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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

November 25, 1964

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IN BROAD REVIEW

Attention of economic and financial observers is naturally centered on the abrupt British bank rate increase and the upward adjustment of Federal Reserve discount rates. Federal Reserve actions, in raising the discount rate and also in raising interest ceilings member banks are permitted to pay on time and savings deposits, were accepted by most market and other observers as a reasonable response to the situation and immediate price reactions in bond, stock, and commodity markets were generally mild.

Three-month Treasury bill rates responded promptly and more positively to the rate actions. On Tuesday, the 3-month bill closed at 3.80 per cent, but prior to that had remained in the 3.44-3.60 per cent range for several weeks. Longer-term Treasury yields reached new lows for the year around mid-November and have risen only moderately since the British and U.S. actions.

Meanwhile, the domestic economic and financial situation apparently has continued strong, although the underlying situation has been obscured by strikes, particularly in the auto industry, and by hedging against a possible steel strike next year. Industrial production in November will apparently recover from the effects of the GM strike and slightly exceed the September level. New housing starts in October rose from the reduced rate of other recent months. Retail sales in early November were still limited by reduced auto stocks and, also, by unseasonably warm weather.

Industrial prices in mid-November appeared to have changed little from the mid-October level, which, however, had risen slightly above the narrow range prevailing from December through September. Price increases were still selective and largely centered in nonferrous and other metals; price decreases were reported for a few industrial products as well as for certain foodstuffs.

In government, corporate and municipal securities markets, yields had declined from late October to mid-November. Stock market prices, already at an advanced level, held within a narrow range from mid-October to mid-November when they rose again to a new high just before the bank and discount rate actions. Since then they have declined slightly.

The volume of long-term financing continued moderate for municipal issues and light for corporate issues in November and the calendar for December does not suggest significant upward pressure on bond yields. Mortgage credit has continued in ample supply with terms about unchanged from those in other recent months.

Bank credit expansion in the first half of November was large at city banks following a sizable decline at all commercial banks in October. During the first 10 months of this year, bank credit expansion was at an annual rate of 7 per cent as compared with 8 per cent for the whole year 1963.

The seasonally adjusted money supply increased substantially in the first half of November following a decline in the second half of October. The annual rate of money supply growth so far this year is 4.2 per cent, with expansion since the June-July bulge at 4.7 per cent annual rate. Seasonally adjusted time and savings deposits also increased substantially in early November and the annual rate so far this year has been close to 12 per cent.

Free reserves, which had been averaging close to $90 million for some time, became slightly negative in the first three weeks of November.

The deficit in the balance of payments has been large so far in the fourth quarter. In addition to the increase in new foreign security issues, the large deficit figures have reflected heavy movements of other funds to Canada, some of which may be reversed in December. Large deficits have usually been recorded in October and November followed by a surplus in December.

The Group of Ten countries plus Austria and the BIS moved on November 25 to provide $3 billion in assistance to Britain for defense of the pound sterling, after the November 23 increase in British Bank Rate from 5 to 7 per cent failed to halt massive speculative pressures. As part of this assistance, which is in addition to the $1 billion standby with the IMF, the System swap arrangement has been increased to $750 million and the Export-Import Bank has made available a $250 million line of credit.

Because of the Holiday, the Supplement to the Green Book will be included in the regular Monday distribution of FOMC materials.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally Adjusted)

	Latest period	Amount			Per cent change: 3/	
		Latest period	Preceding period	Year ago	Year ago	2 years ago
Civilian labor force (mil.)	Oct.'64	74.2	74.2	73.2	1.4	3.1
Unemployment (mil.)	"	3.9	3.8	4.1	-5.8	-1.3
Unemployment (per cent)	"	5.2	5.2	5.6	-	-
Nonfarm employment, payroll (mil.)	"	59.0	59.0	57.6	2.3	5.0
Manufacturing	"	17.3	17.5	17.1	0.8	2.1
Other industrial	"	7.8	7.8	7.6	2.0	4.0
Nonindustrial	"	33.9	33.8	32.9	3.2	6.7
Industrial production (57-59=100)	"	131.7	134.0	126.1	4.4	10.6
Final products	"	130.7	132.6	127.2	2.8	7.9
Materials	"	132.7	135.7	125.5	5.7	13.0
Wholesale prices (57-59=100) 1/	"	100.8	100.7	100.5	0.3	0.2
Industrial commodities	"	101.1	100.7	100.6	0.5	0.7
Sensitive materials	"	100.4	99.5	97.0	3.5	4.0
Farm products and foods	"	98.2	99.3	99.1	-0.9	-2.1
Consumer prices (57-59=100) 1/	Sept.'64	108.4	108.2	107.1	1.2	2.2
Commodities except food	"	104.3	104.2	103.7	0.6	1.0
Food	"	107.2	106.9	105.4	1.7	2.3
Services	"	115.5	115.4	113.5	1.8	3.9
Hourly earnings, mfg. ($)	Oct.'64	2.54	2.58	2.48	2.4	5.8
Weekly earnings, mfg. ($)	"	103.07	104.25	100.63	2.4	6.9
Personal income ($ bil.) 2/	"	498.6	497.9	472.7	5.5	11.4
Retail sales, total ($ bil.)	"	21.5	22.2	20.7	4.0	8.4
Autos (million units) 2/	"	5.963	8.505	7.632	-21.9	-17.3
GAF ($ bil.)	"	5.1	4.9	4.5	14.2	18.0
Selected leading indicators						
Housing starts, pvt. (thous.) 2/	"	1,600	1,465	1,864	-14.2	4.1
Factory workweek (hours)	"	40.6	40.6	40.6	0.0	1.0
New orders, dur. goods ($ bil.)	"	19.0	19.9	18.6	2.0	9.9
New orders, nonel. mach. ($ bil.)	"	2.9	2.9	2.7	10.3	23.7
Common stock prices (1941-43=10)	"	84.85	83.41	73.03	16.2	51.1
Inventories, book val. ($ bil.)	Sept.'64	107.2	106.7	103.1	3.9	7.9
Gross national product ($ bil.) 2/	QIII'64	628.4	618.6	587.2	7.0	12.4
Real GNP ($ bil., 1963 prices) 2/	"	614.9	608.5	586.6	4.8	8.4

1/ Not seasonally adjusted. 2/ Annual rate. 3/ Based on unrounded data.

SELECTED DOMESTIC FINANCIAL SERIES

	Week ended Nov. 20	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds (per cent)	3.55	3.51	3.63	1.00
Treasury bills 3 mo., yield (per cent)	3.61	3.58	3.62	3.42
Net free reserves 2/ (mil. $)	20	4	192	-56
Member bank borrowings 2/ (mil. $)	590	431	590	159
Security Markets (N.S.A.)				
Market yields 1/				
5-year Government securities (per cent)	4.01	4.03	4.12	4.00
20-year Government securities	4.15	4.16	4.24	4.15
Corporate new issues, Aaa (per cent)	n.a.	n.a.	4.52	4.37
Corporate seasoned, Aaa (per cent)	4.42	4.43	4.43	4.40
Municipal seasoned, Aaa (per cent)	3.05	3.08	3.12	3.05
FHA home mortgages-30-year (per cent 3/)	5.45	5.45	5.46	5.45
Common stocks - S&P composite index 4/				
Prices, closing (1941-43=10)	86.28	85.30	86.28	79.02
Dividend yield (per cent)	2.95	2.96	3.10	2.93

	Change in Oct.	Average change-- last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	-63	95	5.4	5.1
Bank loans and investments:				
Total	-900	2,100	9.9	8.1
Business loans	200	400	8.7	11.0
Other loans	-100	700	8.4	11.9
U.S. Government securities	-1,300	500	10.3	-1.5
Other securities	300	500	15.4	10.2
Money and liquid assets:				
Demand dep. & currency	600	600	4.8	4.1
Time and savings dep.	1,400	1,200	12.4	12.6
Nonbank liquid assets	900	1,600	8.0	6.4

N.S.A.--not seasonally adjusted. S. A.--seasonally adjusted. n.a.--not available.
1/ Average of daily figures. 2/ Averages for statement week ending Nov. 18.
3/ Latest figure indicated is for month of October. 4/ Data are for weekly closing prices.

U.S. BALANCE OF PAYMENTS

	1964						1963
	Oct.	Sept.	Aug.	Q-III	Q-II	Q-I	Year
Seasonally adjusted annual rates, in billions of dollars							
Balance on regular trans.				- 2.3	- 2.7	- .9	- 3.3
Exports 1/		26.9	24.6	25.6	24.2	24.4	21.9
Imports 1/		-18.5	-18.9	-19.0	-18.3	-17.4	-16.9
Trade balance 1/		8.4	5.7	6.6	5.9	7.0	5.0
Unadjusted monthly averages, in millions of dollars							
Balance on regular trans.	-773	-65	- 284	- 337	- 191	23	- 272
Trade balance 1/		506	388	433	567	587	416
Securities transactions		- 73	22	- 35	- 64	- 12	- 70
Bank-reported claims 2/		- 136	- 122	- 48	- 198	- 209	- 123
Other		- 362	- 572	- 687	- 496	- 343	- 495
Financing, total	773	65	284	337	191	- 23	272
Special receipts 3/	0	0	0	0	- 14	68	55
Liabilities increase							
To nonofficial 4/	)638	- 141	147	186	36	77	49
To official	)	37	200	128	68	- 151	136
Monetary reserves decrease	135	169	- 63	23	101	-17	32
of which: Gold sales	(37)	(14)	(-28)	(-7)	(-24)	(15)	(38)

1/ Balance of payments basis; differs a little from Census basis.
2/ Adjusted for long-term claims taken over from nonfinancial concerns.
3/ Other than nonmarketable bonds, which are included in liabilities to official Advances on military exports are assumed as zero for individual months in absence of information.
4/ Including international institutions (except IMF), commercial banks and private nonbanks.

THE DOMESTIC ECONOMY

Industrial production. The industrial production index in November is now estimated to have increased about 2-1/2 points from the reduced October level, probably reaching somewhat above the September figure of 134.0. The increase, mainly due to the return of General Motors to full scale operations, was somewhat dampened by the strike at Ford. Net production gains in autos, trucks, and parts amounted to about 2 points in the total index. While data are not yet available, it is anticipated that output of consumer goods, business equipment, and materials other than automotive, continued to increase in November.

In September and October, production losses in the motor vehicle and related industries amounted to 3-1/2 points in the total index. However, output of final products and materials other than automotive continued to rise and the total index declined only 2 points.

Despite the effects of the auto strike, over-all output so far this year is estimated to have increased 6 per cent as compared with a rise of 5 per cent from 1962 to 1963 and a rise of nearly 8 per cent from 1961 to 1962. As the following table shows, the estimated increases for the major market groupings so far this year have been more varied than they were from 1962 to 1963. For consumer goods, the indicated rise is about the same as last year while for business equipment the rise is considerably larger.

INDUSTRIAL PRODUCTION
Percentage increases

	11 months 1963 to 1964	Year 1962 to 1963	Year 1961 to 1962
Total index	6.0	5.1	7.8
Consumer goods	4.6	4.6	6.3
Business equipment	8.1	5.1	10.9
Materials	6.9	5.7	7.9

Prices. As foreshadowed by the weekly estimates of wholesale prices, the industrial commodity index rose between mid-September and mid-October. The industrial index was 101.1 per cent of the 1957-59 average in October compared with 100.7 in September and a range of 100.7 to 100.9 in the whole period from last December through September. The weekly estimates suggest little further change since mid-October.

A reversal in prices of petroleum products accounted for a fourth of the October rise in the industrial average; refined products rose 2-1/2 per cent from a September level that was down more than 5 per cent from last autumn. Another fourth of the rise was accounted for by a further rise in prices of nonferrous metals. Increases in primary refined copper and in copper products were reflected in a rise of 3 per cent in the nonferrous group to a level 12-1/2 per cent higher than early last year. The balance of the October rise in the industrial index was accounted for by previously announced increases for woodpulp and some paper products and by scattered increases among chemicals and general purpose machinery. Few decreases were recorded other than slight further declines for lumber and plywood.

Although the weekly estimates indicate a further rise of only .1 per cent in the industrial average since mid-October, increases have been announced for batteries, following earlier advances in lead, and for primary aluminum and aluminum mill products. Tin prices have dropped about 10 per cent from the extraordinary high reached at the end of October, and one Canadian and two American producers of newsprint have cut prices 7-1/2 per cent for delivery in the western part of the U.S. Substantial reductions have been announced for some plastic materials.

Wholesale prices of foodstuffs declined 1 per cent in October, reflecting decreases for livestock and products in response to expansion in supplies that was mainly seasonal, and they have declined somewhat further since then. The wholesale price index for all commodities, therefore, remained relatively stable through October and the first half of November.

Gross national product. Gross national product in the third quarter is now estimated by the Department of Commerce at an annual rate of $628.4 billion, nearly $10 billion higher than in the second quarter. A feature of this expansion was a very large increase in consumer spending. Business spending for fixed capital, net exports, and State and local government purchases were also strongly expansive. Inventory investment, Federal purchases, and residential construction were lower than in the preceding quarter.

The GNP estimate for the third quarter is $1 billion higher than the preliminary one published last month. Inventory investment, with book value data available for the entire quarter, is now indicated to be at an annual rate of $2.8 billion instead of $1.7 billion; net exports, with September data in, are estimated at $7.0 billion rather than $6.5; and Federal defense expenditures are reported to have been $.5 billion below the earlier estimates.

Present estimates indicate that there has been no significant change in the rate of increase in GNP, in either current or constant dollars since late 1963. In current dollars, the third quarter level was 7.0 per cent above a year earlier and in constant dollars the increase was 5.0 per cent. The relative gains for the full year 1964 over the year 1963 are likely to be similar to those for the third quarter.

GROSS NATIONAL PRODUCT
(Billions of dollars; seasonally adjusted annual rate)

Quarter	Current dollars	1954 dollars
1963 - IV	599.0	502.0
1964 - I	608.8	508.0
II	618.6	513.5
III	628.4	519.6

Data on Federal tax receipts only recently available indicate that earlier Commerce estimates of personal Federal tax payments for the second and third quarters were too low. (See Appendix A) Accordingly, the estimate for the second quarter has been revised up by $1.2 billion (annual rate) to $47.3 billion and the estimate for the third quarter has been revised up by $1.0 billion to $48.2 billion.

These new Commerce estimates are virtually the same as those contained in the GNP projection presented to the Federal Open Market Committee about six weeks ago.

Reflecting these revisions in tax payments, personal saving has been lowered. The personal saving rate is now reported at 7.9 per cent for the second quarter and 7.1 per cent in the third quarter, and compares with the previously published figures of 8.2 per cent and 7.4 per cent. The revision in tax payments also was reflected in larger estimates of Federal Government receipts on a GNP basis and a reduction in the deficit. The deficit is now estimated to have been at an annual rate of $7.8 billion in the second quarter, instead of $9.0 billion, and $5.2 billion in the third quarter, instead of $6.2 billion.

Residential building. Seasonally adjusted private housing starts, which had been at a reduced rate in recent months, recovered sharply in October, advancing to the highest rate since June. The rate was still well below October 1963, when starts also rose appreciably to their recent peak. On a three-month moving average basis, starts in the August-October period were at an annual rate of 1.5 million, moderately above the July-September average.

Seasonally adjusted residential building permits in permit-issuing areas showed a slight rise in October, reflecting mainly some recovery in permits for multifamily structures which had declined nearly a tenth in September.

PRIVATE HOUSING STARTS AND PERMITS

	October (thousands of units) 1/	Per cent change from: Month ago	Year ago
Starts (total)	1,600	+9	-14
Permits (total)	1,235	+1	-12
1 - family	697	0	-7
2-4 - family	91	+3	-29
5-or-more family	447	+2	-14

1/ Seasonally adjusted annual rate; preliminary.

Orders for durable goods. New orders received by manufacturers of durable goods declined 4.5 per cent in October because of the General Motors' strike, which lowered the order level for the auto industry nearly 30 per cent. Outside the auto industry, total new orders were maintained at about the September rate.

Despite a decline for machine tools, total new orders for machinery and equipment were moderately larger in October; however, they were still 3 per cent below the May-June peak. Defense orders were up somewhat but remained well below earlier highs. October orders for primary metals were close to the advanced September level and, except for September, were the highest since April 1963, the peak of that steel stock-building episode.

Shipments also were sharply curtailed in the auto industry in October and generally maintained for other durable goods. Unfilled orders rose considerably further--as in September the rise was concentrated in metals and nonelectrical machinery and equipment--and at the end of the month the durable order backlog was 13 per cent larger than at the end of last year.

Retail sales. Seasonally adjusted retail sales in October declined 3 per cent as a result of a reduction of 25 per cent for the automotive group, because of the General Motors' strike. Excluding auto sales in both months, retail sales advanced 2.7 per cent from September to October.

In October, furniture and appliance sales recovered from their reduced September level and reached a new high; sales in October were some 5 per cent above the third quarter monthly average. Nondurable goods sales attained a new high in October, up 2.4 per cent after a slight hesitation in September, and exceeded their third quarter average by nearly 2 per cent.

Total sales in early November (based on data through November 14), were off from their reduced October level, with declines indicated at both durable and nondurable goods outlets. Among durables, lower auto sales reflected the continued short supply caused by the recent strikes; sales at furniture and appliance stores were down from their record October level. Nondurable goods were off moderately in the first half of November with declines registered among most categories. Continued unseasonally warm weather across most of the nation probably limited sales at apparel and general merchandise outlets.

On a unit basis, total sales of new domestic autos in the first ten days of November were a fourth less than a year earlier, although sales by Ford and Chrysler alone were a fifth higher and up more than seasonally. In October Ford and Chrysler sales had been nine per cent above last year. As a result of the General Motors' strike, stocks of new domestic cars in early November were ten per cent below a year earlier.

Foreign cars have participated in the record auto sales this year. Seasonally adjusted sales of imported cars in the third quarter were at an annual rate of 486,000 cars, 29 per cent above a year earlier and the highest in six years.

Consumer credit. Demands for consumer credit were strong in September but weakened in October when auto sales were down sharply. In September, instalment debt rose $513 million after seasonal adjustment, one of the largest monthly increases this year. Data available for October are incomplete but they suggest a substantial decline from the September rate of expansion, to around the $400 million level. As the table below indicates, this would make October one of the slackest months of the year in the use of credit by consumers.

CHANGES IN INSTALMENT CREDIT
(Millions of dollars, seasonally adjusted)

Period	Change
1964 - January	428
February	579
March	524
April	412
May	493
June	370
July	483
August	435
September	513

While much of the slowdown in October was due to the strike-reduced level of auto sales, it seems likely that personal loan volume in October was off from September's high level. The net increase in personal loans in September was the largest in almost a year and apparently reflected an upsurge in borrowing for educational and travel purposes.

Borrowing to finance the purchase of consumer goods other than autos and for home repair and modernization apparently continued to increase in October. The net change in such borrowing was probably little different than in September.

Third quarter figures are now available showing the proportion of consumer after-tax income committed to payments on instalment debt. This ratio was 14 per cent, unchanged from the first and second quarters. The ratio had been trending up in 1962 and 1963, however, so it probably would have edged up further had it not been for the sharp rise in disposable income following the tax cut.

Personal income. Personal income rose $700 million in October to a seasonally adjusted annual rate of $499 billion. The rise was limited by strikes in the automotive industry and was the smallest in more than eighteen months. The level of personal income in October was 5.5 per cent higher than a year earlier, as compared with year-over-year increases averaging 6.0 per cent from March to September.

The October loss of wages and salaries because of the strikes, estimated at about $1-1/2 billion (annual rate), was only a little more than offset by widespread payroll gains in other industries. Government payrolls were up $600 million, with half of that amount consisting of retroactive payments under the Federal civilian pay increase enacted earlier. Small gains occurred in business proprietors' income, rental income, interest, and transfer payments.

Labor market. Total nonfarm payroll employment was little changed at 59.0 million in October, as gains in nonmanufacturing activities largely offset a decline of about 250,000 in the strike-affected manufacturing sector. Within manufacturing, the sharpest drop occurred in transportation equipment, but the effects of the automobile strike were also felt in the fabricated metals industries. Employment in most other durable and nondurable goods industries showed little change.

Nonmanufacturing employment rose by 185,000, somewhat more than 150 in October 1963. In both periods strong gains in State and local governments, reflecting the hiring of teachers for the new school term, accounted for most of the rise. Employment in the trade and service industries rose moderately.

Full- and part-time labor force. The relatively more rapid growth of part-time than full-time jobs has been an outstanding feature of postwar labor market developments and the past year has been no exception. Part-time positions accounted for more than 1 in 4 of the 1.5 million new jobs added on the average from the first 10 months of 1963 to the corresponding period of 1964. In contrast, only 1 in 8 workers are employed part-time.

Growth in part-time jobs reflects an increasing number of women and younger workers in the labor force. Teenagers alone accounted for more than half the increase in part-time employment in 1964 and these jobs provided almost all the employment gain reported among younger workers.

INCREASES IN EMPLOYMENT
1963 to 1964
(January-October averages)

	Total	Full-Time (thousands of persons)	Part-Time
Total	1,537	1,115	422
Men 20 years and over	618	569	49
Women 20 years and over	661	527	134
14 to 19 years, both sexes	260	20	240

A very high proportion--almost two-thirds--of the young workers has been looking for full-time jobs. The unemployment rate for these was substantially higher than for part-time job seekers. Lack of experience and limited skills are apparently much greater handicaps for young workers looking for full-time jobs than for those seeking part-time work. In the period ahead, growth in the number of young workers in the labor force will continue to be mostly among those seeking full-time jobs.

FULL-TIME AND PART-TIME UNEMPLOYMENT
(January-October averages, 1964)

	Seeking Full-Time Jobs		Seeking Part-Time Jobs	
	Number in thousands	Rate	Number in thousands	Rate
Total	3,306	5.1	663	7.2
Men 20 years and over	1,649	3.8	106	6.4
Women 20 years and over	1,023	5.5	198	4.4
14 to 19 years, both sexes	643	17.6	359	11.8

<u>Hours and earnings</u>. The seasonally adjusted factory workweek in October remained unchanged at 40.6 hours, continuing at the level prevailing since early this year. A slight decline in the durable goods sector was offset by a recovery in nondurable goods industries from a dip in September when some workers took unpaid vacations over the Labor Day holiday.

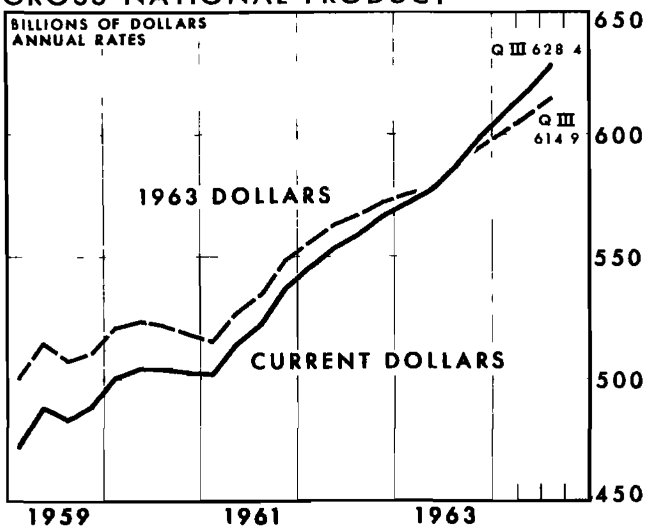
Hourly and weekly factory earnings were down in October mainly because of the curtailment in the high-wage transportation equipment and metalworking industries. At $2.53, hourly earnings were down 3 cents from September, and were only slightly more than 2 per cent higher than a year ago. Weekly earnings declined by about $1 to $103, and were also 2 per cent above a year earlier.

About 2.3 million workers were affected by collective bargaining settlements in the first 9 months of 1964. Of these about half were in manufacturing, and for these workers the straight-time hourly wage increase averaged 2.5 per cent. Included were more than 200,000 workers at Ford and Chrysler who received no immediate money wage increases. Also included were the meat packing and petroleum workers whose contracts were negotiated in the third quarter. In nonmanufacturing industries, collectively bargained wage rate increases were somewhat larger--averaging 3.1 per cent. Most of these workers were in trucking but some were in the telephone, coal mining and railroad industries. These data refer only to changes in wage rates and exclude the value of supplementary benefits. These benefits have been rising relatively more rapidly than straight-time earnings.

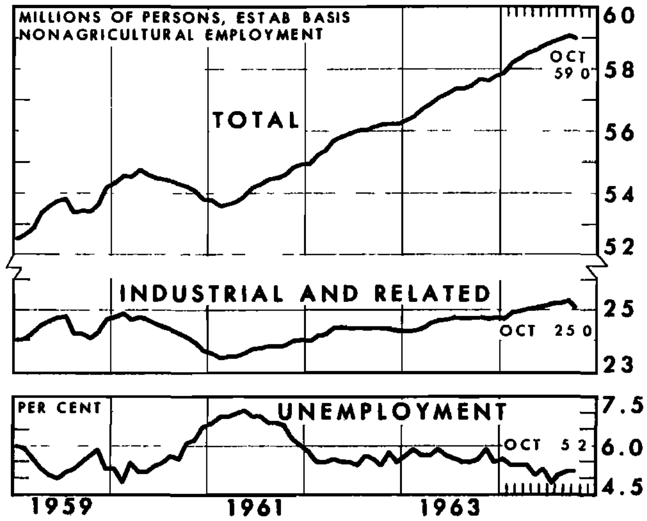
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

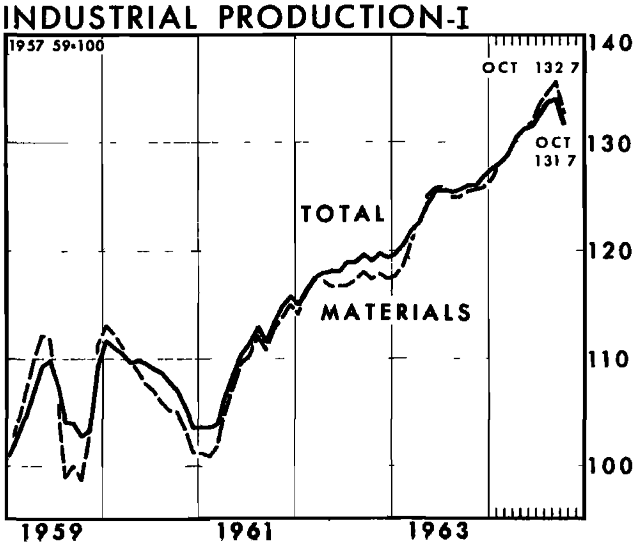
GROSS NATIONAL PRODUCT



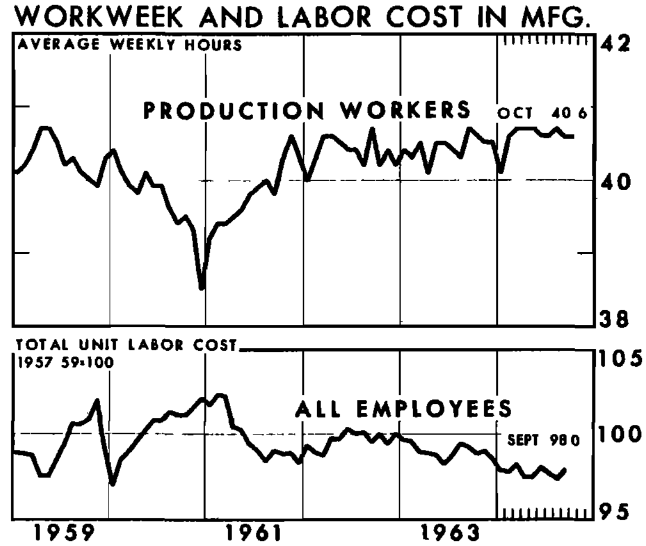
EMPLOYMENT AND UNEMPLOYMENT



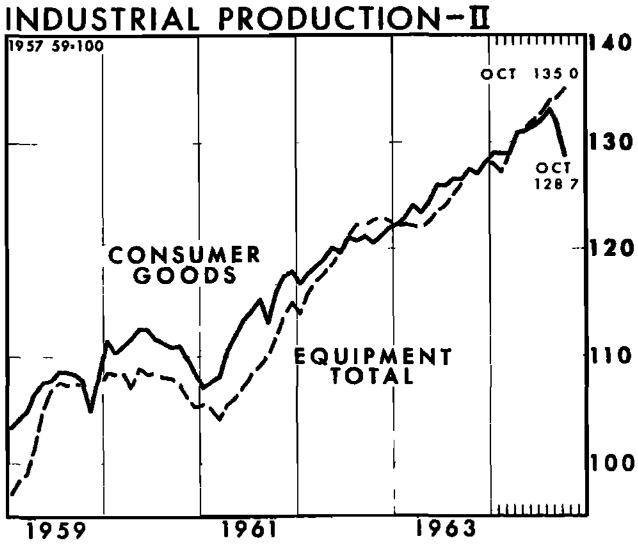
INDUSTRIAL PRODUCTION-I



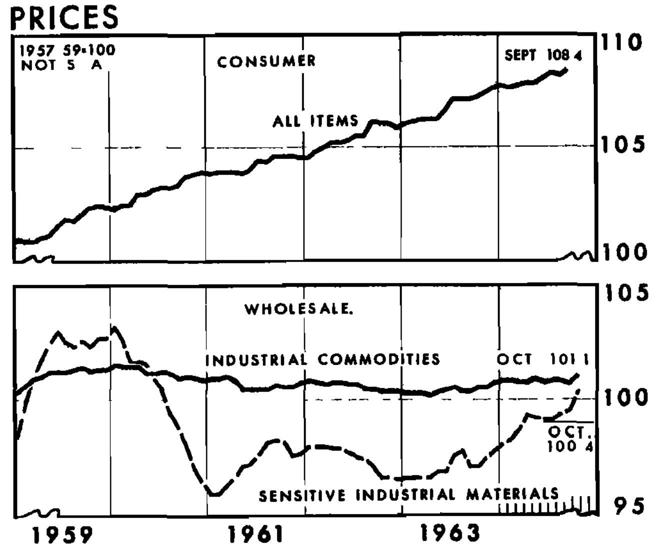
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION—II



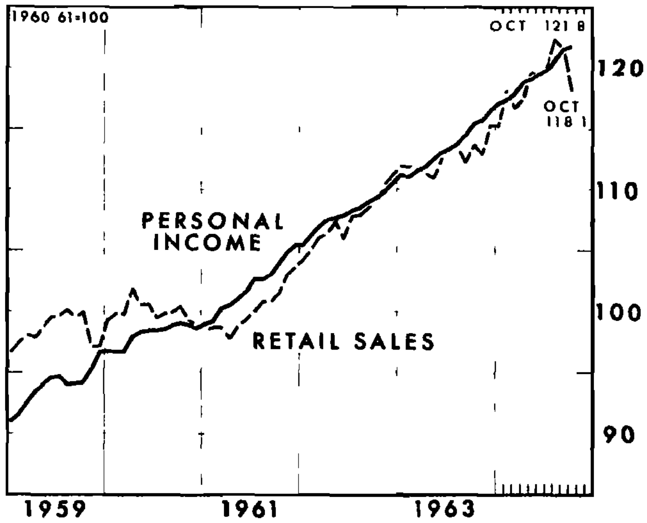
PRICES



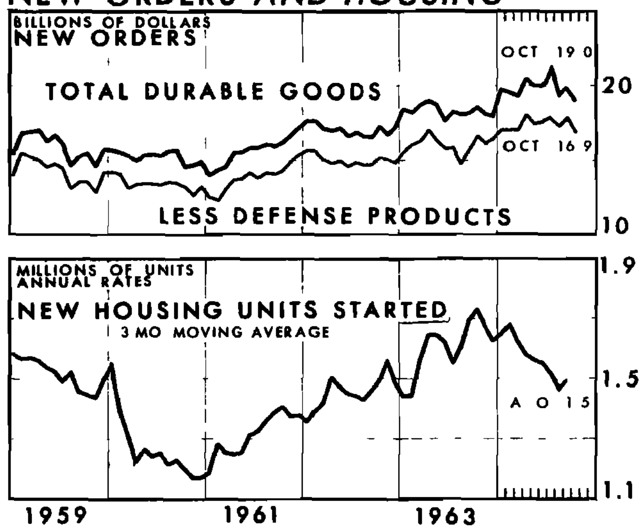
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

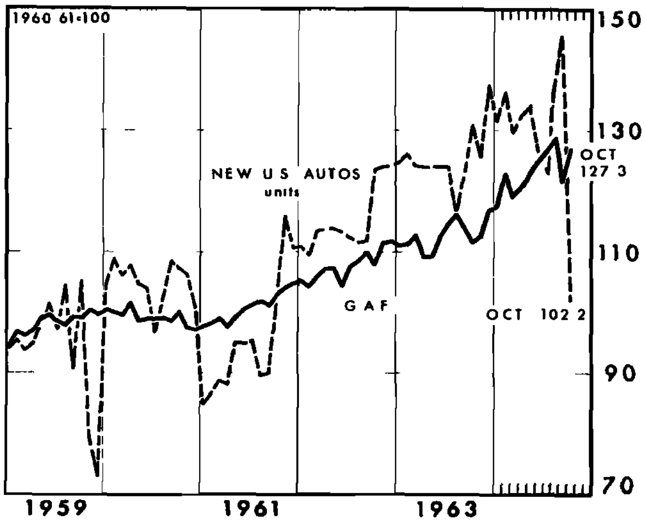
PERSONAL INCOME AND RETAIL SALES



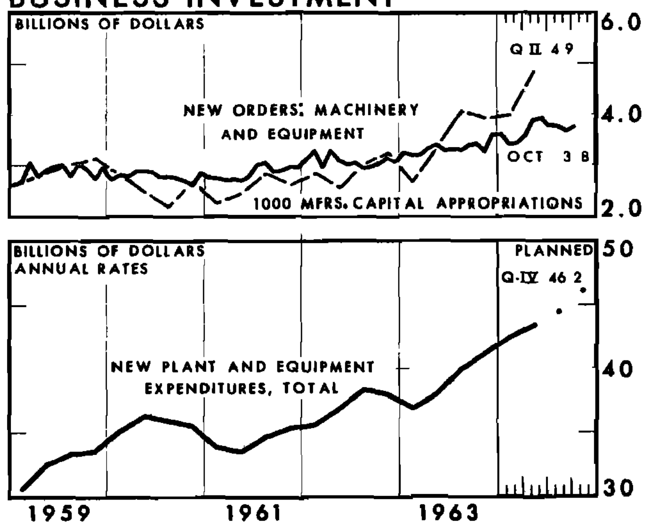
NEW ORDERS AND HOUSING



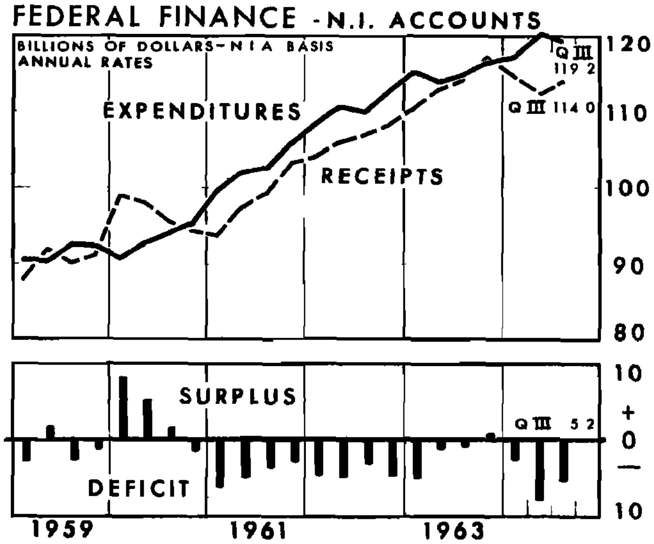
RETAIL SALES



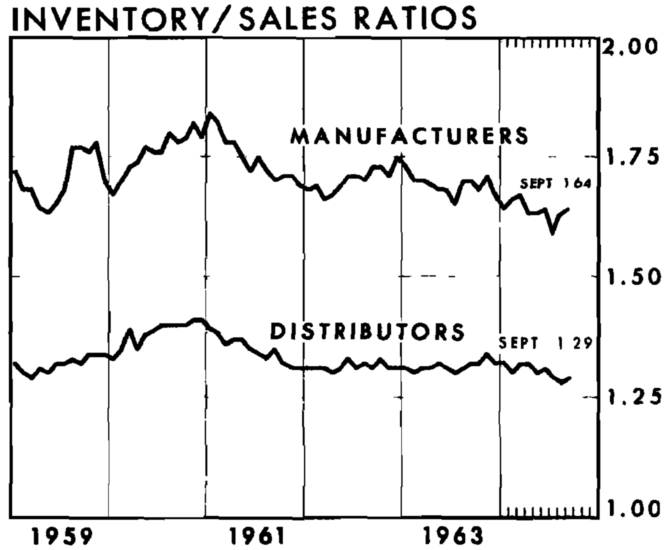
BUSINESS INVESTMENT



FEDERAL FINANCE -N.I. ACCOUNTS



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

Bank credit. The $650 million increased in total credit at city banks over the two weeks ending November 11 was relatively large even allowing for the Treasury bill refinancing that took place during the period, but was smaller than last year when a new one-year bill was issued. This was followed by a larger-than-usual rise at banks in New York and Chicago in the subsequent week, when banks acquired new 18-month Treasury notes. All commercial banks were allotted an estimated $1.5 billion of this issue whereas they held about $1 billion of the maturing issues. Bank acquisitions of governments, net, in the mid-November financings were generally similar to those of earlier years.

NET CHANGE IN CITY BANK CREDIT
FIRST TWO REPORTING WEEKS OF NOVEMBER
(In millions of dollars)

	1964	1963	1962	1961	1960
Total loans & investments	653	916	-735	-136	-726
Loans	1,149	1,271	215	554	215
U.S. Govt. securities	-376	-60	-838	-557	-692
Other securities	-120	-295	-112	-133	-249
Type of loan:	430	812	327	133	144
Business	70	100	106	22	-12
Real estate	463	251	-393	216	-53
Security	135	-40	79	115	35
Nonbank financial					

The substantial early November rise in bank credit was due mainly to a larger-than-usual increase in loans, totaling over $1.1 billion, associated principally with borrowing by Government security dealers and also with a pickup in business loan demand following the

October lull and somewhat larger than usual borrowing by nonbank financial institutions. Bank holdings of both U.S. Government and other securities declined, but less than in the corresponding weeks of most other recent years. Most of the reduction in governments was in Treasury bills but holdings of bonds maturing in more than five years also continued to decline.

The substantial credit expansion at city banks in early November followed a $900 million seasonally adjusted decline in total credit at all commercial banks in October. Over the first ten months of the year, credit increased at an annual rate of 7 per cent, slightly below the 8 per cent rise in the full year 1963. Loan expansion was similar in the two years as was the reduction in holdings of U.S. Government securities, but growth in holdings of municipal and agency issues has slackened materially this year.

Loans to U.S. Government security dealers increased sharply over the first two weeks of November, reflecting principally dealers' needs to carry increased trading positions and to refinance maturing repurchase agreements with nonfinancial corporations which needed funds over the November 1 excise tax date. This was followed by moderate loan repayments by security dealers to New York City banks in the week of November 18. Loans to finance companies also increased in early November, by a little more than in the comparable weeks of past years. In October, these loans had not shown the usual tax period decline.

Business loans at city banks increased $430 million over the two weeks ending November 11, reflecting in part borrowing in connection with large excise tax payments on November 1. This increase was considerably more than in the corresponding weeks of other recent years, except for the unusually sharp rise in 1963, and was followed by a large further rise at New York City banks in the week of November 18. In October, growth in business loans had slackened; the seasonally adjusted rise of $200 million at all commercial banks was one of the smallest of the year, but followed a period of accelerated growth beginning in the spring. Smaller borrowing in October may have reflected, in part, a reaction from earlier anticipatory borrowing, as well as the effects of the GM strike.

In early November, borrowing by food processors and commodity dealers was larger than usual, presumably reflecting almost complete reliance on direct bank financing instead of the customary partial use of acceptance financing which is now more costly than direct financing. Loans to petroleum and chemicals companies continued relatively strong and those to the metals and trade groups increased after a sharp post-September tax period decline. Repayments by public utilities continued heavy and those by textile and apparel concerns were larger than seasonal.

Deposits and turnover. The seasonally adjusted money supply increased $800 million (preliminary) in the first half of November following a $650 million decline in the last half of October. The annual rate of growth since the June-July bulge has been 4.7 per cent, not much above the 4.2 per cent rate so far this year. Relatively slow growth early in the year was offset by the unusually sharp June-July expansion. U.S. Government deposits at commercial banks rose slightly in the first half of November, although in most past years they had declined.

Demand deposit turnover at 343 centers outside New York increased to 35.5 in October from 35.1 in September. Since the April high of 36.0, turnover has fluctuated between 35 and 36. Over the first ten months of 1964, turnover averaged 5.4 per cent above the corresponding months last year; early in the year it was 6.7 per cent higher but since April only 4.5 per cent.

Seasonally adjusted time and savings deposits at all commercial banks increased $900 million (preliminary) in the first half of November, or at a little faster pace than the accelerated October expansion. For the year through mid-November, these deposits have increased at an annual rate close to 12 per cent. At banks in leading cities, expansion in savings deposits in the first two weeks of November continued to exceed that of the corresponding weeks last year, as had been the case over the August-October period. Earlier in 1964, growth in savings deposits had been much smaller than in 1963. In addition, the reduction in other time deposits was smaller this year than last.

Pay-out of Christmas Club funds was offset in part by further increases in CD's. At banks in New York and Chicago, where comparable data are available, CD's increased much more than in the corresponding two weeks last year. At banks in other leading cities, however, CD's declined in early November.

Accompanying the increase in the discount rate, and also effective November 24, the Board of Governors set the maximum rate on savings deposits at 4 per cent regardless of the time the funds are on deposit and raised the maximum rates on time deposits and certificates of deposit to 4 per cent for maturities of less than 90 days from the previous 1 per cent, and to 4-1/2 per cent for all longer maturities from the previous 4 per cent.

Bank reserves. Free reserves averaged $20 million in the week of November 18 following two weeks in which the free reserves figures initially reported were revised to net borrowed reserves. Over the three weeks as a whole, net borrowed reserves averaged about $20 million compared with free reserves close to $90 million in each of the previous months.[1/] Borrowings at all member banks rose sharply to an average of $500 million during the three weeks ending November 18 compared with $325 million over September and October. Excess reserves also rose somewhat to a $475 million average.

The effective rate on Federal funds was 3-5/8 per cent on three days during the October 29-November 18 period and was never below 3-1/2 per cent. Transactions took place generally in the 3-1/2-3-5/8 per cent range although on one day there was some trading at 2-1/2 per cent.

Seasonally adjusted required reserves against private demand deposits increased moderately further over the first three reporting weeks of November as a substantial increase early in the period was offset only in part by subsequent declines.

1/ Based on the average of daily figures for all of the reserve weeks ending in the month as used in the reserve memorandum to the FOMC, rather than an average of all days in the calendar month.

U.S. Government finance. The U.S. Government securities market reacted rather sharply but in an orderly fashion to the announcement on Monday, November 23, of an increase in the British bank rate from 5 to 7 per cent. Further reaction on Tuesday following the announcement late Monday of the rise in the Federal Reserve discount rate from 3-1/2 to 4 per cent was mild in the bond market but more pronounced in the bill market. This pattern of reaction may have been influenced by newspaper reports of Chairman Martin's press conference in which the international reasons for the rise in rate and the Federal Reserve's desire not to restrain the domestic economy were stressed.

YIELDS ON U.S. GOVERNMENT SECURITIES

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1964						
Highs	3.80	3.97	4.22	4.21	4.26	4.26
Lows	3.40	3.50	3.92	3.99	4.12	4.14
1964						
October 16	3.59	3.72	4.05	4.09	4.21	4.22
November 12	3.58	3.75	3.97	3.99	4.12	4.14
November 20	3.62	3.80	4.02	4.01	4.13	4.15
November 23	3.73	3.91	4.12	4.08	4.18	4.18
November 24	3.80	3.97	4.11	4.08	4.18	4.19

Prior to the U.K. and U.S. bank rate actions, the Treasury bond market had staged a rally lasting from about mid-October to almost mid-November, when long-term bond yields touched their lows for the year. The market showed signs of some hesitation around mid-November on the appearance of profit taking by market professionals and in reaction to the publication of net borrowed reserve figures. But these short-run developments did not seem to effect any basic change in market attitudes about the generally favorable long-run outlook for bond prices--which were conditioned by reports that many economic analysts anticipated the pace of economic expansion would moderate in 1965 and by the expectation of continued large savings flows into the capital markets.

The market adjustment on Monday mainly reflected protective dealer price markdowns of as much as a 1/2 point on some long-term bonds, raising long-term yields 3 to 5 basis points. Prices declined somewhat further after announcement of the Federal Reserve discount rate increase. But bond yields on Tuesday were still several basis points below their highs for the year.

Bill rates, as would be expected, adjusted more sharply than yields on coupon issues. The bill market was already under seasonal pressure prior to the central bank rate increases, as market demand tapered off, dealer bill positions remained heavy, and dealer financing became more costly (reflecting the general money market tightness during the first three statement weeks in November).

Bills in the 3- and 6-month area rose around 10 basis points on Monday, and there were also rate advances on other sensitive short-term paper, such as bankers' acceptances and secondary market CD's. In Monday's bill auction, the average issuing rate for 3-month bills rose to 3.76 per cent, up 16 basis points from the previous week and the highest since May 1960. On Tuesday, the new 3-month bill closed at 3.80 per cent. Upward yield adjustments for bills were generally more moderate on that day as dealer inventories were relieved by System bill purchases amounting to $325 million.

The immediate yield adjustments in both the bill and bond markets were substantially larger than those experienced in recent years following increases in the U.K. bank rate. But the circumstances were, of course, quite different. For example, the 5 to 7 per cent rise in the British bank rate in September 1957 followed the August rise from 3 to 3.5 per cent in the Federal Reserve discount rate, and the market response to the British action was negligible. A similar rise in the bank rate in July of 1961 occurred when the U.S. economy was still in the early stage of economic recovery and short-term rates here were well below the Federal Reserve discount rate (then 3 per cent). The bank rate rise in late February of this year took place under more comparable circumstances. But it was only a 1 percentage point rise to 5 per cent; it elicited only a short-lived 5 basis point increase in bill yields; and market expectations of generally rising rates (also influenced by the tax cut at that time) tended to evaporate as the Federal Reserve discount rate remained unchanged. In the present circumstances, however, the fact that the British rate increase was followed by a rise in the U.S. discount rate would tend to confirm market expectations of higher rates in the United States, at least in the short-term market.

<u>Corporate and municipal bond markets</u>. As in the government securities market, the tone of markets for corporate, and State and local government securities strengthened from late October through the first two weeks in November, and yields on many issues slipped to new lows for the year. The drop for seasoned municipal issues was particularly sharp, with yields on Aaa-rated issues falling to 3.05 per cent, their lowest level since May 1963.

BOND YIELDS

	Corporate Aaa		State and local govt.	
	New	Seasoned	Moody's Aaa	Bond Buyer (mixed qualities)
1964 - High	4.54(5/8)	4.43(11/13)	3.16(3/26)	3.32(4/21)
Low	4.30(2/21)	4.35(2/28)	3.05(11/19)	3.13(1/20)
Summer low	4.37	4.40	3.07	3.16
Sept.-Oct. high	4.52	4.43	3.12	3.26
Week ending Nov.20	n.a.	4.42	3.05	3.15

Since the U.K. and U.S. bank rate action, yields on recently-offered corporate bonds have moved up as much as 5 basis points. While yields on municipal bonds rose Monday, most of this advance was offset Tuesday, possibly reflecting market expectations of increased commercial bank purchases of tax-exempts resulting from the changes in Regulation Q.

Little upward pressure on bond yields can be expected from borrowers' demands for funds in the near future. The unusually light November volume of publicly-offered corporate bonds was an important factor in recent market strength; and although offerings next month are expected to increase substantially, they are estimated at less than one-half of last December's volume, and underwriters currently have no unsold syndicate balances.

In the municipal market, the volume of new issues in December should be roughly the same as the moderate November supply which met good retail demand. Dealers' advertised inventories of recently offered municipal issues, which fell more than $200 million during the past month to less than $500 million in mid-November, have since risen to nearly $600 million. It is difficult to gauge actual progress in distributing older issues from data on advertised inventories, however, since the sharp drop in yields over the past few weeks apparently had encouraged dealers to hold offerings off the market in anticipation of price increases.

BOND OFFERINGS 1/
(Millions of dollars)

	Corporate				State & local govt.	
	Public offerings		Private placements			
	1964	1963	1964	1963	1964	1963
Jan.-Aug. avg.	339	389	463	485	920	943
September	376	283	598	501	900e/	480
October	175e/	511	550e/	481	900e/	1,265
November	35e/	183	600e/	549	600e/	754
December	275e/	626	800e/	751	600e/	495

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

Stock market. The British and Federal Reserve rate actions had limited impact on the U.S. stock market. The Standard and Poor's composite index closed at 85.73 on Tuesday, a drop of about one-half of one per cent for the two days. In the preceding week, the index had risen about 1 per cent to a new record high, after fluctuating narrowly ghrough the first half of November. Last week's advance was accompanied by a sharp increase in trading volume which averaged 5.6 million shares a day, up 0.8 million from the October average. Much of the increased trading activity was reportedly in lower priced issues. These developments apparently reflected a combination of factors including favorable corporate profits and increasing dividends, and renewed talk of inflation sparked in part by scattered announcements of commodity price increases.

Stock market credit eased $41 million further during October. Most of this decline took place in customers' debit balances, but customers' credit extended by banks also dropped $5 million, the first month-to-month decline since January.

Home mortgage market. Home mortgage funds have generally continued ample and mortgage terms have remained unusually favorable for qualified borrowers this autumn. In October, the FHA-yield series declined one basis point but at 5.45 per cent, was virtually unchanged from its earlier low for the nineteenth consecutive month. Contract interest rates on conventional first mortgages for new homes were also little changed at 5.80 per cent for new home loans and 5.85 per cent for loans on existing houses.

Average maturities and loan-to-price ratios for conventional first mortgages on homes, continued below earlier peaks, but were moderately higher in September than a year earlier, according to the

Federal Home Loan Bank Board. Loan amounts remained appreciably greater than a year earlier, moreover, reflecting, in part, higher average prices paid for homes and further upgrading by purchasers this year.

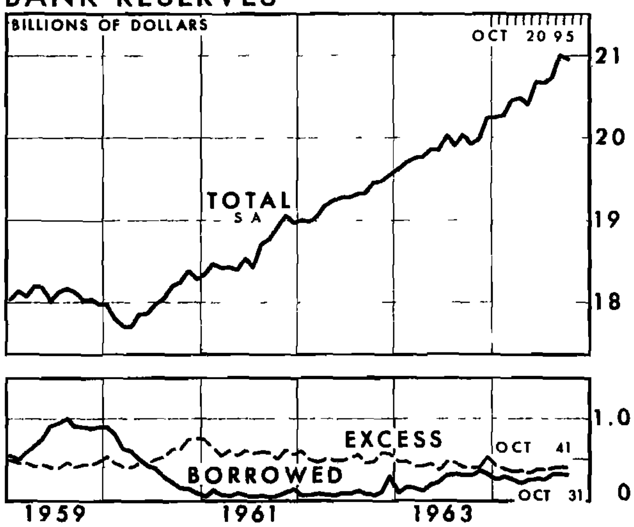
AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES

	August	September	Per cent increase from September 1963
New home loans			
Purchase price ($1,000)	24.2	23.9	+6
Loan amount ($1,000)	17.8	17.6	+7
Loan/price (per cent)	74.4	74.2	+1
Maturity (years)	24.7	25.0	+3
Existing home loans			
Purchase price ($1,000)	19.1	18.8	+5
Loan amount ($1,000)	13.6	13.4	+6
Loan/price (per cent)	71.4	71.6	+1
Maturity (years)	20.1	19.8	+2

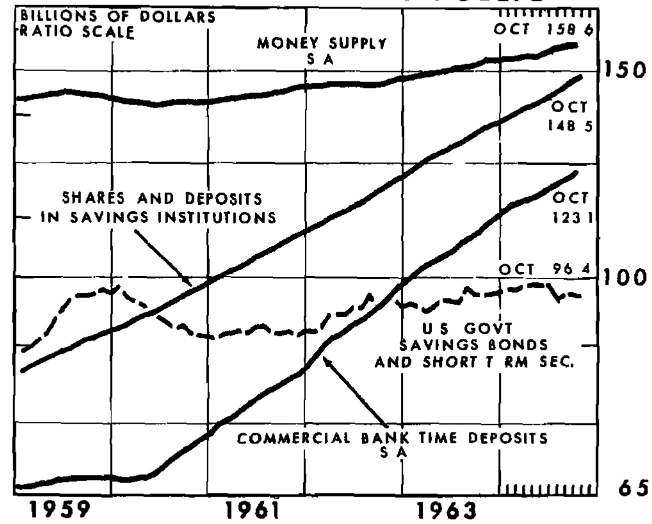
Mortgage delinquencies generally have continued below the advanced rates a year earlier, according to the regular survey conducted by the Mortgage Bankers Association. This survey covers home mortgages held or serviced by Association members and distinguishes mortgages delinquent for 30 days or more from those "in foreclosure" as well as those actually foreclosed. In the third quarter, delinquencies accounted for 3.04 per hundred mortgages surveyed, compared with 3.17 per hundred a year earlier and 2.88 in the third quarter of 1962. While the further general rise in after-tax incomes of mortgagors was a factor in the recent improvement, more rigorous collection policies by lenders were probably also important. Partly reflecting this shift in collection policies, mortgages in process of foreclosure, have showed a net rise this year though they have remained relatively low. In the third quarter, "in foreclosure" rates averaged .38 per hundred, as against .33 per hundred a year earlier and .30 two years earlier.

FINANCIAL DEVELOPMENTS - UNITED STATES

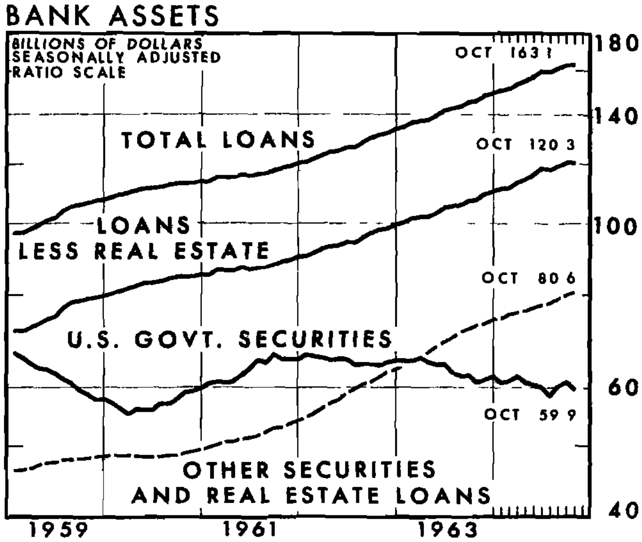
BANK RESERVES



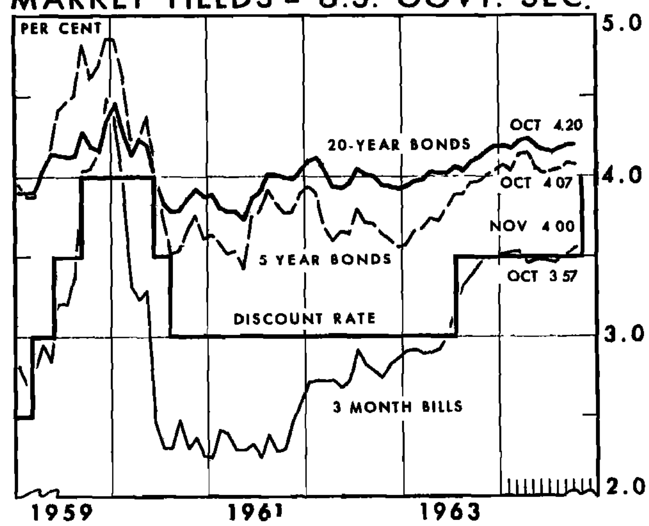
LIQUID ASSETS HELD BY PUBLIC



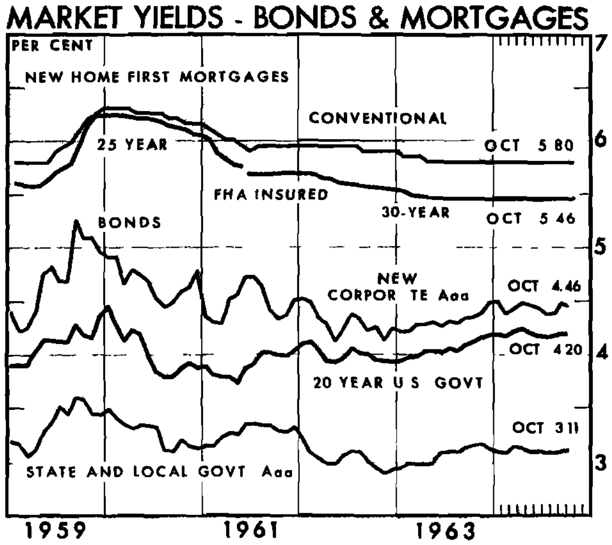
BANK ASSETS



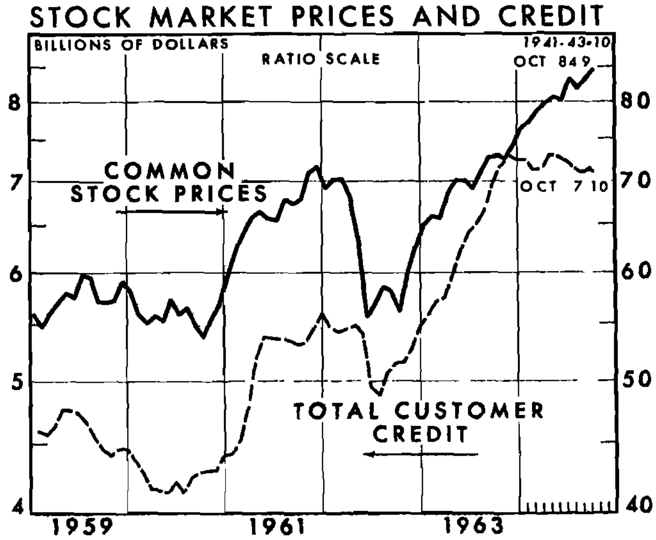
MARKET YIELDS – U.S. GOVT. SEC.



MARKET YIELDS - BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Tentative data for October and the first half of November show an over-all payments deficit of over $900 million. A net surplus in the remaining weeks of the year of some $300-$400 million will be required if the fourth quarter deficit is to remain close to the $2.3 billion annual rate of deficit recorded in the third quarter.

The over-all balance in the fourth quarter as a whole is not greatly affected by seasonal influences. Within the quarter, however, large deficits have usually been recorded in October and November with a surplus in December; in 1963, a surplus of nearly $400 million in December followed an $800 million deficit in October-November. This pattern is associated with a developing habit of movements of corporate funds to Canada early in each quarter and reflows late in the same quarter, large movements of funds into Canada as a result of window-dressing operations of Canadian banks in October and November, and the normal year-end repayments on U.S. Government loans and inflows of private investment income. This year, movements of funds to Canada, as indicated by changes in liabilities of Canadian agency banks to their head offices, have been exceptionally large; these liabilities rose by some $450 million through mid-November. If these outflows of U.S. funds to Canada are reversed, a sizeable payments surplus in December is quite possible.

The major known element that would raise the deficit is the substantial increase in new foreign security issues in the fourth quarter. These issues are now estimated to be higher than in the third quarter by about $400 million, seasonally adjusted. Long-term bank loans to foreigners increased by $110 million in October, continuing the high rate of outflow of these loans that has occurred since midyear; however, this higher rate of outflow has not been reflected in an increase in commitments for these loans. Short-term claims on foreigners reported by banks rose by $95 million in October; part of this rise may have reflected the movements of funds to Canada mentioned above.

Business and financial developments abroad. The rise in Britain's Bank rate from 5 to 7 per cent, which was quickly followed by the rise in U.S. discount rates and an increase in the Canadian discount rate from 4 to 4-1/4 per cent, afforded no relief to pressures on the pount sterling in foreign exchange markets in the first two days following the action. The effectiveness of the Bank rate increase and of the British budgetary measures in bringing about the necessary adjustments in the British economy are still to be determined; and until signs appear that such adjustments are being effected, uncertainties about the pound could be expected to keep conditions unsettled in international financial markets. To meet heavy speculation on a devaluation of the pound and to provide some time for the needed adjustment in Britain's balance of payments, a $3 billion package of international financial assistance for sterling was arranged.

The impact of the measures so far taken by Britain on economic conditions in the rest of Europe is unlikely to be large. Although these actions occurred at a time when recovery from recession in Italy was just beginning and when signs of some weakening were appearing in the French economy, demands in other European countries were continuing very strong and growth in output was being contained by capacity limitations.

In Britain, the Bank rate was increased from 5 to 7 per cent on November 23 in an effort to stem speculation against the pound in foreign exchange markets. In the preceding ten days following the Labor Government's Autumn Budget, sterling had come under heavy and almost continuous pressure. The spot exchange rate dropped to 278.27 cents (November 20), close to the mandatory lower support limit, and very substantial reserve losses led to large drawings on short-term borrowing arrangements with European central banks and with the U.S.

Following the rise in Bank rate speculation against sterling was resumed on a large scale after one day's respite. To defend the pound, the Group of Ten countries, Austria and the BIS announced on November 25 their willingness to provide $3 billion in financial assistance. This amount would supplement a $1 billion drawing from the IMF already arranged.

The Autumn Budget, introduced on November 11 included, only one measure in addition to the import surcharges that is immediately effective and that will tend to dampen domestic demand pressures. This was a 7 cent increase in taxes on gasoline and oil used by road vehicles. The other measures announced are to take effect at the beginning of next April and these included: (1) a large rise in pensions and other welfare benefits about half of which is to be offset by an increase in statutory pension contributions; (2) a rise in income taxes affecting primarily those in the higher income groups; (3) a revision of corporate income taxes shifting a greater part of the burden from retained onto distributed profits; and (4) a comprehensive capital gains tax. On the whole, the new taxes will tend to fall more heavily on the higher income groups while the rise in social welfare expenditures will tend to provide net benefits to the lower income groups.

The budgetary measures would not seem to afford in themselves much relief to the pressures on the domestic economy and hence not to assist correction of the large current account deficit in the balance of payments.

The rise in government revenues from the new taxes is expected only to match the increase in government expenditures. Moreo the shift in demand from imports onto domestic production induced by the import surcharges and the fact that the measures tend to favor consumption at the expense of saving may well heighten internal pressures. A major aim of these measures appears to be to obtain a moderation of union pressures for higher wage rates.

Prior to the above measures, the latest British statistics confirmed the picture of growing or at least continuing pressures of demand: (1) the October trade deficit totaled $260 million, lower than in September but about equal to the average monthly deficit since last spring; (2) prices continued to inch up in October, abetted by rising world commodity prices; (3) the most recent Federation of British Industries survey showed skilled labor shortages to be an increasingly important factor in limiting output and showed a further increase in the proportion of respondents reporting full plant utilization. On the other hand, the preliminary index of industrial production for October declined one point after showing no change for nine months.

An apparent rise in industrial production in Italy in September, coupled with reports of improved business sentiment and a pickup in imports in September, suggests that the Italian recession may have "bottomed out" in August.

The Italian authorities are now actively promoting a revival of economic activity and have taken three major steps in this direction. First, beginning in August the Bank of Italy has increased its lines of credit to the commercial banks, although through September the banks did not use any of this additional available credit. Second, the Bank of Italy will finance purchases by the savings banks of a substantial volume of bonds to be issued by a number of State-owned enterprises. Third, the government has repealed the special purchase taxes on automobiles imposed last February.

There was another large balance of payments surplus in October, provisionally placed at $165 million, bringing the cumulative surplus for the year to $458 million.

Upward price movements have continued in France, despite the use of price controls and other measures over the past year. In September, indexes of wholesale and consumer prices were 1.3 and 2.5 per cent higher, respectively, than a year earlier. Consumer prices in September alone rose by 0.5 per cent and because the October index is expected also to show a large rise, the government has introduced the following additional controls: (1) it has frozen the prices of restaurant meals at late October levels; (2) it has placed price controls on pork and will take measures to ease upward pressures on beef, bread, fish, and butter; and (3) it will postpone for 6 months the increase in controlled rents scheduled for January.

Other developments suggest that recent price increases relate more to earlier than to current demand pressures. The index of industrial production in September was, as expected, little changed from last spring's level. A September survey of the French business situation found little change since July in order backlogs or in industrialists' outlook for production in the following 3 or 4 months. Industrialists continued to be about evenly divided as to whether output would rise or fall, and these results are being interpreted as further evidence that any increase in production over the remainder of 1964 will be very small.

Early in October, the liquid asset reserve requirement of the commercial banks was reduced from 36 to 34 per cent of deposits. This reduction was designed to avoid an expected tightening of money market conditions and to permit the bank credit to expand in line with the 10 per cent a year ceiling previously set.

The pace of economic expansion in Germany has in recent months become more moderate. This somewhat slower growth is attributed in part to the slowing down of foreign demand, but to a greater degree to output limitations. Current utilization of capacity, according to a recent survey, is at about the peak rate reached in the last cycle in spring of 1962. Also, the continuing labor tightness is becoming an increasingly limiting factor to output expansion with 6.7 vacancies for each person unemployed in September as compared with 6.0 a year earlier.

With supply availabilities becoming increasingly limited, pressures on costs and prices are becoming more pronounced. Thus in August and September, domestic prices for industrial goods rose by 0.3 per cent and 0.5 per cent, respectively, much faster than in preceding months.

The passage of the DM 3.2 billion tax cut early this month to take effect in Janaury and higher wage rates likely to result from wage negotiations within the next few months are expected to raise disposable incomes significantly early next year. In addition, investment plans continue to show a rising trend.

Canada's expansion continues to be aided by strong external demand for Canadian exports. Seasonally adjusted exports throughout the third quarter were running 2 per cent above the level of the spring. Unemployment rose in mid-October but this apparently reflected the impact of U.S. auto strikes. Wholesale prices continued to fall through September while consumer prices, which rose 1 per cent earlier in the year, leveled off in September and October.

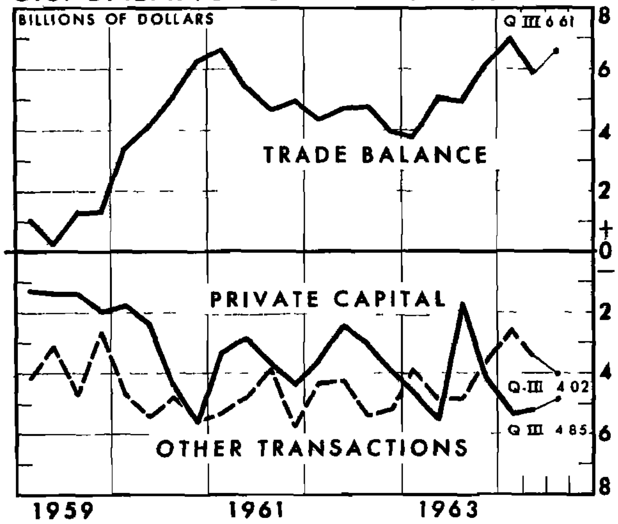
Japanese industrial production rose 2.5 per cent in September, following a pause in the upswing in June-August. Raw materials inventories rose 2 per cent in September, but were still slightly below the peak reached last January. New orders for machinery picked up in August after remaining relatively stable from May through July.

Seasonally adjusted imports rose by 8 per cent in October for the second month in succession; exports also rose sharply. Taking September and October together, the trade deficit averaged $77 million as compared to a monthly average of $50 million in July-August.

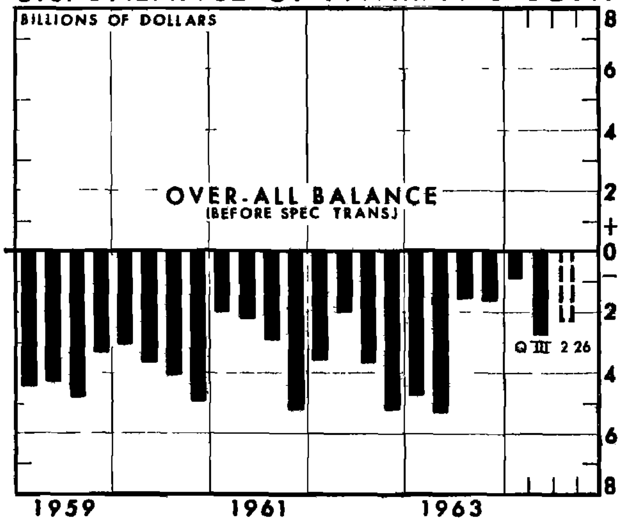
U.S. AND INTERNATIONAL - ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED, ANNUAL RATES

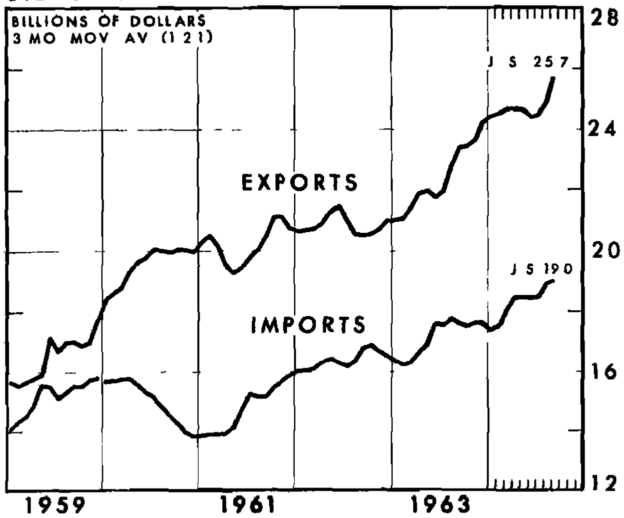
U.S. BALANCE OF PAYMENTS



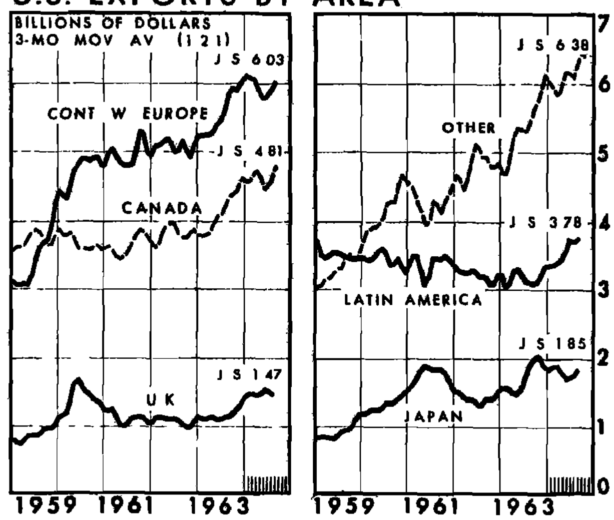
U.S. BALANCE OF PAYMENTS-CONT.



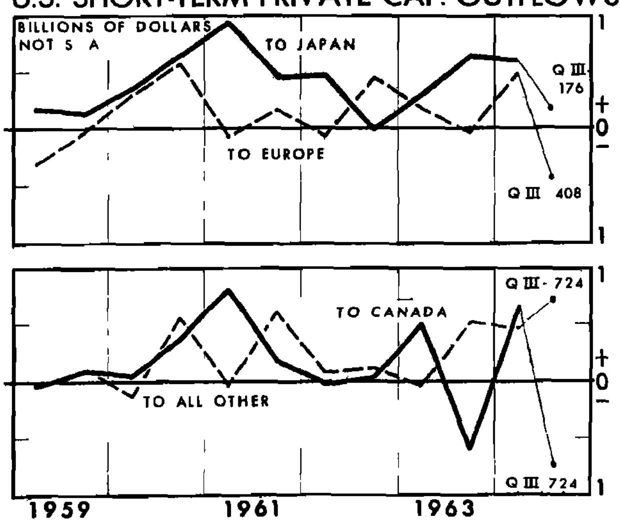
U.S. MERCHANDISE TRADE



U.S. EXPORTS BY AREA



U.S. SHORT-TERM PRIVATE CAP. OUTFLOWS



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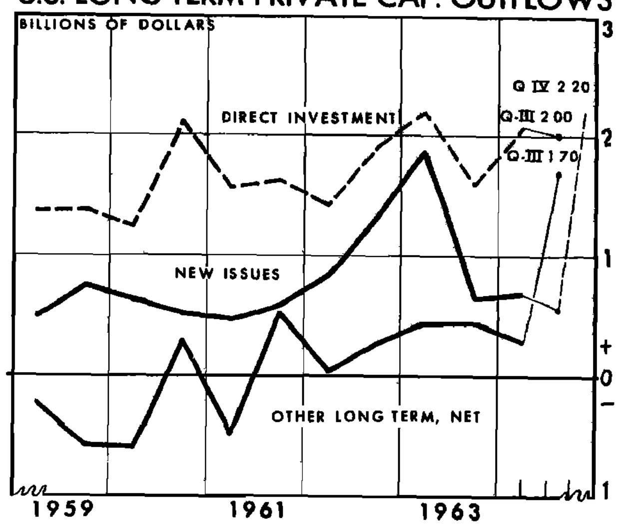

APPENDIX A: FEDERAL BUDGET IN FISCAL 1965 *

The likely budgetary position of the Federal Government in fiscal 1965 has become somewhat clearer with the publication of the Midyear Budget Review and with more recent additional information on the current rate at which individual taxes are being withheld. The Midyear Budget Review, as noted in the previous green book, showed a cash deficit of $3.5 billion for fiscal 1965 and a deficit of $3.2 billion on a national income accounts basis, both smaller deficits than in fiscal 1964.

Meanwhile, the recent evidence on tax withholdings has led the Department of Commerce to increase personal tax payments in the second quarter of calendar 1964 by $1.2 billion (at an annual rate). This upward revision reflects the voluntary adjustment in withheld tax payments apparently made by individuals to compensate partially for the under-withholding implicit in the new 14 per cent withholding rate effective in March of this year.

This development was not apparent earlier in the year because of the manner in which withheld taxes are paid into the Treasury. Employers pay such taxes together with withheld Old Age and Survivors Insurance taxes in one check. The Treasury then uses formulas to distribute these receipts for administrative purposes between individual income and OASDI taxes. During the second quarter and after, the amount of revenue coming into the combined account was higher than anticipated; on the basis of the allocation formula for that period, the increased revenue was credited to the OASDI account. But second quarter data furnished to the Department of Commerce by the Social Security Administration (taken from the forms accompanying the tax payments) suggested that the increased revenue did not represent social security payments. Therefore, it would appear that the additional revenue represented higher withheld income taxes.

This increased revenue indicates that at least some taxpayers voluntarily adjusted their withholding rate, either by dropping exemptions or by specifying a higher rate of payment. Our current estimate would be that the average withholding rate which applies after exemptions has been in the neighborhood of 14.5 per cent rather than the 14 per cent specified in the new tax law. This still represents substantial underwithholding, however, given the new tax structure and given the timing of the drop in withholding rates.

The apparent voluntary upward adjustment of the withholding rate changes the quarterly pattern of Federal receipts somewhat from what was previously expected. We now anticipate that about $500 million is coming in during July-December 1964 which was originally expected to be paid in the spring of 1965 as final settlement of the 1964 individual income tax

* Prepared by Government Finance Section.

liability. This increased withholding reduces the autumn deficit by $500 million and also reduces the expected spring surplus by about the same amount.1/ The autumn-to-spring swing in the cash budget from deficit to surplus is therefore cut by about $1 billion as compared with earlier anticipations.

This would now mean a swing from a cash deficit of nearly $10.5 billion in July-December 1964 to a cash surplus of about $7 billion in January-June 1965. A substantial part of such a swing is, of course, seasonal. But even after allowance for seasonal movements the cash budget is still expected to show an approximately $4 billion swing from a July-December deficit of $3.7 billion to a small surplus of $200 million in January-June 1965, as the accompanying table shows. This contrasts with a swing of only $1.3 billion in the comparable period of fiscal 1964. The quarterly pattern expected for fiscal 1965 shows gradually diminishing deficits as the year progresses, and a turn to a seasonally adjusted surplus in the April-June quarter of 1965, when unpaid individual and corporate tax liabilities for 1964 become due.

Roughly the same quarterly pattern is shown by the projections of Federal receipts and expenditures in the national income accounts--the deficits become smaller as the year progresses, falling from a seasonally adjusted quarterly deficit of $1.3 billion in the third quarter of 1964 to a deficit of only $300 million in the second quarter of 1965. But, the movement toward a less expansionary budget is not as sharp as in the cash budget. The national income budget shows a decrease in the deficit from July-December to January-June of only $1.5 billion, mainly because more smoothing is introduced into this budget by recording corporate tax receipts on an accrual basis. The movement to a smaller deficit, during the course of fiscal 1965 contrasts with the movement toward a larger deficit in the comparable period of fiscal 1964 in the national income accounts budget.

These quarterly patterns are within the constraint of fiscal year totals presented in the Midyear Budget Review. If expenditures should turn out to be somewhat higher than anticipated in the Review, this would be reflected mainly in a reduction in the size of the spring surplus; such a possibility would raise the fiscal 1965 deficit, perhaps by $500 million or so, and would reduce the swing between the two halves of the year commensurately. The expected January-July cash surplus would also be reduced

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1/ Technically, there would be a larger reduction of the spring surplus--perhaps $300 million larger--because of tax payments that we now believe were already made in the last four months of fiscal 1964. This would have the effect of increasing the fiscal 1965 cash deficit from $3.5 to $3.8 billion. But the analysis here has been kept generally within the constraint of the midyear review fiscal year totals.

Federal Receipts and Expenditures
Fiscal Years: 1964 and 1965*

	1963		1964		Fiscal	1964		1965		Fiscal
	III	IV	I	II	1964	III	IVp	Ip	IIp	1965
	Quarterly Totals									
Cash Budget: Unadjusted										
Receipts	27.3	24.5	30.3	33.3	115.4	27.0	24.8	30.6	36.3	118.8
Expenditures.	30.9	30.6	28.6	30.0	120.1	31.1	31.1	28.9	31.1	122.2
Deficit	-3.6	-6.1	+1.7	+3.3	-4.7	-4.1	-6.3	+1.7	+5.2	-3.5
Cash Budget: Seasonally Adjusted										
Receipts	28.5	29.0	29.7	28.4	115.4	28.2	29.2	30.0	31.4	118.8
Expenditures.	30.4	30.0	30.5	29.3	120.1	30.6	30.4	30.8	30.4	122.2
Deficit	-1.9	-.10	-0.8	-0.9	-4.7	-2.5	-1.2	-0.8	+1.0	-3.5
National Income Accounts: Seasonally Adjusted***										
Receipts	28.6	29.3	28.7	28.1**	114.7	28.5	29.2	30.0	30.4	118.0
Expenditures.	28.8	29.2	29.3	30.1	118.5	29.8	30.2	30.5	30.7	121.2
Deficit	-.02	+0.1	-0.6	-2.0	-3.9	-1.3	-1.0	-0.5	-0.3	-3.2
	Quarterly Totals at Annual Rates									
National Income Accounts: Seasonally Adjusted***										
Receipts.	114.2	117.2	114.8	112.3**	114.7	114.0	116.8	119.9	121.6	118.0
Expenditures.	114.9	116.6	117.2	120.2	118.5	119.2	120.8	121.9	122.9	121.2
Deficit	-0.7	+0.6	-2.4	-7.8	-3.9	-5.2	-4.0	-2.0	-1.3	-3.2

* Fiscal 1965 quarterly estimates are within the constraint of fiscal year totals presented in the mid-year budget review.
** Revised, Economic Indicators, November 1964.
*** Seasonally adjusted quarterly totals do not necessarily add to fiscal year totals because the seasonal factors are geared to calendar year totals.
p Projected.

GOVERNMENT FINANCE SECTION　　　　November 25, 1964 if the apparent voluntary increase in the withholding rate is reversed when the second stage of the current tax reduction program becomes effective next January; if this occurs, revenues in the spring would be lower than current projections. Spring revenues could also be lower if an excise tax reduction were passed quickly. However, it appears that a July 1 effective date is the earliest likely for any excise tax reduction. As to the amount of such a reduction, no official proposal has been made yet, but it would seem that excise tax cuts larger than $2 - $2.5 billion per year are unlikely.

On the other hand, there is the possibility that receipts could be buttressed in January-June 1965 by larger than expected capital gains tax payments, although new provisions in the tax law add to the uncertainty of predicting such receipts. Moreover, it is likely that there will be an increase, in some form, of social security taxes and benefits in connection with medicare early in the new session of Congress. It would require rapid passage, however, to have much effect on receipts and expenditures in the last half of fiscal 1965.

Setting aside the above mentioned possibilities, the projected reduction in Federal budgetary deficits in the course of fiscal 1965 reflects in part the effect on tax receipts of the expected continued growth in the economy. But it also reflects a less expansive fiscal policy on the part of the Government in the first half of calendar year 1965. This is seen not only from the timing of tax payments implicit in the new tax law but also in the continued restraint on expenditures especially as recorded in the cash budget. Federal expenditures in the national income accounts are projected to continue to rise moderately for the rest of the fiscal year, but not by enough to offset the swing in tax receipts.