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SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

July 22, 1966

SUPPLEMENTAL NOTES

The Domestic Economy

The Consumer Price Index rose .3 per cent in June, following a rise of only .1 per cent in May, reflecting seasonal recovery in foods and continuation of substantial and widespread increases among services. Nonfood commodities changed little.

CONSUMER PRICES

	Per cent change to June from:		
	May 1966	Dec. 1965	June 1965
All items	0.3	1.7	2.5
Foods	0.4	3.0	3.5
Nonfood commodities	0.1	0.7	1.2
Apparel	0	1.0	2.2
Other nondurables	0.1	0.9	1.9
New cars	-0.2	-1.9	-0.6
Used cars	0.6	0	-3.7
Household durables	0	0.6	-0.6
Services	0.4	2.3	3.7
Medical care	0.7	3.2	4.7
Transportation	0.2	1.6	3.9
Rent	0	0.6	1.3
Other household	0.7	2.8	4.2

Medical services--doctors' and dentists' fees and health insurance changes--rose .7 per cent further in June, and the rise of 3.2 per cent in the first half of this year is almost as large as the one in all of 1965 and exceeds the increase in 1964. BLS notes in its report that mortgage interest rates rose 2 per cent in June, and altogether, household services showed a relatively large increase.

The first-half rise in this group--2.8 per cent--was more than the increase in all of 1965 and twice that in 1964. Even with the rise in rent continuing at a slow pace, the increase in total services this year has accelerated to an annual rate of 4.5 per cent--a rate equaled in 1957 but not exceeded since the Korean War period.

The June increase in food prices was, according to BLS, in line with seasonal expectations. The increase of 3.5 per cent over the year from June 1964 mainly reflects a 14 per cent rise in pork. Supplies of pork usually reach their seasonal low in July. The subsequent expansion in supplies this year will be considerably greater than seasonal.

International Developments

The measures announced by Prime Minister Wilson on Wednesday relate to:

1. Restraint of private domestic demand;
2. Deferment of public investment demand;
3. Limitation of overseas expenditure by the Government and by tourists and emigrants;
4. A "standstill" on wages, dividends, and prices.

The new measures to restrain private domestic demand come on top of a credit policy which is meant to keep bank advances to the private sector at virtually their present level this year and on into next year, despite the great squeeze on business liquidity which the

selective employment tax will create in September-January. Instalment credit downpayments are increased (for cars to 40 per cent) and repayment periods reduced. The existing power to raise indirect tax rates by 10 per cent (the "regulator", last used in 1961) is applied to the taxes on alcoholic beverages and on gasoline and oil, and to the "purchase tax" on a wide range of consumer goods, especially durables. Postal and telephone charges are raised. A 10 per cent surcharge will be levied on surtax paid in the fiscal year that ended last April. Private construction, outside of housing and the industrial field, will be limited by requiring approval for smaller projects than those hitherto covered, and by requiring special permits for any sizable office building construction in the Midlands and the South of England. In so far as any of the foregoing measures necessitate parliamentary action, such action is virtually certain to be forthcoming.

Investment projects of nationalized industries and to a lesser extent those of central and local government (but not those for housing, schools or hospitals) are to be deferred in such a way as to have a significant impact in the current fiscal year and to make a £150 million cut in 1967/68 below what such outlays would have been expected to be. (This would be a cut of the order of magnitude of 10 per cent in the categories to which it applies.)

For a direct impact on the balance of payments, the Government's own overseas expenditures are to be cut by £100 million,

not counting military expenditures in Germany. Of this cut, economic aid would take £20 million, military aid £5, and apparently defense expenditures most of the rest. Mr. Callaghan was in Germany on Thursday to talk about the offset agreement and the strength of British forces there.

British tourists abroad are to be limited to £50 per person a year, excluding fares. Other measures affect emigrants' allowances and cash gifts.

The measures relating to wages, dividends, and prices are not clearly defined. The Government is to consult with the TUC and the Confederation of British Industries and then to issue a White Paper in the near future. A voluntary six-months "standstill" on wages, salaries, and other types of income is called for, followed by six months of "severe restraint." A 12-month standstill on prices is called for, with exceptions for increases necessitated by higher import costs, higher indirect taxes, etc. The Prices and Incomes Bill which is now before Parliament is to be strengthened so as to back up this program.

Corrections

Page III - 6: In the second sentence of the middle paragraph change "lead" to "had" before September.

Delete the last two words in that page.

Page III - 13: Insert "June" between May and July in the table.

Page III - 21: The top part of the table should be in Billions of Dollars.

APPENDIX A: FINAL BUDGET RESULTS FOR FISCAL 1966.

The final budgetary figures for fiscal 1966, show that Federal revenues on all three budgets have risen more sharply than was expected only three weeks ago. The primary reason for this is that the Treasury underestimated the impact of the June 20 acceleration in employer withheld tax payments. In their July revisions the Commerce Department has also built a larger effective withholding rate into national accounts revenues. Small changes in this rate can lead to fairly important changes in total revenues.

The final budget figures show no important changes in Federal expenditures. Special defense expenditures for Vietnam were \$5.8 billion during fiscal 1966, about \$1.1 billion more than expected in January. Total nondefense expenditures were off by about \$500 million.

Cash expenditures are much higher relative to Budget projections than are expenditures on the other accounts. This can be explained by the large first half expenditures of FHLB and the agricultural lending corporations, which are included in total cash payments but not in the other budgets. At the same time, the projection error in cash receipts was larger than in the other budgets, and the deficit deviated from January projections by about the same amount as in the other budgets.

The revenue revisions have the obvious effect of making the budget look more restrictive than it was previously felt to be. Although the full employment surplus in fiscal 1966 was much lower than in 1965, it now appears to have increased moderately during the fiscal year.

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FEDERAL BUDGETS
(In billions of dollars)

	By Half-Years				By Fiscal Years			
	July - Dec. 1964	Jan. - June 1965	July - Dec. 1965	Jan. - June 1966	1964	1965	1966	Jan. 1966 Budget Document
	Half-year totals, not seasonally adjusted							
Administrative Budget								
Receipts	39.6	53.5	43.2	61.4	89.5	93.1	104.6	100.0
Expenditures	48.1	48.4	53.0	53.9	97.7	96.5	106.9	106.4
Deficit (-)	- 8.5	5.2	- 9.9	7.5	- 8.2	- 3.4	- 2.3	- 6.4
Cash Budget								
Receipts	51.3	68.4	55.0	79.4	115.5	119.7	134.4	128.2
Payments	61.5	60.9	67.1	70.5	120.3	122.4	137.6	135.0
Deficit (-)	-10.2	7.5	-12.0	9.1	- 4.8	- 2.7	- 3.2	- 6.9
	Annual Rates, seasonally adjusted							
National Income Budget								
Receipts	116.3	124.5	125.4	138.7	115.0	120.4	132.0	128.8
Expenditures	118.1	120.2	126.7	135.7	116.3	119.1	131.2	131.0
Deficit (-)	- 1.8	4.3	- 1.3	3.0	- 1.3	1.3	.8	- 2.2
Full Employment Budget								
Receipts	121.2	128.8	128.0	138.8	120.8	125.0	133.4	
Expenditures	117.6	119.8	126.4	135.7	115.2	118.8	131.0	
Surplus (+)	3.6	9.0	1.6	3.1	5.6	6.3	2.4	