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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the  
Federal Open Market Committee

By the Staff  
Board of Governors  
of the Federal Reserve System

November 19, 1965

## SUPPLEMENTAL NOTES

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### The Domestic Economy

Personal income in October was at a seasonally adjusted annual rate of \$540.2 billion. This was nearly 7.5 per cent higher than a year earlier but \$5.5 billion below September which had included the large retroactive lump-sum payment of social security benefits. If this one-time payment is excluded from the September total, the increase in October was \$5 billion -- the largest monthly gain this year.

The October rise reflected a \$3.2 billion (annual rate) increase in payrolls, a rise of \$1.2 billion in social security payments because of the 7 per cent increase in OASI benefits appearing in the regular checks for the first time (only the retroactive payment had been made in September), and small increases in most other types of personal income which totaled nearly \$1 billion.

The rise in payrolls was the largest this year. Private payrolls were up \$2 billion with manufacturing accounting for half of this as employment, hours worked per week, and hourly earnings all advanced. The largest increase was again in durable goods industries. Wages and salaries in construction, trade, and service industries also rose. Almost half of the \$1 billion increase in government payrolls was due to the pay raise for Federal civilian employees.

Seasonally adjusted private housing starts, including farm, dipped in October. While this followed a 2 per cent upward revision for September, the seasonally adjusted annual rate was somewhat below the reduced August rate and the lowest this year. On a three-month

moving average basis, starts in the most recent period were at an annual rate of 1.43 million, down slightly from the third quarter average and well below the recent peak in the first quarter of 1964.

Unlike starts, seasonally adjusted residential building permits advanced in October from a revised (upward) September rate. Multifamily permits edged downward further but permits for single family units recovered sharply to a high for this year. Regionally, the overall advance in permits was mainly in the South, but the West also showed some rise.

PRIVATE HOUSING STARTS AND PERMITS

		October <u>1</u> / (thousands of units)	Per cent change from	
			Month ago	Year ago
Starts	(total)	1,402	- 3	- 8
Permits	(total)	1,239	+ 5	--
1	family	744	+10	+ 5
2-or-more	family	495	- 2	- 6
North East		248	- 3	+13
North Central		296	- 5	- 1
South		432	+19	+ 8
West		263	+ 4	-17

1/ Seasonally adjusted annual rate; preliminary.

New orders for durable goods in October were about unchanged from September and from the third quarter average, but they continued well above shipments and unfilled orders expanded further. New orders for machinery and equipment increased appreciably in October. New orders for defense products declined from the exceptionally high September level but remained well above most earlier months this year.

Unfilled orders for both machinery and equipment and defense products continued to expand at a substantial rate. The steel order backlog showed another sizable decline in October although new orders rose moderately from the sharply reduced September level.

### The Domestic Financial Situation

Trading activity in common stocks has picked up again this week to an average of 8.2 million shares daily, the highest since mid-October. While the Standard and Poor's index of 500 stocks has shown little change on balance, price volatility in the most actively traded individual issues -- many of them speculative and glamour types -- has been great.

During the month of October, total customers' credit in the stock market rose \$81 million to \$7.1 billion. Virtually all of this increase was attributable to a moderate \$79 million increase in customers' net debit balances. Bank loans to others rose \$2 million.

### International developments

Li. moving to adopt in modified form some of the recommendations made last spring by the Review Committee for Balance of Payments Statistics (the "Bernstein Committee"), the Government is now summarizing the payments position in a new way, as will be seen from the table in the Commerce Department release. Two balances are shown, as memorandum items. Neither is to be regarded as the measure of the position.

Line A shows a "liquidity" balance, measured by changes in U.S. reserves and in liquid U.S. liabilities to all foreigners

(including convertible Roosa bonds). This balance has been published regularly for about 10 years, but has not recently received much attention. Line B shows an "official settlements" balance, measured by changes in U.S. reserves and in liquid and certain nonliquid U.S. liabilities to foreign official agencies, mainly monetary authorities. This is the type of balance favored by the Bernstein Committee. The balance on "regular types of transactions," which was invented in 1963 as an interim measure pending the Bernstein Committee's study, is no longer published, although it can still be readily computed.

For both of the balances to be published henceforth, debt prepayments (line 8 of the table) and military prepayments (line 10) are treated as receipts that reduce the deficit, rather than as settlement items that help to finance the deficit. (These items must still, of course, be taken into account in analysis, like other large and lumpy transactions.) The Bernstein Committee recommended the treatment now adopted for military prepayments. It recognized that debt prepayments might be handled in different ways for different purposes, and Government statisticians found decisive advantages in the treatment now adopted.

The "official settlements" balance differs in two ways from the "liquidity" balance. First, changes in liquid U.S. liabilities to foreigners other than official agencies (line 13) are placed above the line as ordinary capital flows. Second, changes in certain nonliquid liabilities to foreign monetary authorities are placed below the line as financing items. At present, this second item consists solely of sales and redemptions of nonconvertible Roosa bonds payable in foreign

currencies (line 12), of which there have been none thus far in 1965. Whether to include other foreign official claims on the United States is still being debated. Additional candidates for inclusion include time deposits of foreign monetary authorities with a maturity of more than one year, and the Roosa bonds sold to Canada in 1964 in connection with the Columbia River transactions. It seems likely that ad hoc determinations will continue to be required as to the appropriate classification of new types of Government transactions as they arise.

The marked difference in behavior between the "liquidity" balance and the "official settlements" balance between the second and third quarters of 1965 -- when the former worsened by \$732 million while the latter improved by \$50 million, seasonally adjusted -- occurred mainly in July and August. At that time, large shifts from foreign official to foreign private holdings of liquid U.S. assets resulted from the sterling crisis and from the Italian commercial banks' use of dollars, purchased from the central bank on a swap basis, to build up their assets in the Euro-dollar market. In September, private shifts from sterling into dollars began to be reversed, and shifts in the opposite direction have continued since then. Recently, the Italian banks and monetary authorities have reduced the pace of their swap transactions, apparently in accordance with the desires of both parties.

As a result, the U.S. balance of payments reverted to deficit on the "official settlements" basis in September. It seems likely to remain in deficit on any basis of calculation in the fourth quarter.



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THE U.S. BALANCE OF INTERNATIONAL  
PAYMENTS IN THE THIRD QUARTER

The balance of international payments, as measured by changes in U. S. official reserve assets and in liquid liabilities to all foreigners, was adverse by \$485 million in the third quarter, after allowance for seasonal factors, the U. S. Department of Commerce announced today. This compares with a favorable balance of \$247 million for the second quarter. (See memorandum item A of the attached table.)

Reserve assets were reduced by only \$40 million in the third quarter, following a \$68 million dip in the second. Liquid liabilities increased \$445 million. In the second quarter there had been a reduction of \$315 million in these liabilities, according to the Office of Business Economics, which is responsible for the U. S. balance of payments statistics.

Omission of net receipts from special Government transactions - consisting this year mainly of advance repayments of U. S. Government loans and changes in U.S. Government liabilities associated with military exports (see lines 8, 10, 11, and 12 of the table) - would worsen the third quarter balance by about \$130 million and the second quarter balance by a similar amount.

Alternative measure of balance

The balance of international payments, as measured by changes in U.S. official reserve assets and in liquid and certain nonliquid liabilities to foreign official agencies only, was favorable by \$260 million in the third quarter, showing a moderate improvement over the corresponding second quarter figure of \$210 million. (Memorandum item B.) This measure is presented as a preliminary implementation of one of the recommendations of the Review Committee on Balance of Payments Statistics which reported to the U.S. Bureau of the Budget last spring. Henceforth, a measure of this type will be carried in the statistics prepared by the Office of Business Economics, along with the balance which also includes liquid U.S. liabilities to private foreigners and nonmonetary international organizations.

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The difference between the two versions of the balance in the third quarter was due to a sharp increase in U. S. liquid liabilities to foreign private accounts. In the first half of the year, increases in such liabilities were low. Various actions taken by certain foreign central banks to transfer dollar deposits to foreign private banks, including foreign branches of U.S. banks, contributed to the third quarter increase. Another factor was dollar sales by British authorities, particularly in July and August, to support sterling in the foreign exchange markets. These transactions resulted in shifts of liquid liabilities of U.S. banks from foreign official to foreign private accounts, and to a large extent help explain the difference between the two versions of the third quarter balance.

In 1965 to date, the first version of the balance was adverse by \$939 million, or \$1.25 billion at a seasonally adjusted annual rate. The second version was adverse by \$164 million, or at an annual rate of \$0.2 billion. The difference between the two figures is traceable largely to the third quarter experience. In the first half of the year, the two measures were quite similar, showing a large adverse balance in the first quarter and a favorable balance in the second.

Both versions of the balance show substantial improvements in 1965 to date over the years 1963 and 1964.

#### Capital movements

The adverse changes from the second quarter in certain categories of foreign transactions had been expected. This applies particularly to long- and short-term foreign claims reported by banks which, after seasonal adjustment, declined by \$371 million in the second quarter, but increased again by \$60 million in the third - an adverse change of \$431 million. Some of the third quarter increase may reflect very short-term transactions at the end of that period which were reversed early in October.

By the end of the third quarter the amount of outstanding bank assets covered by the guidelines issued by the Federal Reserve System under the voluntary cooperation program to improve the balance of payments was roughly the same as at the beginning of 1965, and thus about \$470 million below the suggested limit.

Nonbanking corporations, which had repatriated about \$300 million of their short-term foreign assets during the second quarter, probably did not continue such repatriations at that rate, but data to measure this change are not yet available. Another adverse development was the rise in purchases of newly issued foreign securities from \$217 million in the second quarter to \$379 million in the third, after seasonal adjustment.

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These unfavorable developments in the transactions for which data are now available were in part offset by an increase in net sales of outstanding foreign securities (i.e., other than newly issued securities) by U.S. residents from \$45 million in the second quarter to \$130 million in the third.

There was also a small decline in net sales of U.S. corporate securities by foreign residents. The latter, which in the second quarter amounted to \$254 million and in the third to \$240 million, reflect in part conversions by the British Government of securities which had been requisitioned from British residents at the beginning of World War II. Because the conversions were unique with respect to their magnitude, timing, and underlying reasons, they may in the analysis of the balance of payments be considered to have been an extraordinary factor. However, while the balance both in the second and third quarters would have been more favorable if these transactions had not taken place, the quarter-to-quarter change would not have been affected materially.

### International trade

Among the favorable developments during the third quarter were the changes in U.S. exports and imports. It is particularly noteworthy that exports have again resumed an upward trend. While exports had risen by a much larger amount from the first to the second quarter, that change reflected to a large extent the slowdown in shipments caused by strikes during the winter months and the subsequent speedup to move out the accumulated cargoes. If adjustments are made for the effects of the strike, the increase in exports from the second to the third quarter on a seasonally adjusted basis would be about \$300 to \$350 million.

The data on imports were affected by changes in recording procedures for which at present only a rough adjustment can be made. It appears, however, that the rise in imports has slowed down somewhat as compared with the rapid increase during the first half of the year--even after allowance for the effect of the shipping strike in the winter.

Data on other transactions are not yet available. The balance on these transactions (derived as a residual of the recorded credits and debits) indicates an increase over the second quarter in net debits, but not quite to the amount experienced a year ago.

More complete data and analysis will be published in the December issue of OBE's monthly Survey of Current Business, which is available from Field Offices of the Department of Commerce, or from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402, at an annual subscription price of \$6.00, including weekly supplements; single copy 45 cents.

Preliminary figures on the third quarter balance of payments are shown in the accompanying table.

Selected data on foreign transactions in the third quarter  
of 1965 available as of the middle of November 1965

Credits +, Debits -	1963	(Millions of dollars)															
		1964				1965				Adjusted for seasonal variations							
		Year	I	II	III	IV	I	II	III	IV	I	II	III	IV			
Merchandise, excluding military:																	
1. Exports.....	22,069	23,288	6,155	6,304	5,932	6,897	5,617	7,048	6,386	6,149	6,067	6,382	6,690	5,506	6,762	6,857	
2. Imports.....	16,992	18,619	4,348	4,590	4,651	5,030	4,604	5,487	5,273	4,410	4,599	4,709	4,901	4,663	5,469	5,307	
3. Net issues of foreign securities.....	-1,250	-1,063	-127	-284	-71	-581	-322	-321	-390	-124	-183	-157	-399	-899	-217	-379	
4. Redemptions.....	195	193	54	38	38	63	55	51	45	54	38	38	63	55	51	45	
5. U.S. purchases (-) or sales (+) of other foreign securities.....	-49	193	94	40	35	24	34	45	130	94	40	35	24	34	45	130	
Net capital outflows (-) reported by U.S. banks:																	
6. Long-term.....	-754	-942	-249	-71	-240	-382	-462	221	-44	-272	-93	-254	-313	-484	178	-68	
7. Short-term.....	-781	-1,543	-405	-531	84	-671	21	181	258	-383	-523	-162	-455	43	193	8	
8. Nonscheduled receipts on Government loans.....	326	122	52	33	30	7	10	6	180	52	33	30	7	10	6	180	
9. Foreign purchases (+) or sales (-) of U.S. securities.....	282	-84	-42	14	-30	-26	35	-254	-240	-42	14	-30	-26	35	-254	-240	
10. U.S. Government liabilities associated with military exports.....	134	222	163	-62	-28	149	69	126	-50	163	-62	-28	149	69	126	-50	
Net sales of nonmarketable, medium-term, nonconvertible Government securities not associated with specific transactions:																	
11. Payable in dollars.....	31	-16	-5	-8	-2	-1	--	-2	--	-5	-8	-2	-1	--	-2	--	
12. Payable in foreign currencies.....	-74	-20	-50	--	--	30	--	--	--	-50	--	--	30	--	--	--	
13. Net increase (+) in liquid liabilities 1/ to foreign residents other than official agencies and to international organizations other than the IMF.....	619	1,554	227	114	562	691	199	-161	683	71	231	639	613	67	-37	745	
14. Net increase (+) in liquid liabilities 1/ (including convertible, medium-term Government securities) to foreign official agencies.....	1,673	1,073	-400	215	389	869	-861	-107	252	237	48	-116	904	-208	-278	-300	
15. Decrease (-) or increase (+) in U.S. official reserve assets.....	378	171	-51	303	70	-151	842	68	40	-51	303	70	-151	842	68	40	
a. IMF gold tranche position 2/.....	30	266	131	118	135	-118	60	-466	389	131	118	135	-118	60	-466	389	
b. Convertible currencies.....	-113	-220	-228	258	-45	-203	-58	-56	-413	-228	258	-45	-203	-58	-56	-413	
c. Gold 2/.....	461	125	46	-73	-20	172	832	590	154	46	-73	-20	172	832	590	154	
16. Other transactions (derived as residual).....	-6,007	-6,549	-1,068	-1,515	-2,118	-1,848	-653	-1,394	-2,077	-1,483	-1,306	-1,726	-2,034	-1,087	-1,172	-1,661	
<b>Memorandum items</b>																	
A. Increase in U.S. official reserve assets and decrease in liquid liabilities to all foreigners (lines 13, 14, 15 with reversed sign).....	-2,670	-2,758	224	-632	-1,021	-1,369	-180	200	-975	-257	-582	-593	-1,366	-701	247	-485	
B. Increase in U.S. official reserve assets and decrease in liquid and certain nonliquid liabilities to foreign official agencies 1, 3/ (lines 12, 14, 15 with reversed sign).....	-1,977	-1,224	701	-518	-459	-748	19	39	-292	-136	-351	46	-783	-634	210	260	

f Revised. p Preliminary.  
1. Liquid liabilities include foreign deposits in U.S. banks, private marketable debt obligations such as certificates of deposits, bankers acceptances, with an original maturity of less than one year, and marketable or convertible U.S. Government obligations. Government liabilities to foreign official organizations also include gold liabilities to the IMF. The distinction between liquid liabilities to foreign private and those to foreign official accounts is based on records of banks located in the United States. Liquid funds held in the United States by foreign private banks including foreign branches of U.S. banks on behalf of, or under forward contract with foreign official organizations are, therefore, classified as liabilities to foreign private accounts.  
2. Reflects \$259 million payment of gold portion of increased U.S. subscription to IMF in the second quarter of 1965.  
3. Preliminary.  
Source: U.S. Department of Commerce, Office of Business Economics.