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CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

**Prepared for the
Federal Open Market Committee**

By the Staff

**BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM**

November 17, 1965

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SUMMARY AND OUTLOOK

Outlook for demands and output

Prospects for a substantial rise in final demands in the current quarter and in early 1966 are firmer than they were three weeks ago. Another large drop in steel output in October was more than offset by gains in business equipment and defense industries and even in some consumer lines, and total industrial production rose half a point instead of showing a small decline as anticipated earlier. GNP, now estimated at \$677.5 billion annual rate in the third quarter, was up \$11-1/2 billion from the second quarter and a further increase of roughly similar size is expected in the current quarter.

Consumers are now benefiting from the rise in nonfarm employment--larger in October than in the preceding two months--and from higher current social security payments. Retail sales in October were up 1 per cent from third quarter levels, with auto sales continuing high.

In January consumers face a substantial boost in social security taxes, which will act temporarily to moderate the rise in disposable income and presumably also in consumption expenditures in the first quarter. However, some offsetting stimulus to consumption expenditures will accrue from the second round of excise tax cuts, also effective in January. Employers, too, will be affected by the social security tax increase, which will raise labor costs somewhat.

Continued rapid expansion in business fixed investment outlays seems assured for early 1966, on top of notable gains throughout this year and in 1964, and by the first quarter, with the steel inventory liquidation tapering off, the rate of total business inventory accumulation will probably be rising again from the reduced fourth quarter level. Moreover, continued increases are in prospect for national defense outlays.

Capacity utilization and prices

The industrial commodity price index edged up further in October and early November, and some upward creep seems likely to continue. But since mid-year, the rise in prices has been at an annual rate of 1 per cent, compared with a rate of 2 per cent in the preceding nine months.

For particular commodities, shortages have persisted. The price increases that have occurred in most nonferrous metals have been the result of inadequate world mine capacity and repeated strikes and other disruptions to output. For some, such as lead and zinc, market conditions apparently have eased since summer, but for copper, the supply situation has worsened.

In general, however, industrial capacity limitations have not been a source of widespread upward pressures on prices so far. Capacity utilization in manufacturing has been reduced slightly recently, reflecting mainly the drop in steel production, and a GNP growth of \$10-\$12 billion a quarter should not result in much change in the utilization rate over the next few months. But if strong plant and

equipment spending coincides with defense spending substantially larger than now indicated, added pressure on resources in already taxed areas could encourage more rapid increases in prices and costs than have been experienced recently.

Business credit demands

Business loan expansion in October and early November appears to have tapered further from the pace of summer and early fall, raising the possibility that the year-end loan bulge may be more moderate than earlier anticipated. Not only is cessation of inventory stockpiling in the steel-using industries reducing loan demand from metals firms, but bank loans to other industries are increasing less rapidly than earlier in the year.

This slowdown may reflect, in part, increased capital market financing. Bond issues have been large in recent weeks and the calendar remains fairly heavy. With favorable prospects for continued vigorous economic expansion, external financing needs of business are likely to remain large in the aggregate.

Deposit and bank credit expansion

Private demand deposits are likely to grow considerably less rapidly in November than in the previous two months, partly because of bank sales of Treasury issues. On the other hand, time and savings deposits are likely to continue to grow fairly rapidly. With CD's at Regulation Q ceilings in New York, however, further increases in market rates would reduce the flexibility of banks in gaining funds

from this source. Outstanding CD's did decline on balance in early November, but this seemed to be less a reflection of the restraining effect of the Q ceiling than of the reduced bank interest in tapping this source of funds in light of the apparently weaker loan demands at the time, and of the comfortable money position of one large New York City bank.

A temporary bulge in bank credit will result from bank acquisitions of the new Treasury tax bill, to be paid for by tax and loan account credit on the last Wednesday of the month. On a daily average basis, however, bank credit expansion is likely to be comparatively moderate in November, although still substantial for the fourth quarter as a whole.

Securities market prospects

Investor judgment that current rate levels may be sustainable seems to be developing in some key security markets. Nonetheless, both long- and short-term markets remain quite sensitive to changes in prospective supply and demand factors, including monetary policy.

The high yields recently available on new offerings of corporate securities have apparently attracted a good flow of investment funds, although the fairly heavy calendar of corporate issues seems likely to discourage any tendency for the market to rally. The U.S. Government bond market has rallied in recent days, but trading has remained thin and dominated by market professionals. Dealer bill inventories are not exceptionally large for this time of year, but dealers will soon have to take into position the \$2.5 billion of new June tax bills as they are sold by banks.

In the municipal bond market, however, the November calendar remains full at a time when it often shows some seasonal slackening, and bank demand remains well below summer levels. Also, interest rates on home mortgage loans have shown a slight tendency to rise since late summer--the first rise in six years. Large current supplies of high yielding corporate securities, the reduced general liquidity of commercial banks, and the unusually large backlog of loan commitments at major lending institutions are all operating to moderate the availability of funds in home mortgage markets.

Balance of payments

U.S. and Canadian financial authorities are seeking to postpone up to \$200 million of new issues of Canadian securities in the United States previously scheduled for November and December. These efforts enhance the prospects that the fourth quarter deficit on "regular transactions" can be held to about the \$400 million average of the first three quarters. Preliminary data on changes in reserves and liabilities during October are consistent with this outlook. The "official settlements" balance--on a definition that has been revised significantly--will show a reversion to deficit after surpluses in the second and third quarters. For the year, the deficit on the new official settlements basis is expected to be roughly \$1/2 billion, compared with \$1-1/4 billion in 1964.

The U.K. Treasury has liquified about \$1/2 billion of its U.S. security portfolio this year, adding that much to the "official settlements" deficit. On the other hand, the deficit has been reduced

by a number of important temporary influences, including the sterling crisis, the French debt prepayments, and flows of Italian commercial bank funds into the Euro-dollar market. Thus, there remains some distance to go before U.S. international transactions are brought into reasonable equilibrium.

(For further discussion of the changes in balance of payments presentations, see Section IV of this Green Book and the forthcoming Supplement.)

SELECTED DOMESTIC NONFINANCIAL DATA
(Seasonally adjusted)

	Latest Period	Amount			Per cent change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 Yrs. Ago*
Civilian labor force (mil.)	Oct. '65	75.8	75.5	74.3	2.0	3.5
Unemployment (mil.)	"	3.3	3.3	3.9	-15.2	-21.5
Unemployment (per cent)	"	4.3	4.4	5.2	-	-
Nonfarm employment payroll (mil.)	"	61.0	60.8	58.4	4.5	6.9
Manufacturing	"	18.2	18.2	17.2	6.1	6.7
Other industrial	"	7.9	7.9	7.7	2.6	4.6
Nonindustrial	"	34.9	34.7	33.5	4.2	7.6
Industrial production (57-59=100)	"	143.6	143.0	131.6	9.1	13.9
Final products	"	144.1	142.6	130.5	10.4	13.3
Materials	"	143.2	143.0	132.6	8.0	14.1
Wholesale prices (57-59=100) <u>1/</u>	"	103.1	103.0	100.8	2.3	2.6
Industrial commodities	"	102.4	102.3	101.1	1.3	1.8
Sensitive materials	"	103.0	103.0	100.4	2.6	6.2
Farm products and foods	"	103.7	103.5	98.2	5.6	4.6
Consumer prices (57-59=100) <u>1/</u>	Sept. '65	110.2	110.0	108.4	1.7	2.9
Commodities except food	"	104.9	104.7	104.3	0.6	1.2
Food	"	109.7	110.1	107.2	2.3	4.1
Services	"	118.5	117.9	115.5	2.6	4.4
Hourly earnings, mfg. (\$)	Oct. '65	2.65	2.64	2.54	4.3	6.9
Weekly earnings, mfg. (\$)	"	108.77	107.40	102.97	5.6	7.9
Personal income (\$ bil.) <u>2/</u>	Sept. '65	545.3	532.0	501.7	8.7	16.2
Retail sales, total (\$ bil.)	Oct. '65	24.0	23.8	21.4	12.0	15.7
Autos (million units) <u>2/</u>	"	8.4	8.9	5.8	44.2	11.6
GAF (\$ bil.)	"	5.5	5.4	5.1	8.6	21.9
Selected leading indicators:						
Housing starts, pvt. (thous.) <u>2/</u>	Sept. '65	1,424	1,422	1,445	- 1.5	-16.9
Factory workweek (hours)	Oct. '65	41.0	40.8	40.5	1.2	1.0
New orders, dur. goods (\$ bil.)	Sept. '65	21.9	21.5	19.9	10.0	20.0
New orders, nonel. mach. (\$ bil.)	"	3.3	3.3	2.9	12.4	26.0
Common stock prices (1941-43=10) <u>1/</u>	Oct. '65	91.39	89.38	84.85	7.7	25.1
Inventories book val. (\$ bil.)	Sept. '65	116.7	116.7	108.5	7.6	13.2
Gross national product (\$ bil.) <u>2/</u>	QIII '65	677.5	665.9	634.8	6.7	14.2
Real GNP (\$ bil. 1958 prices) <u>2/</u>	"	609.7	601.4	582.6	4.7	10.1

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

SELECTED DOMESTIC FINANCIAL SERIES

	Week ended	Four-Week	Last six months	
	Nov. 12	Average	High	Low
<u>Money Market</u> ^{1/} (N.S.A.)				
Federal funds rate (per cent)	3.97	4.02	4.25	1.00
U.S. Treas. bills, 3-mo, yield (per cent)	4.06	4.05	4.06	3.77
Net free reserves ^{2/} (mil. \$)	62	-73	62	-233
Member bank borrowings ^{2/} (mil. \$)	334	437	627	334
<u>Security Markets</u> (N.S.A.)				
Market yields ^{1/} (per cent)				
5-year U.S. treas. bonds	4.48	4.39	4.40	4.13
20-year U.S. treas. bonds	4.40	4.36	4.36	4.20
Corporate new bond issues, Aaa	4.73	4.63	4.73	4.49
Corporate seasoned bonds, Aaa	4.60	4.58	4.60	4.43
Municipal seasoned bonds, Aaa	3.32	3.32	3.32	3.09
FHA home mortgages, 30-year ^{3/}	5.49	5.49	5.49	5.44
Common stocks S&P composite index ^{4/}				
Prices, closing (1941-43=10)	92.13	91.91	92.55	81.60
Dividend yield (per cent)	2.98	2.92	3.11	2.91
	Change in October	Average change last 3 mos.	Annual rate of change (%) 3 mos. 1 year	
<u>Banking</u> (S.A., mil. \$)				
Total reserves	53	1	0.1	4.4
Bank loans and investments:				
Total	1,700	2,500	10.5	10.6
Business loans	500	600	11.0	19.5
Other loans	1,300	1,200	12.0	12.9
U.S. Government securities	500	200	4.2	-5.0
Other securities	400	500	14.2	15.8
Money and liquid assets:				
Demand dep. & currency	1,300	1,000	7.6	4.3
Time and savings dep.	2,000	2,000	17.4	16.3
Nonbank liquid assets	1,400	1,700	7.8	6.3

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted.

^{1/} Average of daily figures. ^{2/} Averages for statement week ending November 10.

^{3/} Latest figure indicated is for month of October. ^{4/} Data are for weekly closing prices.

U.S. BALANCE OF PAYMENTS

	1965					1964		
	Oct.	Sept.	Aug.	QIII	QII	QI	QIV	Year
Seasonally adjusted annual rates, in billions of dollars								
Balance on regular transactions				-2.5	0.5	-3.1	-6.2	-3.1
Current account balance					6.8	5.2	8.1	7.7
Trade balance <u>1/</u>		6.0	7.3	6.2	5.1	3.7	7.2	6.7
Exports <u>1/</u>		27.2	27.8	27.4	27.0	22.3	26.8	25.3
Imports <u>1/</u>		-21.2	-20.5	-21.2	-21.9	-18.6	-19.6	-18.6
Services, etc., net					1.7	1.5	0.9	1.0
Capital account balance					-5.7	-8.3	-12.5	-9.7
Govt. grants & capital <u>2/</u>					-3.8	-3.2	-4.1	-3.6
U.S. private direct inv.					-3.5	-4.6	-3.3	-2.4
U.S. priv. long-term portfolio					0.5	-2.8	-3.3	-2.0
U.S. priv. short-term					2.0	1.3	-2.3	-2.1
Foreign nonliquid					-0.9	1.1	0.4	0.4
Errors and omissions					-0.7	0	-1.7	-1.2
Monthly averages, in millions of dollars								
Balance on regular transactions (seas. adjusted, - = deficit)				-205	40	-260	-517	-259
Less: Net seas. adjustment				163	16	-174	1	
Balance before adjustment	-350	-464	-425	-368	24	-86	-518	-259
Financing (unadjusted)	350	464	425	368	-24	86	518	259
Advance on military <u>3/</u>				-17	42	23	50	19
Advance debt repayment				60	2	3	2	10
Liabilities increase								
To Nonofficial <u>4/</u>	(59	403	228	-52	66	217	130
To Official <u>5/</u>	268	275	308	84	-39	-286	300	86
Monetary reserves decrease	82	130	-286	13	23	281	-50	14
of which: Gold sales	-12	-9	53	41	197	277	57	10
<u>6/</u> Memo: Official financing <u>6/</u>		405	22	157	-14	-2	251	111

1/ Balance of payments basis which differs a little from Census basis.

2/ Net of associated liabilities and of scheduled loan repayments.

3/ Assumed zero in absence of information.

4/ Includes international institutions (except IMF), commercial banks and private nonbanks.

5/ Includes nonmarketable bonds.

6/ Decrease in monetary reserves, increase in liabilities to foreign official institutions, and advance repayments on Govt. loans.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross national product. GNP increased \$11.6 billion in the third quarter, to a seasonally adjusted annual rate of \$677.5 billion, according to Commerce estimates. Preliminary figures, available a month ago, had indicated a rise of \$11 billion.

The picture remains one of substantial expansion in all major final demand sectors except residential construction. Outlays for residential expenditures were a little lower in the third quarter than in the second. And investment in nonfarm business inventories increased somewhat less in the third quarter than in the second. The slight upward revision in total GNP for the third quarter resulted mainly from slightly larger gains for business fixed investment, net exports, and State and local government outlays. Consumption expenditures increased \$7.8 billion, the same as estimated earlier.

GNP in the fourth quarter is now projected at \$689 billion, up \$11.5 billion from the third quarter. The magnitude of the rise is somewhat greater than that shown here three weeks ago. With retail sales showing renewed strength in October, a slightly larger rise has been projected for consumption expenditures. And recent data on inventories suggest that the decline in the rate of inventory accumulation may be smaller than projected earlier. But residential construction is now shown as declining slightly further, rather than rising. In sum, gross private domestic investment shows the same change in the fourth quarter that was indicated three weeks ago.

A GNP of \$689 billion in the fourth quarter signifies a level for the entire year of \$672 billion, \$43.5 billion, or nearly 7 per cent, above 1964. In real terms the rise would be 5 per cent, which is close to the average annual rate of increase since 1961 when this expansion period began.

With output continuing to rise rapidly, total employment is expected to increase about 0.5 million in the fourth quarter or at an annual rate of 2.0 million. This would be about in line with the rise in the third quarter and over the past year. The civilian labor force is expected to increase somewhat faster than in the first half of this year but close to the rate it has been since July. With employment increasing somewhat faster than the civilian labor force, unemployment has declined and can be expected to continue downward. Moreover, the speed-up in draft calls and enlistments in order to bring the Armed Force strength up to 3.0 million by the second quarter of 1966 -- earlier than previously indicated -- should also tend to lower the unemployment rate somewhat, especially among youths. The overall unemployment rate is estimated to average 4.2 per cent in the current quarter, as compared with 4.4 per cent in the third quarter and 5 per cent a year earlier.

Current indications are for no significant reduction in the rate of productivity increase in this quarter, although inventory liquidation in steel dampened the rise in output per manhour in manufacturing in September and October.

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GROSS NATIONAL PRODUCT
(Billions of dollars, seasonally adjusted annual rates)

	1965				
	IIQ	IIIQ	IVQ ^{1/}	IIIQ from IIQ	IVQ from IIIQ
Gross National Product	665.9	677.5	689.0	11.6	11.5
Personal consumption	424.4	432.2	440.5	7.8	8.3
Durable goods	63.7	65.0	66.0	1.3	1.0
Nondurable goods	187.6	191.1	195.4	3.5	4.3
Services	173.1	176.1	179.1	3.0	3.0
Gross private domestic investment	101.1	102.0	101.6	.9	-.4
Business fixed investment	66.4	68.3	70.1	1.9	1.8
Residential construction	28.0	27.6	27.3	-.4	-.3
Change in business inventories	6.7	6.1	4.2	-.6	-1.9
Net exports	7.5	8.1	8.3	.6	.2
Govt. purchases of goods and services	132.9	135.2	138.6	2.3	3.4
Federal	65.9	67.1	69.3	1.2	2.2
National defense	49.4	50.8	52.3	1.4	1.5
Other	16.5	16.3	17.0	-.2	.7
State and local	67.0	68.1	69.3	1.1	1.2
Gross National Product in Constant (1958) dollars	601.4	609.7	616.8	8.3	7.1
Civilian labor force (millions)	75.5	75.8	76.1	.3	.3
Employment	71.9	72.4	72.9	.5	.5
Unemployment	3.6	3.4	3.2	-.2	-.2
Unemployment rate (per cent)	4.7	4.4	4.2	--	--

^{1/} Staff projection, November 16, 1965.

Industrial production. Industrial production in October rose to 143.6 per cent from 143.0 per cent in September but was still below the record July-August average of 144.3. In October, a further decline in steel output was more than offset by increases in final products and nondurable materials. Compared with a year ago, the index was up 9 per cent but, it must be recalled that in October last year output declined 2 per cent because of strikes in the auto industry. For the first 10⁴ months of 1965, the index averaged 8 per cent above a year earlier.

Production of iron and steel declined 8 per cent further in October, as liquidation of inventories accelerated, and this brought steel output down 22 per cent from the summer level. This decline compares with reductions of 23 per cent in 1963 and 26 per cent in 1962, which also were affected by strike threats.

Output of coal and crude oil recovered in October from the effects of strikes and a hurricane, respectively, and production of most other nondurable materials rose.

Auto assemblies increased from the strike lowered September level to an annual rate of 9.3 million units, somewhat below the spring and summer levels. November production schedules are set at about the same rate. Output of home goods and apparel showed some rise and consumer staples rose further. Production of industrial and commercial machinery continued to advance, and with settlement of a work stoppage in early October in the aircraft industry, output of freight and passenger equipment rose sharply.

Retail sales. The advance September figure for retail sales has been revised upward by nearly 2 per cent and now shows an increase from August and a slight edge on the former record high in July. In October, retail sales rose appreciably further. The September-October rise occurred despite a moderate decline reported at auto dealers, as sales of other durable goods and of nondurable goods showed sizable gains. The auto sales decline may be overstated because of difficulty in adjusting seasonally for the effects of model changeovers.

October retail sales were up one per cent from the third quarter and about 4 per cent from the first quarter. Total sales of durable goods have shown little change since the beginning of the year, as auto sales declined after the first quarter splurge while sales of other durable goods have increased about enough to offset the decline in autos. Sales of nondurable goods have increased steadily throughout the year.

Because of an overall price increase of nearly one per cent, the real volume of retail sales has shown less increase than the dollar volume this year. However, price changes have differed between the durable and nondurable goods sectors. Prices of consumer durable goods have declined about 2 per cent since the beginning of the year, and this means that the real volume of durable goods sales has increased somewhat while the dollar volume has been unchanged. For nondurable goods, on the other hand, prices have increased about 2 per cent and the rise of 6 per cent in dollar sales between the first quarter and October should be discounted accordingly as a measure of the change in real volume.

The table below shows changes in (current dollar) retail sales over the year, in terms of (rounded) indexes based on the fourth quarter 1964 as 100.

CHANGES IN RETAIL SALES DURING 1965
(Indexes, 1964 IVQ. = 100)

	1964	1965			
	IVQ	IQ	IIQ	IIIQ	October
Total	100	105	106	108	109
Durable goods	100	113	110	113	113
Autos	100	120	115	119	114
Other durables	100	103	104	106	112
Nondurable goods	100	101	103	106	108

Auto unit sales. Demands for new cars continued strong in the early weeks of the 1966 model year, although sales declined from the advanced summer level after allowance for seasonal changes. Deliveries of new domestic automobiles in October were at an annual rate of 8.4 million. In early November sales continued at about the October rate but deliveries may have been limited by supply and dealer capacity in both October and November. Dealer inventories at the end of October were equal to only 32 days' supply at the new-model sales rate, compared with the usual 40-50 days' supply.

Sales of imported cars in September were at an annual rate of 0.6 million, a little below the previous month but well above earlier months this year. Large trade-in volume associated with the high summer new car sales put pressure on used car markets and prices in September again declined a little more than seasonally.

Consumer credit. Consumer use of ~~instalment~~ credit has risen further this summer and fall, although the rate of growth has been uneven. Net borrowings were large in July, when they reached an \$8 billion annual rate, mainly because of a spurt in demands for auto credit and travel and education loans. Growth slowed in August but increased again in September to a little above the \$8 billion rate as auto dealers reduced their stocks of 1965 models. Incomplete data now available for October suggest that consumer borrowing may have slackened again.

Repayments on instalment debt have continued to rise, from a \$67 billion seasonally adjusted annual rate in July to \$68 billion in September.

Repayments have been increasing faster than disposable income since the first of the year, and consequently the ratio of repayments to income has risen further. The ratio was 13.9 per cent in the final quarter of 1964, and by the third quarter of this year it has reached 14.4 per cent. The ratio held steady at 13.9 per cent in 1964, as the rise in repayments was matched by a rise in disposable income following the tax cut.

Labor market. Demand for labor continued strong in October. Gains in nonfarm employment accelerated following some slackening during the July-September period and were almost up to the very high rates of increase attained early in the year. Evidence of strength in the labor market also was indicated by the unemployment rate which edged down to 4.3 per cent from 4.4 per cent in September and by a rise in the workweek in manufacturing industries.

Although the unemployment rate declined further in October, there seems to be little evidence of any widespread limitation on production arising from manpower shortages. Employers in those manufacturing industries in which considerable demands for additional manpower exist -- generally the machinery and related metals producing industries -- have mainly relied on overtime work, intensified in-plant training and the hiring of new workers at entry grades to meet their output requirements.

In contrast to earlier trends, when large gains in manufacturing primarily accounted for the upward momentum in employment, much of the October advance -- almost 80 per cent of the total gain -- was due to increases in trade, service, and State and local government employment. As a consequence, most of the requirements for additional workers was readily met from further expansion in the labor force, mainly adult women and youths.

In manufacturing, employment increased in October by 38,000 but only 15,000 of these were production workers. Continued cut-backs in steel production worker employment due to inventory liquidation almost offset further sizable gains in machinery, electrical equipment, and in defense related industries. Other manufacturing industries showed little change and in the nondurable goods lines only apparel advanced significantly in October.

The workweek increased to 41.0 from 40.8 in September and 40.9 in August. The rise was largely concentrated in the transportation industry reflecting heightened levels of automobile output. Somewhat longer workweeks were also reported in machinery, ordnance, apparel,

rubber, and leather. In the lumber, primary metals and petroleum industries, hours of work were reduced.

Since July, labor force growth has accelerated to an annual rate of 1.6 million and in October more than half the gain was represented by teenagers. In contrast, in the first half of this year the labor force increased at a rate of only 1.1 million per year, of whom about 200,000 were youths.

CHANGES IN THE LABOR FORCE
OCTOBER 1964 TO OCTOBER 1965
(Thousands of persons)

	Civilian labor force	Employment	Unemployment
All ages	<u>1,578</u>	<u>2,073</u>	- <u>495</u>
14 to 19 years	939	904	35
Men 20 years & over	- 30	343	- 371
Women 20 years & over	669	826	- 157

The importance of the young workers in the current labor market is shown by the fact that teenagers accounted for almost all of the 300,000 increase in total employment in October. Of the over 2 million increase in employment since October 1964 almost half were younger workers. However, with a sharp rise in their labor force, the number of youth unemployed remained relatively unchanged over the year.

Among women, employment gains have continued large and have exceeded additions to the labor force and thus unemployment declined moderately. Although adult men accounted for the smallest increase

in employment over the past year, the greatest declines in unemployment have been among men, reflecting in large part existing high participation rates and a labor force which is not expanding. In October, the unemployment rate for adult men was down to 2.9 per cent, the lowest rate in 12 years and for married men the rate was 2.1 per cent.

Two special factors will have some specific effect on reducing unemployment further: a speeding-up of the Armed Force expansion to bring the total to 3 million by the second quarter of 1966 -- earlier it had been indicated the goal would not be reached until late in the year -- and programs initiated under the Economic Opportunity Act. Draft calls have been stepped-up from around 17,000 a month last summer to over 40,000 in December and are expected to continue at or above that rate into next year. These increased calls and increased voluntary enlistments are expected to lower unemployment about 150,000 by the second quarter of 1966.

Expansions in the Job Corps, the Neighborhood Youth Corps, and other Economic Opportunity programs are expected to draw down unemployment by an additional 100,000 in the next 6-8 months. As a consequence of these various factors, which mainly will reduce unemployment among youths, the overall unemployment rate is expected to drop 0.3 to 0.4 percentage points by the second quarter of 1966, from the 4.3 per cent level in October.

Earnings and labor costs in manufacturing. Average hourly earnings in manufacturing have continued to advance moderately, rising

in October by 1 cent to \$2.64. In the first ten months of this year, hourly earnings have increased 3.2 per cent, about in line with wage increases in other recent years and close to the gains in overall productivity.

Meanwhile, productivity in manufacturing which had been growing at close to a 4 per cent rate through midyear, showed little change in September and October, primarily because output in the steel industry has declined faster than manhours of work in that industry. When activity is curtailed, it is usual for output to go down faster than employment and hours of work. A temporary decline in productivity occurred last year during the auto strike. A clear reading of current productivity trends will have to await completion of steel liquidation.

With productivity showing little change, unit labor costs are expected to remain above earlier levels in October, but should go down when steel output begins to rise. However, increases in employer contributions to social security funds at the start of 1966 will cause labor costs to go up about 0.5 per cent in almost all private industries and about an equivalent amount later in the year as the rise in the taxable wage base becomes effective.

Prices. The industrial commodity price index, unchanged from mid-August to mid-September, rose 0.1 per cent to mid-October. Weekly estimates indicate a further 0.1 per cent rise to 102.5 per cent of the 1957-59 average in mid-November. Thus, the index has increased 0.4 per cent in the five months since mid-June after rising 1.4 per cent over the preceding nine months. Average prices of foodstuffs have

continued to fluctuate around the advanced level reached in June, and the total wholesale price index has risen an estimated 0.3 per cent since mid-June.

The comprehensive data for October reveal selective advances among paper products and chemicals, and a continuation of the rise in machinery. Further declines occurred in synthetic textiles and gypsum products.

Aluminum producers announced price increases on primary ingot of 1/2 cent to 25 cents a pound -- a level about 3 cents below the peak reached early in 1960. The announcement was followed by a breakdown of negotiations over long-term disposal of the 1.4 million tons of surplus aluminum in the stockpile. The surplus is equal to about six months' domestic production with about one-half needing only Presidential authorization for release. The industry desired a flexible disposal program designed to accommodate variations in market demand, and requested that only 100,000 tons be released in 1966. The Government desired systematic disposal of one-half of the metal by rigid contracts over a five-year period, and cited sharply increased imports and rising military demand as reasons for a more rapid disposal rate. The price increases were rescinded after the Government announced that in addition to its desired release of 200,000 tons in 1966 an additional 100,000 tons would be sold immediately. Subsequently, negotiations resumed and a compromise disposal plan was agreed upon. The industry is to buy a minimum of 100,000 tons and a maximum of 200,000 tons a year, but with a minimum of 150,000 tons in 1966.

One tinplate producer (Wheeling), with 5 per cent of the market, has not followed the steel industry's announced price increase of 2-1/2 per cent effective in December. Thus, with large excess inventories of tinplate still to be worked off by users, some doubt exists over whether the price increase will become effective. The same producer along with one other also broke with tradition by adopting a policy of pricing at time of order rather than time of shipment except in instances of price decline.

Domestic copper producers -- as expected -- advanced prices 2 cents to the world price of 38 cents a pound. Reflecting fears that Rhodesia might cut supplies from Zambia and Katanga, and also fears of further strikes in Chile, the London price has risen to 68 cents a pound and domestic scrap has risen to a postwar high.

WHOLESALE PRICE INDEXES
1957-59 = 100

	Per cent increase			Index October 1965
	Feb. 1961 to Sept. 1964	Sept. 1964 to June 1965	June 1965 to Oct. 1965	
Total index	-0.3	2.1	0.3	103.1
Industrial commodities	-0.3	1.4	0.3	102.4
Industrial materials	-0.4	1.7	0.3	101.7
Industrial products	-0.2	1.0	0.3	103.1
Foodstuffs	-0.6	4.3	0.3	105.0
Industrial commodities				
Less metals and machinery	-1.4	1.1	0.4	100.5
Metals and machinery	1.3	1.7	0.2	105.1
Nonferrous metals	8.3	8.6	1.0	117.4

Business inventories. Book value of business inventories showed little change in September after increasing sharply in July and August, and for the third quarter the rate of accumulation was down moderately from the second quarter.

Stability in total business inventories in September resulted from roughly offsetting changes at manufacturers and distributors. Manufacturers' inventories increased \$450 million while distributors' inventories declined about \$400 million.

The rise in factory stocks, which was about the same as in August, was entirely in durable goods industries and, as in August, much of the rise was centered in the machinery industries. Stocks also rose at iron and steel producers as their shipments were cut back more sharply than output at the beginning of the steel inventory adjustment now under way. Steel stocks held by metal users declined only slightly in September, but large decreases are expected in the fourth quarter.

Inventories declined at both wholesalers and retailers in September. The decline was centered at retailers and was largely in auto stocks, which had risen sharply in August in anticipation of model changeover. In addition, inventories at food stores declined -- probably temporarily -- in September after a number of months of little change. The book value of other retail stocks was at about the same level as in other recent months.

Between the first and third quarters, the rate of accumulation of total business inventories declined steadily, and this decline, which was substantial at the total level, reflected a very sharp reduction

in the rate of accumulation of distributors' inventories. Accumulation by manufacturers, in contrast, rose sharply in the third quarter, to a rate that was nearly double the amount of accumulation anticipated by manufacturers according to the Commerce August survey. There were temporary features about this spurt in factory stocks -- it was heavily concentrated in a buildup in work-in-process stocks in the durable sector -- and, in line with manufacturers' earlier anticipations, a large decline in the rate of accumulation is in prospect for the fourth quarter.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES
(In billions of dollars, seasonally adjusted)

	1965		
	1st quarter	2nd quarter	3rd quarter
Total	2.50	2.02	1.69
Manufacturers	.76	.92	1.61
Durable goods	.56	.98	1.34
Materials	.38	.47	.28
Work-in-process	.11	.49	.84
Finished goods	.07	.02	.22
Nondurable goods	.20	-.06	.27
Distributors	1.73	1.10	.08
Wholesale	.60	.35	.05
Retail	1.13	.75	.03
Auto dealers	.68	.56	.13
Other retailers	.45	.19	-.10

Business fixed capital investment. Business outlays for new plant and equipment in 1966 are indicated to be 8 per cent larger than this year, according to the McGraw-Hill October survey of spending plans.

Outlays now indicated for 1967 are almost as large as those now planned for 1966. The increase reported for 1966 is considerably larger than had been indicated by the fall surveys in any of the past four years, when actual increases turned out to be considerably larger than indicated by plans reported in the preceding October. Because of this tendency to understate actual increases realized, this survey is being interpreted by McGraw-Hill as suggesting that business fixed "capital spending next year again will be an active force in maintaining a high level of business activity throughout the economy next year," which we, in turn, interpret to mean a rise roughly similar to that being realized this year.

INCREASE IN BUSINESS SPENDING FOR
NEW PLANT AND EQUIPMENT
(Per cent)

	<u>Increase from previous year</u>	
	Indicated by McGraw-Hill fall survey	Actual
1966	7.8	--
1965	4.9	13.4*
1964	4.2	14.5
1963	2.7	5.1
1962	4.0	8.6

* Indicated by Commerce -- S.E.C. August survey.

All major manufacturing industries, except iron and steel (which is down 2 per cent), and all major nonmanufacturing industry groups now plan increases in fixed capital outlays next year. The planned increase for manufacturing is 8.5 per cent as compared with an actual increase this year of 18 per cent; in October 1964, the survey had indicated a rise of 8 per cent.

Increases now planned by most industries are smaller than actually being achieved this year. Major exceptions are: aerospace, shipbuilding and railroad equipment, fabricated metals and instruments, and electric and gas utility industries, which plan 1966 increases larger than realized this year; and food and beverages and rubber producers and airlines, which plan increases of about the same size as this year.

BUSINESS SPENDING FOR NEW PLANT
AND EQUIPMENT

	Estimated 1965 1/		Planned 1966 2/	
	Amount (billions of dollars)	Increase (per cent)	Amount (billions of dollars)	Increase (per cent)
ALL BUSINESS	50.9	13.4	54.9	7.8
Manufacturing	21.9	17.8	23.7	8.5
Durable goods	11.0	16.2	11.9	8.4
Nondurable goods	10.9	19.2	11.9	8.6
Mining	1.3	10.1	1.4	3.8
Railroads	1.6	14.9	1.8	9.9
Airlines	1.1	24.2	1.4	22.1
Other transportation and communications	6.5	12.8	7.1	8.9
Electric and gas utilities	6.7	7.6	7.3	8.7
Commercial	11.8	8.8	12.3	4.0

1/ Commerce -- S.E.C. August survey.

2/ McGraw-Hill October survey.

Construction and real estate. New construction put in place, which has been tending up this year, declined in October slightly below the (revised) record September level. Expenditures for private residential construction were down a little again in October, for the

fourth consecutive month, following some recovery earlier this year. Outlays for business and other private nonresidential construction, after a sustained rise during earlier months to a new high in September, were lower in October. Public construction activity, which has fluctuated this year around an advanced level, was below the new high attained in September.

NEW CONSTRUCTION PUT IN PLACE

	October <u>1/</u> (billions)	<u>Per cent change from:</u>	
		Month ago	Year ago
Total	\$68.2	-1	5
Private	47.6	-1	5
Residential	26.1	-1	2
Nonresidential	21.5	-1	10
Business	15.9	-2	12
Public	20.6	-3	5

1/ Seasonally adjusted annual rates; preliminary.

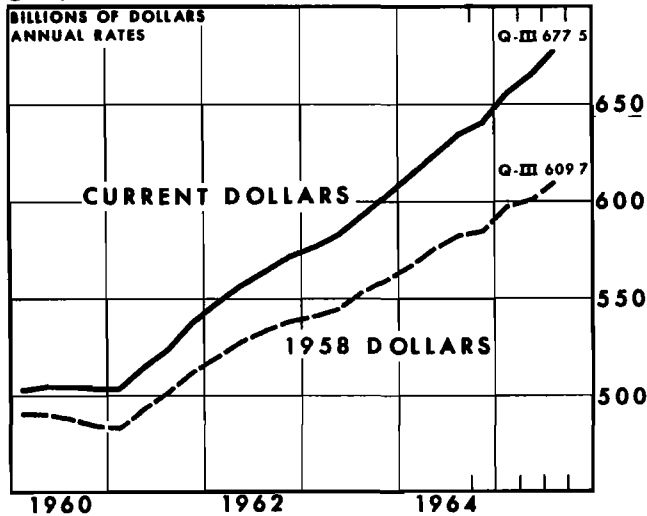
Housing vacancy rates during the third quarter remained within ranges prevailing over the past five years, although completions of new dwellings resulting from starts in earlier quarters have remained high. Compared with the preceding quarter and a year earlier, the average rental vacancy rate of 7.2 per cent was somewhat lower. The 1.5 per cent homeowner vacancy rate was only slightly higher. Rental vacancy rates were reported as below year-earlier levels in all four major geographic regions, but remained unusually high (10.8 per cent) in the West. These national vacancy developments suggest that the large volume

of new dwelling completions has continued to be about offset by growth in final demand and the disappearance from the market of older dwellings, in part to provide sites to accommodate the boom in business construction.

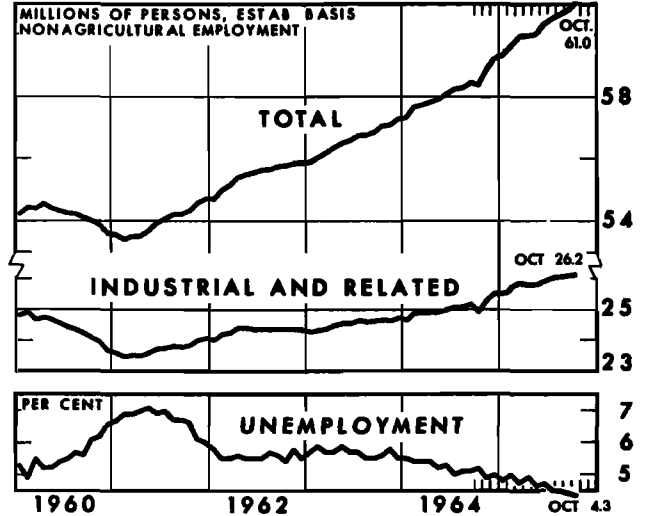
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

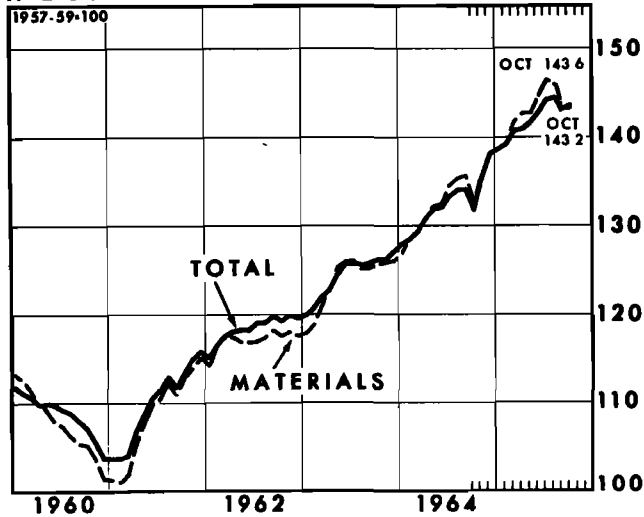
GROSS NATIONAL PRODUCT



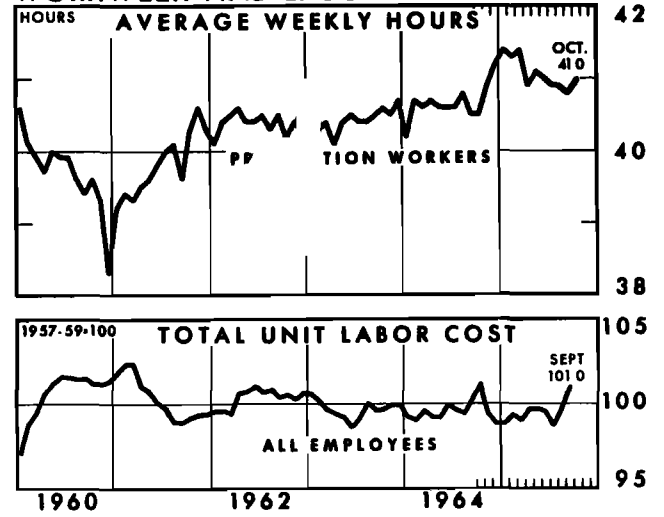
EMPLOYMENT AND UNEMPLOYMENT



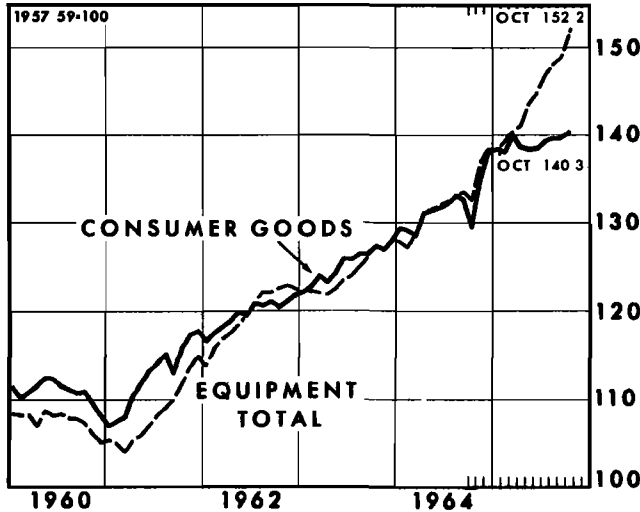
INDUSTRIAL PRODUCTION - I



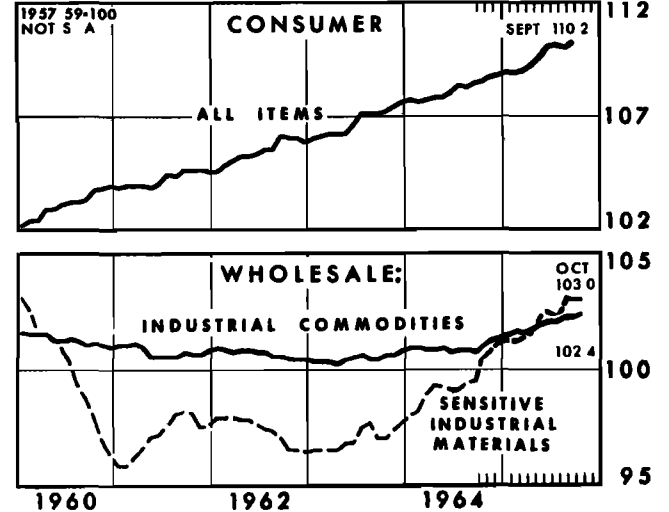
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION - II



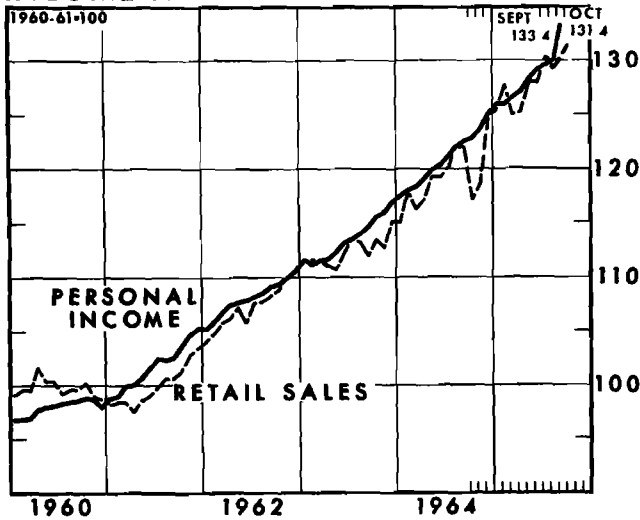
PRICES



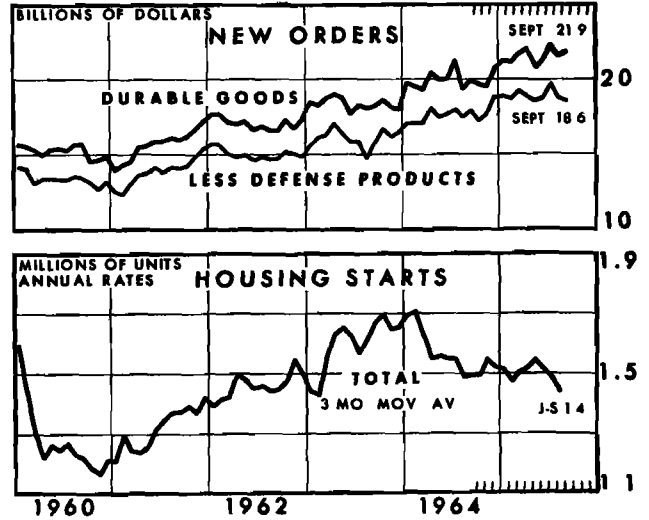
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

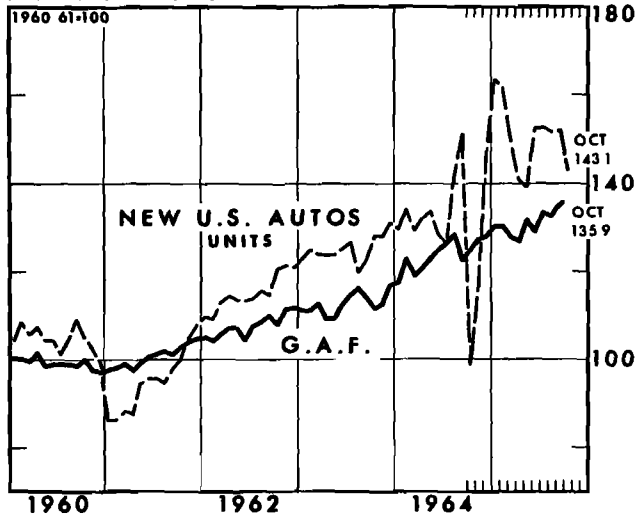
INCOME AND SALES



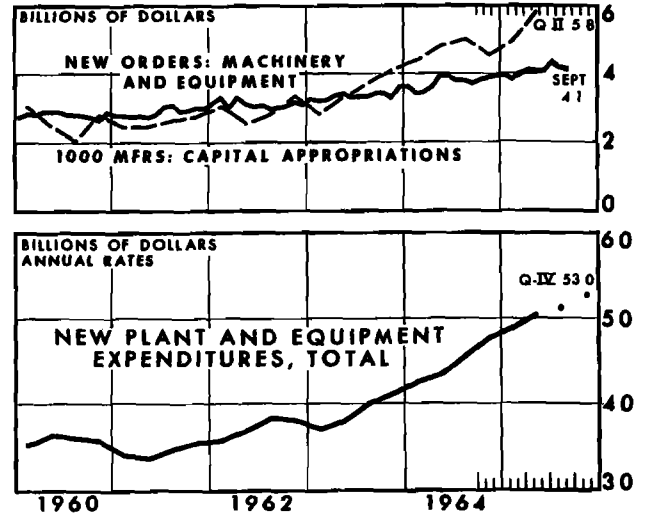
NEW ORDERS AND HOUSING



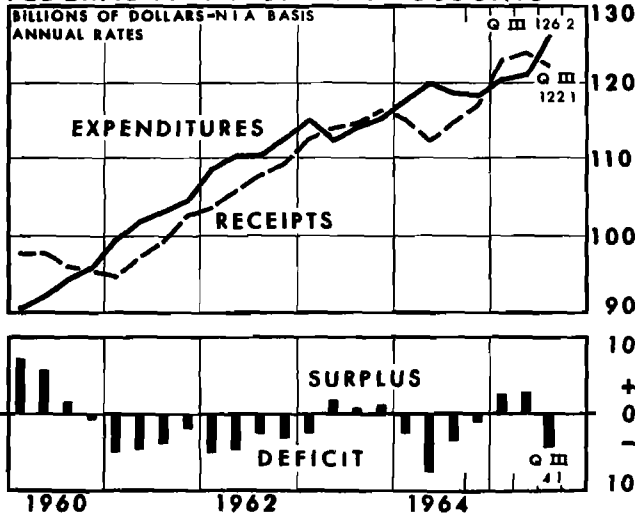
RETAIL SALES



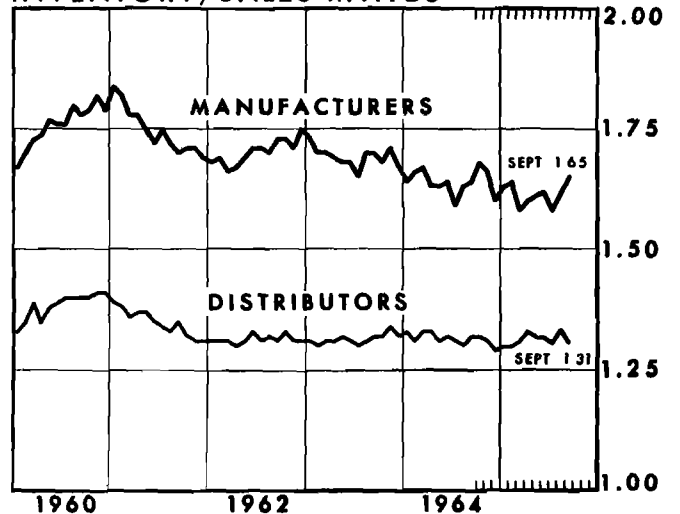
BUSINESS INVESTMENT



FEDERAL FINANCE-N.I. ACCOUNTS



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

Bank credit. Bank credit grew at an annual rate of over 11 per cent during October, about two percentage points more than the expansion in the first three quarters of the year. More than one-third of the bank credit growth for the month was accounted for by acquisitions of Treasury issues and loans to Government security dealers, reflecting the recent Treasury cash financing. Business loan expansion moderated, but banks added to their municipals and agency securities at a faster rate than in September, perhaps because the inflow of time and savings deposits accelerated; but the growth in holdings of such securities remained considerably below the rate of earlier this year.

Weekly reporting bank data for recent weeks indicate a slowing in the pace of bank credit expansion. A reduction in Treasury balances of about \$1.3 billion during the last week in October and in the first week in November was accompanied by heavy liquidation of Treasury issues at weekly reporting banks. Treasury financing operations, however, should lead to a sizable increase in bank credit again toward the end of November when a \$2.5 billion tax bill, payable by 100 per cent credit to tax and loan accounts, will increase bank holdings of Treasury issues. The bills will be paid for on November 24, the last Wednesday of the month, and therefore the financing will be fully reflected in the monthly bank credit increases as measured by the changes between the last Wednesday of the month. In the latter part of November and in December this expansion in bank credit will tend to moderate as banks sell the tax

bills, although it is not clear at this point how rapidly they will have to sell them off--with the pace depending on the movement of Treasury deposits and the strength of business credit demands.

Though growth in total bank credit was rapid in October, the expansion in business and finance company loans moderated to seasonally adjusted annual rates of 9 and 10 per cent, respectively--well below the pace of the first nine months. Some of the slowdown in business loan expansion is attributable to reduced demands of metal and metal products firms, which had been accounting for about one-fourth of the growth of business loans over the first nine months. But most other industry groups also have been increasing their bank loans at a slower rate than earlier in the year, due in part perhaps to increased capital market financing.

Bank loans to finance companies expanded only about \$100 million in October, on a seasonally adjusted basis, despite the high pace of automobile sales. A major factor in this slowdown appears to have been the early October increase in rates charged on such loans at a few banks--especially in New York--which encountered vigorous resistance from finance companies. While some finance company loans were shifted to banks not increasing their rates, there also appears to have been an expansion in commercial paper sales; finance company paper rates were raised in mid-October. There have also been sizable recent and prospective finance company flotations in the capital market. In early November, many banks rescinded the general rate increase on loans to finance companies but, through the second week of November, there was no indication of a return of finance company borrowing to New York banks.

Bank deposits. Time and savings deposits in October continued to increase at the third quarter annual rate of nearly 17 per cent, but early indications for November are that these inflows to banks are moderating somewhat. Bank sales of CD's during the month--almost \$500 million--were somewhat less than during the same period last year and outstandings declined early in November, especially in New York.

While CD rates in New York were generally at Q ceilings in late October and early November, there is as yet no evidence that Regulation Q ceilings are as yet causing any general unwanted run-offs of deposits. Smaller banks--those with deposits of less than \$500 million--continue to hold their own in regional markets, and in the 4 weeks through mid-October, there was only one bank--with deposits of less than \$100 million--whose CD run-off was as high as 4 per cent of deposits. Declines in outstandings in early November are apparently not as closely related to Regulation Q ceilings as they are to a reduced loan demand and to the comfortable money position of one large New York bank. In the second week of November, New York bank CD's rose again by almost \$100 million.

The money stock expanded again in October--growing at a seasonally adjusted annual rate of 9.5 per cent--bringing growth for the year to a 4.4 per cent rate, about the same as for the year 1964. Weekly data thus far available for November indicate that growth in the money supply has slowed. While recent declines in Treasury balances might have been expected to add to growth in the private money stock, this appears to have been offset by absorption of private demand balances from bank sales of Treasury securities.

U.S. Government securities market. Yields on Treasury notes and bonds extended their earlier rise in the first part of November, but the market most recently has firmed and rates have retreated from earlier peaks. Contributing to the recent rate decline have been the good receptions accorded several major corporate offerings and the Administration's success in prompting a roll-back in the price of aluminum. This success, which may have had some effect on inflationary expectations, has been interpreted by some market participants as enhancing prospects that the Administration may also endeavor to hold the line on interest rates.

While the market has been generally quiet and dominated by dealer activity in recent weeks, investor trading was stimulated by the Treasury's November refunding. The refunding met with a relatively unenthusiastic initial investor response, as allotments of the new 18-month notes soared to an unexpectedly high 48 per cent of large subscriptions. But early downward price adjustments were stemmed by official purchases, which reduced dealers' initial holdings of \$361 million by about two-fifths, and no marked selling pressure in the secondary market developed. Instead, net demand for the new notes began to appear from private investors prior to the payment date and, as of November 15, dealer holdings of these notes had been reduced to \$118 million. Some moderate selling by investors of short- and intermediate-term issues did occur against payment for the notes, though.

YIELDS ON U.S. GOVERNMENT SECURITIES
(Per Cent)

Date (closing bids)	3-month bills	6-months bills	3 years	5 years	10 years	20 years
<u>1965</u>						
Highs	4.09	4.25	4.49	4.50	4.48	4.41
Lows	3.76	3.81	4.00	4.08	4.17	4.17
<u>1965</u>						
July 28	3.81	3.88	4.09	4.15	4.20	4.21
Oct. 13	4.01	4.18	4.29	4.30	4.30	4.30
Nov. 3	4.09	4.24	4.44	4.44	4.43	4.38
Nov. 9	4.07	4.24	4.49	4.50	4.48	4.41
Nov. 16	4.09	4.25	4.44	4.46	4.45	4.40

On November 12, the Treasury announced a \$2.5 billion auction of June tax bills to be held November 17. Banks will be allowed to pay for their bills through 100 per cent tax and loan credit and are expected to subscribe for the bulk of the issue. This cash borrowing will complete the Treasury's financing program for 1965, but the Treasury will need additional cash in early January. The market has not focussed on a particular figure for this financing, although some observers have mentioned \$2 billion. The actual cash need could well turn out to be higher than that. After the January financing, a large seasonal surplus is projected.

Treasury bill rates have been fluctuating irregularly since early November after rising in previous weeks. Net dealer sales to private investors have been at reduced levels recently, as demand by corporations and public funds has been partly offset by continued bank selling. In the weeks ahead, the dealers will have to absorb continued

bill sales by banks, especially the new June tax bills. But whether such sales will cause the market to weaken will depend on the state of corporate demand for the bills. Also, sizable System purchases to provide seasonal reserve needs will be a factor strengthening the market in early December.

Corporate and municipal bond markets. Yields on corporate and municipal bonds rose again to new highs for the year during the first half of November after declining slightly in some series (not all of which are shown in the table) in October. At the higher yields now prevailing, the heavy recent volume of corporate bond offerings has attracted a good investor demand, helping to strengthen the tone of bond markets generally.

BOND YIELDS

	Corporate Aaa		State and local Government	
	New	Seasoned	Moody's Aaa	Bond buyer (mixed qualities)
Postwar				
<u>Previous High</u>	5.13(9/18/59)	4.61(1/29/60)	3.65(9/24/59)	3.81(9/17/59)
1965				
High	4.73(11/12)	4.60(11/12)	3.32(10/29)	3.45(11/12)
Low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(2/11)
Week ending:				
July 23	4.56	4.48	3.16	3.25
Oct. 1	--	4.53	3.31	3.41
Oct. 15	--	4.57	3.31	3.38
Nov. 12	4.73	4.60	3.32	3.45

Renewed general upward pressure on bond yields in early November reflected a rapid build-up in listings of publicly offered corporate bonds for November and beyond. While new corporate offerings

in the first week of November were quite light, yields come under pressure early in the month as underwriters released unsold portions of older issues from price restrictions in preparation for the enlarged calendar of subsequent weeks. This action, together with the favorable reception accorded recent offerings, has forestalled any significant build-up in underwriters' unsold balances.

Altogether, the calendar of public offerings scheduled for November totals about \$650 million, with approximately 60 per cent already sold. This total, in addition to being a record for the month, is the fourth largest monthly volume of public offerings this year. Particularly striking, as in earlier periods of heightened pressure on new issue yields, is the high volume of public offerings relative to private placements. This ratio stands at about 50 per cent for November, similar to May when yields on new offerings showed their sharpest rise of the year.

BOND OFFERINGS^{1/}
(In millions of dollars)

	Corporate				State & local govt.	
	Public offerings		Private placements			
	<u>1965 e/</u>	<u>1964</u>	<u>1965 e/</u>	<u>1964</u>	<u>1965 e/</u>	<u>1964</u>
Jan.-Nov. average	478	300	653	536	936	888
September	664	376	700	693	1,000	920
October	300	181	700	642	800	852
November	640	30	700	645	850	578

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

The further rise of yields on State and local government bonds since mid-October has been accompanied by some pickup in both the new issue calendar and dealers' advertised inventories, from the reduced levels that developed in each of these quantities during the first half of October. Although the estimated volume of new issues for November is below the average monthly volume for the year to date, it slightly exceeds October, and is larger than in November of other recent years. Investor reception of this seasonally large calendar has been less favorable than in the corporate bond market.

Of longer-run significance are the results of November bond issue referenda. Voters approved approximately \$2 billion of the \$3 billion submitted. This greatly exceeded the previous "off-year" election high of \$1.1 billion, largely on the basis of the \$1 billion authorization of New York State water pollution control bonds.

Mortgage markets. Returns on home mortgages have tended higher recently, as yields in other sectors of the capital markets have been under upward pressure. Reflecting this firming, there was a further increase in secondary-market offerings of Federally-underwritten mortgages to FNMA, and in FNMA purchases, during the four-week period ended November 11. Offerings have risen in part because FNMA buying prices, which have not been changed for some time, have become more favorable as discounts on FHA and VA loans have edged up in the private market.

Yields in the secondary market on certain FHA-insured new-home loans rose slightly in October for the third consecutive month, reaching 5.49 per cent as the average discount on these 5-1/4 per cent 30-year

loans exceeded 2 points for the first time since early 1963. Average contract rates on conventional first-mortgage loans on new homes in October were also up a bit to 5.85 per cent, the highest level in more than 2-1/2 years in this FHA series. On existing-home loans, interest rates remained unchanged at the higher 5.90 per cent level reached in August.

The FHLBB-FDIC series on conventional first-mortgage terms showed mixed changes, on balance, in September from the previous month and from a year earlier, as shown in the table.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASE

	1965		Per cent increase in September from a year ago
	August	September	
New home loans			
Contract rate (per cent)	5.76	5.75	--
Purchase price (\$1,000)	24.9	24.9	4
Loan amount (\$1,000)	18.2	18.1	3
Loan/price (per cent)	73.8	73.7	-1
Maturity (years)	24.5	24.9	--
Existing home loans			
Contract rate (per cent)	5.86	5.89	-1
Purchase price (\$1,000)	19.7	19.2	2
Loan amount (\$1,000)	14.1	13.7	2
Loan/price (per cent)	72.1	71.6	--
Maturity (years)	20.4	20.1	2

Delinquency rates of 30 days or more on home mortgages increased about seasonally during the third quarter, according to the regular survey by the Mortgage Bankers Association of America of its members. Although the average level of 3.2 per cent was the highest for the third

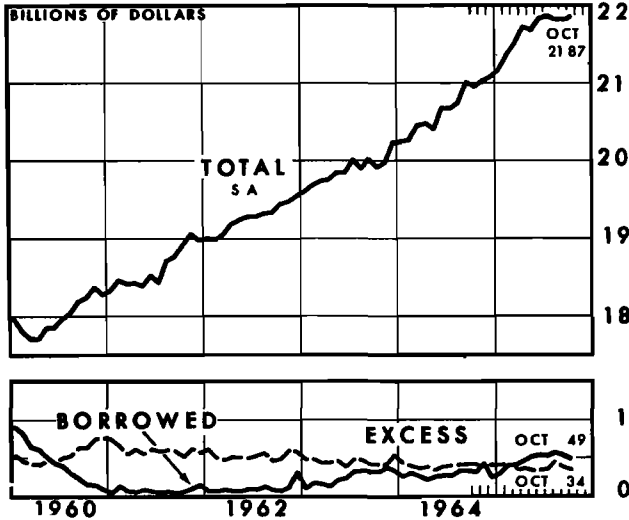
quarter since the series commenced in 1953, it was only slightly above the previous third-quarter high two years ago. As in the second quarter, delinquency rates on conventional as well as Government-underwritten mortgages were above year-earlier levels. The average foreclosure rate reported in the third quarter was unchanged from both the second quarter and from a year earlier.

Stock market. Common stock prices, as measured by Standard and Poor's composite index of 500 stocks, closed at 92.41 on November 16, slightly below the record high set the day before. But some other popular stocks averages have not recovered their earlier highs. At the current level, the Standard and Poor's index is almost 2-1/2 per cent above its May peak and about 13 per cent above the June low of 81.60.

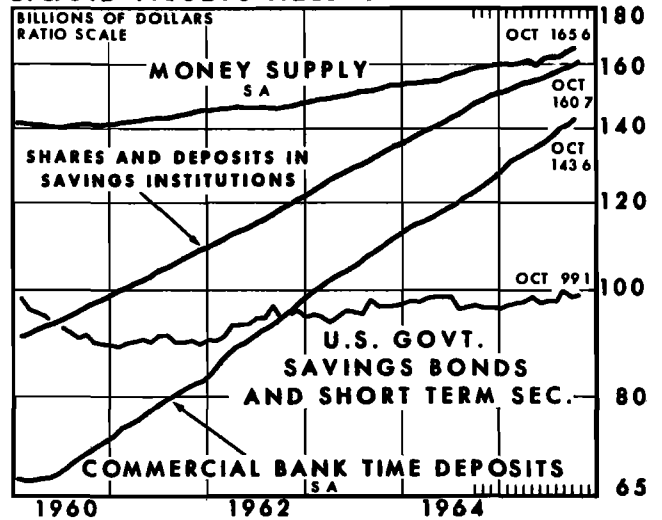
The aluminum episode had a dampening effect on stock prices for several days in early November. But continuing reports of good earnings and increased dividend payments by corporations have apparently helped to counter this influence. Price movements during most of the past three weeks have been confined to a narrow range, with daily trading volume averaging about 7 million shares. The glamour stocks are still well represented on the list of most active issues, but even for such issues, there is some evidence of reduced price volatility.

FINANCIAL DEVELOPMENTS - UNITED STATES

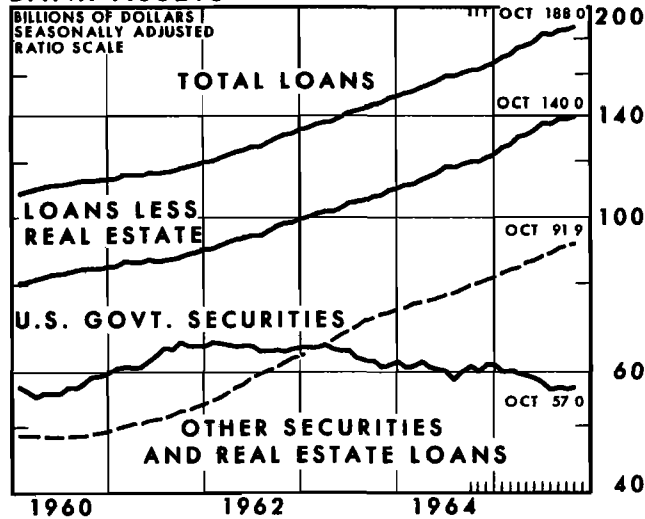
BANK RESERVES



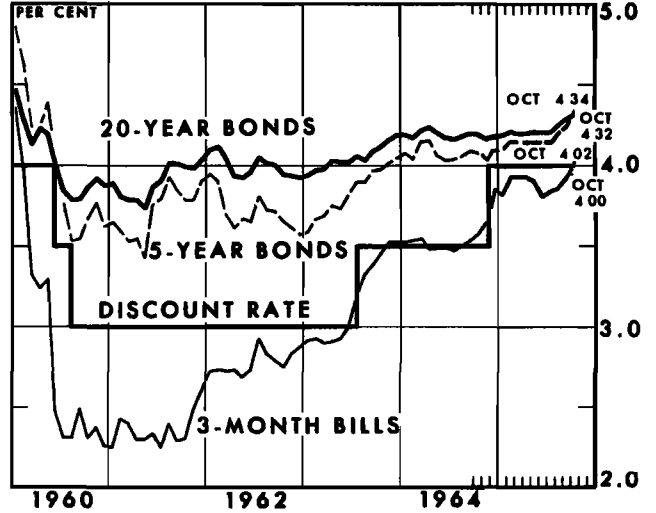
LIQUID ASSETS HELD BY PUBLIC



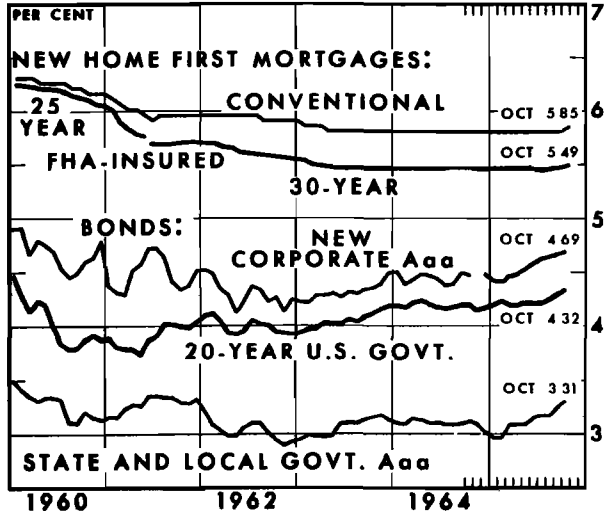
BANK ASSETS



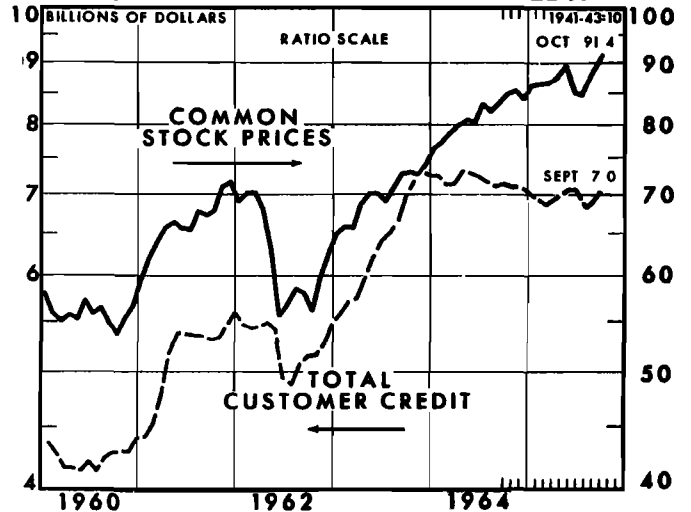
MARKET YIELDS - U.S. GOVT. SEC.



MARKET YIELDS - BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. Balance of payments. The seasonally adjusted deficit on regular transactions in the third quarter has been revised to \$615 million; bringing the total for the first three quarters to \$1.3 billion. The October deficit (preliminary) is estimated at about \$300 million before seasonal adjustment but after adjustment for an identified instance of double-reporting U.S. liabilities to foreigners. The deficit for October customarily accounts for a large share of the total for the fourth quarter; the preliminary result for this year is about half the average October deficit in the previous 3 years. Thus, on regular transactions the deficit for the first 10 months appears to be about \$1-3/4 billion at a seasonally adjusted annual rate.

The "regular transactions" concept, and also the category "special Government transactions," are no longer to be used in official balance-of-payments tabulations. Instead, as agreed by a technical committee charged with implementing the recommendations of the Bernstein Committee Report, a "liquidity" balance (previously published but not publicized) and an "official settlements" balance will be shown, starting with today's press release by the Commerce Department. For both balances, debt prepayments and military prepayments will be treated as above-the-line receipts, reducing the deficit rather than helping to finance it. Hence, the new balances will look more favorable than those usually cited in the past. (Further details of these changes will be given in the forthcoming Supplement.) The new "liquidity" balance shows a seasonally adjusted deficit of \$485 million in the third quarter, and \$940 million for the first three quarters. The new "official"

settlements" balance shows a surplus of \$260 million in the third quarter, and a deficit of \$160 million for the first three quarters.

Recent information on the third quarter reveals some elements of strength in the trade account and the doubtless more temporary influence of further reflows of liquid funds. Incomplete data show a net reflow of liquid funds of roughly \$150 million for the quarter, almost entirely from Canada and representing reductions in both foreign-currency and U.S. dollar-denominated money market assets. (This reported decline reinforces indications from confidential Canadian data that the increase in U.S. dollar-denominated deposits in Canadian banks in the third quarter did not represent outflows from this country.) In part, the reflows of U.S. funds may reflect hesitancy to place funds in Canada following the failure of Atlantic Acceptance Corporation.

The third-quarter trade surplus -- \$6-1/4 billion at an annual rate -- reflected both a dip in imports and a further advance in exports. Much of the decline in imports from the second to the third quarter was attributable to lower imports of industrial supplies, which customarily account for about half of the total. But purchases of capital equipment, foods and beverages and consumer goods all declined more (or increased less) than they had between the same two quarters a year ago. Because the declines this year were from levels swollen by a post port strike bulge, the more moderate levels of imports in the third quarter may be more representative of underlying trends.

The decline in imports of industrial supplies represented in part a return to levels more in line with past experience following an acceleration in the second quarter, particularly in purchases of steel

products. Although decreasing during the third quarter, steel imports still remained well above the pre-strike-threat level and should decline further. On the other hand, most categories of imports can be expected to increase further with advances in output in this country. Moreover, third quarter imports may be understated in the figures because of statistical changes; the understatement would not have affected payments for imports or the over-all balance, but it would dampen slightly the outlook for the trade balance.

U.S. EXPORTS
(In billions of dollars, at seasonally adjusted annual rates)

	1963	1964		1965	
		1st Half	2nd Half ^{1/}	1st Half ^{1/}	3rd Qtr.
Non-Agricultural Exports^{2/}					
Canada	3.6	4.1	4.4	4.6	5.2
Western Europe	5.9	6.5	6.8	6.3	6.8
Latin America	2.8	3.1	3.4	3.1	3.4
Rest of world	<u>5.2</u>	<u>5.6</u>	<u>6.1</u>	<u>6.0</u>	<u>6.2</u>
Total	17.6	19.3	20.8	20.0	21.6
Agricultural Exports	<u>5.6</u>	<u>6.2</u>	<u>6.4</u>	<u>5.7</u>	<u>6.7</u>
Total	23.3	25.5	27.2	25.7	28.3

^{1/} Affected by strike

^{2/} Includes Department of Defense military shipments and other special category exports (which ranged from \$0.6 to \$0.9 billion at annual rate) in order to facilitate year-to-year comparisons.

The continued growth in exports since last year resulted from an expected rise in agricultural exports and from further marked increases in non-agricultural exports to Canada where domestic expansion continued strong. Non-agricultural exports to other areas do not, on the basis of available evidence, appear to have risen significantly above the second half of last year. Stability in non-agricultural exports to Western Europe and Japan doubtless reflected the essentially stable levels of output which have persisted since late last year. Expansion in U.S. exports from the

strike-depressed first half of 1965 occurred in the face of a decline in sales of "special category" military goods; statistics on these goods, normally excluded from the regional trade figures, are included in the table to permit year-to-year comparisons that would otherwise be made difficult by changes in definitions and coverages.

Agricultural exports, seasonally adjusted, rose sharply in the third quarter over the depressed level of the first half. In part this rise represented sales to Western Europe of wheat, stimulated by poor European harvests, and of feed grains and soybeans.

Early in November, the U.S. Treasury and the Canadian authorities announced that they would ask Canadian borrowers to defer until 1966 the payments on new security issues previously scheduled for the remainder of the fourth quarter. The calendar prior to the announcement called for about \$200 million of new Canadian issues in the remainder of the fourth quarter, including a \$50 million issue by the Quebec Hydroelectric Commission, which has already been postponed until early next year.

Canadian new issues in the first ten months of the year were about \$650 million, and in the absence of any deferrals appeared likely to reach \$850 million for the year -- compared to \$700 million in each of the two preceding years. Moreover, in the first ten months of this year Canadian reserves (including the creditor position in the IMF) rose \$170 million, and they are now more than \$350 million above the level of mid-1963, when Canada obtained an exemption from the IET, on the understanding that Canadian borrowing here would not be a means of adding to Canadian reserves.

Industrial production in Western Europe. Aggregate industrial production in Western Europe has risen little since early 1964, and has leveled out since early this year. In Germany, the Netherlands, and the Scandinavian countries, output growth is still hampered by plant capacity limitations and tight labor markets, although weakening of demand pressure is also a factor in some industries. Reduced pressure of consumer demand in the United Kingdom this year has lessened somewhat the significance of supply limitations as a factor restraining further U.K. output growth. Production is rising again in France and Italy; both countries have substantial margins of unutilized productive capacity, and private investment is still depressed in both.

INDUSTRIAL PRODUCTION, OECD EUROPE
(Seasonally adjusted, Q-IV 1963=100)

	1964	1965					
	Q-IV	Q-I	Q-II	June	July	Aug.	Sept.
TOTAL	<u>105</u>	<u>107</u>	<u>107.5</u>	<u>107.5</u>	<u>106</u>	<u>n.a.</u>	<u>n.a.</u>
United Kingdom	104.5	105.5	105.5	104.5	105.5	105.5	n.a.
E.E.C.	105	106	107	107	105.5 ^{a/}	107 ^{a/}	n.a.
France	103.5	101.5	103.5	104	100 ^{b/}	100 ^{b/}	105.5
Germany	107.5	111	111	111	108.5	111	106.5
Italy	97	98	101.5	103.5	103	n.a.	n.a.
Sweden	105.5	106.5	108	109	100	n.a.	n.a.

^{a/} Estimated at the Board of Governors.

^{b/} July-August figures for France are significantly understated (to an unknown extent) because of difficulties in making adequate seasonal adjustment for the vacation period.

Note. Data computed from rounded OECD indexes based on 1960 = 100.

In Germany, industrial production was generally level on the average from February through the third quarter. (It is too early to tell whether the apparent drop-off in September is significant.) Much of this stability was due to pressure on available supplies of labor and plant capacity, especially for machinery and equipment. But easing of demand played a part in some cases, notably in construction. So far this year, building activity has not advanced beyond last year's levels. While this may have been due in part to bad weather in the second quarter, better weather in the third quarter did not produce a large upsurge in construction.

The fact that underlying demand forces are still very strong in Germany, despite the leveling-off in total industrial production this year, is evidenced by the continued rapid rise of imports through September, although some of the increase is reportedly attributable to the increased competitiveness of some foreign goods.

In France, industrial production (excluding construction) has moved up from the recession low reached last January. In the second quarter the seasonally-adjusted index was up 2 per cent from the first-quarter, and in September it showed a further gain of 2 per cent.

The gains in industrial production this year reflect expansion in three sectors of demand. First, seasonally-adjusted exports rose nearly 10 per cent from the first quarter to July-August (comparison of monthly averages), continuing the rapid uptrend that resumed in the fall of last year. French exports to Germany have been exceptionally strong, and France has also benefited from the recovery to date in Italian imports. Second, budget expenditures have continued to rise. Third

and most important, consumer expenditures began to rise again in the second quarter, after declining during the preceding twelve months, and the rise continued in the third quarter.

The outlook for industrial production in the near term seems fairly promising, with reduced manufacturers' inventories of most consumer products and some basic and intermediate products, increased orders for nearly all goods of these kinds, and a marked increase in September over July (according to INSEE) in manufacturers' optimism regarding their production levels in the next few months.

In Italy, the recovery of industrial production, which was slow earlier this year, accelerated in the second quarter. In June, the seasonally adjusted index was 6 per cent above the first-quarter average. A fractional decline occurred in July, the latest month for which figures are available.

Booming exports have been one of the main factors in the output rise. In June-July, seasonally adjusted exports exceeded the first quarter level by 8 per cent, and the June-July level of 1964 by 20 per cent.

In the second quarter, consumer goods production (seasonally adjusted) averaged 6.5 per cent above January-March, marking the first quarterly increase in total consumer goods output since the final quarter of 1963. In July, consumer goods output rose further by 2 per cent over the second-quarter average. The second quarter also saw a vigorous revival of automobile production, as well as of output in the rubber industry--probably tires. Production of other consumer goods, taken as a group, also advanced in the second quarter and in July, but the textile sector was generally weak and output declined through July.

In the investment-goods sector, steel output continued to rise rapidly, but output of other producers' goods was generally down in the first quarter and mixed in the April-June period. Construction activity--not included in the industrial production index--continued to drop, a pick-up in public works being more than offset by continuing declines in housing construction.

In the United Kingdom, industrial production was level through August, a little below the new peak reached last January. The cessation in output growth this year reflects mainly the easing of private demand which took place after the first quarter. Second-quarter production was also adversely affected by wildcat strikes.

According to the Industrial Trends Survey of the Confederation of British Industry, released in mid-October, the economy is still operating at high levels of output and employment but the trend of new orders has leveled off sharply since June, and the number of firms working below capacity has increased slightly.

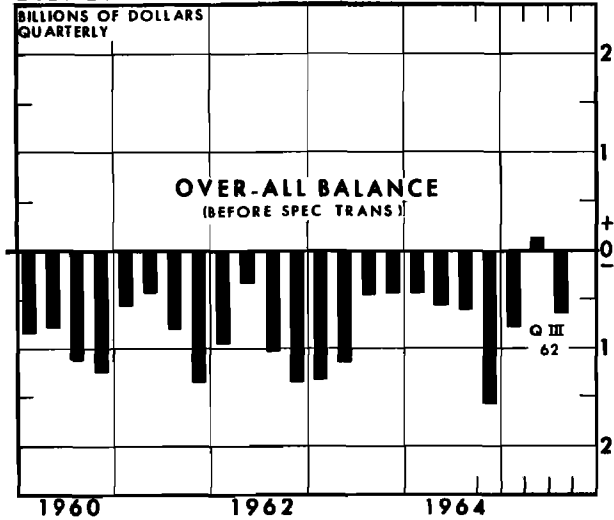
Industrial production in Japan. Preliminary data on industrial production in Japan for September indicate that seasonally adjusted output rose 2.5 per cent over the August level. However, this upswing followed a substantial dip in August. The September level of production was about the same as earlier this year, and only 1 per cent higher than a year earlier, indicating that the economy was still in a state of comparative stagnation.

A recent Bank of Japan report states that domestic demand remains sluggish. Output of most commodities has been relatively steady, but steel and textile production fell moderately in September due to industry cutback programs. Machinery led other industries in the September gain in output.

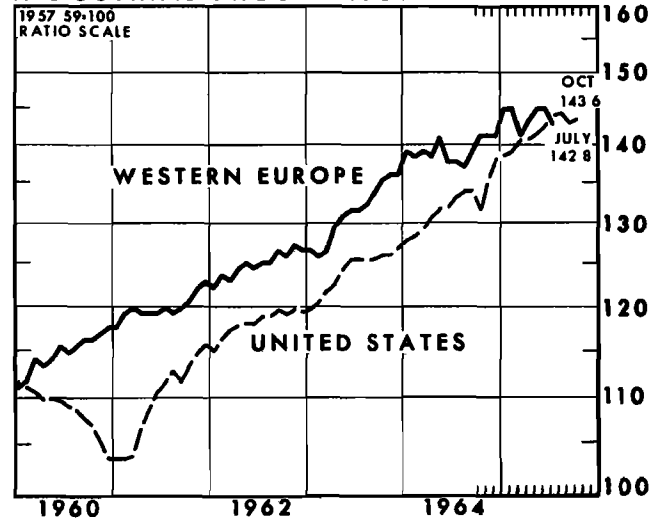
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

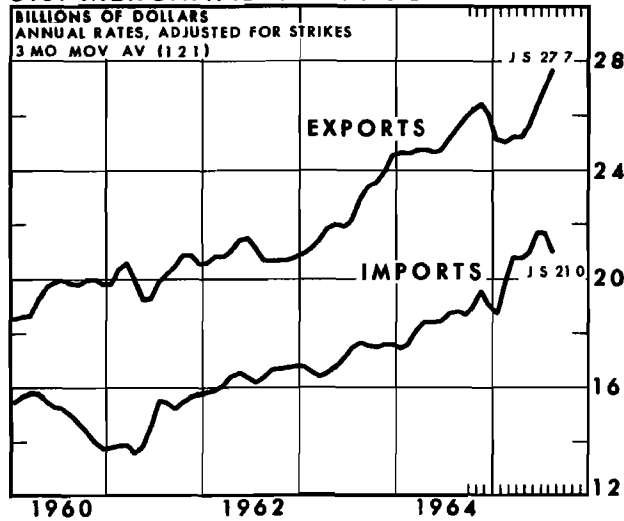
U.S. BALANCE OF PAYMENTS



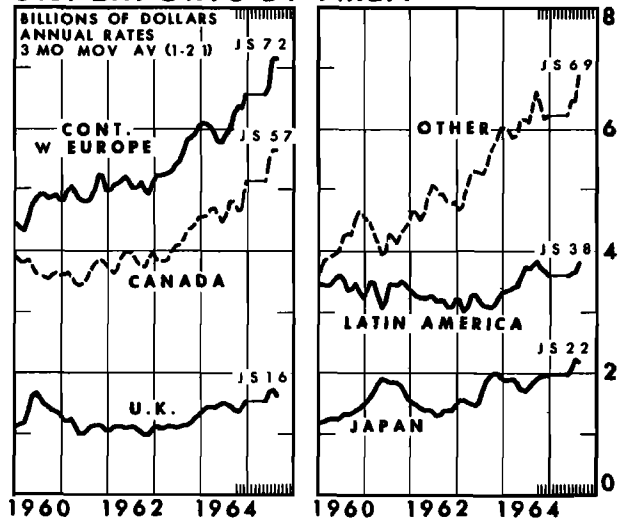
INDUSTRIAL PRODUCTION



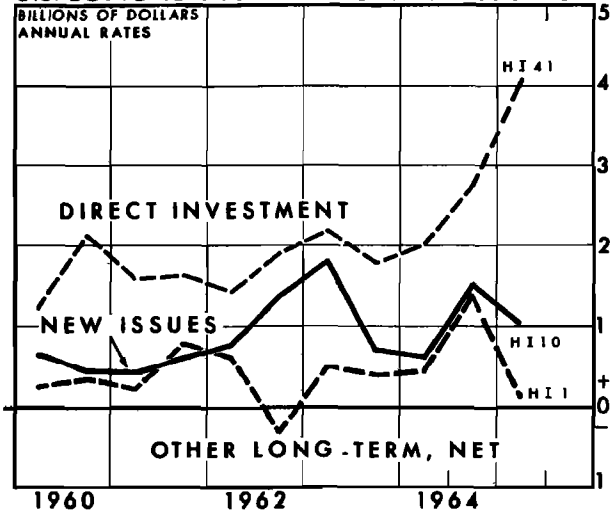
U.S. MERCHANDISE TRADE



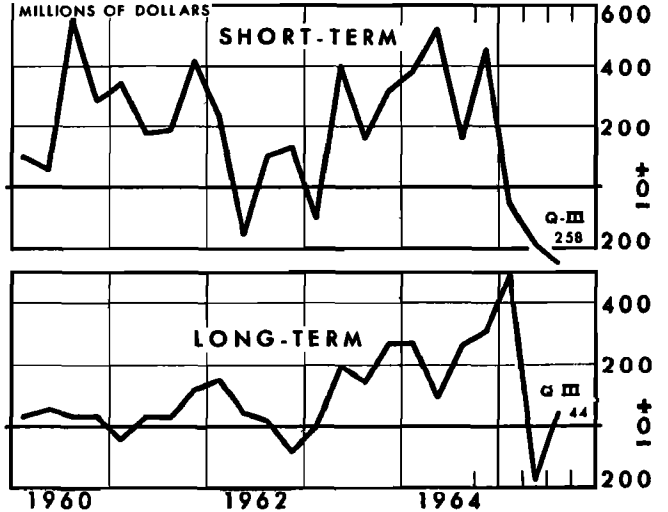
U.S. EXPORTS BY AREA



U.S. LONG-TERM PRIVATE CAP. OUTFLOWS



PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



APPENDIX A: SOME ASPECTS OF THE RECENT COMPREHENSIVE GNP REVISION*

The large upward revision in the producers' durable equipment (PDE) component of the GNP--as much as one-fifth in the current level of the constant dollar figure--has brought the series broadly in line with the trend of the business equipment component of the Board's production index for the period from 1958 to date. Before the revision there had been substantial differences in these two measures, as shown in the accompanying chart.

Some differences in quarterly and trend behavior of the two series should be expected partly because of differences in concept and coverage for such items as government purchases of nonmilitary equipment and exports and imports of equipment. In addition, some of the differences shown between the two series in the 1954-56 period reflect the inclusion in the GNP series of a fixed portion of new auto sales for business purposes. Also, there appears to be some differences resulting from the seasonal adjustments used, particularly in the third-quarter figures during the mid-fifties.

The revision of PDE provides a different picture of the pattern of investment in the 1954-56 period which has certain implications for appraisal of economic policies at that time. Before the revision, GNP as well as other data led to the view that capital goods output was on a downtrend during 1954 and expanded only after a boom in autos and housing late in 1954 and in early 1955. Thus, real PDE and business equipment output were both at a low in the fourth quarter of 1954 and the SEC-Commerce investment expenditure series on new plant and equipment reached its low point of \$25.6 billion, annual rate, in the first quarter of 1955. The expenditure series subsequently rose steadily to a peak of \$37.8 billion in the third quarter of 1957, reflecting in part rising prices and costs for equipment and structures.

In the revised real PDE figures the low point of the 1954 recession in this sector is moved from the fourth quarter to the first quarter of that year before the low for the economy as a whole was reached. A peak in PDE is reached in the fourth quarter of 1955 which is not exceeded until 1960 and then by only a slight amount in a single quarter. Within the next year ending in the fourth quarter of 1956, PDE declines 5 per cent while business equipment rises further by 12 per cent.

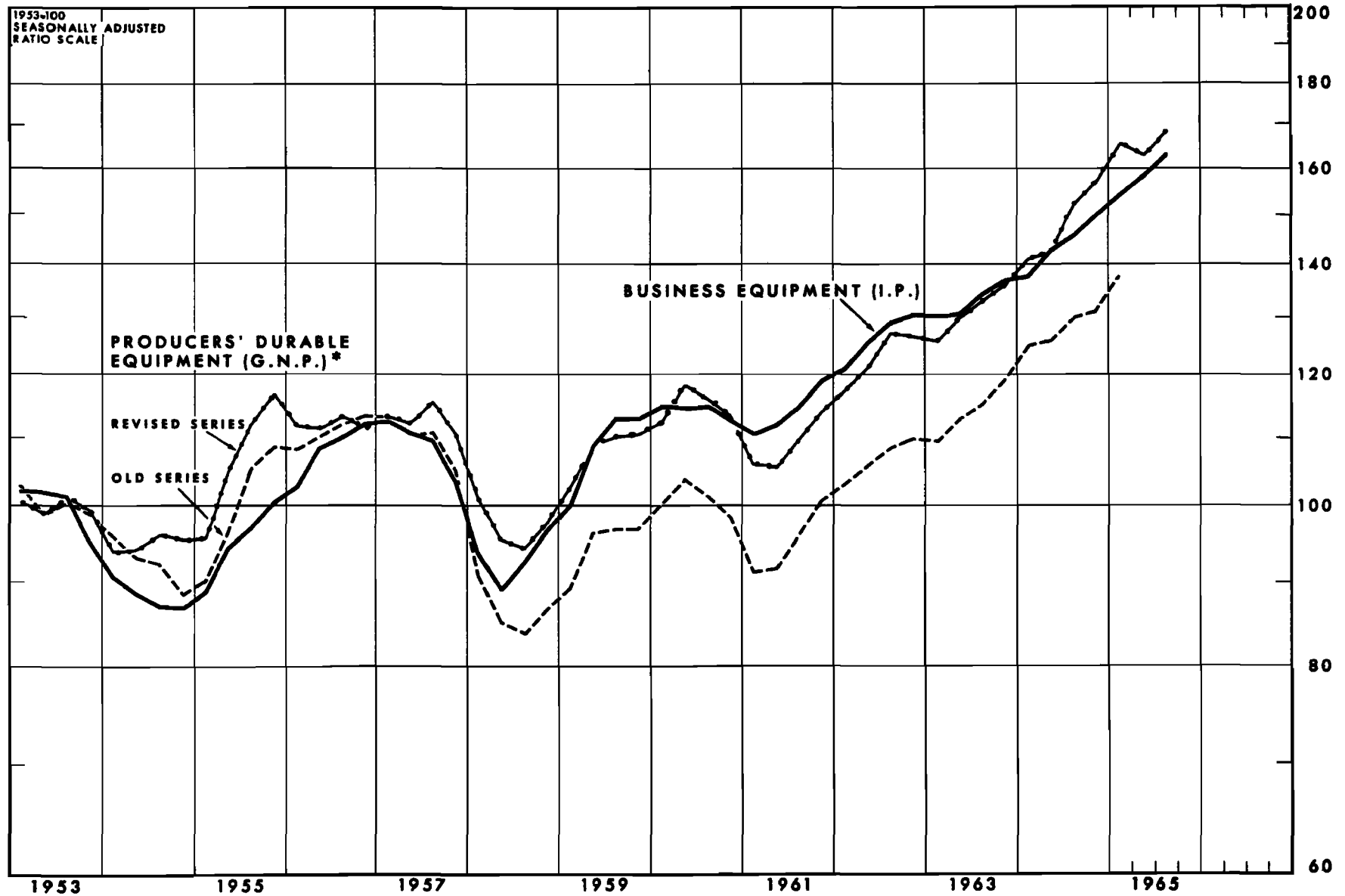
In considering these alternative results it may be noted that subsequent revisions of the monthly production indexes are hardly likely to follow the new 1954-56 changes shown by PDE. Fluctuations in major subtotals of production indexes are influenced by a pattern of monthly

* Prepared by Clayton Gehman, Chief, Business Conditions Section, Division of Research and Statistics.

events which are fairly firmly defined by independently reported series on employment and average hours, manufacturers' shipments and inventories, electric power, and freight traffic--in addition to the available output series themselves. Consequently, while the levels of production indexes over longer periods have been subject to substantial revision on occasion, these revisions usually have been reflected mainly in the steepness of the slopes of monthly changes rather than in major shifts in the timing of cyclical changes--also partly because periodic review of seasonal factors in recent years has generally kept their revisions to a minimum.

Reflecting in part the upward revision in PDE, the whole goods component of the GNP is 6 per cent greater now relative to 1947 than before--177 rather than 167. Furthermore, the early postwar level of total GNP was reduced somewhat so that the revised total is about 2-1/2 per cent larger relative to 1947 than previously. The amount of this revision in the GNP total was limited by large downward revisions in the construction series and by the elimination of consumer interest from the services component.

OUTPUT TRENDS IN EQUIPMENT



* In Constant Prices

APPENDIX B: FEDERAL BUDGET OUTLOOK *

A major uncertainty in evaluating fiscal policy over the coming months, is the level of Government spending, especially for defense. The January budget document will shed light on near-term prospects but, in the meantime, Federal Reserve staff projections have been revised upward to reflect what appears to be something like a median forecast of additional defense spending resulting from the greater U.S. commitment in Vietnam.

Cash payments for fiscal year ending in June 1966 are currently projected at \$131.4 billion. This is \$4 billion above the amount shown in the Budget document of January 1965 and \$9 billion above the actual payments in fiscal 1965. As compared with the Budget document estimate, defense spending may be up only \$1-2 billion in fiscal 1966. Presumably defense spending will build up over the course of the current fiscal year, perhaps to a level by mid-1966 which would be \$5 billion (annual rate) above mid-1965. Of that amount about \$1 billion represents the recent military pay increase.

Cash receipts are also expected to increase in fiscal 1966, although not by quite as much as spending. Our most recent projections indicate cash receipts may total \$127.5 billion, up \$4 billion from the Budget document figure and nearly \$8 billion from the actual fiscal 1965 inflow. Withheld individual taxes have continued high thus far in the calendar year, as growth in personal income has been sustained. And corporate tax receipts are projected about \$3 billion above fiscal 1965 collections, reflecting not only further growth in profits but also the acceleration of tax payments to a more current basis. While the two-stage reduction in excise taxes will reduce revenues from these taxes by over \$2 billion in fiscal 1966, almost three-fourths of this will be offset by greater cash inflows because of increased social security taxes effective January 1, 1966.

These developments as they affect the posture of fiscal policy are indicated by the full employment budget shown in the bottom three lines of the table. Reflecting the large social security lump-sum payment in September 1965, the higher permanent benefits, and some pick-up in defense spending, the full-employment budget appears in balance in the July-December 1965 period. A return to surplus, however, is expected in the first half of calendar 1966, when the new social security taxes go into effect. These taxes,

* Prepared by Government Finance Section,
Division of Research and Statistics.

together with revenue from voluntary medical insurance, are expected to add \$5.6 billion (national income basis) to receipts at an annual rate in calendar 1966.

As finally passed, the social security tax increase will have a less restraining effect on the private economy than would have been the case with the original proposals. The final bill established a higher wage ceiling and a lower tax rate than the original one; such a combination was selected in order to spread the increase in tax collections more evenly through the year.

Taking the year as a whole, fiscal policy would seem to be more expansive in fiscal 1966 than in fiscal 1965, as judged by a greater reduction in the projected full employment surplus. But this more expansive fiscal policy is concentrated in July-December 1965, a period almost over. As the economy enters 1966, fiscal policy can be expected to begin exerting a more restraining effect than currently, at least insofar as can be seen from information now available.

Note: The figures indicated here are consistent with the income and expenditure estimates shown in the GNP discussion in the first section of this Green Book.

Various Federal Budgets by Quarters
(In billions)

	1964				1965				1966		Calendar Years		Fiscal Years	
	I	II	III	IV	I	II	III	IV ^P	I ^P	II ^{1/P}	1964	1965 ^P	1965 ^P	1966 ^P
	<u>Quarterly Totals</u>													
Cash Budget														
Receipts	30.3	33.4	27.0	24.3	30.7	37.7	29.2	26.5	31.1	40.7	115.0	124.1	119.7	127.5
Payments	28.7	30.1	30.9	30.6	28.3	32.6	33.1	33.6	32.3	32.4	120.3	127.6	122.4	131.4
Surplus/Deficit	1.6	3.3	-3.9	-6.3	2.4	5.1	-3.9	-7.1	-1.2	8.3	- 5.2	- 3.5	- 2.7	- 3.9
	<u>Annual Rates, Seasonally Adjusted</u>													
National Income														
Receipts	114.8	112.0	114.6	116.8	122.7	123.7	122.0	123.0	128.9	130.1	114.5	123.0	119.4	126.0
Expenditures	117.5	119.6	118.2	117.9	120.2	120.8	126.6	128.0	129.6	131.6	118.3	124.0	119.3	128.9
Surplus/Deficit	-2.6	-7.6	-3.6	-1.1	2.5	2.8	-4.6	-4.0	- .7	-1.5	- 3.8	- 1.0	.2	- 2.9
Full Employment														
Receipts	124.2	120.1	122.0	123.6	125.8	127.8	126.2	127.6	133.4	134.6	122.5	126.8	124.8	130.6
Expenditures	116.8	119.0	117.7	118.4	119.8	120.4	126.2	127.6	129.2	131.3	118.0	123.5	119.1	128.6
Surplus	7.4	1.1	4.3	5.2	6.0	7.4	0	0	4.2	3.3	4.5	3.3	5.7	2.0

1/ Receipts in 1966-II contain a median estimate of nonwithheld individual income tax receipts. Depending on the ultimate size of 1965 tax cut, cash receipts in the second quarter could be as high as \$41.7 billion or as low as \$39.7 billion.

P Projected.