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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

May 5, 1965

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IN BROAD REVIEW

Changes reported in the domestic economic scene since early March have been of a kind generally conducive to further expansion in activity over the near-term without widespread price advances. Temporary extension of the steel labor contract on a noninflationary basis has allayed concern that a wage-price spiral might develop from that source. And at the same time it has given steel users time to reappraise their inventory needs in a less hectic atmosphere. Another major development was the McGraw-Hill plant and equipment survey which raised the projected outlays for this year well above those reported earlier.

Other indications of continued economic expansion include the materially improved performance of the labor market in March, with the gains apparently holding in April. Industrial production rose 1 point further in March to an index of 140 and a further but more modest rise seems likely for April.

Retail sales, although at very high levels, apparently were off a little in March and probably also in April, as auto sales did not show the usual large seasonal rise from the advanced January-February levels. Late spring in some parts of the country and storms and floods in the Midwest also may have contributed to the easing in reported retail sales.

Business inventory accumulation generally appears to be continuing under control with accumulation in the first quarter initially estimated only moderately above the fourth quarter rate. Steel stocks have increased further to levels above those reached in comparable periods in 1962 and 1963 and some protective build-ups have also apparently developed in related industries.

Pressure on commodity prices increased somewhat, particularly in the metals and machinery areas, but in the latest week the index for industrial prices as a whole was only .1 per cent above the stable first quarter level and about at the early 1960 high. Consumer prices rose .1 per cent further in March.

Bank credit expansion, which was unusually large in March, dropped back in April to about the average monthly rise in 1964. Business loan expansion was vigorous on balance in April, although less than the very rapid rise during the first quarter when a number of unusual factors, including the steel inventory build-up, the dock strike, and phenomenal auto sales affected demands for credit.

Time deposit growth slackened further to less than $1 billion in April. The stimulative effect of the increase late last year in Regulation Q ceiling rates seemed to be wearing off more quickly than in earlier periods of Regulation Q change. The money supply, meanwhile, increased rapidly in April for the second month in succession, following three months of little net change.

Bank reserve positions tightened further in April. Net borrowed reserves averaged $140 million during the April reserve weeks, as compared with $50 million in March. Federal funds traded at an effective rate of 4-1/8 per cent on two-thirds of the business days in April.

Despite tighter reserve positions, Treasury bill rates receded 4 or 5 basis points from mid-April to early May when the 90-day bill was 3.90. Bond yields moved up a little for most Treasury and corporate issues and municipal securities held close to their highs for the year. Stock market prices, impelled by favorable business and labor news and sharply higher profits in the first quarter, rose to a new high in early May, when the Standard and Poor's index was more than 2 per cent above its former peak in early February.

The May Treasury refunding operation, announced April 28, apparently has met with a favorable market response. The Treasury cash balance is unusually large and is likely to continue so at least through June.

A further surplus in the U. S. balance of payments is indicated for April by partial data, but the surplus will probably be sharply reduced from the $500 million record in March (not seasonally adjusted). The over-all payments deficit in the first quarter is now estimated at a $3 billion seasonally adjusted annual rate, about half the size of the deficit in the fourth quarter of 1964. The reduction in the deficit resulted principally from lower net outflows of private capital, particularly purchases of new foreign security issues and short-term capital outflows. Effects of the interest equalization tax and the voluntary program to restrain outflows of long-term bank loans after February 10 were offset by the very large outflows in the first six weeks of the quarter.

The exchange market for sterling has been somewhat stronger in the past three weeks. Relaxation of uncertainties about the two reserve currencies has been reflected in the London gold market. The gold price has declined by more than 6 cents per ounce from the point reached on April 15 to $35.108 on May 5. Current demands are being met out of new gold production.

Abroad, there is further evidence of a gradual recovery in Italian economic activity and some indications that the decline in French industrial production since last fall did not go further in the early months of 1965. In Germany, industrial order backlogs have begun to lengthen again.

In Britain, where advances in wages and prices are continuing, further action was taken at the end of April to restrain bank lending.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per cent change: Year Ago*	Per cent change: 2 Yrs. Ago*
Civilian labor force (mil.)	Mar.'65	74.9	75.1	73.8	1.6	3.3
Unemployment (mil.)	"	3.5	3.7	4.0	-12.1	-14.7
Unemployment (per cent)	"	4.7	5.0	5.4	--	--
Nonfarm employment, payroll (mil.)	"	59.9	59.7	57.8	3.7	6.6
Manufacturing	"	17.8	17.8	17.2	3.5	5.2
Other industrial	"	8.0	7.9	7.7	3.5	7.2
Nonindustrial	"	34.1	34.0	32.9	3.9	7.2
Industrial production (57-59=100)	"	140.1	138.9	129.0	8.6	14.9
Final products	"	139.2	137.8	128.7	8.2	12.9
Materials	"	141.1	140.0	129.3	9.1	16.8
Wholesale prices (57-59=100)1/	"	101.3	101.2	100.4	0.9	1.4
Industrial commodities	"	101.6	101.6	100.8	0.8	1.3
Sensitive materials	"	101.4	101.2	98.9	2.5	5.1
Farm products and foods	"	99.0	98.7	98.2	0.8	1.6
Consumer prices (57-59=100)1/	"	109.0	108.9	107.7	1.2	2.6
Commodities except food	"	104.8	104.7	104.3	0.5	1.8
Food	"	106.9	106.6	105.7	1.1	2.2
Services	"	117.0	116.9	114.5	2.2	4.2
Hourly earnings, mfg. ($)	"	2.60	2.59	2.51	3.6	6.6
Weekly earnings, mfg. ($)	"	107.81	106.78	101.81	5.9	9.5
Personal income ($ bil.)2/	"	513.5	511.0	482.9	6.3	12.5
Retail sales, total ($ bil.)	"	22.9	23.3	21.2	7.9	12.5
Autos (million units)2/	"	8.8	9.6	7.6	15.9	21.0
GAF ($ bil.)	"	5.2	5.3	4.8	8.0	13.9
Selected leading indicators						
Housing starts, pvt. (thous.)2/	"	1,549	1,420	1,663	-6.9	-1.8
Factory workweek (hours)	"	41.5	41.3	40.6	2.2	2.7
New orders, dur. goods ($ bil.)	"	21.6	21.1	19.3	12.4	15.3
New orders, nonel. mach. ($ bil.)	"	3.1	3.1	2.8	10.6	22.4
Common stock prices (1941-43=10)1/	Apr.'65	87.97	86.83	79.94	10.0	27.9
Inventories, book val. ($ bil.)	Feb.'65	110.4	110.0	105.4	4.7	9.6
Gross national product ($ bil.)2/	Q1 '65	649.0	634.6	608.8	6.6	13.5
Real GNP ($ bil., 1964 prices)2/	"	641.6	630.6	612.9	4.7	9.3

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended April 30	Four-Week Average	Last six months High	Last six months Low
Money Market1/ (N.S.A.)				
Federal funds rate (per cent)	4.05	4.08	4.12	1.00
U.S. Treas. bills, 3-mo. yield (per cent)	3.91	3.92	3.94	3.76
Net free reserves 2/ (mil. $)	-130	-138	256	-198
Member bank borrowings 2/ (mil. $)	345	471	590	122
Security Markets (N.S.A.)				
Market yields1/ (per cent)				
5-year U.S. Treas. bonds	4.16	4.15	4.18	4.08
20-year U.S. Treas. bonds	4.21	4.20	4.22	4.15
Corporate new bond issues, Aaa	--	4.46	4.53	4.33
Corporate seasoned bonds, Aaa	4.43	4.43	4.45	4.41
Municipal seasoned bonds, Aaa	3.09	3.09	3.10	2.94
FHA home mortgages, 30-year3/	5.45	5.45	5.45	5.45
Common stocks S&P composite index4/				
Prices, closing (1941-43=10)	89.11	88.43	89.11	83.66
Dividend yield (per cent)	2.92	2.94	3.05	2.92

	Change in March	Average change-- last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	5/ 225	186	10.4	6.1
Bank loans and investments:				
Total	3,400	2,800	12.8	9.2
Business loans	1,200	1,300	27.8	16.2
Other loans	2,700	1,600	17.6	11.9
U.S. Government securities	-600	-600	-12.5	-5.0
Other securities	100	500	16.7	13.0
Money and liquid assets:				
Demand dep. & currency	5/1,000	300	2.5	4.1
Time and savings dep.	5/ 900	1,500	13.7	14.5
Nonbank liquid assets	800	1,300	6.5	5.3

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted. n.a.--not available.
1/ Average of daily figures. 2/ Averages for statement week ending April 28.
3/ Latest figure indicated is for month of March. 4/ Data are for weekly closing prices. 5/ Change in April.

U.S. BALANCE OF PAYMENTS

	1965			1964				1964
	Mar.	Feb.	Jan.	QIV	QIII	QII	QI	Year
	Seasonally adjusted annual rates, in billions of dollars							
Balance on regular transactions				- 6.0	- 2.6	- 2.5	- 1.1	- 3.1
Current account balance				7.6	7.6	6.4	7.9	7.4
Trade balance 1/		- 0.3	- 0.1	7.1	6.6	5.8	6.7	6.6
Exports 1/		18.7	14.2	26.7	25.5	24.2	24.4	25.2
Imports 1/	-22.2	-19.0	-14.3	-19.6	-18.9	-18.4	-17.7	-18.6
Services, etc., net				0.5	1.0	0.6	1.2	0.8
Capital account balance				-11.6	- 9.2	- 8.7	- 8.4	- 9.5
Govt. grants & capital 2/				- 4.1	- 3.7	- 3.6	- 3.1	- 3.7
U.S. private direct inv.				- 2.6	- 2.3	- 2.3	- 2.1	- 2.3
U.S. priv. long-term portfolio				- 3.4	- 2.4	- 1.1	- 0.9	- 2.0
U.S. priv. short-term				- 2.0	- 1.4	- 2.2	- 2.4	- 2.0
Foreign nonliquid				.5	.8	.5	.1	.5
Errors and omissions				- 1.9	- 1.0	- .1	- .6	- .9
	Monthly averages, in millions of dollars							
Deficit on regular transactions (seas. adjusted)				502	220	207	89	254
Additional seasonal element				- 6	- 118	12	112	---
Financing (unadjusted)	- 487	477	203	508	337	196	- 23	254
Special receipts 3/	0	0	0	51	1	- 10	68	27
Liabilities increase								
Nonofficial 4/	- 282	- 22	524	207	184	36	78	126
Official 5/	- 371	151	- 650	299	129	69	- 151	86
Monetary reserves decrease	166	348	329	- 50	23	101	- 17	14
of which: Gold sales	(355)	(215)	(263)	(57)	(- 7)	(- 24)	(15)	(10
Memo: Official financing 6/	(- 205)	(499)	(- 321)	(300)	(153)	(159)	(- 101)	(128

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.
5/ Includes nonmarketable bonds.
6/ Decrease in monetary reserves, increase in liabilities to foreign official institutions, and special receipts.

THE DOMESTIC ECONOMY

Industrial production. Industrial production in April is estimated to have increased somewhat further from the March level of 140 per cent. Available production data are too sketchy to indicate the size of the April change but it will probably be smaller than the March rise of one point. Output of business equipment and materials is expected to increase further while production of consumer goods is expected to change little.

Auto assemblies in April declined 5 per cent from the record March level, but at a seasonally adjusted annual rate of 9.4 million units, they were still 15 per cent above a year earlier. Production schedules for May and June indicate that assemblies will be maintained at about the recent rate. Output of home goods and apparel is expected to change little in April. Television production rose early in the month, however, as output of color sets increased further.

In April, truck production rose and was at a record rate. Output of steel ingots increased further as consumption of steel apparently continued upward and demands for stockpiling continued strong. In early April, output of coal increased and paperboard production continued high. Output of crude oil and refined petroleum products was maintained in large volume.

In March, inventories of finished steel mill products held by steel consumers (manufacturers) rose by 1.1 million tons to a total of 13.6 million tons, according to the special Census report which shows data without seasonal adjustment. In the preceding five months such accumulation had averaged 600,000 tons per month. Steel consumption rose in March and steel mills in order to meet consumer demands reduced their own stocks of semi-finished steel. Steel consumption and inventories of steel users were well above the highs in 1962 and 1963, as shown in the table.

INVENTORIES AND CONSUMPTION OF FINISHED STEEL HELD BY STEEL CONSUMERS
(Millions of short tons)

	Inventories	Consumption	Ratio Inventory to Consumption
April 1962	12.2	4.9 1/	2.5
July 1963	11.9	5.4 1/	2.2
March 1965	13.6	6.2	2.2

1/ Consumption data are for May in 1962 and 1963, the peak rate in the first half of each year.

In the first four months following the labor contract settlements in 1962 and 1963, steel production dropped 25 per cent and 29 per cent respectively. In both cases, the loss amounted to about 1.5 points in the total index. The extension of the present contract seems to present at least two alternatives regarding the course of steel production in the near future. An early settlement--which most observers think is unlikely--would probably lead to sharp production curtailment comparable to those experienced in 1962 and 1963. If contract negotiations appear likely to continue through the summer, however, inventory accumulation may taper off and production might decline only moderately. Actual inventory liquidation and sharp production curtailment might then be deferred until either a settlement is reached or a strike is called.

Retail sales. Retail sales in March and April were moderately below their record February level, after allowances for the usual seasonal variation and the changing date of Easter. The March total (according to revised data) was down nearly 2 per cent from February and preliminary data for April suggest a fractional further decline. Meanwhile, personal income has continued to rise.

Sales of both durable and nondurable goods were off from their highs, but the decline was more pronounced for durable goods. Auto sales failed to show all the usual large seasonal rise from the sharply advanced February level, and seasonally adjusted sales declined considerably between February and April. Other durable goods showed only a slight decline.

Sales of nondurable goods were reduced about 1 per cent in March, with the largest decline at apparel stores. In April, sales at nondurable goods outlets appear to have held at the March level.

CHANGES IN SEASONALLY ADJUSTED RETAIL SALES*
(Per cent)

	Feb. 1965 to Mar. 1965	Mar. 1964 to Mar. 1965	4th Qtr. 1964 to 1st Qtr. 1965
Total	-1.8	7.9	5.0
Durables	-3.0	11.4	13.0
Automotive	-4.7	18.8	20.6
Furn. & appliances	1.9	1.3	-0.5
Lumber	-1.6	4.2	1.5
Nondurables	-1.2	6.2	1.3
Apparel	-5.6	2.7	0.3
General merchandise	-0.8	13.5	4.2
GAF total	-1.4	8.0	2.2

*--Based on final February and preliminary March figures.

Unit sales of domestic automobiles were at an annual rate of 8.2 million vehicles in April, as compared with 8.8 in March. Sales during the last 10 days of the month dipped below their level a year earlier for the first time since the autumn strike. Floods and the special income tax situation this year may have been partly responsible, but it appears likely that the strike backlog of orders which sustained record sales earlier this year has been largely used up. The average rate of sales over the first seven months of the current model year was 8.3 million vehicles, compared with a rate of 7.7 million in the same period of the 1964 model year.

Consumer credit. Consumers added $637 million to their instalment debt in March, about the same as in February. For the first quarter as a whole, instalment credit rose at a seasonally adjusted annual rate of $7.8 billion, in dollar amount the highest on record. In percentage terms, however, the net addition to debt was less than in some of the peak quarters in 1955 and 1959.

Auto credit continued to increase at a rapid pace despite some slowing in auto sales. This type of credit accounted for 48 per cent of the expansion in total instalment debt in the January-March period as compared with 41 per cent for all of 1964. Other types of credit have also continued to expand, although at a less rapid rate than auto paper. Personal loans advanced at a seasonally adjusted annual rate of $2.1 billion in the first quarter while other consumer goods paper increased at a rate of $1.8 billion. Both rates were somewhat above those for 1964.

Construction and real estate. Outlays for new construction edged down in April, according to preliminary estimates, from the record March total. The slight decline occurred mainly in public activity, with other major categories showing little change.

With completions of new dwellings and other net additions to the housing supply exceeding net new household formation, residential vacancy rates in the first quarter averaged a little higher than in the same period of the preceding two years. Inside metropolitan areas--where nearly all new high-rise apartment building has been taking place--rental vacancy rates reached a postwar high for the quarter. Outside these areas, rental vacancy rates were also up but appreciably below earlier highs. By region, year-over-year changes in average rental vacancy rates were mixed. Increases were reported in the Northeast and West, a decline in the North Central states and no change in the South.

Plant and equipment expenditures. Business expenditures for new plant and equipment this year will be 15 per cent larger than last year, according to the McGraw-Hill survey conducted in March and early April. This increase compares with an anticipated rise of 12 per cent reported in February in the Commerce-SEC survey. The larger rise indicated by the McGraw-Hill survey comes from stepped-up spending plans for manufacturing, mining, and public utilities. Only for railroads have earlier spending plans been reduced. Every major industry except shipbuilding and railroad equipment manufacturers now plans larger outlays this year than last, and outlays by these two industries will equal last year's.

New plant and equipment expenditures of $51.7 billion now planned by business would account for 7.8 per cent of a projected gross national product of $661 billion this year. The proportion last year was 7.2 per cent and in 1956, when capital outlays soared 22 per cent, the proportion was 8.4 per cent and was followed by a recession.

Business also now plans fixed capital outlays over the next three years to continue at a very high level. The nonferrous metals, rubber, and electric and gas utilities industries even have tentative spending plans for the next three years which average more than their planned outlays this year, and expenditures planned for next year by iron and steel producers and by the railroads exceed their plans for this year.

Manufacturers as a group reported they were operating at 88 per cent of capacity at the end of 1964, up from 85 per cent a year earlier. Manufacturers' preferred operating rate is 92 per cent. Several industries were operating at or above their preferred rates, notably nonferrous metals, rubber, textiles, and food and beverages. Producers of motor vehicles and parts and apparently also iron and steel producers were operating very close to their desired rates. All of these industries, as well as some others, have relatively large increases in capital outlays planned for this year.

Manufacturers now plan to increase their capacity by nearly 6 per cent this year as compared with 4 per cent last year. All industries except the petroleum and coal products group plan larger increases in capacity this year than last. The motor vehicles group and chemical producers indicate plans for 8 per cent increases in capacity.

Manufacturers' plans to accelerate capacity growth are also evident in greater emphasis on expansion of facilities in contrast to modernization. They now plan to devote 45 per cent of this year's capital outlays to expansion, and a slightly larger proportion during the 1966-68 period. In the period from 1959-1964, spending for expansion was only about one-third of total fixed investment.

The need for additional capacity stems, along with the pressure of higher operating rates, from expectations of substantial increases in sales. A 7 per cent increase in physical volume of sales this year and a 19 per cent further increase by 1968 is anticipated. Expenditures for research and development are being increased considerably more this year than last, and substantial further increases are planned for the next three years.

Businesses will continue to rely heavily on their own resources to finance their capital spending programs this year. But they also anticipate increasing their external financing for all purposes by 5 per cent. In 1964, according to the survey, the reduction in corporate income tax rates, liberalized depreciation rates, and investment tax credits combined to boost capital investment by nearly $1 billion. These inducements are expected to continue to stimulate fixed capital spending in 1965.

BUSINESS CAPITAL SPENDING PLANS AND OPERATING RATES
SELECTED INDUSTRIES

	Planned 1965		Operating rate at end of 1964
	Billions of dollars	Per cent change from 1964	
ALL BUSINESS	51.7	15	n.a.
Manufacturing	22.5	21	88
Iron and steel	2.0	18	n.a.
Nonferrous metals	.7	44	98
Nonelectrical machinery	2.1	26	87
Electrical machinery	.9	30	84
Autos, trucks, and parts	1.8	18	95
Chemicals	2.5	26	85
Paper and pulp	1.2	25	94
Rubber	.4	33	96
Petroleum & coal products	4.2	24	91
Food and beverages	1.3	22	86
Textiles	.9	16	96
Mining	1.5	22	n.a.
Railroads	1.6	12	n.a.
Airlines	1.3	40	n.a.
Other transportation and communications	6.2	8	n.a.
Electric and gas utilities	6.9	11	n.a.
Commercial	11.7	8	n.a.

n.a.--not available.

Orders for durable goods. New orders for durable goods, which were about unchanged in February, rose 2-1/2 per cent in March to a new high. With sales up by a larger percentage, the backlog of unfilled orders stabilized after a steady advance over the preceding 14 months. Unfilled orders represented 2.6 months' shipments at the advanced March rate as compared with 2.5 months in late 1963.

New orders for machinery and equipment rose in March, after declining moderately in February, and were at a new high, slightly above the advanced levels reached last spring. New orders--and shipments--rose sharply in the auto industry in March. On the other hand, in the steel industry new orders showed a large decline and, with shipments up sharply, the order backlog declined appreciably after months of steady advance. However, the steel order backlog at the and of March was about double the year-earlier level. Outside the steel industry unfilled orders for durable goods were up 11 per cent.

Manufacturers' inventories. Seasonally adjusted book value of manufacturers' inventories increased only $280 million in March, bringing the increase for the first quarter to $700 million. This increase was the same amount manufacturers had anticipated in February and was sharply below the extraordinary $1.9 billion increase in the fourth quarter. Inventory accumulation by durable goods manufacturers totaled about $500 million and was down from almost $1.4 billion in the fourth quarter. In nondurable goods industries, the increase was $200 million in the first quarter as compared with $550 million in the fourth quarter.

In March as in February, the bulk of the stock increase was in steel-fabricating lines in the durable goods sector. Sales of both durable and nondurable goods rose sharply in March, and stock-sales ratios remained low.

<u>Labor costs.</u> Unit labor costs for all employees in manufacturing in March continued below levels of a year ago although they have risen somewhat since December. Premium pay for increased overtime hours worked has been mainly responsible for the recent rise, as basic wage rates apparently have been advancing at about the same pace as earlier. Fringe cost increases, however, have slowed up somewhat and the rise from a year earlier was somewhat less than in similar periods in other recent years. The effect of the change in fringe costs on total unit labor costs, however, has been small.

<u>Contract settlements.</u> Increases in hourly compensation in recent major labor contracts have continued close to the guideposts. The relatively moderate and long-term nature of the settlements provides some support to the hope that unit labor costs will remain relatively stable.

The interim agreement reached in the steel industry postponed the threat of a possible steel strike at least until September 1. The companies will put 11.5 cents into escrow to be used for wages or other benefits to be determined in the final settlement. The increase amounts to about 2.6 per cent based on average hourly compensation of $4.40 an hour in the steel industry.

The extension agreement seems to set a lid on retroactivity but does not commit either side as to the size of the final settlement. Negotiations prior to the extension, however, considerably narrowed the original wide differences between the company and the union.

Union leaders have indicated that they believe the 11.5 cents or 2.6 per cent an hour rise is a "floor" and they are demanding a package worth 3.2 per cent plus cost of living adjustments. While it is widely expected that the cost of the final settlement will be higher than the interim agreement, it is not, at this time, thought that it will be high in relation to the Administration guidepost.

Negotiations for the new steel contract are scheduled to be resumed on May 18. On June 1, the new president of the steel union will take over complete responsibility for reaching an agreement with the companies. Subcommittees have been set up to settle specific differences and are scheduled to have final reports ready for the top bargaining group on July 1. These subcommittees will carry on, in effect, the same functions as the Human Relations Committee did in previous negotiations. The reported strike deadline of September 1 is not automatic and requires a formal reopening of the contract. The parties have the option of continuing negotiations without a reopening. However, any time after July 30 either side can ask for a reopening with a 30-day waiting period before a strike can be called.

The rubber settlement provided for increases in wages and fringes, excluding pensions and insurance, estimated at 28 cents per hour over the 2-year contract period. The new contract provides for a 6-1/2 cent an hour wage increase for nontire workers on May 10, 1965, and for a 7-1/2 cent increase for tire workers on June 7. A year later both groups will receive a 9-cent an hour increase. A pay inequity correction of 7 cents an hour for skilled or maintenance workers, a ninth paid holiday, longer vacations and liberalized supplementary unemployment benefits are estimated to cost 10 cents the first year and 1.5 cents an hour additional in the second year of the contract. Since the above estimates do not include pension costs of 14 cents for a 3-year period negotiated last year, the rise in hourly employment costs in the rubber industry is understated relative to package costs being announced in other industries.

Contracts between the aluminum companies and the steel workers union expire June 1. In the past, aluminum contracts usually have been signed after settlements in the steel industry. With minor exceptions, aluminum settlements have been within the same framework as the steel agreements. There is a possibility that aluminum contracts may be extended until after new union officers take over on June 1.

Steel productivity and labor costs. The Council of Economic Advisers, in a special report on the steel industry, calculated the productivity trend in the industry as 3 per cent per year from 1947-1964--when adjusted for changes in steel operating rates. This rate is close to the guidepost figure of 3.2 per cent for the over-all private economy. The Council concluded, that if wage increases in steel this year approximate the economy-wide productivity trend, labor costs per ton of steel will remain approximately stable. Thus by implication the report suggests that the steel industry can increase its final wage settlement somewhat above the 11.5 cents, or 2.6 per cent, granted in the interim agreement, presumably to slightly over 13 cents per hour, or 3 per cent, without raising steel prices.

What is mainly new in the Council report is the method used in calculating the industry productivity trend. The current official BLS output per manhour figures for the steel industry show an average rise of 2.2 per cent from 1957-1964 (the industry has been using 2 per cent based on the BLS data published late last year for 1957-1963). Because of the wide fluctuations in steel operating rates, the Council smoothed short-term variations in output per manhour by introducing the capacity operating rate as a variable into the trend equation for productivity. A further correction was made by eliminating the strike-affected third and fourth quarters of 1959 from the analysis. The net result is that the Council calculated the trend increase in productivity to be 3.0 per cent.

Increases in wage plus fringe costs per manhour have averaged 3.8 per cent per year for the 1957-1964 period for the steel industry. But the average conceals a rather sharp decline in the rate of increase during the period. The 1956 contract provided wage and fringe benefits of 8 per cent per year; the 1960 contract, 3.7 per cent; and the 1962 and 1963 contracts, only 2.5 per cent. Unit labor costs, therefore, rose between 1957 and 1960-1961 and have declined each year since then. In 1964, they were slightly below the average for 1958-1959.

<u>The summer of the 18-year olds</u>. During the year ending July 1, 3.7 million young persons will have celebrated their 18th birthday, one million more than one year or two years earlier. High schools are expected to graduate 600,000 more this June than in 1963, while colleges will enroll 300,000 more freshmen this fall than they did two years earlier.

POPULATION AND SCHOOL ATTENDANCE

	Youths 18 years old (as of July 1)	High School Graduates	College Freshman Enrollment (Fall of each year)
		(thousands of persons)	
1960	2,573	1,864	930
1963	2,753	1,952	1,046
1964	2,737	2,315	1,235
1965	3,729	2,533 1/	1,379 1/

1/ Projected.

The influx of teenage students in search of summer work and graduates looking for permanent jobs usually begins in May and reaches its peak in June. Additions to the teenage labor force totaled close to 2.8 million from April to June last year, and 35 per cent of the increase was reflected in the unemployment series. Assuming no change in the rate of teenage labor force participation from last year, total teenage additions to the labor market would be 200,000 more than last year, or about 3.0 million in total.

The labor force participation rate of teenagers has declined significantly from a year earlier, with much of the drop among young men since last fall. As a result, the teenage labor force was only 120,000 higher in the first quarter this year than a year earlier.

This was far short of the annual increase of roughly 400,000 to 500,000 projected for this age group for the period. Nevertheless, teenage employment rose no faster than the labor force, and the teenage unemployment rate at 14.5 per cent in the first quarter was the same as last year.

If there should be a catch-up in their labor force participation rate in coming months, the number of young people in the labor force could rise sharply between the first and second quarters of this year. The unemployment rate for youth in the second quarter is almost certain to rise because of the large labor force increase expected this summer in relation to available job opportunities.

Prices. The industrial commodity price index, according to the weekly estimates, has edged up about .1 per cent from its stable first quarter level, and is equal to the peak reached early in 1960. Most of the rise in the index since last summer has been in the metals and machinery groups, and an index of industrial commodities excluding metals and machinery continues to show little change. While trade reports suggest that price concessions and discounts are no longer widespread, numerous announced increases in list prices during the last few months have been quietly rescinded.

Wholesale prices of foodstuffs, continuing the rise that began early this year, have increased sharply in recent weeks; reduced marketings of hogs and steers, increasing beef demand, and reduced supplies of fresh vegetables as a result of unfavorable weather conditions have been mainly responsible. The total wholesale price index in March at 101.6 per cent of the 1957-59 base period, was marginally above the top of the narrow range within which it has fluctuated for the last seven years.

In recent weeks the FRB sensitive index and the BLS daily index, reflecting price increases in nonferrous and steel scrap, tin, rubber, and some paper products, have risen further. Shortages of tin, copper, and zinc persist as a result of a continuing rise in world consumption, and in the case of copper and zinc, also because of chronic supply disruptions. At the beginning of this week, the Chilean Government announced a one cent increase in the export price of copper to 36 cents. Major U.S. and foreign producers followed, raising prices 2 cents and 3-1/2 cents respectively to match the new Chilean price, and domestic fabricators have raised prices for copper products. Prices of copper in the free markets and tin, although still below earlier peaks, have returned to the high levels of early December. A zinc release by the GSA was oversubscribed by three times, while a lead release was undersubscribed. List prices have been raised recently for a number of stainless steel products by up to seven per cent; however, these products account for less than one per cent of all steel shipments.

The consumer price index rose .1 per cent in March to 109.0 per cent of the 1957-59 average. Services and commodities each rose .1 per cent to 117.0 and 105.6 per cent, respectively. Prices of new cars fell about seasonally, and food prices rose mainly because supplies of fresh vegetables were curtailed by abnormally cold weather.

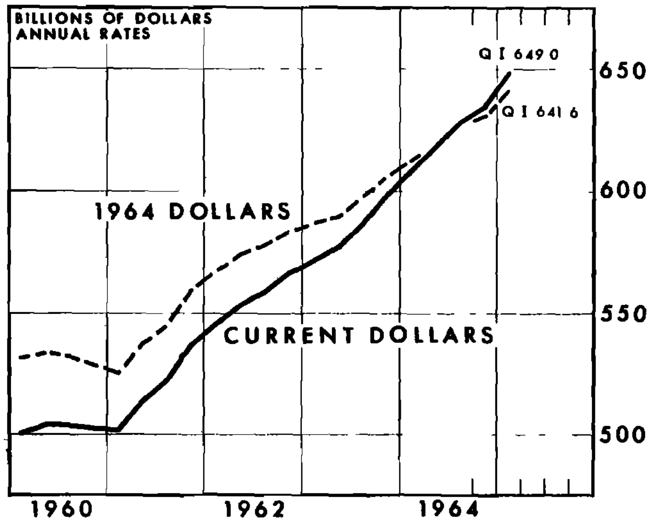
CONSUMER PRICE INDEX
1957-59 = 100

	Index March 1965	Per cent change to March from: February 1965	March 1964
All items	109.0	.1	1.2
Commodities	105.6	.1	.8
Food	106.9	.3	1.1
Commodities less food	104.8	.1	.5
New cars	100.8	-.2	-1.0
Used cars	121.7	0	1.8
Household durables	98.0	.2	-.7
Apparel	105.0	.1	.5
Services	117.0	.1	2.2
Transportation	118.4	.2	3.8
Medical care	125.9	.3	2.9

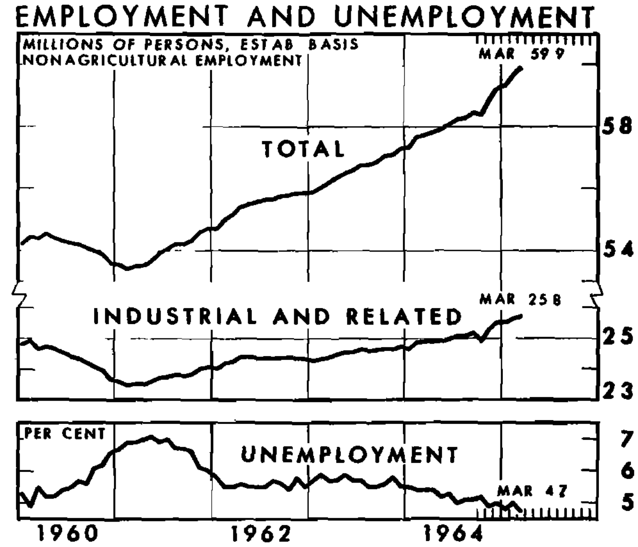
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

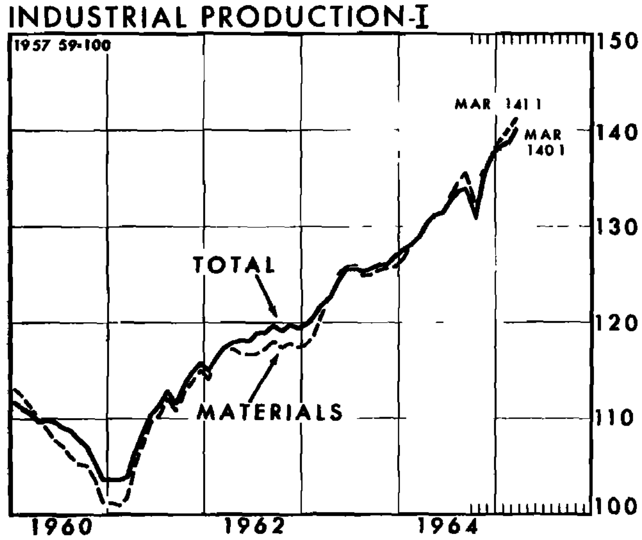
GROSS NATIONAL PRODUCT



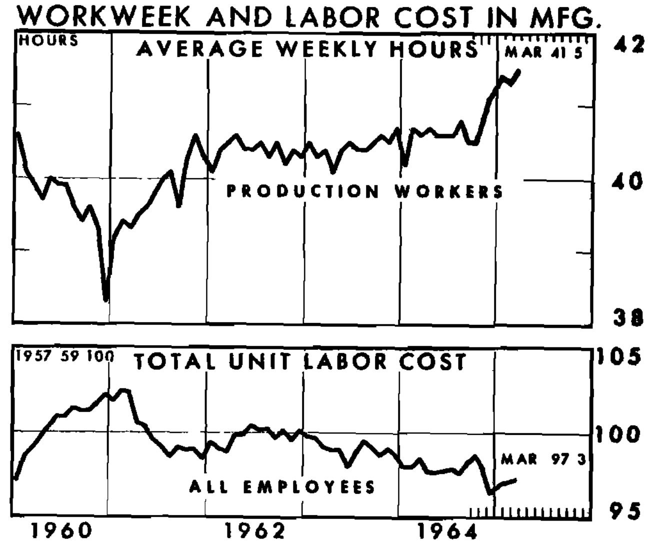
EMPLOYMENT AND UNEMPLOYMENT



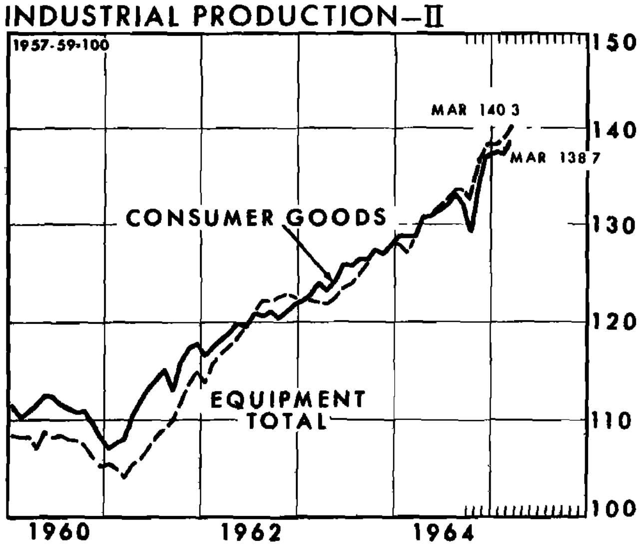
INDUSTRIAL PRODUCTION-I



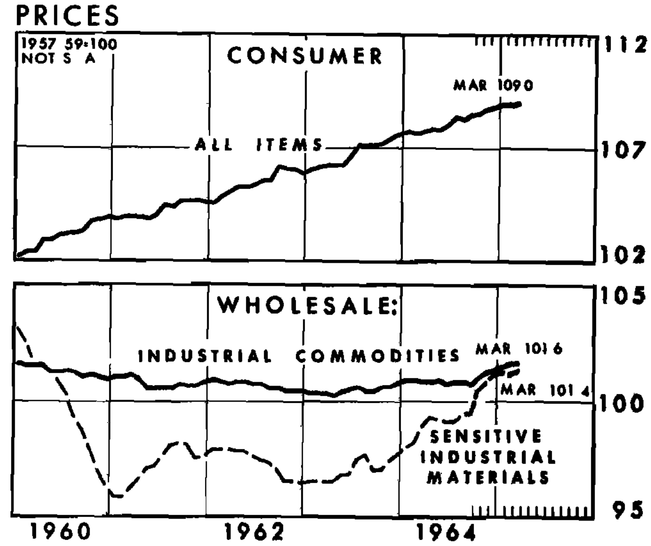
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION—II



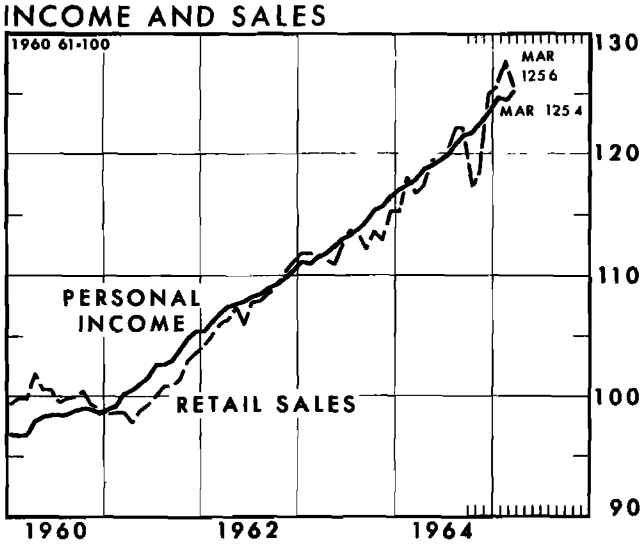
PRICES



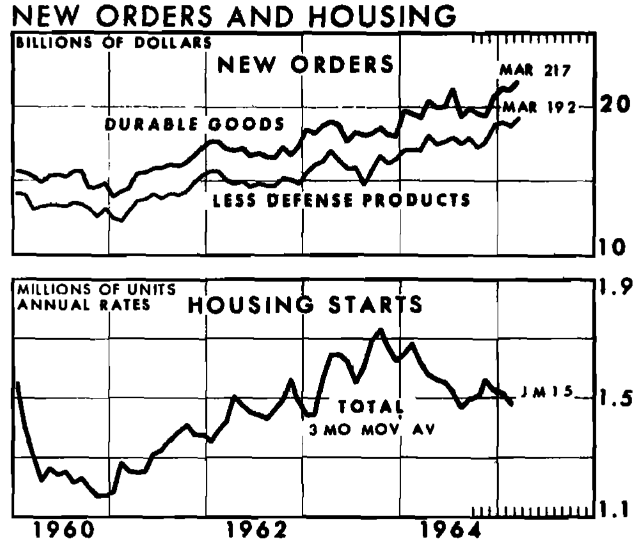
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

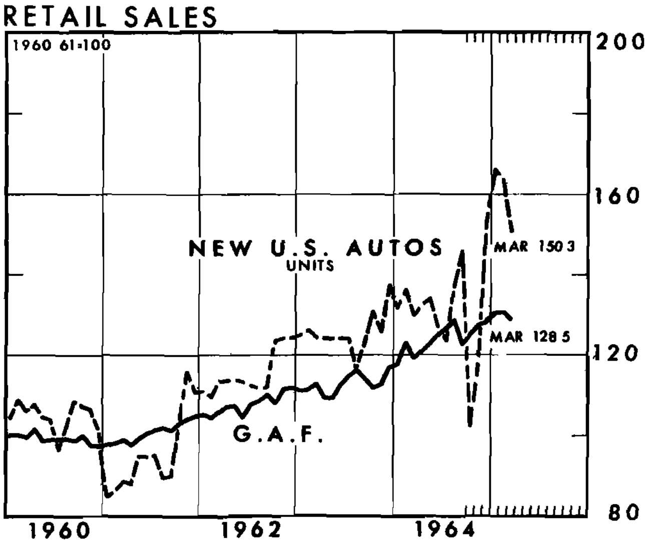
INCOME AND SALES



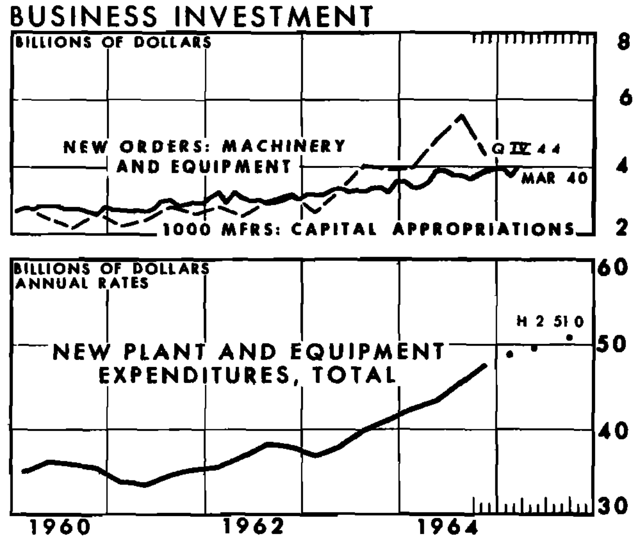
NEW ORDERS AND HOUSING



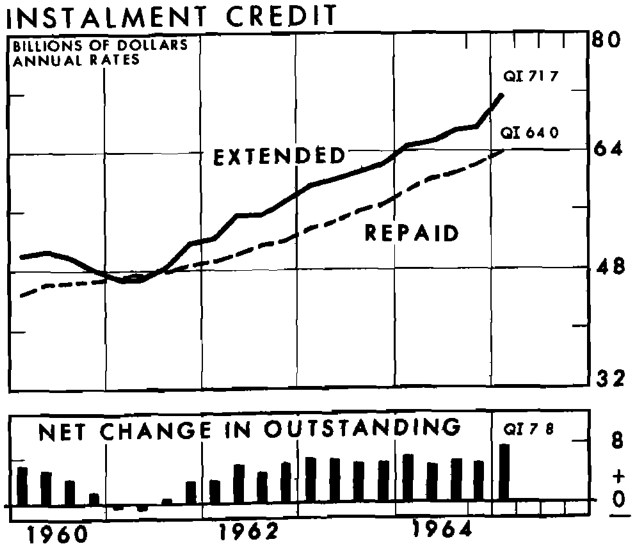
RETAIL SALES



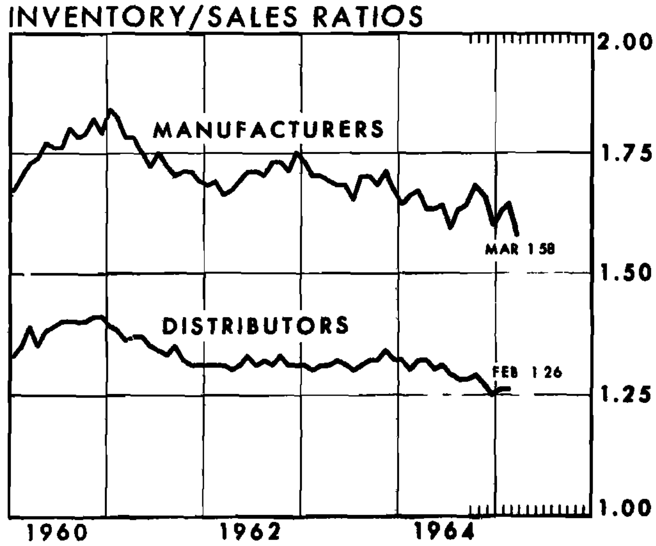
BUSINESS INVESTMENT



INSTALMENT CREDIT



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

Bank credit. Following an unusually large increase in March, growth in total bank credit receded to $1.6 billion (seasonally adjusted) in April according to preliminary estimates--the same as the average monthly rise in 1964. The two months together, however, recorded an expansion in total bank credit substantially larger than in the same period a year ago, reflecting mainly the greater increase in business loans during March-April 1965. The average monthly increase in total bank credit in the two months--$2.5 billion--was about the same as the January-February rate of expansion.

Loan growth in April was much less than in any month so far in 1965. Thus, the frantic pace of loan expansion earlier in the year, buoyed by a variety of special factors--the sharp rise in loans to foreign borrowers in the opening weeks of 1965, the dock strike, the accumulation of steel inventories, and an exceptionally high level of auto sales--may now be subsiding. Apart from the miscellaneous "other" loans category, all types of loans appear to have increased by about the same amount in April 1965 as they did in the same period a year ago.

There are, nevertheless, signs of continued underlying strength in credit demands faced by the banking system, especially from business borrowers. City bank reports for the first 3 weeks of the month indicate small but contraseasonal increases in loans to producers of metals and metal products and to textile firms, and larger than seasonal increases in loans to miscellaneous manufacturing and mining companies. Loans to construction companies also rose more than seasonally, following a relatively weak performance in March. Business loan growth at these banks, furthermore, continues to be tempered by greater-than-usual declines in loans to commodity dealers, which had risen contra-seasonally during the dock strike.

NET CHANGES IN COMMERCIAL BANK CREDIT
(Seasonally adjusted in billions of dollars)

	April 1965p	April 1964	March and April 1965	March and April 1964
Total loans & investments	1.6	0.4	5.0	3.4
U. S. Gov't securities	-0.3	-1.3	-0.9	-0.4
Other securities	0.7	0.2	0.8	0.2
Total loans	1.2	1.5	5.1	3.6
Business	0.7	0.6	1.9	0.7
Security	0.1	0.1	1.0	0.5
Nonbank financial	0	0.1	0.5	0.5
Real estate	0.3	0.2	0.6	0.6
Consumer	0.3	0.2	0.6	0.5
"Other"	0.1	0.5	0.5	0.8
Loans (ex. security)	1.1	1.4	4.1	3.1

The abrupt decline in the growth of total loans during April was the main factor in the slower growth of total bank credit. Bank holdings of Treasury issues fell moderately further, but securities other than Treasury issues rose sharply in April after showing little change in March. A significant part of the April increase in bank holdings of other securities may have come from purchases of two Federal agency issues, and from delivery of New York State tax anticipation notes replacing issues maturing in March.

The March-April increase of $0.8 billion in bank holdings of non-Treasury securities was about one-half the January-February increment, mirroring the slower growth of time deposits in the last two months. Real estate loans at banks, however, have shown little discernible relation to the growth of time deposits this year. Bank acquisitions since December have been slightly smaller than in the same period of 1964.

Money supply and time deposits. While the April increase in bank credit was much smaller than in March, on a daily average basis earning assets rose substantially in April, reflecting the carryover of the large increase that took place late in March. On the liability side of the balance sheet, a significant portion of the March to April increase in average levels took the form of increased Treasury deposits.

The privately-held money stock rose sharply again in April, however, increasing at an annual rate of 7.5 per cent--with most of the increase occurring in the first half of the month. The April data seem to confirm the view, suggested by the March figures, that the impact of time deposit rate changes on the demand for money balances persisted over a shorter time span than had been the case in earlier periods when ceiling rates under Regulation Q were raised. Increased transactions demand for money accompanying the brisk rise in GNP apparently has registered its effect in the March and April statistics on money holdings.

Nevertheless, growth in money holdings since November has not been large--the annual rates for the period having been 3.5 per cent for currency, 2.5 per cent for demand balances, and 2.6 per cent for the total money stock. Turnover of demand balances from November through

March increased sharply, and a further rise may well have occurred in April.

Growth in time deposit holdings slackened further to less than $1 billion in April--below the average monthly increase for 1964 and substantially lower than the average gains of January and February. The abatement of total time deposit growth reflects a slower expansion of both savings accounts and other time deposits, suggesting that the initial sharp upsurge in bank time deposits which follows a marked change in time deposit rates is behind us.

Withdrawals of time deposits for payment of individual income tax liabilities may have been larger than seasonal this year, contributing to the slower growth of time deposits, but this factor alone could not have accounted for the abrupt slowdown in time deposit expansion in the past two months. Reports from the city banks, in fact, indicate that savings deposits declined less in April than they did in the comparable weeks of last year.

Growth in other time deposits at city banks during April was about $50 million larger this year than last, due mainly to a greater increase in CD's. The growth in outstanding CD's in April was principally at New York City banks, but Chicago banks and other weekly reporting members also increased their outstandings moderately. Nevertheless, CD's outstanding at banks outside New York City remained below the peaks attained earlier this year, when rates quoted on prime CD's were far enough below regulatory ceilings to give smaller banks elbow room to price their liabilities attractively.

Despite the absence of upward pressures on bill rates, CD rates quoted by prime banks drifted marginally higher during the month--the most-often-quoted rate on 180-day prime paper was 4-3/8 per cent, compared with the 4-1/4 per cent level generally prevailing in March. Rather high dealer positions in CD's late in March may have put some upward pressure on rates quoted by prime banks. It seems more likely, however, that the slight stiffening of CD rates was evidence of an increased willingness of large banks to bid for CD money (in view of the underlying strength of business loan demand), and also a reflection of the tauter reserve position of member banks that prevailed during the month.

Bank reserves. The increase in average net borrowed reserves from $50 million in March to about $140 million in April [1/] mainly took the form of increased member bank borrowings. Excess reserves of member banks have remained at relatively low levels throughout the period. If the preliminary estimate of $333 million for April holds, average excess reserves for the month will be about equal to the lowest level recorded in any month of recent years. When excess reserves are this low, it may be that quantities of surplus reserves held by most individual banks are not sufficient to compensate for efforts to keep more fully invested, except at very high rates of interest on earning assets.

The effective rate on Federal funds was at 4-1/8 per cent on 15 of the 22 days from April 1 to April 30, and at 4 per cent on the remaining 7 trading days.

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.

U.S. Government finance. Recent activity in the Treasury bond market has been dominated by the May refunding whose terms were announced on April 28. The Treasury is offering two issues in exchange for $8.4 billion of maturing securities (of which $4.1 billion are held by the public). The short-term option or anchor issue is a 15-month, 4 per cent note due in August 1966 and priced to yield about 4.12 per cent. The longer-term option is a 9-year, 4-1/4 per cent bond due in May 1974 and priced to yield about 4.22 per cent. Both offerings are reopenings of outstanding issues.

The market considered the pricing of the reopened 4-1/4's to be more favorable than for the shorter-term option. The former issue had been in short supply before the financing, and was priced well below the yield curve at the time of the announcement. Under these conditions, current market guesses suggest that exchanges into the 4-1/4's of 1974 could be in the neighborhood of $1.5 billion, with the dealers apparently willing to take up a sizable amount of these bonds for later redistribution.

The shorter option in the financing should also prove attractive to banks, corporations, and other investors who may be constrained by liquidity considerations from exchanging their maturing "rights" for the longer-term option. But a potentially inhibiting consideration in this respect has been the availability of a somewhat higher rate of return on the latest 1-year bill--converted to a bond or investment yield basis from a discount basis--than on the 15-month anchor issue in the refunding. In the first few days after the announcement, however, dealers reported relatively light amounts of demand for bills from sellers of rights to the May refunding.

YIELDS ON U. S. GOVERNMENT SECURITIES

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1965						
Highs	4.00	4.05	4.16	4.18	4.24	4.21
Lows	3.76	3.91	4.00	4.08	4.17	4.17
1964-65						
December 31	3.82	3.92	4.06	4.12	4.21	4.21
April 13	3.94	4.00	4.11	4.14	4.20	4.20
April 28	3.92	3.97	4.12	4.16	4.21	4.21
May 4	3.90	3.95	4.10	4.15	4.20	4.21

Treasury bill rates have been edging downward recently despite continued pressure on bank reserve positions. In late April and early May, the key 3-month bill traded around the 3.90 per cent level, down 4 or 5 basis points from mid-April. Strong seasonal purchases of bills by public funds, improved demand from corporations, and stock-piling of bills by dealers in anticipation of demand from sellers of rights helped to maintain downward pressure on rates. In addition, in late April and early May there were market purchases by Treasury investment accounts and by System account totalling about $650 million. Under these conditions, the average issuing rates for 3- and 6-month bills in the first weekly auction in May dropped to their lowest levels since mid-winter--with the 3-month bill going at 3.90 per cent and the 6-month bill at 3.95 per cent. Other short-term rates, however, have remained generally firm in the recent period; these have included rates on secondary market certificates of deposit, commercial and finance company paper, and bankers' acceptances as well as rates on Federal funds and dealer loans.

In the period after the Treasury refunding was announced, the decline in bill rates, together with some fading of the premium on the "rights", increased the attractiveness of the short 15-month option and thereby lessened the likely amount of attrition in the financing. While a large attrition may have brought the market to question the sustainability of current interest rate levels, at least in the shorter-term coupon area, it would not have found the Treasury short of cash.

The Treasury's cash balance has been running above projections for some weeks now. It was augmented in April by higher than expected individual income tax receipts.[1/] This, together with a continued holding of the line on expenditures, has brought the cash operating balance at the end of April to $8 billion, as compared with $5 billion a year ago. Assuming a minimum attrition in the current financing and no new cash raised in May and June, the Treasury may be expected to close the fiscal year with a balance somewhat above $10.5 billion, even after paying off $3.3 billion of tax bills that mature in mid-June.

1/ It is too early to tell how much of the enlarged April income tax receipts represent greater payments on the 1964 liability (either because the forecast of underwithholding was too small or because the liability, including capital gain taxes, was larger than expected) and how much are initial payments on estimated 1965 taxes. This information will not be available for two months.

Corporate and municipal bond markets. Investors in corporate and State and local government securities have continued to press for some yield improvement in recent weeks, and the generally cautious tone in evidence in bond markets since late March has persisted. Yields on corporate bonds--new issues as well as seasoned--have advanced to levels barely below their 1965 highs; but published yield series on municipals have remained relatively stable.

BOND YIELDS

	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
1965				
Low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(2/4)
High	4.48(2/12)	4.44(1/8)	3.09(4/1)	3.20(3/4)
Week ending April 2	4.43	4.42	3.09	3.16
Latest week	4.47 2/	4.43	3.09	3.15

1/ Week ending December 4. 2/ Week ending April 23.

Hesitancy on the part of investors produced a substantial inventory build-up among corporate underwriters around mid-April, with six new issues in syndicate at the same time. Syndicate restrictions on three of these issues were subsequently terminated--with unsold balances still large--and their yields advanced 2-5 basis points in the secondary market. Dealers have since tended to back off a bit in their bidding for new competitive offerings; at the more liberal yields resulting, investor interest has improved.

In the municipal market, most new issues offered prior to the last week in April were reported as poorly received. As the month progressed, dealers began to make price concessions to move some older issues out of inventory, and late in the month new offerings were reportedly also being priced below similar issues offered earlier. While these adjustments have not been reflected in the published yield series--which tend to lag the market--they have apparently affected investor demands. As April closed, underwriters were experiencing greater success in selling tax exempts.

BOND OFFERINGS 1/
(In millions of dollars)

	Corporate				State & local govt.	
	Public offerings		Private placements			
	1965 e/	1964	1965 e/	1964	1965 e/	1964
Jan.-May average	394	366	478	448	932	947
March	550	361	500	353	950	868
April	420	383	500	480	950	1,293
May	650	470	500	537	950	709

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

In May public offerings of corporate bonds are expected to swell to the largest monthly total since April 1962, nearly two-fifths above May volume a year ago. Utility bonds scheduled for competitive bidding account for $300 million of this total--the largest monthly volume of such issues in over a year.

While the flow of new municipal bonds to market was quite light throughout most of April, an unexpectedly large supply in the final week expanded volume for the entire month almost to the March level. Early in the month, sales of older issues at slightly reduced prices were sufficient to compensate for slow sales of new offerings, so that over-all dealers' inventories of unsold issues--although remaining unusually high--did not exceed the record $800 million plus mark reached temporarily in March. Recently, inventories have edged up to more than $800 million again under pressure from heavy new issue volume, but a combination of improved sales of new issues and some liquidation of older inventories has continued to keep dealers' stocks below their earlier high. Since the supply of new municipal bonds estimated for May is also large, the tone of the market remains cautious, as participants wait to see how much of the continuing supply will be absorbed by commercial banks.

Stock market. After fluctuating within a narrow range for two months, common stock prices advanced sharply during the past month to an all-time high. Standard and Poor's composite index closed at 89.51 on May 4, 4 per cent above the late March level and more than 2 per cent above the previous high reached at the start of February. Among other things the further advance of stock prices has reflected first quarter earnings reports even better than many had expected, cessation of earlier selling pressure arising from the need to pay April income taxes, and the postponement of the deadline for a steel settlement until September 1. Trading volume averaged 5.7 million shares a day in April, with volume rising as prices advanced.

<u>Corporate profits</u>. Published reports now available for larger companies indicate a sharp first quarter rise in corporate earnings to a seasonally adjusted annual rate of profits before taxes in the neighborhood of $62.5 billion. While this total is above the $61 billion first quarter figure contained in the recent Board staff projection, it is consistent with that figure when allowance is made for the revision in GNP and fourth quarter profits that occurred after the projection was made. The revised fourth quarter profits total was $57.4 billion, and the comparable figure for the first quarter of 1964 was $56.6 billion.

Manufacturing industries accounted for most of the first quarter rise in corporate earnings this year. Data now available for about 750 companies suggest that aggregate profits after <u>taxes</u> of manufacturers were nearly 20 per cent larger in the first quarter than a year ago. Earnings this year were bolstered by recovery in auto production and by efforts of business to build steel inventories, but the rise in profits was not restricted to these industries; year-to-year increases occurred in every major manufacturing industry. After-tax profits were also pushed up by the second half of the 4 point reduction in Federal income tax rates, but in almost every manufacturing industry the rise in profits was larger than could be attributable to the tax cut alone.

<u>Mortgage markets</u>. While mortgage lenders have remained somewhat more selective, competition for loans to qualified borrowers has continued active this spring. A recent survey by the National Association of Real Estate Boards of its panel of realtors underscored

the availability of home-mortgage funds. Lenders also reported further increases in their forward mortgage lending commitments during the early months of the year, and recent Home Loan Bank data on average nonrate terms for home loans confirm the continuance of a borrower's market. Interest rates on home mortgage loans have remained unchanged.

Notwithstanding the continued availability of funds, the first quarter increase in mortgage debt was apparently no larger than the record growth for the same period a year earlier. The rate of expansion in home-mortgage debt was the smallest for the first quarter in three years. But debt secured by multi-family and commercial properties increased more than in the first quarter a year ago, and farm mortgage debt continued to grow at about the same advanced rate as a year earlier.

MORTGAGE DEBT OUTSTANDING BY TYPE OF HOLDER
(Billions of dollars, without seasonal adjustment)

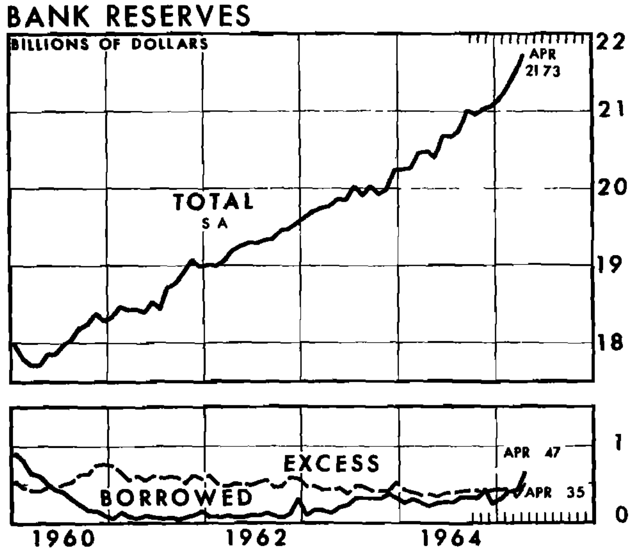
	Amount p/ 3/31/65	Increase in first quarter of 1965 p/	1964	1963
All holders	317.1	$6.0	$6.1	$5.4
Financial institutions	245.4	4.6	4.8	4.7
Commercial banks	44.5	.6	.8	.8
Mutual savings banks	41.5	1.0	.9	1.0
Savings and loan assoc.	103.0	1.8	2.2	2.3
Life insurance companies	56.4	1.2	.8	.6
Federal agencies	11.5	.1	.1	-.3
FNMA	4.5	--	-.1	-.4
Individuals and others	60.1	1.3	1.2	1.0

Source: Federal Reserve estimates. p/ Preliminary.

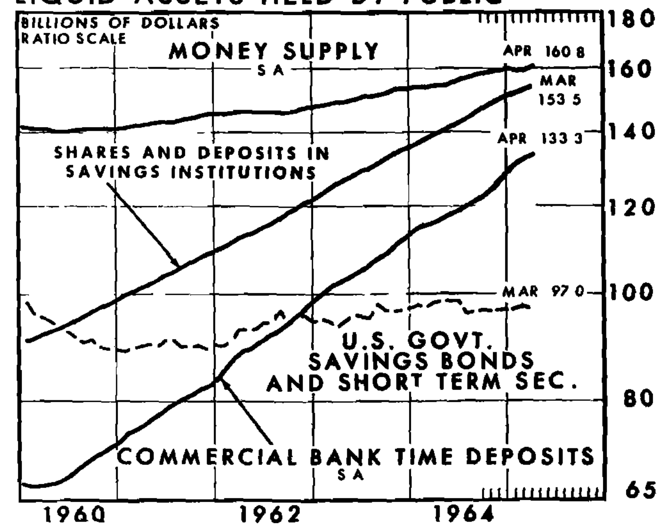
First quarter expansion in the mortgage portfolios of major private lenders as a group was about the same or a little less than in the comparable periods of 1964 and 1963. Only life insurance companies continued to report substantial year-over-year increases in the net amount of takings. Savings and loan associations experienced the smallest expansion in mortgage holdings since early 1961, accounting for only a little over three-tenths of the total rise in debt during the first quarter. However, they maintained their recently increased share of debt expansion on apartments and other non-home properties. Net acquisitions of commercial banks also grew less rapidly than a year ago while acquisitions of mutual savings banks held about even.

FINANCIAL DEVELOPMENTS - UNITED STATES

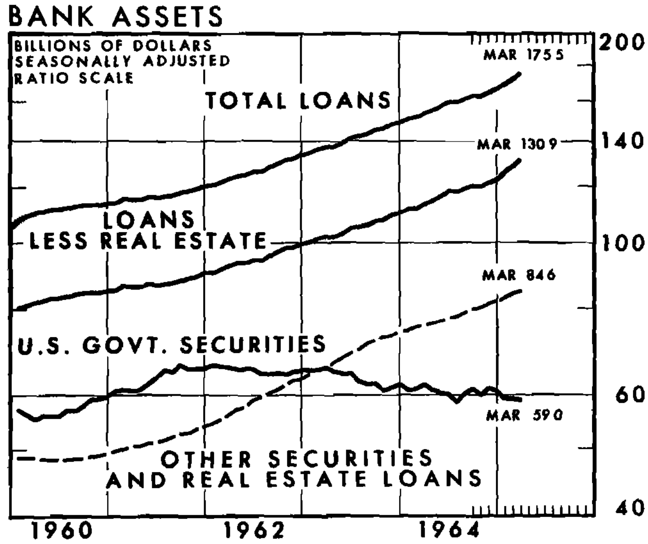
BANK RESERVES



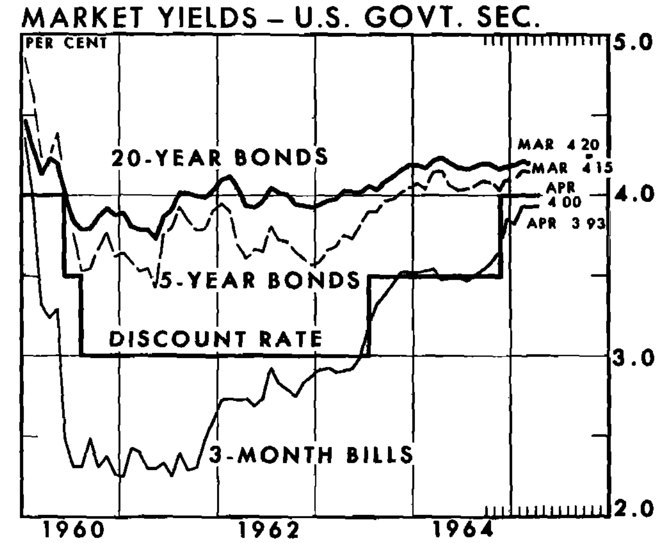
LIQUID ASSETS HELD BY PUBLIC



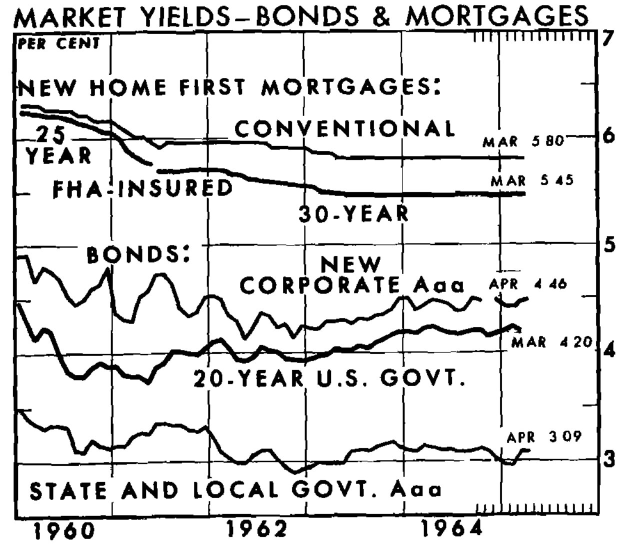
BANK ASSETS



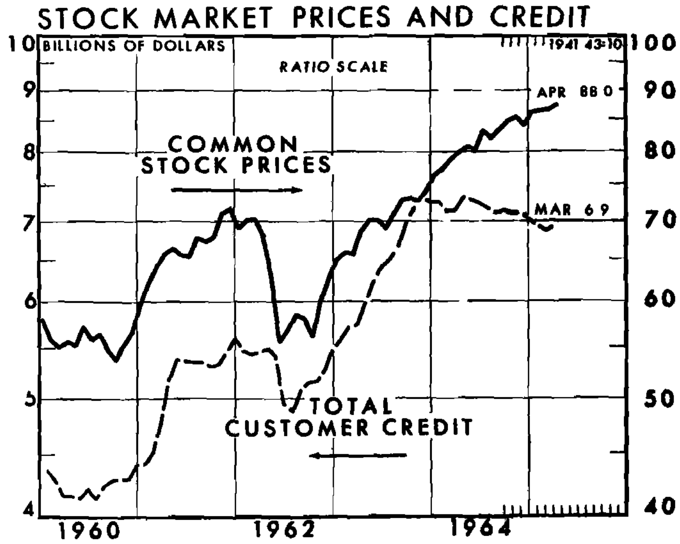
MARKET YIELDS – U.S. GOVT. SEC.



MARKET YIELDS–BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Latest data confirm earlier estimates of a first quarter payments deficit on regular transactions of about $300 million. On a seasonally adjusted basis, the deficit will probably be shown as about $750 million, or $3 billion at an annual rate, when it is released later this month. Seasonal adjustments to the payments data are currently undergoing substantial revision by the Commerce Department, and the $750 million figure incorporates the tentative new (and higher) adjustment for the first quarter.

The payments surplus which appeared in March continued into April. However, partial weekly data suggest that deficits reappeared later in the month, and for the month as a whole the surplus will probably be less than half the size of the $500 million March surplus. The change in the over-all balance from March to April was partly accounted for by seasonal factors. Further gold sales in April brought the total reduction in U.S. gold holdings since the beginning of the year to almost $1 billion.

As compared with the fourth quarter of 1964, the deficit in the first quarter was reduced by one-half. From the fragmentary data now available on payments transactions, it would appear that the bulk of the reduction resulted from lower net outflows of U.S. private capital.

Outflows of long-term bank credit to foreigners, as expected, were fairly small in March. Preliminary totals for the month show an outflow of only $40 million, as compared with outflows of about $230 million in both January and February. For the quarter as a whole, however, the seasonally adjusted outflow amounted to more than $500 million, up $200 million from the fourth quarter.

Outflows of U.S. short-term capital reported by banks totaled $100 million in March, a little smaller than in February. However, the large inflow that occurred in January reduced the net movement for the quarter almost to zero, or to a small net outflow on a seasonally adjusted basis. In the fourth quarter of last year, these outflows had totaled nearly $450 million, seasonally adjusted. In addition to the reduction in outflows of bank-reported claims on foreigners, reports and some indirect evidence suggest a net inflow of funds from abroad by U.S. nonfinancial concerns.

U.S. purchases of new foreign security issues in the first quarter totaled about $300 million after seasonal adjustment. These purchases had been almost twice as large in the last three months of 1964. Also, sales of foreign stocks by U.S. holders to foreigners increased.

The changes in these capital flows account fairly well for the improvement in the over-all balance between the fourth and the first quarters. It would appear that the flow of net receipts from trade was well maintained in the first quarter as a whole, despite the disruptions to the physical movements of exports and imports caused by the dock strike. In the balance of payments accounts, a sharp reduction in the recorded trade surplus will be shown, but there will probably also be large receipts on unrecorded transactions.

The latest trade figures continue to mirror efforts to move strike-delayed shipments. Imports began to catch up in February. In March, the first full month following the end of the strike, they jumped further by 17 per cent, seasonally adjusted. No data have yet been released on exports in March, but it is thought that they will show a rise of well over 50 per cent from the still depressed February rate.

From these irregular data, it is still not possible to judge how well the export surplus is holding up, apart from strike effects. One factor tending to raise imports, and which was already apparent in the fourth quarter, is increased purchases of foreign steel in anticipation of a steel strike. Industry reports claim that steel imports are currently averaging 1 million tons a month, which would be about double the monthly import rate for 1964. Such a rise would be smaller proportionately than that which occurred around the time of the 1959 strike, but larger than the increase occurring in similar circumstances in 1962 and 1963. A rise of this magnitude in steel imports would add approximately $65 million per month -- or 4 per cent -- to the value of total imports. In the past, much of the steel ordered from abroad in anticipation of a steel strike has not arrived until after the strike has begun or after a settlement has been reached.

New orders for exports of durable goods, other than motor vehicles, recovered in February from a sharp dip in January, according to revised data. The February rise represented mainly an increase in aircraft orders. For other durables, export orders appear to have fallen off, with the December-February average 7 per cent below the average for the preceding three months and down 4 per cent from the corresponding period a year earlier.

Economic activity in Western Europe. Expansion of over-all activity in Europe has continued to be somewhat faster than during the mid-1964 pause, but below the rapid rate of early 1964.

During the past year or so, three countries -- Italy, France and Belgium -- have experienced a slowing of growth in response to government stabilization measures. Italy, in fact, went through a recession of significant dimensions, from which recovery started last fall. The EEC Commission at the end of March suggested that the internal situation in these countries was such that further restraint was no longer necessary, and that a cautious reversal of restrictive policies, despite continuing upward cost trends, is indicated.

In contrast, the authorities of Germany, the Netherlands, the Scandinavian countries, Switzerland and the United Kingdom consider that the growth of demand in their countries is outrunning, or threatens to outrun, the growth of domestic resources, and are continuing their anti-inflationary efforts.

In France a downturn in economic activity -- the first since 1958 -- became distinctly evident after September 1964. However, the decline was not prolonged. Apart from effects of work stoppages in the public sector in December and January, industrial output was about stable from December through February. The latest Government survey of industry found that producers expect their output during the next three or four months to rise rather than decline.

Since mid-1964 unemployment has been rising and working hours have been steadily reduced. In March unemployment was 22 per cent above the preceding year's low level. While these developments have affected consumer demand adversely, the general freeze on factory prices imposed in September, 1963 (helping to slow retail price increases considerably) has apparently allowed real wages to rise faster than in 1963. Consumer prices remained stable during the last three months of 1964, and the 0.6 per cent increase registered in January was due primarily to seasonal increases in food prices and an increase in rents. In February, consumer prices rose only fractionally.

This relative stability of prices, combined with advances in money wages -- which, though slower than before, are still continuing -- allegedly has produced a profit squeeze which is impairing business incentive and capacity to invest. The INSEE quarterly survey of the French economy, based on February data, foresees a fall of 5 or 6 per cent in investment in the manufacturing sector in 1965 as compared with 1964. The year-to-year increase in investment in mining, construction, agriculture, various "tertiary" activities, and petroleum is to slow down -- from 11 or 12 per cent in 1964 to only 5 or 6 per cent in 1965. But the survey concluded that there may be a possibility of a general upturn in the fall.

Under these conditions, the authorities have been under pressure to relax their fiscal and monetary restraints. So far, they have been willing to do so only in a limited way. Since last summer, money market conditions have been smoothed, and on the average eased somewhat, through intermittent temporary reductions in the banks' liquid assets reserve requirement. On April 8 the Bank of France reduced its discount rate by half a per cent; the effect of this action is mainly psychological since no reduction was made in the ceilings on bank credit expansion. On the fiscal side, the authorities recently acted to stimulate private investment by a sharp reduction in the tax rate on dividends.

These moves toward a policy of less restraint have been facilitated by the continuing improvement in France's foreign trade position and a further substantial rise in her official reserves. (See Appendix B on France's External Position, 1959-65.) Exports in February (after a temporary fall in January) were close to the year-end high, while imports in January-February were about 4 per cent below the last quarter of 1964.

Official reserves increased by a considerable amount -- $232 million -- during the first quarter of 1965. To some extent the gain reflected private withdrawals of funds from Britain. During the latter half of April reserves remained virtually unchanged.

In Italy, recovery from recession is continuing, though the outlook for the building industry remains bleak. The wage-price spiral continues to be a cause of concern.

Industrial production in January was up 4 per cent from the third quarter. Details available through December show that output of investment goods rose from its third-quarter level, after declining steadily earlier in 1964. The decline in consumer goods output continued, but at a much slower pace. The movements of imports also suggested an upturn in aggregate demand. While monthly changes have been erratic, from October through January imports averaged 4 per cent above the third quarter.

These developments have led the Banca Nazionale del Lavoro declare "... that a feeling of confidence is being gradually restored." Helping to improve business confidence was the public spending program announced in mid-March which, among other things, shifted a part of contribution toward social security from employers to the government.

Two trouble spots remaining are the weakness in the building sector and the continuing upward trend of wages and prices. Wholesale prices rose only 1.3 per cent in the twelve months to January, but consumer prices -- which are particularly important because wages in major Italian industries are linked to the consumer price index -- were continuing to rise in January at an annual rate of about 5.5 per cent. Wage rates in manufacturing, reflecting both the sliding scale and contractual agreements, averaged about 13 per cent higher in 1964 than in 1963, and expectations are for further increases in 1965.

Italy's balance of payments, which swung back into surplus with last year's decline in imports and rise in capital inflow, has not been visibly affected as yet by the continuing cost pressures nor by the easing of credit since last summer. In the first quarter of 1965 -- seasonally the poorest quarter of the year for the balance of payments -- the payments surplus was about $75 million, and a substantial surplus is indicated for April.

In Germany, economic activity has continued to expand. Productivity gains have allowed further increases in output despite acute labor shortages.

Industrial production in January-February was 4 per cent above its average in the last quarter of 1964. New orders remained at their very high November-December 1964 level, and order backlogs reportedly lengthened.

Further growth of German imports is helping to moderate the impact of rising demand upon the domestic economy. First-quarter imports were up by about one-fourth from a year earlier. However, renewed growth of exports since last August is resulting in a new rise in the German trade balance. The first quarter trade surplus, at $295 million, was well above the $113 million registered in the last quarter of 1964, though less than half as large as in the first quarter of 1964.

With demand continuing to expand in all major sectors, upward pressure on prices is also continuing. In the investments goods sector, price advances have accelerated since last summer. The Bundesbank has continued to pursue a policy of restraint, and in April it reduced the rediscount quotas of the banks by 20-25 per cent, to take effect next autumn. The impact of this particular move may be mainly psychological, since total rediscountable assets under the new quotas are estimated to amount to about DM 12-15 billion whereas outstanding rediscounts are now only DM 3.6 billion.

Great Britain. The continuing concern in the United Kingdom is how to balance external requirements -- among which restoration of confidence in the pound is the most pressing -- and domestic growth.

Current trends in output are obscure. The index of industrial production, which had remained stable during the first nine months of 1964, rose by 4 per cent between September and December 1964 and moved up slightly further in January, but slipped back to the December level in February. The labor situation remains very tight. Unemployment in April was down to 1.5 per cent of the labor force, the lowest April level in four years, and the number of unfilled job vacancies (after seasonal adjustment) rose to the highest level since September 1955.

Pressures of demand are reflected in the continuing rise in wages and prices; from December to March retail and whole prices and wage rate all rose at annual rates of about 4 per cent. Future success of the Government's incomes policy is imperilled by recent wage increases in the public sector, such as the very large award (amounting to 20 per cent over a two-year period) granted to postal workers a few days after the guidelines of 3 to 3-1/2 per cent were published; and also by the repudiation of the incomes policy by the Transport and General Workers' Union on April 30. Previously, a quickening in the pace of price increases in advance of the start of activity of the new Prices and Incomes Court had been reported.

In foreign trade, some improvement occurred in the first quarter. Despite a disappointing January, exports during the quarter were 1-1/2 per cent higher and imports 4 per cent lower than in the preceding three months. The trade deficit was reduced from its monthly average of £95 million during 1964 to £62 million in the first quarter of 1965. The reduction in the import surcharge effective at the end of April is expected to produce a bunching of import arrivals in May.

In view of renewed expansion of bank loans in March and April, the Bank of England on April 29 moved to reduce bank liquidity by calling special deposits by the clearing banks amounting to 1 per cent of their gross deposits. The requirement becomes effective in two stages, at mid-May and at mid-June. At mid-April, the clearing banks' liquidity ratio had been above the 28 per cent conventional minimum by 1.5 percentage points.

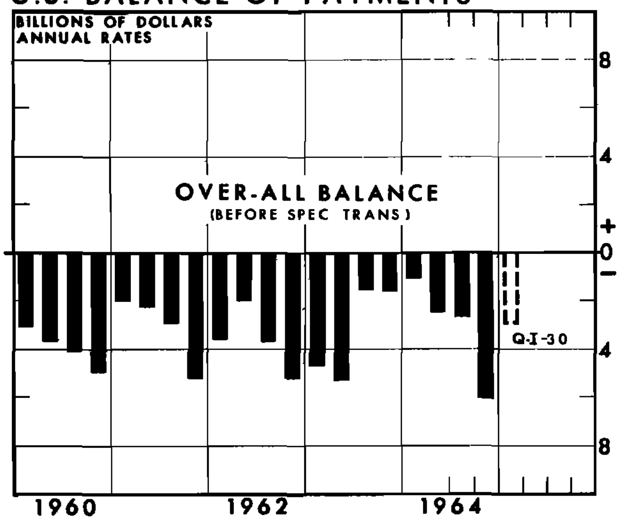
Economic activity in Japan. After a peak reached last October, industrial production declined about 2 per cent in the following months through March of this year (preliminary). High levels of inventories may have been inhibiting a rise in production. Producers' inventories of finished goods continued their general rise through January of this year, but fell very slightly in February. Inventories of imported raw materials have declined moderately in recent months, but materials inventories in total have been relatively stable at a high level.

The trade balance improved sharply further in March as exports, seasonally adjusted, rose 3 per cent and imports fell 5 per cent. Part of this decline in imports, however, may have been due to reduced shipments from the U.S. during the January-February dock strike. International reserves rose $3 million in March and in April fell $34 million, to a level of $2,019 million. Part of the decline in April can be attributed, according to Japanese sources, to developments affecting capital flows, including the maturing of a large volume of import bills, the drying up of working capital loans from abroad, and a relatively low volume of Japanese bond issues abroad during the month.

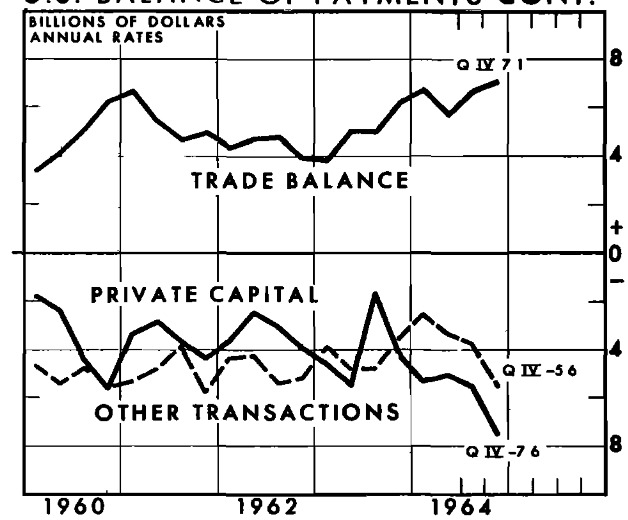
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

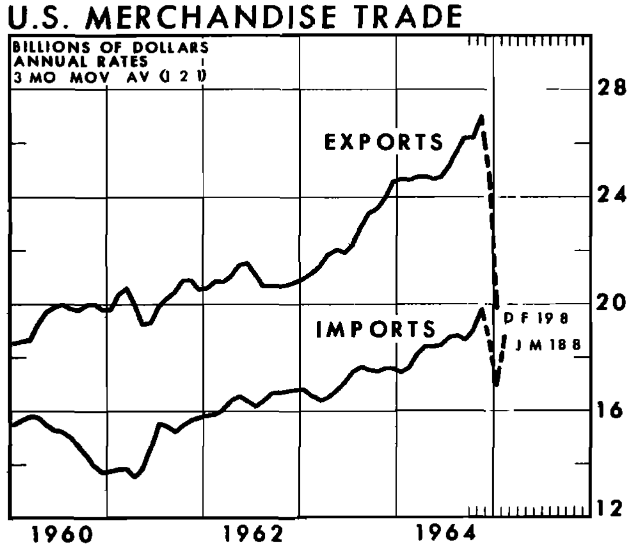
U.S. BALANCE OF PAYMENTS



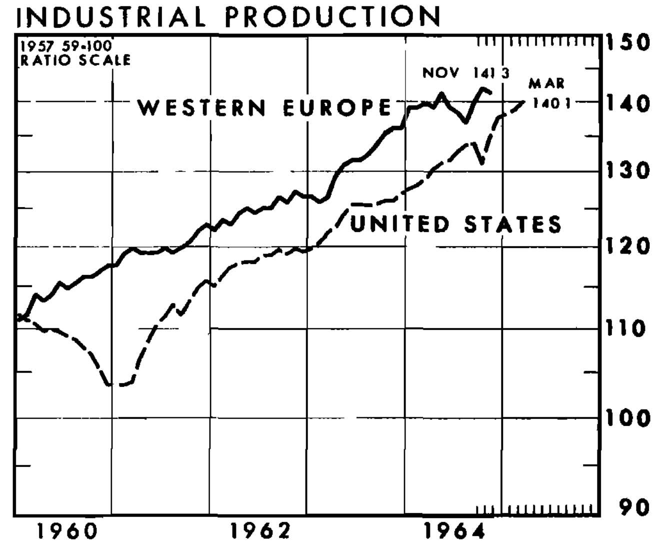
U.S. BALANCE OF PAYMENTS-CONT.



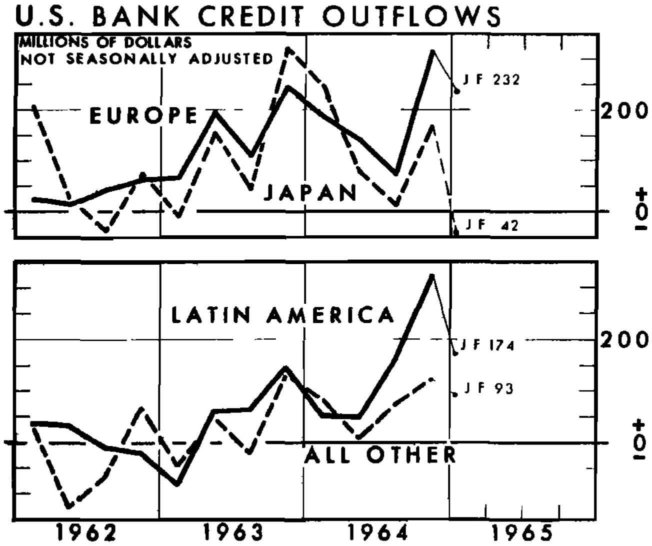
U.S. MERCHANDISE TRADE



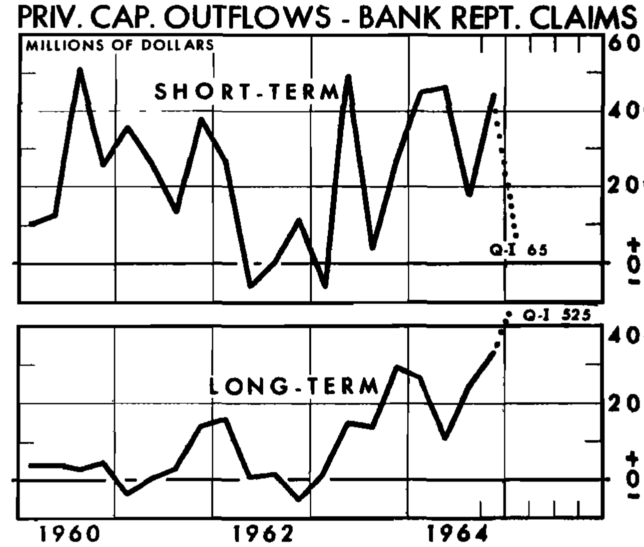
INDUSTRIAL PRODUCTION



U.S. BANK CREDIT OUTFLOWS



PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



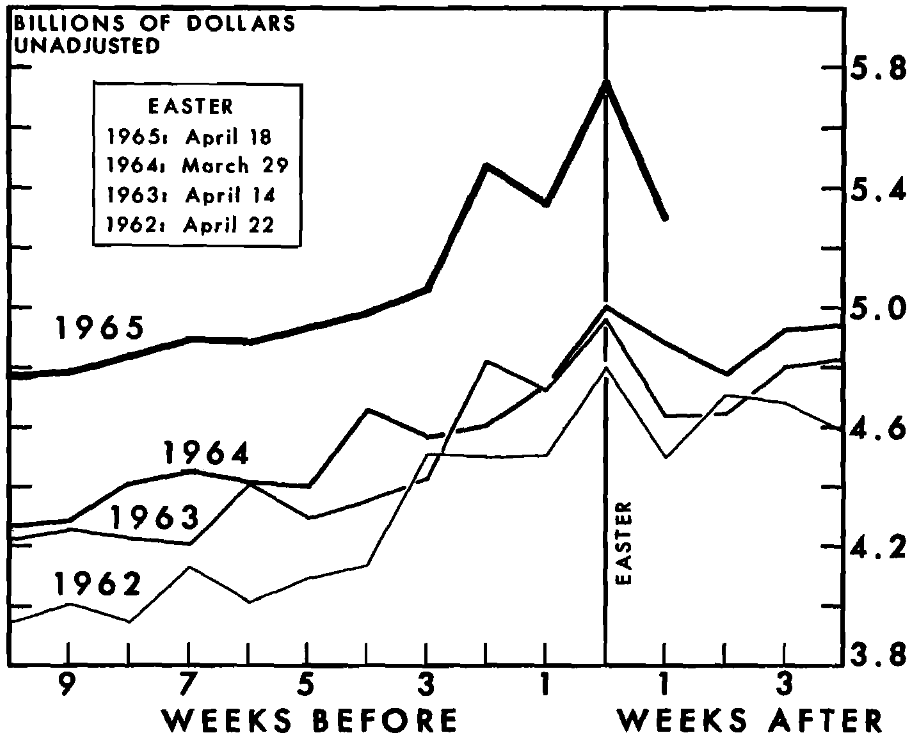
APPENDIX A: EASTER AND RETAIL SALES

Strength in retail sales so far this year is indicated by their substantial margin of gain from a year ago, which was evident early this year and continued through the pre-Easter period. In the eight or so weeks prior to Easter Sunday this year retail sales exhibited roughly the same pattern of general but uneven rise they have in each of the three preceding years. The recent course of total sales is shown weekly in the upper chart on the following page. The figures plotted are unadjusted for seasonal variations. They cover the ten weeks before and four weeks after Easter (one week after for 1965) with Easter of each year from 1962 as the reference point.

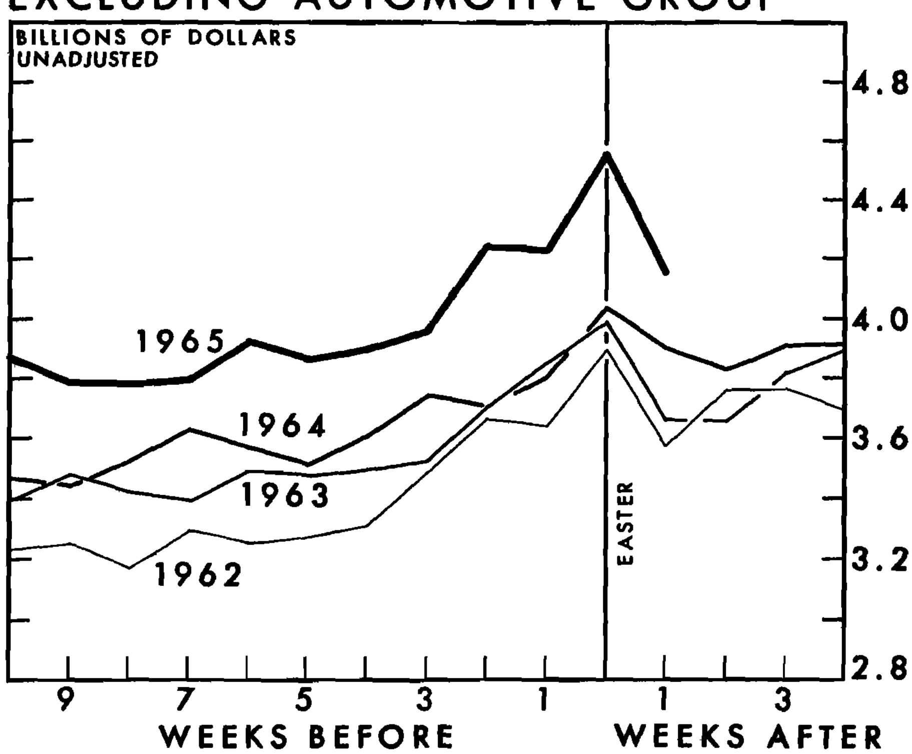
The effect of Easter on retail sales is even more clearly evident when sales of the automotive group are excluded from the total, as in the lower chart. Sales of automobiles are large in dollar amount and are not greatly influenced by Easter.

WEEKLY RETAIL SALES

TOTAL



EXCLUDING AUTOMOTIVE GROUP



APPENDIX B: FRANCE'S EXTERNAL POSITION, 1959-1965

Since 1963, French officials have been proposing fundamental changes in the international payments system under which surplus countries would automatically receive gold in settlement of all (or most) of their surpluses. This official French attitude is shaped in part by the continuing strength of the French balance of payments. Over the last six years, France has had the largest surpluses of any country in Europe. Although the French surplus has been reduced from its record high of $1.3 billion (before debt prepayments) in 1961, it was still nearly $800 million in 1964.

The French surplus is expected to be large again in 1965. Consequently, France will continue to be in a position to demand large amounts of gold. The French authorities stated early in January 1965 that they would in fact convert into gold all of their future dollar earnings, irrespective of any changes in world payments arrangements, and since last February they have been buying gold in amounts equal each month to the previous month's dollar accruals. (In addition, in January and March they also bought a total of $300 million of gold with dollars accumulated in prior years.)

Surpluses began in 1959. In 1958, France redressed her internal finances and, in the closing days of 1958, devalued the franc for the second time in two years. Thereafter, over the six years 1959-64, France had a cumulative balance of payments surplus of 4.5 billion dollars, even after making almost $1.4 billion of advance payments on debts owed to the United States, Canada, and the IBRD, as well as to various European creditors on debts contracted under the European Payments Union.

France has experienced external surpluses despite rapid internal growth over most of this period. GNP at constant prices rose at an average annual rate of about 5 per cent in 1959-64. Capital formation has equalled 20 per cent of gross national expenditure, Common Market internal tariff cuts have provided powerful incentives to efficiency, and the government has attempted to stimulate growth by national economic planning. Yet the continuing surpluses cannot be traced to a good record on internal price stability. The 12 per cent rise in French wholesale prices from 1959 to 1964 exceeded the increases which occurred in the United States and in other major European countries.

There are several reasons for the continuing strength of the French balance of payments. In the first place, the two devaluations of 1957 and 1958 (totaling almost 30 per cent) led in the next few years to exceptionally large surpluses on current account, which attained a peak of $953 million in 1961. From 1962 to 1964, inflationary pressures

BALANCE OF PAYMENTS OF THE FRENCH FRANC AREA, 1959-64 1/
(In millions of dollars)

	1959	1960	1961	1962	1963	1964 2/
I. CURRENT ACCOUNT	741	634	953	844	511	87
Exports 3/	3810	4502	5191	5864	6745	7,587
Imports f.o.b. 3/	-3375	-4410	-4774	-5364	-6568	-7,700
(Trade balance) 3/	(435)	(92)	(417)	(501)	(177)	(-113)
Private services	212	459	368	242	136	29
French govt. services	-284	-246	-268	-199	-198	-197
Foreign govt. services	347	338	367	245	269	266
Private donations	32	46	96	115	114	126
Government donations	-1	-55	-26	-60	13	-24
II. PRIVATE CAPITAL	567	239	283	287	444	448
Foreign capital	439	358	454	503	502	585
(Long-term)	(439)	(319)	(427)	(465)	(457)	(550)
(Short-term)	--	(39)	(27)	(38)	(45)	(35)
French capital	128	-119	-171	-215	-58	-137
(Long-term)	(128)	(-14)	(-57)	(-63)	(59)	(-2)
(Short-term)	--	(-105)	(-114)	(-152)	(-117)	(-135)
III. GOVERNMENT CAPITAL	-274	-354	-440	-722	-429	-82
Debt prepayments	--	-185	-320	-583	-281	--
Other	-274	-169	-120	-138	-148	-82
IV. ERRORS, OMISSIONS, AND ITEMS PENDING SETTLEMENT	-56	27	30	38	-4	63
V. NET BALANCE OF OVERSEAS FRANC AREA	59	-14	125	138	132	260

BALANCE OF PAYMENTS OF THE FRENCH FRANC AREA, 1959-64 - Continued

	1959	1960	1961	1962	1963	1964
VI. OVER-ALL BALANCE (I through V)	1,037	532	951	585	654	776
VII. OVER-ALL BALANCE BEFORE DEBT PREPAYMENTS	1,037	717	1,271	1,168	935	776
VIII. MONETARY MOVEMENTS (= VI) (no sign = increase in assets or decline in liabilities)	1,037	532	951	585	654	776
Official:	1,423	518	1,073	688	856	815
Gold 4/	540	351	480	466	588	554
Convertible foreign exchange	125	24	429	200	226	95
IMF quota and GAB	263	--	2	6	--	100
IMF franc holdings	16	186	231	10	12	69
Other	479	-44	-69	6	30	-3
Commercial banks	-386	14	-122	-103	-202	-39

1/ Items I through IV are for Metropolitan France. Item V is the net balance on all transactions between the overseas franc area and third countries.
2/ Preliminary.
3/ Payments basis.

4/ Includes foreign exchange held by government agencies in addition to exchange included in the official reserves (holdings of the Bank of France and the Exchange Stabilization Fund).

Source: French Ministry of Finance.

helped to reduce the current surplus very sharply, but because it was so large to begin with, the current account could deteriorate greatly without shifting into a deficit. For 1964, preliminary estimates show a current surplus of $87 million. Furthermore, the deterioration in the trade balance was halted during 1964.

Large capital inflows have been a continuing feature. Large and growing capital inflows have been a second major cause of the external strength of the franc. Foreign investment in Metropolitan France averaged about $400 million yearly in 1959-60, increased to $500 million per year in 1962-63, and is provisionally estimated at $585 million in 1964. Direct investment has been the largest single component of those totals, but security purchases and loans have also figured prominently. U.S. investment in France in the years 1960 to 1963 averaged about $125 million per year.

After confidence in the franc was restored by the financial measures taken in 1958, French residents repatriated capital on a large scale in 1959. Net outflows of French capital in subsequent years, averaging $140 million annually, have been much smaller than the foreign capital inflows.

The French balance of payments does not include the foreign aid extended by the French government to the former colonies that are part of the franc area, and this aid accounts for around 90 per cent of total French aid. Although net public grants and capital outpayments to other areas (excluding debt prepayments) averaged $146 million annually in 1962-64, about one-half comprised scheduled payments on France's foreign debts, and not all of the remainder was aid. Conversely, the overseas franc area has been gaining substantial amounts of foreign exchange, which it transfers to France in exchange for French francs; these accruals rose sharply to $260 million (preliminary) in 1964.

Finally, the balance on government payments for services (a part of the current account) has been favorable for France. In 1964, the French government spent $197 million abroad (outside the franc area) whereas foreign governments spent $266 million in France. Over the six years 1959-64, the excess of foreign government expenditures in France over French government expenditures abroad averaged $73 million per year.

Trade balance deterioration was arrested in 1964. The decline in the current account surplus from $953 million in 1961 to only $87 million in 1964 reflected both a decline in the surplus on private services and an even greater adverse swing in the trade balance from a $501 million surplus (payments basis) in 1961 to a $113 million deficit in 1964. But the trade balance deterioration was arrested in 1964. The French authorities took strong anti-inflationary measures in 1963 which led in the following year to a decided slowing of price increases;

in fact, wholesale prices rose hardly at all last year. Industrial production levelled off in the second quarter of 1964 and tended slightly downward from September to January of this year. Imports (seasonally adjusted) rose only very slightly during 1964, while exports continued to expand, and the trade balance improved. This improvement is reflected in the year-to-year comparisons of the (unadjusted) quarterly balance of payments trade figures; these comparisons were much more favorable for the last half of 1964 than for the first half.

BALANCE OF PAYMENTS TRADE FIGURES, 1963-64
(Metropolitan France with countries outside the franc area; in millions of dollars)

	Quarters				
	I	II	III	IV 1/	Year 2/
Imports f.o.b.					
1963	1,525	1,616	1,508	1,919	6,568
1964	1,950	1,8[illegible]8	1,752	2,110	7,700
Exports					
1963	1,555	1,628	1,606	1,956	6,745
1964	1,825	1,833	1,830	2,099	7,587
Trade Balance					
1963	+31	+12	+98	+37	+177
1964	-125	-55	+78	-11	-113

1/ Fourth quarter data are not published. The fourth quarter figures shown here are derived from those for the first three quarters and the yearly totals. They are not precise because the annual data reflect revisions which are not made to the quarterly data.
2/ Preliminary for 1964.
Source: French Ministry of Finance.

Outlook for 1965. In 1965, the French surplus may recede from the $776 million level of 1964, especially if economic activity resumes its upward trend and brings forth a rise in imports. The payments balance was also improved in 1964 and the first quarter of 1965 by the speculation against sterling, and a reverse movement of short-term funds may occur. Furthermore, French officials believe that the private services account will continue to change unfavorably. But with such a strong base to start out with, in all likelihood France will record another very large surplus. Official reserves have increased $211 million in the first three months of this year.

France's official gross reserves of gold and convertible currencies increased by $4,055 million from the end of 1958 to the end of 1964, an amount not much less than the cumulative balance of payments surpluses (after debt prepayments) which totalled $4,535 million. The official reserve gains were held down by $895 million of transactions with the IMF comprising repayments of drawings made by France prior to 1959, drawings of French francs by other countries, and the gold subscription for a quota increase; and also by substantial repayments made in 1959 on short-term official debts. But the effect of these transactions on the official reserves was in large part offset by a $771 million increase in the net foreign liabilities of the commercial banks in France. Official reserves, following the further increase in the first quarter of 1965, totalled $5,316 million on March 31.

FRENCH OFFICIAL RESERVES, 1958-65
(end of period; in millions of dollars)

	Gold	Convertible currencies	Total	Gold percentage
1958 - December	750	300	1,050	71.4
1959 - "	1,290	430	1,720	75.0
1960 - "	1,641	429	2,070	79.3
1961 - "	2,121	818	2,939	72.2
1962 - "	2,587	1,023	3,610	71.7
1963 - "	3,175	1,282	4,457	71.2
1964 - "	3,729	1,376	5,105	73.0
1965 - January	3,913	1,259	5,172	75.7
February	3,974	1,280	5,254	75.6
March	4,197	1,119	5,316	79.0

Source: International Monetary Fund.

The gold portion of the official reserves generally fluctuated between 70 and 75 per cent in 1959-64, a proportion that was lower than for several other major countries including the United Kingdom, Switzerland, the Netherlands and Belgium. However, French gold purchases in the first three months of 1965 raised the gold ratio to 79 per cent at the end of March. The gold ratio will rise gradually in the future if France continues the policy begun this year of regularly converting into gold all of the fresh accruals of dollars during the preceding month. At present, French dollar holdings amount to about $1.1 billion, and these could also be converted into gold. However, French officials have indicated that they will not be so used in any large degree because France still owes $660 million of official debts to the United States and Canada and desires to keep a dollar working balance of roughly $400 million.

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