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CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

**Prepared for the
Federal Open Market Committee**

By the Staff

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

July 20, 1966

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SUMMARY AND OUTLOOK

Outlook for GNP, prices and resource use

Developments over the past month have tended to confirm the main outlines of the earlier GNP projection. Expansion is still expected to accelerate in the current quarter; the staff estimate is for a \$14 billion increase, midway between the \$11 billion rise of the second quarter and the \$17 billion rise of the first.

The main reason for this acceleration is the probability that consumer spending--which was on the soft side in the second quarter--will speed up sharply. The softening in consumer buying occurred in April and May. In June, retail sales recovered somewhat as new car sales increased substantially, nonfarm employment stepped up briskly, and personal incomes rose more rapidly.

Personal income is expected to increase substantially in the current quarter because of the Federal pay increases and the large boost in prospect for transfer payments under Medicare and other Federal programs. Moreover, the personal tax take is likely to show only about half as large an increase as in the second quarter when the new withholding rates were first put into effect.

A large rise in business fixed investment is in prospect for the present quarter; such spending is likely to return to earlier targets after a pronounced lag in the second quarter when business construction was curtailed by strikes. In addition, the war in Vietnam continues to

intensify and July-September draft calls suggest further expansion in the size of the armed forces. These developments seem to preclude any slackening of the sharp upward trend in defense spending in the current quarter.

On the other hand, the rate of inventory accumulation should decline from the high second-quarter rate, as the large stock of 1966 autos is run down. Residential construction activity is also expected to weaken further.

The projected expenditure patterns indicate continuance of pressures on resources and the outlook for prices remains much as it was a month ago. The utilization rate for manufacturing has remained between 92 and 93 per cent. Employment increased sharply in June as a record number of teenagers entered the labor force and most found jobs. The over-all unemployment rate held at 4 per cent but within this total there was a marked further decline in long-duration unemployment. Through the summer, production will be affected by an unusually long model changeover in the auto industry, and the unemployment rate by the movement of students into and out of the labor force.

Industrial prices are expected to rise at a 3.0 to 3.5 per cent annual rate. In the months ahead, prices of sensitive materials are not likely to rise as rapidly as they did in the first five months of this year and there is little that suggests an acceleration in the rise in other industrial commodities. Prices of foodstuffs, however, may turn down by the end of the third quarter.

Bank loans and deposits

Bank loan expansion may moderate over the months ahead. In the immediate period ahead, a number of transitory influences will work in this direction. These include ending of the unusually large business loan demand associated with acceleration of payments on corporate income and withheld taxes and also repayments of the recent exceptionally heavy finance company borrowing. Lending to finance companies had been heavy not only because of redemption of open-market paper around tax dates but also because of an expanded over-all need for funds to cover floor-plan financing of the temporarily enlarged dealer inventories of new cars.

Over the longer run, loan growth, at least at city banks, probably will be less rapid than during the first half despite generally strong underlying demands for credit. The recent surge of loan expansion, together with the reduced liquidity of banks and the uncertain outlook regarding the availability of CD funds, is causing many large banks to reappraise their lending capabilities. Increasingly restrictive lending policies are expected to result from these reviews.

Time and savings deposit inflows in the period ahead are expected to recede from the accelerated rate of early July as one-time transfers of funds at the mid-year interest-crediting period are completed, with most of the slowdown anticipated to be at large city banks. The Board's actions in raising reserve requirements and in reducing ceilings on multiple-maturity certificates should have some dampening influence on the attractiveness of time deposits to both banks and their customers.

In addition, the recent rise in yields on market instruments and on savings accounts at nonbank institutions increases the attractiveness to investors of such outlets relative to banks. Finally, negotiable CD maturities remain large in this and the next two months, and banks may encounter difficulties in replacing them--let alone building CD's further--in view of the attractive yields currently available on Treasury bills, agency issues, and finance company paper.

Outlook for capital markets

The tight position of commercial banks is likely to have important implications for capital markets. More customers are likely to be diverted from banks to the open market. Banks themselves may reduce their U.S. Government securities holdings (for example, by not rolling over all maturing issues in the August refunding) and may participate less actively in the municipal and Agency markets.

Diminished bank interest has been a principal factor pushing municipal yields to new highs in recent weeks. At recent yield levels, a few borrowers have postponed scheduled financings. Any further rise in yields might elicit other postponements and help to moderate the pace of the yield advance.

In the corporate market, the relatively light July calendar will be followed by heavy August offerings. The calendar for next month is already in excess of \$600 million--some \$250 million larger than in August a year ago. However, about two-fifths of the calendar is represented by one A.T.&T. issue that was announced some time ago, so that the market may have discounted a good part of the impact of the August offerings.

The Federal Government will also be in the market in the weeks ahead with its mid-August refunding (to be announced July 27). While just a little more than \$3 billion of the maturing issues are in public hands, market attitudes as to future interest rates are sufficiently uncertain so that some upward adjustment in intermediate- and longer-term yields could follow in the wake of the financing. Such an adjustment would depend in large part on the nature of the offering, but even restriction to a single short-term offering might require so attractive a coupon as to occasion some switching out of bonds.

In home mortgage markets, recent pressures on lenders to minimize new loan commitments may moderate somewhat if the net July shrinkage in savings flows to all S&L's and mutual savings banks proves to be no larger, or smaller, than in April. The availability of loan funds at California savings and loan associations and at New York City mutual savings banks has apparently not been as severely restricted by early July net withdrawals as had been feared, presumably largely due to responses to rate increases at those institutions. However, whether the July experience of similar institutions in other parts of the country was also better than expected is not yet known. In any event, mortgage market conditions are likely to remain generally tight.

Balance of payments

The payments deficit for the second quarter is now tentatively estimated at about a \$1 billion annual rate on the liquidity basis, and somewhere between \$1 billion and \$2 billion on the basis of official

reserve transactions. The apparent improvement in the liquidity deficit from its first-quarter rate of \$2-1/4 billion can be fully accounted for by an increased flow of foreign official and international institution funds out of liquid claims on the United States into certain types of claims classed as nonliquid--viz., into time deposits with original maturities more than one year, and agency bonds or notes of over one-year original maturity.

Since the magnitude of further net shifts of these kinds is not readily predictable, the reduction in the liquidity deficit from the first to the second quarter provides no guide to current trends. In fact, apart from these shifts in U.S. liabilities, the other transactions affecting balance of payments statistics would have produced liquidity deficits in both the first and second quarters at an annual rate of about \$3 billion. There is no basis at present for altering estimates made a month ago that the liquidity deficit apart from such shifts might continue at about a \$3 billion rate in the second half of 1966.

Trade data for June are not yet complete. Exports showed considerable improvement from April-May, in line with recent projections. Information on June imports will not be available until next week.

SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest Period	Amount			Per cent change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 years Ago*
Civilian labor force (mil.)	June '66	77.1	76.3	75.7	1.9	3.8
Unemployment (mil.)	"	3.1	3.0	3.6	-13.4	-22.3
Unemployment (per cent)	"	4.0	4.0	4.7	--	--
Nonfarm employment, payroll (mil.)	"	63.4	63.1	60.3	5.1	9.2
Manufacturing	"	19.0	18.9	17.9	6.2	10.6
Other industrial	"	8.1	8.0	7.9	3.0	6.1
Nonindustrial	"	36.2	36.1	34.5	5.1	9.2
Industrial production (57-59=100)	"	155.8	155.0	142.7	9.2	18.0
Final products	"	154.5	153.5	140.7	9.8	17.1
Materials	"	156.8	156.0	144.5	8.5	18.4
Wholesale prices (57-59=100) ^{1/}	"	105.7	105.6	102.8	2.8	5.7
Industrial commodities	"	104.5	104.3	102.1	2.4	3.8
Sensitive materials	"	106.6	106.8	102.5	4.0	7.6
Farm products and foods	"	107.7	107.9	103.5	4.1	10.9
Consumer prices (57-59=100) ^{1/}	May '66	112.6	112.5	109.6	2.7	4.5
Commodities except food	"	106.3	106.0	105.2	1.0	1.9
Food	"	113.5	114.0	107.9	5.2	7.6
Services	"	121.5	121.1	117.5	3.4	5.7
Hourly earnings, mfg. (\$)	June '66	2.70	2.69	2.61	3.4	6.7
Weekly earnings, mfg. (\$)	"	111.16	111.60	106.93	4.0	8.1
Personal income (\$ bil.) ^{2/}	"	576.4	573.0	532.2	8.3	16.7
Corporate Profit before tax (\$ bil.) ^{2/}	QI '66	82.7	78.7	74.5	11.0	25.7
Retail sales, total (\$ bil.)	June '66	24.8	24.6	23.3	6.5	14.0
Autos (million units) ^{2/}	"	8.3	7.3	8.9	-7.0	10.7
GAF (\$ bil.)	"	5.9	5.8	5.3	12.5	17.0
Selected leading indicators:						
Housing starts, pvt. (thous.) ^{2/}	"	1,288	1,295	1,566	-17.8	-20.5
Factory workweek (hours)	"	41.2	41.4	41.0	.5	1.2
New orders, dur. goods (\$ bil.)	"	24.1	24.2	21.3	13.1	20.4
New orders, nonel. mach. (\$ bil.)	"	3.5	3.5	3.2	9.0	14.7
Common stock prices (1941-43=10)	"	86.06	86.78	85.04	1.2	7.3
Inventories, book val. (\$ bil.)	May '66	125.5	124.1	114.5	9.6	17.2
Manufacturers	"	71.0	70.3	64.3	10.5	17.4
Gross national product (\$ bil.) ^{2/}	QII '66	732.0	721.2	672.9	8.8	16.6
Real GNP (\$ bil., 1958 prices) ^{2/}	"	644.2	640.5	607.8	6.0	11.4

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended	Four-Week	Last six months	
	July 15	Average	High	Low
<u>Money Market</u> <u>1/</u> (N.S.A.)				
Federal funds rate (per cent)	5.33	5.33	5.50	1.50
U.S. Treas. bills, 3- mo., yield (per cent)	4.85	4.60	4.70	4.33
Net free reserves <u>2/</u> (mil. \$)	- 155	- 366	- 10	- 457
Member bank borrowings <u>2/</u> (mil. \$)	819	777	827	218
<u>Security Markets</u> (N.S.A.)				
Market yields <u>1/</u> (per cent)				
5-year U.S. Treas. bonds	5.19	5.05	5.09	4.76
20-year U.S. Treas. bonds	4.89	4.80	4.82	4.49
Corporate new bond issues, Aaa	5.61	5.52	5.64	4.84
Corporate seasoned bonds, Aaa	5.14	5.11	5.16	4.73
Municipal seasoned bonds, Aaa	3.77	3.69	3.77	3.39
FHA home mortgages, 30-year <u>3/</u>	6.45	6.45	6.45	5.51
Common stocks S&P composite index <u>4/</u>				
Prices, closing (1941-43=10)	86.91	86.47	94.06	84.41
Dividend yield (per cent)	3.34	3.34	3.40	3.01
	Change in June	Average change last 3mos.	Annual rate of change (%) 3 mos. 1 year	
<u>Banking</u> (S.A., mil. \$)				
Total <u>6/</u>	- 9	84	4.5	3.9
Bank loans and investments:				
Total <u>5/</u> <u>6/</u>	2,200	2,100	8.3	8.8
Business loans	2,000	1,300	21.0	17.2
Other loans <u>5/</u> <u>6/</u>	900	800	7.9	10.6
U.S. Government securities <u>5/</u>	- 500	- 500	-10.7	- 6.4
Other securities <u>5/</u>	- 100	500	12.3	11.9
Money and liquid assets:				
Demand dep. & currency	1,600	600	4.5	5.7
Time and savings dep. <u>6/</u>	1,200	1,500	12.0	13.4
Nonbank liquid assets	- 400	300	1.2	5.5

N.S.A.--not seasonally adjusted. S.A. Seasonally adjusted.

1/ Average of daily figures. 2/ Averages for statement week ending July 13.

3/ Latest figure indicated is for month of June. 4/ Data are for weekly closing prices. 5/ Based on revised seasonally adjusted series described in appendix.

6/ In comparisons involving June 1966 allowance has been made for the \$1.1 billion of balances accumulated for the payment of personal loans which were excluded from time deposits and from loans on June 9.

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

	1 9 6 6				1 9 6 5			1965
	Jun.	May	Apr.	QI	QIV	QIII	QII	Year
	(billions)							
	Seasonally adjusted							
Current account balance				1,269	1,290	1,527	1,761	6.0
Trade balance <u>1/</u>		260	200	1,118	1,271	1,231	1,317	4.8
Exports <u>1/</u>	2,450	2,330	2,300	7,121	7,027	6,826	6,798	26.3
Imports <u>1/ 2/</u>		-2,070	-2,100	-6,003	-5,756	-5,595	-5,481	-21.5
Services, etc., net				151	19	296	444	1.2
Capital account balance				-1,604	-1,560	-1,821	-1,426	-6.9
Govt. grants & capital <u>3/</u>				-955	-881	-743	-949	-3.4
U.S. private direct investment				-630	-731	-569	-859	-3.4
U.S. priv. long-term portfolio				-244	-154	-363	101	-1.1
U.S. priv. short-term				-14	-27	105	412	0.8
Foreign nonliquid				239	233	-251	-131	0.2
Errors and omissions				-228	-80	-240	-109	-0.4
	Balances, with and without seasonal adjustment (- = deficit)							
Liquidity bal., S.A.				-563	-350	-534	226	-1.4
Seasonal component				485	-3	-472	-37	--
Balance, N.S.A.	+37	-77	-230	-78	-353	-1,006	189	-1.4
Official settlements bal.,				-245	-1,158	236	238	-1.3
Seasonal component				625	33	-508	-184	--
Balance, N.S.A. <u>4/</u>	n.a.	-286	-181	380	-1,125	-272	54	-1.3
Memo items:								
Monetary reserves (decrease -)	+53	-11	-110	-424	-271	-41	-68	-1.2
Gold purchases or sales (-)	-53	-86	-70	-68	-119	-124	-590	-1.7

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

2/ Monthly figures tentatively adjusted for changes in carry-over of import documents

3/ Net of loan repayments.

4/ 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. Gross national product is projected at a seasonally adjusted annual rate of \$746 billion in the third quarter, up \$14 billion from the second. This increase is larger than in the second quarter but smaller than in the first quarter in both current and constant dollars. (See Appendix C for summary of the Department of Commerce revision of GNP.)

CHANGES IN GNP AND MAJOR COMPONENTS
(Billions, seasonally adjusted annual rates)

	1966		
	I	II	III Projected
Gross national product	16.8	10.8	14.0
Expanding in Q III	<u>17.4</u>	<u>8.9</u>	<u>17.3</u>
Personal consumption expenditures	10.4	3.3	9.6
Business fixed investment	3.1	1.3	3.0
Federal defense purchases	2.1	2.4	2.5
Other Federal purchases	.1	.2	.7
State & local govt. purchases	1.7	1.7	1.5
No change or declining in Q III	<u>-.6</u>	<u>1.9</u>	<u>-3.3</u>
Net exports	.1	-.7	--
Residential construction	1.0	-.5	-.8
Change in business inventories	-1.5 <u>a/</u>	3.1 <u>a/</u>	-2.5 <u>a/</u>

a/ These are changes in rates of accumulation of business inventories.

Consumer spending is the key factor accounting for the slower rise in GNP in the second quarter and the anticipated acceleration in the third quarter. These shifts in consumer spending correspond fairly

closely with changes in disposable income and, thus, the saving rate showed little change from the first to second quarter and is expected to increase only moderately in the third quarter. Disposable income increased only \$4-1/2 billion in the second quarter, as the rise in personal income slowed markedly and the personal tax take showed an exceptionally large increase. In the current quarter, the rise in personal income is expected to accelerate again; gains in employment and wages and salaries are estimated to be somewhat larger than in the second quarter but are not expected to be so large as the sharp rates of increase last winter. The rise in personal income will come mainly from Federal pay raises and the large boost in transfer payments expected under Medicare and other Federal programs. Moreover, personal tax payments are expected to rise only about half as much in the current quarter as in the second quarter when withholding rates were first increased. Altogether a rise of \$13 billion is projected for personal income in this quarter with disposable income rising over \$11 billion.

Moderate recovery in consumer purchases of durable goods is expected in the current quarter, following the sharp second quarter decline. Retail sales of durable goods began to rise in June as new domestic auto sales recovered considerably from the reduced May level; in early July, durable sales appear to have risen further. Moreover, consumer purchases of nondurable goods, which showed only a small rise in the second quarter, are expected to increase somewhat more, although the projected rise is below the increases of late 1965 and early 1966

when food prices were increasing rapidly. Service outlays are expected to continue to rise at a fast pace.

Business fixed investment is also expected to speed-up again in the current quarter, following a short fall in the second quarter mainly due to strikes in construction. Continued rapid expansion in defense spending is projected, with part of the third quarter rise reflecting the military pay raise. Other Federal purchases are up mainly because of the civilian pay raise.

Residential construction activity is expected to decline further in the current quarter as housing starts continue downward in reflection of the tight mortgage financing situation. The rate of business inventory accumulation is also expected to slow markedly from the high second quarter rate, mainly because of the run-off in auto stocks from their record midyear high.

The implied GNP deflator is projected to rise in the current quarter at the same rate as in the two preceding quarters. In the current quarter, real GNP is estimated to rise at an annual rate of 4-1/2 per cent, as compared with 2-1/2 per cent in the second quarter and 6 per cent in the first. Moderation of the rise in industrial production and in nonfarm employment accompanied the slower growth in real GNP in the second quarter. However, the real GNP growth appears unusually small as compared with industrial production, which increased at an annual rate of 8 per cent from the first to the second quarter and with nonfarm employment which rose at a rate of 4 per cent.

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

	1964	1965	1965		1966 Proj.		
			III	IV	I	II	III
Gross national product	631.7	681.2	686.5	704.4	721.2	732.0	746.0
Final sales	627.0	672.1	677.8	694.0	712.3	720.0	736.5
Personal consumption expenditures	401.4	431.5	435.0	445.2	455.6	458.9	468.5
Durable goods	59.4	66.1	66.7	68.0	70.3	66.8	68.3
Nondurable goods	178.9	190.6	191.4	197.0	201.9	204.7	208.7
Services	163.1	174.8	176.9	180.2	183.4	187.4	191.5
Gross private domestic investment	93.0	106.6	106.7	111.9	114.5	118.4	118.1
Residential construction	27.6	27.8	27.8	27.6	28.6	28.1	27.3
Business fixed investment	60.7	69.7	70.2	73.9	77.0	78.3	81.3
Changes in business inventories	4.7	9.1	8.7	10.4	8.9	12.0	9.5
Nonfarm	5.3	8.1	7.2	9.0	8.5	11.8	9.5
Net exports	8.5	7.0	7.1	6.1	6.0	5.3	5.3
Govt. purchases of goods and services	128.9	136.2	137.7	141.2	145.0	149.4	154.1
Federal	65.2	66.8	67.5	69.8	71.9	74.6	77.8
Defense	50.0	50.1	50.7	52.5	54.6	57.0	59.5
Other	15.2	16.7	16.8	17.3	17.4	17.6	18.3
State and local	63.7	69.4	70.2	71.4	73.1	74.8	76.3
Gross national product in constant (1958) dollars	580.0	614.4	618.2	631.2	640.5	644.2	651.2
GNP implicit deflator (1958=100)	108.9	110.9	111.0	111.6	112.6	113.6	114.6
Personal income	496.0	535.1	541.9	552.8	564.6	573.3	586.5
Wages and salaries	333.6	358.4	360.8	370.8	380.0	387.2	396.0
Personal contributions for social insurance (Deduction)	12.5	13.2	13.2	13.5	16.9	17.1	17.9
Personal tax and nontax payments	59.4	66.0	65.7	66.7	69.5	73.6	75.5
Disposable personal income	436.6	469.1	476.2	486.1	495.1	499.7	511.0
Personal saving	24.5	25.7	29.0	28.5	26.9	27.6	28.9
Saving rate (per cent)	5.6	5.5	6.1	5.9	5.4	5.5	5.7
Total labor force (millions)	77.0	78.4	78.5	79.0	79.4	79.7	80.2
Armed forces	2.7	2.7	2.7	2.8	2.9	3.1	3.2
Civilian labor force"	74.2	75.6	75.8	76.2	76.5	76.7	77.0
Employed	70.4	72.2	72.4	73.0	73.6	73.7	74.2
Unemployed	3.9	3.5	3.4	3.2	2.9	3.0	2.8
Unemployment rate (per cent)	5.2	4.6	4.5	4.2	3.8	3.9	3.7

*GNP expenditure and income figures are based on Department of Commerce revised data.

Industrial production. Industrial production continued to advance in June, and at 155.8 per cent of the 1957-59 average, the index was up 0.5 per cent from May. On a quarterly average basis, the increase in the index slowed to 8 per cent in the second quarter from 14 per cent in the first quarter, as shown in the table. The pattern of slower growth was widely distributed. Even business equipment showed some slackening, although the rate of increase was still very rapid.

INDUSTRIAL PRODUCTION
(Per cent increases, in annual rates)

	II Qtr. 1966 from I Qtr. 1966	I Qtr. 1966 from II Qtr. 1965
Total	8.0	14.0
Final products	6.5	10.3
Consumer durables	-1.9	8.0
Consumer nondurables	3.8	5.9
Business equipment	12.7	14.9
Defense equipment	18.4	31.6
Materials	9.5	16.4
Durable goods	11.8	23.9
Nondurables	6.8	9.4

In June, output of both final products and materials rose further. Business and defense equipment continued to increase and was 18 per cent above a year earlier. Consumer goods also generally continued upward, with the exception of autos. Auto assemblies remained at the May annual rate of 8.6 million units down 7 per cent from the rate in the first four months of this year. Schedules for July, after allowance for shutdowns for model changeovers, indicate a further decline in assemblies of about 10 per cent.

The July index could post a relatively large increase. The seasonal adjustment factors allow for a 5 per cent decline from June to July for the total index, but with unfilled orders at advanced levels, plant shutdowns for vacations may be fewer than usual. The seasonal factors would operate to influence the index in the opposite direction in the following 3 months.

Personal income. Personal income rose to \$576.5 billion (seasonally adjusted annual rate) in June, \$3.5 billion higher than in May in terms of the newly revised figures. (The revised figures for May and also the first quarter are \$7.5 billion higher than reported before.) The June increase was the largest since February. Most of the increase, as usual, was in wages and salaries. Part of the increase in payrolls reflected resumption of high level construction activity following strikes; a larger-than-usual increase occurred in government payrolls. Transfer payments were up somewhat and farm income down a little further.

Retail sales. Total retail sales increased one per cent in June according to advance figures--recovering part of the sharp decline in April and May. The June increase was at durable goods stores, where the earlier decline had taken place, and within the durable sector most of the fluctuations over the three-month period reflected marked shifts in the pace of auto sales. In June, unit sales of new domestic cars recovered to a seasonally adjusted annual rate of 8.3 million units; between March and May they had declined from a 9.2 to a 7.3 million rate.

In early July, sales of durable goods stores--and total retail sales--appear to have increased further, although the durable rise was primarily at furniture and appliance stores where sales of air conditioners and fans were stimulated by the heat wave. Unit deliveries of new domestic cars were down moderately to an estimated annual rate of 8 million.

Inventories of new cars continued to rise in June and at month-end were at 1.7 million units. During the first 10 days of July, with production curtailed, inventories were virtually unchanged.

In recent months, total sales of nondurable goods have been relatively stable, following the large run-up last fall and winter which reflected in part rising food prices. Food store sales have declined since April, while sales at general merchandise outlets have increased moderately further. Sales at apparel stores in June were at about the high reached early in the year.

Consumer credit. The expansion in consumer instalment credit slowed further in May. The increase, \$493 million, was sharply less than a year earlier and the smallest since November 1964. The slackening occurred mainly in the auto and other consumer goods categories. Personal loan volume continued at a relatively high level.

INCREASE IN CONSUMER INSTALMENT CREDIT OUTSTANDING
(Seasonally adjusted, millions of dollars)

1965 - Q1 (monthly average)	618
Q2	665
Q3	689
Q4	651
1966 - Q1	595
Q2 (estimate)	520
April	531
May	493
June (estimate)	525-550

The pace of credit expansion apparently picked up again in June as sales of autos and other durable goods recovered somewhat from their recent lows. Preliminary reports from commercial banks suggest renewed vigor, particularly in auto credit demands. Personal loan activity was also quite strong in June.

The supply of funds available to lenders has continued tight, and lenders in turn increasingly have adopted restrictive lending policies. Maturity, downpayment, and other contract terms remain essentially unchanged, but lenders have been screening applicants more carefully than previously.

Finance companies have been turning more and more to the commercial paper market to obtain short-term funds. And the commercial paper rates have continued to rise. By early July, the rate for directly placed finance company paper with maturities of 3-6 months had advanced to 5.50 per cent; last September, it was 4.25. Very recently, Ford

Motor Credit Corporation posted 5-5/8 per cent on its long-term (210-270 days) notes. This marked the first instance of a major finance company raising its rates above those for comparable maturity CS's. At the same time, some finance companies have moved to slightly lower rates on shorter-term paper which has been less difficult to sell recently as corporations have been showing a preference for shorter maturities.

Business inventories. On a GNP basis, nonfarm business inventory accumulation in the second quarter is estimated by Commerce at a seasonally adjusted annual rate of \$11.8 billion -- the highest in many years and up \$3.3 billion from the first quarter. Accumulation accelerated at both manufacturers and retailers in the second quarter.

The book value of retail inventories increased over \$500 million in May and for April and May the increase averaged \$350 million, as compared with \$200 million monthly in the first quarter. The step-up from the first quarter rate occurred in the durable goods sector. Auto stocks showed a large run-up in April and May and continued to rise in June despite considerable recovery in sales; stocks at furniture and appliance stores also increased substantially. For autos as well as furniture and appliances, inventories had shown little change in the early months of the year.

The book value of manufacturers' inventories increased nearly \$700 million in May, as in April. This monthly increase compares with an average of about \$550 million in the first Quarter. The pick-up

in the rate of accumulation was in durable goods industries. Following some months of little change, stocks of durable materials and supplies rose appreciably in April and May, owing, in part, to termination of the protracted liquidation of steel stocks which began early last fall. Moreover, stocks of finished durable goods increased at a somewhat faster pace than in the early months of the year. Work-in-process inventories continued to rise at about the earlier fast pace.

Orders for durable goods. New orders for durable goods continued to show little change in June at a level moderately below the March peak. The new order level remained well above shipments and unfilled orders expanded substantially further.

New orders for defense products rebounded to about the high March-April level, while ordering of most other types of products showed moderate declines. New orders for steel, which had risen sharply in May, declined 7 per cent in June but the steel order backlog continued to rise. New orders for machinery and equipment were moderately below the record May level, but unfilled orders increased sharply further.

Construction activity. Seasonally adjusted new construction put in place, which on the basis of revised figures dropped 4 per cent further in May, edged off again in June to an annual rate of \$73.7 billion. This was 6 per cent below the high reached last March and was the lowest rate since last October. Residential expenditures apparently accounted for all the June decline.

The second quarter estimates most likely exaggerate the underlying decline in private nonresidential construction because of strikes. Nevertheless, such outlays probably reached their peak in the first quarter. Expenditures for public construction also have turned down somewhat as rising financing costs have forced rescheduling of State and local projects.

NEW CONSTRUCTION PUT IN PLACE

	2nd quarter 1966 <u>1/</u> (billions)	Per cent change from	
		First quarter	Year ago
Total	\$74.9	-3	4
Private	52.4	-3	5
Residential	26.9	-2	--
Nonresidential	25.5	-5	11
Public	22.4	-2	4

1/ Seasonally adjusted annual rates; preliminary.

Private housing starts, which had dropped 14 per cent further in May, edged off somewhat more in June to the lowest rate in the past five years. The decline during the second quarter, which ran somewhat ahead of initial projections, brought the average for the quarter to an annual rate of 1.36 million. This was a tenth below both the first quarter level and the average for 1965 as a whole.

There was a sharp further decline in building permits in June to about the low reached in March 1960. Most of the decline was in multifamily structures. As in May, all regions participated in the June decline. The June volume ran uniformly about a fourth below a year earlier.

PRIVATE HOUSING STARTS AND PERMITS

	June <u>1</u> / (thousands of units)	Per cent change from	
		May	Year ago
Starts (total inc. farm)	1,288	- 1	-18
Permits (total)	941	-14	-25
1 family	574	- 4	-18
2-or-more family	367	-27	-33
Northeast	200	-10	-24
North Central	226	-18	-26
South	320	-17	-26
West	195	- 8	-23

1/ Seasonally adjusted annual rates; preliminary.

Labor market. Demands for labor showed renewed strength in June with employment gains accelerating sharply after having slowed in the two preceding months. The increase in nonfarm employment was close to the rapid first quarter rates. A large part of the employment rise in June was associated with the additions to the labor force of a record number of young workers seeking temporary summer jobs or beginning regular jobs as the school year ended. Despite the flood of teenagers, most of them were readily absorbed into jobs. The over-all unemployment rate remained at 4.0 per cent, the same as May but well below the 4.7 per cent reported a year ago.

Nonfarm employment. Nonfarm employment increased by 324,000 in June, with gains in all major sectors. At an annual rate of 3.9 million, the rise in June was well above the increase over the past 12 months. The annual rate of increase in the second quarter amounted to

4 per cent, compared to 7 per cent in the first quarter. But even at this somewhat slower rate of increase intensive pressure continued on skilled labor resources.

INCREASE IN NONAGRICULTURAL EMPLOYMENT
(In millions of employees, at annual rates)

	From June 1965 to June 1966	From May 1966 to June 1966
Total nonagricultural	3.1	3.9
Manufacturing	1.1	1.3
Durable	.8	.9
Nondurable	.3	.4
Nonmanufacturing	2.0	2.6
Trade	.5	.5
Finance & services	.5	.4
Government	.8	.9
Federal	.2	.3
State and local	.6	.6
Other <u>1/</u>	.2	.8

1/ Mining, transportation and public utilities, and construction.

Employment in manufacturing showed greater strength in June than in any month since February, increasing by 110,000. While employment gains over the month continued largest in the machinery industries, primary metals also advanced considerably and the increases in nondurable goods were larger and more general than in other recent months.

Notwithstanding further weakening in construction activity, employment increased in June -- in part reflecting recovery from strikes and bad weather -- following two months of declines. The level of

of construction employment in June was only slightly below the first quarter and almost 150,000 above a year ago. The recent easing in activity apparently has not, as yet, reduced skilled worker shortages, particularly in the nonresidential sector. In trade, employment advances also accelerated.

The stepped-up pace of government hiring has continued. Adding to continued rise in State and local government, growth has been faster in Federal employment, which prior to June 1965 had been relatively stable for a number of years.

Expansion in the Armed Forces has also absorbed a substantial amount of manpower. Over 400,000 men have been added to the services since August 1965 when the Vietnam build-up began. In June, the armed forces total 3.1 million and were above the Budget projected strength for the end of fiscal 1967 (3,093,000 by June 30, 1967). Announced draft calls for coming months suggest about the same number as over the past 10 months -- net additions of about 40,000 per month.

Unemployment. Because of the large rise in the teenage labor force, resulting both from the larger population in that age group and rising participation rates, unemployment among teenagers has remained relatively high with only a slight improvement shown over the past year. Reductions in unemployment among youths have been entirely among white job seekers. Nonwhite youths have failed to share proportionately in the employment rise and their unemployment has increased. For example, the unemployment rate for 18-19 year old Negroes rose

from 27 per cent in June 1965 to 32 per cent in June 1966 (unadjusted). For white youth of the same age the rate fell from 19 to 15 per cent.

While large additional supplies of temporary and relatively inexperienced workers have been forthcoming, skilled workers are still scarce and the number of adult males unemployed remain around frictional levels. An important indication of tightness in the labor market has been the rapid decline this year in the number and proportion of long-term unemployed. At less than a half million in June, long-term unemployment has declined sharply in the past two months and down almost a third since the start of year. In June only 0.6 per cent of the civilian labor force was unemployed for 15 or more weeks, the lowest percentage since the end of the Korean War. In contrast, short-term unemployment was significantly higher than earlier in the year and accounted for the rise in unemployment from the April low of 3.7 per cent. Consequently, a much larger proportion of temporary job seekers and workers changing jobs are in the current unemployment total than earlier this year.

DISTRIBUTION OF UNEMPLOYMENT BY DURATION
(Seasonally adjusted in thousands)

	Total		Less than 15 wks.		15 weeks & over	
	Number	Per cent	Number	Per cent	Number	Per cent
1966 - Jan.	2,945	100	2,285	78	660	22
Feb.	2,815	100	2,235	79	580	21
Mar.	2,920	100	2,330	80	590	20
Apr.	2,895	100	2,295	79	600	21
May	3,180	100	2,645	83	535	17
Jun.	3,110	100	2,630	85	475	15

Collective bargaining. Probably the most critical issue now developing in collective bargaining arises from a widening differential in wage rates among industries. In part, it reflects rather large wage increases above the guideposts granted in some unionized sectors in recent years (construction, teamsters, longshoremen). But even more important are the differences which have emerged in the past year in wage rates between workers whose contracts include cost-of-living adjustments and those not so covered. The 2 million workers now covered by escalator clauses are in large unions (auto workers, machinists, teamsters) and in strategic sectors. Partly as a result of the rise in CPI, basic wage rates of these covered workers have risen about 5 per cent in the past year. In current negotiations -- such as the airlines dispute -- unions are pointing to wage gains which have already taken place in comparable job classifications as justification for their own large demands.

AUTO INDUSTRY LABOR CONTRACT

Date of adjustment	Wage rate increases from:	
	Cost-of-living adjustment	Annual improvement factor
(In cents per hour)		
1965		
March	1	
June	1	
September	2	7.4
December	0	
1966		
March	2	
June	4	
September	?	10.5

Without fanfare or publicity, the auto workers have had a significant amount added to their basic wages. Over the past year, the average basic wage rate in the auto industry (about \$3.20 per hour) has gone up 15.5 cents or almost 5 per cent (not including fringes). Of this amount, 8 cents (2.5 per cent) have come from increases in the CPI and 7.5 cents (2.4 per cent) from the annual improvement factor effective last September. In September of this year, the auto workers will receive an additional 10.5 cents from the annual improvement factor. Thus, even if the CPI were to show no further rise, the auto workers are already assured a wage gain of 16.5 cents or over 5 per cent in the year ending September 1966. Contracts containing escalator clauses similar to those in autos are in effect in meat-packing, aerospace and agricultural machinery. Workers in these industries have received wage rate increases comparable to those in autos,

The importance of this is that while the public may not be aware of the size of the auto and similar escalator wage increases, union officials are. Other unions are citing the auto gains in current bargaining. It is hardly a coincidence that the machinists union in its current dispute with the airlines has set a 5 per cent wage increase and an escalator clause as its major bargaining demands. Not only do the airline mechanics come from the same general occupational job market as the auto workers, but the machinists union is also one of the major unions in the aerospace industry, whose contracts generally provide for CPI adjustment in wages. The airlines, however, continue to stand

on the recommendations of a government panel for a 3.5 per cent wage increase--about in line with the guideposts.

While much has been made of the pattern-setting importance of the General Electric and Westinghouse negotiations later this fall, the auto wage gains already realized are likely to provide the more important target in major negotiations this year. Even in the electrical industry the rise of over 5 per cent in auto wage rates presents an important goal for union negotiations. In the past, wage increases in the electrical equipment contracts have been at the bottom of the range of negotiated wage gains. This, in part, reflects strong and determined companies bargaining with relatively weak and divided unions. Also, the very high proportion of salaried workers and women employees in the electrical industry tends to limit the wage gains of factory workers.

Wholesale prices. Industrial commodity prices continued to move up in June, according to the comprehensive midmonth indexes, and fragmentary information indicates that the rise has persisted since mid-June. The average monthly increase through the second quarter and through the first half of the year was 0.3 per cent, as the table indicates. The increase was a little larger than that in May and a little smaller in June. With prices of foodstuff unchanged in June and up moderately in the first half of July, the all-commodity index has edged up to a new high, estimated at 106.2 per cent of the 1957-59 average.

Sensitive materials edged down 0.2 per cent in June, after increasing 3.5 per cent through the first five months of the year and

accounting for a disproportionately large share of the rise in the industrial average. As had been anticipated, the sharp rise in lumber was reversed in June and that in hides and leather was not extended. The metals component of the sensitive index, which reflects mainly the influence of copper and aluminum products, rose further. Industrial materials other than the sensitive (three-fourths of total materials), rose 0.3 per cent in June, the same as in each of the preceding two months. The June rise reflected increases for petroleum products, newsprint and other paper products, and plumbing equipment and brass fixtures.

Among finished industrial products, producers' equipment rose half as much as in May, but the increase equaled the average monthly rise during the first half of the year. Consumer goods continued to move upward at a relatively slow pace, with much of the June rise attributable to gasoline and nonalcoholic beverages. Consumer durable goods generally remained stable.

The strength in prices of foodstuffs in June and July was expected on seasonal grounds. Marketings of hogs in recent months have been at a level that should prove to be the low preceding a combined seasonal and cyclical expansion. Reports on the number of cattle placed on feed during the first half of the year suggest expansion in cattle marketings as well. The decline in prices of livestock and meats was interrupted in June and the first half of July, and prices of grains and dairy products rose appreciably.

WHOLESALE PRICE INDEXES

	June 1957-59=100	Per cent change to June from		
		May 1966	March 1966	December 1965
All Commodities	105.7	.0.1	.0.3	1.5
Industrial	104.5	0.2	0.9	1.7
Sensitive materials	106.6	-0.2	1.1	3.3
Other materials	103.3	0.3	0.9	1.5
Producers' equipment	107.8	0.3	1.0	1.8
Consumer goods	103.2	0.2	0.7	0.9
Foodstuffs	109.2	-0.1	-1.4	1.3
Livestock and products	110.4	-0.3	-3.5	-0.2
Crops and products	107.5	0	1.0	2.8

Consumer prices. June figures are not yet available for the CPI, but an increase in the total is almost a certainty. Early indications are that food prices, after declining 0.4 per cent in May, increased almost as much in June. Trade reports suggest that seasonal discounts for new cars were somewhat larger than usual.

The increase in New York City's transit fares from 15 cents to 20 cents will have a noticeable effect on the index for July. The impact could be as much as 4.0 per cent on the public transportation component and 0.005 per cent on the total index.

Farm production prospects. The July 1 survey of crop prospects indicates that 1966 output may fall somewhat short of last year's record harvest. Acreage in crops is down a little from 1965 and yield prospects are extremely spotty. Yields will depend more than usually on the timeliness and adequacy of rains during the rest of the season.

Among the big export crops, wheat and cotton production will be smaller, feedgrains and tobacco about the same, and soybeans and rice much larger than last year. Wheat prospects, widely watched because of tightening world supplies and India's need for continued large aid-financed exports from the U.S., improved slightly in June but the crop may be down 7 per cent from the relatively large 1965 crop. A record rice crop is in prospect, 60 per cent in excess of domestic needs. Total output of feedgrains will be close to last year's record, with gains in corn offsetting declines in oats, barley, and grain sorghums. Supplies for the year beginning October 1 will be about 2 per cent below a year earlier because carry-in stocks are being reduced by record feeding and exports this year.

Soybean acreage is 7 per cent larger than last year's record. Demand has been very strong, however, and stocks of soybeans are expected to be down to a month's use by September 1. Acreages of other oilseeds are smaller this year.

Cotton acreage is down 25 per cent reflecting heavy participation in this first year of the new 4-year acreage diversion program, which was designed to bring the huge surplus under control. A crop of 11.5 to 12.0 million bales seems likely as compared with the 15.0 million bale crop of 1965. Sharp cut-backs in tobacco acreages last year were largely maintained this year in an effort to reduce stocks. Larger crops of sugar cane, potatoes, vegetables for processing, and dry edible beans and smaller crops of deciduous fruits and fresh summer vegetables are in prospect.

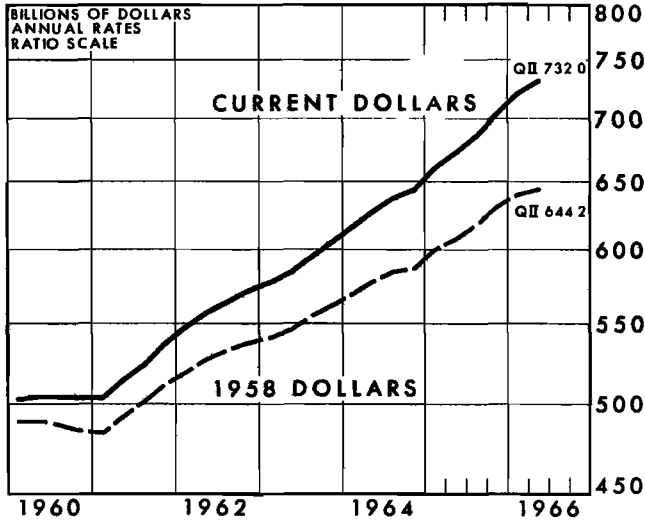
Acreage in crop retirement programs this year amounts to 64 million acres, 5 million more than last year. Most of the increase is cotton acreage and land put into the new cropland adjustment program.

High-protein food output, third quarter. Record beef and poultry production is expected to continue in the third quarter, and pork production may climb above last year's low output as hogs from the larger spring pig crop begin to reach markets. Production of eggs and milk is likely to stay below year earlier levels although egg production is trending upward. Milk production rose slightly in June following 15 months of decline, but output was still 3 per cent below last June. The recent boost in dairy price supports, the second this year, represents an effort by the USDA to arrest the rapid shift of resources out of dairying and to increase current production by making heavier feeding more profitable. Current milk production is ample for domestic use but leaves little surplus manufactured dairy products for distribution in foreign aid programs.

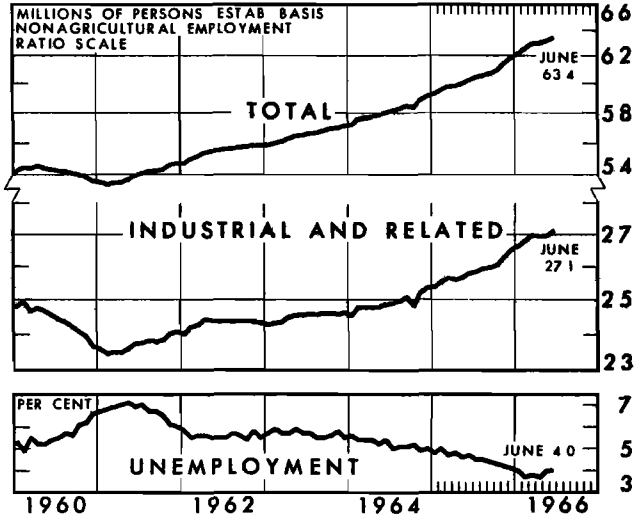
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

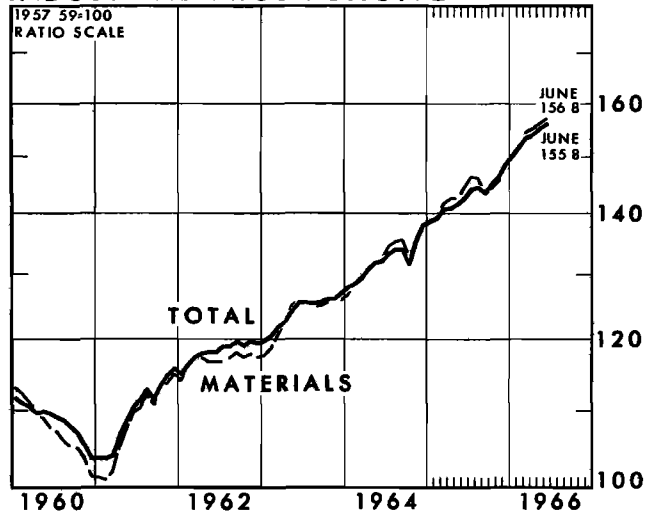
GROSS NATIONAL PRODUCT



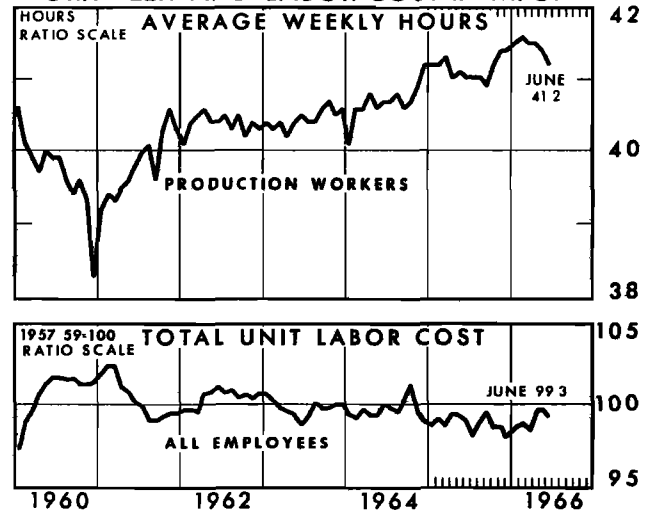
EMPLOYMENT AND UNEMPLOYMENT



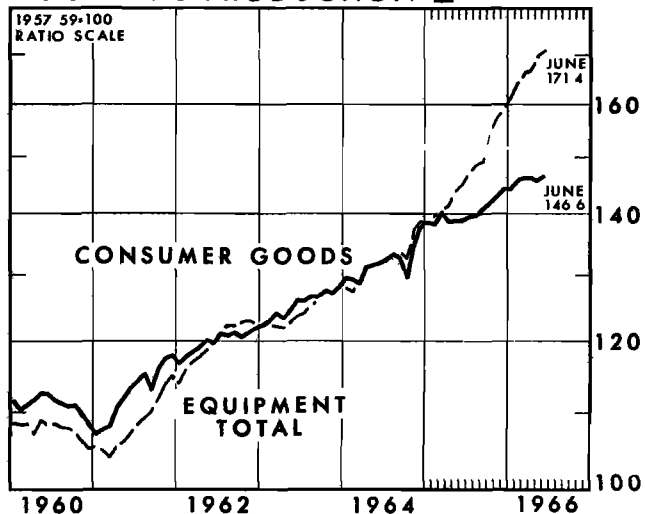
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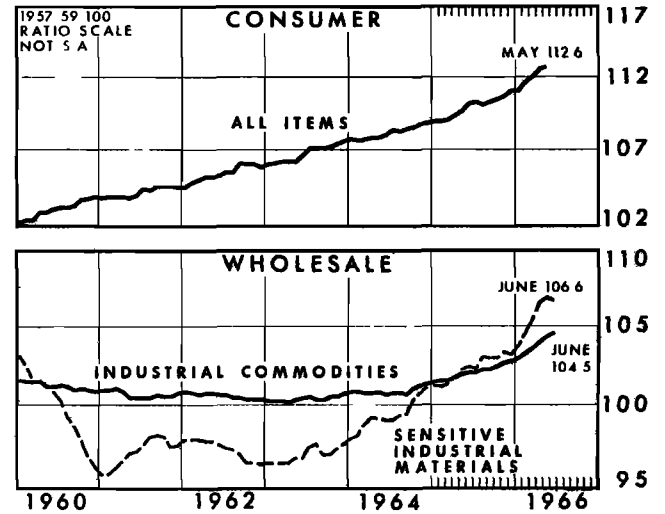
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



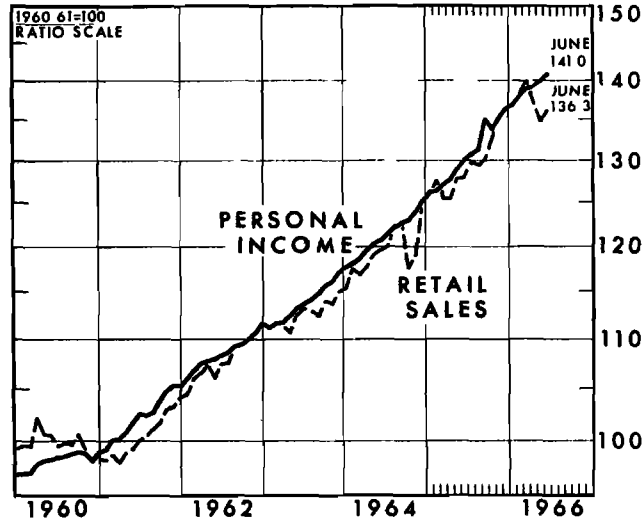
PRICES



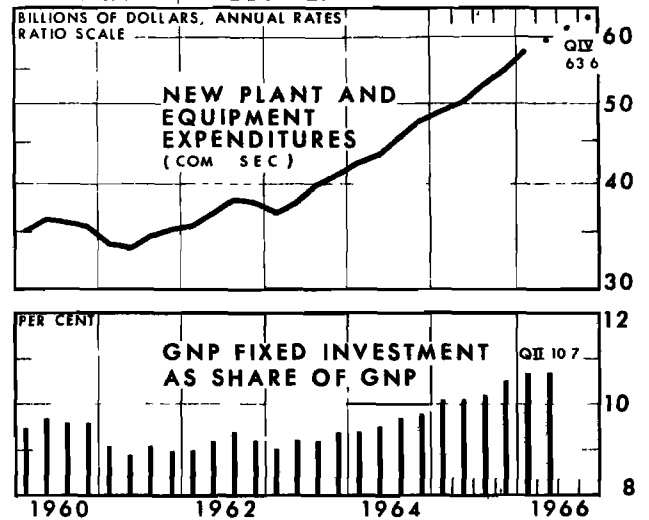
ECONOMIC DEVELOPMENTS - UNITED STATES

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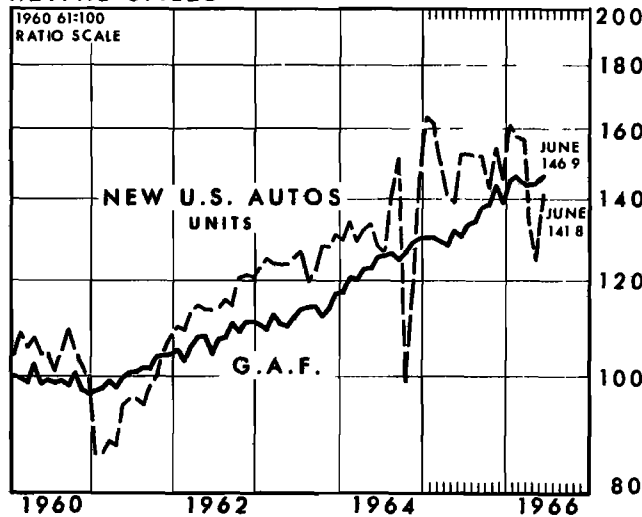
INCOME AND SALES



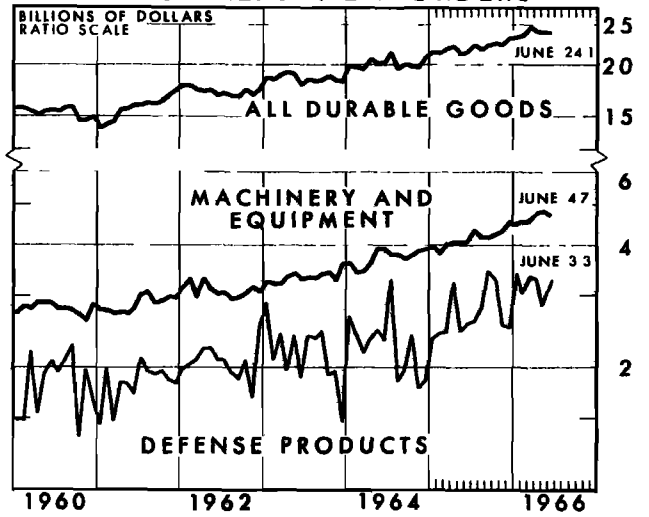
BUSINESS INVESTMENT



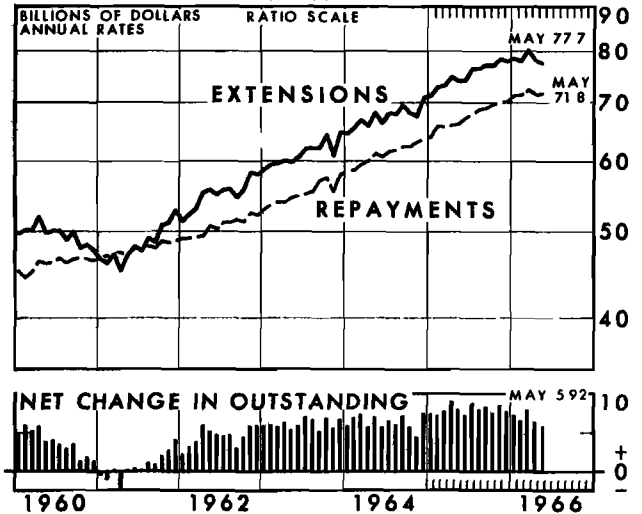
RETAIL SALES



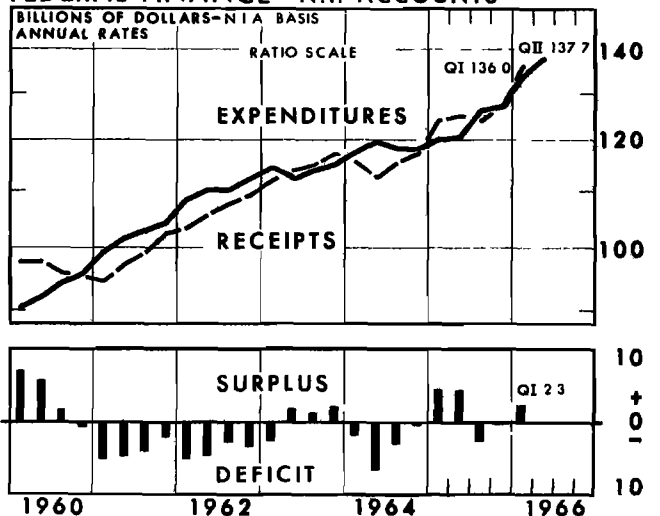
MANUFACTURERS NEW ORDERS



INSTALMENT CREDIT



FEDERAL FINANCE-N.I. ACCOUNTS



DOMESTIC FINANCIAL SITUATION

Bank credit. Outstanding bank credit increased by \$2.2 billion in June or at an 8.7 per cent annual rate, according to revised seasonally adjusted data to be published in the July Bulletin and reproduced in part in Appendix B. Although this growth rate was a little faster than the average for earlier months this year, it was well below the 10.2 per cent pace for 1965 as a whole.

CHANGES IN COMMERCIAL BANK CREDIT
Seasonally Adjusted Annual Rates
(Per cent)

	1966				1965
	June	1st half	2nd Qtr.	1st Qtr.	Year
<u>Bank credit and major components</u>					
Total loans & investments	8.7	8.2	8.3	8.0	10.2
U.S. Gov't. securities	-10.9	-11.1	-10.7	-11.8	- 5.6
Other securities	- 2.5	10.3	12.3	8.0	15.8
Total loans	17.2	13.4	12.7	13.8	14.7
<u>Selected loan categories</u>					
Business	32.3	20.5	21.0	19.1	18.7
Nonbank financial	85.7	28.8	28.6	27.1	21.6
Real estate	4.7	9.8	7.1	12.2	13.1
Consumer	9.6	10.1	7.6	12.3	15.1

NOTE: The changes in total credit and total loans described above, and in total time and savings deposits, described later in this report, do not reflect the exclusion from loans and time deposits on June 9 of \$1.1 billion of balances accumulated for the payment of personal loans.

Expansion in total loans accelerated in June, mainly reflecting direct and indirect financing of businesses. But banks were under considerable restraint--from reduced reserve availability, a slackened inflow of time and savings deposits (mainly at city banks), and a seasonally adjusted decline in U.S. Government deposits--and to meet loan demand, they made substantial liquidation of their investments, mainly Treasury bills. Holdings of other securities also declined slightly, the second monthly decline in this upswing according to the revised bank credit series. Banks were not heavy buyers of new agency issues late in the month, even though there was a large volume of offerings at attractive yields; some bank selling of municipals was also reported.

These portfolio adjustments occurred mainly at large banks, however. Smaller banks, where loan demand has not strengthened markedly this year and where growth in time and savings deposits has been well sustained, added further in June to their holdings of other securities at the same pace as a year earlier, and reduced their holdings of Governments the same amount as in the comparable period last year.

In the first two reporting weeks of July, data for banks in New York City suggest that these banks have found it necessary to make further adjustments in view of their tight reserve positions and of the increase in reserve requirements effective July 14. They have made additional reductions in their holdings of Treasury issues, contraseasonal

reductions in other securities mainly agency issues and long-term municipals, and raised their rates on broker loans one-quarter percentage point above the prime rate after having kept them identical over the previous 3-1/2 months.

Business needs for bank financing were unusually heavy in June, reflecting in large part the acceleration of payments on corporate income and withheld taxes. Direct borrowing at banks by businesses reached a record \$2 billion, one-third more than the previous monthly record. In addition, borrowing by finance companies mainly to cover redemption of their maturing commercial paper held by businesses, expanded by a record \$900 million.

Moreover, in contrast with developments in past years, business loans at city banks continued to expand into early July, probably reflecting accelerated payments of withheld taxes. At banks in New York City, business loans rose nearly \$200 million in the first two weeks of July this year in contrast with a decline of \$140 million in the comparable period last year.

To the extent that recent borrowing has been influenced by temporary factors--the acceleration of tax payments and the build-up in dealer inventories of new cars--the growth rate can be expected to moderate in the coming weeks. While a generally strong undercurrent of demand is expected to persist after these influences have abated, another factor that may contribute to slower loan growth is a further tightening of bank lending policies. Although fewer banks reported

that they were adopting more restrictive policies in the June lending practices survey than in March, as shown in Appendix A, the percentage of such banks remained high and the persistence of strong loan expansion into July has probably resulted in reappraisal of lending policies and further tightening at some banks since the June survey date.

Deposits and money stock. The money stock, after reaching a new peak around the June tax payment dates, receded in subsequent weeks. For the month as a whole, it averaged \$171.1 billion, \$1.6 billion higher than in May but the same as in April. The June increase presumably reflected the seasonally adjusted decline in U.S. Government deposits during the month as well as the sharp loan expansion associated with large June corporate tax payments. Over the first half of 1966, the annual rate of growth was 4.4 per cent, a little below the 4.8 per cent rate for all of 1965. While transactions needs have expanded substantially over this period, growth in the money stock has been held in check by the high opportunity cost of holding cash associated with high and rising yields on money market investments.

Growth in time and savings deposits at commercial banks slackened from May to June, and the increase for the month as a whole was at an annual rate of 9.4 per cent, a little below the average rate of growth over the first half. Growth at country banks was at an annual rate of nearly 14 per cent, representing a considerable acceleration from reduced rates earlier in the year, while growth at reserve city banks declined further from the rapid pace of April.

The net increase in time and savings deposits at weekly reporting member banks during the last week of June and the first week of July was somewhat smaller than in the comparable weeks of March-April. But within the time and savings deposit structure, shifts among types of deposits were much less sharp than in the spring. The decline in savings deposits and the increase in other time deposits were each about \$500 million less in the recent than in the earlier period. The smaller growth in CD's accounted for most of the slower growth in total time and savings deposits.

NET CHANGE IN TIME AND SAVINGS DEPOSITS
AT WEEKLY REPORTING BANKS
(In millions of dollars)

	Two weeks ending July 6, 1966	Two weeks ending April 6, 1966
Total time & savings deposits	780	967
Savings deposits	-240	-760
Other time deposits (excluding CD's)	730	1,212
Negotiable CD's	290	515

The pattern of smaller flows of savings and other time deposits (excluding CD's), which prevailed in nearly all Federal Reserve Districts, probably is attributable to several factors. These include (1) the existence of only a moderate volume of delayed transfers of funds to banks in response to rate increases that either missed out following the March interest crediting or were not feasible until July owing to

semi-annual interest crediting; (2) the more aggressive competition of other savings institutions, through raising rates and introducing new instruments, which served to moderate their deposit outflows; (3) the increased relative attractiveness of market instruments; and (4) the reduced incidence of bank rate increases and promotional activity in June, compared with March, presumably in part as a result of the threat of Congressional action.

By offering ceiling rates on large blocks of funds, at relatively short maturities, when necessary, city banks were able to replace most of their large mid-June run-offs of CD's by the end of the month. The largest volume of CD sales in June, according to the June 29 maturity survey, lead September maturities. These totaled \$1.2 billion, four-fifths as much as those for July and August combined. Total maturities through September amounted to 56 per cent of outstandings on the survey date.

Thus far in July, there has been some attrition in outstanding CD's, possibly reflecting in part the recent rise in yields on Treasury bills and on a number of other market instruments. In July 1965, outstanding CD's had continued to increase steadily throughout most of the month of July.

U. S. Government securities market. Yields on U. S. Government securities of all maturities rose to new highs over the past month, following declines in early June. Announcement of an increase in reserve requirements against time deposits on June 27 triggered the turn-around in yields, and yields rose further following an increase in the prime loan rate to 5-3/4 per cent and removal of certain FHLBB restrictions on S and L dividends. The market also was affected by a number of other factors, including increased bombing in North Vietnam, an increase in the British bank rate and talk of a discount rate hike. As prices declined, dealers were able to reduce their holdings of coupon issues maturing in over 5 years. Such holdings have declined by \$150 million since June 27, and are now at only about \$25 million.

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

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
<u>1959-1961</u>						
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
<u>1966</u>						
Highs	4.96	5.06	5.30	5.22	5.10	4.88
Lows	4.33	4.46	4.78	4.76	4.56	4.49
<u>1965-1966</u>						
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
June 15	4.54	4.63	4.98	4.93	4.79	4.72
June 27	4.33	4.54	5.06	4.98	4.83	4.74
July 19	4.96	5.01	5.25	5.15	5.02	4.85

In the Treasury bill market, rates have risen sharply after reaching a 4.33 per cent low for the year on June 27. New highs have been set in the regular weekly auctions for three consecutive weeks. In the latest auction the average issuing rate on the 3-month bill was almost 5 per cent, but the bill traded below that rate subsequently.

With public demand for bills becoming more moderate and the System on the selling side in recent weeks, the high dealer financing costs began to bite and contributed to the rapid rate rise. Dealer borrowing rates in New York reached a new peak of 6-1/2 per cent on new loans, but have eased back slightly in the last few days. In view of these high borrowing rates, dealers were reluctant bidders in the regular weekly auctions and have been able to keep their trading positions in bills at the very low levels reached in early June. To illustrate, bill trading positions were at \$523 million on July 18, less than one-third their more typical year-ago level.

The System initiated last week the use of matched sale-purchase contracts for the purpose of absorbing some of the temporary excess reserves generated by the airline strike. Between July 13 and 19, the Desk made \$1,439 million of such transactions and for periods as long as three trading days. These sales would not be reflected in dealer position figures, which are on a commitment basis, because they are matched by a future purchase commitment.

SELECTED SHORT-TERM INTEREST RATES 1/

	1965	1966	
	Dec. 3	June 27	July 15
Commercial paper 4-6 months	4.375	5.50	5.625
Finance company paper 30-89 days	4.375	5.375	5.50
Bankers' Acceptances 1-90 days	4.25	5.375	5.625
Certificates of deposit (prime NYC)			
Highest quoted new issue:			
3-months	4.50	5.50	5.50
6-months	4.50	5.50	5.50
Highest quoted secondary market issue:			
3-months	4.50	5.55	5.65
6-months	4.59	5.65	5.76
Federal Agencies:			
3-months	4.34	5.12	5.40
6-months	4.49	5.40	5.70
9-months	4.58	5.58	5.72
Prime Municipals 1-year	2.65	3.40	3.75

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.

Along with the rise in Treasury bill rates, yields on other short-term credit instruments also rose, as noted in the table, except for rates on new CD issues which were already at their legal ceiling.

Federal Agency securities market. A new high yield on a Federal Agency security was set when the Federal Home Loan Banks priced the \$250 million 18-month portion of their \$785 million July 12 financing to yield 5.80 per cent. Even at this high yield, reception of the issue was only fair and the yield moved higher to around 5.84 per cent

shortly after it was offered. In this already congested market, the Banks for Cooperatives had to place a still higher 5.90 per cent yield on their \$266 million 6-month issue, offered July 19. The issue was very well received at that rate.

Treasury finance. The Treasury will announce its August refunding on July 27. Outstanding maturities held by the public amount to \$3.2 billion. The nature of the financing will remain uncertain until close to announcement in view of the current fluid market situation. The Treasury will also be raising new cash toward the end of next month, presumably through tax bills.

Corporate and municipal bond markets. Yield averages on municipal and new corporate bonds rose about 20 basis points from mid-June to mid-July, as market expectations of further near-term tightening of credit intensified. Very recently, bond yields have stabilized--due partly to the fact that the Federal Reserve discount rate was not raised last week in advance of the imminent "even-keel" period of Treasury refunding.

BOND YIELDS
(Per cent per annum)

	Corporate Aaa			State & local Government	
	New		Seasoned	Moody's	Bond Buyer's
	With call Protection	Without call Protection		(mixed qualities)	
<u>1965</u>					
Low	4.33(1/29) ^{1/}		4.41(3/12)	2.95(2/11)	3.04(2/11)
<u>1966</u>					
High	5.47(7/15)	5.67(7/15)		3.77(7/15)	3.98(7/15)
Low	4.79(1/7)	4.84(1/21)		3.39(1/21)	3.51(1/21)
<u>Weeks Ending</u>					
Mar. 4(High)	--	5.38	4.85	3.63	3.83
Apr. 8(Low)	4.86	5.03	4.98	3.44	3.55
June 17	5.39	5.50	5.06	3.59	3.74
July 1	--	5.64	5.10	3.64	3.83
July 15	5.47	5.67	5.12	3.77	3.98

^{1/} Issues with and without call protection averaged together.

Upward rate pressures over the past three weeks were particularly pronounced in markets for municipal securities, where yields on some outstanding issues with short maturities rose more than 75 basis points. While the volume of new municipal offerings has been smaller since late June and is expected to show a continuing seasonal lull for the full month of July as well as for August, dealers advertised inventories rose in early July to more than \$600 million. Since then they have declined somewhat, but the advertised figure reportedly understates the volume of inventory which dealers would offer for sale if there were less risk of triggering further yield advances.

To a considerable extent recent weakness in the municipal market reflected a tapering off of bank interest in new issues as well

as some outright selling of outstanding issues by money market banks under reserve pressure from continuing loan demands. In addition, however, recent Federal Reserve actions affecting time deposits raised the question whether further increases in money market rates to levels above 5-1/2 per cent would necessarily be matched by an upward adjustment in the Regulation Q ceiling. Market participants are highly sensitive to the fact that if the Regulation Q ceiling were not increased and market rates continued to rise, the resulting bank liquidation of assets would very likely be concentrated in the municipal market.

Given the uncertain outlook for yields, a number of smaller municipal dealers whose capital positions had already been squeezed by losses realized in earlier periods of rapid yield advance, reportedly stopped bidding on new bond offerings in early July. Moreover, among dealers who continued to bid, spreads between bids widened substantially. In these circumstances, several sizable borrowers rejected all bids on new offerings. Altogether postponements totaled \$60 million in the first two weeks of July, and with new additions to the calendar also tending to slacken, the July volume is now estimated at only \$700 million.

STATE AND LOCAL GOVERNMENT BOND OFFERINGS
(In millions of dollars) 1/

	1966	1965
1st Quarter, total	2,881	2,851
2nd Quarter, total	<u>3,125_e/</u>	<u>3,046</u>
Half year, total	6,006 _e /	5,897
July	700 _e /	995
August	700 _e /	733

1/ Data are for principal amounts of new issues.

From mid-June to mid-July, yields on new callable corporate bonds adjusted to a triple-A basis advanced nearly 20 basis points. At these more attractive yield levels, the reduced volume of new publicly-offered corporate issues elicited a more active investor interest and underwriter's inventories of recently offered issues were fully distributed--though not without marked upward adjustments in their free-market yields. As the overhang of unsold syndicate inventories was reduced, the general tone of the corporate bond market improved.

Looking ahead, the expected July volume of publicly-offered bonds (at \$440 million) is almost one-third below a year ago, and nearly half of this total consists of convertible debentures. In August, however, new issue volume is expected to pick up again to a level well above August last year. A large part of the August total is accounted for by the \$250 million A.T.&T. and \$175 million Pan Am issues--scheduled for offering early in the month.

CORPORATE SECURITY OFFERINGS 1/
(In millions of dollars)

	Bonds				Stocks	
	Public Offerings <u>2/</u>		Private Placements		1966	1965
	<u>1966</u>	<u>1965</u>	<u>1966</u>	<u>1965</u>	<u>1966</u>	<u>1965</u>
1st Qtr.	1,773	905	2,586	1,673	734	429
2nd Qtr.	1,909 <u>e/</u>	1,864	2,131 <u>e/</u>	2,258	1,011 <u>e/</u>	920
May	481	694	477	630	68	449
	800 <u>e/</u>	748	900 <u>e/</u>	980	725 <u>e/</u>	309
July	440 <u>e/</u>	542	600 <u>e/</u>	780	100 <u>e/</u>	122
August	625 <u>e/</u>	369	500 <u>e/</u>	468	125 <u>e/</u>	93

1/ Data are gross proceeds.

2/ Includes refundings.

e/ Estimate.

Stock market. Common stock prices have fluctuated without apparent trend in recent weeks, and at mid-July were little changed from late May. On July 19, Standard and Poor's composite index of 500 stocks closed at 86.33, about 3 per cent above the year's low reached in mid-May but more than 8 per cent below the early February high.

Trading activity has continued quite moderate. Since mid-June, the volume of trading on the New York Stock Exchange has averaged about 6-1/2 million shares per day, or roughly 30 per cent below the volume in April when speculative interest in stocks was high. On the American Stock Exchange, the decline in recent volume has been even more dramatic-- amounting to a 60 per cent reduction from the April average. Demand for "blue chip" industrials and utility stocks has picked up in recent weeks, however, following further price declines--in the case of utilities to the lowest levels in three years.

Despite the narrow price movements and lower volume of activity in June, the New York Stock Exchange margin panel shows a (preliminary) June increase of \$90 million in regular margin credit. While customer's net debit balances declined slightly over the same period, this probably reflected the effects of other forms of credit which are not included in regular margin accounts. Thus, the increase in special subscription accounts, generated by the \$600 million of stocks sold through "rights" offerings in June, was apparently not sufficient to offset the sharp decline of clearing balances in cash accounts which developed as a result of the June drop-off in trading activity. Clearing balances represent temporary credit arising from the 4-day delivery rule for settling stock purchases.

Mortgage market developments. Pressures on the mortgage market mounted further in June and presumably in July, reflecting continuing lender uncertainties about the size of savings flows in the new interest-accrual period now under way. Although recent changes in the structure of competitive interest rates appear to have improved the relative flow of savings to some important local mortgage markets, a number of these markets are reportedly still quite disorganized.

Market uncertainties during the second quarter were accompanied by a drop in net mortgage debt formation among the four major private lender groups, according to tentative estimates to the lowest second quarter volume in five years. The net increase for savings and loan associations was probably less than half the rise in the peak second quarter of 1963, and only the life insurance companies showed some year-to-year advance. Moreover, acquisitions of mortgages by the FNMA are reduced from their earlier highs as further adjustments in prices and other purchase conditions were made to stem the flow of offerings of mortgages to FNMA by private lenders. As a result, the sharp year-to-year deceleration in portfolio growth of private lenders was only partially offset by additions to FNMA holdings.

NET CHANGE IN MORTGAGE HOLDINGS - Selected Groups
(Billions of dollars)

	In Second Quarter:			
	1963	1964	1965	1966P
Total, incl. FNMA	6.3	6.5	6.3	5.3
Private	6.9	6.5	6.4	4.8
Savings and loan associations	3.5	3.0	2.7	1.6
Mutual savings banks	.9	1.0	.9	.5
Commercial banks	1.7	1.4	1.7	1.4
Life insurance companies	.8	1.0	1.0	1.2
FNMA	-.6	-.1	-.1	.5

Note: Detail will not always add to total due to rounding. Second quarter data include estimates for June.

Pressures from the reduced availability of funds continued to be most acute for government-underwritten home mortgages, despite a further increase in the maximum contract rate to 5-3/4 per cent. In June, secondary market yields for FHA-insured 30-year mortgages rose 13 basis points further to 6.45 per cent. This yield was a full percentage point higher than in June 1965 and was slightly above the average contract rate (6.40 per cent) for conventional first mortgages on new homes. Contract rates for conventional loans (excluding fees and charges) also continued upward in June--an average of 10 basis points in the case of loans on new homes, and 15 basis points (to 6.50 per cent) for loans on existing houses.

While yield increases demanded by lenders have been pronounced, shortening of mortgage-loan maturities in recent months have been slight,

judging from data available through May. Also, although loan-to-price ratios have tended to be less liberal, home purchase prices have continued generally upward--reflecting among other things cost inflation and upgrading--and average loan amounts have moved to or above earlier highs.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES

	1966		Per cent change in May from a year ago
	April	May	
New home loans			
Loan amount (\$1,000)	18.2	19.2	5
Loan/price (per cent)	73.9	73.4	-1
Maturity (years)	24.6	24.7	-1
Existing home loans			
Loan amount (\$1,000)	14.5	14.7	4
Loan/price (per cent)	72.2	71.8	--
Maturity (years)	20.6	20.6	1

Source: FHLBB and FDIC.

Financial intermediaries. Midyear interest rate increases on savings accounts at the New York City mutual savings banks and the California State chartered savings and loan associations apparently prevented end-of-quarter savings outflows at these two key groups of institutions from ballooning to the proportions that had been feared. The special significance of rate changes at New York City savings banks is suggested by the comparative figures in the table. Thus, during the end-of-June grace period, when only one of the largest New York City banks had announced the move to a 5 per cent passbook rate, the net

outflow of savings for all 15 banks was larger than in the March grace period and nearly double that of June a year ago. In the first 15 days of July, on the other hand, when the new 5 per cent passbook rate had become more general, the trend was reversed; the resulting net inflow substantially exceeded that of the like period a year ago.

No comparative data for earlier periods are available for the California State chartered S & L's, but members of the industry report that net outflows during the June-July reinvestment period were both less than expected and below the March-April volume. As the table shows, about a fifth of the net shrinkage of savings capital experienced at these institutions during late June and early July had been offset by July 11. Announcement of higher passbook rates at the California S & L's did not become general until after the July 4 holiday.

Given the recently improved position of California S & L's, the question naturally arises whether associations in other parts of the country--where dividend rates are generally lower-- have done as well. To measure S & L experience for the country as a whole, the Federal Home Loan Bank Board collected net flow data from a sample of 40 associations in each District. When this sample is blown up to represent the more than 4,000 associations not surveyed, the Bank Board estimate shows a net outflow at all S & L's in the first 8 days of July of \$1.2 billion. Because of the rough character of the blow-up factor applied, this figure may be wide of the actual 8-day outflow by several hundred million dollars. Moreover, since S & L's typically experience

RECENT SAVINGS FLOWS
(In millions of dollars) 1/

<u>At the 15 largest New York City Mutual Savings Banks</u>			
	<u>June - July</u>		<u>March - April</u>
	1966	1965	1966
End of quarter grace period (3 days)	-255	-136	-205
First 2 business days of new quarter	- 47	- 19	- 87
Remaining business days to midmonth	<u>+155</u>	<u>+ 58</u>	<u>- 73</u>
Cumulative total	-117	- 97	-365

<u>At the 205 State-chartered California Savings and Loan Associations</u>		
	<u>June - July</u>	
	1966	
End of quarter grace period (4 days)	-126	
First 4 business days of new quarter	-144	No comparative data available
Next 2 business days of quarter	<u>+ 58</u>	
Cumulative total	-212	

1/ All figures exclude interest credited.

some net inflow of funds following the period of concentrated withdrawals early in July, the \$1.2 billion estimate undoubtedly overstates the likely attrition in savings capital for the month as a whole. Even so, it seems clear that the net shrinkage of savings capital in July will be large.

Evidence on reduced savings flows to financial intermediaries during the first quarter of 1966 suggested that much of the shrinkage in flows to all depository-type institutions developed from the competition of yields on directly purchased marketable securities--with commercial banks sharing in the general cut-back. While data on second quarter savings flows suggest that competition from securities markets has continued to be important, flows to savings and loan associations, and mutual savings banks also seem to have been substantially affected by competition from the commercial banks. As the table shows, flows to both the S & L's and mutual savings banks experienced a large further year-to-year contraction during the second quarter. Net flows to commercial banks, on the other hand, showed a year-to-year expansion. As a result, the commercial bank share of total flows to all three depository-type institutions jumped to 84 per cent, from 57 per cent in the first quarter and 40 per cent in the second quarter of 1965.

NET SAVINGS FLOWS TO:

	<u>S&L's</u>		<u>Mutual Savings banks</u>		<u>Commercial banks</u>	
	<u>1966</u>	<u>1965</u>	<u>1966</u>	<u>1965</u>	<u>1966</u>	<u>1965</u>

(In millions of dollars)

Unadjusted

1st quarter	1.3	1.9	.8	1.1	3.5	5.0
2nd quarter <u>2/</u>	<u>.5</u>	<u>2.3</u>	<u>.0</u>	<u>.6</u>	<u>4.4</u>	<u>2.9</u>
Total	1.8	4.2	.8	1.7	7.9	7.9

Seasonally adjusted

1st quarter	1.5	2.1	.6	.9	2.9	4.5
2nd quarter <u>2/</u>	<u>.2</u>	<u>2.0</u>	<u>.4</u>	<u>.9</u>	<u>3.1</u>	<u>1.9</u>
Total	1.7	4.1	1.0	1.8	6.0	6.4

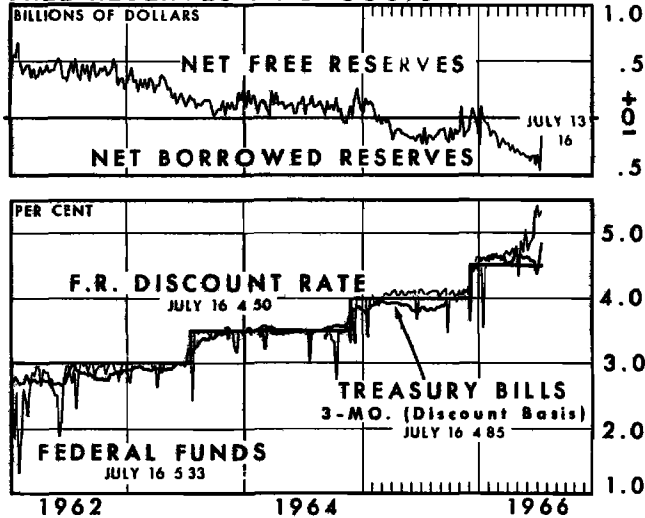
In share of total flows, seasonally adjusted

1st quarter	30	28	13	12	57	60
2nd quarter <u>2/</u>	5	41	11	19	84	40

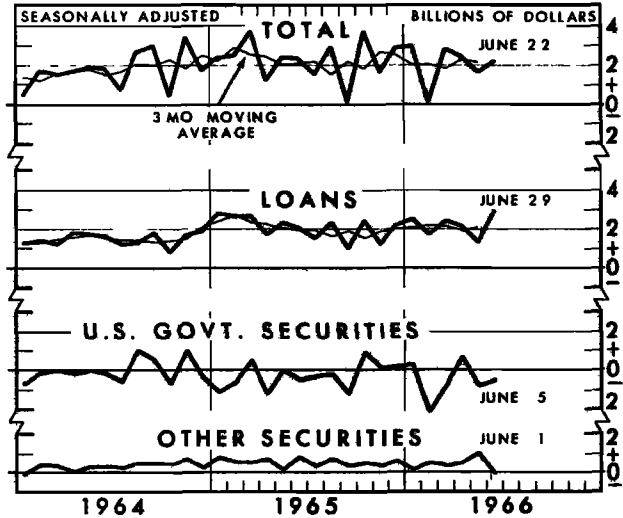
1/ Time and savings deposits, less CD's at weekly reporting banks.2/ Figures for June in second quarter are estimated.

FINANCIAL DEVELOPMENTS - UNITED STATES

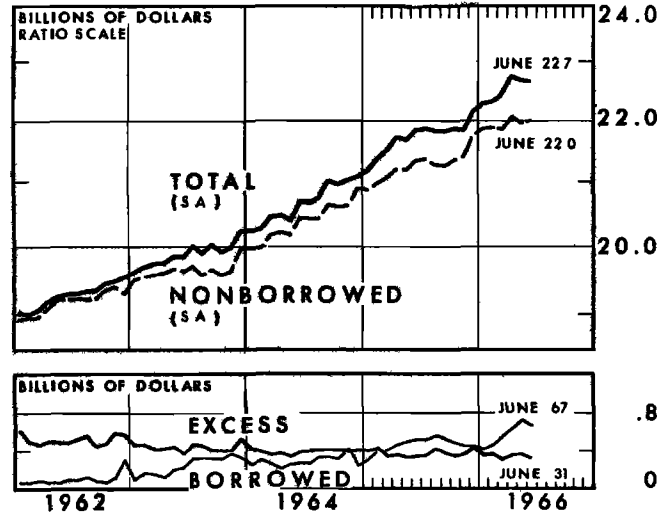
FREE RESERVES AND COSTS



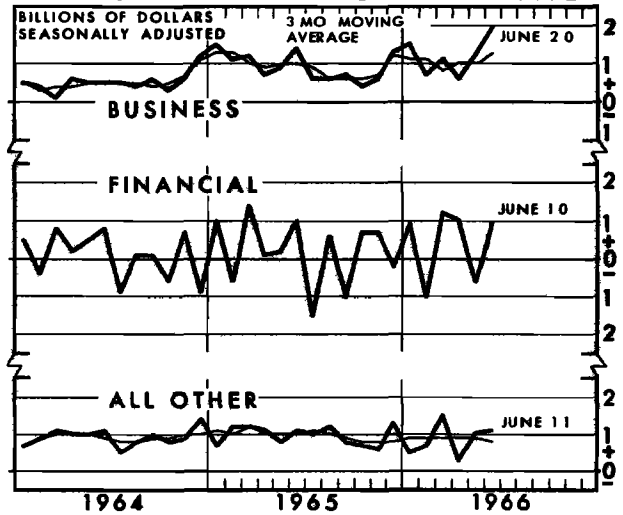
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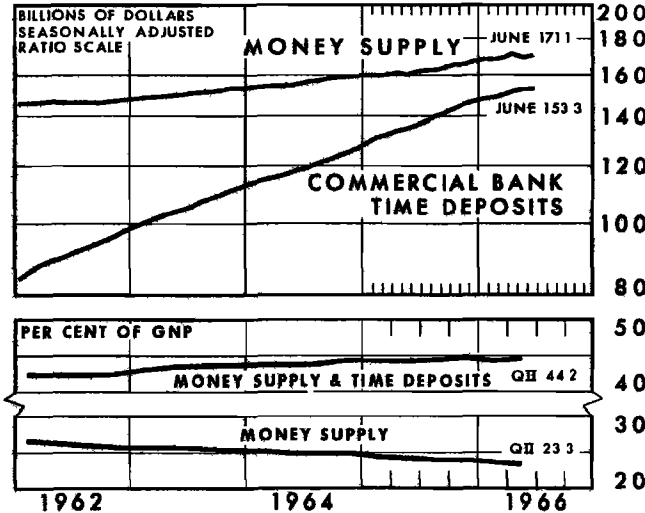
BANK RESERVES



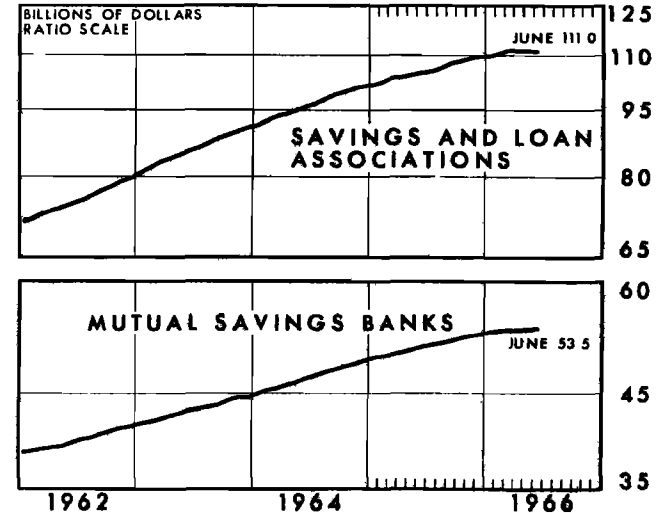
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

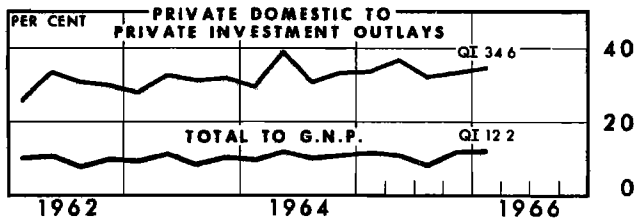
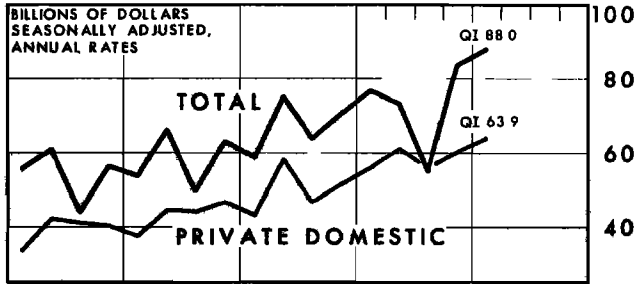


SAVINGS SHARES AND DEPOSITS

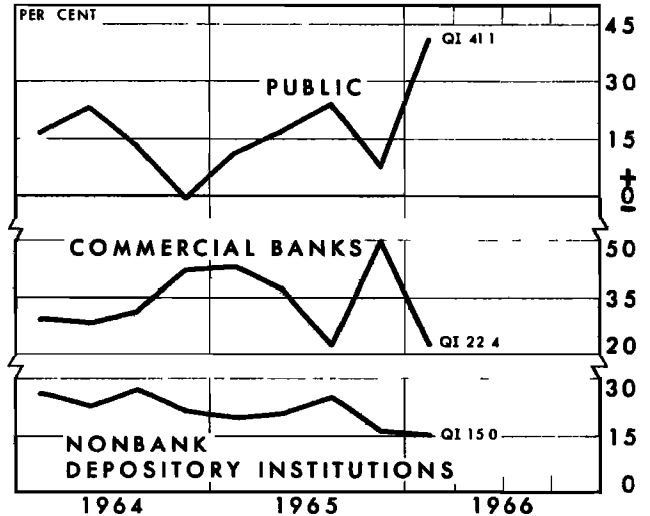


FINANCIAL DEVELOPMENTS - UNITED STATES

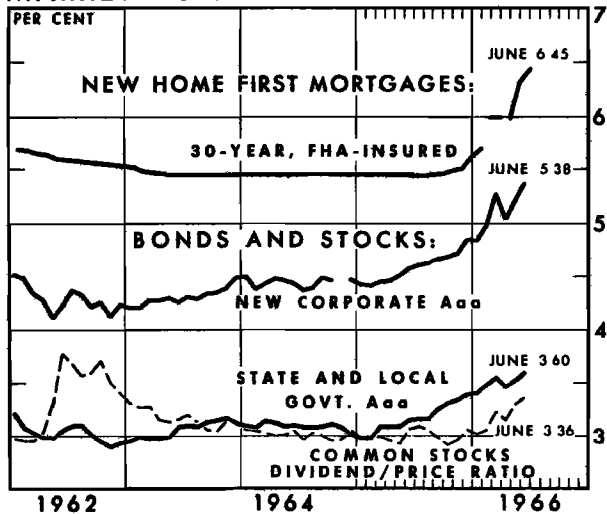
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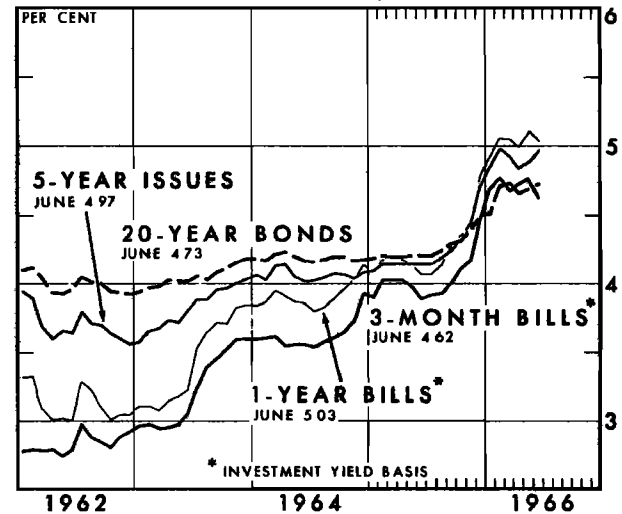
SHARES IN TOTAL CREDIT



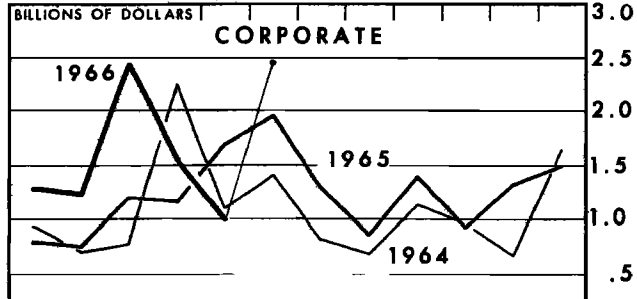
MARKET YIELDS



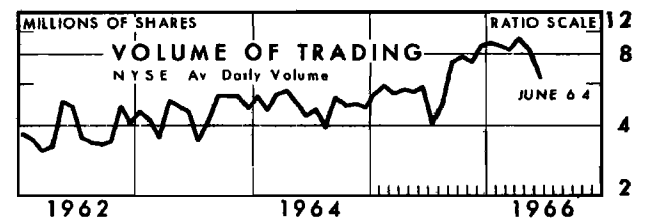
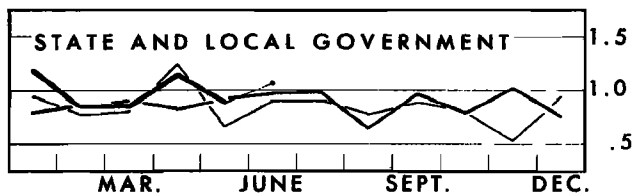
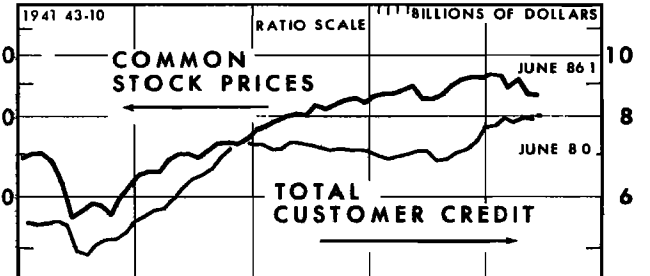
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Preliminary information for June (drawn partly from sample data) brings the second-quarter balance of payments deficit to \$270 million on the liquidity basis. After seasonal adjustment, the deficit in the second quarter was at an annual rate of close to \$1 billion, compared with the first quarter rate of \$2-1/4 billion.

This reduction in the deficit reflected an unusual bunching of special transactions. Shifts of funds of foreign monetary authorities and some international lending institutions into technically non-liquid dollar assets (U.S. Government agency bonds and time deposits maturing in over a year) reduced the liquidity deficit in the second quarter by at least \$500 million; shifts of funds by international lending institutions in June, for which data are not yet available, may increase this estimate. In the first quarter similar transactions benefitted the liquidity balance by a smaller amount, about \$150 million. Apart from these shifts, the deficit in each quarter would have been at a seasonally adjusted annual rate of about \$3 billion.

For the first half as a whole, including the reduction of the deficit by these shifts into non-liquid assets, the deficit was at an annual rate of slightly more than \$1-1/2 billion.

The stability of the deficit between the first and second quarters (before reduction by these shifts) occurred in the face of a

sharp decline in the trade surplus for April and May. For these two months combined, the excess of exports over imports was at a seasonally adjusted annual rate of only \$3 billion, down \$1-1/2 billion from the first quarter. Other factors (including a possible improvement in the trade balance in June) apparently improved by close to \$1-1/2 billion on balance between the two quarters.

Exports rose sharply in June -- reaching a seasonally adjusted rate of \$29-1/2 billion. However, for the second quarter as a whole, exports were no higher than in the first. Examination of the area distribution of exports, based on data through May, fails to shed much light on the disappointing lack of growth; the moving averages shown in the chart on page IV - C-1 have been generally rising since January for all areas except Latin America. However, a comparison of exports for the period January through May, with the same period in 1965 shows that while total exports rose about 13 per cent, exports to Canada, Western Europe, and Latin America rose at a faster rate, while gains in shipments to less-developed countries in Asia and Africa were smaller than the over-all average increase. Exports to Australia, New Zealand and South Africa were down 14 per cent. The year-to-year gain in total exports was concentrated in grains and machinery. Aircraft exports, for which order backlogs have increased sharply, were little changed.

Imports in April-May rose 4 per cent from the first quarter; June data are not yet available. Much of this rise appears to have reflected a resumption of imports of industrial materials which had

been held down in the first quarter by sales from Government stockpiles and by lower imports of steel. But imports of steel were higher in April-May than in the first quarter, and imports of consumer durables, other than autos, rose further.

Largely offsetting the effects of the decline in the trade surplus was a reduction in new foreign security issues. Offerings of new foreign issues, almost entirely Canadian, declined after April, and for the quarter the net outflow was about \$225 million seasonally adjusted. This was only half the first quarter rate, which had been swollen by postponements of some Canadian issues from late last year.

Foreign private purchases of U.S. corporate stocks, including rights offerings, increased in April and May, to offset much of the larger net sales from the official British portfolio. Total net foreign sales of U.S. stocks in the first 5 months have been only \$85 million, less than half the rate of 1965, although net British sales (possibly including some private sales) were \$235 million in the first 5 months, compared to \$400 million for all of last year. Foreigners made net purchases of more than \$100 million of U.S. corporate bonds in the first five months of 1965 (in addition to the special purchases of U.S. Government agency issues mentioned earlier). Through mid-June, their purchases of new issues by domestic affiliates of U.S. corporations established to finance direct investment abroad are estimated at \$300 million, implying some net reduction in their holdings of other corporate bonds.

Net outflows of bank credit, which resumed in May, continued in June, according to preliminary information under the VFCR. The net

outflow of roughly \$60 million in the second quarter was only about equal to the normal seasonal rise. In the first quarter there was a net reflow of about \$250 million, seasonally adjusted. U.S. banks continued to trim their rate of commitment on new term loans to foreigners. In the second quarter, these commitments averaged about \$50 million per month, down from \$70 million per month in the first quarter and \$100 million per month in the second half of 1965.

Speculative attack on sterling. U.K. reserve losses since the first of July have been the heaviest since the exchange crisis in November 1964. The underlying cause of speculative pressure has been the continuing rise in British wages and prices. The new attack against sterling was set off by the announcement of a sizable reserve loss in June, despite the use of central bank aid, and was nourished by various evidences that U.K. policies for dealing with inflation and the balance of payments have not yielded hoped-for results.

A series of Government policy announcements on July 12 and 14 failed to bolster sagging confidence in sterling. On July 12, Chancellor Callaghan announced that the ceiling on bank advances -- 105 per cent of the March 1965 level -- would remain in effect until March 1967 and until further notice thereafter. He also stated that contrary to his plans last April, no special arrangements would be made with the banks to help companies pay their initial selective employment tax liabilities, which fall due in early September. On Thursday, July 14, the Bank of England raised Bank rate from 6 to 7 per cent and at the same time raised the special deposit requirements of the London clearing banks from 1 to 2 per cent and those for the Scottish banks from 1/2 to 1 per cent. This announcement brought only a temporary pause in the attack against the pound, and late that day the Prime Minister announced that his government would soon disclose new measures that would dampen private and public spending in Britain and cut the foreign exchange costs of national defense. The vagueness of this announcement contributed to a further deterioration of market conditions on Friday, July 15. Selling

pressures against the pound continued on July 18 and 19. The Government's new measures, which are being made public as these notes go to press, will be reported in the Supplement.

Current economic situation in industrial countries. In the majority of industrial countries economic policies continue to be concentrated on holding down the inflation of wages and prices. This is the case in Britain, Germany, the Netherlands, Switzerland and Sweden, and also in Canada. In some countries policies are being directed toward a cautious restimulation of demand after previous periods of restraint; these countries include France, Italy, Austria, and Japan.

INDUSTRIAL PRODUCTION
(Indexes, 1960-100; percentage changes)

	<u>Indexes (1966)</u>			<u>Annual rates of change^{1/} to 1966-I from:</u>		
	April	March	Q-I	1965- IV	1965- III	1965- I
United Kingdom	117	118	118	1	3	1
EEC	<u>139</u>	<u>139</u>	<u>137</u>	<u>5</u>	<u>6</u>	<u>5</u>
Germany	<u>137^{a/}</u>	<u>137</u>	<u>135</u>	<u>6</u>	<u>5</u>	<u>3</u>
France	135	135	134 ^{b/}	<u>0^{c/}</u>	5	7
Italy	150	149	148 ^{b/}	7	9	10
Belgium	134	134	135	-1	7	1
Netherlands	143	142	140	9	12	7
Sweden	118	119	118	-7	-1	-1
Austria	129	129	128	7	3	3
Canada	153	152	151	12	10	11
Japan	186 ^{d/}	184	182	18	10	5

^{1/} Computed from rounded monthly indexes as published by OECD.

^{a/} May: 135.

^{b/} Depressed by strikes.

^{c/} Output was abnormally high in December, preceding the January strikes.

^{d/} May: 188.

Despite differences in inflationary pressures, expectations for growth of real GNP in coming months, expressed in terms of the annual rate of increase from the first to the second half of 1966, cluster around 4-1/2 or 5 per cent with a few notable exceptions. In Japan, growth of real GNP at an annual rate of about 9 per cent is expected. In Britain and Belgium growth is expected to fall far short of the average.

In April, industrial production was above its first-quarter average in all countries shown in the table above except Britain, Belgium, and Sweden. In most of the Common Market countries, annual rates of increase in industrial production have been in the 5 to 10 per cent range since the third quarter of last year.

In Britain, total industrial production has been virtually stable since October, with advances in output in some industries, including machinery, offset by declines elsewhere. Since November, retail sales (excluding autos) have moved up only slightly in volume. However, sales have risen more noticeably in value, as retail prices continue to rise at a rate of 4 per cent a year.

With the unemployment rate unchanged from January to June at only 1.2 per cent of the labor force and with wages rising rapidly, disposable incomes are continuing to increase. In March-April, average weekly earnings in manufacturing were 9 per cent higher than a year earlier. The basic problem of upward wage and price pressures remains acute.

Private residential construction has been declining since the end of 1964, but public authorities were still increasing housing

construction throughout 1965. Non-residential fixed investment outlays, adjusted to real volume terms, have continued to rise in the public sector (utilities, rails, communications), have fluctuated without clear trend in manufacturing, and have tended to decline in the private services and distributive trades.

The selective employment tax is expected to cause a rise in prices for services and thereby restrain aggregate real consumption. It will also tend to curtail investment further in the private services and distribution sector. Other restrictive measures, including tight credit as well as the new measures announced today, will check the rise in public sector investment and are likely to bring a fall in manufacturing investment.

In Germany business developments are mixed. Some signs suggesting that the period of somewhat slower economic expansion may be coming to an end are these: sharply increased foreign demand this year compared with most of 1965; continued strong consumer demand supported by rapidly rising wages; and a renewed uptrend in public construction, even in the face of increasing financing difficulties. On the other hand, a further slowdown in private investment demand appears to be occurring, particularly in the investment goods sector itself. Symptoms of the over-all easing of demand pressures, at least until lately, include the leveling off in imports of materials and semi-finished products, and a slight easing in the very tight labor market situation.

Industrial production, after remaining relatively stable during the last nine months of 1965, began to expand again in early 1966. In May, however, output was somewhat reduced from the high Marcy-April level.

Germany's GNP, in real terms, in the first quarter of 1966 was 4 per cent above its level a year earlier. Construction activity, which was hampered last year by bad weather conditions, was sharply higher. Apart from this recovery in construction activity, the rate of real GNP growth since a year ago is estimated at about 3-1/2 per cent.

With foreign orders flowing to those industries, such as machinery, where domestic demand is weakening, not much further easing of pressures on resources is expected. Consequently, German economic policies will probably continue to remain restrictive.

Business conditions in France have continued to improve as demand has expanded further. The major development has been a decided revival in private investment demand, the first signs of which became apparent in the last two months of 1965. Order backlogs in the equipment industries have been building up rapidly, while at the same time their output has risen sharply. The ten per cent investment tax credit, applicable to deliveries of investment goods after February 15, has added momentum to the underlying upward trend.

French private consumption demand remains strong, as employment is increasing (though the decline in unemployment since last autumn has been only moderate) and the upward movement of wages is accelerating. Only in those areas where growth was very fast in the latter half of 1965 -- for example, demand for automobiles -- does there appear to be some slowdown. Residential construction, which was tending to level out last year after a boom of several years' duration, may be declining somewhat this year.

The general outlook for the remainder of 1966 appears strong. The National Accounts Commission recently revised its GNP estimates, putting the rise in real GNP from 1965 to 1966 at 5 per cent instead of the 4.5 per cent projected in September 1965.

Demand expansion in Italy continued to gather strength through the first half of 1966. The available resources can still easily accommodate substantial further increases in demand. Italy is thus the only country on the European continent where renewed price pressures do not -- at least for the moment -- present a policy problem.

The recovery continues to be carried by private consumption demand: retail sales have expanded vigorously, and demand for new cars has begun to rise again since the beginning of the year. Currently there are signs that other areas of demand may also be strengthening. Order backlogs for investment goods have been rising. Business surveys since January have been increasingly bullish and show that producers of investment goods expect a substantial advance in demand for equipment.

Building permits issued for residential construction, after declining for two years, have begun to rise again and in December and January (latest available) exceeded their year-earlier levels. Recovery in construction will be especially helpful in reducing unemployment.

Economic expansion in Canada has continued at a fast pace through the spring of 1966. GNP, in real terms, in the first quarter of 1966 was 7 per cent above a year earlier, with private investment outlays and exports up particularly sharply. While industrial production has continued to increase rapidly, pressures on resources appear to have increased. Order backlogs have risen. The unemployment rate, which

was at 4 per cent by the end of 1964, declined further last year. Since September 1965 it has fluctuated within a range of 3.3 to 3.7 per cent; in May it was at the upper end of this range.

The Government has taken a number of monetary and fiscal measures this year to restrain growth of demand. The Bank of Canada's discount rate was raised in March. The 1966/67 budget reduced public investment spending. A number of tax measures designed to postpone private investment have been enacted, and the 10 per cent income tax cut passed in 1965 was revised down for middle and above-average incomes.

An early reaction to tight money and rising construction costs was a downturn in the value of building permits early this year, particularly for residential construction, following a three-year advance to a peak at the end of 1965.

In Japan, a strong upswing in industrial production has been under way since last October. Following an earlier upturn in consumer goods output, production of materials has been rising rapidly. Output of investment goods has also increased.

Business profits have improved. In the six months ending March 31, 1966, profits of 340 top corporations are estimated to have been 15 per cent greater than in the previous six months, although not as large as a year earlier. Although the number of corporate bankruptcies has remained high, both the amount of debt per bankruptcy and the total amount of debts involved have been declining.

Business inventory data for recent months show typical responses to rising demands. Producers' inventories of finished goods

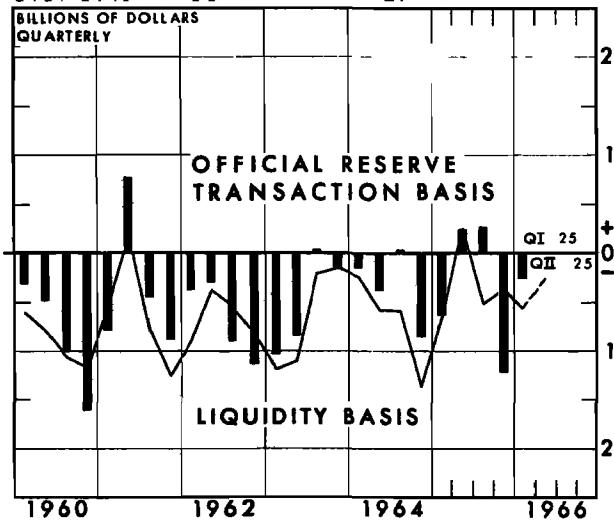
fell 4 per cent from March to May, after changing little in the six months since September. Raw materials inventories, on the other hand, showed signs of rising this spring after remaining relatively steady since mid-1964. Between February and May they increased 3 per cent.

Wholesale prices have continued to rise, increasing 0.6 per cent in June to a level 4.4 per cent higher than a year earlier. This 12-month increase is an especially sharp rise for Japan.

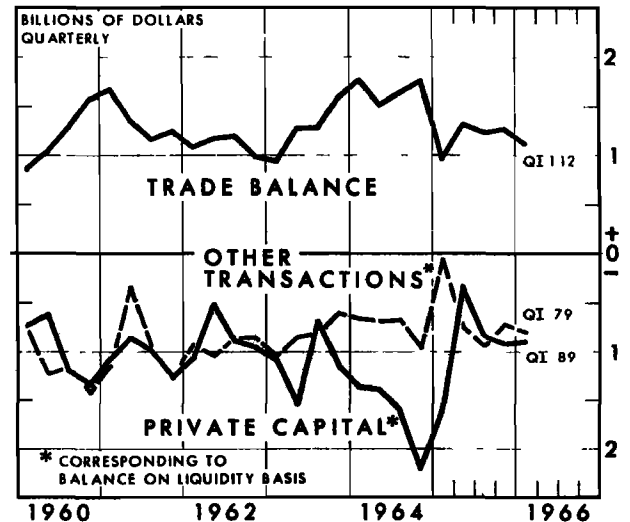
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

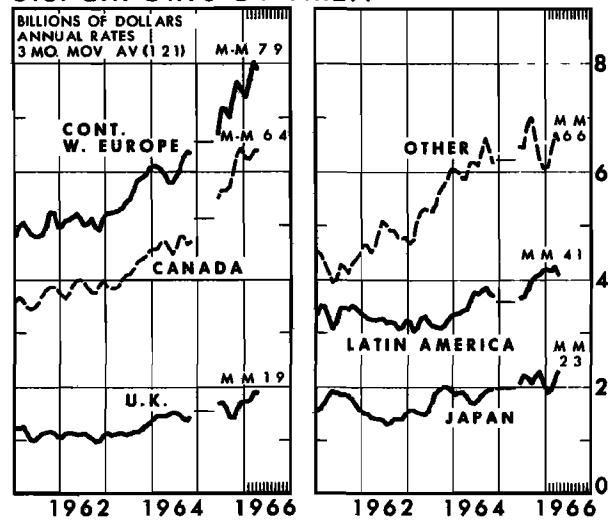
U.S. BALANCE OF PAYMENTS



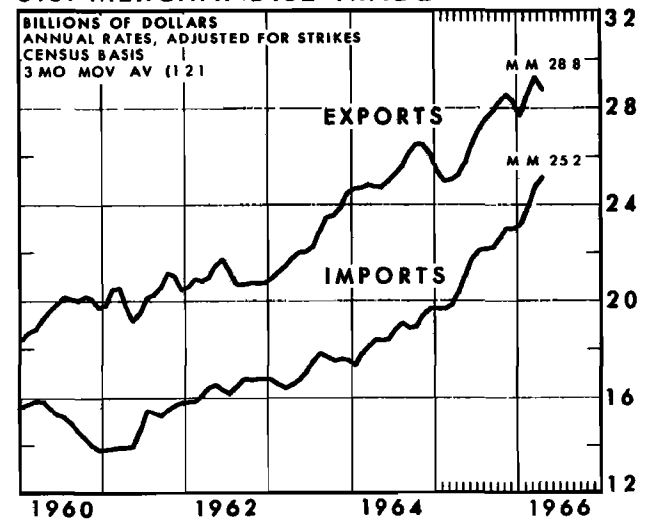
U.S. BALANCE OF PAYMENTS - CONT.



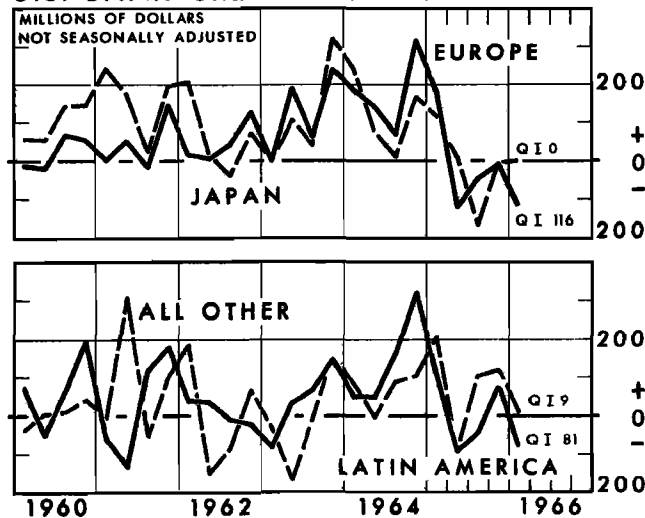
U.S. EXPORTS BY AREA



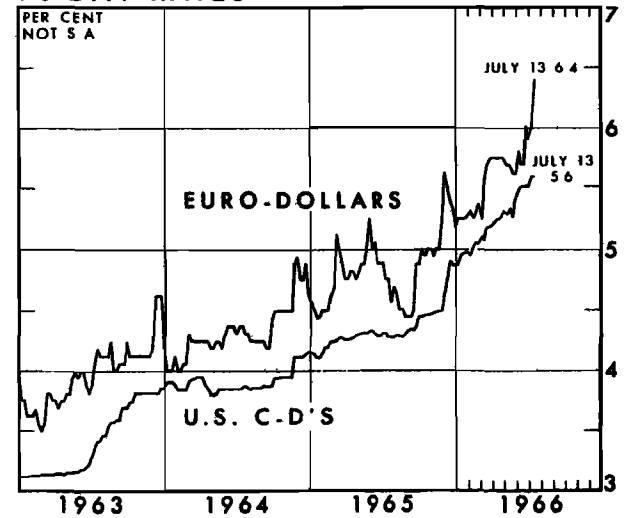
U.S. MERCHANDISE TRADE



U.S. BANK CREDIT OUTFLOWS



90-DAY RATES



APPENDIX A:
SURVEY OF BANK LENDING PRACTICES, JUNE 1966*

The results of the eighth quarterly survey of changes in bank lending practices are summarized in the following paragraphs and accompanying tables. Reports were received from the 81 banks included in the quarterly interest rate survey.

Nearly three-fourths of the respondents (58 out of 81 banks) reported a firming of loan demand in the second quarter of this year--somewhat less than the record four-fifths in the first quarter. There was also a decline in the number of banks reporting a firming in their policies from the record numbers that reported such action in the first quarter of this year. Significantly no bank eased policies during the second quarter in any area covered by the survey.

These results may reflect in part the mid-June timing of the survey at most banks. This preceded the late-June surge in loan demand and the increase in the prime rate at the end of the month. Ten survey banks reported their lending practices as of the beginning of July and all of these indicated stronger loan demand and greater firming of lending practices than was typical of banks that reported as of mid-June.

About four-fifths of the respondents stated that their policies were firmer on both interest rates and compensating balance requirements for business borrowers in the second quarter. In the March survey, which immediately followed the March 10 raising of the prime rate, all survey banks had firmed their policies on interest rates and four-fifths on compensating balance requirements. Between three-tenths and half of the banks also had tightened their policies on other terms and conditions of their loans in the second quarter and more than half of the banks indicated they were less aggressive in seeking new loans and were less willing to make term loans than formerly.

In lending to finance companies, as in lending to other businesses, fewer banks firmed their policies than in the first quarter of this year. As in previous surveys, the firming affected finance companies to a smaller degree than nonfinancial businesses.

In explaining changes in their policies a number of banks commented on the limited availability of loanable funds in the face of continued heavy demand for loans. One Chicago bank stated that it had been compelled to turn down any sizable requests from new customers for the past three months in order to take care of its regular customers. In commenting on the heavy demand for loans one bank stated that many of the new applicants came from outside its banking area and another

* Prepared by Caroline H. Cagle, Economist, Banking Section, Division of Research and Statistics.

indicated that these applicants included a substantial number that had been declined loans by their regular banks. In summing up the changes in its lending practices, a large New York City bank indicated that money market pressures and reduced liquidity had now become overriding factors in loan decisions.

A - T--1

U. S. Total
 Survey of Changes in Bank Lending Practices
 March - June 1966.

(Number of banks)

Lending to Nonfinancial Businesses

	<u>Stronger</u>	<u>Weaker</u>	<u>Unchanged</u>
1. Strength of loan demand	58	--	22
	<u>Greater</u>	<u>Less</u>	<u>Unchanged</u>
2. Aggressiveness of bank in seeking new loans	--	44	36
3. Factors considered in deciding whether to approve credit requests:			
	<u>More important</u>	<u>Less important</u>	<u>Unchanged</u>
Applicant's value to the bank as a depositor or source of collateral business	59	--	22
Applicant's intended use of loan proceeds	57	--	24
4. Practices with respect to reviewing lines of credit or loan applications of:			
	<u>Firmer</u>	<u>Easier</u>	<u>Unchanged</u>
Established customers	36	--	45
New customers	68	--	13
Local service area customers	39	--	41
Nonlocal service area customers	57	--	22
5. Terms and conditions of loans:			
	<u>Firmer</u>	<u>Easier</u>	<u>Unchanged</u>
Interest rates	65	--	16
Compensating or supporting balances	63	--	18
Standards of credit-worthiness	37	--	44
Type and amount of collateral	24	--	57
Maturity	37	--	43

A - T--1 (cont.)

6. Term Loans

	<u>More willing</u>	<u>Less willing</u>	<u>Unchanged</u>
Willingness to make	--	45	36
	<u>Longer</u>	<u>Shorter</u>	<u>Unchanged</u>
Maximum maturity bank will approve	--	6	74
	<u>Years</u>	<u>Number of banks</u>	
	1	1	
	2	1	
	3	7	
	5	37	
	6	1	
	7	8	
	8	4	
	10	2	
	n.a.	20	

Lending to Finance Companies

	<u>Firmer</u>	<u>Easier</u>	<u>Unchanged</u>
Interest rates	47	--	34
Size of compensating or supporting balances required	34	--	47
Enforcement of balance requirements	43	--	38
Establishing new or larger credit lines	60	--	21

Source: Survey of Lending Practices at Large Banks in the Federal Reserve Quarterly Interest Rate Survey conducted as of June 15, 1966. At ten banks the date of the report was, June 30, or July 1, 1966.

Net Number of Banks Reporting Firmer Lending Policies in Lending Practices Survey
(Number of banks reporting firmer policies less number reporting easier policies)

Item	Date of Survey							
	June 1966	Mar. 1966	Dec. 1965	Sept. 1965	June 1965	Mar. 1965	Dec. 1964	Sept. 1964
<u>Lending to nonfinancial businesses</u>								
Aggressiveness of bank in seeking new loans	44	51	24	13	11	-6	-2	-2
Factors considered in deciding whether to approve credit requests:								
Applicant's value to the bank as a depositor or source of collateral business	59	70	53	36	33	24	34	44
Applicant's intended use of loan proceeds	57	61	29	16	16	20	14	25
Practices with respect to reviewing lines of credit or loan applications of:								
Established customers	36	42	18	6	4	4	6	2
New customers	68	73	51	32	35	19	21	26
Local service area customers	39	42	15	8	8	3	7	4
Nonlocal service area customers	57	62	35	35	27	15	22	27
Terms and conditions of loans:								
Interest rates	65	81	77	44	40	46	35	13
Compensating or supporting balances	63	64	51	39	28	29	33	22
Standards of credit-worthiness	37	45	29	22	22	15	22	30
Type and amount of collateral	24	30	15	10	12	10	14	15
Maturity	37	48	23	11	14	5	4	3
Term loans:								
Willingness to make	45	45	23	14	13	6	7	7
Maximum maturity bank will approve	6	12	8	-	3	-2	-2	-4
<u>Lending to finance companies</u>								
Type of requirement:								
Interest rate	47	76	75	10	10	13	12	3
Size of compensating or supporting balances required	34	35	26	5	11	7	8	-
Enforcement of balance requirements	43	47	38	18	19	17	22	13
Establishing new or larger credit lines	60	62	47	38	23	13	16	18
Strength of loan demand (net number reporting stronger demand)	58	67	54	41	45	37	27	48

**APPENDIX B:
REVISED SERIES FOR COMMERCIAL BANK CREDIT***

Seasonal factors have been revised for total bank credit and for three major components. Revised data from 1948 to date will be published in the July Bulletin, and references to bank credit in this issue of the Green Book are based on the revised series. The accompanying table provides revised data beginning with 1963 covering the principal revisions.

The most noticeable change in the seasonally adjusted series is in movements of total loans and investments around midyear. Seasonal factors for June have been raised, reflecting increasing expansion of loans to businesses, finance companies, and security dealers during the tax and dividend period. The sharp reversal of June credit expansion in the following month is reflected in lower seasonal factors for total bank credit in July.

To some extent this reduced seasonal importance of July reflects larger repayments of loans, although shifts in Treasury financing patterns are the most important change influencing the July factors. Until recent years, banks typically increased their holdings of U.S. Government securities and their security loans in July, as the Treasury normally engaged in large cash financings in that month and also sold 1-year bills at midmonth. With these large cash financings shifted to other months, and with the 1-year bill cycle changed from a quarterly to a monthly basis, banks now reduce their holdings of U.S. Government securities and security loans seasonally in July. For additional details regarding the revision, see the description accompanying the revised data in the July Bulletin.

* Prepared by Edward R. Fry, Economist, Banking Section, Division of Research and Statistics.

Loans and Investments at Commercial Banks Revised Seasonally Adjusted Series
(Last Wednesday of Month,^{1/} In Billions of Dollars)

Month	Total ^{2/}	Loans ^{2/}	Securities	
			U.S. Gov't.	Other
1963--January	229.6	134.8	65.0	29.8
February	231.6	136.4	64.9	30.2
March	232.3	137.2	64.4	30.7
April	233.3	137.6	64.4	31.2
May	235.5	139.3	64.3	31.9
June	237.2	141.0	63.9	32.3
July	239.5	142.8	63.8	32.8
August	239.5	143.6	62.4	33.5
September	241.5	145.4	62.2	33.8
October	242.1	146.7	61.2	34.3
November	244.2	148.4	61.4	34.4
December	246.2	149.7	61.5	35.0
1964--January	246.7	151.0	60.8	34.9
February	248.4	152.4	60.7	35.3
March	249.9	153.6	60.7	35.6
April	251.6	155.4	60.5	35.6
May	253.6	157.1	60.5	35.9
June	255.3	158.7	60.3	36.2
July	256.0	159.9	59.7	36.4
August	258.7	161.2	60.7	36.9
September	261.7	163.0	61.2	37.4
October	262.1	163.8	60.5	37.8
November	265.5	165.5	61.5	38.5
December	267.2	167.4	61.1	38.7
1965--January	269.6	170.2	60.0	39.5
February	272.1	172.8	59.4	40.0
March	275.8	175.4	59.9	40.5
April	277.0	177.1	58.7	41.2
May	279.4	179.4	58.7	41.3
June	281.7	181.4	58.2	42.1
July	283.2	182.9	57.9	42.4
August	286.1	185.2	57.7	43.1
September	286.2	186.2	56.5	43.4
October	289.9	188.6	57.4	43.9
November	291.5	189.8	57.5	44.2
December	294.4	192.0	57.7	44.8
1966--January	297.4	194.5	58.0	44.9
February	297.5	196.2	55.9	45.4
March	300.3	198.6	56.0	45.7
April	302.7	200.7	55.8	46.2
May	304.3	202.0	55.0	47.2
June	305.4	203.7	54.5	47.1

^{1/} Data are partly estimated except for June 30 and December 31 call dates. Data for December 31, 1963 and for June 30, 1966 are estimated.

^{2/} Interbank loans excluded. June 1966 estimates exclude about \$1.1 billion of deposits accumulated for payment of personal loans.

**APPENDIX C:
REVISION OF GROSS NATIONAL PRODUCT AND NATIONAL INCOME ESTIMATES***

The national income and product accounts have undergone their regular annual revision to incorporate data which have become available since the earlier estimates were made. The revision covered the period from the first quarter of 1963 to the first quarter of 1966 and the earlier estimates of gross national product have been raised for each quarter. The changes are typically small but the cumulative effect is to raise the level of GNP in the first quarter of this year by \$7.3 billion to an annual rate of \$721.2 billion -- 1 per cent above the former figure. The increase in total GNP now shown for the first quarter of 1966 is almost the same as the former increase.

The implicit price deflators were changed only slightly during the revision period and thus, virtually all the revisions in the current dollar estimates are reflected in the constant dollar figures. Real GNP is now shown to have risen a little more rapidly throughout this period than indicated by the earlier data.

**PER CENT INCREASE IN REAL GROSS NATIONAL PRODUCT
(In annual rates)**

	<u>GNP Estimates</u>	
	<u>Revised</u>	<u>Former</u>
1963	4.0	3.8
1964	5.3	5.0
1965	5.9	5.5
1962 IV - 1963 IV	4.4	4.0
1963 IV - 1964 IV	4.5	4.4
1964 IV - 1965 IV	7.5	6.8
1962 IV - 1966 I	5.5	5.2

The upward revision in total GNP in 1963 was largely due to higher estimates for each major type of personal consumption expenditures. And in 1964 and 1965 the durable and nondurable consumption items were revised up slightly further. State and local

*Prepared by J. Cortland G. Peret, Economist, National Income, Trade, and Labor Section, Division of Research and Statistics.

purchases of goods and services were also revised up somewhat in 1964 and 1965, while outlays for producers' durable goods were revised down a little. The earlier estimates of investment in nonresidential structures (construction) were also revised up in the latter half of last year. The earlier estimates of change in nonfarm business inventories were little changed for the period through 1965, but for the first quarter of this year the revised estimate is \$1.1 billion (annual rate) higher than the earlier figure.

The pattern of Federal defense spending was altered slightly as defense purchases were revised up in the latter part of 1965 and then down in the first quarter of 1966. The present second quarter estimate, however, is the same as we were using with the older estimates.

Corporate profits and personal income were also revised up. The present estimate of corporate profits for the first quarter of this year is nearly 2 per cent higher than the earlier one. The new estimates of personal income, both before-tax and after-tax, are 1.3 per cent higher; less than half of the increase was in wages and salaries with most of the balance in farm income, personal interest income, and transfer payments. The personal saving estimate for the first quarter also was raised somewhat, as the estimate of personal consumption expenditures was revised up less than 1 per cent.

The revised figures show Federal government receipts on income and product account to be a little higher than shown earlier throughout all except the very early part of the period, while Federal expenditures (total) were virtually unchanged. Thus, the revised figures show the Federal surplus to be larger or the deficit smaller than indicated by the earlier figures.

FEDERAL GOVERNMENT SURPLUS OR DEFICIT (-) ON NATIONAL
 INCOME ACCOUNT BASIS
 (Billions of dollars, seasonally adjusted, annual rate)

	Estimates	
	Revised	Former
1963, calendar	.7	.3
1964, "	-3.0	-3.8
1965, "	1.6	.7
1963 - I.	-2.4	-2.5
II	1.8	1.8
III	1.2	.6
IV	2.1	1.2
1964 - I	-1.9	-2.6
II	-6.7	-7.6
III	-3.0	-3.6
IV	- .5	-1.1
1965 - I	4.5	3.6
II	4.4	3.8
III	-2.5	-2.9
IV	- .2	-1.8
1966 - I	2.3	.3