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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

February 24, 1965

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IN BROAD REVIEW

In recent weeks the seriousness of the U.S. balance of payments problem and the risks involved in the U.S. commitment in Southeast Asia have become somewhat clearer. Increased recognition of the problems has contributed to some economic and financial uncertainty but the positive actions taken to deal with these problems have provided some reassurance.

In the stock market prices are down somewhat from earlier highs, although most recently prices have been rising. In markets for fixed return securities yields have increased generally, but the main impact has been on short-term yields. Sensitive commodity markets have shown surprisingly little response to these domestic and foreign developments.

Economic activity has continued to reflect strength of demands. The degree of strength was still being obscured by the dock strike--not yet fully settled, the aftermath of the auto strike, and uncertainty in the steel industry relating to the union election and contract negotiations and, hence, for inventory accumulation.

The money supply showed little change in early February, following a relatively slow rate of increase in December and January. Time and savings deposits rose sharply further in early February, however, following a record increase in January. Bank credit expansion has accelerated, reflecting both the large inflow of time and savings deposits and a record demand for business loans. Free reserves have been reduced in recent weeks.

Among changes shown by nonfinancial indicators, the further rise in industrial production in January was notable because it occurred even though auto and steel output showed little change from their capacity-pressing levels in December. Production schedules for autos call for sustained record rates in February and March. For steel, delays in labor negotiations will prevent for some time yet any cutback in production for inventory.

Retail sales in early February appeared to have remained at their slightly reduced January level. Sales so far this quarter, including the sharp rise in auto sales, are consistent with a very substantial increase in total consumption expenditures and also in total GNP in this quarter.

Continued strength in final takings, including further growth in business fixed investment outlays, is also being signalled by new orders for durable goods. These orders recently have broken out above the high level prevailing most of last year. Unfilled orders also continue large. Business inventory accumulation was large in the fourth quarter and apparently also in the first quarter. Steel and autos, where special situations prevail,,are currently important parts of the inventory build-up; elsewhere inventory buying apparently has remained orderly.

The labor market has shown significant signs of strength in recent months. In January, nonfarm employment rose appreciably further, the work week was further raised in manufacturing, and the unemployment rate declined to 4.8 per cent.

Commodity prices have continued roughly stable so far this year. While most announced price changes have been on the upside, not all of these increases have become effective and the industrial price index is only fractionally higher than a year ago and no higher than 5 years ago.

The U.S. balance of payments deficit in the first month and a half of 1965 appears to have continued very large, as in the fourth quarter. This seems to confirm numerous reports of heavy bank lending in anticipation of application of the IET to banks' term loans. Very large commitments on term loans were entered into by banks in the fourth quarter and again in January.

Private buying of gold on the London market has continued heavy, having been stimulated by the Viet Nam crisis and by President de Gaulle's remarks on February 4 calling for a return to the gold standard.

Though U.S. foreign trade statistics for the month of December showed an unusually large export surplus, the underlying trend remains obscure because of effects of the anticipated port strike, which became a reality on January 11. Activity at Atlantic ports was resumed on February 15.

Prospects for further expansion of U.S. exports in 1965 remain moderately encouraging, in the light of a review of the demand and production outlook in Europe and Japan.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest period	Amount			Per cent change	
		Latest Period	Precedg Period	Year Ago	Year Ago*	2Yrs. Ago*
Civilian labor force (mil.)	Jan.'65	74.9	74.7	73.7	1.7	3.5
Unemployment (mil.)	"	3.6	3.7	4.1	-11.2	-12.3
Unemployment (per cent)	"	4.8	5.0	5.5	--	--
Nonfarm employment, payroll (mil.)	"	59.3	59.2	57.3	3.4	6.0
Manufacturing	"	17.7	17.6	17.1	3.3	4.7
Other industrial	"	7.8	7.9	7.5	3.8	6.0
Nonindustrial	"	33.8	33.7	32.7	3.4	6.8
Industrial production (57-59=100)	"	137.7	137.0	127.7	7.8	14.9
Final products	"	137.5	137.0	128.5	7.0	12.6
Materials	"	137.6	136.9	126.7	8.6	16.9
Wholesale prices (57-59=100) 1/	"	101.0	100.7	101.0	0.0	0.5
Industrial commodities	"	101.6	101.4	100.9	0.7	1.3
Sensitive materials	"	101.3	101.2	98.0	3.4	5.0
Farm products and foods	"	98.1	97.2	99.7	-1.6	-1.7
Consumer prices (57-59=100) 1/	Dec.'64	108.8	108.7	107.6	1.1	2.8
Commodities except food	"	104.9	104.8	104.5	0.4	1.5
Food	"	106.9	106.8	105.4	1.4	3.3
Services	"	116.2	116.0	114.1	1.8	4.1
Hourly earnings, mfg. ($)	Jan.'65	2.56	2.57	2.50	2.4	5.8
Weekly earnings, mfg. ($)	"	106.37	105.65	101.11	5.2	8.3
Personal income ($ bil.) 2/	"	509.6	505.9	479.4	6.3	12.0
Retail sales, total ($ bil.)	"	22.4	22.7	21.0	6.6	9.8
Autos (million units) 2/	"	9.7	8.9	7.7	26.2	32.9
GAF ($ bil.)	"	5.2	5.1	4.8	9.8	16.3
Selected leading indicators						
Housing starts, pvt. (thous.) 2/	"	1,487	1,596	1,718	-13.4	13.2
Factory workweek (hours)	"	41.4	41.2	40.2	3.0	2.2
New orders, dur. goods ($ bil.)	"	20.9	20.7	19.7	6.1	13.4
New orders, nonel. mach. ($ bil.)	"	3.0	3.1	2.8	7.7	21.5
Common stock prices (1941-43=10) 1/	"	86.12	83.96	76.45	12.6	32.4
Inventories, book val. ($ bil.)	Dec.'64	108.8	108.1	105.1	3.5	8.5
Gross national product ($ bil.) 2/	Q4 - 64	634.6	628.4	599.0	5.9	12.0
Real GNP ($ bil., 1964 prices) 2/	"	630.6	626.6	606.2	4.0	8.1

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Feb. 19	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.00	3.99	4.13	1.00
U.S. Treas. bills, 3-mo., yield (per cent)	3.94	3.90	3.96	3.47
Net free reserves 2/ (mil. $)	-59	53	256	-59
Member bank borrowings 2/ (mil. $)	353	327	590	122
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.15	4.13	4.16	4.04
20-year U.S. Treas. bonds	4.20	4.20	4.22	4.15
Corporate new bond issues, Aaa	--	4.38	4.53	4.33
Corporate seasoned bonds, Aaa	4.41	4.41	4.45	4.41
Municipal seasoned bonds, Aaa	2.99	2.96	3.12	2.94
FHA home mortgages, 30-year 3/	5.45	5.45	5.46	5.45
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	86.21	86.81	87.56	83.45
Dividend yield (per cent)	3.02	2.99	3.05	2.94

	Change in Jan.	Average change-- last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	87	75	4.3	4.6
Bank loans and investments:				
Total	2,700	2,600	12.1	8.9
Business loans	1,700	1,000	21.3	13.0
Other loans	1,500	1,300	14.2	12.3
U.S. Government securities	-1,400	-100	-2.8	-2.1
Other securities	900	500	15.9	12.6
Money and liquid assets:				
Demand dep. & currency	400	400	3.0	3.9
Time and savings dep.	2,400	1,900	18.8	13.2
Nonbank liquid assets	700	900	4.3	5.4

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted. 1/ Average of daily figures. 2/ Averages for statement week ending Februrary 17. 3/ Latest figure indicated is for month of January. 4/ Data are for weekly closing prices.

U.S. BALANCE OF PAYMENTS

	1965 Jan.	1964 Dec.	1964 Nov.	1964 QIVp	1964 QIIIr	1964 QIIr	1964 QIr	1963 Year
Seasonally adjusted annual rates, in billions of dollars								
Balance on regular transactions				- 5.8	- 2.7	- 2.5	- 1.0	- 3.3
Current account balance					7.0	6.5	8.0	4.9
Trade balance 1/		9.3	5.8	6.9	6.5	5.8	6.8	5.0
Exports 1/		28.8	26.0	26.5	25.4	24.2	24.4	22.0
Imports 1/		-19.5	-20.2	-19.6	-18.9	-18.4	-17.6	-17.0
Services, etc., net					0.5	0.7	1.2	- 0.1
Capital account balance					- 9.1	- 8.9	- 8.2	- 7.8
Govt. grants & capital 2/					- 3.6	- 3.9	- 3.1	- 3.8
U.S. private direct inv.					- 2.1	- 2.3	- 2.1	- 1.9
U.S. priv. long-term portfolio					- 2.3	- 1.1	- 0.8	- 1.7
U.S. priv. short-term					- 1.7	- 2.2	- 2.3	- 0.7
Foreign nonliquid					0.6	0.5	0.1	0.3
Errors and omissions					- 0.7	- 0.2	- 0.7	- 0.3
Monthly averages, in millions of dollars								
Deficit on regular transactions (seas. adjusted)				483	226	211	82	272
Additional seasonal element				- 8	- 112	15	105	--
Financing (unadjusted)	215	261	264	491	338	196	- 23	272
Special receipts 3/	(0)	(0)	(0)	33	2	- 10	68	55
Liabilities increase								
Nonofficial 4/	-113	(- 596	519	207	184	36	77	49
Official 5/		(514	374	300	129	69	- 151	136
Monetary reserves decrease	328	343	- 629	- 50	23	101	- 17	32
of which: Gold sales	(262)	(95)	(40)	(57)	(- 7)	(- 24)	(15)	(38)
[Memo: Official financing]6/		(857)	(- 255)	(284)	(154)	(160)	(- 100)	(223)

1/ Balance of payments basis which differs a little from Census basis.
2/ Net of associated liabilities and of scheduled loan repayments.
3/ Advance repayments on U.S. Govt. loans and advance payments for military exports: assumed zero in absence of information.
4/ Includes international institutions (except IMF), commercial banks and private nonbank.
Includes nonmarketable bonds.
6/ Decrease in monetary reserves, increase in liabilities to foreign official institutions, and special receipts.

THE DOMESTIC ECONOMY

Gross national product. A very large increase in gross national product is indicated for the current quarter. Rebound in auto sales from reduced fourth quarter levels is contributing heavily to this expansion. Inventory investment is apparently continuing at around the high November-December rate which was above the fourth quarter as a whole. A major uncertainty relates to the effects of the dock strike on net exports.

Gross national product in the final quarter of 1964 is now estimated by Commerce Department to have increased $6 billion to an annual rate of $634.6 billion. This rate was 5.9 per cent ($35-1/2 billion) higher than a year earlier in current prices and 4.1 per cent higher in constant prices. For the year as a whole, GNP is now estimated at $622.6 billion, 6.6 per cent more than in 1963; in constant prices the gain amounted to 4.8 per cent.

The present estimate for the fourth quarter is $1 billion higher than the advance Commerce figure, due to higher net exports which were at an annual rate of $7.7 billion instead of the $6.5 billion estimated previously. Anticipation of the dock strike was probably a factor in the rise in net exports from the $7.0 billion rate in the third quarter.

Inventory accumulation is now estimated at $5.7 billion in the fourth quarter--double the $2.8 billion rate in the third quarter. The rise in final purchases was quite small--$3.1 billion--compared with increases of around $10 billion in each of the first three quarters of the year. Consumer expenditures for autos declined nearly $3 billion and residential construction activity showed a small further decline. Federal Government purchases of goods and services showed little change. Increases were somewhat smaller than earlier in the year for business outlays for fixed capital, consumer spending for nondurable goods, and State and local government purchases of goods and services.

Retail sales. In the first half of February, retail sales appeared to be at about the slightly reduced January level, after allowance for seasonal influences. Nondurable goods sales, reflecting gains for most categories, have about returned to the record December level following a decline in January. On the other hand, sales at durable goods stores were apparently off slightly further as a result of declines at lumber, hardware, and furniture and appliance outlets.

Sales of automobiles are still shattering records. In January they reached a seasonally adjusted annual rate of 9.7 million domestic vehicles (10.2 million, including imports). The domestic rate was 8 per cent above December, which also had set a record, and a fourth higher than the 7.8 million rate of January last year. In early February, sales continued a fourth higher than a year earlier. Current extraordinary sales volume is at least partly due to purchases postponed by the autumn auto strikes.

Dealer stocks of new domestic autos in mid-February were up appreciably from a month earlier, but were still slightly less than a year earlier.

<u>Consumer credit</u>. The pace of expansion in consumer instalment credit picked up in December and January following a decided slowdown in October and November. The turnaround largely reflected stepped-up demands for auto credit which accompanied the sharp recovery in sales; consumers also have been increasing their credit purchases of furniture, appliances, and other homegoods at a somewhat faster rate than earlier.

By the end of 1964, instalment debt was up more than $5.5 billion from a year earlier, and noninstalment debt was up about $1.3 billion. The quarterly pattern was uneven, however, as may be seen below.

INCREASES IN INSTALMENT DEBT
(Millions of dollars, seasonally adjusted)

Period	Amount
1964--Quarter 1	1,531
" 2	1,275
" 3	1,431
" 4	1,271

The first quarter was distinguished by a heavy volume of auto credit but an even heavier volume, relatively, of non-auto goods credit. A subsequent slowing in non-auto goods credit expansion was mainly responsible for the slackened pace in the total in the second quarter. In the third quarter demand for personal loans was particularly strong--especially for vacations and educational purposes. In the final quarter, expansion in auto credit fell far behind the pace it set earlier in the year despite strong demands for non-auto goods credit, the rise in the total was the smallest for any quarter in more than two years.

Personal income. Personal income in January rose sharply to a seasonally adjusted annual rate of $509-1/2 billion and was $30 billion or 6.3 per cent higher than in January 1964. More than half of the net rise of $3.7 billion from December was due to the payment, as in the preceding two years, of all the year's annual dividends on veterans insurance in January rather than in the actual policy anniversary months.

Residential building. Seasonally adjusted housing starts declined to slightly below the 1.5 million rate in January, but continued above the recent low of August 1964. In contrast, seasonally adjusted permits turned up in January by more than a tenth and were nearly at the advanced year-earlier rate. Single-family permits moved to the highest rate in almost a year. Multi-family permits, which also showed a striking advance in January, still remained substantially below their peak at the end of 1963.

PRIVATE HOUSING STARTS AND PERMITS

	January (thousands of units) 1/	Per cent change from: Month ago	Year ago
Starts (total)	1,487	- 7	-13
Permits (total)	1,317	+12	- 1
1 - family	768	+ 7	+ 4
2-4 - family	94	+24	-18
5-or more family	455	+20	- 5

1/ Seasonally adjusted annual rate; preliminary.

<u>Orders for durable goods</u>. New orders for durable goods increased slightly in January because of higher defense ordering. For other durable goods, new orders remained close to their record December level. Unfilled orders showed a small decline in January but the total was 14 per cent higher than a year earlier and, if defense orders are excluded, the rise was 21 per cent. The recent course of new and unfilled orders suggests continued strength in industrial production in the months immediately ahead.

As a result of the December and January increases, new orders may have broken out of the pattern which characterized most of 1964. January 1965 exceeded every month in 1964 except July, when there was a pronounced peak in defense orders, as shown in the table. In other months too, gyrations in defense orders had much to do with the ups and downs of total new orders.

NEW ORDERS FOR DURABLE GOODS
(January 1964 = 100)

	Total	Defense products	Durables excluding defense
1964 - January	100	100	100
February	99	90	100
March	98	81	100
April	104	89	106
May	101	93	102
June	101	87	104
July	108	123	105
August	98	70	102
September	101	74	105
October	99	90	101
November	99	67	104
December	105	67	111
1965 - January	106	82	110

For durable goods excluding defense, new orders showed a sizable rise last April and then fluctuated within a narrow range through November. In December and January these orders rose substantially to a level about 10 per cent above early 1964. Most of the large increase in new orders for nondefense durables since November has come from the auto industry, in which November levels were depressed by strikes. In this industry, new orders are about equal to current sales. The electrical machinery group and a collection of "miscellaneous" durable goods industries have also shown sizable gains. New orders for nonelectrical machinery rose only slightly from November to January, and orders for primary metals were about unchanged, at a level a sixth above early 1964.

Business inventories. With December data now available, business inventory accumulation for the entire fourth quarter totaled about $1,450 million and was about double the average rate in the first three quarters of the year.

In December, book value of all business inventories rose about $650 million, or .6 per cent, while business sales increased $2.7 billion, or 4 per cent, from the depressed November level. As a result, the stock-sales ratio declined to the lowest level yet for this expansion period.

Manufacturers' inventories increased considerably less in December than in November and October. Durable goods industries accounted for three-fourths of the total increase for the quarter and steel inventory accumulation was the major factor in the expansion.

Distributors accounted for about $250 million of the accumulation in December but their stocks were still $300 million below the pre-auto strike level in September. The rise in distributors' inventories in December--as in November--was mainly at nondurable retail stores and at wholesalers of durable goods, including steel. Auto dealer stocks showed very little recovery in December as record sales absorbed the bulk of record output.

Industrial production. Industrial production in January increased further to 137.7 per cent from 137.0 in December and continued 10 points or 8 per cent above a year earlier. Output of steel and autos was maintained at the very high December levels while production of nondurable materials and consumer goods other than autos rose. Business equipment was unchanged in January as a rise in commercial equipment was about offset by slight declines in industrial and farm machinery.

The very high rates of output of steel and autos have naturally attracted the attention of economic analysts. It has therefore been easy to overlook the continued widespread nature of increases in output, as is evident in the table. In fact, production of steel and motor vehicles have shown only moderate increases since last July. It should be noted, however, that some of the rise in output of materials has been associated with increased output of steel and autos.

INDUSTRIAL PRODUCTION

	Per cent increase	
	January 1964 to July 1964	July 1964 to January 1965
Total	4.1	3.6
Steel	20.4	2.8
Motor vehicles and parts	4.4	6.6
Remainder	3.2	3.4
Home goods and apparel	3.3	5.9
Consumer staples	1.7	1.5
Business equipment, excl. trucks	5.3	5.5
Materials*	4.0	3.2

*--Excluding steel and motor vehicle parts.

It may be helpful to put into perspective direct effects of possible declines in steel and autos on the total index. Auto assemblies in December and January were at record levels, at seasonally adjusted annual rates of about 9.5 million units, and production schedules for February and March are set at the same rate. It is unlikely that the present pace of output can be sustained. The current high level of sales is in part a makeup of earlier strike losses and at some point dealers' stocks will build up to an adequate level. For illustrative purposes, if auto output should decline from present levels to an 8-1/2 million rate, a decrease of about 10 per cent, this would amount to a direct loss of 0.4 of a point in the total index.

Production of iron and steel has been at or near record rates since last July and, beginning in October, inventories of steel have been rising rather sharply. In December, receipts of steel by manufacturers were reported to have been about 10 per cent above their consumption; it is expected that the rapid rate of inventory accumulation will continue at least through the first quarter.

In both 1962 and 1963, following inventory build-up and subsequent peaceful settlements of labor contracts, steel production declined 25 per cent in four months. If the contract negotiations, which are currently postponed due to union election uncertainties, lead to a peaceful settlement, steel production will likely again be curtailed. Steel consumption rates are presently above those prevailing in 1962 and 1963 but steel output is now higher and the period of accumulation is lasting longer. A decline of 25 per cent in steel production from current levels, as in 1962 and 1963, would amount to a direct loss of about 2 points in the total index.

Labor market. Nonfarm payroll employment in January rose 100,000 further to 59.3 million--a level nearly 2 million above a year earlier. The January increase was smaller than in December partly because of a decline of 85,000 workers in the transportation industry resulting from the dock strike. There was little evidence elsewhere of layoffs attributable to the strike.

Total manufacturing employment in January rose by 80,000 to 17.7 million, the highest level since July 1953, but production worker employment was still considerably below the 1956-57 levels. Most of the January increase continued to be concentrated in the durable sector, reflecting the catch-up in auto production and the steel build-up. In the nondurable sector, employment increases were small and centered in the food and apparel industries.

Employment in trade and services increased further, continuing to account for a sizable share of the rise in total nonfarm employment.

Government employment remained relatively stable as continued expansion in State and local governments about offset a drop in Federal employment.

Employment rose slightly faster than the labor force in January and the unemployment rate declined to 4.8 per cent from 5.0 per cent in December. Although unemployment rates for adult men and women were little changed over the month, they have declined significantly over the past year. The rate for teenagers continued at 15 per cent in January, the same as in most months last year, and almost half again as high as in August 1957.

UNEMPLOYMENT RATES
(Seasonally adjusted)

	January 1965	January 1964	May 1960
Total	4.8	5.5	5.2
Men 20 years and over	3.5	4.2	4.3
Women 20 years and over	4.5	5.5	4.7
Total 14 to 19 years	15.2	15.0	13.2

The civilian labor force in January was 1.2 million higher than a year earlier. Total employment rose by 1.7 million with nonfarm activities up 2 million and farm down 300,000.

Hours and earnings. The average workweek of production workers in manufacturing rose in January to 41.4 hours, seasonally adjusted, the longest since World War II. All of the rise was in the durable sector and most of it was the result of record rates of auto production. Thus, the workweek in the transportation equipment industry, which increased 1.3 hours in December, rose again by 1.0 hour to 43.8 hours.

Average hourly earnings seasonally adjusted, in manufacturing, edged off 1 cent to $2.56 in January, reflecting relative stability in both durable and nondurable goods industries. Compared with a year earlier, these earnings were up 6 cents or 2.4 per cent. Weekly earnings, however, were up $5.26 or 5.2 per cent from a year earlier, with about half the rise being due to the longer workweek.

Industrial relations. Uncertainty as to the winner of the election for the presidency of the steel workers union has continued to hamper contract bargaining. With control of major offices in doubt, firm contract decisions by the current officers are unlikely. These internal difficulties may lead to an extension of the contract beyond May 1.

Unofficial returns gave the challenger, Mr. Abel, a very slight lead in the over 600,000 votes cast. Official tabulation of the vote is expected to be lengthy since a large number of complaints and challenges by local unions must be investigated before the final tally can be given to the Executive Board.

Meanwhile, negotiations with the major can companies have been resumed, but the steel union is expected to ask for an extension beyond the March 1 deadline. These contracts already have gone well beyond their original September termination date with both sides having agreed earlier that the final settlement would be retroactive to October 1, 1964.

It is hoped that negotiations with the steel industry will get underway next week but serious bargaining is doubtful until the election of officers is resolved. Union sources have indicated that an extension of the contract would be acceptable to them in view of the limited time available for negotiations, but would probably agree only if the final settlement were made retroactive to May 1. It is not now known if the steel industry would agree to extension on these terms. Traditionally, steel management has refused contract extensions providing for retroactivity. Support for an extension of the contract came from George Meany, President of the AFL-CIO, this week.

About 85-90 per cent of the striking longshoremen are back at work. Local disputes continue to tie up ports at Galveston, Houston, and Miami, but negotiators believe a settlement is imminent. The strike lasted 33 days before the union issued the back-to-work order shortly before a Presidential panel reported. It was the first time the longshoremen's union has varied from its policy of keeping all workers out until all ports had settled.

The preceding longshoremen's strike--in December 1962 and January 1963--was in effect about the same length of time, 34 days. The impact on foreign trade statistics showed up in both the final quarter 1962 and first quarter of 1963. In the current strike all ports were closed down 20 days in January and 13 days in February. Thus, the primary effect will be on the first quarter data, although the sharp rise in U.S. exports in December may have been partly in anticipation of a strike.

Prices. Commodity markets have not reacted strongly to military developments in the Far East. The standard daily indexes of spot and future prices have changed little. Copper prices on the New York and London exchanges have increased appreciably in recent weeks, after having declined sharply from highs in December, but the increases do not appear to have been provoked by the international tensions.

Comprehensive wholesale price statistics for mid-January show a rise of.1 per cent in industrial commodities from mid-December, and weekly estimates through mid-February show no further change. Thus, after rising last autumn to a December level .6 above that prevailing in the first nine months of 1964, the industrial average has increased only .1 per cent further in the past two months. The mid-February level is .5 per cent above that of early 1961 and equal to the high reached in early 1960.

The price index for foodstuffs rose nearly 1 per cent between mid-December and mid-January, and it has increased somewhat further since then. The rise is attributable chiefly to reductions in marketings of livestock that were in part seasonal. In mid-February, average prices of foodstuffs were close to the levels for this season of the past three years. The index for industrial commodities and foodstuffs combined, at 101.2 per cent of the 1957-59 average in early February, was up about .5 per cent both from December and from February 1964.

Markets for nonferrous metals have been subject to cross-currents this year; the BLS index of prices, after rising nearly 10 per cent in the second half of 1964, has changed little since December. World consumption of metals has remained high, and prospects are for a further increase this year. On the other hand, production of copper is at a record high and it is likely that inventories are being rebuilt following the depletion caused by strikes last summer. Further increases in output of lead and zinc are in prospect for this year. And proposals to authorize release of metals from the U.S. stockpile are under consideration in the Congress. Reflecting assessments of the prospects for improved market supplies, prices for scrap metals have declined slightly this year.

In mid-February, list prices of aluminum sheets were raised by what appears to be an average of 1 per cent. These products account for about 25 per cent of all fabricated aluminum products. Press reports of the increase noted that actual prices have been below the published lists, that the price increases announced last June and November generally did not stick, and that some industry sources expressed doubt that the increases this time would stick.

No additional changes in steel prices have been reported in recent weeks. The unsettled issue of union leadership no doubt will prolong uncertainties about a strike and will cause production to be maintained for some time at maximum rates. However, the prospects for eventual sharp decreases in production are already being reflected in some easing of prices in markets for steel scrap.

The BLS statistics show that prices of lumber and plywood, as reported in the press, increased appreciably between mid-December and mid-January. Production, which had been curtailed by floods in the Northwest, has recovered more rapidly than anticipated, however, and prices have now turned down.

In recent months, price averages for most groups of non-electrical machinery and equipment have increased by one-half to 2 per cent while electrical machinery has declined slightly further. The whole machinery and equipment group has risen by one-half per cent, and at 104.3 per cent of the 1957-59 average, it is 1-1/2 per cent above the level in 1962 and the first half of 1963.

Population. On January 1, 1965 the U.S. population totaled 193.5 million, 2.65 million more than a year ago. The annual gain was about the same as in 1963 but much less than in the late 1950's. Slower population growth in recent years--1.4 per cent in 1964 compared with 1.8 per cent in 1955--has resulted mainly from a significant drop in the birth rate. The death rate has tended to show little change in recent years.

POPULATION GROWTH

	Population		Births		Marriages	
	Net increase during year		Number	Rate 1/	Number	Rate 1/
	000's	per cent	000's	per cent	000's	per cent
Annual average						
1954-56	2,960	1.8	4,133	25.2	1,535	9.3
1957-59	2,938	1.7	4,286	24.7	1,488	8.6
Year						
1960	2,940	1.6	4,305	23.8	1,527	8.5
1961	3,007	1.6	4,317	23.6	1,547	8.5
1962	2,818	1.5	4,167	22.4	1,580	8.5
1963	2,658	1.4	p/4,081	21.6	1,651	8.8
1964	p/2,653	1.4	p/4,054	21.2	1,719	9.0

1/ Per 1,000 resident population.

A further decline in the birth rate occurred during 1964; in the fourth quarter a low of 20.7 per 1,000 was reached. While it is thought that the downward trend will soon be reversed because of a rising number of marriages and a more favorable age distribution, there is no evidence yet of such a reversal. Many reasons have been advanced to explain the decline. The number of women in the most fertile age groups has been declining until recently, the age of marriage has stopped declining and there has been a slowing in the rise in the number of children per family. Recent surveys have indicated that young married couples plan smaller families and are concerned with costs of raising a family, especially educational expenditures.

MARRIAGES AND BIRTHS
Seasonally adjusted quarterly averages at annual rates

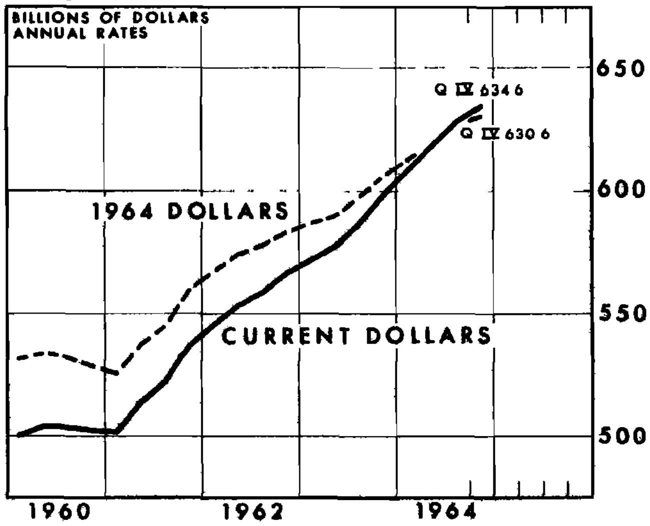
	Marriages		Births	
	Number 000's	Rate per 1,000 population	Number 000's	Rate per 1,000 population
1963 - QI	1,596	8.5	4,112	22.0
QII	1,636	8.6	4,140	22.0
QIII	1,640	8.7	4,072	21.6
QIV	1,752	9.1	3,996	21.1
Year	1,651	8.8	4,081	21.6
1964 - QI	1,756	9.1	4,104	21.7
QII	1,736	9.1	4,124	21.6
QIII	1,696	9.0	3,992	20.9
QIV	1,716	8.9	3,988	20.7
Year	1,719	9.0	4,054	21.2

Marriages rose again in 1964 and were almost up to the higher rates of 1954-56. Economic factors were favorable with lower unemployment rates for men 20-24 years of age an important influence. Further, the age composition of the population continues to favor a growing number of marriages. The draft law revision in November 1963 exempting married men, however, caused a temporary bunching of marriages late in 1963 and in the first half of 1964; by the fourth quarter of 1964 marriage rates had dropped below those earlier in the year and in the fourth quarter of 1963.

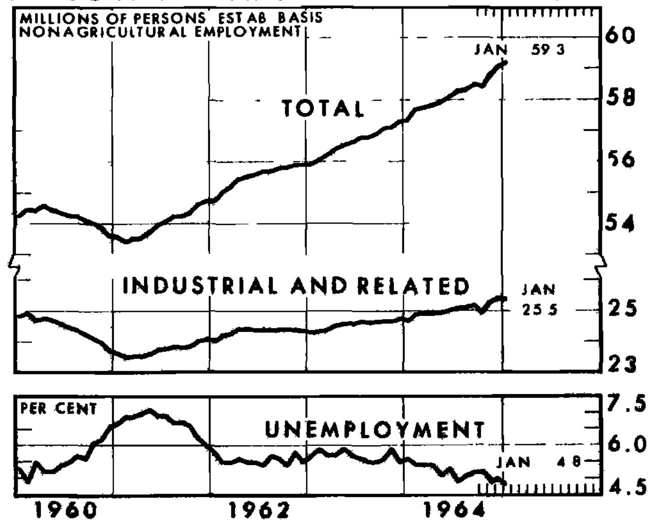
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

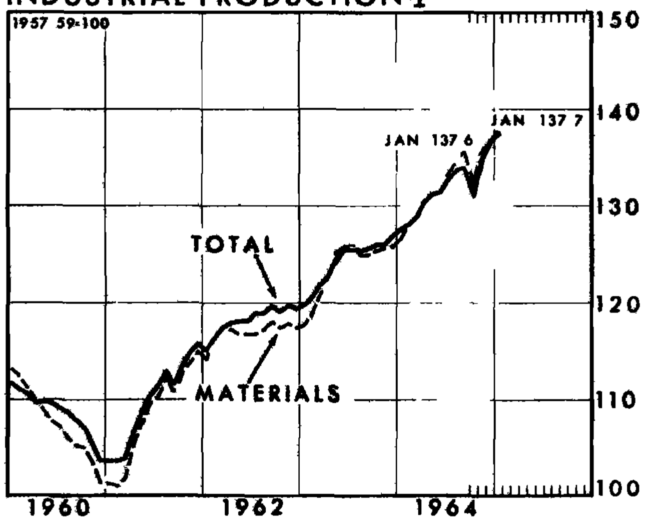
GROSS NATIONAL PRODUCT



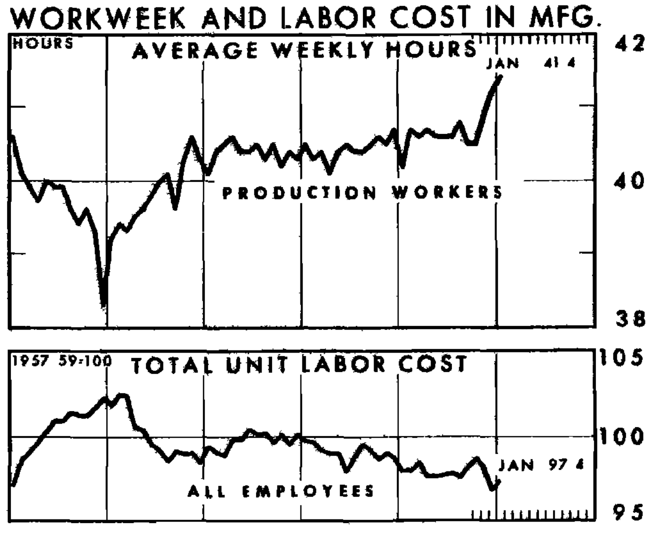
EMPLOYMENT AND UNEMPLOYMENT



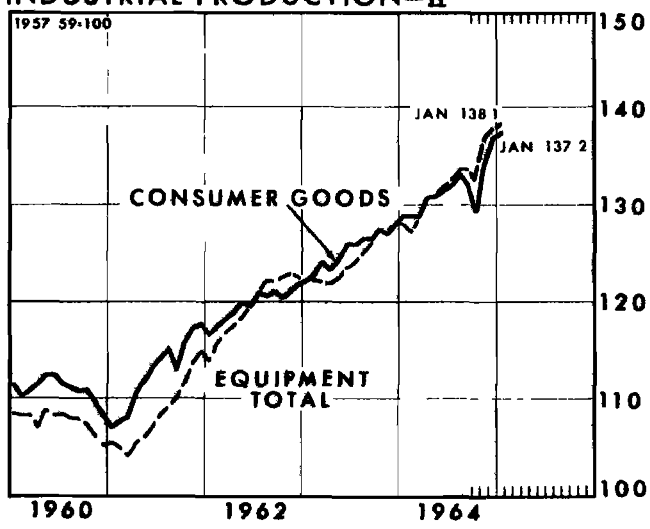
INDUSTRIAL PRODUCTION-I



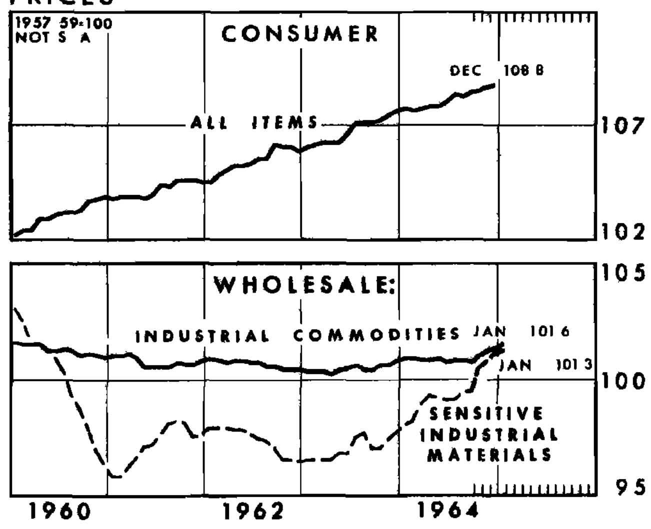
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION—II



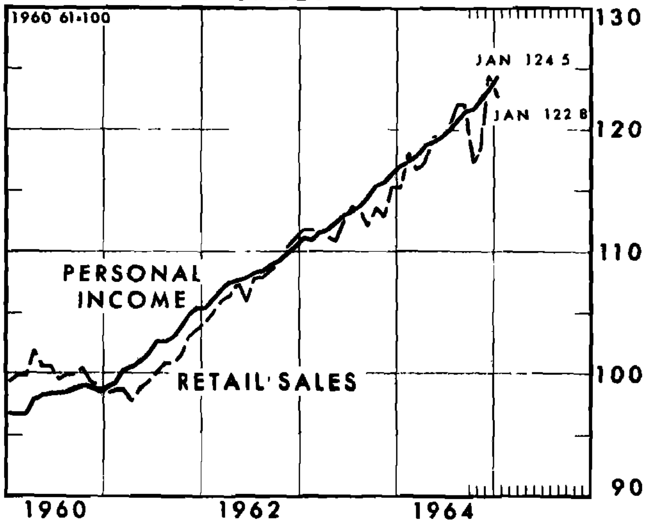
PRICES



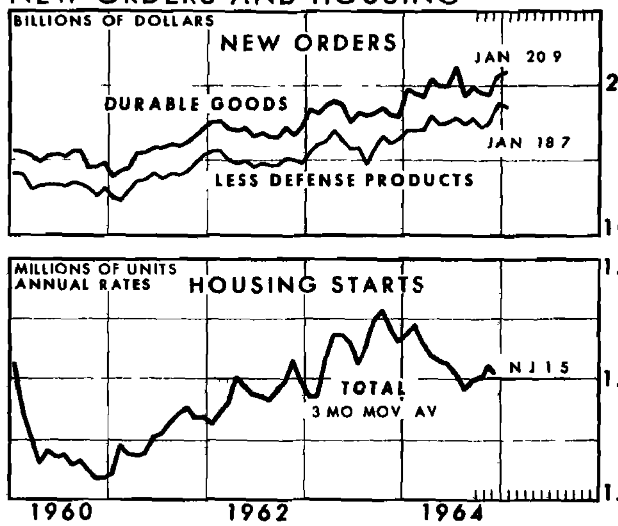
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

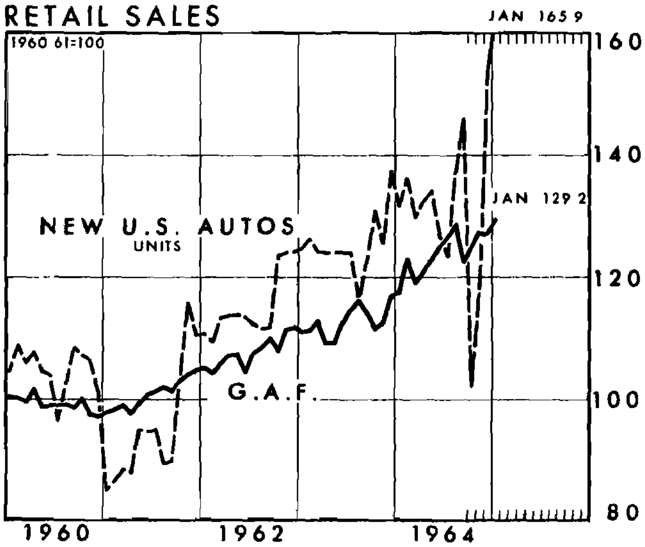
INCOME AND SALES



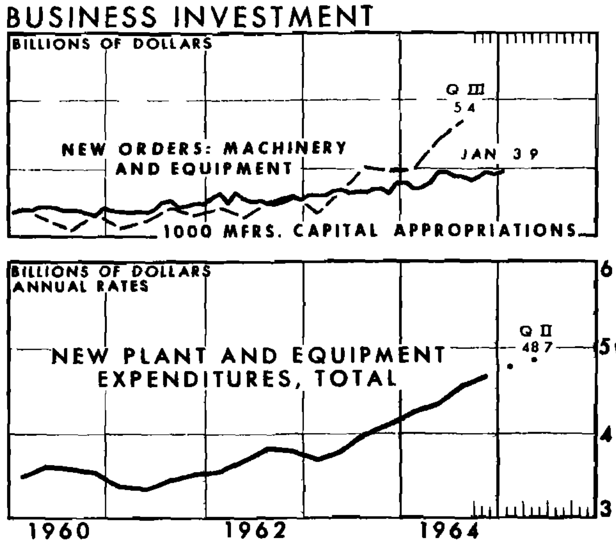
NEW ORDERS AND HOUSING



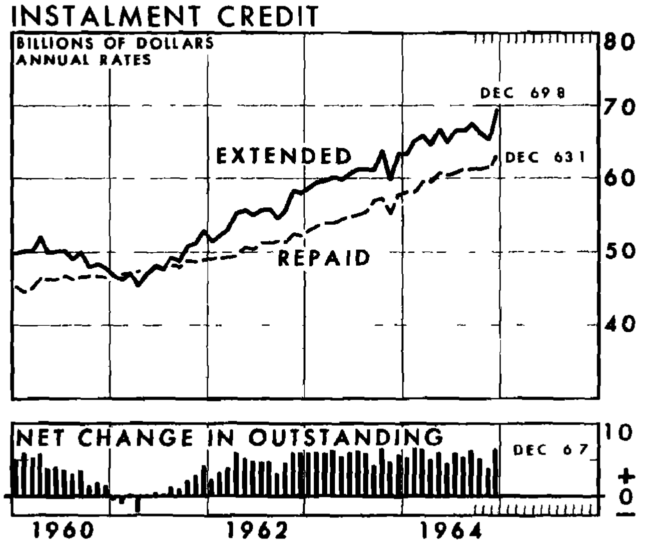
RETAIL SALES



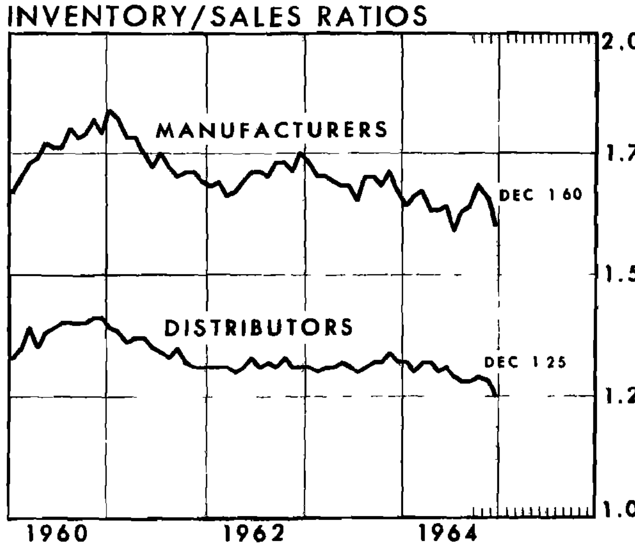
BUSINESS INVESTMENT



INSTALMENT CREDIT



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

Bank credit. In early February, as in January, the rate of growth of bank credit as well as its composition continued to be influenced mainly by strong demand for business loans and a large inflow of time and savings deposits. With expanding time deposits providing a larger than usual offset to the seasonal decline in demand deposits, total credit has declined considerably less than usual. After allowance for seasonal influences, credit growth this year has been somewhat faster than the average for other recent months.

After declining less than usual in January, total loans rose more than usual in early February. Banks also added substantially to their holdings of municipal and agency issues, as they tend to do when inflows of time and savings deposits are large.

A factor moderating the rate of credit expansion this year has been a larger than usual decline in holdings of U.S. Government securities, mainly Treasury bills. This decline appears to have been largely in response to strong loan demand and the altered structure of relative costs among alternative reserve-adjustment procedures since the November increase in the discount rate. Immediately prior to that increase, the bill yield had been appreciably higher than the discount rate, and banks added substantially to their bill holdings. Since then, with bill yields lower than the discount rate and Federal funds and CD rates as well, banks have reduced their bill holdings.

As a result of these reductions in short Governments, together with heavy participation in the January advance refunding, bank liquidity has declined substantially. On February 10, city bank holdings of short-term Governments were at about the same level as in early September, and, except for one week last April, holdings at New York City banks on February 17 were at the lowest level since the summer of 1960, amounting to only 3.6 per cent of total deposits.

Business loans, seasonally adjusted, have been expanding at a record rate so far this year. The January rise of $1.7 billion at all commercial banks is about twice the previous record monthly increase which occurred in March 1956 and over three times the average monthly rise in 1964. In the first two weeks of February, business loans at city banks rose nearly $500 million, about $300 million more than the largest increase in any other recent year. All major industry categories except construction and the textiles-apparel groups have been important contributors to the expansion.

This sharp business loan expansion has stemmed mainly from three unusual and presumably temporary developments, but some step-up in loan demand probably has also been associated with the accelerated pace of over-all domestic economic activity. First, the dock strike, which resulted in tieing up both incoming and outgoing merchandise shipments, has been mainly responsible for the contra-seasonal rise in commodity dealer loans, and it may also have contributed to the stronger loan trend for food processors and possibly trade concerns as well. Although changes in dealer inventories of new automobiles frequently have accounted for unusual fluctuations in trade borrowings in the past, such changes have not been important recently. Second, inventory accumulation to hedge against a possible steel strike probably accounts for most of the contra-seasonal rise in the metals group since December. The contribution of steel inventory borrowing to the total business loan rise during this period, however, has been moderate, probably not exceeding \$250 million on a seasonally adjusted basis. Finally, the pace of foreign business lending rose sharply in early 1965, presumably in anticipation of possible implementation of the Gore amendment. Some increase may also have occurred in borrowing by domestic corporations for use abroad. While figures are not available on the January increase in business loans attributable to foreign lending, it is likely that most of the large rise in total bank loans abroad during that month were in this category.

Money supply and time deposits. The seasonally adjusted money supply showed little change in the first half of February after increasing at a relatively slow rate in December and January. Large transfers of funds into time and savings deposits from other assets, including demand deposits, continue to dampen the rise in the money supply. A larger-than-usual rise in U.S. Government deposits also operated in this direction in the first half of February. Between October and the first half of February, a period of continuous rapid growth in time deposits, the money supply increased at an annual rate of less than 2 per cent.

Turnover of demand deposits at banks outside New York City declined substantially in January to 32.1 from 33.6 in December (based on revised series). The January level is the lowest in over a year and is slightly below that in January 1964.

Seasonally adjusted time and savings deposits at all commercial banks increased $1 billion further in the first half of February following a record $2.4 billion rise over January. The January annual growth rate of 23 per cent had been exceeded only by that in February 1962. Since October, growth in time and savings deposits has been at an annual rate of 20 per cent.

The recent sharp growth in these deposits is attributable to several factors. Rate increases following the November revision of Regulation Q have mainly accounted for the surge in savings deposit inflows so far this year. These deposits at city banks have been expanding over three times as fast as a year ago and at about the same pace as in early 1962 following a previous round of rate increases.

Higher rate ceilings also have enabled banks to attract a large further inflow of other time deposits, but policy decisions by bank management influenced the behavior of these deposits as well. For example, the new nonnegotiable savings and investment certificates that some banks have introduced appear to be attracting substantial amounts of funds, particularly from small businesses and other investors having insufficient funds to acquire negotiable CD's.

Outstanding negotiable CD's have also expanded rapidly further, with the composition of the issuing banks shifting in response to changing policies. In January, banks outside New York and Chicago, where outstandings had shown little change since last May, accounted for most of the record increase. At that time, New York City banks were reported to consider CD funds relatively expensive and only brought outstandings back to the level prevailing at the time of the discount rate increase. So far in February, banks in New York City, which have experienced unusually strong loan demand, have continued to increase their outstanding CD's, while at outside banks, they have declined.

The further advance in the 90-day Treasury bill yield this year to a level approaching the 4 per cent ceiling on 30-90 day CD's undoubtedly has curtailed the available supply of CD funds in this maturity range, except for the shortest maturities at prime banks. This may account in part for the renewed expansion in unsecured notes outstanding. On February 10, these totaled nearly $150 million compared with about $80 million at the end of the year.

Bank reserves. Free reserves averaged $25 million over the three weeks ending February 17, considerably below the $120 million average in December and January.1/ The February average included net borrowed reserves of $59 million in the week of February 17--the first week member bank borrowings have exceeded excess reserves on the initial published estimate since the week ending June 1, 1960. Member bank borrowings averaged $268 million over the three February weeks, somewhat above other recent months except for the temporarily high $417 million level in November. In addition, excess reserves declined

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.

slightly. From January 27 through February 23, the effective rate on Federal funds rose above 4 per cent on two days in early February and fell below on one day later in the month. Some transactions took place above the discount rate on nine days and below it on five days.

U. S. Government securities market. Yields on U. S. Government securities have risen since the latter part of January reflecting the situation in Vietnam, growing expectations of some firming of monetary policy, and an actual decline of marginal reserve availability. These conditions have affected mainly the bill and short-term coupon area, but there has been some associated upward pressure on longer-term rates. Reaction in the bond market was tempered, however, first by press reports of the President's opposition to higher bond yields and more recently by System and Treasury purchases of coupon issues.

YIELDS ON U.S. GOVERNMENT SECURITIES

Date (Closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1964-65						
Highs	3.96	4.03	4.22	4.21	4.26	4.26
Lows	3.42	3.50	3.92	3.99	4.12	4.14
1964-65						
December 31	3.82	3.92	4.06	4.12	4.21	4.21
January 25	3.84	3.94	4.01	4.08	4.18	4.17
February 2	3.88	3.95	4.04	4.12	4.20	4.19
February 23	3.99	4.05	4.08	4.15	4.21	4.20

Dealers have continued to make good progress in distributing bonds acquired in the January advance refunding. Even so, their holdings in mid-February of bonds maturing in more than 20 years remained substantial, as shown in the table on the next page. Investment demand for bonds has come from a variety of institutional investors, notably pension funds, while selling by speculative holders and by some commercial banks has only partly offset this demand. Nevertheless, yields have been pushed higher as individual dealers intensified efforts to work down their holdings.

DEALER POSITIONS IN COUPON ISSUES 1/
(In millions of dollars)

Date	Within 5 years	5 - 10 years	10 - 20 years	Over 20 years	Total over 5 years
1965:					
January 11	85.5	608.8	-0.4	610.3*	1,218.7*
February 1	194.3	326.9	6.2	448.4	781.5
February 23	279.3	135.6	9.3	296.8	441.7

1/ Includes holdings under longer-term repurchase agreements.
* Record level.

Upward pressure on bill rates has stemmed recently from the large supply of bills coming into the market. Commercial banks have become heavy net sellers of bills in order to finance exceptionally large loan demands for this time of year, while the Treasury has continued to add $100 million to each weekly bill auction. The recent advance in bill rates has been accompanied by a rise in most other short-term rates, including rates on finance company paper, bankers' acceptances, and certificates of deposit, as shown in the following table. Most short-term rates are currently at their highest levels in about five years.

RECENT SHORT-TERM INTEREST RATE DEVELOPMENTS
(Offered rates)

	1964	1965	
	November 20	February 1	February 23
Treasury bills, 90 days	3.59	3.85	3.97
Commercial paper, 4-6 months	4.00	4.25	4.25
Finance company paper, 30-89 days	3.75	4.00	4.25
Bankers' acceptances, 1-90 days	3.75	4.00	4.13
Certificates of deposit 1/			
3-months	3.95	4.15	4.25
6-months	4.05	4.25	4.35

1/ Secondary market rates on CD's of large New York banks.

Corporate and municipal bond markets. Yields on corporate and municipal bonds have turned up recently in response to the same expectational influences that have been at work in the Government securities market. In addition, the immediate and prospective supplies of new offerings have expanded somewhat in both markets. The yield series on new corporate issues--which late last month reached its lowest level in nearly a year--has since erased about 2/3 of the decline from its sterling crisis high. While yields on high grade municipal bonds continued to decline through early February to a level only 6 basis points above the six-year low of November 1962, this downward trend was reversed last week when yields rose 5 basis points back to their year-end level.

BOND YIELDS

(Weekly averages - per cent per annum)

	Corporate Aaa		State & local Government	
	New	Seasoned	Moody's Aaa	Bond Buyer (mixed qualities)
1964				
Sterling Crisis High	4.47 1/	4.45	3.09	3.21
Year End	n.a.	4.43	2.99	3.12
1965				
January - High	4.39	4.44	2.99	3.12
Low	4.33	4.42	2.96	3.04
Week ending				
1965 - Feb. 5	4.38	4.41	2.94	3.04
12	4.42	4.41	2.94	3.04
19	n.a.	4.41	2.99	3.10

1/ Week ending December 4.

Recent uncertainties about the near-term course of bond yields have created considerable investor reluctance to buy the four new corporate bonds marketed competitively since early January. Underwriters had bid aggressively for these issues apparently in recognition of the unusually small supply of public offerings that had come to market in recent months. As sales lagged, syndicates on two of the issues were broken with the bulk of the securities involved still undistributed. Subsequently their yields rose 5-14 basis points in secondary market trading. The two issues remaining in syndicate are still less than half sold. Although the over-all supply of new corporate debt over the next several months is expected to be substantially larger than last year, a large part of this increase will reflect private placements already announced in the financial press. Also, of the $400 million in public offerings scheduled for March, close to one-half of the total will consist of convertible issues offered for stockholder subscription.

In the municipal market, despite the good retail demand for the recent $100 million State of California bond--much of it nonbank demand because of the long average term of the issue--retail distribution of a large number of other recent offerings has been disappointing. This, together with the continuing substantial supply of new issues, has swelled dealers' advertised inventories of unsold securities to nearly $750 million, only $20 million under the record mid-May 1962 level. Since most recent offerings of large bonds have moved well, dealer inventories consist mainly of bits and pieces of many offerings rather than large chunks of a few. With the supply of new issues expected to remain sizable in March, some further upward pressure on yields may develop.

BOND OFFERINGS 1/
(millions of dollars)

	Corporate				State & local govt.	
	Public offerings		Private placements			
	1965	1964	1965	1964	1965	1964
Jan.-Mar. avg.	277e/	326	517e/	407	825e/	912
Jan.	165e/	338	550e/	526	825e/	1,009
Feb.	190e/	279	500e/	342	850e/	858
Mar.	400e/	361	500e/	343	900e/	860

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

Common stock prices, as measured by Standard and Poor's composite index of 500 stocks, are now about 1.1 per cent below the 87.58 record level reached on February 1. This represents a recovery of approximately one half of the decline which took place between February 1 and 11, most of which had been accounted for by sharp drops on several days following unsettling developments in Vietnam. Trading volume has been large, averaging about 5.8 million shares a day during the last three weeks.

Total customer credit in the stock market dropped $113 million further during January to $5.9 billion at the month-end. Most of this decline was attributable to a $93 million reduction in customers' net debit balances at brokerage houses. Bank loans to others than brokers and dealers for purchasing and carrying non-Government securities also fell $20 million, one of only two months since the November 1963 change in margin regulations in which such credit has declined.

Mortgage markets. Mortgage funds have generally remained ample for qualified borrowers this winter. In January, yields on FHA-insured, 30-year mortgages sold in the secondary market again averaged 5.45 per cent, as they have almost without change for nearly two years. Contract interest rates for conventional first mortgages on homes also continued unusually stable, at 5.80 per cent for new home loans and 5.85 per cent for loans on existing houses.

In December, loan-to-price ratios on conventional first mortgages on homes stayed at or below earlier advanced levels, according to the Home Loan Bank Board. But prices of new homes purchased by borrowers rose slightly further and loan amounts generally were higher. Maturities also continued moderately longer than a year earlier, as shown in the table.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASE

	November	December	Per cent increase from December 1963
New home loans			
Purchase price ($1,000)	24.0	24.3	+ 6
Loan amount ($1,000)	17.4	17.8	+ 7
Loan/price (per cent)	73.5	73.9	--
Maturity (years)	24.7	25.2	+ 3
Existing home loans			
Purchase price ($1,000)	19.4	19.2	+ 3
Loan amount ($1,000)	13.8	13.7	+ 3
Loan/price (per cent)	71.4	71.7	--
Maturity (years)	20.3	20.1	+ 2

Delinquency rates for 1-to 4-family mortgages increased about seasonally from the third to the fourth quarter, based on the regular survey conducted by the Mortgage Bankers Association of America. At 3.21

per cent, the average for mortgages delinquent 30 days or more remained below a year earlier. The rate of mortgages in foreclosure in the fourth quarter averaged 0.38 per cent, unchanged from the third quarter, though somewhat higher than a year earlier.

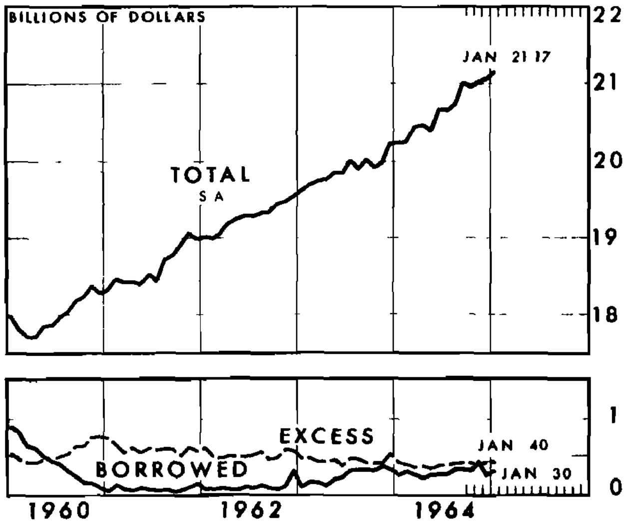
Corporate profits in Manufacturing. Data now available for 600 large companies suggest that total profits of manufacturing corporations held up surprisingly well in the fourth quarter of last year despite the sharp drop in earnings of some auto producers. Total manufacturing profits appear to have shown almost as large a year-to-year gain in the fourth quarter as in the seeond and third quarters and, on a seasonally adjusted basis, to have remained at about their third quarter level.

The 600 companies thus far reporting accounted for over 60 per cent of after-tax earnings for all manufacturing companies in the fourth quarter of 1963. However, representation of the various industries is quite uneven, ranging from less than 30 per cent coverage in foods, textiles and publishing to 85 per cent or more in motor vehicles, steel and basic chemicals. Thus the year-to-year rise of only 9 per cent in aggregate earnings of the 600 companies becomes--when each industry is assigned its usual weight in the total--a rise of 15 per cent for all manufacturing.

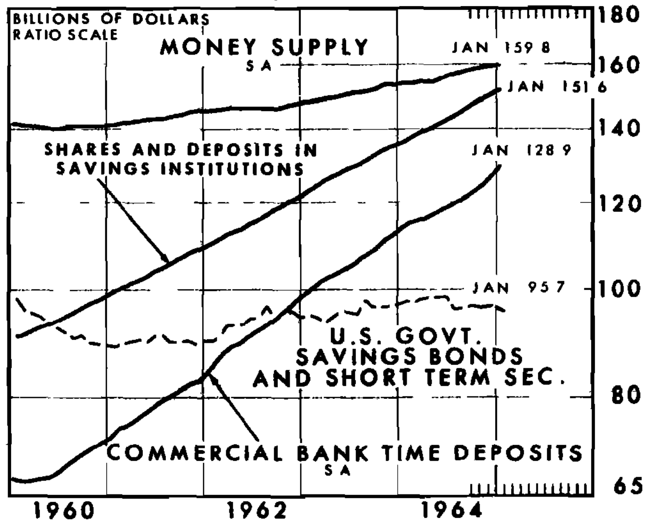
As had been the case through the first three quarters of 1964, a significant part of the year-to-year rise in fourth quarter after-tax profits reflects the cut in Federal income tax rates and the larger benefits from the investment tax credit which accompanied the sharp rise in capital outlays. A 15 per cent rise in profits after taxes is estimated to be consistent with a 10 per cent rise in profits before taxes.

FINANCIAL DEVELOPMENTS - UNITED STATES

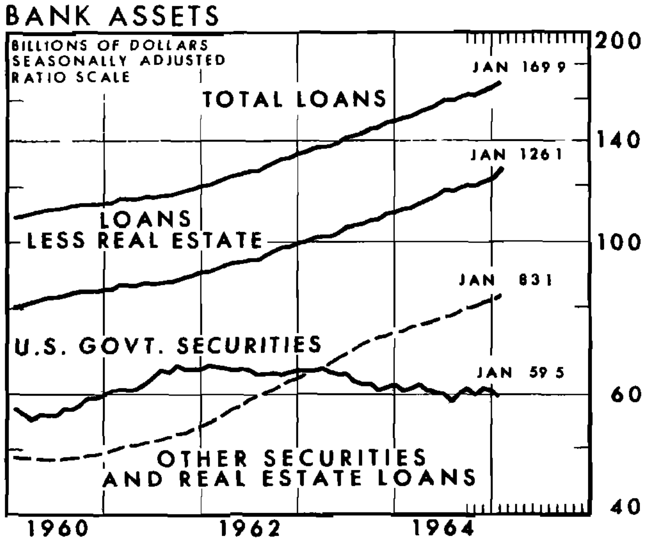
BANK RESERVES



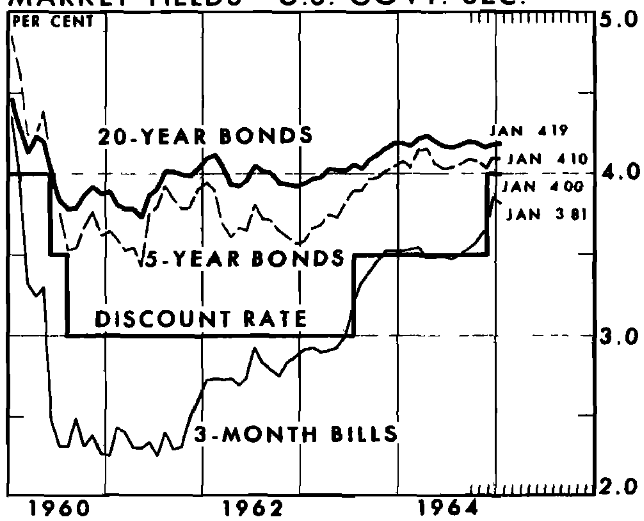
LIQUID ASSETS HELD BY PUBLIC



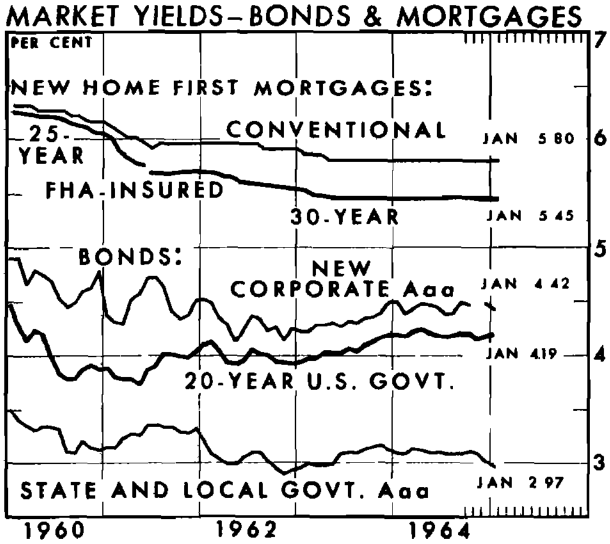
BANK ASSETS



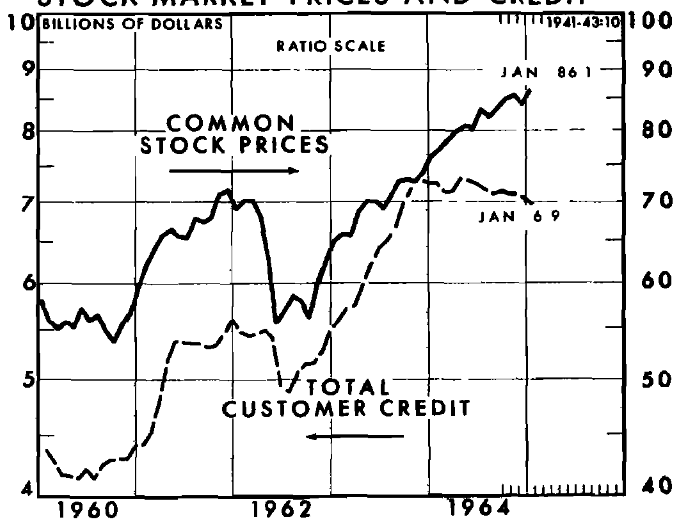
MARKET YIELDS – U.S. GOVT. SEC.



MARKET YIELDS–BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



U.S. balance of payments. A continued substantial payments deficit in January and the first half of February is indicated by available fragmentary data. The deficit for this period may be estimated roughly at around $700 million. In early January, there may have been some unwinding of the large capital outflows that appear to have occurred at the end of December. But large deficits in the four weeks through February 17 would seem to confirm numerous reports of heavy bank lending to foreigners prior to the President's Balance of Payments Message on February 10. Such lending is likely to have consisted heavily of new long-term loans (including take-downs of earlier commitments) as a result of widespread anticipation of the extension of the Interest Equalization Tax to these loans. New commitments on these loans in January were at a rate as high as, or possibly higher than, in the fourth quarter.

Purchases of new foreign security issues in January and February, aside from the World Bank issue, were down sharply from the record fourth quarter rate to a rate close to the $85 million monthly average of such purchases last year. The nearly $200 million of proceeds from the World Bank issue issue were invested in time deposits with a maturity of more than 1-year, which as non-liquid claims are counted as reducing the over-all payments deficit.

Estimates for the fourth quarter, released by Commerce Department on February 11, now set the deficit for the quarter at a seasonally adjusted annual rate of $5.8 billion, slightly less than indicated earlier. The deficit on regular transactions for the year 1964 remains at $3.0 billion. The latest Commerce data incorporate revisions of seasonal factors for several capital account items which have the result of altering the quarterly pattern of the over-all deficit last year. The changes affect mainly the second and third quarters. The quarterly deficits obtained by the use of the old and the new seasonals are as follows:

U.S. PAYMENTS DEFICIT ON REGULAR TRANSACTIONS
(Seasonally adjusted annual rates, in billions of dollars)

	1964			
	I	II	III	IV
Using Old Seasonals	1.0	2.8	2.3	6.0
Using New Seasonals	1.0	2.5	2.7	5.8

In December, private capital outflows reported by banks totaled more than $600 million. This brought the total of these outflows for the year to $2.4 billion and raised the amount of bank-reported claims outstanding to $11.4 billion at the end of the year, of which it is estimated that approximately $10 billion represents bank-owned assets. It is the increase in this last figure that the banks have been asked to limit to 5 per cent in 1965 under the voluntary program to reduce capital outflows.

Short-term claims on foreigners reported by banks rose by nearly $500 million in December, of which increases in bank loans and acceptance credits accounted for nearly three-fourths. A $180 million increase in acceptance credits, mainly to Japan, was about as large as the year before and included a large seasonal element. But in contrast to December 1963, there was also a substantial rise in bank loans to foreign commercial banks and others. Year-end liquidity needs of European banks and tightness in the Euro-dollar market may have prompted these loans. The same forces may also have induced large outflows reported by banks into liquid investments abroad, mainly to Canada and the U.K. (Data for December on outflows of liquid funds from U.S. nonfinancial corporations are not yet available.)

Long-term bank claims on foreigners increased by $120 million in December. One-half of this amount represented further Italian borrowings and another $45 million the refinancing of an existing Export-Import Bank loan to Venezuels.

The upsurge in new commitments on long-term bank loans to foreigners after the middle of last year is shown in the following table together with data on net disbursements on long-term loans, by quarters:

LONG-TERM BANK LENDING TO FOREIGNERS
(in millions of dollars)

	1964				
	I	II	III	IV	Year
Total Commitments	441	336	501	781	2059
Developed Countries	273	169	302	413	1157
Other	168	167	199	368	902
Net disbursements	242	72	241	386	941
Europe	151	78	101	257	587
Japan	61	15	26	34	136
Latin America	19	-11	46	93	147
Other	11	-10	68	2	71

Out of total commitments entered into during 1964, only about one-sixth were for the direct purpose of financing U.S. exports. More than one-third of the commitments were for loans to finance plant expansion and for working capital purposes. As noted earlier, commitments on long-term loans in January remained at least as high as the advanced fourth quarter rate.

Foreign trade data for December are again difficult to interpret owing to the apparent rescheduling of export and import shipments in anticipation of the dock strike at East Coast and Gulf ports which eventually began on January 11. Recorded export shipments rose by more than 10 per cent in December to a seasonally adjusted annual rate of $29.2 billion (Census basis). (This increase was statistically swollen to the extent of $80 million -- $1.0 billion annual rate -- by the inclusion of shipments which ordinarily would have appeared in the January total.) Imports, which had increased sharply in November, fell back somewhat in December; however, they remained at the advanced annual rate of $19.7 billion, perhaps still because of accelerated arrivals and clearance through ports.

For the fourth quarter as a whole, on the balance of payments basis and after adjustment for the statistical overstatement mentioned above, exports totaled $26.5 billion at a seasonally adjusted annual rate and imports totaled $19.6 billion. The resultant trade surplus of $6.9 billion was $0.4 billion higher than in the third quarter. It is doubtful, however, that the balance of payments benefitted to the full extent of this increase since the acceleration of shipments was unlikely to have been accompanied by a fully corresponding acceleration of payments.

The London gold market. Unsettled conditions in Viet Nam and the continuing French advocacy of a return to the gold standard (see Appendix B) have produced heavy demands for gold in the London market since early February. The fixing price has risen to about $35.16 (February 23), nearly 4 cents higher than at the beginning of the month. This price was only about 2-1/2 cents below that reached during the 1962 Cuban crisis. Turnover in the London market has typically been characterized as heavy or very heavy.

European business developments in 1964 and outlook for 1965. There was a noticeable quickening in the rate of increase in European economic activity toward the end of 1964. Following the rapid upswing during 1963, the rise in output had flattened after the first quarter. For the year as a whole, real GNP of the European OECD countries was probably about 5 per cent above the 1963 total.

The pickup in late 1964 was particularly notable in Britain, Germany, and the Netherlands. Furthermore, Italy's recession seemed to have been halted. French industrial output, however, was little if any higher in the fourth quarter than in the spring of 1964.

For 1965, the outlook is for further expansion in both demand and output of the European OECD countries taken as a whole. Our expectation is that 1965 combined real GNP should be 3 to 3-1/2 per cent above 1964, about the same as the increase from second half of 1963 to second half of 1964. The greatest uncertainties arise with respect to Britain and France. In Britain the impact of recent restrictive measures was not yet felt at yearend, and additional measures may have to be taken. In France evidence is accumulating of an easing of expansionary forces, and even of an incipient downturn.

Factors effecting slowdown during 1964. The failure of British industrial production to rise from January to September was attributable in large part to lack of export expansion and to displacement of home production by rising imports of manufactures. On the Continent, internal demand leveled off in Italy and increased very little in France. Elsewhere, scarcities of labor and other supply limitations were major factors in the slowdown.

Some restrictive measures were taken by practically all European countries during the course of the year. Discount rates were raised in the Netherlands, Sweden, the United Kingdom (each twice); in Denmark, Switzerland, and Belgium; and--in January 1965--in Germany. Measures aimed directly at restricting credit expansion were also taken in most countries. These were particularly effective in Italy and France; in other countries, except in Sweden, private investment demand continued to be a major expansionary factor despite credit restraints.

Prices. In 1964, most European countries were less successful than they had been in 1963 in restraining the trend toward larger price increases. Wholesale prices rose somewhat faster than in the preceding year and the pace seems to have speeded up during the second half of the year. For the first time since 1960, export prices (as measured by unit-value indexes of export goods) of major European countries began to rise appreciably after mid-1963, and except in France and Italy, this rise continued throughout 1964.

Foreign trade. Trends in export trade followed much the same patterns as trends in total output, generally flattening out during the second and third quarters of 1964, and then turning up again. Intra-European trade, which had risen sharply during 1963 and into the early months of 1964, was cut back by both the Italian and French stabilization programs. Offsetting this development, exports to North and South America, Australia, and the Soviet countries rose throughout 1964. Toward the end of the year, the upturn--or acceleration--was widespread, affecting intra-European trade and also all segments of

Europe's external exports, including those to Asia and Africa. Gains in Europe's exports to the primary producing countries, somewhat like the corresponding gains in U.S. exports, reflected with some lag the big increase in foreign exchange earnings of those countries during 1963 and early 1964.

During 1964, most European countries managed to halt the deterioration in their trade balances which had been taking place, in most cases, during the preceding two-and-a-half years. (See the table on page IV - 9.) Even the British trade deficit, though still of critically large proportions, decreased a little toward yearend. Although the German trade surplus also increased somewhat in the last quarter of 1964, German trends generally have been the exception to the rule since mid-1963; with government policies aimed at decreasing the embarrassingly large current account surplus that developed in the second half of 1963, and with business activity rising, German imports rose strongly during 1964 while exports leveled off, resulting in a much reduced trade surplus.

The United Kingdom. By mid-1964 it was fairly clear that earlier prospects for continued growth in U.K. output were not materializing, despite generally ample plant capacity. Unemployment was already down to 1.4 per cent, and output appeared to be stable at a high level. This stability of output is generally attributed to the failure of exports to expand and to the increase in imports of manufactures, which in part displaced home production. The trade deficit (seasonally adjusted) rose from $171 million (monthly rate) at the

FOREIGN TRADE OF INDUSTRIAL COUNTRIES
(Seasonally adjusted monthly averages, in millions of dollars)

	1963				1964			
	I	II	III	IV	I	II	III	IV
Exports (f.o.b.)								
Germany	1,111	1,193	1,235	1,299	1,339	1,322	1,310	1,389
France	620	688	688	698	749	750	732	781
Italy	409	421	432	443	452	480	514	506
Netherlands	389	432	424	420	453	478	486	519
Belgium-Lux.	363	405	426	425	456	452	460	481
Total E.E.C.	2,892	3,139	3,204	3,285	3,449	3,482	3,502	3,652
Switzerland	192	203	201	209	212	219	222	229
United Kingdom 2/	949	974	1,005	1,011	1,061	1,058	1,056	1,092
Canada	510	533	530	582	608	652	666	620
Japan	417	441	463	486	482	538	564	624
Imports (c.i.f.)								
Germany	1,048	1,083	1,101	1,080	1,115	1,154	1,248	1,307
France	664	711	730	807	845	822	824	855
Italy	561	630	675	681	671	619	536	544
Netherlands	462	492	508	537	563	595	585	609
Belgium-Lux.	374	407	421	437	470	498	490	474
Total E.E.C.	3,109	3,323	3,435	3,542	3,664	3,688	3,683	3,788
Switzerland	249	273	278	281	295	297	298	308
United Kingdom 2/	1,050	1,106	1,154	1,182	1,313	1,336	1,333	1,338
Canada 3/	474	496	511	539	559	589	569	550
Japan	492	540	573	644	665	657	628	702
Trade balance								
Germany	+ 63	+110	+134	+219	+224	+168	+ 62	+ 82
France	- 44	- 23	- 43	-109	- 97	- 71	- 92	- 74
Italy	-153	-209	-243	-237	-219	-138	- 21	- 38
Netherlands	- 73	- 60	- 84	-117	-110	-117	- 99	- 90
Belgium-Lux.	- 10	- 1	+ 6	- 12	- 14	- 46	- 30	- 3
Total E.E.C.	-217	-183	-230	-256	-216	-204	-180	-136
Switzerland	- 57	- 70	- 77	- 72	- 83	- 77	- 76	- 80
United Kingdom 2/	-101	-132	-149	-171	-252	-278	-277	-246
Canada 1/	+ 36	+ 37	+ 19	+ 43	+ 49	+ 63	+ 97	+ 58
Japan	- 75	- 99	-110	-158	-183	-119	- 64	- 78

1/ October-November average for Italy and the EEC and Canadian exports; October for Belgium-Luxembourg and Canadian imports. Fourth quarter figures partly estimated.
2/ Data for 1963 are not comparable with 1964 series because of change in coverage introduced in February, 1965, retroactive through 1964.
3/ Imports f.o.b.
Source: O.E.C.D., United Kingdom Board of Trade; Bank of Canada, Bank of Japan.

end of 1963 to $278 million in mid-1964. Only private investment grew at about the rate predicted earlier, and may have compounded the trade problem by encouraging purchases of capital goods from abroad.

When the Labor Government took over in mid-October, it was faced with a serious balance of payments problem. Desiring to maintain economic growth, and having little room to maneuver in shifting resources because of the tight labor situation, the Government imposed a 15 per cent surcharge on a wide range of imports; granted certain rebates of indirect taxes on export sales; raised some indirect taxes; announced increases in direct taxation and social insurance benefits to become effective April, 1965, and finally, raised Bank rate to 7 per cent.

Toward the end of the year, there were some signs that economic activity was expanding again: industrial production began to rise, after having been stable for about nine months, exports appeared to be turning up, and imports stopped rising (a development which seemed rather more an autonomous one than a response to the 15 per cent import surcharge). However, uncertainties about the general outlook, prospects of further government restrictive measures, the 7 per cent Bank rate, the net effect of the Government's fiscal measures--all should have some restraining effect on demand. It therefore is expected that demand will grow at perhaps a somewhat slower rate than capacity. For the longer run, the Government appears to be pinning its hopes on putting into effect an incomes and price stabilization policy in order to keep British goods competitive and expand exports.

France. The French stabilization program, begun in September, 1963, had a strong impact on developments during 1964. In addition, the expansionary impulses from the external sector diminished during the year; exports actually declined in the third quarter. A major factor in this development was the cutback in Italian imports, since Italy is one of France's major customers. In the fourth quarter, however, there again appeared to be a revival of exports.

Growth in all major sectors of domestic demand slowed during the year. The weak demand situation contributed to the flattening of the trend of industrial output and the appearance of considerable unused capacity, which in turn are expected to discourage growth in private investment in 1965. Under the Government's policy of price controls, prices of manufactured goods remained relatively stable: in the fourth quarter, wholesale prices were about 1 per cent above the preceding yearend level and consumer prices were up about 3 per cent. These advances were much smaller than those in 1963 (5 and 6 per cent, respectively). Greater price stability is thought to have had some effect on consumers' purchasing behavior and to have played a role in the slowdown in the growth of consumption expenditures.

Unless the Government acts to stimulate demand, observers are questioning the feasibility of achieving the officially projected increase of 5 per cent in real GNP from 1964 to 1965. However, the French authorities are somewhat hesitant about such a shift in policy, because wages continued to rise substantially during 1964 despite the slowdown in economic growth.

Italy. Italy's economic developments in 1964 were dominated by the effects of a stringent stabilitzation program. As a result of the severely restrictive credit policies of the Bank of Italy and deflationary fiscal measures, there was a distinct slowing down in the rise of internal demand and output. Industrial production, reflecting a cutback in inventory investment, fell 5 per cent from the first quarter to October. Fixed private investment demand fell sharply, private consumption demand expanded much more slowly than in previous years, and public demand was curtailed. Exports, however, rose by 14 per cent from late 1963 to late 1964.

Because of the rise in exports and the slowdown in the growth of internal demand (as well as an inflow of capital), there was a large improvement in Italy's payments position during the year, which allowed the authorities to shift their policy goals from deflation to reflation in late summer.

However, the effects of the new policy trend are not yet discernible. Although there now is ample credit availability, uncertainties about the development of demand and reduced profit margins apparently are impeding the revival of investment demand. Continued price and wage increases, despite the slack in output, may limit the Government's possibilities for reflationary measures.

During 1965, the Government has hopes that it may persuade unions to accept some link between increases in wages and productivity and work out an effective incomes policy. However, with important labor contracts expiring this year, the Government may have little time to obtain acceptance of its views; in addition, as long as wages are tied to the cost-of-living index, an effective incomes policy will depend on a stabilization of prices that has not yet been achieved.

Germany. The performance of the German economy in 1964 surpassed earlier growth expectations. At the beginning of the year, it had been thought that real GNP would rise by about 4.5 per cent over 1963; by yearend it was clear that the increase had been about 7 per cent. Furthermore, this faster growth was achieved without the emergence during the year of acute inflationary pressures, which had been widely feared by German officials even at the lower rate of growth. However, wholesale prices did rise by 2 per cent from mid-year to year-end.

During the year there was a shift in the demand factors supporting the business expansion: exports had earlier been the dominant factor but, after the spring, private investment became the main expansionary factor; then, toward the end of the year, private consumption demand appeared to move up faster.

For 1965, the labor shortage and the rising degree of capacity utilization (estimated by an autumn survey as equal to its peak in the preceding cycle) suggest that output limitations will be a dominant factor limiting growth.

During 1964, there was a continuing build-up of inflationary pressures within the German economy, relieved somewhat by rising imports. With the help of a shift in the external payments balance from surplus to deficit, the authorities were able to tighten domestic liquidity considerably by taking a number of moderate monetary measures.

For 1965, further intensification of demand pressures is expected. Consumption demand is likely to be stimulated by the personal income tax cut (effective on January 1) and export demand appears to be picking up again. The decision in early January (1965) to raise discount rate was probably intended to serve notice that the German authorities intend to control the emerging inflationary dangers.

Outlook for Japanese GNP and Trade. Growth in Japan's GNP is likely to be influenced by the relaxation in monetary policy since mid-December. After the very rapid expansion of output during 1963, which was accompanied by a sharp increase in imports, monetary policy was tightened about a year ago. In the course of 1964, the increase in industrial production slackened, especially after July. Imports, seasonally adjusted, tended to decline after January 1964 and through last summer, but moved up sharply in the fourth quarter.

Official economic projections for the fiscal year beginning this April are now based on expectations of a gradual acceleration in economic growth during 1965. The published projections and estimates in the table below relate to the Japanese fiscal year extending from April through March.

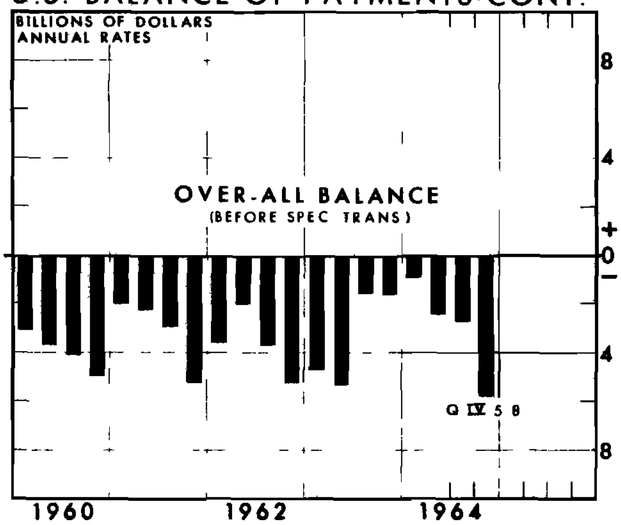
GROWTH IN JAPANESE GNP AND FOREIGN TRADE
(Per cent increase)

	Projected Apr.'65-Mar.'66 over Apr.'64-Mar.'65	Estimated Apr.'64-Mar.'65 over Apr.'63-Mar.'64	Average for previous 4 years
GNP: Constant Prices	7.5	9.4	11.4
Current Prices	11.0	12.9	15.7
Exports	12.5	22.1	13.0
Imports	9.8	11.2	17.4

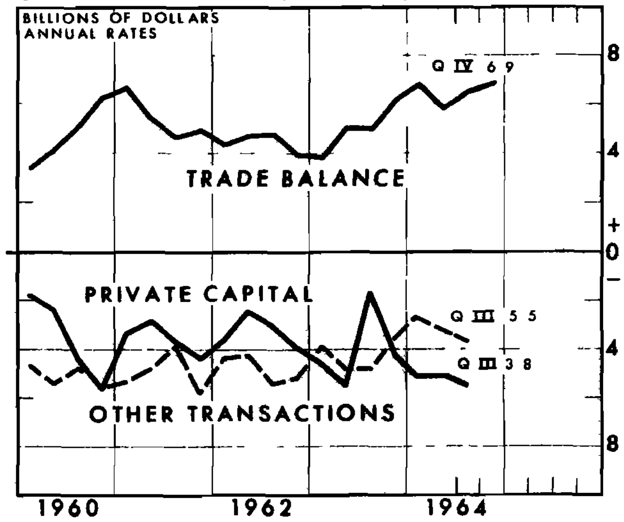
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

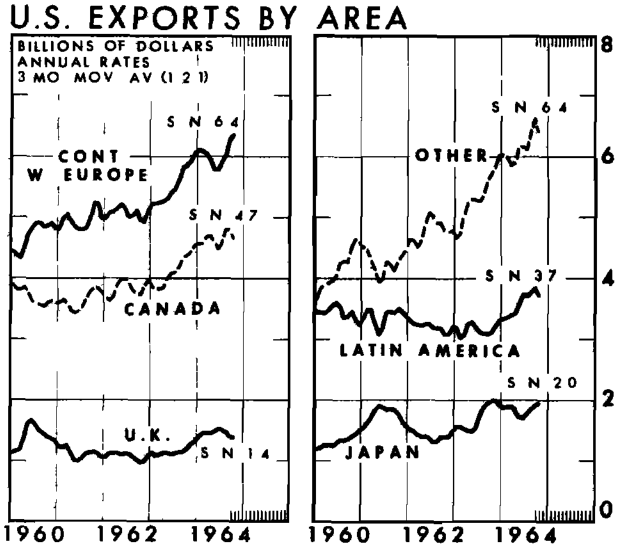
U.S. BALANCE OF PAYMENTS-CONT.



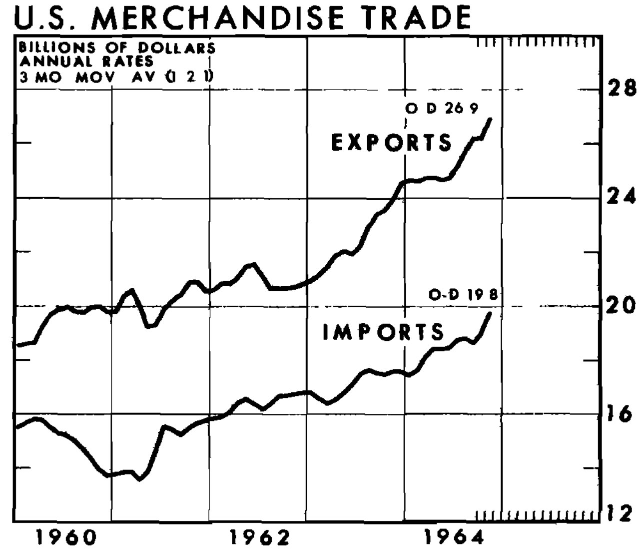
U S BALANCE OF PAYMENTS



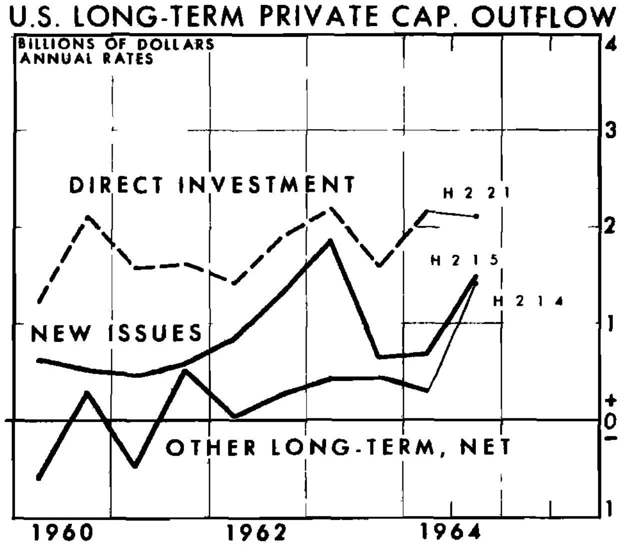
U.S. EXPORTS BY AREA



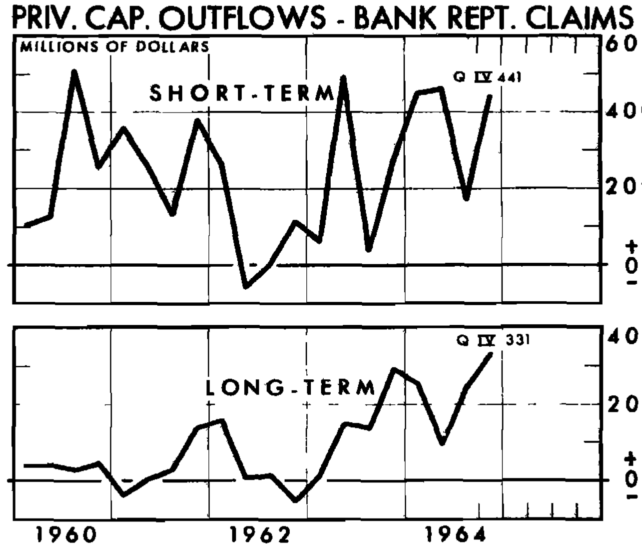
U.S. MERCHANDISE TRADE



U.S. LONG-TERM PRIVATE CAP. OUTFLOWS



PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



APPENDIX A: RECENT SHIFTS IN COMPOSITION OF NEW CONSTRUCTION*

A feature of the growth in new construction expenditures in the 1960's has been the relatively balanced rate of advance among the major construction categories. As a result, the importance of private residential activity in the construction mix has changed only slightly, at an average of about 40 per cent of the total, as shown in Table 1. This proportion contrasts with ratios as high as 54 per cent in the Korean War year of 1950, 47 per cent in the boom year 1955 and 44 per cent as recently as 1959. Changes in the importance of the private nonresidential and public sectors have also been limited so far in the 1960's. Within residential construction activity, changes have taken place with respect to the relative importance of single-family and multifamily housing and among regions and types of financing.

Table 1 - NEW CONSTRUCTION PUT IN PLACE

	1961	1962	1963	1964 (p)	1965 1/
Total (in billions)	$55.4	$59.5	$62.5	$66.0	$67.7
	(Per cent distribution)				
Total	100	100	100	100	100
Total private	69	70	70	70	69
Residential	39	41	41	40	40
Nonresidential	30	29	29	29	30
Business	21	21	20	21	21
Industrial	5	5	5	5	5
Commercial	8	8	8	9	8
Public utilities	8	7	7	7	7
Other nonresidential	9	9	8	9	9
Total public	31	30	30	30	31
Highways	11	11	11	11	11
Other	20	19	19	20	20

Note: Detail will not always add to total because of rounding.
1/ Based on Department of Commerce projections.

This year moderate expansion in residential outlays is expected, according to Department of Commerce and most other estimates, and residential construction activity may again account for 40 per cent of the total. Year-to-year advances in outlays for public and other types of private construction are also expected to be more moderate than in 1964,

* Prepared by Bernard N. Freedman, Economist, Capital Markets Section.

including expenditures for industrial construction, which rose most last year--13 per cent as compared with 6 per cent for total construction. And there is a possibility of scattered declines, notably for office and related construction as well as for farm building and military facilities.

Housing starts. Last year, housing starts totaled 1.5 million, except for 1963 the highest in nearly a decade. This year, the Department of Commerce outlook is for no change in total starts, although, as was the case last year, continued upgrading and some further increase in building costs are expected to account for an over-all increase in dollar outlays. Although stability in the annual starts total may be realized in 1965, there are likely to be further shifts in the composition of starts as summarized separately in the following sections.

Shifts by type of financing. Government-underwritten mortgages dwindled further in 1964 as a proportion of total starts, as shown in Table 2. The decline in their relative share of new starts was much less marked in 1964 than in other recent years, however, and, for a few months toward the year end and in January of this year, their share actually exceeded a year earlier, for the first time since mid-1959.

Table 2 - PRIVATE HOUSING STARTS

	1961	1962	1963	1964 1/
Total, including farm, (thousands of units)	1,313	1,463	1,609	1,549
	(Per cent distribution)			
Type of financing	100	100	100	100
Government-underwritten	25	23	18	17
FHA-insured	19	18	14	13
VA-guaranteed	6	5	4	4
Conventional	75	77	82	83
Region	100	100	100	100
Northeast	18	18	16	16
North Central	21	19	20	22
South	36	37	37	38
West	24	26	27	23
Type of structure	100	100	100	100
1 - family	74	68	63	63
2-or-more-family	26	32	36	37

Note: Detail will not always add to total because of rounding.

1/ Preliminary.

The continued shift away from Government-underwritten mortgages in financing new housing was associated with the further liberalization of conventional mortgage terms, particularly for savings and loan associations since 1961, and with the rapid expansion of new apartment building in recent years. Apartment construction is usually financed with conventional mortgages to a greater extent than are new single-family houses. Other factors contributing to the shift from Government-underwritten financing have included the executive order on open occupancy in Government-assisted housing, which became effective in late 1962; more rigorous screening of marginal borrowers by FHA officers; the improved income and equity positions of potential home purchasers; and increased reliance by some lenders on private types of mortgage insurance.

These and other influences, on balance, probably will not produce much further change in relative shares of conventional and Government-underwritten financing of new starts in 1965. In the case of VA-guaranteed starts, however, some further decline in importance may be expected, as the number of persons with rights to VA-guaranteed mortgages will decline further. VA-guaranteed mortgages have accounted for less than 5 per cent of total starts in recent years, in contrast with a high of nearly 25 per cent in 1955.

Regional shifts. Among the geographic shifts that occurred last year, the decline of one-seventh in the share of total starts from the West was most striking. While changes in the shares for the South and Northeast states were nominal, the North Central states registered an appreciable gain--one tenth. The West's share dropped to less than a fourth for the first year since 1961. In the fourth quarter alone the share was actually less than a fifth.

The decline in the West, which involved single as well as multi-family structures, reflected a number of factors including the unusual expansion in that region through 1963; lender and builder hesitancy in the face of actual or potential reductions in defense activity; and an unusually high rate of rental vacancies by the third quarter of last year. Within the region, the decline appeared to be most marked in the Los Angeles area.

Shifts by type of structure. In 1964, single-family starts declined on the average about as much as multi-family starts and the multi-family share of total starts--37 per cent--changed little after having risen since 1955. For 1965, some decline from the high 1963-64 average multi-family share seems indicated. In the fourth quarter of 1964, multi-family starts were running 16 per cent below a year earlier--as compared with 4 per cent for single-family starts--and building permits for multi-family starts were down even more sharply. While an upturn in multi-family permits occurred this January, the rate remained well under earlier highs.

The pre-1964 spurt in new apartment starts was to a level more than double the annual total as recently as 1960. Such an expansion, by itself, has inevitably involved a reduction in the number of sites most suitable for development and has been associated with further advances in land and other costs. Also, lender assistance to apartment builders appears to have become somewhat more selective during the past year.

Nevertheless most observers do not expect a decline of more than 50,000 in multi-family starts at the outside limit in 1965 from the near record 575,000 last year. This is because the decline in multi-family starts has come at a time when general economic conditions remain favorable and mortgage money for qualified borrowers continues ample. Moreover, underlying demographic factors continue to point to potential further increments in apartment demands over the years ahead. Taking one example, the number of individuals reaching 18 years of age this year will rise a million above the average number in this group in recent years. And, the number of young marrieds and older individuals usually in the market for apartments meanwhile is still growing. Also, scrappage of existing structures has apparently continued high or has been rising. While difficulties have continued to appear in some localities and some regions, vacancy rates in 1964 for the nation as a whole have also remained below earlier peaks.

In addition, with urbanization continuing at a rapid pace, the base of multi-family building has broadened significantly further in terms of types of structures, builders and geographic areas involved. In some key apartment-building areas, moreover, such as New York--where earlier changes in zoning regulations induced substantial acceleration in building schedules through 1963--a shift to more sustainable levels may already have been accomplished.

So far in the 1960's, annual levels of single-family starts have changed relatively little at an average of less than 1 million units, in contrast with earlier peaks of about 1.7 million in 1950, 1.5 million in 1955, and 1.2 million in 1959. By the fourth quarter of 1964 single-family starts were still only moderately below a year earlier and building permits for such structures were holding close to recent highs.

For 1965, upgrading by home owners in a situation of rising incomes and favorable mortgage terms will continue to act as a factor sustaining the demand for single-family homes. This may also lead to a further increase in the value of homes actually purchased. But, as in other recent years, the level of single-family starts in 1965 will probably continue to be limited by a lack of growth in the 25-45-year old segment of the population, which typically forms the major part of the single-home market.

APPENDIX B: THE GOLD-EXCHANGE STANDARD: BACKGROUND INFORMATION ON FRENCH VIEWS, 1965 AND 1926-28

During the month of February, the European financial press has been filled with material related to three major French statements about the gold-exchange standard and about the U.S. dollar made during the month. These statements have had the effect of introducing an added element of uncertainty into the gold and foreign exchange markets. They have also initiated public discussion of current international financial policies in the countries of Western Europe which might culminate in shifts in policies in some European countries with respect to gold and the dollar.

For these reasons, these three French statements constitute a dramatic new development in the international financial community during the past month. Familiarity with the main lines of this discussion becomes important background information for interpreting current trends in international financial thinking, especially in Western European centers. As a convenience, this material is reproduced in this Appendix. Because of its importance, the statement of President de Gaulle--though ambigious and Delphic in character--is reproduced in full. (Pages B-2 to B-6). The other two statements--a 1-1/2 hour speech by Finance Minister Giscard d'Estaing on February 11 and a four-page "Argument With Jacques Rueff" in the February 13 Economist--are only briefly summarized. (Pages B-6 to B-8).

It is clear, especially from specific references in the Rueff interview and from the long historical survey which comprised the early part of the Giscard d'Estaing speech, that current French thinking is much influenced not only by post-World War II international payments developments but by events during the 1920's and 1930's. To throw light upon this basis of current French thinking, selected references to French attitudes during the critical years 1926-28 are reproduced in Part II of this Appendix. These references, selected from Lester V. Chandler's biography of Benjamin Strong, are solely for background information; they are not intended to suggest any close parallel between conditions in 1926-28 and in 1965, nor to be a rounded analysis of French thinking in the earlier period. (Pages B-8 to B-9).

Part I. 1965

A. Statement by President de Gaulle at Press Conference on February 4.

Question: Mr. President, in exchanging a portion of its dollar holdings for gold, France caused reactions which, in themselves, brought out certain defects in the present international monetary system. Are you in favor of reforming this system and, if so, how?

Can you state precisely your policy regarding foreign investments in France, and particularly American investments?

Reply: Very well, I shall try to explain my thinking on this point.

As the countries of Western Europe that were ruined and decimated by the wars recover their wealth, the relative situation in which they were placed tends to appear inadequate and often even unrealistic and dangerous. However, this observation contains nothing which implies that they, and especially France, are in any way unfriendly toward any country, and toward America in particular. But the fact that those countries desire more and more every day to act on their own in the field of international relations results from the natural course of events. This is true of the monetary system that has been in effect, of the monetary relations, if you will, that have been in effect in the world since the ordeals suffered by Europe caused it to lose its balance.

I wish, of course, to speak of the international monetary system, which came into being right after the First World War and which was established following the Second [World War]. We know that this system, after the Genoa Conference in 1922, gave two currencies, the pound and the dollar, the privilege of being considered the equivalent of gold in foreign trade. It is true that the pound was devaluated in 1931 and the dollar in 1933 and one might have believed at that time that the privilege, this signal privilege, this signal advantage of those two currencies was compromised.

But America recovered from its great depression and then, afterwards, the Second World War ruined the currencies of Western Europe, unleashing inflation there. As, after that, nearly all the world's gold reserves were then held by the United States and it was the world's supplier and consequently it had been able to maintain the value of its currency, it may have seemed natural for the countries to place, indiscriminately, either dollars or gold in their foreign exchange reserves and for the differences in the payments balances to be settled by transferring credits or American monetary units, as well as precious metal, and, consequently, this international monetary system, this gold exchange standard, has been accepted in practice since that time.

But it so happens that it no longer corresponds in the same way to present-day realities and that, consequently, it has drawbacks which are becoming more and more serious. As this question--of interest to everyone--must be considered calmly and objectively, which is made possible by the fact that the present situation does not appear to contain any very pressing or alarming elements, this is the time to do so.

Let us note that the conditions that gave rise to the gold exchange standard have changed very greatly. The currencies of the Western European States have been restored to such an extent that the total of the gold reserves held by those States, let us say those six States, the Six, equals that of the Americans and would even exceed it if those States decided to convert into gold all their dollar holdings. Hence, the sort of transcendental value attributed to the dollar has lost its initial basis, which was the possession by America of most of the world's gold.

But, in addition, the fact that many States accept, in principle, dollars on the same basis as gold in the settlement of differences in their favor in the American balance of payments, this fact is causing the Americans to run into debt to foreign countries, at no cost to themselves.

For, what they owe foreign countries, they pay, at least in part, with dollars that they have only to issue, and not with gold, which has a real value, which one has only by having earned it, and which cannot be transferred to others without risks and sacrifices. But also, in so doing, this sort of unilateral facility that is attributed to the United States helps imprint the idea that the dollar is an impartial and international trade medium, whereas it is a credit medium appropriate to one State.

Obviously, there are other consequences of this situation. There is, in particular, the fact that the United States, not having to pay in gold, at least not in full, their balance of payments deficits—contrary to the practice formerly adopted whereby the States [i.e., Nations] were induced and, if necessary, compelled to adopt the proper measures to bring their balance of payments into equilibrium—the United States, I repeat, has deficit balances year after year. Not, to be sure, that all their trade is unfavorable. Their exports of goods exceed their imports.

But this is also true of dollars, whose outflows always exceed receipts. And so, there is being created in the United States, by means of what must indeed be called inflation, capital which, in the form of dollar loans granted to States or private individuals, is exported. And, of course, this increase in American paper currency renders investments within the United States less remunerative. Hence, there is a growing tendency in the United States to invest abroad. The result of this, for certain countries, is a kind of expropriation of certain of their enterprises.

It is true that this practice has long favored, and continues to favor, to a certain extent, the manifold and considerable assistance that America furnishes to many countries and from which we ourselves, in other times, greatly benefited. However, circumstances have changed, and that is why France advocates that the system also be changed, that this kind of fundamental disequilibrium, which is now a fact, cease. France advocated this change, as you know, at the Monetary Conference in Tokyo. In view of the consequences that a crisis occurring in this field would have, we consider that steps to avert it must be taken in time. We believe that international trade must be established—as it was before the great world misfortunes—on an unquestionable monetary basis that does not bear the stamp of any one country in particular.

On what basis? Indeed, there can really be no other criterion, no other standard than gold—yes, gold, which never changes, which can be shaped just as well into ingots, bars, or coins, which has no nationality, and which has, eternally and universally, been regarded as the unalterable monetary basis par excellence.

Moreover, regardless of what was imagined or said, or written, or done during the tremendous ordeals through which we have all lived, the fact is that even today no currency has any value except by virtue of its relationship, direct or indirect, real or supposed, with gold. Naturally, no State can be compelled to do what it should do within its own borders. But in international trade the supreme law, the golden rule--there is no mistake about it--which must be restored to a place of honor and put back into force, is the obligation to bring into equilibrium between one monetary area and another, by actual receipts and outflows of the precious metal, the payments balances resulting from their trade.

Of course, the smooth termination of the gold exchange standard and the restoration of the gold standard, as well as the supplementary and transitional measures that will be essential, particularly the organizing of international credit on this new basis--all that must be examined calmly among the States and particularly among those States which have a special responsibility because of their economic and financial power.

Moreover, the appropriate frameworks for these studies and negotiations already exist. The International Monetary Fund, which was instituted in order to ensure the stability of the currencies--to ensure it in so far as it is possible to do so--the International Monetary Fund is certainly a very suitable framework for such negotiations. The Committee of Ten--which, as you know, is composed, in addition to the United States and Great Britain, of France, Germany, Italy, Belgium, and the Netherlands, on the one hand, and of Japan, Sweden, and Canada, on the other hand--the Committee of Ten would prepare the necessary proposals and then it would devolve upon the Six States--which appear to be in the process of achieving an Economic Community of Western Europe--it would devolve upon them to work out among themselves, and to win outside acceptance for, the sound system which would be in conformity with common sense and correspond to the reviving economic and financial power of our old continent.

France, for its part, is ready to contribute actively to this great reform that is essential in the interest of the entire world.

B. Speech by Finance Minister Giscard d'Estaing to 2,000 students in the auditorium at University of Paris Law School on February 11. The climax of this 1-1/2 hour speech was his announcement of four basis French proposals:

1. A solemn and unequivocal undertaking on the part of principal countries henceforth to settle their deficits by direct movements of gold and no longer by cr ation of additional reserve currency balances, the amount of which has already been universally judged adequate.

   The speaker went on to mention January 1, 1965 as a starting date, but it was not clear whether he was suggesting that all countries agree to full gold settlements as from that date or whether he was simply saying that France would follow this principle.

2. For the financing of "fundamental" balance of payments disequilibria, use should be made only of forms of assistance provided for by existing agreements--that is, I.M.F. and the General Arrangements to Borrow. /That is, no more bilateral assistance, swaps, etc., to finance "fundamental" disequilibria./

3. Reform of the international payments system must be carried out prior to the creation of "any new resources."

4. Guiding principles for such a reform should be as follows:

   a. International settlements among central banks should be made only in gold, as General de Gaulle has proposed (See point 1 above).

   b. Reserves of central banks of major countries would include only (i) gold and (ii) "owned reserves linked to gold."1/ Foreign-exchange holdings would be limited to those necessary to finance normal current transactions.

   c. Elimination of excess reserve currency balances should be effectuated under mutually agreed conditions. Starting immediately, there would be prohibition on paying any interest on such balances. At the same time these excess reserve balances are extinguished, there could be a progressive repayment of debts which were created as a result of financial assistance. [E.g., Roosa bonds.]

   d. Once this extinction is completed, currencies with international responsibilities should normally all become convertible into gold for transactions among central banks, according to procedures to be worked out.

   e. In case of an objectively determined inadequacy in the world's supply of owned reserves (particularly during the period when excess reserve currency balances are being reabsorbed), concerted mechanisms for the creation of reserves "linked to gold" could be put into operation on a joint decision of the countries whose currencies were convertible into gold. [E.g. a "C.R.U." as recommended by French representatives in international discussssions.]

He concluded that, until this reform becomes effective, France will follow these principles in its policies with regard to the international monetary system.

C. "Argument with Jacques Rueff," The Economist, February 13, 1965, pp. 662-5. The quotations are of M. Rueff.

   a. Defect of gold exchange standard: "The debtor country does not lose what the creditor country has gained. So the key currency

1/ "Owned reserves" are usually defined as those whose use is at the unconditional option of their owner and which are subject to no formal repayment obligations.

country never feels the effect of a deficit in its balance of payments. The aim is . . . to ensure that the debtor country loses what the creditor country gains."

b. The price of gold: "I consider the price of gold as only a side issue . . . in 1934 President Roosevelt did not destroy the gold standard, he restored it . . . he definitely restored the gold standard through an increase in the price of gold. Well, what will happen if we try to do the same thing today?"

c. Role of gold in adjustment mechanism: "Let me tell you that I have not at all any religious belief in gold. Gold is not at all the aim, it is only a means for a certain policy . . . . If I want the gold standard it is not because it will impose on central banks a certain policy. It is because it will exert its own influence by the transfer of purchasing power which is the result of the transfer of gold . . . . If you want to replace it by something better, platinum or any other metal . . . . I think there are very few people who consider it realistic in the present condition that gold should be abandoned."

"But surely if any country in the world would have been in the position to do that it would be the United States. They have in the public employment more economists . . . than any other country in the world. And they have had for five years an enormous deficit in the balance of payments. If they have not done by credit policy what the gold standard would have done by automatically restricting purchasing power, it is proof that it is not possible."

d. Experience during the 1920's: "The evolution of the balance sheets of the central banks is exactly the same, exactly in the years of '27 and '28 and '29 to what they are now, and it is the collapse of this system in 1931 which was responsible for the depth of the depression."

"In 1930, I was responsible for the deposits of the French Treasury [in London]. I had in my hands 10 per cent of the deposits of the London banks. They were the direct result of eight years of the gold exchange standard because we had kept this sterling, as my colleague in New York had kept the dollars, which had been pouring into the French Treasury from 1927 onwards."

"I would be in full aggreement with you if I could believe . . . that we could maintain indefinitely for instance what we have done in 1928, 1929, not asking gold in London. But don't you see in full light that the dollar is very near the limit of its

> payment abroad? Look at the figures. The dollar stock in the U.S. is diminishing one billion dollars every year and the claim on gold increasing two billion dollars every year."

Part II. French Views, 1926-28[1/]

In a diary entry of February 6, 1928, Governor Moreau of the Bank of France spelled out the kind of international payments arrangements which, in his view, the Bank of England had in mind:

> "The currencies will be divided into two classes. Those of the first class, the dollar and the pound sterling, based on the pound and the dollar--with a part of their gold reserves being held by the Bank of England and the Federal Reserve Bank of New York. The latter moneys will have lost their independence. Our political influence in countries where we have a vital interest will be seriously compromised . . . ."
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> "We now have the means of exerting powerful pressure on the Bank of England." (p. 380.)

Pressure on the pound from France (as described by Professor Chandler). "London was also under pressure from developments in France. Stabilized at 3.92 cents, the franc proved to be undervalued in exchange markets, which helped France realize a strongly favorable balance of trade. The Bank of France increased its already large holdings of gold and foreign exchange. Moreau's power over the London market grew . . . . Norman wanted the Bank of France to abstain from converting its sterling balances into gold. This was acceptable to neither Moreau nor his government. After the stabilization legislation of June, 1928, the Bank of France was not permitted to purchase foreign exchange, so it had to convert further French gains of foreign exchange into gold . . . ."

"In general, this situation persisted until Britain departed from the gold standard in September, 1931. Norman thought it only reasonable that the Bank of France should cooperate by continuing to hold large balances in London rather than converting them into gold. Moreau, wanting a 'real' gold standard, disagreed . . . . He thought the British were trying to reap the advantage of being an international banking center without meeting the obligations involved in that function." (pp. 378-79.)

The weakness of the British position (as described by Professor Chandler). "Britain did succeed in achieving a surplus on current international account during this period. Its receipts for exports of goods and

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1/ References in this Part II are to Lester V. Chandler, Benjamin Strong, Central Banker (The Brookings Institution, Washington, D. C.: 1958).

services and its earning on foreign investments exceeded its payments abroad for imports of goods and services, leaving a surplus for foreign investment. But its rate of foreign investment tended to exceed its current surplus and to weaken its balance of payments position."

"In such circumstances the monetary conditions required to equilibrate Britain's international receipts and payments were inconsistent with those necessary to promote prosperity at home. To equilibrate its international payments and receipts and to retain sufficient gold to ensure the maintenance of gold payments, it had to keep interest rates in London above those in New York and other important financial centers. . . . At the same time, Britain's international financial position was becoming potentially dangerous. Its relatively restrictive monetary policy did not prevent its long-term foreign lending from tending to exceed its net receipts on current account. But the high rates in London . . . did attract a large volume of short-term foreign balances subject to withdrawal on demand or short notice. Norman was to learn by bitter experience the disadvantages of relying so heavily on such volatile short-term foreign balances." (p. 331.)

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