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CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

December 8, 1965

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SUMMARY AND OUTLOOK

Outlook for demands, output, and prices

In early 1966 sharply expanding Federal expenditures and business capital outlays will be contributing to further expansion in production, employment, and incomes, and to a further reduction in unemployment. Moreover, State and local government expenditures are increasing somewhat faster than earlier and the large drop in the rate of business accumulation in the current quarter is likely to be reversed in the first quarter as steel inventory liquidation tapers off.

The recently reported step-up in administrative budget expenditures for this fiscal year to a possible total of $105 billion would imply cash expenditures of $133 billion. This expenditure level, together with our latest estimate of receipts, would result in an increase in the cash deficit to $5.2 billion. However, the implicit rate of increase in expenditures from here on out is so high as to be questioned. If expenditures do rise as now suggested, the fiscal stimulus in the first half of 1966 will be slightly larger than in the second half of 1965, despite the scheduled boost in social security taxes.

Estimates of business spending for fixed capital in the third quarter have been raised substantially and the increase projected for the fourth quarter is somewhat larger than reported earlier. The increase for the year 1965 is now shown by the Commerce-SEC survey to be 15.4 per cent, instead of 13.4 per cent as indicated previously. Business plans call for a further rise in expenditures in the first half of 1966 at a rate about as rapid as this year.

Altogether, GNP is still expected to rise at an annual rate of $11.5 billion in the current quarter, and by about $12 billion in the first quarter, to a level of $701 billion or so. The increase in real GNP is likely to be sufficient to result in further tightening of the labor market, and -- in conjunction with an expansion of the armed forces -- in further declines in the unemployment rate. Even though acceleration in wage increases will be inhibited by long-term contracts in most major industries, wages outside of the highly organized industries could be larger than earlier because of lessened availability of manpower. Given the spending and employment outlook, prices, which have continued so far to rise selectively and moderately, could come under some increased upward cost and demand pressures, although accelerating growth in manufacturing capacity may be a tempering influence.

Bank loans

Business loan expansion picked up slightly in November, although remaining within the range that has prevailed since midsummer. In recent months, business loan growth has been tempered by liquidation of steel inventories and the higher pace of capital market financing. However, total bank loan expansion has accelerated in the past two months from third-quarter rates, reflecting in large part an unusual bulge in security loans.

Even with recent increases in the discount and prime rates, it is likely that business demands on banks will strengthen further over the next few weeks. Immediate mid-December pressures will be increased by large tax and dividend payments at a time when corporate liquidity is reduced. After the turn of the year, the moderating effect on bank loan demand of the steel inventory liquidation will taper off. Furthermore, it is possible that some temporary increase in loan demand at banks will result from reluctance to undertake long-term borrowing in the current uncertain market atmosphere. Over the long run, however, increases in bank loan rates may well make capital market financing more attractive relative to bank loans.

Bank deposits. Strong loan demands and growing transaction needs for money should support further private demand deposit expansion in the weeks ahead at near the average of recent months. While time and savings deposit growth could pick up as a consequence of the recent change in Regulation Q, a smaller upsurge is expected than followed the previous increases in ceiling rates. The permissible rate on passbook savings has not been changed this time. And if, as suggested below, corporate CD demand does not expand sharply, the only time deposits that may grow more rapidly -- probably at the expense of nonbank financial institutions -- are nonnegotiable savings and investment certificates sold to individuals.

Banks face CD maturities this month over $1 billion larger than in December of last year. While the increase in Regulation Q ceilings will make it easier for banks to roll over their maturing CD's through higher offering rates, they may still find it takes longer to rebuild their outstandings than previously. Corporate demand for CD's may be more restrained as a result of rising demands on internal funds. Large January CD maturities and new Treasury cash financings in the next few weeks will also add to the difficulties facing banks in the sale of their CD's.

Securities markets

In long-term markets, bond yields were generally marked 5 to 10 basis points higher in initial response to the increase in the discount rate. At the same time, bill rates rose 15 to 25 basis points, and the 3-month bill was auctioned at 4.34 per cent following the discount rate announcement. Market reaction was moderated by ample reserve availability. On the second day of trading after the announcement, both short- and long-term markets settled down and bond yields declined somewhat from their previous day's highs.

The course of government security yields through the early weeks of 1966 will be affected, on the one hand, by the usual seasonal tendency for rates to decline with the enlarged flow of investment funds after the turn of the year and, on the other hand, by the larger than usual Federal cash borrowing now expected in January.

In the corporate market, demands for long-term external financing are likely to continue to expand to meet projected large business investment outlays, but over the next few weeks corporate bond offerings may be moderate. At yield levels now emerging, expectations of further rate advances may diminish, which would lead to a cut back in anticipatory borrowing and to reduced pressure on corporate rates. An underlying tendency to shift business borrowing toward the capital market, however, should develop in consequence of the increase in the prime rate.

In the municipal market, further interest rate adjustments may be moderated by the greater leeway afforded commercial banks.under the new Regulation Q ceilings. This should help to relieve some of the recent strain on bank investment positions and obviate the need of further secondary market liquidation of municipals by individual banks -- which has reportedly been occurring recently in some volume.

In mortgage markets, rates and terms may continue to firm. With the prime rate at commercial banks and corporate bond yields both higher, long-term lenders are likely to seek higher mortgage rates as well. Moreover, flows of savings to specialized mortgage lenders such as savings and loan associations and mutual savings banks may be under further pressure, especially if commercial banks begin aggressively to merchandise higher yielding savings certificates and savings bonds to individuals. The mortgage market may receive some support, however, if FNMA holds the line on secondary market purchase prices and expands its purchases even further.

Foreign developments and the balance of payments

The increase in Federal Reserve discount rates was followed immediately by an increase in the Bank of Canada's rate. Pressures of demand upon available resources of labor and industrial capacity are very strong in Canada. In Britain, an early cut in Bank rate now appears even less likely than before. On the European Continent, domestic objectives at present almost certainly rule out discount rate increases in France, Italy, and Belgium. A rise in the German discount rate is possible in view of continuing demand pressures and rapid increases in

German wage rates. On the other hand, the German authorities recognize that efforts to tighten further their already stringent credit policy could provoke undesired capital inflows, and that such inflows would tend to weaken the force of restrictive measures.

In the Euro-dollar market, the usual December rise in rates received an extra push from the announcement of the Federal Reserve rate change. As of Wednesday, rates for 30-day and longer periods were up by 3/8 of one per cent from last Friday.

Further data now suggest that the fourth-quarter deficit on "regular transactions" will probably be below the $440 million average of the first three quarters. As no large debt prepayments are coming in during this quarter, the deficit may be about as large as the average for the earlier period on the "liquidity" basis; and since short-term liabilities to commercial banks abroad are apparently not rising much if any this quarter, the balance will certainly be less favorable than before on the "official settlemtnts" basis.

Direct investment outflows in the third quarter now appear to have been much smaller than in the first two quarters. Nevertheless, the total for the year will be well over $3 billion. The third-quarter cutback, coming as it did after a great outpouring in the first half year, throws little light on prospects for achieving the goal recently announced by the Department of Commerce, of getting direct investment outflows in 1966 down to the 1964 level of $2.4 billion.

SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per cent change: Year Ago*	Per cent change: 2 Yrs. Ago*
Civilian labor force (mil.)	Nov.'65	76.1	75.8	74.4	2.2	3.4
Unemployment (mil.)	"	3.2	3.3	3.7	-12.1	-24.7
Unemployment (per cent)	"	4.2	4.3	4.9	--	--
Nonfarm employment payroll (mil.)	"	61.3	61.0	58.9	4.1	7.4
Manufacturing	"	18.3	18.2	17.5	4.5	7.2
Other industrial	"	8.0	7.9	7.7	2.9	5.8
Nonindustrial	"	35.0	34.9	33.7	4.1	7.9
Industrial production (57-59=100)	Oct'65	143.6	143.0	131.6	9.1	13.9
Final products	"	144.1	142.6	130.5	10.4	13.3
Materials	"	143.2	143.0	132.6	8.0	14.1
Wholesale prices (57-59=100)1/	"	103.1	103.0	100.8	2.3	2.6
Industrial commodities	"	102.4	102.3	101.1	1.3	1.8
Sensitive materials	"	103.0	103.0	100.4	2.6	6.2
Farm products and foods	"	103.7	103.5	98.2	5.6	4.6
Consumer prices (57-59=100)1/	"	110.4	110.2	108.5	1.8	3.0
Commodities except food	"	105.3	104.9	104.6	0.7	1.1
Food	"	109.7	109.7	106.9	2.6	4.6
Services	"	118.7	118.5	115.7	2.6	4.4
Hourly earnings, mfg. ($)	Nov.'65	2.64	2.64	2.55	3.5	6.0
Weekly earnings, mfg. ($)	"	109.30	108.88	104.30	4.8	8.4
Personal income ($ bil.)2/	Oct.'65	540.2	545.7	502.8	7.4	14.2
Retail sales, total ($ bil.)	"	24.0	23.8	21.4	12.0	15.7
Autos (million units)2/	Nov'65	9.0	8.4	6.9	31.1	20.4
GAF ($ bil.)	Oct'65	5.5	5.4	5.1	8.6	21.9
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,402	1,449	1,522	-7.9	-19.8
Factory workweek (hours)	Nov'65	41.4	41.3	40.9	1.2	2.2
New orders, dur. goods ($ bil.)	Oct'65	22.4	22.2	19.6	14.1	20.2
New orders, nonel. mach. ($ bil.)	"	3.3	3.3	3.0	11.4	25.0
Common stock prices (1941-43=10) 1/	Nov'65	92.15	91.39	85.44	7.9	26.9
Inventories, book val. ($ bil.)	Sept.'65	116.8	116.7	108.5	7.6	13.2
Gross national product ($ bil.)2/	QIII'65	677.5	665.9	634.8	6.7	14.2
Real GNP ($ bil. 1958 prices)2/	"	609.7	601.4	582.6	4.7	10.1

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

SELECTED DOMESTIC FINANCIAL SERIES

	Week ended Dec. 3	Four-Week Average	Last six months High	Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.13	4.08	4.25	1.00
U.S. Treas. bills, 3-mo.,yield (per cent)	4.12	4.10	4.12	3.77
Net free reserves 2/ (mil. $)	-153	-67	94	-233
Member bank borrowings 2/ (mil. $)	534	430	627	334
Security Markets (N.S.A.)				
Market yields 1/(per cent)				
5-year U.S. treas. bonds	4.49	4.47	4.50	4.13
20-year U.S. treas. bonds	4.43	4.41	4.41	4.20
Corporate new bond issures, Aaa	4.79	4.75	4.79	4.56
Corporate seasoned bonds, Aaa	4.60	4.61	4.62	4.45
Municipal seasoned bonds, Aaa	3.37	3.35	3.37	3.09
FHA home mortgages, 30-year 3/	5.49	5.49	5.49	5.44
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	91.48	91.97	92.63	81.60
Dividend yield (per cent)	3.05	3.00	3.11	2.88

	Change in Nov.	Average change last 3 mos.	Annual rate of change (%) 3 mos.	1 year
Banking (S.A., mil. $)				
Total reserves	-57	0	0	3.7
Bank loans and investments:				
Total	2,600	1,800	7.5	9.8
Business loans	700	600	11.5	19.5
Other loans	1,100	700	7.0	12.3
U.S. Government securities	600	200	4.2	-6.5
Other securities	200	300	7.4	14.5
Money and liquid assets:				
Demand dep. & currency	200	1,000	7.6	4.2
Time and savings dep.	2,000	1,800	15.7	16.4
Nonbank liquid assets	5/ 1,500	1,600	7.8	6.2

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending December 1.
3/ Latest figure indicated is for month of October. 4/ Data are for weekly closing prices. 5/ Change in October.

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

	1965						1964	
	Oct.	Sept.	Aug.	QIII	QII	QI	QIV	Year
				Seasonally adjusted				
Current account balance					1,718	1,294	2,005	7.7
Trade balance 1/				1,300	1,293	923	1,789	6.7
Exports 1/	2,310	2,260	2,310	6,800	6,763	5,586	6,690	25.3
Imports 1/ 2/				-5,500	-5,469	-4,663	-4,901	-18.6
Services, etc., net					425	371	216	1.0
Capital account balance (regular transactions)					-1,433	-2,064	-3,126	-9.7
Govt. grants & capital 3/					-954	-805	-1,014	-3.6
U.S. private direct investment					-882	-1,159	-821	-2.4
U.S. priv. long-term portfolio					115	-688	-833	-2.0
U.S. priv. short-term					503	314	-568	-2.1
Foreign nonliquid					-215	274	110	0.4
Errors and omissions					-166	-10	-430	-1.2
Balances, with and without seasonal adjustment (- = deficit)								
Bal. on regular transactions, S.A.				-615	119	-780	-1,551	-3.1
Seasonal component				490	47	-521	3	--
Balance, N.S.A.	-304	-464	-425	-1,105	72	-259	-1,554	3.1
Liquidity bal., S.A.				-485	247	-701	-1,366	-2.8
Seasonal component				490	47	-521	3	--
Balance, N.S.A. 4/	-304	-464	-425	-975	200	-180	-1,369	-2.8
Official settlements bal., S.A.				260	210	-634	-783	-1.2
Seasonal component				552	171	-653	-35	--
Balance, N.S.A. 5/	-99	-405	-22	-292	39	19	-748	-1.2
Memo items:								
Monetary reserves (decrease -)	-82	-130	286	-40	-68	-842	151	-.2
Gold purchases or sales (-)	12	9	-53	-124	-590	-832	-172	-.1

1/ Balance of payments basis which differs a little from Census basis.
2/ Q-III includes large upward adjustment from Census data. Adjusted figure tentatively estimated by Federal Reserve as about equal to Aug.-Oct. total imports as reported by Census.
3/ Net of associated liabilities and of scheduled loan repayments.
4/ Differs from balance on regular transactions by counting as receipts (+) debt prepayments and advances on military exports.
5/ Differs from liquidity balance by counting as receipts (+) increase in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increase in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. Ebullient business plans for fixed investment, acceleration of the rise in Federal defense expenditures, and a step-up in the rate of increase in employment and wage and salary income in October and November all confirm the prospect of another large rise in GNP in the current quarter. Continued rapid expansion in Federal outlays and in business fixed investment is in prospect for the first quarter of 1966 and these developments play a major role in further large gains in employment and incomes and in consumer spending. Moreover, the rate of inventory accumulation is likely to recover in early 1966 as steel liquidation tapers off. Altogether, GNP is projected to rise at an annual rate of $11.5 billion in the current quarter and by $12 billion in the first quarter, continuing the rapid pace of advance now recorded for the third quarter of this year.

Business has just reported in a Commerce-SEC survey a much higher level of plant and equipment outlays for the third quarter than had been estimated earlier (these are not yet incorporated in the GNP figures) and has also raised its sights for such spending in the current quarter and in the first half of next year. It appears that the rate of business fixed investment to GNP will rise close to that at the peak of the investment boom of 1955-57.

Federal defense expenditures have been mounting rapidly and a rise of nearly $3 billion in the annual rate is now estimated for total Federal purchases of goods and services in the current quarter, as compared with an earlier estimate of $2.2 billion. (It should be noted that total Federal expenditures are estimated to be up only $1.3 billion because of the sharp drop in transfer payments after the third-quarter bulge in social security payments.) The fourth-quarter increase has been augmented by military and civilian pay raises, and a much smaller increase is projected for Federal purchases in the first quarter. The first-quarter increase is lower than that implied by fiscal year administrative budget expenditures of $105 billion.

The fourth-quarter estimate of consumption expenditures and, in particular, nondurable goods outlays has been lowered somewhat as retail sales appear to have lagged moderately in November. However, the increase for the quarter is still expected to exceed the rise in disposable income, in part owing to the spill-over effects on this quarter's spending of the large lump sum payment of retroactive social security benefit increases in the third quarter.

In the first quarter, a further sizable gain is projected in consumer disposable income despite the boost in social security taxes effective January 1. Continuing large gains in wages and salaries are projected and these will be supplemented by another spurt in Federal transfer payments to persons (veterans' life insurance dividends, higher pensions and social security benefits, and increased payments under the anti-poverty program). Personal consumption expenditures are projected to rise as much as disposable income, with the result that the savings rate holds at the fourth-quarter level of 5.3 per cent.

A rise in GNP at the rate of $11.0 to $12 billion a quarter is, after allowance for continuing price advances at about the recent rate, December 8, 1965.

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

	1965 II	1965 III	1965 IV	1966 I	'65 III from '65 II	'65 IV from '65 III	'66 I from '65 IV
	(Actual)		(Projected)				
Gross National Product	665.9	677.5	689.0	701.0	11.6	11.5	12.0
Personal consumption expenditures	424.4	432.2	439.8	445.8	7.8	7.6	6.0
Durable goods	63.7	65.0	66.0	66.0	1.3	1.0	.0
Nondurable goods	187.6	191.1	194.6	198.2	3.5	3.5	3.6
Services	173.1	176.1	179.2	181.6	3.0	3.1	2.4
Gross private domestic investment	101.1	102.0	101.9	104.8	0.9	-0.1	2.9
Residential construction	28.0	27.6	27.3	27.5	-0.4	-0.3	0.2
Business fixed investment	66.4	68.3	70.4	72.3	1.9	2.1	1.9
Change in business inventories	6.7	6.1	4.2	5.0	-0.6	-1.9	0.8
Net exports	7.5	8.1	7.8	8.1	0.6	-0.3	0.3
Gov. purchases of goods and services	132.9	135.3	139.5	142.3	2.4	4.2	2.8
Federal	65.9	67.1	70.0	71.3	1.2	2.9	1.3
Defense	49.4	50.8	52.8	53.7	1.4	2.0	0.9
Other	16.5	16.3	17.2	17.6	-0.2	0.9	0.4
State and local	67.0	68.1	69.5	71.0	1.1	1.4	1.5
Gross National Product in Constant (1958) Dollars	601.4	609.7	616.8	623.9	8.3	7.1	7.1
Personal income	524.9	535.9	543.3	550.5	11.0	7.4	7.2
Wages and salaries	355.0	360.9	368.0	374.7	5.9	7.1	6.7
Personal contributions for social insurance (deduction)	13.1	13.4	13.6	16.6	0.3	0.2	3.0
Disposable personal income	458.9	471.3	477.5	484.0	12.4	6.2	6.5
Personal saving	23.0	27.2	25.4	25.6	4.2	-1.8	0.2
Saving rate (per cent)	5.0	5.8	5.3	5.3	-	-	-
Total labor force (millions)	78.2	78.5	78.9	79.4	0.3	0.4	0.5
Armed forces "	2.7	2.7	2.8	2.9	.0	0.1	0.1
Civilian labor force "	75.5	75.8	76.1	76.5	0.3	0.3	0.4
Employed "	71.9	72.4	72.9	73.4	0.5	0.5	0.5
Unemployed "	3.6	3.4	3.2	3.1	-0.2	-0.2	-0.1
Unemployment rate (per cent)	4.7	4.4	4.2	4.1	-	-	-

expected to continue to result in employment increases in excess of growth in the labor force with a consequent continuing downdrift in unemployment. Moreover, some downward pressure on unemployment is also resulting from the expansion in the armed forces and from the anti-poverty program.

Industrial production. Industrial production in November is now estimated to have increased to a level above the July-August record of 144.3, from the preliminary October figure of 143.6. For the fourth quarter as a whole the index now appears likely to exceed moderately the 143.9 average for the third quarter.

Weekly data, except for steel, indicate increases or continued high levels of production in November. Production worker manhours -- the basis for our output indexes in a number of industries -- rose considerably further last month to a 10 year high. Increases were widespread in both durable and nondurable goods manufacturing. Also indicative of production developments in November and later, new orders received by durable goods producers reached a record high in October and the backlog of unfilled orders continued to expand.

Steel ingot production, seasonally adjusted, was unchanged in November following sharp reductions in September and October, but output of steel mill products apparently continued to decline. Inventories of steel held by users declined 7 per cent in October, but at the end of the month were still 30 per cent above the peaks in 1962 and 1963. The effect of the November decline in steel output on total industrial production, however, was less than in September and October when steel declines amounted to 1.0 point and 0.6 point, respectively, in the total production index.

Auto assemblies continued strong and were at an annual rate of about 9.3 million units in November, and December schedules are presently set at a 9.5 million rate. Television production, sparked by strong demand for color sets, continued to rise. Output of equipment, both business and defense, also increased further last month.

Retail sales. Retail sales appear to have declined in November -- at both durable and nondurable goods stores -- following a pronounced spurt in October. For durable goods, the decline was centered in furniture and appliance stores. Sales of auto dealers increased in dollar volume following a decline in October; a similar pattern was shown by unit auto sales which rose to a 9 million annual rate for domestic autos from 8.4 million in October. Declines were widespread among nondurable goods stores in November following strong increases in September and October.

Recent sales indications may be subject to more revision than usual in the light of a major overhaul of the probability sample of retail stores now underway at the Census Bureau. In the final report for October, which will be delayed about one month, the Census Bureau will report revised retail sales figures on the new sample basis beginning with January 1964. In the meantime, the advance monthly report for November (due in a few days) and the weekly figures for December will continue on the old sample basis.

Consumer credit. Expansion in total consumer instalment debt slowed markedly in October, as demands for both auto credit and personal loans were at their lowest level of the year. The seasonally adjusted.

annual rate of instalment debt increase was only a little over $7 billion, compared with about $8 billion in the first three quarters. The slower credit growth in October is expected to be temporary.

The slackening in auto credit in October may have been a reaction to the bulge in September when there were very large sales of 1965 models and a correspondingly large rise in credit buying. With the availability of the new models in October, cash buying surged again as it usually does on the new model introduction. The change in the mix of auto sales also may have dampened personal loan demand in October in view of a trend to increasing use of personal loans to purchase cars and other major durable goods.

There was a sharp increase in nonauto goods credit in October, and this provided a partial offset to the slowdown in auto and personal loans. Partly this reflects continuing strong sales of "big ticket" durable goods -- especially color TV -- on credit. But even the small durables frequently are purchased through use of revolving credit accounts at department and other retail stores. The amount of revolving credit outstanding has nearly doubled since 1961; in fact, two-thirds of instalment credit held by department stores is now in this form.

Repayments on instalment debt moved up again in October, about in line with the long-term trend. The October annual rate was $68.6 billion, up from $61.2 billion in October 1964. The ratio of repayments to disposable personal income reached 14.4 per cent in the third quarter, up from 13.9 per cent a year earlier.

<u>Consumer expectations</u>. According to the most recent Census quarterly survey of consumer buying intentions, new car demands will

be as strong during the 1966 model year as they had been for 1965 models. In mid-October, 10.6 per cent of households reported plans to buy new autos over the coming 12 months as compared with 10.4 per cent reporting similar intentions in October 1964 and with 8.9 per cent in October 1963. Used car buying plans were also as numerous as they had been a year earlier.

For major household durable goods, intentions to purchase within 6 months showed more than the usual seasonal rise from July to a level in mid-October slightly higher than a year ago. Plans to buy television sets were particularly strong.

The number of households reporting higher incomes than a year earlier and the number expecting higher incomes a year hence were both significantly larger this October than in October 1964.

Plant and equipment expenditures. Business outlays for new plant and equipment this year, at $51.8 billion, will be 15.4 per cent larger than last year, according to the Commerce-Securities and Exchange Commission survey of business investment intentions conducted in November. The preceding survey, conducted in August, had projected a rise of 13.4 per cent this year. Thus, the November survey indicates business investment has been a stronger factor in overall demand than earlier indicated.

Fixed capital outlays increased by 4.8 per cent in the third quarter -- in contrast to the 1.6 per cent rise shown in the August survey. A rise of 4.0 per cent is now indicated for the current quarter, as compared with a 3.5 per cent increase shown in August.

BUSINESS EXPENDITURES FOR NEW PLANT AND EQUIPMENT
(Billions of dollars, seasonally adjusted annual rates)

	1965	Actual 1965			1966 Anticipated		
	Year	1st Q	2nd Q	3rd Q	4th Q	1st Q	2nd Q
All industries	51.83	49.00	50.35	52.75	54.85	56.70	58.85
Manufacturing	22.51	20.75	21.55	23.00	24.35	24.70	25.85
Nonmanufacturing	29.31	28.20	28.80	29.75	30.50	32.00	33.00

In the first two quarters of 1966, increases in fixed capital outlays are expected to continue large. The increases are now estimated at 13.5 per cent annual rate for the first quarter and 15.2 per cent for the second quarter of 1966. These are much faster rates of expansion than the 8 per cent reported by the McGraw-Hill October survey for the year 1966.

Manufacturers anticipate a pronounced slowdown in the rise in spending in the first quarter but resumption of a rapid pace of advance in the second quarter. Much of the large rise in total business fixed capital spending in the first quarter is expected to result from unusually sharp increases by transportation and public utility companies.

CHANGES IN EXPENDITURES FOR NEW PLANT AND EQUIPMENT
(Per cent)

	1965 from 1964	1964 from 1963	65-IV from 64-IV	65-IV from 65-III	66-I from 65-IV	66-II from 66-I
				(annual rates)		
All industries	15.4	14.5	14.9	15.9	13.5	15.2
Manufacturing	21.2	18.4	20.8	23.5	5.8	18.8
Durable goods	20.3	20.1	20.2	15.3	6.6	27.6
Metal producing	18.9	31.5	20.4	53.8	-27.1	n.a.
Machinery	30.9	19.2	38.0	24.6	-17.4	n.a.
Transportation equip.	30.7	25.2	17.4	7.6	29.6	n.a.
Nondurable goods	22.1	16.8	21.5	32.0	3.3	11.6
Nonmanufacturing	11.9	11.4	10.5	10.0	20.0	12.4
Mining	9.2	14.4	7.7	48.0	-14.3	n.a.
Railroad	19.1	28.2	9.7	0.0	23.5	n.a.
Transportation other than rail	18.9	24.0	19.2	13.3	103.2	n.a.
Public utilities	10.0	10.1	9.4	11.8	40.3	n.a.
Communication, commercial, and other	10.1	9.5	9.5	7.0	0.0	n.a.

Construction activity. Expenditures on new construction edged upward in November, but remained somewhat below the September high and the third quarter average. While private residential expenditures have tended downward since midyear, private nonresidential expenditures have generally continued to rise, and have tempered the downdrift for the private sector as a whole. This pattern continued in November as private construction expenditures held at the moderately reduced October rate.

Public construction put in place has continued to fluctuate at a record level in recent months. Preliminary figures, however, remain uncertain especially for highways. While the November rate is reported to be up appreciably, this followed a 4 per cent downward revision for October.

NEW CONSTRUCTION PUT IN PLACE

	November 1/ (billions)	Per cent change from: Month ago	Year ago
Total	$68.5	1	5
Private	47.8	-	5
Residential	26.1	-1	2
Nonresidential	21.7	1	10
Business	15.9	-	11
Public	20.7	4	5

1/ Seasonally adjusted annual rates; preliminary.

Orders for durable goods. New orders for durable goods in September and October were larger than advance figures had indicated owing mainly to upward revision of defense orders. September now about equals the July high and October new orders rose one per cent to a new record level.

In October new orders for steel recovered from the sharp dip in September; while they equalled August, they were down about 35 per cent from the February high and were well below shipments. Defense orders in October remained close to the advanced September level, and new orders for machinery and equipment increased moderately.

Durable goods shipments have shown little change in recent months and the recent burst in defense ordering led to a step-up in the rate of increase in the durable order backlog in September and October. Over the 8-month period from February through October, the backlog of unfilled orders for durable goods increased 10 per cent, or as much as in the preceding 8 months, despite the reversal of the earlier rapid buildup in the steel backlog.

PER CENT CHANGES IN UNFILLED ORDERS FOR DURABLE GOODS

	June 1964 to Feb. 1965	Feb. 1965 to Oct. 1965
All durable goods	10	10
Steel	73	-44
Defense products	2	21
Machinery and equipment	10	13
Other	9	10

The ratio of unfilled orders to shipments is typically much higher in defense than in other durable goods industries, and the recent large concentration of ordering in defense industries has been a major factor in the rise in overall durable goods orders from the 2.6 month's backlog prevailing in 1962-64 to 2.9 month's in October. In the year 1956, this ratio averaged 4.2.

Business inventories. The first reading on business inventories for October -- only available for manufacturing -- supports the expectation that the overall rate of accumulation, which had tended downward earlier in the year, will show a sizable further decline in the fourth quarter. The decline will be centered in manufacturing; the rate of accumulation of trade inventories which was very low in the third quarter is likely to pick up in the current quarter. We are continuing to estimate that, on a GNP basis, total inventory accumulation will be at an annual rate of $4.2 billion in the fourth quarter as compared with $6.1 billion reported for the third quarter.

The book value of manufacturers' inventories increased $267 million in October, half the monthly rate of the third quarter.

As was to be expected with the shift to liquidation of steel stocks, the rate of accumulation of durable goods was sharply lower. On the other hand, accumulation of nondurable goods, which had picked up during the summer from the low first half-year rates, accelerated further in October.

The durable goods sector in October absorbed a 1.2 million ton reduction in steel inventories held by metals users and still reported a book value increase of about $100 million. The persistence of overall accumulation in the face of a high rate of liquidation of steel inventories reflected in large part mounting inventory requirements in the strongly expansive defense and business equipment industries. The only major industry reporting an appreciable reduction in inventories was the auto industry; in other consumer durable lines inventories continued about unchanged.

CHANGE IN BOOK VALUE OF MANUFACTURERS' INVENTORIES
(Monthly averages, seasonally adjusted, millions of dollars)

	1965 First Half	1965 Third Quarter	October
Total	280	547	267
Durable goods	257	450	98
Defense products	32	77	79
Machinery & equipment	72	190	34
Consumer durables (incl. autos)	77	40	-93
Other durables	76	143	78
Nondurable goods	24	98	169

Labor market. The labor market picked up momentum in November. Nonfarm employment advanced more rapidly than in any month this year with significant gains reported in all major groups. In manufacturing the rise in employment was the largest this year and the work week rose further to an average of 41.4 hours, well above the first quarter high, according to revised data.

Responding to the rising demand for workers and increases in the armed forces, labor force growth continued to exceed official projections by substantial amounts. Nevertheless, employment gains were again greater than labor force additions and unemployment declined to 4.2 per cent from 4.3 per cent in October and 4.9 per cent in November 1964.

Nonfarm employment increased by almost 300,000 in November and was 2.4 million above a year earlier. Adding to the continued large gains in trade, and public and private services was an increase of 115,000 in manufacturing. Metals industries were especially strong, reflecting, in part, a halt in cutbacks in steel employment. Meanwhile, employment gains accelerated in the transportation equipment industry reflecting high auto output and a step-up in aircraft production. In addition, employment in the machinery and electrical equipment industries continued to advance rapidly as orders and expenditures for capital investment were raised. In most nondurable goods activities employment showed little change.

In nonmanufacturing, trade, service and State and local government increased employment by 120,000, about the same high monthly rate as over the past year. Construction employment which had remained relatively stable since early this year, increased by more than 50,000 in November.

The pattern of change in the average workweek in manufacturing in 1965 has been altered as a result of a BLS revision. Adjustment to March 1964 benchmarks and new seasonal factors have reduced the first quarter workweek from 41.4 to 41.2 hours. Stability at a lower level thereafter through October in the old series now ends in September. The new series shows a substantial rise in hours in October and in November, the workweek increased again to reach a new high for the year and the highest level since World War II.

AVERAGE WEEKLY HOURS IN MANUFACTURING
(Seasonally adjusted)

	New	Old		New	Old
January	41.2	41.4	July	41.0	40.9
February	41.2	41.3 -	August	41.0	40.9
March	41.3	41.4	September	40.9	40.8
April	41.0	40.9	October	41.3	41.0
May	41.1	41.1	November	41.4	
June	41.0	41.0			

Unemployment and labor force. Unemployment continued to edge downward in almost all groups in November. For men 25 years and over the rate declined to 2.4 per cent and for married men the rate was 2.0 per cent -- the lowest for these groups since October 1953. Among teenagers the rate was also lower in November, but at 12.5 per cent it was a little below the rates reported most of this year. The unemployment rate for nonwhite workers at 8.2 per cent showed no improvement in November, although it was down from 9.3 per cent a year ago. The nonwhite unemployment rate continued more than double that of white workers and for teenage nonwhite youth the rate remained unchanged at 25 per cent.

Long-term unemployment declined to a low for this year and was substantially below a year earlier. More than half of the decline in unemployment in the past year has been among those who have been out of work for 15 weeks or more.

Substantial increases in the labor force have been the major source of workers for expanding employment. In November, for instance, the total labor force grew by about 300,000 raising the total increase from a year earlier to 1.7 million. This is well above the growth of 1.35 million projected for this year by the Labor Department. Higher than expected increases have been evident since July and apparently reflect continuing strong demands for labor. All of the additions have been among youth and women, since the adult male labor force has shown no increase over the past year. About 900,000 youth and 800,000 women have been added to the labor force since November 1964, with most of the increase, especially among youths, taking place since mid-summer.

The armed forces increased to 2.8 million in November and were about 100,000 above the August total prior to the step-up in draft calls. The armed forces are expected to reach the currently planned total of 3,040,000 by the second quarter of 1966.

Wages. Average hourly earnings in manufacturing have continued to advance moderately, increasing by one cent in November to $2.64 per hour, compared to $2.55 a year ago. For the 11 months of this year, hourly earnings averaged 3.2 per cent above a year earlier. Weekly earnings also have increased, in part reflecting longer hours of work. At $109.30 in November, weekly earnings were $5 above a year earlier.

AVERAGE HOURLY EARNINGS

	Dollars per hour 1965 1/	Annual rate of increase 1964-65 1/	1960-1964
Manufacturing	2.61	3.2	2.9
Hotels and motels	1.31	5.2	3.7
Laundries	1.50	5.0	3.8
Retail trade	1.94	4.2	3.6

1/ Change and level based on average of first 9 months this year, except manufacturing which is for first 11 months.

While the rise in manufacturing wages has not accelerated, wages in retail trade and many of the lower-paid service industries have risen more rapidly than earlier and at rates well above the guideposts. In hotels, motels and laundries, for example, increases in average hourly earnings have been 5 per cent or more this year and in retail trade, the rise in the first 9 months of this year was 4.2 per cent above a year earlier. Special reports of wage changes among other low wage workers for whom regular monthly statistics are not available, such as hospital attendants, also indicate that their rates have begun to rise somewhat more rapidly than earlier.

The step-up in wage gains in these industries and occupations appears to be in response to continued strong demands for workers while significant reductions have begun to take place in the pool of less skilled workers. Efforts to catch up to the high wage industries are typical in a period of extended expansion and favorable labor market conditions. Recent minimum wage increases may also have contributed to a limited extent to the larger wage gains. Most of the lower paid service and trade establishments, however, are not covered by the Federal minimum wages, and hence, market forces must be considered the most important influence. For example, only retail outlets doing a relatively large volume of business are covered, and all laundries, except industrial, and all hotels and motels are excluded from minimum wage coverage.

In general, it is expected, that even if wage increases in trade and services were in line with guideposts, prices in these sectors would rise somewhat because productivity gains tend to be below the total private trend productivity rise of 3.2 per cent now used in the guideposts. Relatively high rates of increase in wages in trades and services are thus likely to exert upward pressure on the consumer price index. Guidepost policy has been largely concentrated on wages in the heavy industrial and highly organized sectors of the economy and has mostly ignored developments in trades and services which are little organized. Consequently, even if wholesale prices of commodities were held relatively stable by continuation of the guidepost policy, it seems likely that the consumer price index would continue to move upward.

Wholesale prices. The industrial commodity price index in recent weeks has continued to edge up at about the rate prevailing since midyear. At 102.6 per cent of the 1957-59 average at the end of November, the industrial index was up .5 per cent from midyear and nearly 2 per cent from the summer of 1964 when the current rise began. Prices of foodstuffs also have risen in recent weeks to somewhat above the advanced levels reached last summer, and the total wholesale index has risen .4 per cent since mid-October to 103.5 per cent of the 1957-59 average.

Continuing and little-publicized increases in steel prices have raised the index of finished steel products about 1 per cent above the level in the first half of the year to 104.0 per cent of the 1957-59 average.

Copper and brass producers rescinded price increases after the Government announced an emergency release of 200,000 tons of copper from the strategic stockpile and introduced export controls on copper scrap. It is expected these Government actions will permit the expected 1966 deficit of domestic demand over supply to be met. The 36-day strike -- now ended -- at large Chilean mines has required producers to reduce by around two-thirds their February shipments of copper to Europe. How shipments to the United States will be affected is not yet clear. Some loss of Zambian production has occurred with the blowing up of electric power transmission lines on the Zambian-Rhodesian border.

Meat prices have remained near last summer's peak levels as a result of seasonally reduced supplies of beef and larger than seasonal reductions in hog supplies. Prices of dairy products have risen about seasonally while egg prices have increased sharply as a result of reduced laying flocks. Edible oils have risen mainly because of increased export demand, and cocoa prices are continuing to recover from postwar record lows.

Consumer prices. From mid-September to mid-October the consumer price index rose .2 per cent to 110.4 per cent of the 1957-59 average. Food prices, which usually decline seasonally in October, were unchanged as increases in eggs and restaurant meals offset decreases in meats and fresh fruits and vegetables. Prices of nonfood commodities advanced .4 per cent, or about seasonally, and prices of services continued on their persistent upward trends.

The consumer price index has risen somewhat more over the past year than in earlier years of this expansion, chiefly because of the sharp rise in food prices last spring when meat supplies declined. Nonfood commodities have risen little over the year; prices of apparel and some other nondurable commodities have increased, but autos and household durables goods generally have declined, in part because of excise tax reductions. The BLS estimated prices of new 1966 model cars, after adjustment for quality changes and the excise tax reduction, to be .8 per cent below comparable 1965 models.

CONSUMER PRICE INDEXES
(1957-59 = 100)

	Index October 1965	Per cent increase to October 1965 from: February 1961	October 1964
All items	110.4	6.3	1.8
Nonfood commodities	105.3	3.6	0.7
New cars	97.7	-4.8	-3.6
Used cars	119.4	22.3	-2.1
Household durables	96.0	-3.0	-2.0
Apparel	106.9	4.7	1.4
Food at home	107.8	5.6	2.4
Food away from home	119.2	11.6	3.0
Services	118.7	9.7	2.6
Medical care	128.1	14.4	3.3
Transportation	120.7	11.1	4.7
Shelter 1/	111.2	6.7	1.8

1/ Includes rent, home ownership costs, and hotel and motel rates.

<u>Agricultural situation and outlook</u>. Analysts participating in the USDA's mid-November Outlook Conference predicted a further gain in the farm economy in 1966 within the framework of continued rise in over-all economic activity. For farmers, the year 1965 has been the best since 1952. Net realized income of $14 billion in 1965 will be $1 billion higher than in 1964 and nearly $2 billion above the average of the preceding 10 years. The improvement has resulted mainly from very favorable prices for livestock. Expanding markets, continued strong livestock prices, and the new farm program are expected to result in a further increase in realized net income in 1966, possibly of one-quarter to one-half billion dollars.

The long uptrend in the value of farm assets continued during 1965, and was at a somewhat faster pace than in recent years. Much of the increase was due to the continued advance in land values but other physical assets also showed market gains. Value of farm machinery inventories increased because of continued heavy investment in improved and heavier equipment; value of the crop inventory increased because of the record size of 1965 harvests and the resulting larger stocks on farms on January 1; value of the livestock inventory increased because of the higher valuation per head.

Farm debts also increased during 1965. The increase of $3.4 billion, to a total of $39.4 billion, was less than the rise in total assets. As a result farmers net worth increased about 6 per cent to an estimated total of $212 billion at the end of 1965.

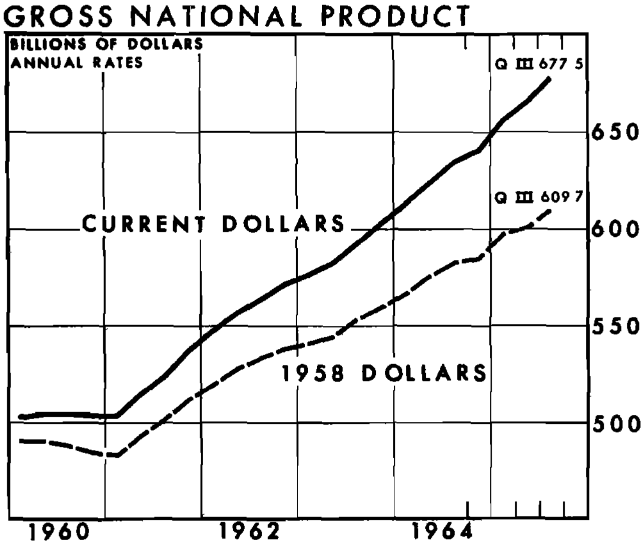
Consumer expenditures for food in 1965 are estimated to be 6 per cent above 1964, with about half of the increase reflecting higher prices. A further but smaller rise in expenditures is expected by the USDA in 1966. Per capita consumption is expected to hold at about the 1965 level. Meat prices will probably average above 1965, although pork supplies are expected to increase late in 1966. Larger supplies and lower prices are in prospect for poultry, potatoes, fresh vegetables, and fruits. Smaller packs of processed vegetables and deciduous fruits may result in higher prices for these foods.

November hog marketings were down a fifth from a year earlier and hog prices were boosted to near record levels for November. Normally this period of the year is one of seasonally high marketings and correspondingly lower prices. Recent marketings, however, have been far below expectations. No new information on the hog supply situation will be available until the release of the Pig Crop Report on December 23. Earlier reports have shown the spring pig crop now coming to market to be down 10 per cent and it is now clear that producers are beginning to withhold hogs to expand breeding stocks. If a substantial expansion in production is underway, withholding for breeding will probably compete with marketings for slaughter primarily in November through January. It is also possible that producers, finding themselves with fewer hogs and large stocks of new crop corn, some of it of lower quality, are feeding hogs to heavier weights, although this does not yet show in reported marketings. Any contraction in marketings due to this factor, however, would be of short duration.

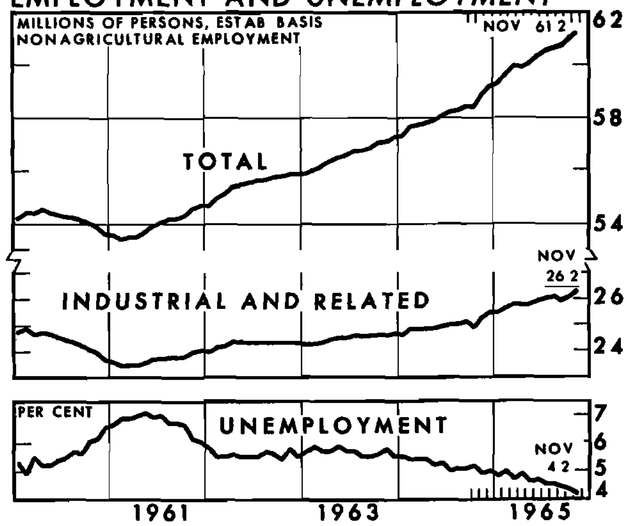
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

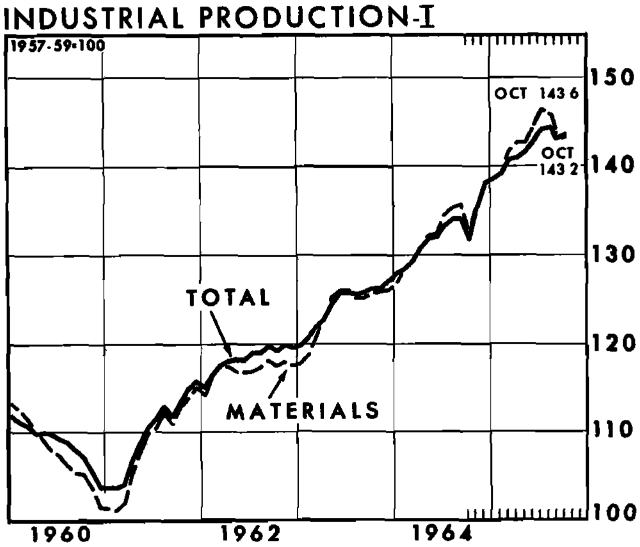
GROSS NATIONAL PRODUCT



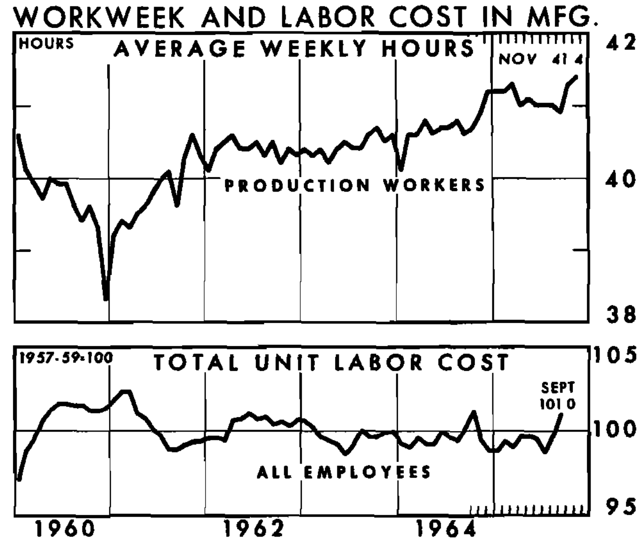
EMPLOYMENT AND UNEMPLOYMENT



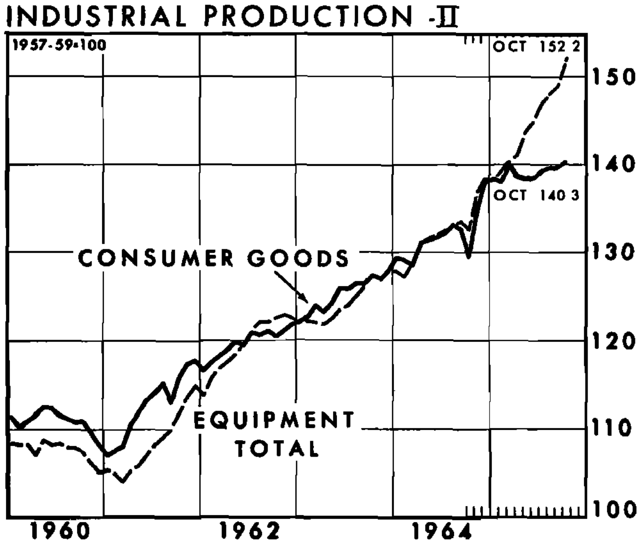
INDUSTRIAL PRODUCTION-I



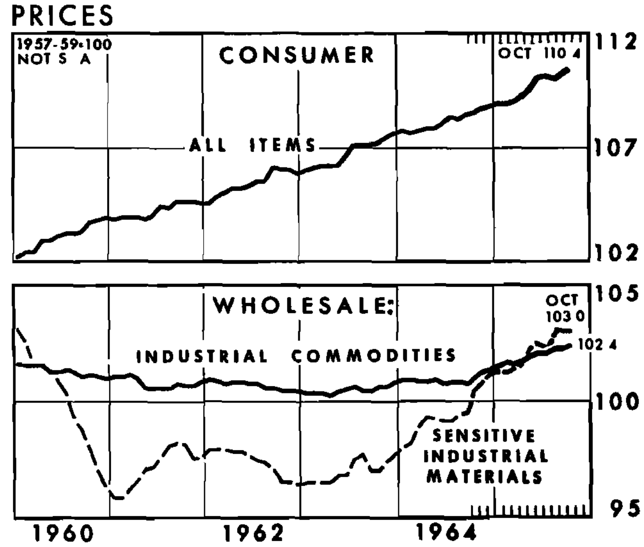
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION -II



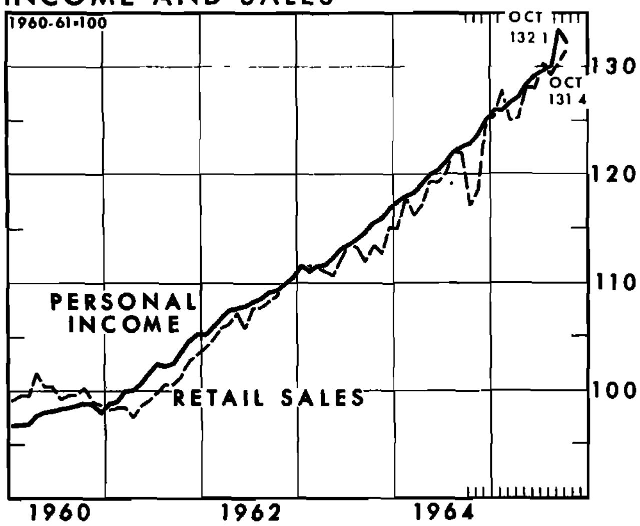
PRICES



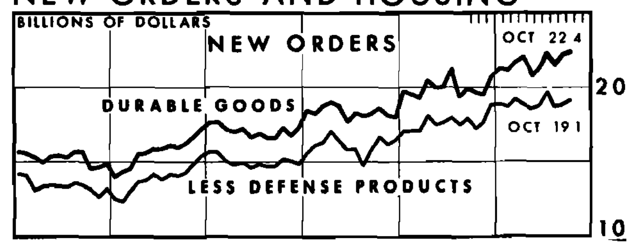
ECONOMIC DEVELOPMENTS - UNITED STATES

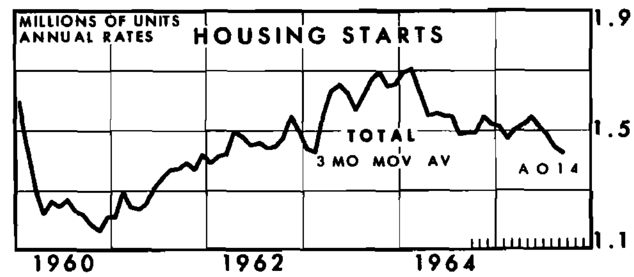
SEASONALLY ADJUSTED

INCOME AND SALES

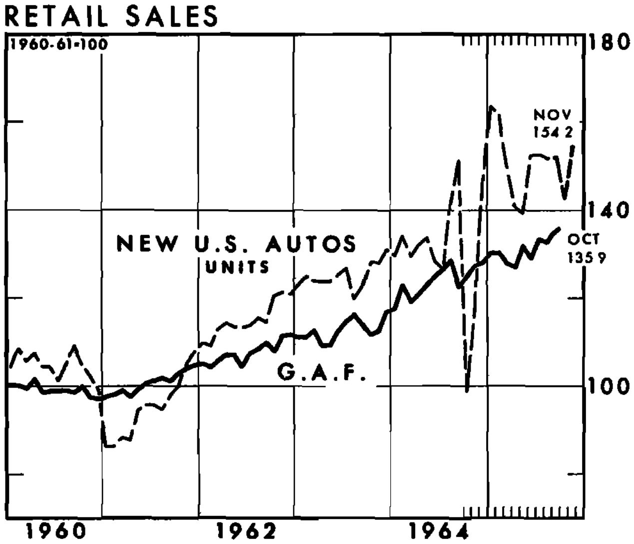


NEW ORDERS AND HOUSING

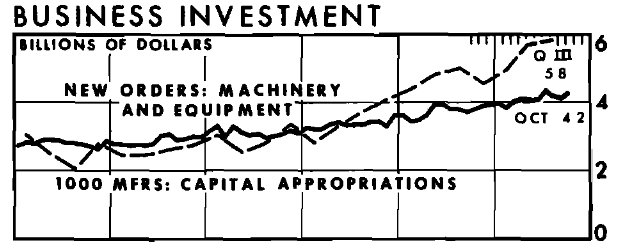


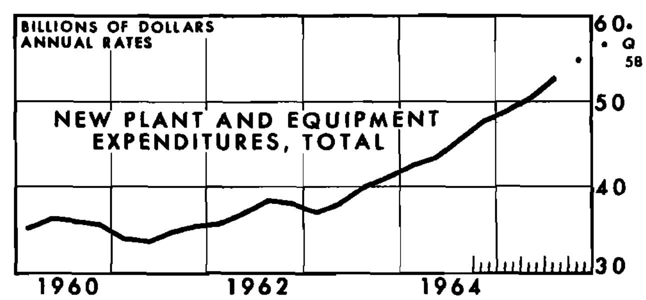


RETAIL SALES

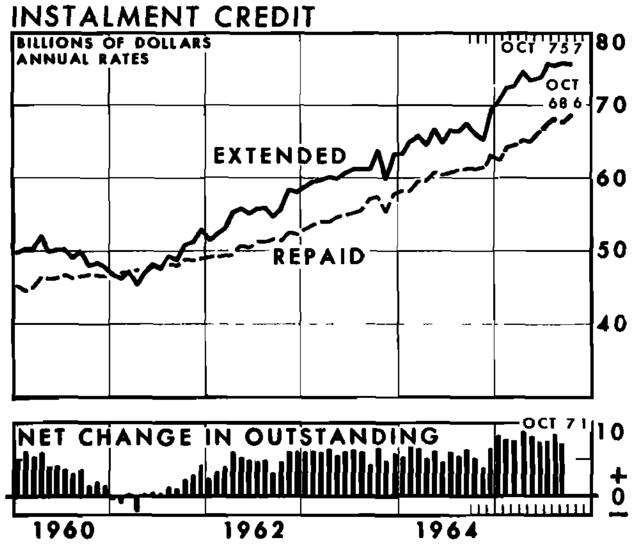


BUSINESS INVESTMENT

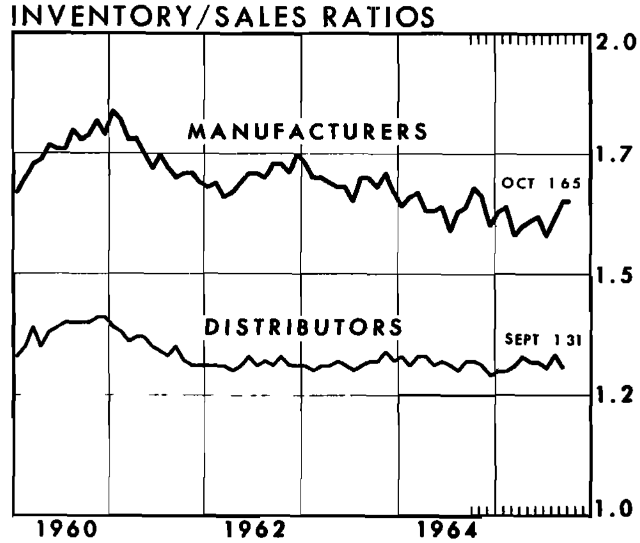




INSTALMENT CREDIT



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

Bank credit. Bank credit during November expanded at a 10.8 per cent seasonally adjusted annual rate, using end-of-month figures, a rate about the same as in October . On an average daily basis, however, expansion was considerably slower in October -- a 4.3 per cent rate of increase, as measured by the credit proxy for member banks, as compared to 13.5 per cent in October. The difference reflects the timing of the two tax bill financings. In October, bills were delivered the second week and liquidation did not begin until the last week of the month. In November, liquidation of Treasury securities continued throughout the month, but the new bills were delivered on the final reporting date, and were fully reflected in the end-of-month data.

Business loan growth expanded modestly in November from the reduced October rate. Over the last two months combined, these loans rose at a 10.7 per cent rate -- about 1 percentage point below the rate of the third quarter. While business loans in most industry categories showed some increase during November, after allowance for seasonal factors, steel-using industries continued to reduce their loans somewhat more than seasonally -- reflecting liquidation of inventory.

Business loan demands in the weeks ahead are likely to be large. Economic expansion continues to be rapid and seasonal needs to finance tax and dividend payments in mid-December will be greater than last year. Fourth-quarter dividends -- including extras that reflect higher profits -- are projected to be up substantially. These seasonal needs cannot be readily shifted elsewhere even though bank loan rates have increased.

Over the longer run, however, the increase in the prime loan rate to 5 per cent may make capital market financing relatively more attractive to potential borrowers, even though immediate uncertainties in securities markets, as they adjust to the discount rate change, could temporarily encourage borrowing at short-term from banks.

Security loans in November continued to be relatively strong for the second consecutive month. Such loans were especially strong in New York and were mainly for purchasing or carrying private securities. In addition, loans to finance companies have risen in recent weeks, after earlier declines. This return to bank financing probably reflects the rescinding of earlier loan rate increases as well as tighter money markets and higher bond yields. Finance company needs for funds to refinance maturing commercial paper are expected to be large at midmonth.

Banks reduced net acquisitions of municipal and agency securities further in November. So far in the fourth quarter total bank holdings have expanded at an 8.3 per cent annual rate, considerably below the 13.3 per cent growth rate of the third quarter, despite continued large inflows of time and savings deposits. New York banks have reduced their holdings much more than seasonally since late September. This general slowdown probably is due in part to the declining liquidity position of commercial banks, as well as the need to underwrite Treasury issues in both October and November.

Bank deposits. So far in the fourth quarter, maintenance of the growth of private deposits, together with a slower decline in Treasury balances, has accelerated total deposit growth above the third-quarter rate.

Total deposits, seasonally adjusted, should continue their growth in December with Treasury balances expected to show a seasonally adjusted expansion, with maintenance of a fairly high growth rate for time and savings deposits, and with higher transactions demands for money.

In mid-December, individual banks will be faced with large CD maturities. For the month as a whole, $3.5 billion of CD's will mature -- only $200 to $400 million more than for months with tax and dividend dates earlier in 1965 but $1.1 billion more than last December. The proportion of outstandings due this December is up only slightly from a year ago at banks in New York City, but it is considerably higher at outside banks. The increase in Regulation Q ceilings will ease the problem banks face in replacing their maturing CD's. Nevertheless, banks still may have some difficulty in view of the tighter financial position of corporations.

On the other hand, even with rate pressures, New York banks were able to make large CD sales. However, the high level of maturities last month kept the net increase in outstandings to a low level -- about $75 million in New York, and about $150 million at other weekly reporters. In addition, short-term notes outstanding rose $150 million in November (to a level of over $500 million), with most of the increase in the New York and Chicago Districts. Presumably, the higher Q ceiling, together with the shortening of permissible maturities at which they can compete, will reduce the need and/or desire of banks to use the note market.

Even with only modest net growth in CD's, total time and savings deposits in November continued to grow as rapidly as in October -- at nearly a 17 per cent rate. The money stock expanded considerably slower -- at a 1.4 per cent as opposed to a 9.5 per cent rate -- as money holdings were reduced to more normal operating levels after the earlier bulges. So far this year, time deposits and the money stock have expanded at a 16.4 and 4.2 per cent annual rate, respectively; for all of 1964 they grew at a 12.8 and 4.3 per cent rate.

Seasonally adjusted Government balances -- which have been declining each month since midyear -- are expected to rise substantially on balance during December, reflecting mainly the Treasury financing in late November. But even with an increase in Treasury deposits projected for the month as a whole, a sharp decline in these balances is expected over the early weeks of December and this may be reflected in a rapid liquidation by banks of recently acquired tax bills.

Corporate and municipal bond markets. Yields on corporate and municipal bonds were marked sharply higher in their initial response to the recent Federal Reserve actions. When the Southern California Edison Company announced an indefinite postponement of the $75 million bond originally scheduled for bidding on Tuesday, December 7, however, yields on investment-grade corporate bonds eased back a little and are presently about 2 to 4 basis points above levels prevailing at the end of last week. An initial larger yield advance of 10 basis points or so on recently offered municipals, however, seems to have been maintained.

During the week prior to announcement of the discount rate increase, participants in corporate and municipal bond markets became increasingly doubtful that interest rates could be kept from rising. With the release of Budget estimates indicating a further rise in Federal spending, yields on both corporate and municipal bonds came under considerable upward pressure. The major new corporate bond issue was reoffered to yield 4.85 per cent, 5 basis points above comparable Aa-rated new issues in the preceding week, and 17 basis points above yields on equivalent issues at the recent low in late October. Yields on three recently offered corporate issues which were released from syndicate rose 10 basis points. In the municipal bond market, the relatively sensitive Bond Buyer average of seasonal bond yields rose another 3 basis points, extending its overall advance from mid-October to 12 basis points.

BOND YIELDS

	Corporate Aaa		State and local Government	
	New	Seasoned	Moody's Aaa	Bond buyer (mixed qualities)
Postwar Previous High	5.13(9/18/59)	4.61(1/29/60)	3.65(9/24/59)	3.81(9/17/59)
1965				
High	4.79(12/3)	4.61(11/26)	3.37(12/3)	3.50(12/3)
Low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(2/11)
Week ending:				
July 23	4.56	4.48	3.16	3.25
Oct. 15	4.63 1/	4.57	3.31	3.38
Nov. 19	4.70	4.61	3.36	3.46
Dec. 1	4.79	4.60	3.37	3.50

1/ Week of October 29.

After last week's syndicate terminations in the corporate bond market, only one recently offered issue remained in syndicate and this was virtually all sold before the discount rate increase. Thus, with only minimum market pressures being exerted by older inventories acquired at lower yields, corporate underwriters are in a good position to bid for current and prospective new offerings. The volume of new issues already scheduled for public offering in December, though down seasonally from November, is larger than a year ago.

BOND OFFERINGS 1/
(In millions of dollars)

	Corporate				State & local govt.	
	Public offerings		Private placements			
	1965 e/	1964	1965 e/	1964	1965 e/	1964
Jan.-Dec. Average	474	300	707	604	938	904
September	664	376	706	693	1,000	920
October	300	181	700	642	800	852
November	640	30	700	645	950	578
December	400	320	1,200	1,342	800	1,078

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

At this point the December volume of new municipal bond offerings seems likely to drop back from the seasonally large November supply. But in contrast with the corporate market, the technical position of the municipal market was quite weak at the time of the discount rate change. Not only did bank acquisitions of municipals occur at a slower pace in November; some banks were reportedly making sizable block sales in the secondary market as well. Although the Blue List of advertised dealer inventories has fluctuated between $650 and $700 million for some time, dealers have had to cut prices substantially on older inventories in order to make room for acquisitions of new issues. In the face of sizable losses on some of these older issues, dealers developed an increasingly cautious approach to bidding on new offerings.

Stock market. A very sharp initial decline in stock prices followed announcement of the discount rate change but was quickly reversed in continued heavy trading. By the close of the market on Tuesday, Standard and Poor's index of 500 stocks stood at 91.39, slightly above the closing level last Friday. Since reaching an all-time high in mid-November, common stock prices have eased slightly on balance in very active trading. The index is now about 1 per cent above the May high. Except for this week's brief reaction, the broad index has moved within a narrow range. In contrast, however, prices of many individual stocks -- especially those of a speculative or glamour variety -- have shown great volatility.

Trading volume has been consistently heavy. Since mid-November, trading on the New York Stock Exchange has averaged about 8 million shares daily, with volume exceeding that figure in 10 of 16 trading sessions and twice topping 10 million. Somewhat more moderate activity early in November held the monthly average to 7.4 million shares daily, about the same as in September and October.

Mortgage markets. For several months mortgage markets have been showing a gradual shading in tone toward greater firmness. But the concensus in trade circles seemed to be that terms in early 1966 would be only moderately different from those which have prevailed recently, partly reflecting the general expectation of little or no upturn in residential construction activity next year. Initial reaction to the discount rate increase by mortgage lenders and builders, however, is that interest rates and other terms may now show appreciable firming.

Statistical evidence of the recent change in tone has been centered mainly in the <u>secondary mortgage markets</u>. Yields on FHA-insured mortgages in that market rose 3 basis points in October, the sharpest rise since the autumn of 1959. And Federal National Mortgage Association purchases of Government-underwritten mortgages increased to the largest volume for any month since early 1962. At the same time mortgage offerings by commercial banks and other private holders for purchase by FNMA more than doubled in October, expanding nearly to the record level reached in October of 1956. With FNMA holding purchase prices unchanged, both offerings and purchases are indicated to have risen further during November.

Through the third quarter of this year, underlying adjustments in mortgage holdings among individual investor groups have been much more pronounced than shifts in the overall total. As shown in the table, based on recently revised data, mortgage debt outstanding rose about as much in the third quarter as in the same period of each of the preceding two years. Among the major financial institutions, however, only the commercial banks apparently registered some year-to-year acceleration. Expansion by savings and loan associations continued to moderate in line with altered competitive and regulatory factors. For the first time in more than three years, moreover, net acquisitions by FNMA contributed to the overall rise.

MORTGAGE DEBT OUTSTANDING BY TYPE OF HOLDER
(Billions of dollars, without seasonal adjustment)

	Amount 9/30/65 p	Increase in third quarter of 1965 p	1964 p	1963
All holders	334.0	8.0	8.1	8.1
Financial institutions	258.3	6.2	6.3	6.7
Commercial banks	48.1	1.6	1.3	1.4
Mutual savings banks	43.6	1.1	1.2	.9
Savings and loan assoc.	108.2	2.4	2.8	3.5
Life insurance companies	58.4	1.0	1.0	.9
Federal agencies	11.9	.2	.1	-.1
FNMA	4.5	.1	-.1	-.2
Individuals and others	63.8	1.6	1.7	1.5

On a seasonally adjusted basis, mortgage debt expansion through the third quarter of this year has been at a rate just below the peak reached in the second half of 1964, when net expansion in multifamily and commercial debt was at a high. The rate of expansion in debt on 1-to-4 family properties is indicated to have changed relatively little since the second quarter of 1964.

INCREASES IN MORTGAGE DEBT OUTSTANDING
(Seasonally adjusted annual rates in billions)

	Total	1-4 family	Multifamily & Commercial 1/	Farm 1/
1963 III	30.5	16.3	12.4	1.8
1964 I	30.1	16.8	11.3	2.0
II	29.8	15.4	12.4	2.1
III p.	30.7	14.9	13.8	2.0
IV p.	30.8	14.9	13.5	2.4
1965 I p.	30.2	15.3	12.8	2.1
II p.	30.3	15.2	13.0	2.1
III p.	30.3	15.0	12.9	2.3

1/ Includes estimates for holdings of individuals and others which are excluded in the flow of funds series.

Net savings flows to depositary-type institutions. In October net savings inflows to savings and loan associations and mutual savings banks continued to run below a year ago, whereas time and savings deposits at commercial banks showed the largest (seasonally unadjusted) monthly increase of the year. Similarly, for the first 10 months of 1965, growth in time and savings deposits at commercial banks was more rapid than in any other year--including 1962. Since some of this growth occurred at the expense of other depositary-type institutions, however, the rate of growth in total savings accounts at all such institutions fell short of the unusual rates of overall acceleration in these flows in 1961 and 1962.

The January-October short-fall in net savings flows to institutions other than commercial banks was most pronounced at savings and loan associations, where maximum interest rates paid have not risen appreciably since early 1963. For this reason, the relative share of savings and loan associations in the total growth of savings accounts at all depositary-type institutions dropped to less than 25 per cent in the first 10 months this year, compared with shares of more than 35 per cent in 1963 and 1964, and more than 50 per cent in 1960.

NET CHANGE IN SAVINGS CAPITAL AT DEPOSITARY-TYPE INSTITUTIONS
JANUARY - OCTOBER, 1960-65
(In billions of dollars)

	Total	Savings & Loan Associations	Mutual Savings Banks	Commercial Banks
October				
1965	2.8	.60	.17	2.0
1964	2.5	.75	.23	1.5
January-October				
1965	26.0	5.9	2.7	17.3
1964	22.5	8.0	3.3	11.2
1963	23.3	8.5	2.5	12.3
1962	22.0	6.8	2.2	12.9
1961	16.4	6.5	1.3	8.6
1960	10.8	5.6	.8	4.3

U.S. Government securities market. Yields in the U.S. Government securities market rose sharply following the increase in the discount rate announced December 5, but market conditions remained orderly as the System made prompt and sizable purchases of bills. The initial yield increases in all maturities were somewhat greater than a year ago, and also greater than in July 1963, when the discount rate was raised by 1/2 per cent.

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

Date (Closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1959 - 1961						
Highs	4.68	5.15	5.17	5.11	4.90	4.51
Lows	2.05	2.33	3.08	3.30	3.63	3.70
1965						
Highs	4.36	4.48	4.69	4.69	4.62	4.50
Lows	3.76	3.81	4.00	4.08	4.17	4.17
1965						
July 28	3.81	3.88	4.09	4.15	4.20	4.21
Nov. 23	4.12	4.26	4.45	4.45	4.45	4.40
Dec. 3	4.12	4.26	4.54	4.52	4.53	4.44
Dec. 7	4.36	4.48	4.66	4.66	4.60	4.50

Yields on Treasury notes and bonds began to rise in late November following a mild decline in the previous two weeks. The yield advance was initially triggered by news of an enlarged Federal budget deficit and a growing conviction that interest rates would sooner or later have to rise. In this market environment, dealer offerings expanded, but investment selling remained light, apart from tax swapping transactions by banks; indeed, net institutional buying developed on a sliding scale of prices. This buying contributed to a reduction in dealer inventories in all maturities, including a decline in holdings of bonds due in over 5 years from $119 million on November 26 to $59 million on December 6. The official accounts have not been active in the market for Treasury notes and bonds since early November, when the Treasury purchased a sizable amount of "when issued" 18-month notes from dealers.

Treasury bill rates had been edging upward since the second week of November and they adjusted several basis points higher following the increase in the discount rate. The key 3-month bill was auctioned at an average rate of 4.344 per cent on December 6, up from an average of 4.115 per cent the week before. Net demand for bills from private investors has been relatively light in recent weeks, apart from demand for short maturities, but dealers sold over $1-1/4 billion of bills to the System between November 24 and December 6, thereby helping to reduce their heavy inventories.

The Treasury is expected to announce within a couple of weeks a cash financing to cover at least the first installment of the sizable cash drains anticipated in January. Some earlier projections by market observers had indicated that the Treasury might need to borrow around $2 billion in January, but the budget estimates recently released suggest that the Treasury's needs may be higher than anticipated earlier.

Budget Outlook. Tentative Administrative Budget totals of $105 billion of expenditures and $96.5 billion of receipts in fiscal 1966 were released in late November. Using this expenditure figure as a benchmark and assuming receipts will turn out to be higher than this, cash expenditures would total $132.8 billion and cash receipts $127.6 billion, resulting in a deficit of $5.2 billion.

RECENT BUDGET ESTIMATES FOR FISCAL YEAR 1966
(billions of dollars)

	Administrative Budget	Consolidated Cash	National Income Accounts
Receipts	98.5	127.6	126.0
Expenditures	105.0	132.8	130.2
Surplus/deficit	-6.5	-5.2	-4.2

The increased rates of spending implicit in the $105 billion administrative budget figure suggest higher estimates of total cash outlays than shown in previous projections. These tentative budget totals indicate a sharp acceleration in Federal spending in the spring of 1966 since actual spending during the first five months of this fiscal year has been consistent with a lower fiscal year total. The new projections, shown quarterly in the following table indicate a smaller cash surplus in the first half of calendar 1966, and therefore, a reduction in the amount of net debt repayment below earlier expectations.

On a national income basis, these budget totals imply that Federal spending will reach a level of $135 billion (seasonally adjusted annual rate) by the second quarter of 1966. To reach this level would require an increase of $7.5 billion in Federal expenditures between the fourth quarter of 1965 and the second quarter of 1966. If the $105 billion Administrative total is achieved, the rapid rise in expenditures would more than offset the increase in social security taxes which is scheduled to become effective January 1 and which will add $5.3 billion at annual rates to receipts during the first half of calendar 1966.[1/]

On a full-employment basis, the projected increase in expenditures would turn the small surplus in the second half of the calendar year 1965 into a deficit for the first half of 1966. Earlier projections had indicated that the surplus would increase in the spring because of the social security tax increase. For fiscal year 1966 as a whole, the figures now imply a full-employment budget in balance as compared to a $5.7 billion surplus in fiscal 1965.

1/ On January 1, the social security tax rate, including health insurance, will be raised from 7.25 per cent of taxable wages and salaries to 8.4 per cent and the maximum income subject to tax per employee will be raised from $4,800 per year to $6,600 per year. The higher ceiling extends the collection of social security taxes further into the calendar year because it takes longer to reach the ceiling, after which the tax is no longer paid. In addition to the increased tax rate and wage ceiling, $600 million (at annual rates) of revenue is scheduled to take effect at mid-year, when payments for the voluntary health insurance program begin.

December 8, 1965

III -- T-1

Various Federal Budgets by Quarters
(In billions)

Assumes $105 Billion Aministrative Budget Expenditures

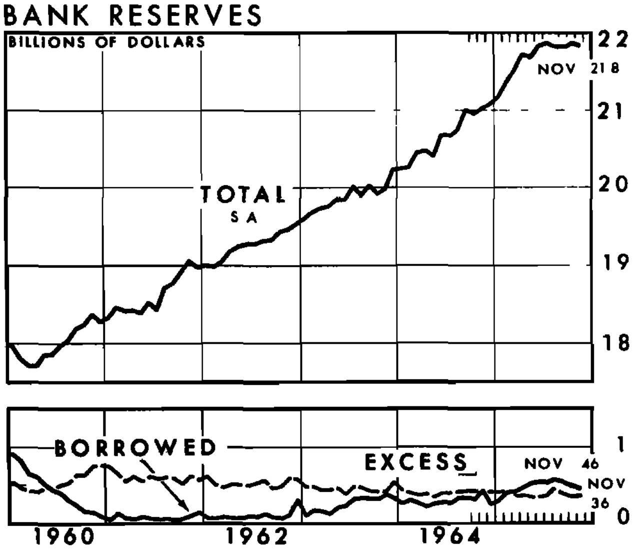
	1964				1965				1966	
	I	II	III	IV	I	II	III	IV P	I P	II 1/ P
					Quarterly Totals					
Cash Budget										
Receipts	30.3	33.4	27.0	24.3	30.7	37.7	29.2	26.5	31.1	40.7
Payments	28.7	30.1	30.9	30.6	28.3	32.6	33.1	32.6	33.0	34.1
Surplus/Deficit	1.6	3.3	- 3.9	- 6.3	2.4	5.1	- 3.9	- 6.1	- 1.9	6.6
					Annual Rates, Seasonally Adjusted					
National Income										
Receipts	114.8	112.0	114.6	116.8	122.7	123.7	122.1	123.6	128.5	129.8
Expenditures	117.5	119.6	118.2	117.9	120.2	120.8	126.2	127.5	132.3	135.0
Surplus/Deficit	- 2.6	- 7.6	- 3.6	- 1.1	2.5	2.8	- 4.1	- 3.9	- 3.8	- 5.2
Full Employment										
Receipts	124.2	120.1	122.0	123.6	125.8	127.8	126.3	127.8	132.2	133.1
Expenditures	116.8	119.0	117.7	118.4	119.8	120.4	125.9	127.2	132.1	134.9
Surplus	7.4	1.1	4.3	5.2	6.0	7.4	.4	.6	.1	- 1.8

1/ Receipts in 1966-II contain a median estimate of nonwithheld individual income tax receipts. Depending on the ultimate size of the tax cut, cash receipts in the second quarter could be as high as $41.7 billion or as low as $39.7 billion.

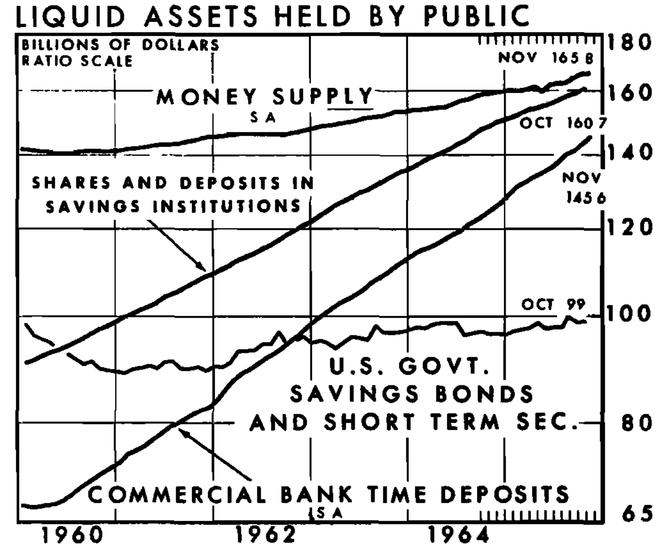
P Projected.

FINANCIAL DEVELOPMENTS - UNITED STATES

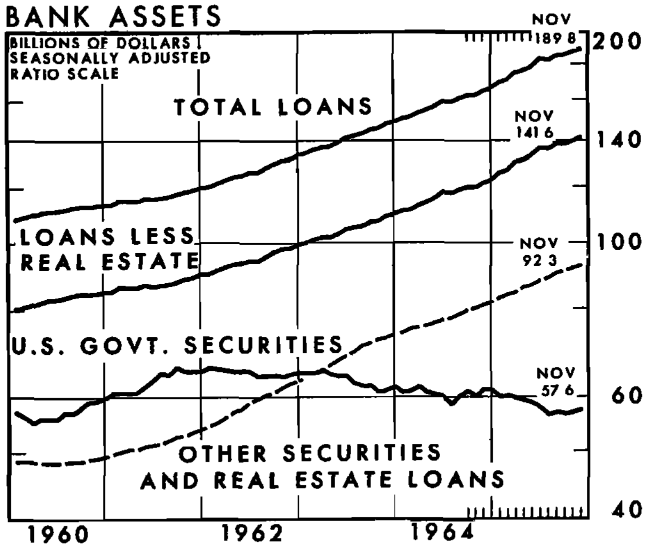
BANK RESERVES



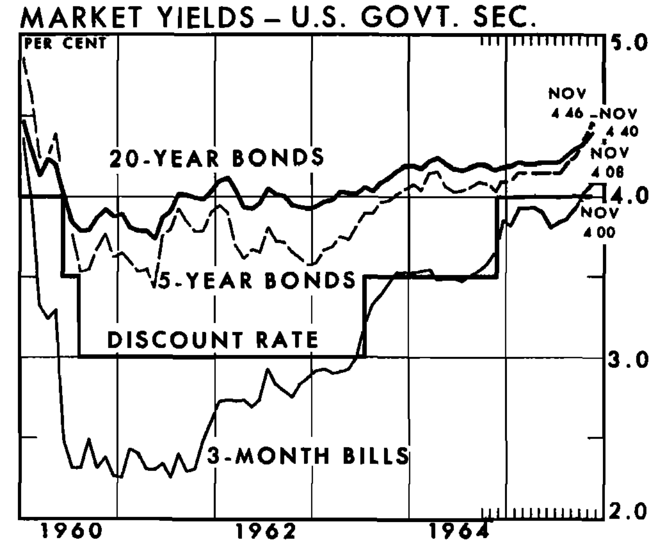
LIQUID ASSETS HELD BY PUBLIC



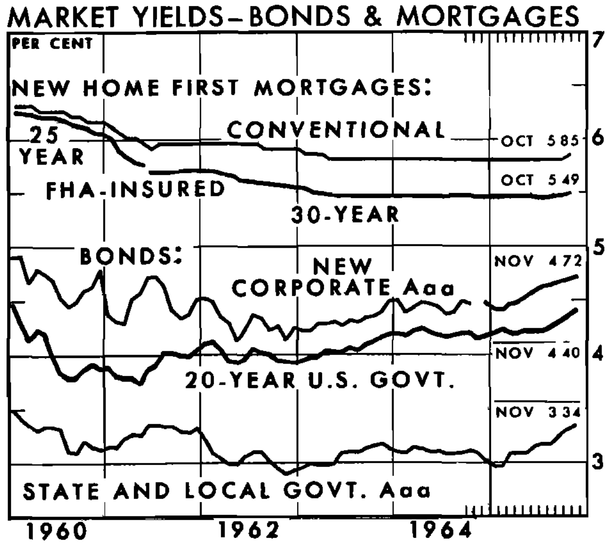
BANK ASSETS



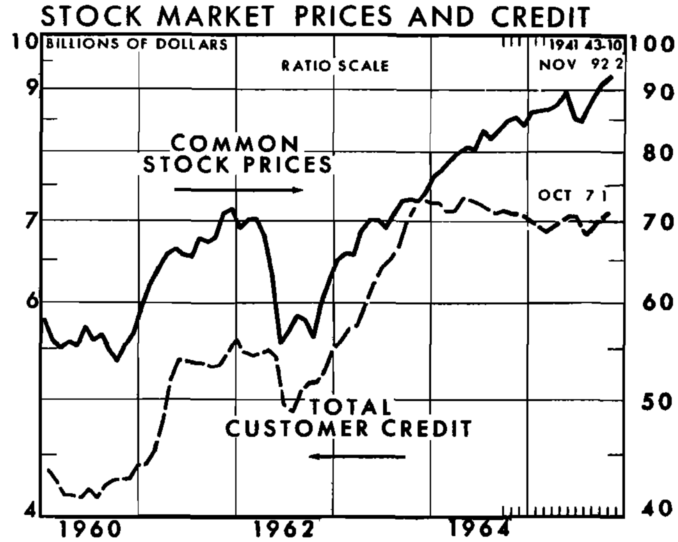
MARKET YIELDS – U.S. GOVT. SEC.



MARKET YIELDS–BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. Balance of Payments. Preliminary weekly balance of payments indicators show a surplus for November and early December, suggesting that the U.S. payments deficit in the fourth quarter, on either the liquidity basis or the old regular transactions basis, may well be no larger than the $300 million figure for the month of October. This would make the deficit on regular transactions approximately $1-1/2 billion for the year; the modest improvement in this measure of the deficit, compared to estimates of a month ago, may in part reflect postponement of Canadian new issues. The estimates assume that the United Kingdom will defer its year-end debt payments.

On the official settlements basis, the deficit in November apparently continued at approximately the October rate of $100 million a month, not adjusted for seasonal variation. The deficit on official settlements is still estimated at less than $0.5 billion for the year.

Revised data on import arrivals indicate that the trade surplus since midyear has been approximately $5-1/2 billion at a seasonally adjusted annual rate. The very high import figure published for October apparently included a sizable amount of shipments that actually arrived in the third quarter, and the average level of imports in the four months July-October ($22 billion annual rate, seasonally adjusted) is probably the best available indication of the recent rate of purchases from abroad.

U.S. IMPORTS
(In millions of dollars)

	1962-63 Annual average	1964 year	1964[1] II	1964[1] III	1965[1] II	1965[1] July-Oct[2]
Industrial Supplies	9,020	9,766	9,802	9,778	11,781	10,744
of which:						
Petroleum	1,835	1,911	1,856	1,921	2,139	1,937
Steel	611	826	839	827	1,501	1,365
Non-ferrous metals	1,121	1,263	1,226	1,304	1,605	1,576
Capital Equipment	889	1,161	1,148	1,143	1,647	1,510
Consumer Goods	2,798	3,388	3,246	3,601	3,966	4,342
of which:						
Apparel & other non-durables	800	973	888	1,180	1,128	1,289
Passenger cars	540	754	768	629	903	821
Electrical appliances	307	347	316	374	419	487
Food and Beverages	3,591	3,780	3,680	3,551	3,848	3,882
of which: Coffee	991	1,197	1,154	1,009	1,002	1,046
Other	481	590	564	580	700	759
Total	16,776	18,685	18,440	18,653	21,944	21,236

1/ Annual rates, not seasonally adjusted.
2/ Components and total in this table are not adjusted for change in statistical procedures.

This July-October rate was little changed from the second quarter, which had been swollen by the catching up following the port strike. Imports in these four months still included heavy arrivals of steel, which were more than 60 per cent above year-ago levels. Apart from steel, data in the table reveal few instances in which July-October rates for other categories of imports appear obviously out of line with recent trends. Imports of capital equipment were up 40 per cent from the rate in the third quarter of 1964, imports of consumer goods were up 20 per cent, and imports of foods and beverages (apart from coffee) were up 12 per cent. In each case the increase represented a continuation of the year-to-year gain already recorded for the second quarter.

Exports have continued strong through October; in that month they were a little under a $28 billion annual rate (balance of payments basis), and for the four months July-October they averaged $27-1/2 billion at an annual rate, up 7 per cent from a year earlier. The higher level of exports since midyear has in large part reflected a pick-up in agricultural exports (see Green Book for Nov. 17). But there has been a continued rise in new export orders for durable goods, and in the third quarter these were about 15 per cent above a year earlier. The increase in orders for jet aircraft was most pronounced, but orders for machinery continued at a level about 10 per cent above a year earlier, and orders for other durables also rose.

NEW EXPORT ORDERS FOR DURABLE GOODS[1/]
(Monthly averages, millions of dollars, not seasonally adjusted)

	1964				1965		
	I	II	III	IV	I	II	III
TOTAL	668	713	678	694	675	779	785
Aircraft	71	84	83	71	100	117	130
Machinery	367	394	361	377	366	423	401
Other	230	235	234	246	209	239	254

1/ Excluding motor vehicles and parts.

<u>Financial markets abroad</u>. During the three months up to December 6 no major changes were made in monetary and credit policies of major foreign countries. On December 6 the Bank of Canada's discount rate was raised by 1/2 percentage point in line with the Federal Reserve discount rate increase.

The economic background of the financial market developments summarized in the following pages has included: a continuing improvement in Britain's reserve position, but with persistent strains in the domestic labor market; strong demand and very tight labor markets in Germany and some other European countries, and also in Canada; further recovery of economic activity in Italy, a definite upturn in France this autumn after a year and a half of little change in the level of activity, and a further stretch-out of the year-long pause in Japanese economic expansion.

In <u>Britain</u>, no fresh steps to tighten credit have been taken since the July change in installment credit regulations. Bank credit expansion has slowed markedly. The rise in bank advances (seasonally adjusted) from March to November at an annual rate of 3 per cent was well within the 5 per cent annual growth ceiling, and it compares with an increase in the year-earlier period of 17 per cent (at an annual rate). Installment credit levelled off over the summer.

The impact of credit controls on total spending has been mitigated by a surge in new corporate security issues, which in July-October were over 50 per cent greater than in the previous four months. Also, the earlier decline in new loans by the building societies has begun to be reversed, as their intake of deposits has picked up.

Reflows of funds to London caused interest rates to ease in September. Since then most changes have been moderate. The yield on War Loan of 6.49 per cent on December 2 was still sharply below its August high, though up 16 basis points from the end of September.

To maintain confidence in sterling and encourage inflows of private funds, the Bank of England has resisted any tendency for short-term market rates to decline in expectation of a Bank rate cut. The Treasury bill rate, at 5.24 per cent on December 3, was only 3 basis points lower than on October 1.

In France, the money market unexpectedly became very tight in November, when the Treasury substantially reduced its outstanding borrowings at the Bank of France. Call money rates averaged 4.6 per cent in November, up sharply from the range of 3.8 to 4 per cent during the preceding three months. To what extent the improvement in the Treasury's cash position may be lasting is not yet known.

Continuing tightness in the money market would presumably lead to offsetting action by the monetary authorities, to foster the current revival of economic activity in France. Earlier, in mid-September, the banks' liquid assets reserve requirement was reduced (from 36 to 34 per cent). This move kept the market relatively easy in October despite the lack in that month of net official acquisitions of foreign exchange and gold. In the bond market, yields have risen considerably since the end of August--by 20 basis points in the case of public sector bonds--as the result of a heavy volume of new issues, including a 1 billion franc Treasury issue in October for relending to industry.

Italian banks have continued to add rapidly to bond portfolios; their purchases were a factor in a decline of bond yields by about 10 basis points from August to October (monthly averages), the first sizable yield decline since the first quarter. To intensify downward pressures on domestic interest rates, in November the Bank of Italy stopped giving the larger banks dollar-lira swaps to increase their foreign exchange assets. In the first ten months of 1965 the banks had improved their net position vis-a-vis nonresidents by more than $900 million, achieving a net creditor position for the first time in October.

Conditions in German financial markets tightened slightly further in September-October. Reduction of the banks' rediscount facilities with the Bundesbank by 12-1/2 per cent took effect October 1. In November, continuing inflows of short-term funds from abroad eased pressures in the money market somewhat, but bond yields have stayed very high despite the curtailment being made in the volume of new issues by public authorities. The average yield on public authority bonds on November 30 was 7.74 per cent, up from 7.60 per cent at the end of August.

In Switzerland, the central bank acted to limit the rise in Swiss bond yields by cutting back the allowed volume of new domestic issues. The October-December quota of $137 million equivalent compares with applications reportedly totalling in excess of $200 million, and with $157 million of actual flotations in the fourth quarter of last year. Despite the trimming of new domestic issues (and continued stiff rationing of foreign access to the Swiss capital market), long-term bond yields have moved up slightly further. In the money market, seasonal influences were mainly responsible for a rise in the 3-month deposit rate from 3.7 per cent in late August to the present 4 per cent.

Rising demand for credit in Canada has caused further interest rate increases in recent months, in particular a rise in the rate on 3-month finance company paper from 4.81 per cent on September 3 to 5.62 per cent on December 3. This jump (concentrated in late October and early November) is ascribed largely to heavy consumer demand for credit, especially in reflection of booming auto sales. In addition, a spate of unfavorable publicity concerning operations of some Canadian finance companies had adverse repercussions on the demand for finance company paper.

From the end of August to December 2, the tender rate on Canadian Treasury bills edged up 8 basis points, and long-term bond yields moved up irregularly by around 10 basis points. On December 6, the Bank of Canada raised its discount rate from 4-1/2 per cent to 4-3/4 per cent, and the market rate on Treasury bills increased by 1/8 percentage point.

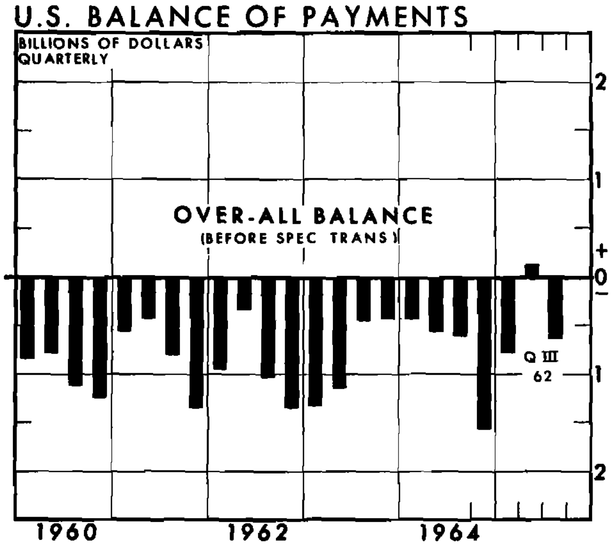
In Japan, credit market conditions have become unusually easy. During October and November the rate on call loans repayable at a day's notice stood at 5.8 per cent, the lowest level in a decade and far below the high of 11.3 per cent in September 1964. By September of this year the average rate on commercial bank loans and discounts had fallen to 7.68 per cent, from 7.99 at the end of 1964. With money market conditions easy, stock market speculation has been readily financed. Despite a series of recent increases in margin requirements to the highest level in three years, recovery in stock prices from last July's low has continued.

The Japanese Government is contemplating domestic bond issues early next year to finance a planned budget deficit, the first in 15 years. Its outstanding bonds currently yield 6.4 per cent, but reportedly the new bonds will carry more realistic yields of 6.7 to 7.1 per cent.

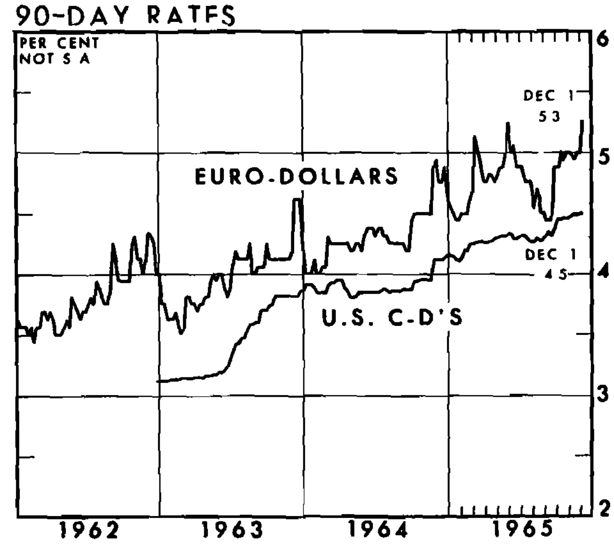
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

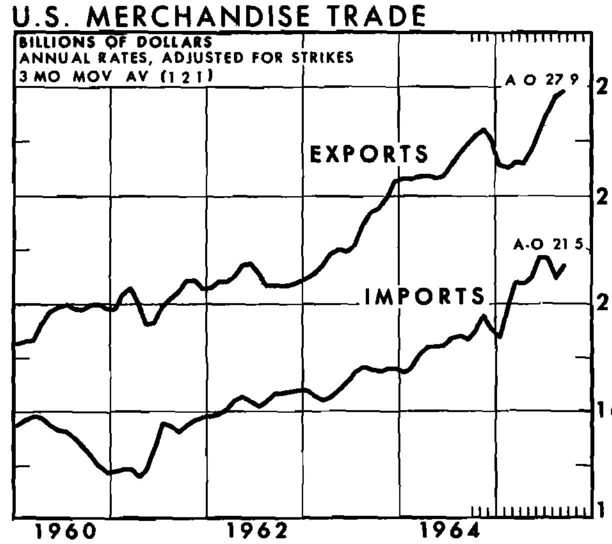
U.S. BALANCE OF PAYMENTS



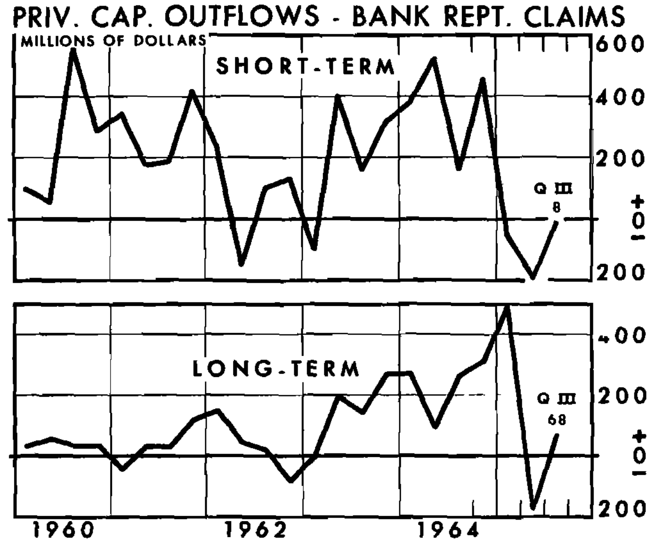
90-DAY RATES



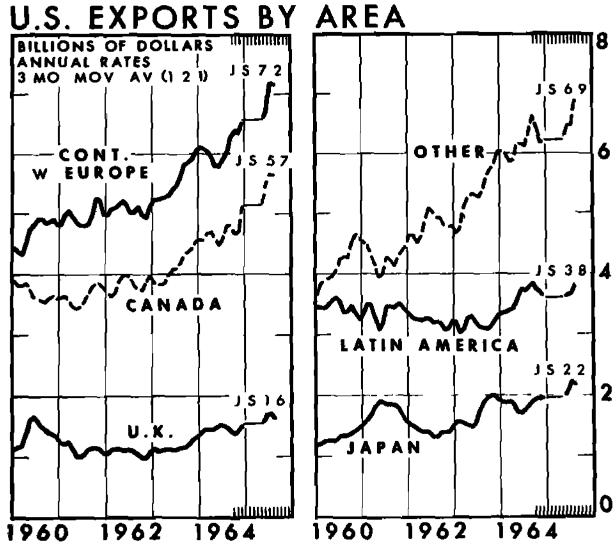
U.S. MERCHANDISE TRADE



PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



U.S. EXPORTS BY AREA



U.S. BANK CREDIT OUTFLOWS