. Among nondurable goods stores brisk sales are being reported at apparel, drug, and general merchandise outlets. Among durables, furniture and appliance sales are up slightly.

On a unit basis, sales of new autos for the first 20 days of January shattered earlier records. If maintained at this pace for the remainder of the month, seasonally adjusted sales in January will be around a 10 million annual rate, including imports. This rate is moderately above the advanced December level and sharply higher than a year earlier. Dealer stocks of new autos continue moderately below a year earlier and are unusually low in relation to sales.

Orders for durable goods. New orders for durable goods rose 5 per cent in December to the highest level in five months. The rise reflected mainly a sharp gain in the auto industry as it fully recovered from the effects of the autumn strikes and reached record

levels. New orders for primary metals and fabricated metal products also increased in December after being reduced somewhat in October and November. In the strategic producers' equipment sector, new orders were maintained at the record rate first reached last May. Defense orders declined further.

A large rise in shipments--particularly in the auto and primary and fabricated metal industries--accompanied the new order increase, and the backlog of unfilled orders for durable goods showed only a small further gain in December.

Over the year 1964, however, unfilled orders increased 15 per cent, as compared with a 6 per cent rise in 1963. As the table shows, stepped-up increase in unfilled orders came mainly in primary and fabricated metals and machinery and equipment. Sales were also up substantially last year (11 per cent) and the ratio of unfilled orders to sales of durable goods showed only a slight increase.

UNFILLED ORDERS FOR DURABLE GOODS

	Amount			Per cent increase	
	(\$ million, seasonally adjusted)			Dec. 1963	Dec. 1962
	Dec. 1964	Dec. 1963	Dec. 1962	to Dec. 1964	to Dec. 1963
Total	53,522	46,676	44,094	15	6
Defense products	19,665	18,724	18,148	5	3
Civilian products	33,857	27,952	25,946	21	8
Primary metals	6,529	3,930	3,761	66	4
Fabricated metals	4,850	4,062	3,944	19	3
Machinery & equip.	13,397	11,186	9,828	20	14
All other	9,081	8,774	8,413	3	4

Residential building. Seasonally adjusted housing starts increased in December from the reduced November level, and the fourth quarter average was moderately above the third quarter. The annual rate was 1.5 million in December, the same as the total for the year. Building permits, which tend to lead starts, declined during the fourth quarter, thus raising some question about the sustainability of the rise in starts.

For the year 1964, starts were down only moderately and, except for 1963, were the highest since 1955. For the year, both single-family and multi-family units showed similar relative declines. The decline in multi-family units, however, was especially significant in part because such units had accounted for most of the expansion in total starts during the preceding three years and in part because their attrition continued throughout the year. In December permits for multi-family units were the lowest since mid-1962.

Among regions, the decline in starts in 1964 was concentrated in the West which had led the expansion in 1963. Starts in the Northeast and South changed little in 1964 from 1963, while in the North Central states they rose sharply.

## PRIVATE HOUSING STARTS

	1964 Total (thousands of units) 1/	Per cent change:	
		1964 from 1963	QIV 1964 from QIV 1963
Total	1,544	- 4	- 9
1-family	973	- 5	- 5
2-or-more-family	571	- 3	-18
Northeast	250	- 1	+10
North Central	346	+11	- 5
South	595	--	- 4
West	363	-16	-31

1/ Data for regions include 10,000 public starts; all data are preliminary.

Gross national product. Gross national product in the final quarter of 1964 was at an annual rate of \$633.5 billion, up \$5 billion from the preceding quarter, according to the preliminary Department of Commerce estimate. The increase in total outlays was only half as large as the \$10 billion gain in each of the preceding three quarters, with the shortfall largely attributable to sharply reduced auto output.

Final purchases of goods and services increased less than \$2 billion; this compares with increases averaging \$11 billion in the three earlier quarters. On the other hand, inventory accumulation increased sharply to an annual rate of \$6.0 billion, notwithstanding curtailments resulting from the auto strikes in October and November. In the first three quarters inventory accumulation had averaged \$3.0 billion.

Personal consumption expenditures in the fourth quarter increased on balance by only \$1.6 billion; spending for autos decreased nearly \$3 billion from the third quarter and spending for nondurable goods

increased only \$1.3 billion. At the same time, consumer after-tax incomes rose \$6.4 billion. Consequently, the ratio of personal saving to disposable income increased sharply to 8.1 per cent from 7.1 per cent in the third quarter, which was about the average for the past decade.

For 1964 as a whole, gross national product is now estimated at \$622 billion, \$38.5 billion or 6.6 per cent more than in 1963: In constant prices, gross national product was up 4.7 per cent as compared with gains of 3.4 per cent in 1963 and 6.4 per cent in 1962, the first full year of expansion after the 1960-61 recession.

Personal income. Personal income showed an unusually large increase in December--\$3-1/2 billion--to an annual rate of \$506 billion. Wages and salaries were up \$2 billion from November, reflecting further increases in employment, particularly in construction and durable goods manufacturing. Corporate dividends were up \$700 million, reflecting larger than usual year-end extra payments. Other types of personal income were little changed.

For the year 1964, personal income totaled \$491 billion, \$27 billion or 5.9 per cent more than in 1963. Wages and salaries were up 6.2 per cent.

Employment. At year-end, the labor market was strong. In nonfarm activities over 200,000 persons were added to payrolls in December with gains fairly widespread among industries.

Most significant has been the rapid rise in both employment and the workweek in durable goods industries. December employment in

hard goods industries was 100,000 above September; the workweek, at almost 42.0 hours, was up more than one-half hour and was one of the longest in recent years. Extensive overtime at automobile plants was a major factor in this lengthening.

In contrast, employment advances in nondurable goods industries have been moderate and the average workweek has remained relatively stable; it was close to 40 hours a week in December, the same as a year ago.

Further gains in construction employment were also reported in December, reflecting mainly continued good weather. In trade and private and public service activities, increases in employment continued strong.

Over 1.8 million workers were added to nonfarm employment over the past year. This compares with gains of 1.4 million during 1963 and 1.2 million during 1962. The increase in manufacturing employment last year was much sharper than in earlier years, especially for production workers. Employment increases in non-manufacturing industries last year were about in line with their trends.

CHANGES IN NONAGRICULTURAL EMPLOYMENT FROM DECEMBER OF EACH YEAR  
(In thousands)

	1963 to 1964	1962 to 1963	1961 to 1962
Total	1,806	1,410	1,158
Manufacturing, all employees	473	249	225
Production workers	423	187	100
Nonproduction workers	50	62	125
Mining	3	6	-33
Construction	173	139	51
Transportation & public utilities	72	18	5
Trade	368	325	226
Finance and service	353	376	351
Government	354	297	333



Unemployment. Unemployment in December was 5.0 per cent of the civilian labor force compared with 4.9 in November and 5.5 per cent a year ago.<sup>1/</sup> The current rate, although below that of recent years, is about the same as in the spring and early summer of 1959, when steel inventories also were being built up rapidly. The unemployment rate again fell to about 5 per cent in early 1960, when industrial activity expanded following the steel settlement.

Unemployment of married men is relatively low; the December rate of 2.6 per cent compares with 3.3 per cent a year earlier. While fluctuating from month-to-month, unemployment for teenagers has shown little net change at around the 15 per cent level. Teenage employment, however, increased almost 300,000 in 1964, about the same amount as their labor force growth.

Labor costs. Unit labor costs in manufacturing declined to 97.0 (1957-59=100) in December as output expanded sharply. The cost index in December was lower than in any other month in 1964. For the year as a whole, unit labor costs averaged somewhat below 1963. Taken together, wage and fringe benefits per employee in manufacturing advanced about 3.4 per cent from 1963 to 1964. This was below the rise in output per manhour in manufacturing of 4.2 per cent, as implied by the Board's production index, and about in line with the guideposts based on trend productivity in the private economy of 3.2 per cent a year.

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<sup>1/</sup> See Appendix note on revision of seasonally adjusted labor force data.

Industrial relations. Although New York longshoremen last week voted to accept a new contract, ports along the East and Gulf coasts remained on strike for a third week. The union rule is that no port returns to work until all have settled. In some instances, the local unions are demanding more favorable terms than provided in the New York contract while in others employers have refused to accept the guaranteed wage or the minimum crew size provisions of the contract. There are 60,000 men on strike.

With bargaining in the basic steel industry recessed until February 15, the steel union leadership shifted its primary efforts to the major can companies in hope that an early settlement could be obtained prior to the union election on February 9. The companies, however, requested that negotiations be postponed until after the election. The contracts in the can industry expire on March 1. The union proposals include higher wages and increased job security but no indication has been given as to the size of the package. An early settlement with the can companies might provide a contract pattern that could be adapted to the basic steel industry. The acceptance by the can companies of an extended vacation plan in 1962 was followed by adoption of a similar plan by the steel industry the next year.

Wage rate increases specified in contracts negotiated in previous years will be received by 3.7 million workers during 1965, or 1.3 million more than last year. Negotiation of long-term contracts in the automobile, farm equipment, and trucking industries in 1964 account for most of the additional workers receiving such increases. In the first quarter of 1965 deferred increases affect 1 million

nonmanufacturing workers. Soft coal miners and nonoperating railroad workers have already received increases and in February 300,000 truckers will receive wage gains averaging 8 to 10 cents an hour. Almost 1.7 million manufacturing workers will receive automatic raises this year, including increases for most employees in the electrical equipment industry in April and for workers in the automobile and farm equipment industries in September or October.

About the same number of workers as last year will be involved in new wage negotiations this year as a result of contract expirations or wage reopenings. In addition to the steel and can industries, major contract negotiations are scheduled in rubber, shipbuilding and aircraft.

Two million workers are covered by agreements providing for cost-of-living adjustments in 1965, about the same number as in 1964 and 1963, but only half the peak 4 million at the end of 1958. The decline reflects the greater stability in the consumer price index in recent years and increasing worker interest in job security. Cost-of-living adjustments for workers covered in 1964 were 3 to 4 cents an hour. Most of the covered workers are concentrated in the auto, aircraft and meat packing industries, although a few are in chemicals, retail trade and public transit. Escalator clauses were eliminated from the steel workers' contracts in 1962 and from the railroad contracts in 1960.

Prices. The comprehensive wholesale price statistics for mid-December confirm a rise of .1 per cent in industrial commodities

from a month earlier, following increases of .2 per cent in November and .4 per cent in October. The weekly estimates indicate an additional .1 per cent rise to mid-January. At 101.5 per cent of the 1957-59 average, the industrial price level in mid-January was a half of 1 per cent above a year ago, 1 per cent above 2 years ago, and equal to the high reached in the first quarter of 1960.

Wholesale prices of foodstuffs were unchanged in December and then showed a slight seasonal rise to mid-January. The current level is about 1 per cent lower than in this season of the preceding 4 years. The combined index for foodstuffs and industrial commodities in mid-January, at 101.0 per cent of the 1957-59 average, was unchanged from a year ago and at the upper end of the narrow range through which it has fluctuated during the past 7 years.

Recovery in prices of petroleum products, which accounted for a large part of the rise in the industrial average in the early autumn, has continued. In mid-January, prices for these products were up more than 5 per cent from September and were back to the level of January 1964.

Prices of nonferrous metal products also rose further in December, and the whole nonferrous group was then up 15 per cent from its level in the first quarter of 1963, before the rise began. Since mid-December, copper prices have fallen sharply on the London and New York exchanges, as a result of progressive improvement in supplies, although they are still above prices maintained by primary producers. Speculative enthusiasm in nonferrous metal markets generally appears

to have been dampened by proposed legislation to release large quantities of surplus metals from the U.S. stockpile.

No further price increases have been announced for steel products. There have been reports, however, that list prices have been discontinued for some products, and on a negotiated basis, prices are said to be higher than formerly. The BLS price index for finished steel products in the week ended January 19, at 102.9 per cent of the 1957-59 average, was unchanged from late December. The index was 102.2 at the low in September and was 103.1 in January 1964.

By mid-December, prices of lumber and plywood averaged about 4 per cent lower than last spring before residential construction activity weakened. At the year-end, prices were reported to be going up because of the threat to supplies posed by the floods in the Northwest.

In markets for textile mill products, prices have been edging up in response to strong demands for inventory as well as current consumption. Early last year, prior to enactment of "one price cotton" legislation, buyers of cotton yarns and fabrics had sharply reduced their purchases and their inventories in anticipation of lower prices. Since mid-1964, they have been rebuilding inventories and order backlogs have increased appreciably. Prices of cotton textiles have increased about 1 per cent since summer. Moreover, they are less than 1 per cent lower than a year ago although the effective cost of raw cotton is down about a fourth as a result of the one-price cotton legislation and a reduction in Federal support levels. Prices

of fabrics made with synthetic fibers also have edged up while prices for some of the fibers have been reduced.

Land values. Farm real estate values rose 1.5 per cent during the 4-month period ending on November 1, 1964 (confidential) bringing the total advance for the year (November to November) to 7 per cent. Land values increased 6 per cent in 1963 and 5 per cent in 1962. Values rose in every region with the sharpest advances in the Southern areas and the smallest in the Corn Belt.

The rising trend in land values is in contrast to net farm incomes from farming which have held stable for four years. Cash receipts from the sale of farm products, the only 1964 income figures available as yet on a regional basis, averaged slightly less than 1963. In some regions, changes in land values were somewhat related to income changes. Thus, in New England, a profitable year for potato growers may have sparked the 5 per cent rise in land values following a year of stability. Similarly, in the Corn Belt reduced cash receipts for corn and grain sorghums and for cattle and calves may have moderated the rise in land values. The 30 per cent higher direct payments to farmers during the year may have had a stimulating effect even though legislative authority for these payments is temporary.

Easier credit for farm mortgages also may have contributed to the rise in land values. Farm mortgage debt expanded more rapidly in 1964 than in the preceding year. Keen competition among commercial lenders with ample funds to invest apparently resulted in some lengthening of maturities on farm real estate loans and in smaller

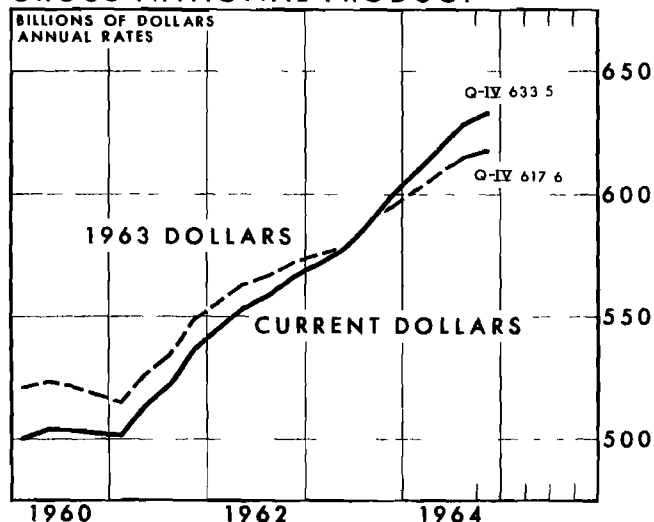
down payments. Easier credit policies of commercial lenders may have caused the first interruption since 1946 in the uptrend in the proportion of credit sales seller-financed by land contracts.

Periodic surveys indicate that the market continues to be dominated by demand for land for farm enlargement. In 1963, two-thirds of farm transfers were to active farmers, 15 per cent to tenants and 51 per cent to owner-operators. The owner-operators are generally progressive farmers buying land for farm enlargement. They are often willing to pay a relatively high price for additional tracts of land in order to spread overhead costs. Nonfarm uses also have affected land prices. Extension of urban areas and building of highways have boosted prices in adjacent areas of land used for agricultural purposes. The actual supply of land in farms has been reduced only 2 per cent in the five years since 1959, while the number of farms has decreased 18 per cent.

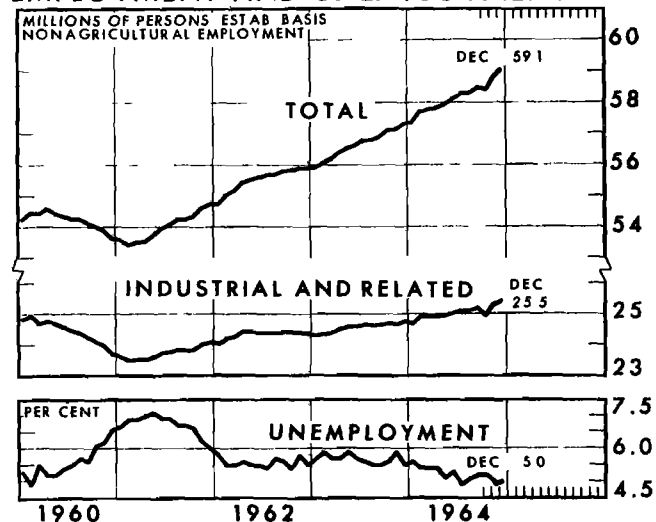
# ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

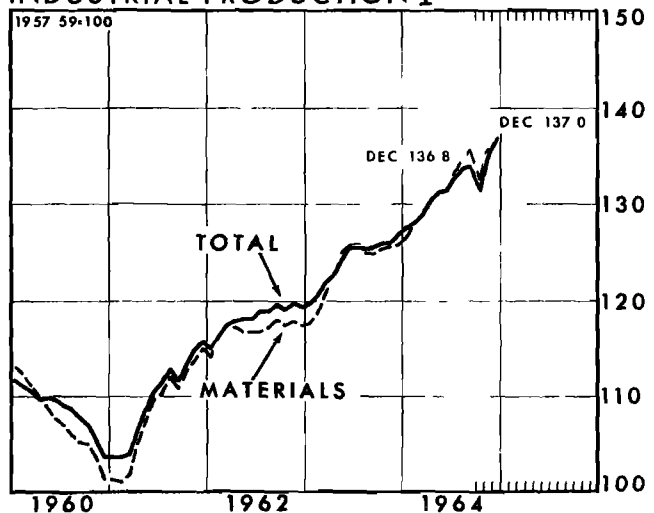
**GROSS NATIONAL PRODUCT**



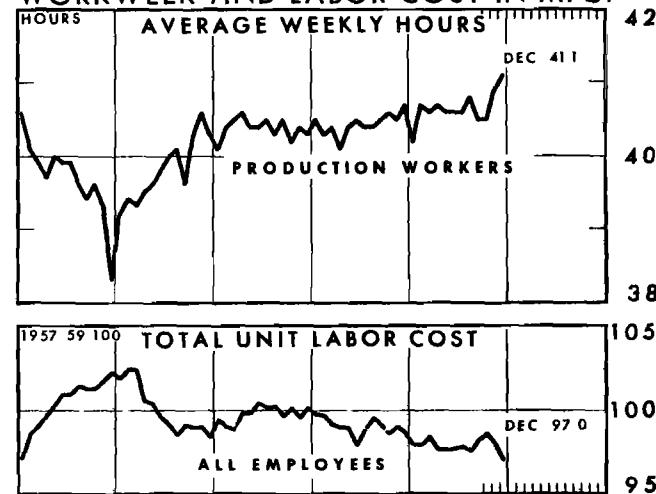
**EMPLOYMENT AND UNEMPLOYMENT**



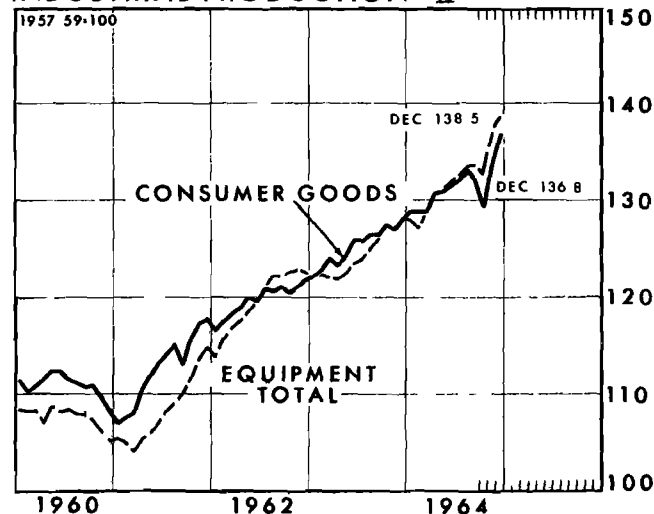
**INDUSTRIAL PRODUCTION-I**



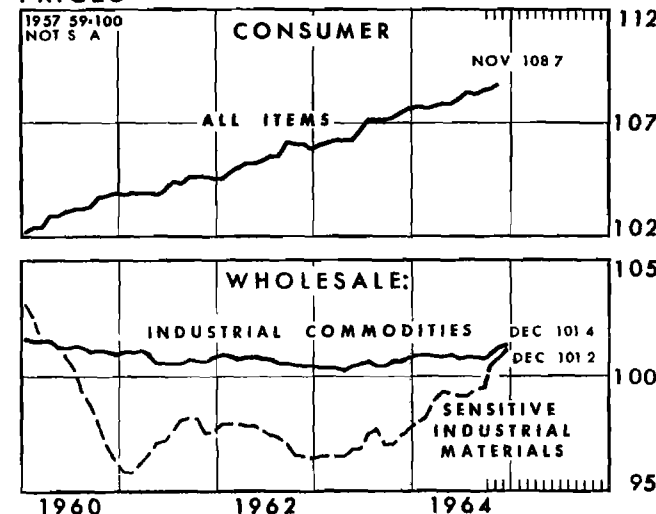
**WORKWEEK AND LABOR COST IN MFG.**



**INDUSTRIAL PRODUCTION-II**



**PRICES**

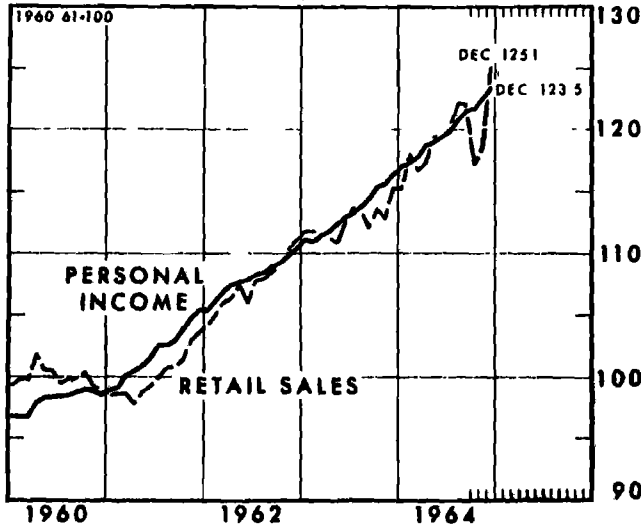




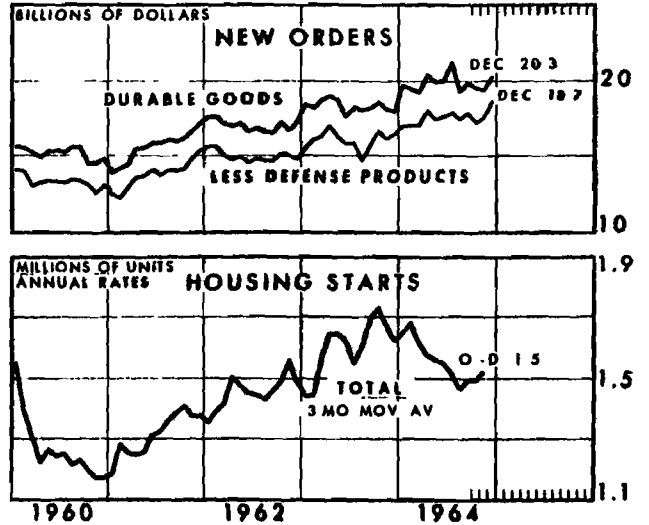
# ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

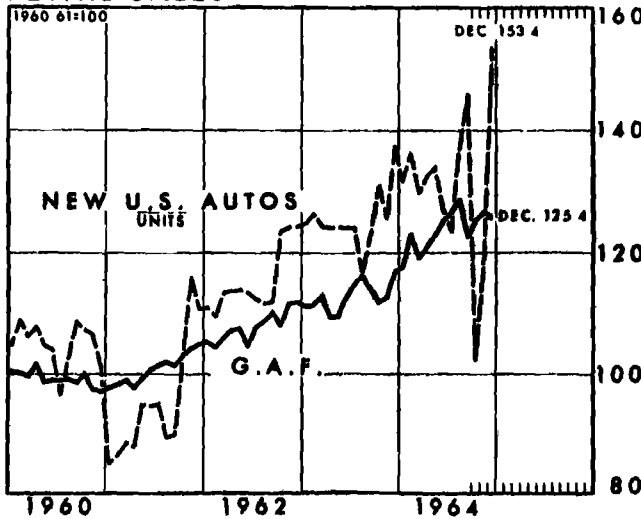
**INCOME AND SALES**



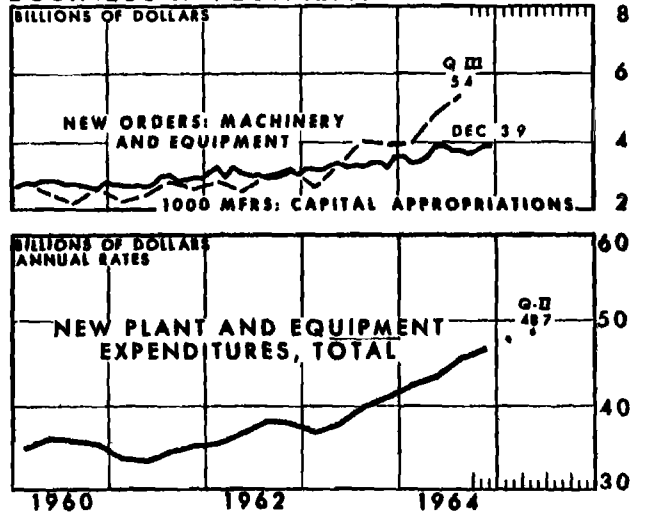
**NEW ORDERS AND HOUSING**



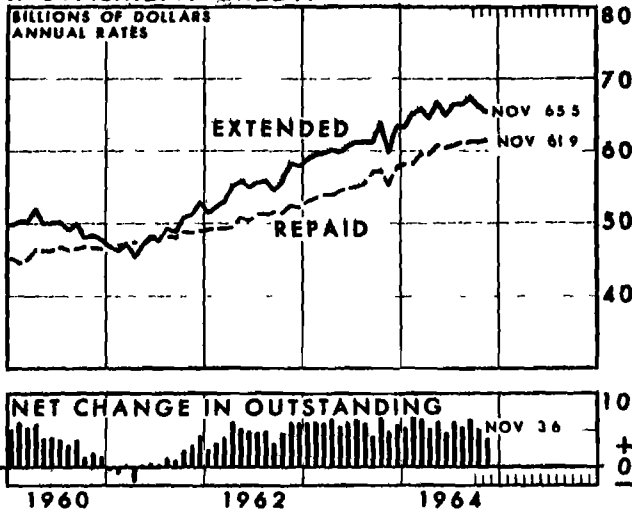
**RETAIL SALES**



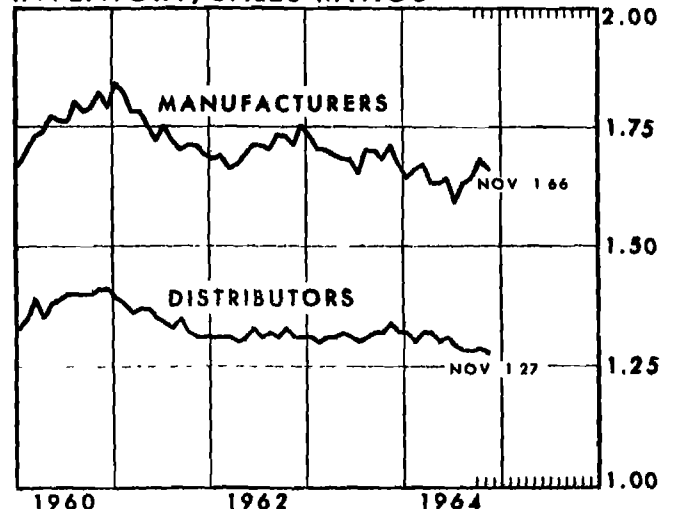
**BUSINESS INVESTMENT**



**INSTALMENT CREDIT**



**INVENTORY/SALES RATIOS**



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 DOMESTIC FINANCIAL SITUATION
 

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Federal budget. While Federal expenditures projected for fiscal year 1966 as recorded in the administrative budget are just under \$100 billion, the President's budget message outlines a program which by many conventional measures is somewhat more expansionary than in the preceding two fiscal years. Most of the expansionary thrust comes, however, in the first half of fiscal 1966--that is, in the July-December 1965 period.

 FEDERAL BUDGET DEFICITS, FISCAL YEARS 1964-66  
 (In billions of dollars)

	1964	1965	1966
Administrative	- 8.2	- 6.3	- 5.3
Receipts	89.5	91.2	94.4
Expenditures	97.7	97.5	99.7
Cash	- 4.8	- 4.0	- 3.9
Receipts	115.5	117.4	123.5
Payments	120.3	121.4	127.4
National income accounts	- 3.9	- 5.0	- 6.0
Receipts	114.7	116.0	121.0
Expenditures	118.5	121.0	127.0

The proposed Federal fiscal program as reflected in various measures of the budget is summarized in the table above. There, it can be seen that while a somewhat smaller deficit is anticipated in fiscal year 1966 for the administrative budget, the cash budget contains a deficit--at \$3.9 billion--virtually unchanged from the year before.<sup>1/</sup> This unchanged deficit is accompanied, however, by

<sup>1/</sup> The fiscal 1965 cash deficit of \$4 billion is somewhat higher than the \$3.5 billion figure reported in the appendix to the November 25 green book, which was the official estimate at the time.

a \$6 billion rise in cash payments proposed for the coming fiscal year, in contrast to a \$1 billion rise in the current fiscal year. A similar rise in expenditures is also scheduled for the Federal sector of the national income accounts, but with a somewhat enlarged deficit at the same time.

Larger Federal spending is projected mainly for trust funds and for health, labor, welfare, and education programs; a virtually constant level of spending is expected for defense and space taken together. As to credit programs reflected in the cash budget, higher projected loan disbursements are just about offset by increased asset sales and loan repayments.

Receipts in the cash budget are projected to rise about in line with expenditures, reflecting in large part continued growth in GNP. A proposed cut in excise taxes, effective July 1, is expected to result in a net loss of \$1.1 billion in revenue in fiscal 1966,<sup>1/</sup> but this would be more than offset for the fiscal year as a whole by a projected \$2 billion rise in revenue expected in January-June 1966 through already scheduled and newly proposed increases in social security taxes (including funds for medicare) effective January 1, 1966.

The pattern of expenditures and receipts implied by the budget leads to a larger than usual swing within calendar year 1965-- from a first half surplus in the cash budget that is close to earlier

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<sup>1/</sup> The proposed cut reduces excise taxes by \$1-3/4 billion annually, but of this amount only \$1.5 billion will be reflected in fiscal 1966 due to timing of collections. This amount will be partially offset by a proposed \$420 million increase in excises that are considered to be user charges.

projections at \$6.6 billion (seasonally unadjusted) to a July-December deficit of \$13 billion, as shown in the table below. While the distribution of the budget by half-years is still preliminary and conjectural, these figures suggest a second half deficit larger than in July-December 1964 and in the order of magnitude of that obtaining in 1958, when, of course, GNP was considerably smaller. The projected deficit assumes that Congress passes the Presidential program as requested, including particularly increased social security benefits payable in the second half of calendar 1965 retroactive to January 1, 1965 and increased social security receipts that do not begin until January 1, 1966.

FEDERAL RECEIPTS AND EXPENDITURES, CALENDAR YEARS 1963-65  
(In billions of dollars, by half-years)<sup>a/</sup>

Calendar Years	1963		1964		1965	
	I	II	I	II	I	II
<u>Cash Budget: Unadjusted</u>	<u>Half Year Totals</u>					
Receipts	60.7	51.8	63.7	51.4	66.0	52.2
Expenditures	<u>55.6</u>	<u>61.5</u>	<u>58.8</u>	<u>62.0</u>	<u>59.4</u>	<u>65.2</u>
Deficit/Surplus	5.1	- 9.7	4.9	-10.7	6.6	-13.0
<u>Cash Budget:</u>						
<u>Seasonally Adjusted</u>						
Receipts	55.4	57.4	58.2	56.9	60.5	57.9
Expenditures	<u>56.7</u>	<u>60.4</u>	<u>60.0</u>	<u>60.9</u>	<u>60.5</u>	<u>64.1</u>
Deficit/Surplus	- 1.4	- 3.0	- 1.8	- 4.0	0	- 6.2
<u>National Income Accts.</u>	<u>Seasonally Adjusted at Annual Rates</u>					
Receipts	111.7	115.7	113.6	114.3	117.5	118.1
Expenditures	<u>114.6</u>	<u>115.7</u>	<u>118.7</u>	<u>119.8</u>	<u>122.0</u>	<u>126.3</u>
Deficit/Surplus	- 2.9	0	- 5.2	- 5.5	- 4.5	- 8.2
<u>Full-Employment</u>						
Receipts	123.0	126.3	121.8	121.1	124.5	126.1
Expenditures	<u>113.3</u>	<u>115.2</u>	<u>118.1</u>	<u>119.3</u>	<u>121.5</u>	<u>125.8</u>
Deficit/Surplus	9.7	11.1	3.7	1.8	3.0	0.3

<sup>a/</sup> As estimated by Government Finance Section based on the January 1965 Budget Document.

A similar pattern is indicated for the budget program as it is reflected in the national income accounts and in measures of the full employment surplus. In the former case, a deficit of \$4.5 billion (seasonally adjusted annual rate) in January-June 1965 is followed by an \$8.2 billion deficit in the second half of the calendar year, as expenditures rise fairly sharply and receipts, affected by the proposed excise tax cut, grow more slowly.

The fiscal stimulus provided the economy as measured by the full employment surplus also increases in the second half of the year, when the surplus falls to only \$300 million from a relatively low \$3 billion in January-June 1965.<sup>1/</sup> It should be kept in mind, however, that there is a sharp snapback in the full-employment surplus to around \$6 billion in the first half of 1966 in reflection of higher social security taxes. Such a movement would represent a greater swing toward surplus than is likely to occur between July-December 1964 and January-June 1965, when the surplus is projected to rise by just over \$1 billion.

U. S. Government securities market. Treasury bond yields have declined since the Treasury closed the books on its highly successful advance refunding. Yields on most issues currently are close to their levels of mid-December when they began to adjust upward in anticipation of a possible advance refunding in January. The unexpectedly large exchanges by public holders in the advance refunding,

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<sup>1/</sup> Between \$600 and \$700 million of the decline in the full employment surplus is due to the lump-sum payment for increased social security benefits that retroactively covers the first six months of the year.

notably for the 4-1/4's of 1987-92, have generally been interpreted as an indication of the strength of investment demand and confidence in current interest rate levels rather than as overspeculation by dealers and other temporary underwriters.

Since the completion of the advance refunding, dealers have reported good investment demand for the new bonds. Some selling by speculative holders has also been in evidence, but it has been readily absorbed so far. There have been no purchases by official accounts in the coupon market since the books were closed, except for some relatively small and routine transactions for Treasury investment accounts.

#### YIELDS ON U. S. GOVERNMENT SECURITIES

Date (Closing Bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
<u>1964-65</u>						
Highs	3.88	4.03	4.22	4.21	4.26	4.26
Lows	3.40	3.50	3.92	3.99	4.12	4.14
<u>1964-65</u>						
December 15	3.87	3.96	4.06	4.07	4.17	4.16
December 31	3.82	3.92	4.06	4.12	4.21	4.21
January 12	3.80	3.94	4.04	4.11	4.19	4.19
January 25	3.85	3.93	4.02	4.09	4.17	4.17

Public and dealer participation in the two most recent Treasury advance refundings resulted in record exchanges, which are shown in the tables. While dealers have made better initial progress in distributing their acquisitions in the current refunding, they came out of the advance refunding with much larger holdings of the 4-1/4's of 1987-92 and remain relatively more exposed in the over-20-year maturity area.

Table A

JANUARY 1965 ADVANCE REFUNDING COMPARED WITH JULY 1964  
(In millions of dollars)

New issues	Exchanged by Public		Held by dealers after books closed	
	January 1965	July 1964	January 1965	July 1964
4's of 10/69		3,728		250
4's of 2/70	4,057		172	
4-1/8's of 11/73		4,353		395
4-1/8's of 2/74	2,776		254	
4-1/4's of 8/87-92	2,211	1,176	559	350
Totals	9,044	9,257	985	995

Table B

DEALER POSITIONS ON SELECTED DATES  
(In millions of dollars)

Dates	Total holdings of notes and bonds					
	Within 1 year	1 - 5 years	5 - 10 years	10 - 20 years	Over 20 years	Total over 5 years
<u>1965</u>						
January 8 (books closed)	69	39	574	-2	583	1,155
January 26 *	90	40	398	5	509	912
<u>1964</u>						
July 16 (books closed)	156	86	812	3	362	1,177
August 3 *	225	95	707	9	339	1,055

\* Twelve trading days after books close.

Treasury bill rates have fluctuated irregularly so far in January. Rates on the shortest maturities, in particular, moved higher during the period and 30-day bills rose from around 3-1/2 per cent in late December to 3-3/4 per cent on January 26. On the other hand, seasonal demands for bills in the 3-month area and re-investment demand for longer bills from sellers of rights to the advance refunding

created market scarcities of these bills and some attendant downward rate pressures. These pressures were moderated and then reversed however, by the auction of \$1-3/4 billion June tax bills on January 12 and \$100 million additions to the weekly auctions starting January 18. Also, a generally taut atmosphere in the money market and associated relatively high dealer financing costs at money market banks tended to maintain upward pressure on the bill market.

The Treasury's February refinancing will be a small operation, which is expected to involve an offering of a short-term coupon issue to refund \$2.2 billion of maturing bonds, including \$1.7 billion held by the public. Given the recent reduction of short-term coupon issues because of exchanges in the advance refunding and the current low dealer holdings of such issues, as may be seen in Table B above, the February refunding is likely to be quite routine.

Corporate and municipal bond markets. Markets for both corporate and municipal bonds have continued to strengthen in recent weeks. Yields on seasoned municipal obligations--which had started to decline from their sterling crisis highs early in December--have since eased further; currently, the series on high grade issues is only 8 basis points above its six-year low reached in November 1962. The first investment grade corporate issue brought to market since early December was offered competitively last week at a reoffering yield of 4.39 per cent (adjusted to a composite triple-A basis).



This was 3 basis points below the adjusted yield on the early December offering, and close to the recent low reached in the new issue series last July.

**BOND YIELDS**  
(Weekly averages - per cent per annum)

	Corporate		State & local govt.	
	Aaa		Moody's Aaa	Bond Buyer (mixed qualities)
	New	Seasoned		
1962 - year end	4.24	4.23	2.94	3.05
1963 - " "	4.54	4.37	3.11	3.26
1964 - " "	4.47 <u>1/</u>	4.43	2.99	3.12
1964 - High	4.54(3/3)	4.45(12/11)	3.16(3/26)	3.32(4/21)
Low	4.30(2/21)	4.35(2/28)	2.99(12/31)	3.12(12/31)
<u>Sterling Crisis High</u>	4.47	4.45	3.09	3.21
<u>Week ending</u>				
1965 - Jan. 22	4.39	4.43	2.96	3.07

1/ Week ending December 4.

In the corporate bond market, the visible supply of new issues continues to be relatively light for the near-term and inventories of unsold bonds remain negligible. This supply situation, coupled with the success of the Treasury's advance refunding, encouraged investors to snap up the recent \$200 million offering of World Bank bonds and to bid prices of recently offered corporate bonds higher in the secondary market.

The supply of municipal offerings in January is expected to be substantial, but still about one-fifth below the unusually large December volume. The largest offering of the month, the \$124 million issue of the City of New York, attracted substantial bank interest and was about four-fifths sold on the day of offering. Generally aggressive

pricing of other January offerings, however, has resulted in slow retail demand for some issues. Dealers' advertised inventories of unsold securities, which had dropped to about \$550 million early in the month, have expanded to about \$650 million.

The unusually large volume of State and local government bonds sold in December raised the gross volume for 1964 to a new record, 3 per cent above the previous high set in 1963. Gross offerings of corporate bonds, on the other hand, totaled about 5 per cent less than in 1963--a year which included a substantial volume of publicly offered refunding issues. While public offerings of corporate bonds dropped, nearly 1/4 below 1963, private placements rose to a new record, one-tenth larger than the previous high set in 1963. The bulk of this year-over-year growth was attributable to an estimated record monthly volume of private placements taken down in December.

BOND OFFERINGS 1/  
(millions of dollars)

	<u>Corporate</u>				<u>State &amp; local government</u>	
	<u>Public offering</u>		<u>Private placements</u>		<u>Current period</u>	<u>Previous year</u>
	<u>Current period</u>	<u>Previous year</u>	<u>Current period</u>	<u>Previous year</u>		
1964	3,608 <sub>e</sub> /	4,714	6,778 <sub>e</sub> /	6,158	10,888 <sub>e</sub> /	10,538
November	30 <sub>e</sub> /	183	642 <sub>e</sub> /	549	600 <sub>e</sub> /	754
December	305 <sub>e</sub> /	626	1,200 <sub>e</sub> /	751	1,050 <sub>e</sub> /	495
1965-January	200 <sub>e</sub> /	338	500 <sub>e</sub> /	526	850 <sub>e</sub> /	1,009

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

Stock market. Common stock prices have recently reached a new record high in above average trading activity. At its January 26

closing, Standard and Poor's composite index registered 86.93, nearly one per cent above its previous high of November 20 and 4-1/2 per cent above its December low. Trading averaged 5.5 million shares a day during the last two weeks, up 0.8 million shares from the daily average in December.

Total customer credit in the stock market fell \$55 million during December as a further decline of \$81 million in customer net debit balances at brokerage houses more than offset a \$26 million increase in "purpose loans" at banks. In the thirteen months that have elapsed since the raising of margin and retention requirements to 70 per cent, customers' net debit balances with brokers have declined \$507 million. While this attrition has been partly offset by further growth in bank "purpose loans," total stock market credit has contracted \$245 million over the period.

Shrinkage of stock market credit in a year of general stock price advance is unique in the postwar period. In the past when margin requirements were increased under similar circumstances growth in stock market credit tended to slow or level off. But it never actually contracted, so long as stock prices continued to rise. Undoubtedly, the contraction in credit this time has reflected the simultaneous increase in both margin and retention requirements.

Mortgage markets. Competition for mortgages by lenders has continued active. In the secondary market, yields on FHA-insured, 30-year mortgages held at 5.45 per cent in December, marking the twenty-second month of virtual stability. Contract interest rates for

conventional home mortgages also remained unchanged at the end of 1964, according to the Federal Housing Administration; the average was 5.30 per cent for new home loans and 5.85 per cent for loans on existing homes. Partly reflecting this stability, the spread between yields on mortgages and yields on new Aaa corporate bonds has remained unusually narrow.

In November, the latest month for which data are available, average loan amounts for conventional mortgages were continuing well above a year earlier, reflecting mainly increased buyer preferences for upgraded new homes and higher-priced existing homes. While loan-to-price ratios changed little, maturity terms for existing homes also rose in November and were near a record high for the series.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASE

	October	November	Per cent increase November 1964 from a year ago
<b>New home loans</b>			
Purchase price (\$1,000)	24.1	24.0	+ 6
Loan amount (\$1,000)	17.4	17.4	+ 6
Loan/price (per cent)	73.2	73.5	--
Maturity (years)	24.5	24.7	+ 2
<b>Existing home loans</b>			
Purchase price (\$1,000)	18.7	19.4	+10
Loan amount (\$1,000)	13.3	13.8	+11
Loan/price (per cent)	71.4	71.4	+ 1
Maturity (years)	20.0	20.3	+ 5

Bank credit. Loans and investments at city banks declined less than usual over the three weeks ending January 13 following a relatively moderate rise over the earlier part of December. Loan liquidation was considerably smaller than in most other recent years, reflecting mainly contraseasonal expansion in security and business loans. On the other hand, in the absence of the usual Treasury cash financing in early January, holdings of U.S. Government securities showed an unusually large decline. This was offset in part by a contraseasonal rise in holdings of other securities, presumably reflecting delivery on the large volume of December offerings of municipals. Holdings of municipal and agency issues had shown only usual seasonal movements in December.

NET CHANGE IN CITY BANK CREDIT  
LATE-DECEMBER TO MID-JANUARY  
(In millions of dollars)

	12/23/64 to 1/13/65	12/25/63 to 1/15/64	12/26/62 to 1/16/63	12/27/61 to 1/17/62	12/21/60 to 1/11/61
<u>Total loans and investments</u>	-706	-235	-928	-2,364	-1,369
Loans	-131	- 98	-1,510	-2,049	-1,780
U.S. Govt. securities	-819	- 7	601	-293	352
Other securities	244	-130	- 19	- 22	59
<u>Type of loan:</u>					
Business	270	-217	-554	-690	-476
Real estate	54	23	61	8	- 17
Security	318	645	-158	-867	-756
Nonbank financial	-548	-353	-598	-380	-343
"Other"	-98	3	- 99	- 24	-101

On January 13, not reflected in the above figures, commercial banks acquired virtually all of the \$1-3/4 billion June tax anticipation bills, for which commercial banks could make payment up to 50 per cent by credit to Tax and Loan Accounts. On January 19, commercial banks shifted \$5.6 billion of issues maturing in 5 years or less into those maturing in over 5 years through participation in the Treasury's advance refunding. Banks acquired \$2.8 billion of the 4 per cent bond of 1970, \$1.8 billion of the 4-1/8 per cent bond of 1974, and \$1.0 billion of the 4-1/4 per cent bond of 1987-92. The total exchanged was nominally greater than the large volume exchanged in the July refunding; exchanges into the longest bonds were almost twice as large.

Following a larger than usual rise in early and mid-December business loans at city banks rose contraseasonally in the three weeks ending January 13. Several major loan categories showed contraseasonal increases or smaller than usual declines, including loans to metals companies, public utilities, petroleum and chemicals companies, service concerns, and all the seasonally oriented industries (food processors, commodity dealers, and trade concerns). In addition, loans to mining and crude petroleum companies rose more than usual. While inventory accumulation may have contributed to these demands in some categories, particularly metals, expanding investment outlays and declining liquidity may have figures in others.

The contraseasonal rise in security loans was due mainly to borrowing by Government security dealers in connection with the advance refunding. Other security loans declined more than usual.

Money supply, turnover, and time deposits. The seasonally adjusted money supply increased \$800 million in the first half of January following a moderate \$300 million rise in December. The substantial early-January rise was associated in part with a larger-than-usual decline in U.S. Government deposits and the strong uptrend in business borrowing. Since part of the money supply increase was in currency and reserves against net interbank deposits declined, the growth in total money supply was larger than the small rise in average seasonally adjusted reserves against private demand deposits (which include those against net interbank) would imply. Over the last five months of 1964, following the June-July bulge, money supply growth averaged \$500 million per month, an annual rate of 4.1 per cent.

Seasonally adjusted turnover of demand deposits at 343 centers outside New York declined to 35.2 in December, continuing to move within the narrow range which has prevailed since spring. Over the year, turnover averaged 5.2 per cent higher than in 1963, but in the last quarter of 1964, it averaged only 3.7 per cent above the rate in the October-December 1963 period.

Seasonally adjusted time and savings deposits at all commercial banks showed an unusually sharp advance of \$1.3 billion in the first half of January. This followed a record monthly rise of \$2 billion in November and a relatively large increase of \$1.4 billion in December. Over the last quarter of 1964, growth in these deposits was at an annual rate of 16 per cent compared with 11 per cent earlier in the year.

Expansion in savings deposits at weekly reporting banks in the three weeks ending January 13 was much larger than in the

corresponding weeks of any other recent year, over twice as much as a year ago. Growth was up sharply in nearly all Federal Reserve districts and presumably reflected rate increases following the November revision of Regulation Q. Expansion in other time deposits, as in early December, continued larger than a year earlier although in other recent months it had been smaller. Negotiable CD's at banks in New York and Chicago, where comparable data are available, increased in similar volume in the two years. In the week of January 13, when the large city banks were facing a large volume of mid-month CD maturities, and also were under unusual reserve pressure from heavy dealer financing and a sharp reduction in U.S. Government deposits, outstanding CD's at all city banks rose by a record \$500 million.

Bank reserves. Free reserves averaged \$90 million over the three weeks ending January 20, somewhat below the \$128 million average in December.<sup>1/</sup> Member bank borrowings at \$337 million were above the December level but about the same as the September-December average. Excess reserves increased slightly in January to \$427 million. Over the December 31-January 26 period, the effective rate on Federal funds remained at 4 per cent through January 18 and then dropped to 3 per cent on the 19th and 2 per cent on the 20th. Subsequently, it rose to 4 per cent again. Some transactions took place at 4-1/8 per cent on one day in early January and on several days recently.

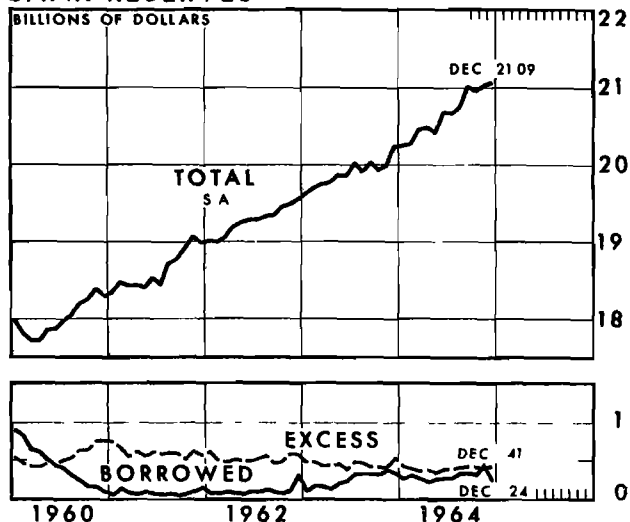
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<sup>1/</sup> Based on the average of daily figures for all of the reserve weeks ending in the month as used in the reserve memorandum to the FOMC.

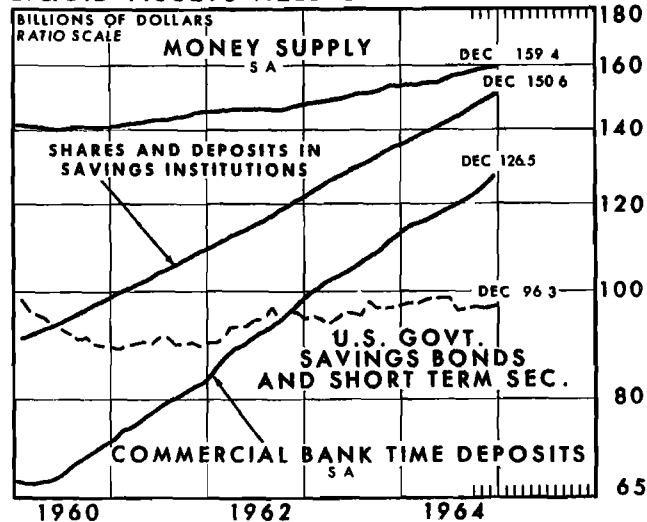


# FINANCIAL DEVELOPMENTS - UNITED STATES

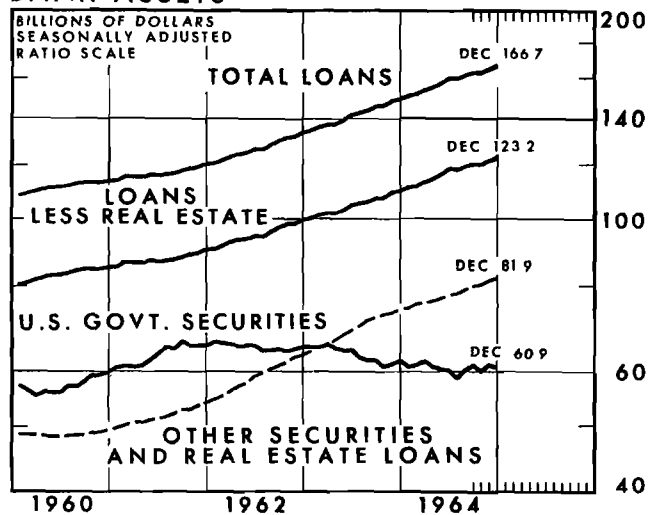
**BANK RESERVES**



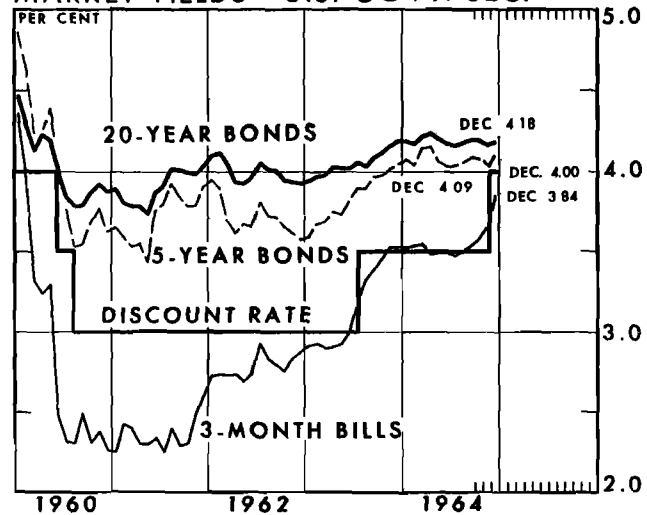
**LIQUID ASSETS HELD BY PUBLIC**



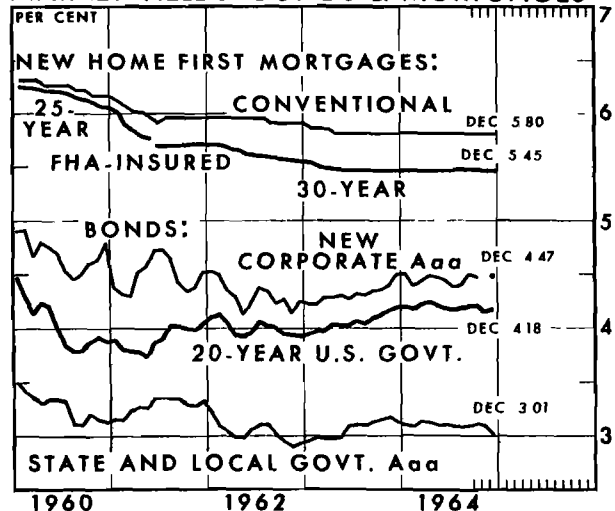
**BANK ASSETS**



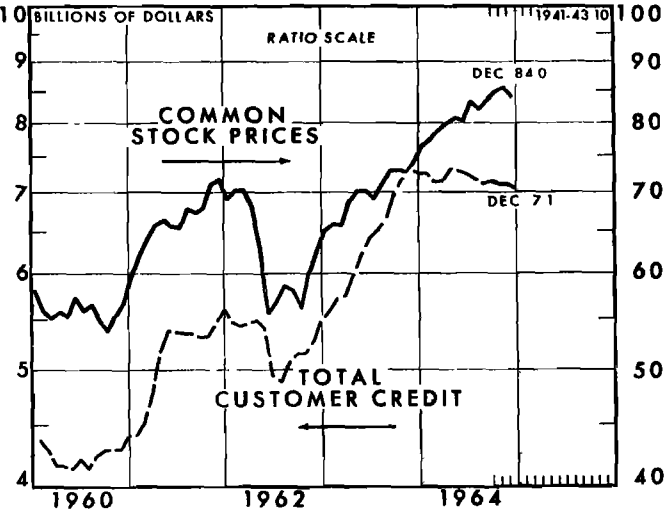
**MARKET YIELDS - U.S. GOVT. SEC.**



**MARKET YIELDS - BONDS & MORTGAGES**



**STOCK MARKET PRICES AND CREDIT**



## INTERNATIONAL DEVELOPMENTS

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U.S. balance of payments. Fairly complete information now indicates a balance of payments deficit in 1964 of \$3 billion. The upward revision (from the \$2-1/2 billion estimated earlier) stems largely from the incurrence of a deficit in December instead of the surplus that had been anticipated. In addition to the failure of Britain to make its usual year-end payments, the December deficit reflected unexpectedly large outflows of U.S. short-term capital.

The revised fourth quarter deficit totals \$1.5 billion, or nearly \$1 billion higher after seasonal adjustment than in the third quarter. Of this seasonally adjusted increase, some \$400 million resulted from the bulge in new Canadian security issues, \$140 million from Britain's failure to make its debt servicing payments, and more than \$500 million from increased outflows of long- and short-term loans and other funds reported by banks. About half of this deficit was financed by unusually large increases in U.S. liquid liabilities to foreign commercial banks and other private holders, a development which had begun in the third quarter.

Outflows of short-term bank credit and other short-term capital reported by banks were exceptionally large in December, totaling \$500 million (seasonally unadjusted). This is the largest monthly increase so far recorded in these claims, and compares with outflows of \$215 million in December 1963. Some preliminary information indicates that this outflow included a large volume of acceptance credits, some outflows of liquid funds into U.S. dollar deposits abroad and a substantial outflow of short-term bank loans, including loans to foreign branches for the presumable

purpose of tiding them over year-end pressures in the Euro-dollar market. A good deal of this outflow may well have been temporary, and support for this argument might be adduced from the payments surplus indicated so far in January by fragmentary data, which would be consistent with the unwinding of such positions. The January surplus might also reflect receipt by U.S. corporations of dividends that had been deferred until the farther cut in corporate tax rates became effective at the beginning of the year.

In November merchandise exports and imports appear again to have been heavily influenced by the threat of a port strike. There was a particularly sharp increase in imports. Until labor conditions at ports are settled and normal work schedules resumed, recent trends in exports and imports will remain difficult to judge. An interim assessment might be based on the October-November returns: on a seasonally adjusted basis, exports in these two months averaged about \$25-1/2 billion at an annual rate and imports averaged about \$19-1/2 billion; compared with the third quarter, these rates represent only a slight improvement for exports and a rise of almost 3 per cent for imports. The indicated trade surplus, at a \$6 billion rate, was a little less than the 1964 average.

Production developments abroad. In industrial countries abroad, though levels of activity were well above those of the pending year, 1964 was generally a period of slower growth in industrial output within the year. Aggregate industrial production in Europe rose 4-5 per cent during the year as compared to 7 per cent during 1963. Capacity limitations and labor shortages were a major hindrance to more rapid expansion of economic

activity in several countries. In others, restrictive fiscal and monetary policies adopted to curb inflationary pressures, tended to restrain increases in output. Among the latter, Italy underwent a recession during a large part of the year though the decline in activity appears to have bottomed out in the autumn, while in France, as the year went on, increasing signs appeared of a slackening of demand. Outside Europe, industrial production continued to expand rapidly throughout the year in Japan, while in Canada, production moved irregularly upward during the year.

INDUSTRIAL PRODUCTION  
1953 = 100  
(Seasonally adjusted averages)

	<u>1963</u>	<u>1964</u>			
	Year	Q <u>I</u>	Q <u>II</u>	Q <u>III</u>	
Western Europe	178	189	190	188	192 (Oct.)
U.K.	136	144	145	143	147 (Nov.)
Continental Europe	197	210	211	210	214 (Oct.)
Germany	207	221	221	222	225 (Nov.)
France	202	215	217	209*	215 (Nov.)
Italy	241	250	242	239	241 (Nov.)
Canada	152	164	164	165	165 (Oct.)
Japan	349	390	402	415	418 (Nov.)

\* Unduly low because of inadequate seasonal adjustment of summer vacation months.

Capacity limitations impeded growth of German industrial output in 1964, perhaps more than in any other European country. In November, the index of industrial production was 5 per cent higher than in the fourth quarter of 1963, as compared with a rise of 5-1/2 per cent in the preceding 12-month period; but after the first quarter the rise was only 2 per cent.

The slowing of expansion was most marked in the machinery and equipment sector, where order backlogs are very large. Demands for automobiles and other consumer goods (especially appliances) were strong throughout the year, and further growth in production of consumer goods may be expected in 1965 because of additions to consumers' disposable incomes as a result of the January tax cut.

Output in Italy fell by 6 per cent from the first quarter to the third quarter. This decline in production was precipitated by the restrictive monetary policy and other measures adopted by the Italian government to correct a serious balance of payments deficit and to reduce consumer demand at home. Although output declines were widespread throughout industry, they were especially severe in the cases of investment goods and automobiles, the latter being most strongly hit by the government's policies to restrain consumer spending. In the months September-November, the seasonally adjusted index of industrial production appears to have picked up a little. Moreover, the most recent monthly business survey showed a relatively smaller percentage of firms with "low" production than in earlier months, and order backlogs were not as low as had been reported in previous surveys.

In France, industrial production rose by only 0.4 per cent between the second quarter and September-October last year. Consumer goods and equipment industries have been the weakest areas of production. In textiles, output fell in that period by 4 per cent; and production of automobiles in November was reported to be 10 per cent below November 1963. The decline in machinery and equipment production was related to

the fact that fixed investment by private industry in 1964 is estimated to have been about 2 per cent less than in 1963. Even in those industries in which production had been increasing -- chemicals, petroleum products and building materials -- signs of weakness have appeared in recent months.

In October and November the British index of industrial production moved upward by 3 per cent, the first changes in the index since January. Through September, there had been some falling off in production in the engineering and allied industries (which account for about half of the total index of industrial production) and in textiles and paper production.

Canadian industrial production in October was only about 1.5 per cent higher than in January. The slower rate of growth last year followed an exceptionally rapid rise in production in the last half of 1963. Output picked up a bit after a pause in the spring but appears to have leveled out again from August through October. The automobile strike in the U.S. appears to have affected Canadian production in October. The continuing strength of new and unfilled orders, together with rising employment, suggest, however, that output has moved up again since October.

Japanese industrial production last year continued the upward trend evident since the beginning of 1963. However, because of the restrictive policies pursued by the Japanese monetary authorities in 1964, the seasonally adjusted increase in industrial production from January to November was held down to 10 per cent compared to an increase of 20 per cent for the same period in 1963. Production of capital goods registered the sharpest advance in 1964, showing an increase of 27 per cent in October over the level of a year earlier. Consumer goods showed

rather divergent trends, with the output of non-durable goods rising 13 per cent against a rise of only 3 per cent for durables.

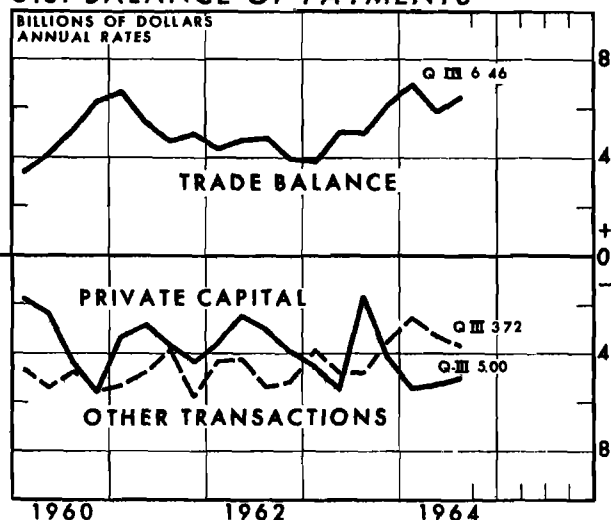
Other Selected Developments Abroad. Britain's trade deficit for December, seasonally adjusted, declined to \$171 million from the November deficit of \$288 million. A 4 per cent decline in imports probably included some impact of the import surcharges imposed in October, but these are likely to have most of their effect in subsequent months. A 7 per cent increase in exports was reported in December which may represent the beginning of some renewed expansion of exports.

On January 22, the German Federal Bank raised its discount rate from 3 per cent to 3.5 per cent, the first change since May 5, 1961 when the rate was reduced from 3.5 per cent to 3 per cent. The increase in the German rate followed similar actions taken by eight major countries during 1964. In past weeks, the German authorities have become increasingly concerned about the quickening rate of domestic price increases and other signs of inflationary pressures. The likely immediate impact of the discount rate action on financial markets, however, is believed to be small because of the relatively easy money market conditions at this time of year.

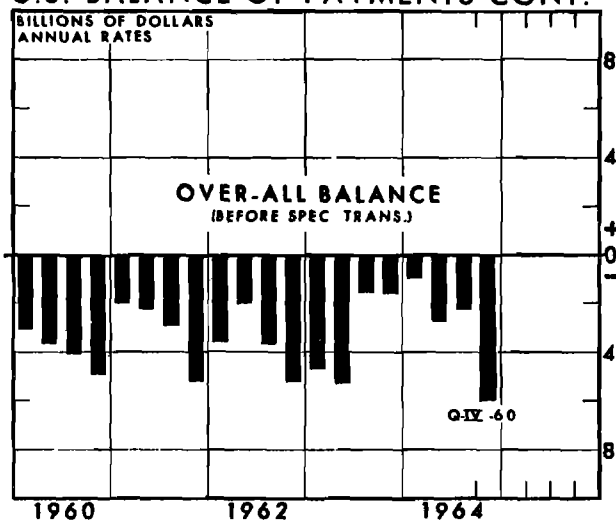
# U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

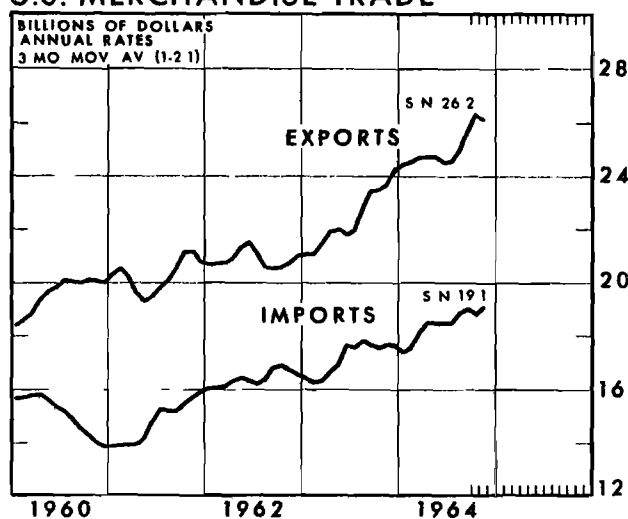
U.S. BALANCE OF PAYMENTS



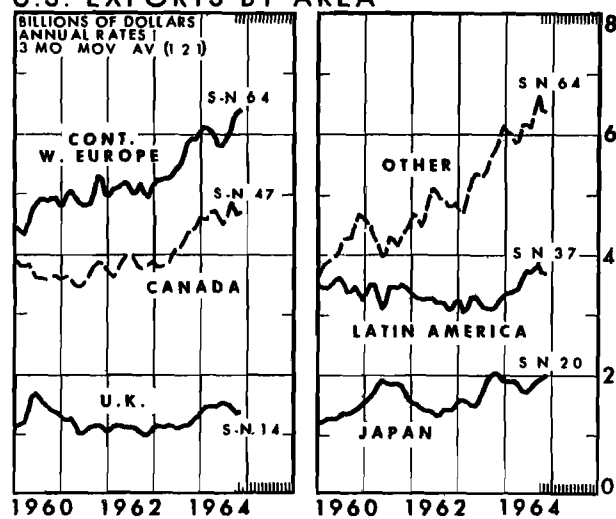
U.S. BALANCE OF PAYMENTS-CONT.



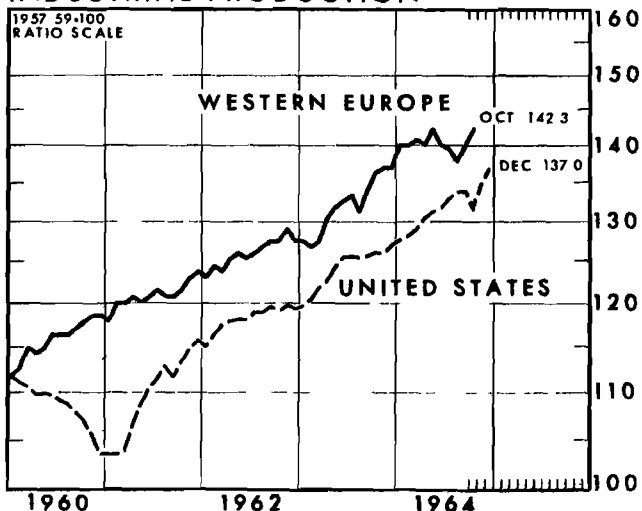
U.S. MERCHANDISE TRADE



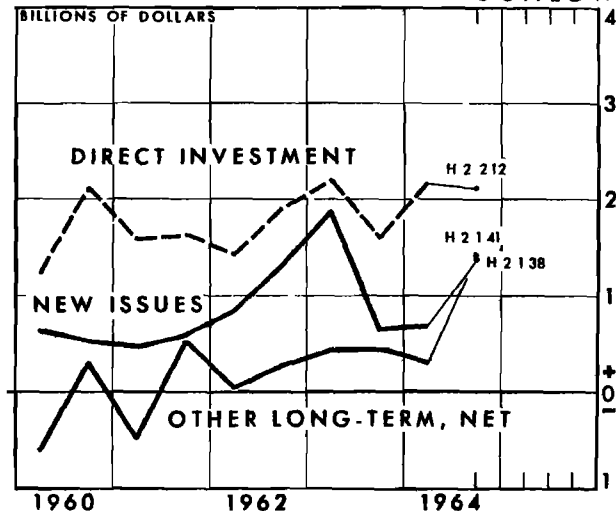
U.S. EXPORTS BY AREA



INDUSTRIAL PRODUCTION



U.S. LONG-TERM PRIVATE CAP. OUTFLOWS





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**APPENDIX A: STATISTICAL NOTE ON LABOR FORCE STATISTICS**


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The annual revision of seasonal adjustment factors for the labor force series has been completed and has resulted in relatively minor changes in the data. The unemployment rate was revised by 0.1 percentage point in 13 of the months since April 1948; 6 of these revisions occurred in 1964 including both November and December. The revised rate for December is 5.0 per cent and for November 4.9 per cent--a reversal of the unrevised rates. The revision also reduced somewhat the sharp rise in nonfarm employment earlier this year but increased the year-end rise. Data for January 1965 will be released on the revised basis February 4. Complete monthly data for all seasonally adjusted series will be included in the January 1965 Monthly Report on the Labor Force to be released February 17.

**JANUARY 1965 REVISION  
SEASONALLY ADJUSTED LABOR FORCE DATA  
(In thousands of persons)**

	Civilian labor force	Employment			Unemployment	
		Total	Nonagri- cultural	Agri- culture	Number	Rate
<u>1963</u> January	72,395	68,256	63,133	5,123	4,139	5.7
February	72,433	68,137	63,230	4,907	4,296	5.9
March	72,535	68,427	63,487	4,940	4,108	5.7
April	72,861	68,726	63,708	5,018	4,135	5.7
May	72,946	68,632	63,613	5,019	4,314	5.9
June	72,868	68,748	63,825	4,923	4,120	5.7
July	73,193	69,042	64,055	4,987	4,151	5.7
August	72,996	68,968	64,089	4,879	4,028	5.5
September	73,172	69,125	64,253	4,872	4,047	5.5
October	73,239	69,118	64,205	4,913	4,121	5.6
November	73,543	69,275	64,371	4,904	4,268	5.8
December	73,380	69,333	64,449	4,884	4,047	5.5
<u>1964</u> January	73,654	69,568	64,685	4,883	4,086	5.5
February	73,819	69,842	65,051	4,791	3,977	5.4
March	73,798	69,812	65,175	4,637	3,986	5.4
April	74,507	70,486	65,695	4,791	4,021	5.4
May	74,477	70,639	65,790	4,849	3,838	5.2
June	74,305	70,345	65,519	4,826	3,960	5.3
July	74,188	70,496	65,632	4,864	3,692	5.0
August	74,255	70,458	65,641	4,817	3,797	5.1
September	74,280	70,465	65,650	4,815	3,815	5.1
October	74,259	70,379	65,658	4,721	3,880	5.2
November	74,409	70,755	66,084	4,671	3,654	4.9
December	74,706	71,004	66,463	4,541	3,702	5.0

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**APPENDIX B: U.S. PRIVATE CAPITAL MOVEMENTS, 1964\***

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An upsurge in U.S. private capital outflow in the fourth quarter brought the total for the year to about \$6 billion, including estimates for data still missing. The fourth quarter outflow reflected a marked increase in long-term capital outflow from the rate for the first three quarters, and a return of short-term outflows to the very high rate of the first half of the year. The increased long-term outflow reflected primarily a jump in U.S. purchases of newly issued foreign securities from a quarterly average of \$160 million in the first three quarters to about \$550 million in the fourth quarter, while the outflow of long-term bank loans rose further to a level of \$300 million for the quarter, apart from take-overs of Ex-Im Bank loans, up more than 50 per cent from the first half rate. Direct investment is thought to have remained high; data are not yet available.

Outstanding short-term claims reported by U.S. banks rose about \$500 million seasonally adjusted, after having changed negligibly in the third quarter. Details are not available on the composition of the large December change in bank-reported claims, and there are no data past October on claims by nonfinancial concerns, who customarily have reported short-term outflows early in the quarter and reflows in December.

In a longer perspective, comparison of total outflows of U.S. private capital in 1964, known and estimated, with those of the preceding two years indicates that a major part of the increase -- from \$3.4 billion and \$4.2 billion in 1962 and 1963 respectively -- resulted from higher recorded short-term outflow. Within this broad category there were increases in the outflows of both bank credit and corporate liquid funds. Long-term capital outflows, which had already risen sharply in 1963, increased somewhat further in 1964.

Short-term Capital. For the first ten months of the year, the short-term outflow was roughly in line with the peak rates reached in late 1960 and early 1961. The recorded short-term outflow through October was approximately equally divided between bank loans and acceptance credits, on the one hand, and deposits and money market investments on the other, with a smaller part representing commercial credits. As shown in Table 1, outflow of bank credits was mainly concentrated early in the year, and in the autumn. The bulge in the first four months reflected large Japanese borrowing demands (involving substantial amounts of credits from the Euro-dollar market as well as from U.S. banks) and also more moderate amounts of credits to Europe and to less developed countries

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\* Prepared by Robert Gemmill, Special Studies Section.

(particularly in Asia). After midyear, borrowing by Latin America accounted for a major share of the outflow. Much of the second half outflow to Latin America may be accounted for by the usual seasonal pattern, but the outflow may also reflect improved U.S. exports to that area, as appears to have been the case with the more-than-seasonal growth of credits to Latin America in the first half.

The concentration of the outflow of short-term bank credits to Japan and to less-developed countries in 1964 represented a continuation of the pattern of recent years. (In part the credits to Japan reflected a routing through banks in the United States of Japanese borrowing in the Euro-dollar market.)<sup>1/</sup> Short-term credits to Europe (and to Canada) were not substantial, and the reason appears to be that any European borrower of sufficient standing to obtain credits from U.S. banks can also obtain short-term funds through the Euro-dollar market, probably at lower cost.<sup>2/</sup>

The large outflows of liquid funds in the first half of 1964 probably included some flows routed to Europe by way of Canada as well as the amounts shown in Table 2 as having moved directly. Most of the October outflows to Canada were seasonal movements by nonfinancial concerns, associated with window-dressing by Canadian banks. Although no data are available for November and December, the usual seasonal pattern leads us to expect some considerable reflux of U.S. corporate liquid funds from Canada in December, and the large decline which occurred in December in the dollar liabilities to Canada reported by U.S. agencies of Canadian banks would be consistent with such a reflux.

<sup>1/</sup> In the first three quarters of last year, Japanese banks transferred about \$100 million from affiliates in the U.K., France and Germany to their U.S. agencies, which in turn provided credits to affiliates in Japan. This particular type of transaction has the effect of "grossing-up" both U.S. liabilities to foreigners and U.S. claims on foreigners, compared to the situation in which the European branch advanced the funds to Tokyo directly, and in assessing the U.S. capital outflow to Japan in Table 2 one must keep in mind that \$100 million of the credits to Japan represent a flow-through of Euro-dollar funds rather than a direct provision of U.S. credits. Equally important, if various affiliates of banks with branches, agencies or head offices in the United States develop the practice of channeling large amounts of funds through the United States, the measure of our payments deficit may be adversely affected by these intra-bank transactions.

<sup>2/</sup> At the end of November, outstanding short-term bank credits to Europe totaled \$0.6 billion, and credits to Canada \$0.2 billion, out of total U.S. bank credits to foreigners of \$4.9 billion.

Two-thirds of the outflow of U.S. liquid funds through October took the form of U.S.-dollar-denominated deposits in foreign banks, and after the first quarter there was no net outflow into foreign-currency money market instruments.

The evidence for the belief that some U.S. funds were transferred to Europe via the actions of Canadian banks is found in confidential data on the U.S. dollar position of the latter. These banks increased their Euro-dollar assets by \$250 million in the first three quarters of last year and also sold some U.S. dollars for Canadian dollars or other currencies, while making little change in their dollar assets in the United States. But the entire \$250 million cannot be regarded as "on-lending" of dollars obtained from the United States, since the Canadian banks also obtained large amounts of U.S. dollars from Canadian residents.<sup>3/</sup>

But even allowing for some flow to Europe via Canada, the facts remain (as may be seen in Table 3) that the short-term flows to Europe have not accounted for a large part of the total U.S. private short-term outflow, and that short-term outflows have been a relatively modest part of total U.S. capital outflows to Europe. Moreover, during 1964 and especially after midyear, these short-term outflows to Europe were more than matched by inflows of foreign private funds. These inflows (not included in Table 3) came in part directly from European nonbanks and also, on a large scale, through banking channels. American bank branches in Europe were obtaining U.S. dollars from various sources, and in the third quarter alone they increased their balances with their U.S. head offices by \$235 million.

Long-term Capital. The largest component of U.S. long-term capital outflow in 1964, as in earlier years was, direct investment. This outflow, plus U.S. purchases of foreign stocks (which together represent the outflows responsive to the factors that influence equity investments), have accounted for the bulk of total long-term outflows, and prior to 1963 also accounted for the bulk of the outflows to Europe.<sup>4/</sup> While direct investment flows to Europe have continued to rise -- and these increased particularly sharply in 1964 -- perhaps the most striking feature of U.S. outflows to Europe beginning 1963 has been step-up of long-term lending, in particular by banks.

Although the outflow on bank loans had attained a high level in the second quarter of 1963 -- before proposal of the Interest Equalization Tax -- the continuation of the outflow at this rate in the year to

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<sup>3/</sup> These data are based on an analysis by Mr. Karlik, Balance of Payments Division of the Federal Reserve Bank of New York.

<sup>4/</sup> Flows to Canada have included large U.S. purchases of new security issues, and the heavy outflow on new issues in the fourth quarter of last year primarily reflected Canadian issues.

mid-1964, and the subsequent further increase in long-term lending since that time, both strongly suggest that European and other demands for capital that might otherwise have been provided through foreign bond issues have been met (at least in part) through U.S. bank term loans. But the over-all expansion of long-term lending shown in the table is emphasized by the fact that the outflow on long-term loans in the past two years has much exceeded the levels attained by U.S. acquisitions of new European securities.

The large supplies of U.S. bank funds for these term loans reflect the interest of a relatively few large U.S. banks in developing their foreign term loan business. The special survey of bank lending to foreigners last spring showed that 90 per cent of the net outflows on long-term loans in the 9 months ended April 30, 1964 were accounted for by a dozen banks, and the confidential data on commitments on term loans (collected under the Interest Equalization Tax law) show no evidence of a significantly wider dispersion in the past eight months. Since early 1963 term loans to foreigners (reported by all banks, but reflecting almost entirely the loans of the large lenders) have accounted for virtually the entire net increase in total term loans outstanding (to nonbanks) reported by New York City banks.

The returns on these loans (interest rates generally around 5-1/2 per cent for prime European borrowers and, with a compensating balance, a gross return of 6 per cent or more) make them attractive assets to hold against time deposits -- probably more attractive than prime municipal bonds. Thus, it is not surprising that the recent confidential commitment data covering the second half of last year show an acceleration in rate of commitments from that for the first half of 1964.

B - Table 1

U.S. Short-term Capital Flows  
(millions of dollars)  
(- indicates outflow)

<u>U.S. Short-term Capital</u>	<u>1960-61</u>	<u>1962</u>	<u>1963</u>	<u>1963 F/</u>				<u>1964</u>				
	<u>(Quarterly Averages)</u>			<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>I(r)</u>	<u>II(r)</u>	<u>III(p)</u>	<u>Oct.(p)</u>	<u>Nov.(p)</u>
1. Bank credit	-190	- 70	-130	+ 60	-149	- 89	-347	-316	-190	- 90	- 90	-160
2. Liquid funds												
a. dollar assets	- 60	- 20	+ 10	- 60	-190	+ 90	+180	-100	-225	- 75	-310	
b. foreign currency assets	- 50	- 20	0	+ 30	- 30	0	0	-140	- 90	+ 30	+ 40	
c. Total	-120	- 40	+ 10	- 30	-220	+ 90	+180	-250	-310	- 50	-270	
3. Commercial credits	- 40	- 30	- 70	- 50	- 40	- 20	-190	- 60	- 60	-110	- 10	
4. Total short-term	-350	-140	-190	- 12	-403	- 16	-351	-625	-560	-240	-370	

Details may not add to totals because of rounding.

B - Table 2

Capital Outflows, by Type and Country, Reported by  
U.S. Banks and Nonfinancial Concerns, Jan.-Oct. 1964  
(millions of dollars)  
(- indicates outflow)

	<u>Bank Credit</u>		<u>Liquid Funds</u>		<u>Com- mercial credits</u>	<u>Total, Short-term Cols 2-5</u>
	<u>Long- term</u>	<u>Short- term</u>	<u>U.S. dollars</u>	<u>Foreign currencies</u>		
	(1)	(2)	(3)	(4)	(5)	
Europe	-383	-106	-141	- 33	- 36	- 316
Canada	- 2	- 17	-523 <sup>a/</sup>	- 33	--	- 573 <sup>a/</sup>
Latin America	- 77	-247	+ 5	- 11	-127	- 380
Japan	-101	-219	- 51	- 55	- 8	- 333
Other Asia	- 33	-101	+ 2	- 8	- 13	- 120
Other	<u>- 56</u>	<u>+ 3</u>	<u>+ 2</u>	<u>- 14</u>	<u>- 32</u>	<u>- 41</u>
World	-652	-687	-706 <sup>a/</sup>	-154	-216	-1,763 <sup>a/</sup>

<sup>a/</sup> Includes outflow of \$285 million in October, mainly or entirely associated with year-end window-dressing by Canadian banks, and probably largely reversed by the end of 1964.

B - Table 3

U.S. Private Capital Outflows  
to All Areas and to Europe  
(- indicates outflow)

<u>To all areas</u>	(billions of dollars)				3 quarters at annual rate (seas. adj.)	
	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	
Total	-3.9	-4.2	-3.4	-4.2	-5.6	
Short-term	-1.3	-1.5	-0.6	-0.7	-2.2	
Long-term (of which, direct invest)	-2.6 (-1.7)	-2.7 (-1.6)	-2.8 (-1.7)	-3.5 (-1.9)	-3.4 (-2.2)	

<u>To Europe</u>	(millions of dollars)				3 quarters <u>not</u> seas. adj.	
	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1963</u>	<u>1964</u>
Total	-1,524 <sup>a/</sup>	-1,146	-1,314	-1,686	-1,204	-1,438
Short-term	-421	-47	-185	-73	-37	-276
Long-term (of which, direct invest)	-1,103 <sup>a/</sup> (-962) <sup>a/</sup>	-1,099 (-724)	-1,129 (-867)	-1,613 (-869)	-1,167 (-645)	-1,162 (-950)
(transactions in outstanding securities) <u>b/</u>	(-126)	(-233)	(-16)	(+2)	(-53)	(+131)
(new bond issues)	(-24)	(-57)	(-150)	(-272) <sup>c/</sup>	(-238)	(-11)
(long-term bank loans)	(-1)	(-126)	(-85)	(-497)	(-243)	(-330)
(other) <u>d/</u>	(+10)	(+41)	(-11)	(+23)	(+12)	(-2)

a/ Includes \$370 million for Ford purchase of U.K. affiliate.

b/ Mainly stocks.

c/ Includes \$115 million for Shell Funding Corp.

d/ Security redemptions and commercial claims.