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Content last modified 6/05/2009.

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

May 4, 1966

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SUMMARY AND OUTLOOK

Outlook for GNP

A further sharp advance in gross national product appears to be taking place in the current quarter. The increase is unlikely to match the $17 billion rise in the first quarter, largely because of more moderate increases in food prices. In real terms, however, the rise in over-all output should approximate the 6 per cent increase, annual rate, achieved in the first quarter and contribute to continued pressure on productive capacity and further reductions in available manpower supplies.

Higher personal consumption expenditures, business fixed investment and Federal expenditures are again proving to be the major stimuli for expanding output and incomes. However, it is not likely that the rapid first quarter advance in consumer expenditures will be equalled. Expectations of a lower rate of spending reflect the tapering off in food prices, which will tend to slow the rise in non-durable goods expenditures. Also, early evidence that auto sales are receding from the high first quarter rate suggests little change in consumer purchases of durable goods this quarter.

Expenditures for fixed business investment should maintain their strong upward momentum, as far as can be judged from recent order data and special (albeit partial) surveys of businessmen's plans. No cutback in business inventory accumulation is expected; indeed, any further slowdown in automobile sales could push up inventories faster than now projected for this quarter.

Another substantial rise in Federal outlays seems likely for this quarter. Defense spending rose faster than anticipated in Budget projections in the first quarter and estimated expenditures for the current quarter also could be higher than indicated in the January Budget. Beyond midyear there continues to be much uncertainty. There is talk of reassessment of defense needs but no confirmation has appeared in official quarters. Meanwhile, the President last week issued a statement indicating that additions to original Budget requests so far made or proposed by Congress would add more than $3 billion to next fiscal year's nondefense expenditures.

Resource utilization and prices

A further rise in GNP such as described above will sustain upward pressures on resource utilization and on prices. The unemployment rate is expected to drift down from the 3.8 per cent of March, and capacity utilization in manufacturing is likely to remain near the 92 per cent rate of the first quarter.

Through the first quarter and perhaps in April as well, industrial commodity prices rose at an annual rate of between 3 and 3.5 per cent--about midway between the 1.5 per cent of last year and the 5.0 per cent of late 1955 and early 1956. The price rise is likely to continue at a rate higher than last year, partly because increases have begun to appear for electrical machinery and some other products that had been stable or declining. Labor costs per unit of output in manufacturing have been edging up, and in the context of generally strong demands, these cost increases are being translated into higher prices and maintained or increased profit margins.

Contributing to the more rapid price advance this winter was the steep rise in food prices. The peak in food prices, which owed much more to curtailment of supplies than to expansion in demands, probably was passed in February-March. Supplies are now expanding again, and apart from a possible seasonal strengthening in the early summer, food prices should decline and tend to limit increases in the total indexes.

Outlook for deposits

The relatively rapid rate of expansion in time and savings deposits at commercial banks since mid-March is likely to slow down over coming months, but still remain above the reduced first quarter rate. The slowdown will likely result from the tapering off of the shifts that occurred at the time of the quarterly crediting of interest on accounts at nonbank institutions, when many banks raised rates on savings certificates and similar instruments. Inflows to commercial banks in the months ahead are likely to be confined to time deposits, as these instruments continue to be more attractive than bank savings deposits or savings at other financial intermediaries.

Nonbank institutions are likely to find their inflows re-duced below the first quarter rate; they may even find themselves facing further net withdrawals, especially at the midyear interest-crediting period. Furthermore, smaller banks may continue to lose funds to larger banks, unless small banks compete more aggressively. If credit demands and monetary policy are reflected in higher yields on market instruments, the growth of claims on all financial institutions, including banks, would be moderated further.

With respect to other deposits, the private money supply over the remainder of the quarter is expected to show a considerably reduced rate of growth relative to March and April, as Treasury deposits rise in May and as banks liquidate assets acquired in April--both as the result of repayment of temporary financings and sale of liquid securities. Over the longer run, continuing large growth in GNP should sustain transactions demands for cash, particularly if interest rates remain at current levels in the face of rising credit demands.

Credit demand

Total external financing needs of business remain large, but loan demands at banks have been somewhat below earlier expectations. Business loan expansion was relatively modest in April, and there is increasing evidence of some bank loan repayment from the proceeds of capital market financings. Banks earlier had tightened lending standards and aggressively acquired time deposits, partly in anticipation of very large business loan demands, and when such loan demands did not in fact materialize last month, banks increased their holdings of relatively liquid securities, including Agency issues. As a result, banks may have added a small cushion of liquidity that provides a basis for accommodating future increases in loan demand.

Businesses have continued to rely heavily on capital markets for their external financing, and this contributed to renewed upward pressures on bond yields in April. Market expectations of a tax increase also faded last month and increased monetary restraint was generally assumed to be more likely. In the period immediately ahead bond yields seem likely to continue to drift upwards.

Recent listings on the corporate public calendar for May and June and reports of private placement activity among underwriters both suggest that new corporate security offerings in the second quarter will continue large. In the municipal bond market, current demands for funds also remain strong, with the major question continuing to be to what extent prospective borrowers may be priced out of the market, at least temporarily. The last minute build up in the April municipal calendar--and the fact that some of the issues postponed in February and March have since been financed--suggests that if interest rates decline, borrowers in the market may seize the opportunity to finance. While the Federal Government will not be a significant factor in securities markets through its direct debt, there are indications that very sizable amounts of new cash will be raised through Agency issues over the next several weeks.

Balance of payments

The payments deficit on the liquidity basis turns out to have been at a $2 billion annual rate during the first quarter--higher than previously estimated and a little above the $1.8 billion rate in the second half of 1965. At annual rates, the merchandise trade surplus was $1/2 billion smaller than in the preceding half year but reflows of bank credit were about $1/2 billion larger. The outflow of U.S. capital into new foreign security issues increased, owing mainly to postponement of Canadian issues from late 1965 to early 1966. On all other transactions that affect the liquidity deficit, taken together--military and service transactions, direct investment, and Government aid--there appears to have been little net change from the second half of 1965 to the first quarter of this year. There was, however, a marked shift in flows of foreign liquid funds from abnormal outflow to large inflow; this shift reduced the rate of deficit calculated on the basis of official reserve transactions from about $2 billion in the second half of 1965 to about $1 billion in the first quarter of 1966.

Weekly data indicate that in April the rate of deficit on either basis of calculation was at least as large as during the first quarter.

For the period ahead, changes in the trade surplus will probably dominate the change in the over-all position. Changes in other current transactions seem likely to be roughly offsetting, with increases in military expenditures abroad roughly matching increases in investment income. There is little prospect of further sizable reduction in the net outflow of either U.S. Government capital or U.S. private capital, and increases are a possibility. Even if direct investment outflows decline a little between the year 1965 and the year 1966, they are likely to be at a higher rate than in the second half of 1965.

The merchandise trade surplus diminished from the fourth quarter to the first, as imports increased 4 per cent while exports rose only 1 per cent. Over the next few months, further rapid expansion of imports is to be expected as domestic demand rises. The first quarter increase was concentrated in autos and parts, aircraft, and machinery. There was no increase in imports of steel (now back to late-1964 levels), petroleum and products, or other industrial supplies--groups that accounted for nearly half of total imports in 1965 and that normally advance rapidly during periods of strong domestic demand pressure. Also coffee imports may turn up soon, since U.S. inventories of coffee have been drawn down to low levels.

Demand conditions abroad are generally buoyant, in less developed countries as well as in industrial countries. But whether U.S. exporters will be able to take advantage of these conditions may depend increasingly on domestic developments in this country. Given the strength of domestic demand now foreseen for the months ahead, there remains a clear danger that the trade surplus and the over-all payments position will deteriorate.

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.)	Mar'66	76.3	76.4	75.0	1.8	3.3
Unemployment (mil.)	"	2.9	2.8	3.5	-17.8	-27.5
Unemployment (per cent)	"	3.8	3.7	4.7	--	--
Nonfarm employment payroll (mil.)	"	62.8	62.5	59.8	5.0	8.9
Manufacturing	"	18.8	18.7	17.8	5.7	9.4
Other industrial	"	8.2	8.1	7.9	3.7	7.4
Nonindustrial	"	35.9	35.7	34.2	4.9	8.9
Industrial production (57-59=100)	"	152.9	151.4	140.7	8.7	18.3
Final products	"	152.2	151.0	140.1	8.6	18.4
Materials	"	153.4	151.7	141.7	8.3	18.5
Wholesale prices (57-59=100) 1/	"	105.4	105.4	101.3	4.0	5.0
Industrial commodities	"	103.6	103.3	101.6	2.0	2.8
Sensitive materials	"	105.3	104.4	101.4	3.8	6.5
Farm products and foods	"	109.5	109.8	99.0	10.6	11.5
Consumer prices (57-59=100) 1/	"	112.0	111.6	109.0	2.8	4.0
Commodities except food	"	105.6	105.4	104.8	0.8	1.2
Food	"	113.9	113.1	106.9	6.5	7.8
Services	"	120.1	119.7	117.0	2.6	4.9
Hourly earnings, mfg. ($)	"	2.68	2.67	2.59	3.5	6.8
Weekly earnings, mfg. ($)	"	111.33	111.05	106.82	4.2	9.6
Personal income ($ bil.) 2/	"	561.0	557.2	517.8	8.3	15.8
Retail sales, total ($ bil.)	"	25.6	24.5	22.9	12.2	20.4
Autos (million units) 2/	"	9.2	9.2	8.8	4.5	21.1
GAF ($ bil.)	"	5.9	5.9	5.2	12.3	20.6
Selected leading indicators:						
Housing starts, pvt. (thous.) 2/	"	1,543	1,365	1,489	3.6	- 3.1
Factory workweek (hours)	"	41.6	41.6	41.3	0.7	2.5
New orders, dur. goods ($ bil.)	"	24.6	23.7	21.7	13.4	27.9
New orders, nonel. mach. ($ bil.)	"	3.5	3.3	3.1	13.3	26.7
Common stock prices (1941-43=10)	"	88.88	92.69	86.83	2.4	12.8
Inventories, book val. ($ bil.)	Jan'66	120.6	119.8	111.5	8.2	14.3
Manufacturers' inv. ($ bil.)	Mar'66	69.7	69.0	63.7	9.4	15.5
Gross national product ($ bil.) 2/	QI'66	714.1	697.2	657.6	8.6	16.3
Real GNP ($ bil., 1958 prices) 2/	"	633.6	624.4	597.7	6.0	11.7

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Apr. 29	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A)				
Federal funds rate (per cent)	4.35	4.64	4.88	1.00
U.S. Treas. bills, 3-mo., yield (per cent)	4.64	4.62	4.70	4.04
Net free reserves 2/ (mil. $)	- 280	- 273	98	- 310
Member bank borrowings 2/ (mil. $)	642	638	642	218
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.85	4.83	5.03	4.43
20-year U.S. Treas. Bonds	4.69	4.66	4.81	4.38
Corporate new bond issues, Aaa	5.12	5.09	5.22	4.70
Corporate seasoned bonds, Aaa	4.95	4.96	5.00	4.57
Municipal seasoned bonds, Aaa	3.50	3.46	3.63	3.32
FHA home mortgages, 30-year 3/	6.00	6.00	6.00	5.46
Common stocks S&P composite index 4/				
Prices closing (1941-43=10)	91.60	91.67	94.06	87.35
Dividend yield (per cent)	3.15	3.15	3.27	2.91

	Change in March	Average change last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total 5/	357	168	9.0	4.9
Bank loans and investments:				
Total	2,800	2,000	8.0	8.9
Business loans	1,200	1,100	19.6	17.6
Other loans	2,600	1,400	13.4	11.1
U.S. Government securities	- 700	700	-13.9	- 6.7
Other securities	- 300	100	3.6	12.2
Money and liquid assets:				
Demand dep. & currency 5/	2,000	900	6.7	6.3
Time and savings dep. 5/	1,900	1,200	9.5	13.5
Nonbank liquid assets	4,000	1,900	8.7	6.4

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted. n.a.--not available.
1/ Average of daily figures. 2/Averages for statement week ending April 27.
3/Latest figure indicated is for month of March. 4/Data are for weekly closing prices. 5/ Change in April (projected).

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

	1966 Mar.	1966 Feb.	1966 Jan.	1966 QI p/	1965 QIV	1965 QIII	1965 QII	1965 Year (billions)
				Seasonally adjusted				
Current account balance					1,434	1,590	1,746	6.1
Trade balance 1/	490	330	330	1,150	1,274	1,235	1,320	4.8
Exports 1/	2,560	2,280	2,270	7,110	7,029	6,829	6,800	26.3
Imports 1/ 2/	-2,070	-1,950	-1,940	-5,960	-5,755	-5,594	-5,480	-21.5
Services, etc., net					160	355	426	1.3
Capital account balance (regular transactions)					-1,708	-1,957	-1,549	-7.3
Govt. grants & capital 3/					-973	-941	-988	-3.7
U.S. private direct investment					-701	-515	-891	-3.3
U.S. priv. long-term portfolio					-111	-357	159	-1.0
U.S. priv. short-term					-41	53	417	0.7
Foreign nonliquid					118	-197	-246	--
Errors and omissions					-252	-316	-81	-0.7
Balances, with and without seasonal adjustment (- = deficit)								
Bal. on regular transactions, S.A.					-526	-683	116	-1.8
Seasonal component					50	-454	-69	--
Balance, N.S.A.	-80	76	-21	-25	-476	-1,137	47	-1.8
Liquidity bal., S.A.					-384	-517	258	-1.3
Seasonal component					50	-454	-69	--
Balance, N.S.A. 4/	-40	53	-51	-38	-334	-971	189	-1.3
Official settlements bal., S.A.					-1,226	244	247	-1.3
Seasonal component					104	-516	-193	--
Balance, N.S.A. 5/	-94	176	295	377	-1,122	-272	54	-1.3
Memo items:								
Monetary reserves (decrease -)	64	-263	-225	-424	-271	-41	-68	-1.2
Gold purchases or sales (-)	-73	--	5	-68	-119	-124	-590	-1.7

1/ Balance of payments basis which differs a little from Census basis.
2/ Figures for January - March tentatively adjusted for changes in carry-over of import documents.
3/ Net of associated liabilities and of scheduled loan repayments.
4/ Differs from balance on regular transactions by counting as receipts (+) debt prepayments, advances on military exports, and net sales of non-convertible Roosa bonds.
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. Economic activity is continuing to expand very strongly in the current quarter, but the increase in gross national product is not expected to equal the exceptionally large -- $17 billion -- rise posted in the first quarter. We are now estimating the second quarter at $729 billion, a rise of $15 billion or 8.3 per cent, annual rate, compared with 9.7 per cent in the first quarter.

More of the rise in GNP is expected to be in real output, and less in prices. Real GNP in the current quarter is expected to advance at close to the 6 per cent, annual rate, achieved in the first quarter. Prices (GNP implicit deflator) are projected to increase at an annual rate of 2.8 per cent as compared with 3.6 per cent in the first quarter reflecting less increase in food prices.

Increased personal consumption expenditures, fixed business investment and Federal spending again should make the major contributions to expansion in GNP. Consumer outlays are estimated to rise by a little under $9 billion, somewhat less than the $11.5 billion in the preceding quarter. Recent consumer-buying surveys and automobile sales in April both suggest a lower rate of auto sales. Durable consumer goods expenditures are now projected at about the first quarter level. The expected slowing in the rise of consumer food prices should moderate the current dollar increases in nondurable goods spending. Outlays for services, however, are expected to continue to push upward in line with past trends.

Increases in consumption expenditures in the current quarter will be a little less than the large further rise projected for disposable income and the savings rate should increase slightly from the reduced first quarter rate. In the first quarter, the sharp rise in retail food prices and the increase in social security taxes were reflected in an appreciable decline in the savings rate.

No let-down is anticipated from the high rate of expansion in business fixed investment in the first quarter when plant and equipment outlays proved to be about in line with the plans reported in the McGraw-Hill March survey which called for an increase of 19 per cent for the year 1966. In the light of this survey and a resurvey by Lionel Edie (confidential), we have projected the increase in business fixed investment in the second quarter to be about the same amount as the first quarter.

Residential construction outlays are expected to decline moderately in the second quarter, reflecting a lower average number of housing starts in the first quarter. Business inventory investment is projected to rise slightly in the second quarter.

Defense spending registered a very large advance in the first quarter, \$3 billion or almost \$1 billion more than had been estimated on the basis of the January Budget. We now expect another sizable increase, possibly around \$2 billion, in the second quarter on the assumption that the spending momentum will continue and carry outlays above the relatively high March level. Other Federal purchases and State and local government expenditures are projected to rise slightly faster than in the first quarter.

<u>Commerce GNP estimates -- First Quarter</u>. Preliminary Commerce estimates lifted gross national product to an annual rate of $714 billion in the first quarter. This rise -- $17 billion -- was the largest since the Korean War. It also included the sharpest increase in the implicit price deflator since the Korean War; a third of the increase in dollar volume represented higher prices. Real GNP in the first quarter increased at an annual rate of 6 per cent, exceptionally large in view of the current high rate of plant utilization and sharply reduced manpower supplies.

GROWTH IN GROSS NATIONAL PRODUCT

	Gross National Product		GNP implicit
	Current prices	Constant prices	price deflator
	(Quarterly per cent change at annual rates)		
1965 - IQ	10.3	8.9	1.5
IIQ	6.8	3.9	2.9
IIIQ	7.6	6.3	1.5
IVQ	9.2	7.2	1.8
1966 - IQ	9.7 p	6.0 p	3.6 p

Personal consumption expenditures rose $11.5 billion, or at an annual rate of 10.5 per cent; in real terms, the gain was about

7 per cent. The increase was heavy for both durable and nondurable goods. Sales of automobiles and household durables were extremely high and the more rapidly rising food prices were reflected in larger-than-expected gains in nondurable goods. Outlays for services rose about in line with earlier trends.

The large rise in personal consumption expenditures exceeded the rise in disposable income, and the ratio of personal saving to disposable income declined to 4.8 per cent from 5.6 per cent.[1/]

Both residential construction and business fixed investment increased markedly in the first quarter. The rise in residential activity reflected the surge in new housing starts at the end of last year. The rise in business plant and equipment investment raised total fixed investment to 10.6 per cent of gross national product, a higher proportion than in 1965 and about the same as at the peak reached in the third quarters of 1956 and 1957. In constant prices business fixed investment in the first quarter was a larger share of total real product -- 10.9 per cent -- than at any time since 1950.

1/ If, however, personal income in the first quarter were adjusted to exclude the increase in social security taxes due to lifting the wage base -- a deduction which actually does not affect actual consumers' first quarter income, the ratio of savings to income would have been 5.1 per cent.

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

	1964	1965	1965			1966 - Projected	
			II	III	IV	I 1/	II
Gross National Product	628.7	676.3	668.8	681.5	697.2	714.1	729.0
Final sales	623.9	668.1	662.4	673.9	687.1	705.8	720.5
Personal consumption expenditures	398.9	428.7	424.5	432.5	441.0	452.6	461.3
Durable goods	58.7	65.0	63.5	65.4	66.4	68.8	69.0
Nondurable goods	177.5	189.0	187.9	190.5	195.0	201.1	206.0
Services	162.6	174.7	173.1	176.7	179.6	182.7	186.3
Gross private domestic investment	92.9	105.7	102.8	106.2	110.3	111.8	114.2
Residential construction	27.5	27.6	28.0	27.7	27.2	28.1	27.7
Business fixed investment	60.5	69.8	68.4	70.9	73.0	75.4	78.0
Changes in business inventories	4.8	8.2	6.4	7.6	10.1	8.3	8.5
Nonfarm	5.4	7.9	6.6	7.0	8.9	7.6	8.0
Net exports	8.6	7.1	8.0	7.4	6.9	6.1	6.0
Gov. purchases of goods and services	128.4	134.8	133.5	135.4	139.0	143.6	147.5
Federal	65.3	66.6	65.7	66.5	69.2	72.5	75.0
Defense	49.9	49.9	49.2	49.8	52.0	55.0	57.0
Other	15.4	16.7	16.5	16.7	17.2	17.5	18.0
State and local	63.1	68.2	67.8	68.9	69.8	71.1	72.5
Gross National Product in Constant (1958) Dollars	577.6	609.6	603.5	613.0	624.4	632.8	642.3
GNP Implicit Deflator (1958=100)	108.9	110.9	110.8	111.2	111.7	112.7	113.5
Personal income	495.0	530.7	524.7	536.0	546.0	556.9	568.0
Wages and salaries	333.5	357.4	353.6	359.0	368.1	377.0	385.5
Personal contributions for social insurance (deduction)	12.4	13.2	13.0	13.3	13.6	16.8	17.0
Disposable personal income	435.8	465.3	458.5	471.2	480.3	488.7	498.6
Personal saving	26.3	24.9	22.4	26.8	27.1	23.6	24.5
Saving rate (per cent)	6.0	5.4	4.9	5.7	5.6	4.8	4.9
Total labor force (millions)	77.0	78.4	78.1	78.5	79.0	79.4	79.8
Armed forces "	2.7	2.7	2.7	2.7	2.8	2.9	3.0
Civilian labor force "	74.2	75.6	75.4	75.8	76.2	76.5	76.8
Employed "	70.4	72.2	71.9	72.4	73.0	73.6	74.1
Unemployed "	3.9	3.5	3.6	3.4	3.2	2.9	2.7
Unemployment rate (per cent)	5.2	4.6	4.7	4.5	4.2	3.8	3.5

1/Gross national product and income figures are Department of Commerce preliminary estimates.

Industrial production. Industrial production increased 1 per cent further in March and was 8.7 per cent above a year earlier. Incomplete production data for April suggest a further increase in industrial activity, although probably by a smaller amount than in March.

Annual rates of increase in industrial output from the fourth quarter of 1965 to the first quarter of 1966, shown in the table, were exceptionally large considering that in the fourth quarter capacity utilization in manufacturing was already very high. The total index rose at an annual rate of 12.8 per cent as compared with 8.5 per cent for the year period ending with the first quarter of 1966.

Materials production increased at an annual rate of 15 per cent from the fourth quarter of 1965 to the first quarter of 1966 and accounted for more than three-fifths of the increase in the total index.

INDUSTRIAL PRODUCTION
(Annual rates of change)

	IV Qtr. 1965 to I Qtr. 1966	I Qtr. 1965 to I Qtr. 1966
Total index	12.8	8.5
Final products	9.6	8.5
Consumer goods	5.6	4.4
Durables	8.4	5.2
Nondurables	4.4	4.1
Business equipment	14.8	16.1
Defense equipment	30.8	24.6
Materials	15.2	8.4
Durables	22.0	8.6
Steel	47.6	-6.8
Nondurables	8.8	8.2

Output increases were widespread in durable and nondurable materials in this period and the rise in output of iron and steel, recovering from the curtailed fourth quarter level, was particularly fast. From March to April steel ingot output was about unchanged but still 6 per cent above the advanced first quarter average.

Inventories of steel mill products held by consuming manufacturers declined further in February, the latest month available, and at the end of the month were 35 per cent below the August 1965 peak. Partially offsetting, inventories at steel mills increased 15 per cent in the same period. At the high steel production rates of March-April it is believed that over-all steel inventories were rising.

Output of consumer durables goods showed an exceptional gain between the fourth and first quarters, but the rise is now likely to slow down. Output of defense equipment will, most probably, continue to show large gains. However, because of its relatively small importance of such equipment in the total index, a rise at the rapid annual rate of 31 per cent contributed only 0.3 percentage points to the increase in the total index between the fourth and first quarters.

Retail sales. In April retail sales apparently receded from the very advanced level in March, owing in part to unfavorable weather in most areas of the country. The March level of sales was 3.3 per cent above the end of 1965 and 12 per cent above a year earlier. Sales of new U.S.-made autos in April dropped. Sales at furniture and appliance stores and at lumber, building materials and hardware stores were off sharply. The weekly data suggest that total sales at nondurable goods stores changed little, with declines at apparel, general merchandise, and eating and drinking establishments about offset by sizable increases at food stores.

Unit auto sales and stocks. Deliveries of domestic autos fell sharply in the first 20 days of April, and although they picked up in the final 10 days, deliveries for the month fell to a 7.8 million annual rate and were about 15 per cent below the peak rate in the first quarter and 5 per cent below April 1965. Three developments probably contributed to the April decline. The reimposition in March of the one percentage point excise tax was used as a promotional device and this may have caused some bunching of sales in the first quarter. Total sales of domestic cars then were an annual rate of 9.3 million compared with 8.6 in the fourth quarter of last year. Sales in April may also have been adversely affected by publicity given to auto safety considerations and by factory recalls of a number of cars to adjust faulty parts or assembly.

Auto producers so far have acted as though they expect a strong selling season this spring. Production was briefly curtailed by the railroad strike but then was raised again in late April to near-peak rates of about 210,000 per week -- a seasonally adjusted annual rate of more than 9 million. Thus dealer stocks have continued to increase, reaching a level 30 per cent above both a year ago and two years ago.

Consumer credit. Renewed vigor in consumer credit activity is indicated for March. The borrowing pace had slowed in January and still further in February to the point where the rise in outstanding instalment debt in the latter month was the smallest in over a year. Despite the faster tempo in March, the increase in instalment credit for the first quarter as a whole was substantially less than for most quarters in 1965.1/

INCREASES IN CONSUMER INSTALMENT CREDIT
(Seasonally adjusted, annual rates)

Period	Billions of dollars1/
1965 - IQ	7.4
IIQ	8.0
IIIQ	8.3
IVQ	7.8
1966 - IQ	(e)7.2

1/ Revised series.

The slower credit growth in January and February was centered in the auto area; borrowing to finance household goods and personal needs continued to increase about as usual. The turnaround in March appears also to have been mainly in autos but with household goods credit also moving up vigorously.

1/ These comparisons are based on revised data. The commercial bank sector of the consumer credit estimates has been adjusted to call reports for June and December 1964 and June 1965. The revision has raised the level of total instalment debt on a gradually increasing basis throughout the period July 1963 to date, with the adjustment reaching a maximum of about $1 billion last June. However, short-term movements in the series remain much the same as before.

Manufacturers' new and unfilled orders. New orders received by manufacturers of durable goods rose sharply further in March. Large increases were registered by all industry groupings, except iron and steel. In the first quarter, new orders to durable-goods manufacturers were 5.5 per cent higher than in the final three months of 1965 and 12 per cent higher than in the first quarter of last year. Orders for durable goods have increased by progressively larger amounts in each of the past four quarterly periods.

MANUFACTURERS' NEW ORDERS
(Per cent change)

	March 1966 from February 1966	First quarter 1966 from Final quarter 1965	First quarter 1966 from First quarter 1965
TOTAL DURABLE GOODS	3.7	5.5	12.2
Iron and steel	-2	22	-8
Other primary metals	5	6	22
Fabricated metal products	7	4	9
Machinery	5	4	18
Transportation equipment	2	4	13
Other durable goods	5	4	12
Addendum:			
Machinery and equipment	-1	3	15
Defense products	6	15	33

Unfilled orders of durable goods producers in March were 2 per cent higher than a month earlier, as new orders continued to exceed shipments. Unfilled orders of all major industry groups rose, with the largest increases in the primary metals industry.

Manufacturers' inventories and shipments. Factory stocks increased by $640 million (book value) in March, a little more than the January-February average. For the first quarter as a whole, factory inventory accumulation amounted to $1,660 million, close to the $1,750 million of the fourth quarter. The first quarter 1966 increase in inventories sharply exceeded producer anticipations in February. At that time producers anticipated a second-quarter buildup of only $1,300 million.

Manufacturers' shipments in March were up 3 per cent from February, which was little changed from the month before, and 9 per cent from a year ago. In the recent rise, shipments of defense products, machinery, and consumer durables have been particularly important.

Construction activity. The value of new construction activity put in place, which had tended up since last autumn, dipped in March to a seasonally adjusted annual rate of $75 billion. This was slightly below the record level reached in February, according to preliminary estimates. (Such estimates in some previous months have been revised later by substantial amounts.)

Over the first quarter, the record pace of new construction was highlighted by a further advance in private nonresidential outlays. During the past four quarters, about half the rise in the value of all types of construction apparently reflected higher costs.

NEW CONSTRUCTION PUT IN PLACE

	First quarter 1/ (billions)	Per cent change from	
		IVQ 1965	Year ago
Total	$75.5	3	8
Private	53.7	4	10
Residential	27.3	3	2
Nonresidential	26.4	5	20
Public	21.8	--	2

1/ Seasonally adjusted annual rates; preliminary.

Private housing starts as well as private building permits turned up in March after declining in the two preceding months. Although month-to-month changes were quite sharp during the first quarter, the three-month averages for both starts and permits ran only a little below the advanced rates reached in the fourth quarter of 1965 and were at the same level as for the year 1965. In view of recent developments in home mortgage markets, a lower volume of residential construction seems very likely in coming months.

Plans for fixed capital spending. The McGraw-Hill survey in March found plant and equipment outlays planned for this year by all business up 19 per cent from last year, compared with the 16 per cent indicated by the Commerce-SEC survey taken a month or so earlier. Both surveys were taken before the President made his appeal to business to postpone or stretch-out capital.outlay programs. A subsequent recheck by Lionel Edie (received on a confidential basis) found that, although some firms cut back, total business plans were unchanged from his February survey.

If the increase in capital outlays should be limited by postponement of projects to amounts below those planned, then presumably inflationary pressures would be less than otherwise, both because expenditures and income would be less and because the increase in unfilled orders would not be so large. If the increase in spending should be limited by shortages and if unfilled orders in these circumstances accumulate rapidly, the only easing effect would be through the spending-income flow and that might be limited by price advances.

The McGraw-Hill and the most recent Commerce-SEC survey results are shown in the following table.

BUSINESS NEW PLANT AND EQUIPMENT SPENDING IN 1966
(Per cent increase from 1965)

	Commerce-SEC Jan.-Feb. Survey	McGraw-Hill March Survey
All business	16	19
Manufacturing	19	24
Nonmanufacturing	13	15
Mining	16	19
Railroad	6	9
Other transportation and communications	13	10
Public utilities	16	25
Commercial and miscellaneous	13	8

Step-ups in planned spending by primary metals and electrical machinery industries account for most of the relatively larger increase shown by the McGraw-Hill survey for manufacturing. Increases were also larger for some nondurable goods industries, mainly those producing materials for further processing.

According to the McGraw-Hill survey, manufacturers were operating at 90 per cent of capacity at the end of 1965 (no data are given for current rates of utilization) and, on average, now consider 93 per cent of capacity as the most desirable operating rate as compared with the 92 per cent they reported when last surveyed in 1962.[1/] Manufacturing capacity is expected to increase 8 per cent this year compared with 7 per cent last year, which itself was revised up from 6 per cent projected a year ago. Manufacturers also expect their sales to rise by 8 per cent this year. Thus, even if the larger increase in capacity is achieved, utilization rates would remain very high.

With manufacturers operating plants at higher rates than at any time in recent years, the need for expanding capacity continues pressing. As a result, the proportion of new investment going to expand facilities has been increased to 48 per cent from 45 per cent last year and only about one-third between 1959 and 1964.

For the first time, McGraw-Hill asked its survey respondents to indicate the major factors which might cause actual expenditures to fall short of planned spending. The two major reasons given were delays in equipment deliveries (34 per cent) and construction delays (27 per cent). Labor shortages (only 9 per cent), high interest rates (only 5 per cent), and material shortages (only 4 per cent) were considered less important.

<u>The labor market</u>. With demands for labor continuing exceptionally strong and with the unemployment rate continuing to drift down, available supplies of workers with recent job experience have become stringent.

1/ These rates are conceptually a little different than those calculated by FRB. Roughly 2 points should be added to the McGraw-Hill figures to make them comparable to FRB.

Increasingly, new entrants into the labor force -- mostly young people and adult women -- are becoming the predominant source of additional labor. For experienced workers receiving unemployment compensation benefits, unemployment rates have declined to the lowest levels since World War II.

The number of persons filing new claims for unemployment benefits declined from March to April -- to the smallest for the period since World War II -- reflecting further reductions in lay-off rates throughout industry and the apparent speed with which laid-off workers have found other jobs.

UNEMPLOYMENT COMPENSATION CLAIMS

	1953	1965	1966
Initial claims	Average weekly number in 000's		
April	195	227	169
March	175	222	174
Insured unemployment		Rates 1/	
April	2.5	3.2	2.1
March	2.5	3.2	2.3

1/ Average weekly insured unemployment as a per cent of average covered employment. April 1966 partially estimated.

The number of persons receiving unemployment benefits also declined significantly last month. Only 2.1 per cent of all covered workers are now receiving unemployment benefits -- the lowest rate in the post-war period. In April 1953 the rate was 2.5 per cent.

Earnings and labor costs. Hourly earnings in manufacturing in March rose slightly further, to a level 3.5 per cent above a year ago, and reflecting the effect of longer hours worked at premium pay, total weekly earnings were up 4.2 per cent. After adjustment for the rise in consumer prices, the increase in total real earnings was reduced to 1.4 per cent and was substantially less than the increase in real earnings in 1965.

For workers with three dependents, after tax spendable earnings have increased 2.6 per cent over the past year -- less than half as much as in the previous year. Partly, the slow-up this year reflects the recent rise in social security taxes, whereas the year before spendable earnings had benefited from tax reductions.

WEEKLY EARNINGS OF MANUFACTURING PRODUCTION WORKERS
(March of each year)

	Total earnings		After taxes with 3 dependents	
	Current dollars	1957-59 dollars	Current dollars	1957-59 dollars
	(Per cent change over a year ago)			
1965	5.2	4.0	5.7	4.5
1966	4.2	1.4	2.6	-0.2

When consumer price increases are also taken into account, the real weekly spendable earnings of factory workers with 3 dependents have not increased in the past year. The recent leveling off in purchasing power defined in this way is in contrast to earlier years of the expansion, when prices were rising less rapidly. Lack of improvement in the purchasing power of take-home pay this past year has occurred despite the record workweek put in by production workers. In the months ahead, if retail food prices stabilize or decline as expected, real earnings are likely to turn up again.

Somewhat lower productivity gains and increased social security taxes have been the major factors pushing up unit labor costs this year. In March, labor costs in manufacturing were .5 per cent above the January level and .7 per cent above a year ago. Over the year, the rise in labor costs has been less than the rise in industrial prices.

Looking ahead, unions can be expected to demand larger wage increases, pointing to rising consumer prices, wholesale price rises in excess of increases in unit labor costs, and higher profits as reasons why wage gains should exceed the guidepost in contract reopenings this year. The effect of these increased demands will become more evident later this year when an increasing number of important negotiations will get underway, such as the electrical workers.

Wholesale prices. Industrial commodity prices apparently continued to rise in April at the accelerated pace of the first quarter of this year. Prices of foodstuffs declined appreciably further, however, with the result that the total wholesale price index remained at about the advanced February-March level. At that level, the index is about 5 per cent higher than in the 1958-1964 period. While the sharp rise in foodstuffs since 1964, amounting to more than 10 per cent, has accounted for a disproportionately large share of the increase in the total, industrial commodity prices have increased about 3 per cent.

A third of that 3 per cent increase in industrial commodities has occurred since the beginning of this year, when the rise accelerated to an annual rate of between 3.0 and 3.5 per cent from the 1.5 per cent rate prevailing from September 1964 through 1965. Much of the speed-up reflects machinery and equipment prices, which increased 1.1 per cent in the first quarter compared with 1.7 per cent in all of 1965. While several categories of nonelectrical machinery have been rising faster this year than last, a major feature of the acceleration is the upturn in electrical machinery. The electrical group rose 1.5 per cent in the first quarter, after having been stable in 1965 and having declined in the preceding 5 years, and press reports indicate a continuation of the rise in April.

Copper products were rising rapidly again in the first quarter; the total nonferrous group increased 3 per cent after having declined somewhat from November to December when prices of copper and some products were rolled back following an announcement of an emergency release of supplies from the strategic stockpile and the imposition of export controls on scrap. In the first quarter, the copper shortage intensified, in part because of a 28-day strike in Chile, and prices soared on the London Metal Exchange to 95 cents a pound, compared with the 36 cents maintained by U.S. primary producers. In late April, the Chilean Government raised its price, up to 62 cents from 42 cents a pound, in part to recover foreign exchange earnings lost during the strike, and Zambian producers retruned to their practice of some years ago of tying their price to the forward contract on the London Exchange. At the time of these actions, the forward contract was quoted at 78.5 cents a pound; it subsequently fell to 61 cents but then recovered to 69 cents. These increases in producer prices for primary copper are almost certain to bring about a change in the allocation of supplies and a reduction in the over-all amount demanded. U.S. users continue to receive roughly two-thirds of their copper at the domestic price of 36 cents.

Prices of steel mill products, according to the BLS index, continued to edge up slowly in the first quarter and are 1.5 per cent higher than a year ago. Production of steel has recovered sharply from the low reached last November, after the threat of a strike had passed. At current output rates, not much more than 5 per cent below the advanced levels of last spring and summer, inventories probably are being increased, but in general, supplies are readily available and new orders appear to have leveled off while unfilled orders are still relatively low. The absence of strong demand pressures in this industry is suggested also by some weakening recently in prices for steel scrap.

Among industrial commodities other than metals and machinery, price increases have become somewhat more numerous but are still limited. Lumber and products have increased appreciably -- in response, reportedly, to Government buying, the threat of strikes, and a shortage of freight cars -- and a few other building materials have risen. Hides and leather products are sharply higher than at the end of last year, but hide prices have been declining since early March in association with Government action to limit exports to the total in 1964. Increases in paperboard and some converted paper products have raised the paper group average about 1 per cent since December. An increase of about 5 per cent in cigarette prices was reflected in the March index, but part of this increase was subsequently rescinded. Reports of price increases among industrial chemicals have been more numerous this year, but the index was a little lower in March than in December. Fuels have declined somewhat, mainly as a result of seasonal influences. Prices of furniture have been raised, but other consumer durable goods generally have remained stable.

Wholesale prices of foodstuffs turned down in March, and by late April they averaged about 2.5 per cent below the February high. From their peaks in February, prices of livestock have declined 8 per cent and those of meats 4 per cent. In the latter part of April, production of meat, particularly beef, increased appreciably. Expansion in marketing may have been stimulated by Government and other statements of prospective price declines and by release of the report on the number of cattle on feed as of April 1, which pointed to marketings of cattle in the May-September period somewhat larger than previously expected. Prospects for expansion in pork and poultry supplies as well may be encouraging reduction in cold storage stocks of meats. In April, prices of eggs and dairy products also declined, but the decreases were mainly seasonal and left prices substantially higher than last spring. Decreases for livestock and products were partially offset by larger-than-seasonal increases in prices of fruits and vegetables.

Consumer prices. The consumer price index showed another sizable increase in March, with foods again accounting for half or more of the rise. After increaseing .6 per cent in February, the index rose .4 per cent in March to 112.0 of the 1957-59 average and was 2.8 per cent higher than a year earlier.

Food prices generally rose in March and the average increased .7 per cent further, for a cumulative increase of 3.0 per cent since December and 6.5 per cent from March a year ago. Although average prices of meats rose somewhat further, to a level nearly a fifth above a year earlier, pork prices turned down. Retail prices of beef as well as pork may have declined in April.

Prices of nonfood commodities increased .2 per cent in March. The year-to-year rise of .8 per cent was about in line with the trend rate of increase evident since 1958, but the increase would have been larger had not excise taxes been reduced. Over the past year, increases have been concentrated in nondurable goods, particularly clothing and footwear. Durables generally have declined, but the decreases are largely accounted for by the excise-tax reductions.

Services rose .3 per cent in March to a level 2.6 per cent above March 1965. Since last fall services have been rising faster than the 2 per cent annual rate of increase earlier in this expansion. Medical care services account for much of the acceleration, and they may rise more sharply with the midyear inauguration of benefits under Medicare.

Agricultural supply and price situation. Increasing supplies of high protein foods during the rest of the year now seem assured following the very tight situation in the first quarter. In reappraising supply prospects for the rest of 1966, USDA analysts have raised their projections of poultry meat, pork, and beef by small amounts. Average prices received by farmers for meat animals, already down 4 per cent from March to April because of increased marketings, are expected to decline further.

The April 1 report showing 13 per cent more cattle on feed than a year ago raised supply prospects and lowered price prospects for fed cattle for the next two quarters, at least. Feeders intend to market 12 per cent more cattle in the second quarter than a year earlier--a gain of 4 to 5 per cent over the relatively large marketings of the first quarter. This expansion is expected to keep prices of choice steers (Chicago) in the current range of $26 to $27, which is down from the $29 to $30 quoted in March and early April and about the same as last autumn.

Hog marketings are expected by late May to exceed those of a year ago and by the fourth quarter of 1966 to be up as much as 12 per cent. The usual summer rise in hog prices will probably be small and autumn prices could fall a little more than seasonally to $18 to $19, a decline of around $10 from January and February.

A sharp expansion in production of broilers and turkeys is also in progress. Supplies of poultry meat are expected to exceed year earlier levels by 10 per cent in the second and third quarters, and the year-to-year gain in supplies in the fourth quarter will be about 8 per cent, unless growers cut back broiler production in response to price weakness in the late summer. Prices of broilers are expected to remain above year earlier levels through early summer or until pork and turkey marketings gain momentum. Egg production by the fourth quarter will be significantly above year earlier levels. Milk production in the first quarter, down 5 per cent from a year earlier, is expected to increase in the latter part of the year, reflecting improved pasture conditions and the April 1 increase of 8 per cent in the support price.

Fresh vegetables are being marketed now in increasing volume following the reduced supplies caused by bad weather earlier in the season. Total spring tonnage is expected to be well above last year. Potatoes, in particular, will be in more ample supply. Canners and freezers are planning big packs of vegetables in 1966. Farmers planting intentions indicate that, with average yields, vegetables grown for processing may equal the record output of 1962.

Farm income. Farm incomes benefited from sharply higher prices received in the first quarter. Cash receipts averaged 17 per cent above the low first quarter of 1965. Increases were much greater in areas specializing in livestock.

The USDA has estimated that cash receipts of farmers in 1966 will be around $2 billion above the $38.9 billion of 1965. Marketings of livestock and products are expected to be up slightly and prices for the year are expected to average above 1965 despite expected declines in average prices in the second half of the year. Volume of crop marketings is expected to exceed 1965 if the growing season is normal and prices are expected to average lower than in 1965. Cash receipts from marketings of cotton will be down substantially reflecting the effects of the new cotton program provisions calling for retirement of acreage and a 29 per cent reduction in the loan rate for cotton to 21 cents per pound, approximately the world price. Growers will receive compensating payments.

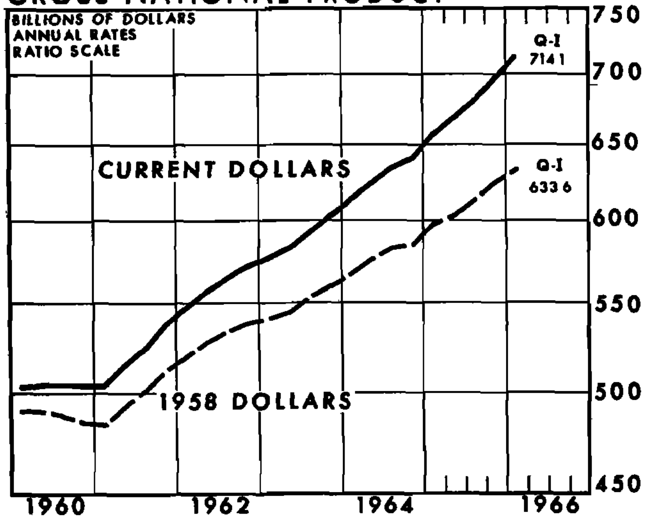
Government payments to farmers are projected to exceed the $2.5 billion of 1965 by about $1 billion reflecting mainly higher payments on wheat and the addition of up to $500 million in diversion and price support payments to the cotton farmers. The termination of subsidy payments by the Commodity Credit Corporation to cotton users and exporters will offset much of the rise in payments to cotton farmers.

Farmers are apparently borrowing more heavily for production expenses than a year earlier, judging by PCA lending activity. Cash advances to farmers by PCA's were up 27 per cent in the first quarter from a year earlier and loans outstanding at the end of March were 15 per cent above a year earlier. Increases in borrowing from the PCA's occurred in all areas of the country but were largest in the cattle feeding areas.

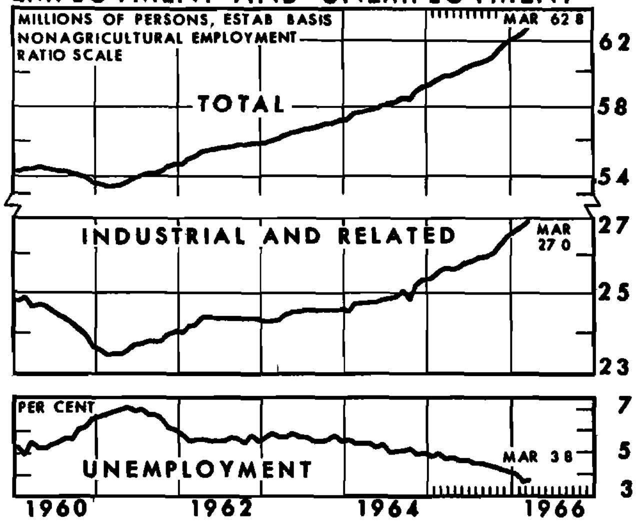
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

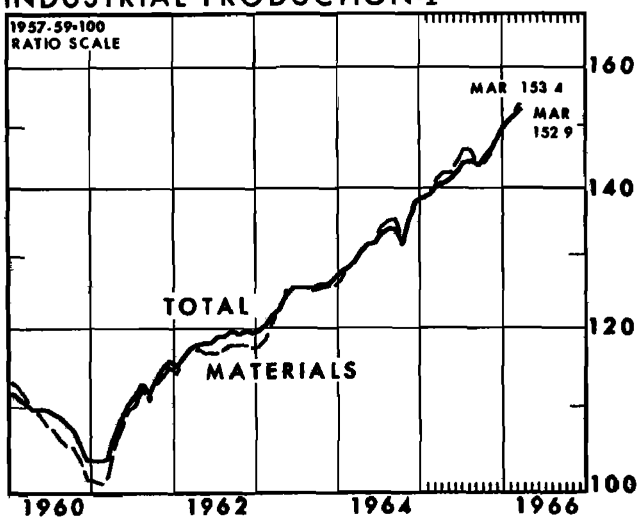
GROSS NATIONAL PRODUCT



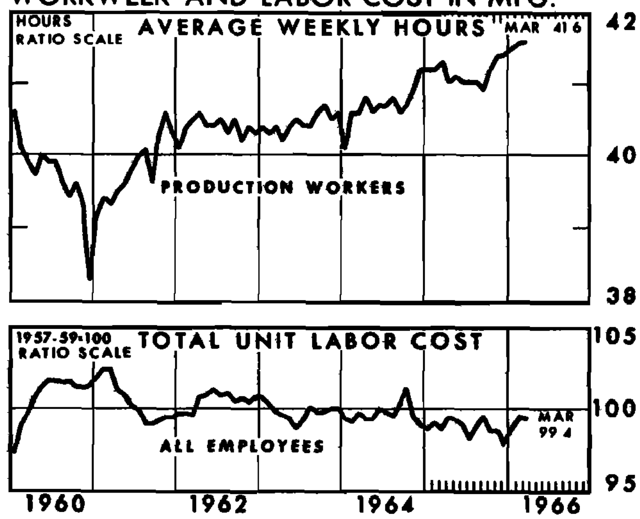
EMPLOYMENT AND UNEMPLOYMENT



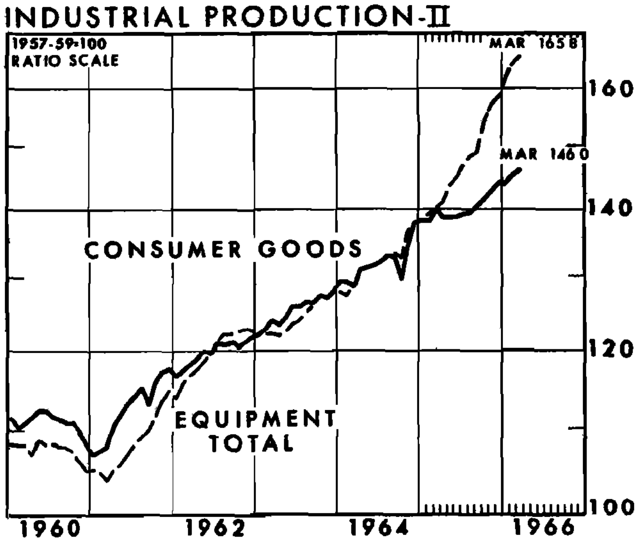
INDUSTRIAL PRODUCTION-I



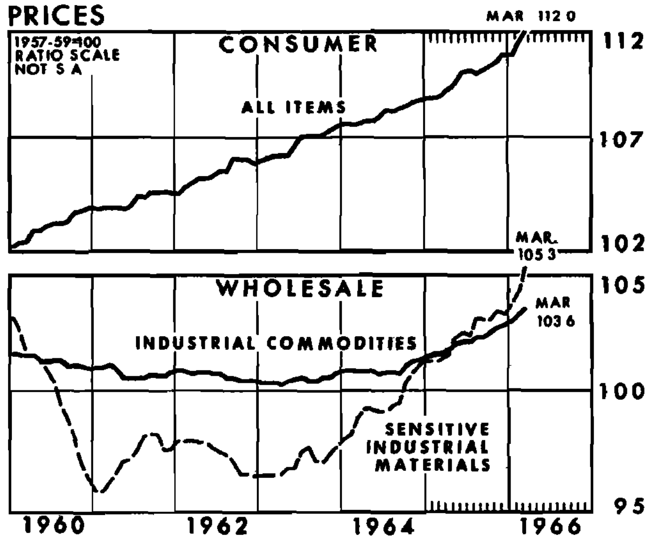
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



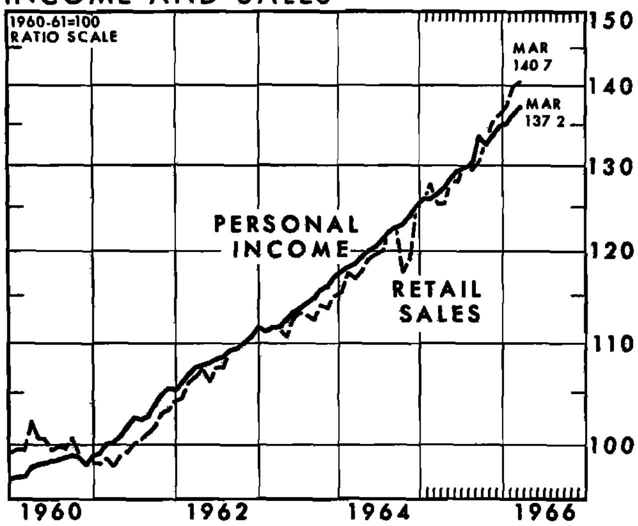
PRICES



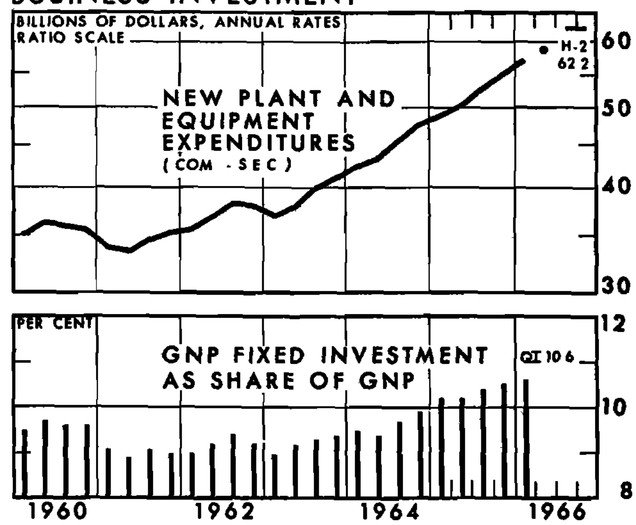
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

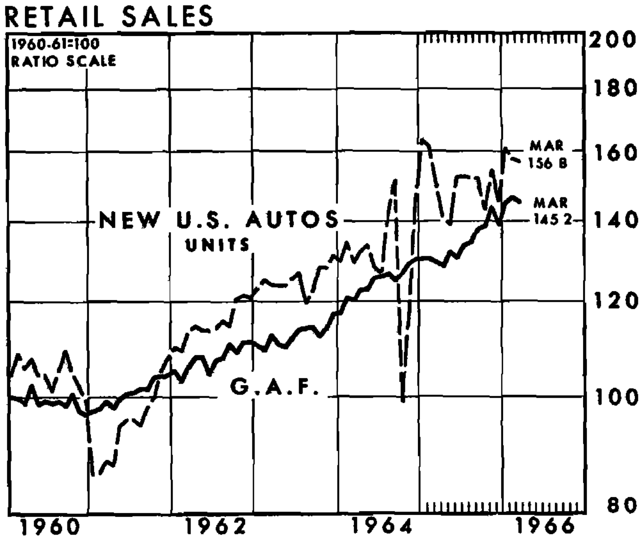
INCOME AND SALES



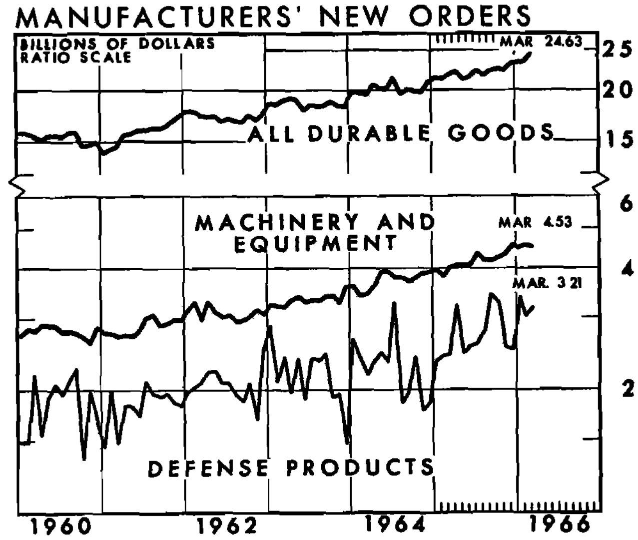
BUSINESS INVESTMENT



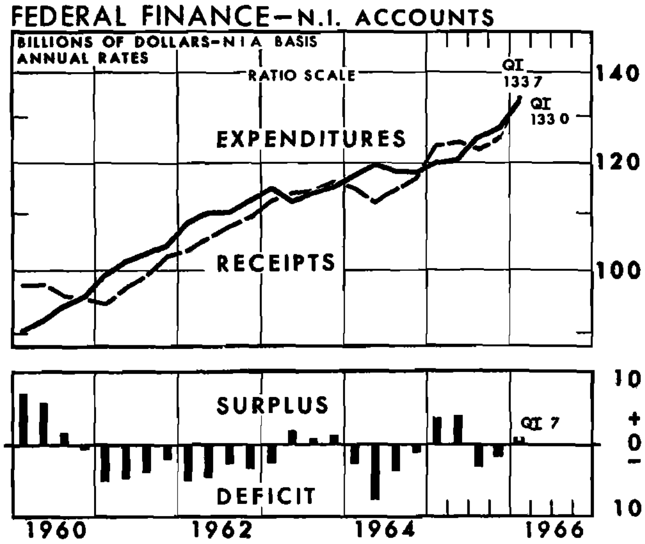
RETAIL SALES



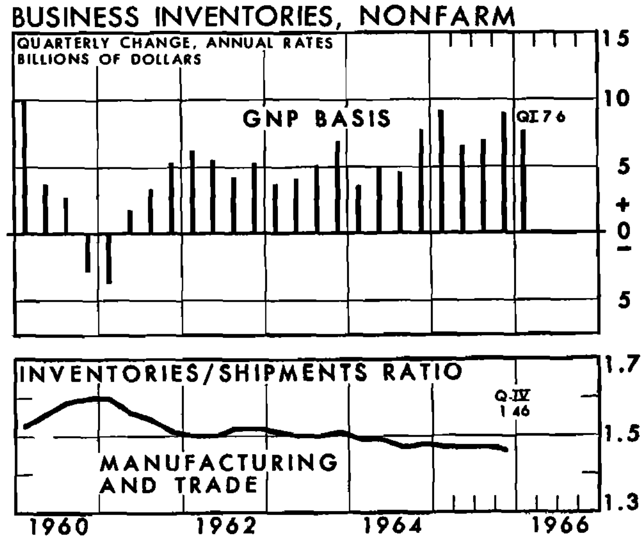
MANUFACTURERS' NEW ORDERS



FEDERAL FINANCE—N.I. ACCOUNTS



BUSINESS INVENTORIES, NONFARM



DOMESTIC FINANCIAL SITUATION

Funds raised in credit markets. Preliminary figures on credit flows in the first quarter indicate a total borrowing rate, seasonally adjusted, of about $90 billion dollars, well above even the high rate of $84 billion in the fourth quarter of last year. The increase occurred in both private and Federal Government borrowing.

The increase in total business and household borrowing, from a $60 billion rate to $63-1/2 billion, appears to have been about in line with the increases in investment spending and purchases of consumer durable goods, which together were $4 billion higher than the preceding quarter on a gross basis and $2 billion higher measured net of capital consumption allowances. The first quarter relationship of borrowing to investment is close to that of the preceding five years. But businesses were exceptionally large borrowers in capital markets during the first quarter. Within the private total, corporate net bond issues, at a $13 billion annual rate for nonfinancial corporations, were well above the previous peak rate of $8 billion last summer and higher than any quarter since 1952 even after allowance for growth of the economy.

State and local government security issues were slightly down from the fourth quarter after seasonal adjustment, but both the fourth and first quarters, at an $8-$10 billion rate of net new issues, were high historically, particularly in view of the growth over the last year in the net surplus of state and local governments as estimated in the income-and-product accounts.

While the rate of Federal borrowing in direct debt was also down somewhat from the fourth quarter, agency issues and loan participation certificates were sufficient to put the total of credit-market funds raised by the Federal government about $3 billion higher at annual rates. Much of this increase in agency borrowing was offset by expanded Federal lending activities, particularly in mortgages.

Recent bank credit flows. Preliminary estimates indicate a large seasonally adjusted increase in bank credit during April--almost half again as large as the average income of the first three months of the year. On a daily average basis, the increase in bank credit at member banks is indicated to have been at an 18 per cent annual rate. But because of a large increase the last week of March and some repayments the end of April, the end of month credit series indicates a seasonally adjusted annual rate of growth only slightly above the 11.3 per cent rate of March. While changing seasonal patterns for April suggest that undue emphasis should not be placed on the April figures, it appears clear that loans and investments at banks expanded quite rapidly throughout most of the month.

Business loans rose only moderately in April, at near the reduced February pace of an 11 to 12 per cent annual rate, compared to a 19.6 per cent rate of the first quarter, and, as a whole, they showed no particular strength during the week of the April tax date. However, large loan repayments from the proceeds of capital market financings by two corporations totaled over $300 million; these repayments alone had the effect of reducing the annual rate of growth of aggregate business loans at banks during the month by about 5 percentage points.

The April corporate tax payment of approximately $2.5 billion generated little pressure on banks to make direct loans to businesses.

Instead firms apparently had funded these liabilities in advance--via holdings of Treasury issues, RP's, finance company paper, and CD's. Thus, in the week of the tax date, when such assets were liquidated by businesses and when dealer and finance company borrowings from corporations was reduced, banks absorbed bills and made large loans to dealers and finance companies rather than stepping up their direct lending to businesses. The following week, in New York, dealer and broker loans, as well as security holdings by banks, were reduced as some of the financial assets liquidated by businesses to pay tax liabilities were shifted by banks to still other holders. Thus, on an end-of-month basis, total bank loans rose only about one-half as rapidly in April as in March.

Bank holdings of securities, however, reversed recent trends and increased by nearly $1 billion in April, offsetting two-thirds of the first quarter decline. This increase apparently occurred mainly at city banks, with a very large share accounted for by New York City banks. Smaller banks, unlike most of the first quarter, are believed to have added little to their holdings of securities. The growth in security portfolios at city banks, and the modest growth at other banks, is directly tied to the composition of deposit inflows, as described below.

Most of the $300 million increase in banks holdings of Governments in April was in bills, reflecting acquisition from corporate customers over the tax period, and perhaps also efforts of banks to rebuild liquidity. The sharp increase in other security holdings probably stems in large part from acquisitions of the new issue of $650 million of New York State tax anticipation bills and several issues of new Federal agency issues and participation certificates which totaled over $1.6 billion. While no firm data are available, the latter issues likely account for a large part of April's seasonally adjusted increased bank holding of other securities.

The increase in bank credit in April was accompanied by a 14 per cent annual rate of growth in the money stock, following an 8.6 per cent rate of increase in March. While seasonal problems suggest that the April rate of growth may be overstated, it seems clear that the private money stock rose sharply in the first half of April and more slowly thereafter. Part of this recent growth reflects reductions of Treasury balances in March and mid-April, but System operations designed to permit banks to finance tax pressures seemed to contribute relatively more to this increase, with nonborrowed reserves expanding at an annual rate in excess of 13 per cent last month. If tax date liquidation of assets by corporations and sales of large quantities of Federal agency obligations had been forced through the market, it would undoubtedly have entailed increasing market yields; System operations permitted banks directly or indirectly to acquire a large portion of these assets. Not only did this reduce pressure on market yields and sharply increase bank credit growth, but, in addition, the absorption of such assets by banks was reflected in an increase in demand deposits.

Flows of saving. On the supply side of credit markets, there was a marked shift from the fourth quarter of 1965 to the first quarter of 1966 in the pattern of flows. The reduced growth between the two quarters in money supply, time deposits, and savings accounts of all types was reflected in a drop in lending by commercial banks and nonbank, financial institutions from an exceptionally high $70 billion seasonally adjusted annual rate in the fourth quarter to no more than a $50 billion rate in the first. During the past month, inflows of funds to commercial banks accelerated, but nonbank institutions apparently experienced larger than seasonal withdrawals of funds, as best can be judged from partial data thus far available.

The drop in institutional flows during the first quarter of 1966 reflected a transfer of funds by the public into direct purchases of market instruments in a period of rising market interest rates. Such direct purchases appear to have been at more than a $30 billion annual rate during the first quarter, an unprecedented high in the postwar period.

There were large purchases of all types of instruments, particularly Federal securities, municipal issues, corporate bonds, and finance company paper. State and local governments appear to have been a major source of funds to the Federal securities market, relative to the fourth quarter, probably reflecting reinvestment of proceeds of their own capital market financing. Households also increased their purchases of Governments while maintaining their fourth-quarter flow into municipals and supplying a large part of the funds to the heavy volume of corporate bond issues during the quarter. With finance companies turning sharply to the open market for funds, corporations appear to have put much of their liquidity growth into finance company paper, with some increase in time deposits and little change in holdings of Government securities.

With respect to flows of saving through financial institutions, commercial banks do not appear to have fared much better than other financial institutions in the first quarter of 1966, but have gained considerable ground in recent weeks. After the increase in the prime rate in March, city banks not only increased their offering rates on CD's, but also began to compete more aggressively with their smaller denomination savings certificates and other time deposits. As a result, the net inflow of time and savings deposits at reserve city banks in April accelerated to an annual rate in excess of 25 per cent, with New York and Chicago banks expanding inflows even faster, while country banks showed only a 6.5 per cent rate of expansion, the same as in March and down from the 12.7 per cent rate in January and February.

As indicated in the table all of the growth in time and savings deposits since mid-March reflects time deposits. Consumer-type time deposits mainly at weekly reporting banks outside New York accounted for the bulk of the increase. Savings deposits declined quite sharply, and this decline undoubtedly reflected movements of deposits to take advantage of higher rates available on saving certificates and similar instruments.

CHANGES IN TIME AND SAVINGS DEPOSITS
Weekly Reporting Banks
March 16-April 20, 1966
(Millions of dollars)

	Total	New York City	Other
Total	1,740	775	965
Savings	-1,589*	-217	-1,372
Negotiable CD's	992	621	371
Time deposits other than CD's	2,337	371	1,966

*During the same period of 1965 savings deposits rose by $142 million.

There was also an increase in CD's, mainly at New York City banks. CD's had increased sharply in the latter part of March, but rose more slowly, net, in April. The sharp increase in March in part reflected the initial increase in CD offering rates subsequent to the prime rate increase. Offering rates were maintained in April, and the premium of CD rates over Treasury bills remained relatively large, thus enabling banks to roll over large maturing issues.

While the growth of time and savings deposits at weekly reporting commercial banks was dramatic after mid-March, this should not be allowed to obscure the fact that savings flows to all of the major depositary-type institutions--savings and loan associations, mutual savings banks, <u>and</u> commercial banks--showed a marked year-to-year shrinkage during the first quarter this year and probably continued this trend in April. As the table shows, first quarter net flows to these depositary-type institutions were the smallest for any first quarter in the last five years. First quarter inflows to savings and loan associations were the smallest since 1961, and net inflows to mutual savings banks also fell well-below levels achieved in each of the past three years. Relative to the 1965 record, net flows to commercial banks were also down sharply.

NET SAVINGS FLOWS BY TYPE OF INSTITUTION
First Quarter, 1962-66
(Millions of dollars)

	Total	Savings and loan assocs.	Mutual savings banks	Commercial banks: All time and savings	Commercial banks: Less negotiable CD's*
1962	$7,465	$2,000	$ 754	$4,711	n.a.
1963	8,486	3,016	910	4,560	n.a.
1964	6,813	2,318	1,101	3,394	$2,255
1965	9,345	1,887	1,082	6,376	4,997
1966	6,701	1,344p/	786	4,571	3,475

p/ Preliminary
* CD's at weekly reporting banks only.

A drop in the total volume of net funds flowing to depositary-type institutions is not unusual in periods of economic boom and accompanying monetary restraint. In 1955-56 and again in 1959-60, net flows to such institutions were similarly restricted as yields on marketable securities rose relative to rates on time and share accounts. In those earlier periods, however, the bulk of the adjustment in flows occurred at commercial banks, which were constrained by the Regulation Q ceiling and hence could make less effort than the S & L's and mutual savings banks to match the adjustment in market rates.

In the current expansion, with greater flexibility available under Regulation Q ceilings, commercial banks have been able to shift more of this adjustment on to nonbank institutions. And the recent increase in rates paid on time deposits at commercial banks has exerted further pressure on such institutions. Complete information is not yet available for April, but estimates based on results for the first 20 days suggest that savings and loan associations experienced a net loss of funds for the month as a whole which may total at least

$500 million, $400 million more than in April a year ago and by far the largest April outflow on record. Similarly, for the first 15 days of April, New York City's 15 largest mutual savings banks experienced net withdrawals amounting to $160 million, more than four times the outflow for the comparable weeks of 1965.

Thus, the acceleration of time and savings deposit inflows at commercial banks since late March appears to be in large part at the expense of other financial intermediaries. It is also likely that reserve city banks may have captured some funds from country banks. Finally, all depositary institutions are gaining funds more slowly as a result of the attractive yields available to investors in the open market. Such movements of funds serve to extend the pressure of monetary policy throughout the financial system.

Mortgage markets. The shrinkage of first quarter savings inflows at depositary-type institutions did not lead to as sharp a contraction in their mortgage lending as some had expected. Preliminary data suggest that commercial banks took advantage of their improved relative position in the market for savings to maintain their first quarter participation in mortgage loans at about the same level as in the first quarters of the three preceding years. Savings and loan associations were forced to cut-back their net first quarter acquisitions of mortgages relative to a year ago, but by only $200 million and net acquisitions at mutual savings banks showed a year-to-year decline of only $300 million. Further reductions in S and L acquisitions were forestalled by temporary resort to sources of funds other than new savings. Most important, deposits were drawn down by $175 million more than in the same period a year ago, and seasonal repayment of debt to the Home Loan Banks was about $250 million smaller.

The relatively moderate shrinkage in net mortgage lending at S & L's and mutual savings banks was more than offset by sharply expanded net mortgage purchases of the Federal National Mortgage Association, which ballooned to $800 million during the quarter. Consequently, with funds supplied by life insurance companies, individuals, and others showing little change on balance from a year ago, total mortgage debt outstanding grew by $6.4 billion, a new first quarter record, $300 million larger than in the first quarter of each of the two preceding years.

MORTGAGE DEBT OUTSTANDING 1/
(In billions of dollars)

	Amount End of March 1966	Increase in First Quarter 1966	1965	1964	1963
All holders	349	6.4	6.1	6.1	5.5
Financial institutions	269	4.4	4.8	4.9	4.7
Commercial Banks	50	.8	.8	.8	.8
Mutual Savings Banks	46	.7	1.0	.9	1.0
Savings & Loan Assoc.'s	112	1.6	1.8	2.2	2.3
Life Insurance Cos.	61	1.3	1.1	.9	.6
Federal Agencies	13	1.0	.1	.1	-.3
FNMA	6	.8	-.1	-.1	-.4
Individuals and Others	67	1.0	1.2	1.2	1.1

1/ As estimated by staff of the Federal Reserve.

During the current quarter the rate of growth in mortgage debt seems likely to slacken--particularly if FNMA purchases fall off as expected. While outstanding commitments for future mortgage lending are still at or near record highs, the weight of these commitments is a factor tending to force greater selectivity on the part of lenders in accepting new loan applications. In addition, the prospect of further contraction in savings flows for savings banks and savings and loan associations is reportedly causing these institutions to moderate their lending policies further. At the S and L's this change is being reinforced by efforts of the Home Loan Bank Board to restrict the volume of advances being used for expansion purposes, as well as by further increases in Home Loan Bank rates on advances.

In the first half of April, FNMA mortgage purchases under its secondary market operations did drop sharply, reflecting further reductionsduring prior weeks in its price and tightening in other purchasing requirements. Even at this reduced level of activity, however, the remaining purchasing authority of the FNMA could be exhausted before the end of summer in the absence of a change in legal authorization or a further tightening in purchasing policy.

Given these continuing tendencies toward greater restraint in mortgage markets, it is hardly surprising that yields on new home mortgages rose further in March to the highest levels in over five years. Even so, the rise in yields was less than that on new corporate bonds, so the yield spread favoring home loans was narrowed again to an unusually small margin.

On conventional mortgages, contract rates for new-home loans averaged 6.15 per cent in March and those on existing-home loans 6.20 per cent, in both cases 35 basis points above the levels which had prevailed between early 1963 and late 1965. On certain 5-1/2 per cent FHA-insured 30-year mortgages traded in the secondary market, yields reached 6.0 per cent, reflecting a "discount" of more than 4 points. In an effort to reduce the size of the discount--which must be paid largely by sellers of homes--ceilings on FHA and VA contract rates were raised again in April by 1/4 per cent, to 5-3/4 per cent.

As in 1959, rates on home mortgages have now reached levels where usury ceilings in some state laws are likely to become more of a restraining factor. Eleven eastern states, for example, have a

6 per cent limit on permissible contract rates or yields on mortgages made to individuals and partnerships and (in some cases) to corporations. One of these states (Kentucky) has recently authorized an increase to 7 per cent, effective several months hence.

U.S. Government securities market. Since early April, yields have risen in all maturity sectors of the U.S. Government securities market. In the bond sector, the recent advance has served to erase 1/3 to 1/2 of the March decline, while Treasury bills in the 3-month area are currently trading at a level just under their previous highs.

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

Date (Closing bids)	3-month bill	6-month bill	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
1966						
Highs	4.70	4.90	5.07	5.03	5.02	4.81
Lows	4.46	4.65	4.78	4.76	4.56	4.49
1965-1966						
Dec. 3	4.12	4.26	4.54	4.52	4.52	4.44
Feb. 28	4.64	4.84	5.06	5.03	5.02	4.81
Apr. 4	4.48	4.66	4.86	4.81	4.69	4.60
Apr. 12	4.66	4.79	4.84	4.83	4.73	4.63
May 3	4.68	4.80	4.98	4.90	4.81	4.72

The recent increase in Treasury bond yields has reflected growing conviction among market participants that a tax increase is not likely to be recommended by the Administration and that monetary policy might tighten further after the Treasury completes its May refunding. Market activity has tapered off in recent weeks and has been largely dominated by dealer trading. Dealers have reduced their net holdings of bonds due in more than 5-years from around $115 million in early April to $30 million in early May; concurrently, their holdings of shorter-term coupon issues have increased, reflecting in part acquisitions of maturing rights in the May refunding.

The terms of the Treasury's May refunding, announced April 27, were in line with market expectations and resulted in very little price adjustments on outstanding issues. However, the new issue failed to generate any market enthusiasm in the early stages of the refunding. The Treasury offered a new 18-month 4-7/8 per cent note, priced to yield 4.98 per cent, in exchange for $9.3 billion of maturing securities, including a relatively small $2.5 billion held by the public. The refunding will clear the Treasury financing calendar through direct debt until July, but sizable offerings to raise new money are expected in the Federal Agency market over the balance of the current fiscal year.

Treasury bill rates have risen from their recent lows established in early April, with the increase most pronounced in the shortest maturities. Contributing to this rise has been the tight atmosphere in the money market which has produced higher financing costs for dealers. Investment demand for bills remained sizable through mid-April but has diminished most recently.

In April yields on short-term debt instruments other than bills remained at their highs established after the prime loan rate increase, or moved up slightly further, as is shown in the table.

SELECTED SHORT-TERM INTEREST RATES 1/
1965-66

	Dec. 3	Apr. 1	May 1
Commercial paper 4-6 months	4.375	5.375	5.375
Finance company paper 30-89 days	4.375	5.25	5.375
Bankers' Acceptances 1-90 days	4.25	5.00	5.125
Certificates of deposit (prime NYC)			
Most often quoted new issues:			
3-months	4.50	5.25	5.125
6-months	4.50	5.25	5.25
Secondary market:			
3-months	4.49	5.25	5.30
6-months	4.57	5.40	5.40
Federal Agencies			
3-month	4.34	4.99	4.98
6-month	4.49	5.09	5.12
Prime Municipals 1-year	2.65	3.15	3.25

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

Corporate and municipal bond markets. Yields on municipal and new corporate bonds have also advanced over the past three weeks, and now stand approximately midway between the highs registered early in March and the lows reached in early April. As in the Government securities market, the yield upturn has been due partly to changed expectations regarding the relative possibilities of a tax increase and more restrictive monetary policy. In the face of this changed psychology, marketing of the sizable April volume of new corporate and municipal bond offerings has exerted further upward pressures on yields.

BOND YIELDS

(Per cent per annum)

	Corporate Aaa		State and local government	
	New 1/	Seasoned	Moody's Aaa	Bond Buyer (mixed qualt's)
Previous Postwar High	5.13(9/18/59)	4.61(1/29/60)	3.65(9/24/59)	3.81(9/17/59)
1965 Low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(2/11)
Weeks ending:				
Dec. 3	4.79	4.60	3.37	3.50
Mar. 4 (High)	5.38	4.85	3.63	3.83
Apr. 8 (Low)	4.90	4.98	3.44	3.55
Apr. 15	5.06	4.95	3.42	3.53
Apr. 22	5.22	4.95	3.47	3.54
Apr. 29	5.12*	4.95	3.50	3.62

1/ Adjustment for call protection has not been incorporated in this series.

*--Not representative.

With the upturn of bond yields after early April, investors in the corporate bond market again adopted a waiting game, playing for a break in new issue syndicates and a subsequent advance in secondary market yields. In this tactic they were successful, for over the past three weeks underwriters have been forced to terminate nearly three-fourths of the syndicates on major new corporate issues--in some cases with sizable balances still unsold. As a result, yields on these issues were adjusted from 8 to 18 basis points higher in secondary market trading. Likewise, in the market for State and local government securities, dealers have recently had to raise yields on older issues in order to attract continued investor demand. Even so, dealers advertised inventories grew from a low level of about $360 million in the third week of March to around $570 million at the end of April.

BOND OFFERINGS 1/

(In millions of dollars)

	Corporate				State and local government	
	Public offerings		Private placements			
	1966	1965	1966	1965	1966	1965
January	480	161	740	565	1,183	849
February	560	187	800	450	816	966
March	785e/	557	925e/	658	845e/	1,036
April	650e/	422	700e/	648	1,150e/	994
May	575e/	694	700e/	630	900e/	987

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

In April the volume of new municipal issues was swollen to nearly $1.2 billion by the last minute addition of a $240 million New York City issue and, to a more limited extent, by the reappearance of a number of the smaller issues that were postponed in March. Similarly, April volume in the corporate market, although less than in March still substantially exceeded the previous year. Looking ahead to May, however, preliminary estimates show a smaller volume of new corporate offerings -- less than in April and also less than in May a year ago. Offerings of municipal issues are likewise estimated at a somewhat lower level not very different from a year ago. It should be remembered, however, that bond offerings of all corporations -- financial as well as nonfinancial -- were very much larger in the second than in the first quarter last year and exerted significant upward pressure on bond yields even though funds available from institutional lenders were substantially less committed than they are now.

Stock market. During the first few weeks of April, speculation in stocks--on the major exchanges and over the counter--increased further and became generally recognized as a problem not only by those within the industry but by outside observers as well. In an attempt to curb this outburst--especially the participation of small and uninformed investors seeking quick gains in the low-priced and low-quality stocks--both the New York American Stock Exchanges imposed new rules effective April 25. In general, these actions required additional equity to open a new margin account with a broker and increased the amount of margin required for day trades. Since the announcement of these restrictions, the popular price averages have declined and trading activity has slackened significantly. Much of the contraction, however, has occurred in stocks which have not shared particularly in the recent speculative play and thus reflects other factors than the recent rule changes.

Since April 21, common stock prices--as measured by the Standard and Poor's composite--have edged downward about 1.7 per cent. At this recent level, they are still more than 4 per cent above the mid-March low and have retraced somewhat more than half of their February-March decline. The ratio of these lower prices to fourth quarter earnings is a moderate 17.4, down from 17.9 associated with the February 9 peak in the price index.

The record volume of trading activity and its concentration in speculative and glamour stocks--often low priced--was the major evidence of spreading speculative psychology. During the first three weeks in April, trading on the N.Y. Stock Exchange averaged almost

10 million shares daily, and the American Exchange reported an even faster acceleration in activity with a new record of 6 million shares per day established in the week ending April 15. Moreover, brokers reported a substantial pick-up in activity in stocks traded over the counter, with investor interest in new issues contributing to significant price advances. By the last week in April, however, the daily average volume of trading had been reduced on both the Big Board and Amex to 7.7 million and 4.0 million shares respectively.

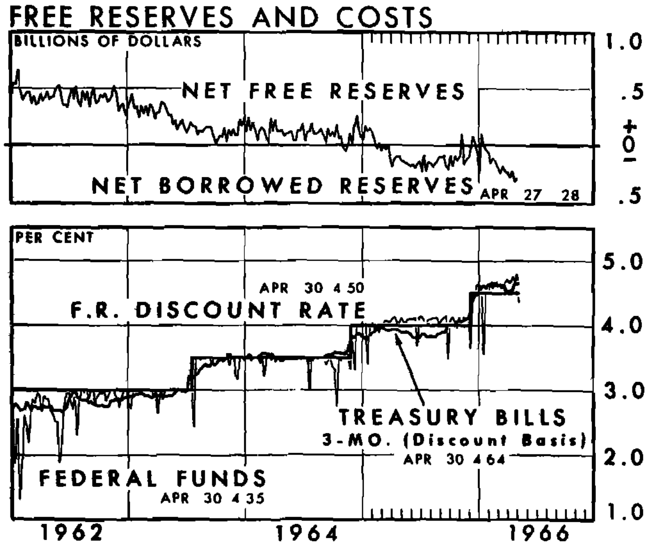
Total stock market credit declined $125 million in March with $100 million attributable to shrinkage in customers' net debit balances. Taking a somewhat longer view, the volume of total credit in use in the stock market has risen nearly $1 billion, or about 20 per cent, during the period of rising trading activity since last summer. Most of the expansion, however, occurred in the last 5 months of 1965; in fact, margin credit shown in the New York Stock Exchange margin panel showed virtually no net change during the first quarter of 1966.

Corporate profits. Corporate profits appear to have shown another strong rise in the first quarter. Profits of manufacturing companies, according to data now available for about 600 large firms that account for three-fifths of the profits of all manufacturing corporations, were 12 per cent larger than in the first quarter of last year. For manufacturing industries other than motor vehicles and iron and steel, the year-to-year increase was 17 per cent, the same as for 1965 as a whole. In the motor vehicle group, profits were little changed from a year ago and in the iron and steel group they were one-fifth below last year's unusual first quarter.

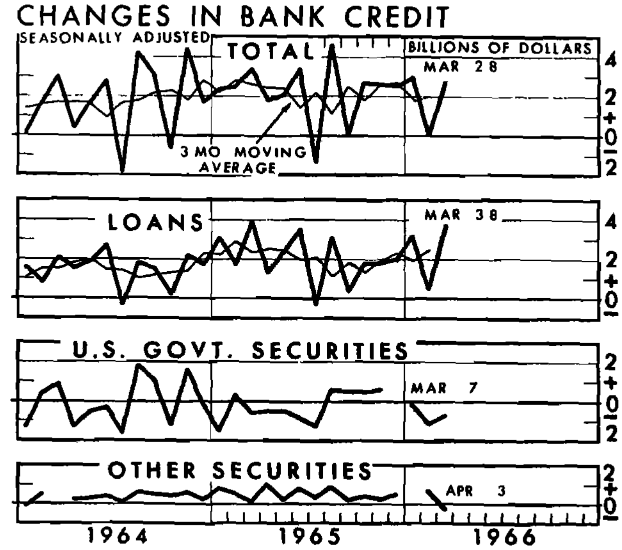
A year-to-year increase of 12 per cent in manufacturing profits implies a seasonally adjusted rise of about 7 per cent from the fourth quarter of 1965. While little information is available for nonmanufacturing industries, it seems likely that profits continued to increase here also, though more slowly than in manufacturing. Thus, it appears that current staff estimates of total corporate profits in the first quarter, derived from the latest GNP figures, are reasonable: i.e., a little over $81 billion (seasonally adjusted annual rate) for profits before taxes and $78.5 billion for profits and inventory valuation adjustment. These compare with fourth quarter 1965 rates of $77.0 billion and $75.2 billion respectively.

FINANCIAL DEVELOPMENTS - UNITED STATES

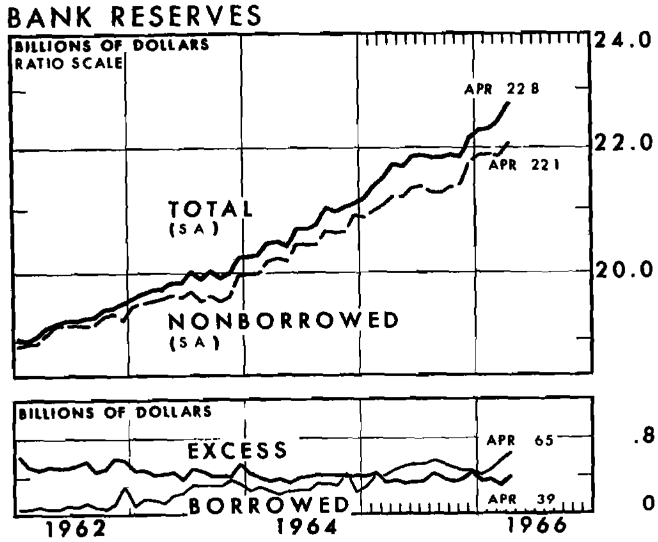
FREE RESERVES AND COSTS



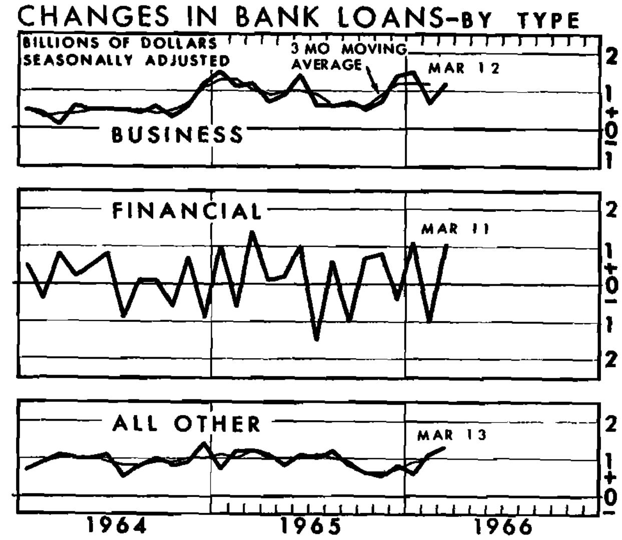
CHANGES IN BANK CREDIT



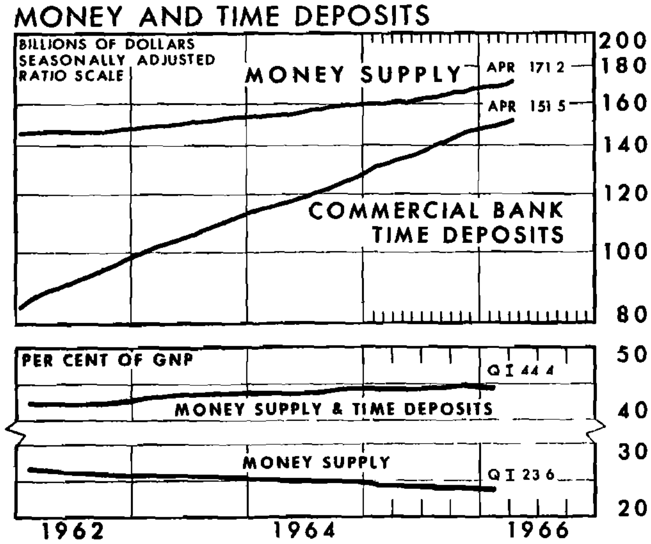
BANK RESERVES



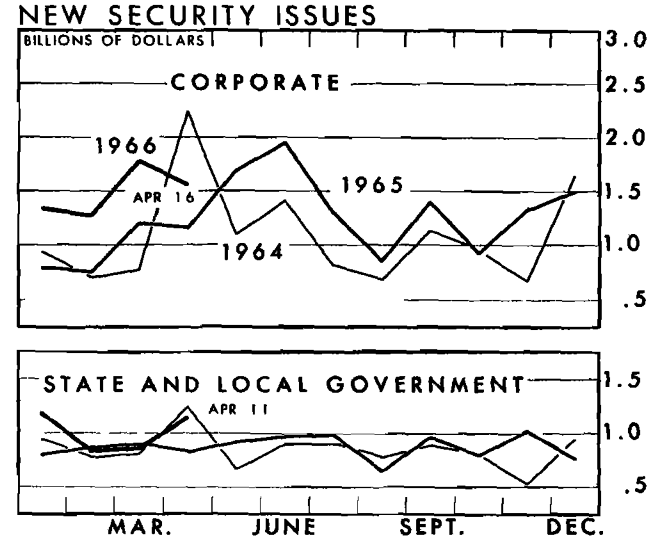
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

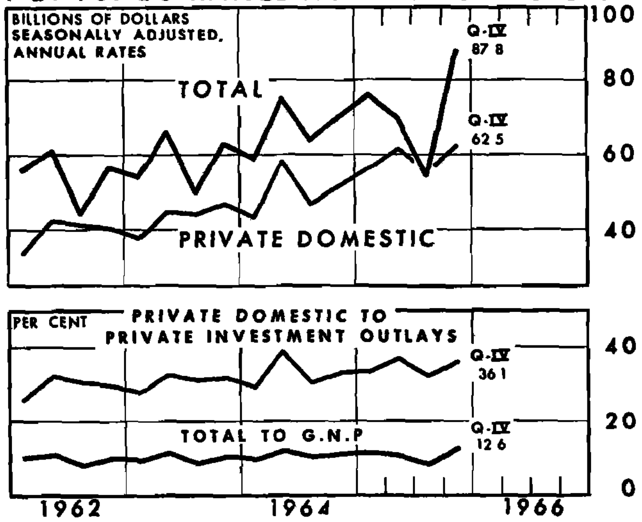


NEW SECURITY ISSUES

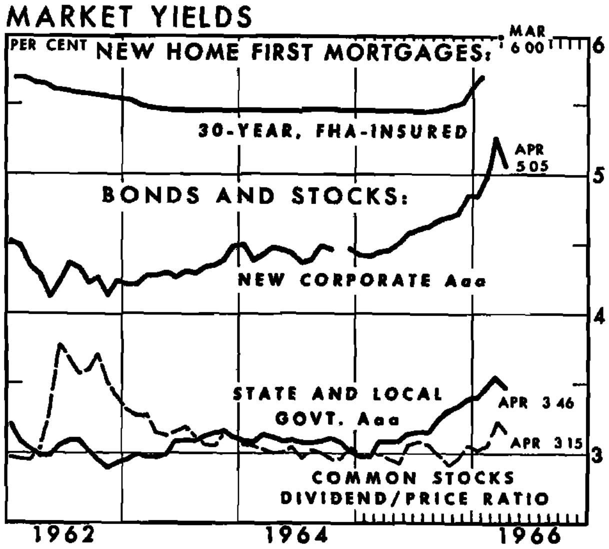


FINANCIAL DEVELOPMENTS - UNITED STATES

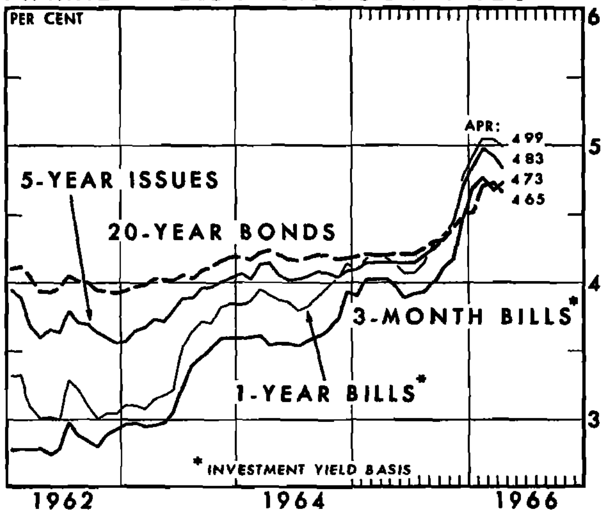
NET FUNDS RAISED-NONFINANCIAL SECTORS



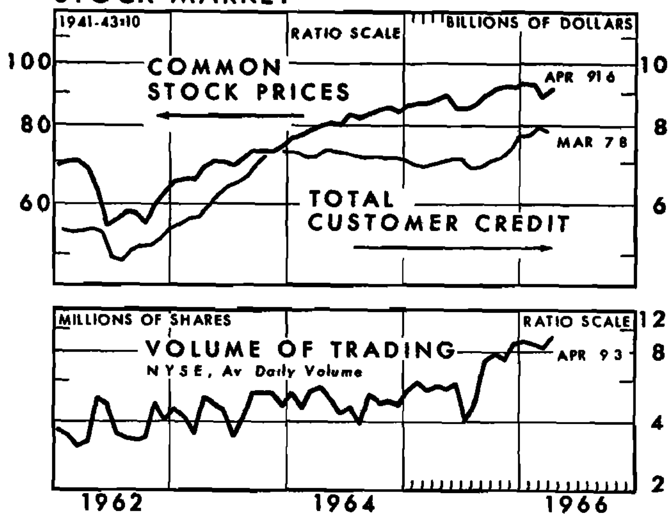
MARKET YIELDS



MARKET YIELDS—U.S. GOVT. SEC.



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Complete figures for March reveal a deficit on the liquidity basis of $40 million before seasonal adjustment, a less favorable result than was suggested by the weekly indicators. Weekly figures for most of April point to the likelihood of a relatively sizeable deficit in that month.

The deficit for the first quarter, after seasonal adjustment, was about $500 million. This figure was swollen by issues of Canadian bonds in New York postponed from the fourth quarter. Without this temporary bulge, net of partially offsetting Canadian official transactions, the first quarter figure would have been about $100 million lower, at an annual rate of roughly $1-1/2 billion.

The total of new foreign security issues in the first quarter was about $520 million, almost 90 per cent of which was for Canadian account. Apart from issues postponed into the first quarter, the adjusted total of about $370 million was about one-fourth greater than the quarterly average in 1965. New issues were large again in April.

U.S. foreign trade returns for March were favorable: exports rose by 12 per cent from the depressed January-February level. However, this spurt included exceptional elements, notably a sharp expansion of shipments to India following a temporary slow-down in aid shipments. Both on this account and because of normal irregularities in this statistical series, it would be premature to regard the March results as marking a new trend in exports. For the first quarter as a whole merchandise exports were only one per cent above the fourth quarter 1965 level.

Merchandise imports in March were also up strongly -- about 6 per cent from February -- and in the first quarter were 4 per cent above the fourth quarter. The first-quarter trade surplus was thus only $4.6 billion as compared with $5.1 billion in the fourth quarter 1965 and $4.8 billion for the full year 1965 (balance-of-payments basis, seasonally adjusted annual rates).

Exports to the United Kingdom rose sharply in the first quarter over the fourth quarter level, and exports to Continental Western Europe, Latin America and the primary producing countries were up by about 4 per cent. This growth was partly offset by the levelling off of shipments to Canada and a decline in exports to Japan.

The rise in imports in the first quarter occurred despite a decline in industrial materials imports. Imports of aircraft, other capital equipment, and motor vehicles and parts were up sharply, and there was also an increase in imports of consumer goods other than autos. Increased deliveries of aircraft accounted for one-third of the rise in first quarter imports. Reduced imports of steel accounted for nearly half the decline of industrial materials imports. Steel imports had advanced sharply in 1965 through the third quarter in anticipation of a possible steel strike. In the first quarter, they were down roughly to the fourth quarter 1964 level.

For the first quarter as a whole, the reflow of bank-reported capital, both long and short-term, came to $260 million (seasonally adjusted), as a net outflow in March of $120 million (not seasonally adjusted) offset part of the very heavy reflows earlier in the year.

Banks covered by the VFCR reported an outflow of $90 million in March after experiencing reflows of $380 million in January-February (not seasonally adjusted). At the end of March, bank claims on foreigners covered by the VFCR were about $800 million below the target ceiling applicable to the second quarter.

Recent data show long-term loan commitments to foreigners in the first quarter have averaged about $60 million a month -- a slightly higher rate than had been indicated by earlier data, but still well below the $100 million per month average of the second half of 1965. Term loan commitments were very low in February, but they have picked up significantly since then; data for March and preliminary returns for April indicate that commitments were running above the first quarter average. However, commitments to finance U.S. exports declined in March-April, rather than rising with the increase in the total, and in these two months accounted for less than 10 per cent of total commitments, compared to about half of the total for January-February.

Payments balances of other countries. Many shifts in international payments positions have occurred over the past year. In Britain heavy drains were being experienced around the end of 1964, and again in the third quarter of 1965. In the six months from Septermber 30, 1965 to March 31, 1966, however, the United Kingdom had a small surplus as measured by changes in reserves (excluding the proceeds of U.S. securities liquidated, added to reserves in February), in official liabilities, and in the net foreign position of commercial banks. Shifts in the opposite direction occurred in the balances of payments of many countries: typically, surpluses became smaller or deficits larger. But in some important cases the shifts were not great.

The Common Market countries had a combined net surplus averaging over $2 billion a year in 1964 and 1965, as measured by changes in net official reserves (including IMF position and bilateral assistance given) plus net foreign assets of their commercial banks. In the final quarter of 1964 and first quarter of 1965, they attained an annual rate of surplus of over $3 billion (roughly adjusted for seasonality). In the latest two-quarter period (ending March 1966) the rate was a little under $2 billion. Unadjusted, the combined half-year surplus was about $700 million, as shown in the table; to this should be added about $200 million as a rough seasonal adjustment for the Italian balance of payments.

Almost all of the EEC surplus in this recent period accrued to France and Italy. Since the middle of 1965 imports have been rising more rapidly than exports in these two countries, and the change in their trade balances since then has been contributing to gradual shrinkage of their over-all payments surpluses. In comparison with the year-earlier period (ending March 1965) changes in long-term capital flows have been important. The inflow to France has diminished and the inflow to Italy, which was unusually large around the end of 1964, has changed to a moderate outflow.

Germany and the Netherlands have had over-all deficits in the recent period. For Germany, the deficit has been relatively small and

PAYMENTS BALANCES MEASURED BY CHANGES IN
NET OFFICIAL RESERVES AND COMMERCIAL BANKS POSITIONS1/
(Millions of dollars)

	6 months October-March			Year		
	1965 -66	1964 -65	1963 -64	1965	1964	1963
United Kingdom	182a/	-991	-627	-421	-1,887	-538
Germany	- 83	43	291	-281	95	512
France	463b/	543	221	961	796	654
Italy	314	533	-884	1,577	800	-1,259
Netherlands	- 90b/	254	- 74	- 24	67	181
Belgium	86b/	120	- 54	134	176	18
Total EEC	690	1,493	-500	2,367	1,934	106
Sweden	1	63	54	25	188	- 21
Switzerland2/	- 128	109	66	61	148	149
Japan	137b/	209	-235	410	-110	- 64
Canada	40b/	31	-276	-261	586	128c/
Total Group of Ten ex. U.S.	922	914	-1,518	2,181	859	-240
Austria	- 89	- 4	----	- 6	88	148
Spain	-258	48	90	-104	366	97
Other Europe	230p/	95	191	- 70	391	385
Australia3/	64	-195	347	-372	67	493
South Africa	190	- 91	- 21	-124	- 62	118
New Zealand	- 91	- 32	- 31	-100	23	- 28
LDC's	745e/	623	674	1,070p/	277	878
Total other than Group of Ten	791	444	1,250	294	1,150	2,091

1/ Data for Group of Ten countries are balances measured by net official reserves and banks' positions; from confidential B.I.S. compilations; net reserves include IMF positions. Data for other countries from IMF; gross official reserves and net IMF positions only.

2/ Balances measured by changes in net official reserves only.

3/ Banks' foreign assets are included with reserves.

a/ Omits March change in official liabilities and in banks' position. Excludes $885 million proceeds of securities liquidated, added to reserves in February.

b/ Omits March change in banks' position. For Canada, incomplete also for January and February.

c/ Omits 1963 change in banks' position.

p/ Preliminary.

e/ Estimated.

has shown no clear trend. After reaching its maximum for any six-month period in recent years during the second and third quarters of 1965, the German deficit (unadjusted) diminished in the fourth quarter, counter to its usual seasonal tendency of worsening at that time of year. But early this year, when ordinarily a sizable surplus would appear, the German surplus was very small. The Netherlands deficit, unlike the German, has clearly been growing. Effective May 2, the Netherlands Bank raised its discount rate from 4-1/2 per cent to 5 per cent, signaling official intentions of acting more vigorously to damp the domestic inflationary pressures that have caused worsening of the external balance on goods and services.

In a number of other European countries, including Spain, Switzerland, Austria, and Sweden, balance-of-payments surpluses that characterized the year 1964 have since been shrinking and, in several cases, turning to deficits. In Switzerland, shifts in capital movements appear to explain this trend, but in other cases more rapid increases in imports than in exports have been the primary factor. The Spanish and Austrian deficits were continuing to grow early this year. In Sweden, on the contrary, imports reached a peak at mid-1965; with industrial production level or falling in recent months and unemployment rising, the balance of payments took a turn for the better early this year.

Outside Europe, the pattern of a shift from payments surplus to deficit was exemplified from mid-1964 to mid-1965 in Canada, and here again the largest factor in the shift was the more rapid rise in imports (in Canada's case especially from the United States) than in exports.

However, incomplete data (including commercial bank positions along with official reserves) indicate that in January and February, 1966, the balance of payments was again in surplus.

Japan's pause in economic expansion brought a shift in the other direction, from payments deficit in 1964 to surplus in 1965. In the latest two-quarter period the surplus (measured, as for other Group-of-Ten countries in the table, by the official reserves and commercial bank position combined) was about $140 million, approximately the amount of the gain in official reserves. Japanese banks reduced their foreign indebtedness further in this period, but drew down their foreign assets to do so. The trade balance has remained in surplus, with both imports and exports rising in recent months. Net long-term capital outflows -- a new development in the Japanese balance of payments last year -- have tended to increase.

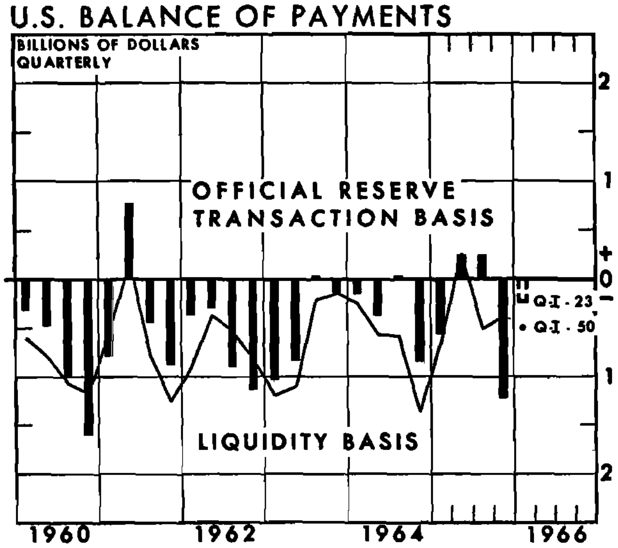
Other important cases of recent shifts from deficit to surplus have been those of South Africa and Australia. South African imports reached a peak about mid-1965, and their subsequent decline brought a rise in the country's reserves after September. In Australia the turn has been even more recent; there the import peak was reached in September.

Incomplete data for less developed countries indicate substantial reserve gains for some in 1965. Reserve increases of Middle East petroleum producers were concentrated in the first half of last year, when renegotiated contracts gave some of them abnormal extra receipts. In late 1965 and early 1966, reserve gains for other primary producers reflected, among other factors, strengthening of their export markets and actions taken earlier to limit import growth. Throughout 1965, Brazil was a relatively large gainer of reserves, as the exchange rate adjustments begun in 1964 and carried further last year bore fruit in export expansion and import curtailment; increased injections of foreign assistance were also a factor.

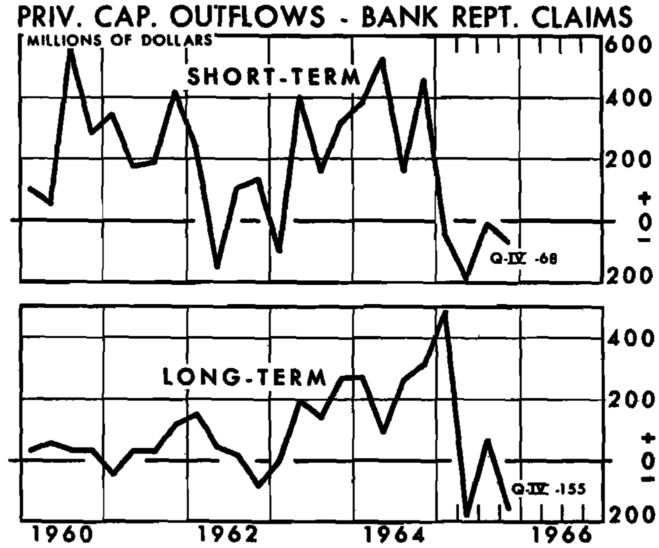
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

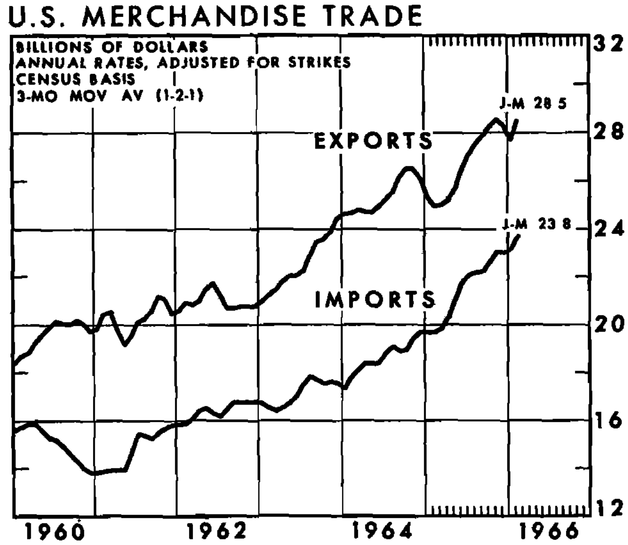
U.S. BALANCE OF PAYMENTS



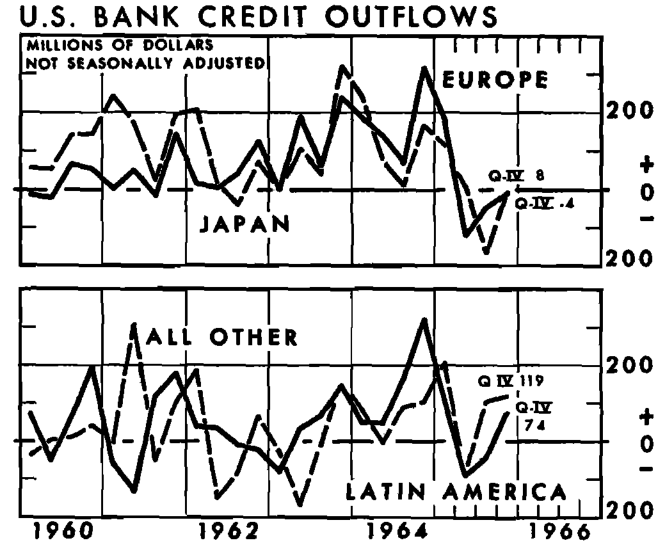
PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



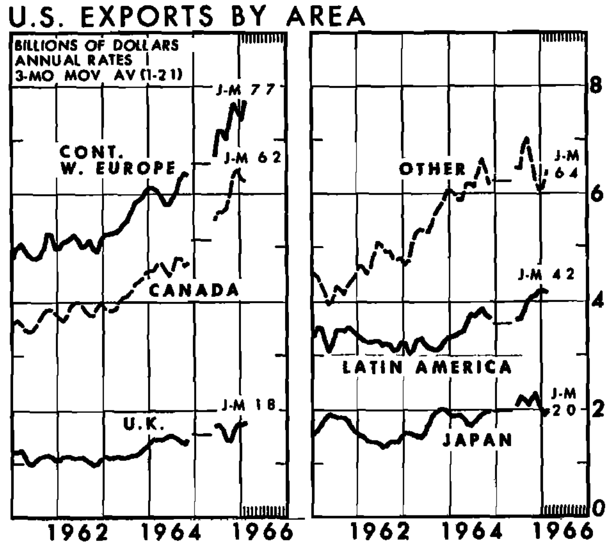
U.S. MERCHANDISE TRADE



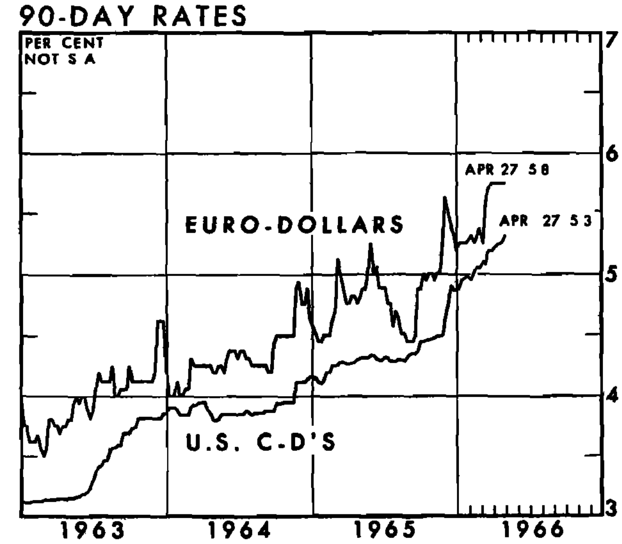
U.S. BANK CREDIT OUTFLOWS



U.S. EXPORTS BY AREA



90-DAY RATES



APPENDIX A: THIRD ANNUAL CONFERENCE OF GOVERNORS OF CENTRAL BANKS OF THE AMERICAN CONTINENT*

This year's conference, held at Montego Bay, Jamaica, followed the informal pattern set at the outset of this series of meetings.1/ Non-Latin participants included the central banks of Canada, British Guiana, Jamaica, and the United States. All of the Latin American countries except Ecuador, Honduras, and Nicaragua were represented.

The fundamental purpose of these gatherings is to provide an informal forum for the exchange of views among the central banks of this hemisphere. The quality of this year's discussions and the breadth of subjects covered offered impressive evidence of the success of these talks.

Latin American Governors' Conference

A conference of Latin American central bank governors -- the second in a series which probably will be held semi-annually -- preceded the hemispheric conference; however, the non-Latins were invited to and did attend as observers. In the two days of discussions at the Latin American meeting, the following major themes were covered:

Clearinghouse and payments systems, primarily for the countries that are members of LAFTA,2/ was the first item on the agenda. The construction of a network of bilateral agreements among LAFTA central banks is continuing. These agreements provide for inter-central bank credits up to the value of 1/4 of the annual trade balance for a period of 60 days. A number of agreements were signed during the Jamaica conference and more signings were planned for the following week in Mexico City. The central bank of Peru, which acts as the settlement agent, hopes to have the system operating fully by midyear. Venezuela, though not a member of LAFTA, signed a similar agreement with Mexico which can provide a precedent for future expansion of the payments system, apart from formal LAFTA membership, if necessary.

The role of Latin America in plans for reforming the international monetary system was discussed in the light of a resolution by the Inter-American Economic and Social Council referring this subject to the central bank Governors to examine and to formulate views on the

1/ Similar conferences were held at Antigua, Guatemala in 1964 and at Punta del Este, Uruguay in 1965.
2/ The Latin American Free Trade Area includes Mexico and most of the important South American countries except Venezuela.

* Prepared by James K. Nettles, Economist, Special Studies and Operations Section, Division of International Finance.

next steps to be taken. Reports submitted by a group of experts to CIAP and by CEMLA to the Governors contained some interesting points, such as the strong Latin American desire to see discussions of this subject shifted to the IMF, and a desire to link the provision of liquid assets to the provision of development aid. A much briefer and more forward-looking document was produced at the conference and signed as the "Declaration of Jamaica". In essence, it reaffirms Latin America's desire to participate in the discussions, calls for greater symmetry between deficit and surplus countries in making balance of payments adjustments, advocates a central role for the IMF in liquidity creation, calls for better international coordination and cooperation, and rejects the idea that the distribution of any newly created liquid asset be restricted to any particular group of countries.

Latin American reserve pool discussions were shifted to a technical committee to be set up by the LAFTA members of the clearing-house. CEMLA's proposal that any new liquidity created and distributed to Latin America be devoted to the establishment of a reserve pool or B.I.S.-type bank received little support.

Increased marketability for IDB bonds held by central banks was the subject of a plan accepted in principle by the Governors. Under this proposal, the central banks would make the recent IDB bond issue placed with Latin American central banks into a more acceptable reserve asset by reciprocally agreeing to buy bonds from another central bank when balance of payments pressures threaten the latter's reserve position. Although it was recognized that this proposal had some attractive political aspects, such as greater use of Latin America's own resources for the development of the area and the impetus the plan give to hopes for greater coordination and cooperation among the Latin American central banks, it was decided to put the proposal on a strict banking basis rather than to depend solely on mutual good-will if accommodation should become necessary. The mechanics of this arrangement will be worked out jointly with the IDB.

Western Hemisphere Conference

Following the conclusion of the Latin American part of the conference, the continental meeting convened. Governor Rasminsky described the progress being made within the Group of Ten on the issue of monetary reform and international liquidity.

Dr. Massad of the Central Bank of Chile followed Governor Rasminsky's report with a summary report on the Latin American view of liquidity and monetary reform. Governor Hall of the Bank of Jamaica expressed the Jamaican interest in monetary reform and support for the position that the obvious choice of origin for such reform is the IMF.

President Hayes commented briefly on the monetary reform and international liquidity issue, and there followed a general discussion of the problems of achieving reform and of how Latin America's views might best be communicated to the Group of Ten.

Chairman Martin reported on the state of the U.S. economy and on present U.S. monetary policy issues and problems.

Governor Mitchell reported on the U.S. balance of payments and on the likely impact of current policy on both the domestic economy and the balance of payments during coming months. In response to questions from some of the Latin American governors, Governor Mitchell also described the linkage studies and his hopes for what might eventually emerge from these studies.

Two reports on the Latin American experience with the tools of monetary policy were presented by Governors Massad (Chile) and Schwalb (Peru). These presentations differed sharply from those of earlier years in that their focus was much more on specific problems, such as the impact of tax date pressures on the money markets, rather than on broader issues of central bank philosophy; the discussions which followed were similarly more in the vein of sharing experiences in the use of various techniques of monetary management in Latin American countries.

As the meetings came to an end, there was strong general recognition that the usefulness of these interchanges had been amply confirmed and that the discussions and contacts have laid the basis for increased cooperation among the central banks of this hemisphere.

APPENDIX B POPULATION DEVELOPMENTS*

Neither the recent marked advance in economic activity nor the large increase in the number of 18-24 year olds in the population has been reflected in any significant change in recent trends in marriage rates. The marriage rate has been rising. But except for a bulge in the third quarter of 1965 when Selective Service changed the draft status of married men without children, increases both last year and so far this year have been moderate. The birth rate has been continuing its downward course. Not only has the downward trend in births which began in 1957 continued, but the decline in 1965 was more pronounced than earlier, with the birth rate declining to levels close to those in the early 1930's. Because of the small increase in births last year, both the net addition to the population and the rate of population increase (1.2 per cent) were the smallest in two decades.

Marriages. Since the very early postwar boom, marriage rates have been trending downward, although they exhibited some short-term sensitivity during periods of cyclical expansion and during the Kroean War. From a peak of 2.3 million in 1946 and a rate of 16.4 per 1,000 population, marriages dropped to a low of 8.4 per 1,000 population in 1958. This was followed by a period of relative stability from 1958-1962, reflecting a less favorable age composition of the population as well as slow economic growth. A moderate uptrend ensued as the expansion progressed and the wartime babies began to reach marriageable age.

Table I

MARRIAGES

	Number (000's)	Rate per 1,000 total population
	Annual average	
1930-34	1,114	8.9
1935-39	1,371	10.7
1940-44	1,619	12.1
1945-49	1,857	13.1
1950-54	1,567	10.1
1955-59	1,516	8.9
	During year	
1960	1,523	8.5
1961	1,548	8.5
1962	1,577	8.5
1963	1,651	8.8
1964	1,720	9.0
1965	1,789	9.2

*Prepared by Jane Moore, Economist, National Income, Labor, and Trade Section, Division of Research and Statistics.

In 1965 marriages increased somewhat to 1.8 million and the rate rose further to 9.2 per 1,000 population. During 1965 the marriage rate fluctuated around that higher rate, as shown by quarterly seasonally adjusted data in Table II. An apparent downtrend in the marriage rate which developed after mid-1964 was halted early in 1965. The third quarter 1965 bulge in the marriage rate undoubtedly reflected the announcement by Selective Serice that men married after August 26 would have the same draft status as single men. In early 1966 an expected increase in the marriage rate as a result of higher draft calls did not materialize; the rate in the first two months of 1966 was about the same as in 1965, suggesting that increased inductions were tending to reduce, instead of increase, the number of marriages.

Table II

MARRIAGES
(Seasonally adjusted)

	Number in 000's annual rates		Rate per 1,000 total population	
	1964	1965	1964	1965
Q 1	1,756	1,748	9.1	9.2
Q 2	1,736	1,708	9.1	8.8
Q 3	1,696	1,880	9.0	9.7
Q 4	1,716	1,840	8.8	9.3
Year	1,720	1,789	9.0	9.2

Because of the unusually sharp rise in the population of young persons in 1965 and the rapid expansion in economic activity, an acceleration in the rate of marriages had been expected by many authorities. Largely in retrospect, a number of possible reasons have been suggested for the lack of faster growth in the marriage rate. First is the sharp increase in the rate of college enrollments last fall indicating a heightened awareness among young persons of the higher educational attainment required for an increasing number of jobs in today's labor market. Second, and associated with increased school enrollments, is the trend away from the postwar pattern of early marriage. The median age of women at first marriage has moved upward and in 1965 was 20.6 years compared with 20.2 years during most of the 50's. A third reason is the concentration of the increase in population in 1965 among those 18 years of age, well below the median age for marriage, especially for men. Finally, an increasing number of unmarried men in their early twenties have entered the armed services.

Births. Births declined by nearly 300,000 in 1965 to 3.8 million, the smallest number since 1950. The drop in the birth rate to 19.6 brought it down to the low level of the depression years 1930-34.

Table III

BIRTHS

	Number (000's)	Rate per 1,000 total population
	Annual average	
1930-34	2,453	19.7
1935-39	2,421	18.8
1940-44	2,872	21.2
1945-49	3,491	24.1
1950-54	3,903	24.8
1955-59	4,259	24.8
	During year	
1960	4,307	23.8
1961	4,317	23.5
1962	4,213	22.6
1963	4,142	21.9
1964	4.070	21.2
1965	3,806	19.6

The birth rate has been declining since 1957, but the number of births continued to total close to 4.3 million until 1962 when the current downtrend began. By the fourth quarter of last year the rate and number of births were more than 8 per cent below the level of a year earlier. In the first two months of 1966, however, the decline slackened. With marriages rising moderately, the reduction in births in 1966 would perhaps be less rapid than the year before.

The decline in birth rates has occurred among women in all child-bearing age groups. In the middle and older age groups a decline was expected from the high rates of the 1950's for two reasons. Many couples who started their families immediately after World War II are now no longer having children. The low average age at marriage in the earlier postwar years resulted in a high proportion of couples completing their families at a relatively young age.

Why birth rates have declined in the younger ages is still uncertain. Part of the explanation seems to be that young couples are starting their families later and spacing their children farther apart than in the 1950's. If this is the explanation, then the current decline in the birth rate may be only temporary. Another possible explanation is that young couples want to have fewer children because, for one thing, they realize that the mounting costs of higher education for a large family will be difficult to meet. For another, it may reflect the wife's ability and desire to spend more of her time working outside the home in order to capitalize on her higher educational attainment, or to achieve the greater prestige and security her addition to family income makes possible. A continuation of the current trend to smaller families would reduce population growth significantly.

Other factors affecting population growth have been fairly stable in recent years. Net civilian immigration averaged 300,000 a year in the 1950's and 370,000 in the 1960's. Deaths per 1,000 total population have also been relatively constant at an average rate of 9.4 per 1,000 population over the past 15 years, after declining from a rate of 10.0 per 1,000 population in the early postwar years.

Table IV

POPULATION CHANGE

	Net increase (including armed forces overseas)	
	Number (000's)	Per cent
	Annual average	
1930-34 1/	835	0.67
1935-39 1/	950	0.73
1940-44	1,543	1.14
1945-49	2,274	1.58
1950-54	2,690	1.72
1955-59	2,960	1.74
	During year	
1960	2,940	1.64
1961	3,007	1.65
1962	2,827	1.53
1963	2,712	1.44
1964	2,612	1.37
1965	2,348	1.21

1/ Population includes armed forces overseas and from 1940 Alaska and Hawaii. Increases are from January 1 for years 1940 to date and July 1 from 1930-39.

Population. With the number of births sharply reduced, the net addition to population of 2.3 million persons in 1965 was the smallest since 1946 and about one-fourth less than in 1956. The rate of increase of 1.2 per cent during the year was also the smallest annual gain since 1945, and well below 1.8 per cent per year in the mid-1950's. There is no way of telling when the rate of decline will level off, since marriage rates have been increasing relatively slowly but even these increases have not been reflected in a rise in the birth rate.

The substantial slowdown in the rate of population growth has received relatively little attention mainly because it has been taking place in a period of sharply expanding economic activity and very large increases in the labor force stemming from the very high birth rates in the very early postwar period. It may be argued that the effect of the slowdown in population growth now is only temporary and the major impact will not come for another 18 years or so when those now being born reach labor force age. However, while the implications are not entirely clear, important changes apparently have been taking place both with respect to age of marriage and expected size of families. Some speed-up in marriages should take place over the next year or two, as an increasing number of youths graduate from schools and reach the marriage age. Nevertheless, experts have less assurance than earlier as to the timing of any reversal in the downward trend in birth rates and the likely level of future births. Continuing reevaluation of population projections will be required. In any event, less emphasis on population growth as a major factor in sustaining economic growth in the next few years would seem to be necessary.