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

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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

December 10, 1965

SUPPLEMENTAL NOTES

The Domestic Economy

Business inventory accumulation in the third quarter was larger than earlier estimates had indicated and in October the rate of accumulation showed an unexpectedly small decline. Wholesale trade inventories were revised upward about $200 million for September and the third quarter increase in the book value of business inventories now totals $1.9 billion, down only slightly from $2.0 billion in the second quarter. In October, according to preliminary figures, business inventories increased by $580 million, as compared with average monthly accumulation of $640 million in the third quarter.

The book value increase for October was moderately below the third quarter rate because of a sharp drop in the rate of accumulation by manufacturers. On the other hand, trade inventories, which had declined somewhat in September and had shown only a small rise for the third quarter as a whole, showed a sizable ($315 million) increase in October. Much of this increase reflected gains in inventories of auto dealers and food stores, which had declined temporarily in September.

Manufacturers anticipate only moderate increases in their sales and inventories in the fourth and first quarters, according to the Commerce Department quarterly expectations survey conducted in late October and November. The expected sales gains average 1 per cent a quarter, as compared with a quarterly average increase of 2.5 per cent in the first three quarters of this year. Sales expected in the fourth quarter are somewhat below manufacturers' August estimates because of an appreciable short-fall for nondurable goods producers.

Inventory accumulation is expected to total $400 million in each of the fourth and first quarters. Such a rate compares with $1.6 billion in the third quarter and with an average of $840 million in the first two quarters of this year. Liquidation of excess steel inventories apparently contributes significantly to the expected low rate of overall accumulation; durable goods producers anticipate an inventory reduction of $100 million in the fourth quarter and accumulation at the rate of only $200 million in the first quarter. It should be noted that manufacturers' actual inventory accumulation in the third quarter was considerably above expectations and also that actual accumulation in October -- when liquidation of steel stocks proceeded at a rapid rate -- was well above the anticipated monthly rate for the fourth quarter.

Retail sales in November were unchanged from the record October level, according to the advance figures reported by the Census Bureau. Sales at durable goods stores as a group were up 1 per cent from October, while sales at nondurable goods stores were down slightly. Increases were reported for sales at auto dealers and at furniture and appliance, apparel and general merchandise stores.

The Domestic Financial Situation

The single major issue on this week's reduced corporate calendar met a favorable reception at a yield 8 basis points higher than that on a comparable issue two weeks ago. In the municipal market, the $90.2 million Public Housing Authority package was also favorably received, at yields about 10 basis points above those expected prior to the discount rate change.

In secondary trading, the sharp post-discount rate decline of prices on recently-offered, high-grade corporate bonds was erased during the week. But only a part of the initial decline in municipal bond prices has been recovered. Published yield series on outstanding issues -- which tend to lag yields on more recently offered issues -- showed further advances for the week, ranging to 3 basis points in the corporate bond market and to 7 basis points in the municipal bond market.

Common stock prices have posted a net gain of about 0.3 per cent this week on extremely heavy trading, according to Standard and Poor's composite index which registered 91.56 at the close on December 9. Trading has averaged 10.0 million shares daily, the highest weekly volume this year.

In the secondary mortgage market, the Federal National Mortgage Association lowered its purchase prices on offerings received beginning December 10. In the case of FHA-insured and VA-guaranteed 5-1/4 per cent mortgages, the downward adjustment amounted to $1 for each $100 of outstanding loan amount. The adjustment was made in response to the discount rate increase as well as to the general downtrend in mortgage resale prices and the unusual volume of offerings from private investors which had already developed in recent months.

Third quarter SEC-FTC data (not yet released) show no further decline in profit margins of manufacturing corporations. During the second quarter the seasonally adjusted profit-before tax/sales ratio of such corporations had dropped to 9.3 per cent, from the unusually high 9.8 per cent rate realized in the first quarter. The estimated third quarter rate was 9.4 per cent.

The SEC-FTC survey also shows a drop of $600 million in liquid assets held by manufacturing corporations. This was somewhat larger than the average decline for this period over the past five years. Such holdings are now $1.5 billion below their level at this time last year.

Corrections

Page I - T-3: The "seasonal components" of the three balances should be + where shown as -, - where shown as +.

Page IV - 7: The Bank of Canada raised its discount rate from 4-1/4 per cent to 4-3/4 per cent.