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CONFIDENTIAL (FR)

CURRENT ECONOMIC and FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

February 24, 1966

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SUMMARY AND OUTLOOK

Outlook for GNP

GNP rose nearly $16 billion in the fourth quarter, and seems likely to be increasing as much in the current quarter. Some moderate slowing is indicated for the second quarter, if the rate of increase in government spending slackens as implied in the budget document.

The recent growth rate in real GNP--7 per cent annual rate--has been unusually rapid for this stage of cyclical expansion. In fact, it is close to rates achieved in the early stages of cyclical recovery, as, for example, from early 1961 to early 1962 and in 1955. However, it is still well below the 9.5 per cent rate achieved in the first year of the Korean War, when Federal defense spending increased by 140 per cent as compared with current increases of about 20 per cent per year.

Sharp actual and prospective increases in defense spending have been superimposed on an already booming civilian economy, and, in the context of accelerated final sales and of prospects of supply shortages, delivery delays and price increases, business inventory demands have been stepped up sharply. Over-all inventory accumulation rose sharply further in the fourth quarter to the highest rate of the whole expansion period and is expected to hold around this higher rate in the first half of 1966 as steel accumulation resumes. Despite the sharp inventory rise in late 1965, stock-sales ratios generally remained low.

The rise in personal income was very small in January when the social security tax boost became effective, and for this reason a smaller rise in consumption expenditures was to be expected. In coming months, resumption of rapid gains in income--particularly if accompanied by further escalation of the war in Vietnam--may be expected to heighten consumer spending.

Prices and costs

Demands on manpower resources have intensified further as employment in January continued to increase vigorously and the armed forces added 50,000 more men to its expanding strength. Continued rapid expansion in production, as well as employment, resulted in further increases in rates of industrial resource utilization. For manufacturing industries, the current operating rate of about 92 per cent was equaled briefly in late 1955 and exceeded only in the Korean War period.

The strong expansion in aggregate demands and the general tightening of labor supplies have resulted in wages in most industries moving up a little more rapidly than earlier. Even in manufacturing, where wage increases have been moderate and a large portion of the workers are covered by long-term contracts, an upward drift in wage rate increases now appears to be getting underway. Industrial prices appear to be increasing at only a slightly more rapid pace than the 1.5 per cent annual rate that prevailed over most of 1965.

An unusually large gain in manufacturing capacity is being projected for this year, and should it be realized, the over-all rate of utilization of manufacturing capacity is not likely to increase significantly further. Operating rates would remain very high, however, and delays and bottlenecks would be a growing problem. Unemployment is expected to continue downward to well below 4 per cent, and with aggregate demands expanding sharply further, consumer prices are likely to continue to increase and demands for higher wages to intensify; the outlook for the voluntary wage guideposts does not appear very favorable. In these circumstances, and with general expectations for continued expansion in activity very high, increases in industrial prices are likely to be somewhat larger and more widespread than over the past year.

Bank credit demand and related bank adjustments

Expansion of bank credit is expected to be at a slower pace during the spring than it was in December-January, although picking up from the considerably reduced pace of late January and February to date. Loan demand is expected to strengthen, following the comparative moderation of recent weeks. But Treasury financing, which contributed significantly to the bank credit expansion of recent months, will be of little if any importance. In accommodating loan demand, city banks may be expected to make further reductions in their holdings of U.S. Government and other securities, the amounts depending in part on the strength of demand and in part on their ability to obtain funds for meeting this demand by loan sales or participations, issuance of CDs, or purchase of Federal funds.

Recently, to obtain funds for lending city banks have increased reliance on asset liquidations and placed less emphasis on time deposit expansion. The volume of CDs outstandings at all weekly reporting banks has not yet reattained the earlier highs reached prior to the December tax period.

Banks undoubtedly feel inhibited from competing aggressively for CD money because marginal CD funds would be costly relative to the return on loans, with the prime rate at 5 per cent. For example, 90 day and longer CD money would cost banks 5-1/4 - 5-1/2 per cent, after including costs for reserve requirements and FDIC insurance, although the cost of shorter maturities would be lower. Late last fall (before the discount rate increase) CD costs for all maturities were about 1/4 percentage point above the then prevailing prime rate. In the weeks immediately ahead, even with relatively high costs, banks may have to bid more aggressively for CD funds to keep from losing ground because of heavy run-offs during the March tax and dividend period and potential further difficulties in April. But in the process, the present yield structure suggests that banks may be forced more into shorter-term maturities.

Structure of interest rates

During the past month, the yield curve has developed less of a downward slope. As will be recalled, the initial market response to the discount rate action was chiefly in the short- and intermediate-term area, and a yield curve with considerable downward slope emerged. But this particular interest rate structure proved to be unsustainable partly because investors and borrowers came increasingly to expect higher interest rates and partly because long-term markets were under pressure from rising borrowing demands to finance current business investment and from bank portfolio adjustments.

Recent upward interest rate adjustments have been principally in the long-term area. Since mid-January, the 20-year U.S. Government bond and high-grade corporate securities have risen about 20 to 25 basis points, while the 3-month Treasury bill has risen only some 5 basis points.

The stability of the present interest rate structure over coming months is open to question. A continued increase in our military and economic commitment in Vietnam would certainly militate against any change in market expectations that would lead to diminution of pressures on long rates relative to short. Financing demands of non-financial businesses and others may continue to be enlarged by anticipatory factors and long-term rates may rise further, although it is not clear how general or widespread such rate increases are likely to be.

Corporate rates may be under relatively more upward pressure than Government bond yields in view of the recent narrowing in the yield advantage of corporates over long Government issues, the inability of the Government to issue more securities in the long-term area because of the 4-1/4 per cent ceiling, and the expected build-up in the corporate new issue calendar. In the municipal market, upward yield adjustments have developed only belatedly, and interest rates there may adjust further, especially if bank participation in the market continues at a reduced level. In the mortgage market, the rather substantial turn-of-year rise in yields may have largely discounted near-term developments, although any further rise in corporate bond yields could put pressure on the mortgage market as well.

If long-term market rates rise significantly further, there may be a feedback effect putting increased upward pressure on bank lending rates. If banks, in turn, find they can lend (or invest) at higher yields, they might then move closer toward the Regulation Q ceiling in their bidding for CDs. Thus, there is the possibility of a ratchet-like movement of upward rate pressures down the maturity curve.

Balance of payments

The fragmentary information available on U.S. international transactions early in 1966 provides no adequate basis for either confirming or questioning the view that it will be difficult to reduce the deficit on the liquidity basis this year. However, one piece of information may be regarded as quite encouraging; U.S. banks reduced their foreign claims under VFCR much more than seasonally in January.

Merchandise exports and imports in January were both off a little from the high December levels. With corrections for statistical carryover, the trade surplus was approximately the same as in December.

Data on new security issues, including issues scheduled for March, indicate an unusually large outflow of U.S. capital through this channel, principally to Canada.

Reflecting these and all other transactions, U.S. reserves and liquid liabilities have shown little net change through January and part of February. But seasonal influences are favorable in the first quarter and the partial results suggest, therefore, a continued deficit on the liquidity basis in early 1966. No estimate can be given yet of the balance on basis of official reserve transactions. There does appear to have been a substantial build-up of balances in the United States by foreign commercial banks (including U.S. branches abroad) which would tend to hold down official reserve accruals, but this build-up was perhaps on no greater scale than in the early weeks of 1965.

The various capital flows mentioned above are not inconsistent with recent financial market developments here and abroad. The rise in U.S. money market rates since November has been paralleled by a rise in Euro-dollar interest rates, illustrating how U.S. rates put a floor under Euro-dollar rates. An important mechanism through which this relationship gets maintained is the continuing effort of U.S. bank branches to draw on the Euro-dollar market for funds for the use of their head offices.

In foreign markets for short-term and long-term funds other than U.S. dollars, rates have risen less than U.S. rates, and in some cases have declined. On the basis of information presently available, it is not possible to give a full explanation of the pullback of U.S. bank credit that would take account of interest rate differences. It is reasonable to suppose, however, that the pressure of U.S. domestic demand for bank credit relative to supply has been active as a causal factor to reduce the banks' foreign lending.

Canadian long-term interest rates held a somewhat larger than usual spread over U.S. long-term rates last autumn, a relationship that may have contributed to the large volume of Canadian bond issues in the United States during the last few months. Since early December, Canadian long-term rates have moved up a good deal less than U.S. rates; if this narrowing of spread should persist, we might hope to see a slowing of Canadian borrowing in the United States. Developments will depend, however, on Canadian monetary policy, and this may be influenced in turn by the state of Canada's current account balance of payments and its needs for financing by capital flows.

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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.)	Jan.'66	76.8	76.6	74.9	2.5	4.2
Unemployment (mil.)	"	3.0	3.1	3.6	-16.3	-25.8
Unemployment (per cent)	"	4.0	4.1	4.8	--	--
Nonfarm employment, payroll (mil.)	"	62.1	61.9	59.3	4.7	8.5
Manufacturing	"	18.5	18.4	17.6	5.0	8.4
Other industrial	"	8.1	8.1	7.7	4.2	8.6
Nonindustrial	"	35.5	35.4	33.9	4.8	8.5
Industrial production (57-59=100)	"	149.9	148.5	138.6	8.2	17.2
Final products	"	149.5	148.8	138.4	8.0	16.0
Materials	"	150.1	148.3	138.8	8.1	18.5
Wholesale prices (57-59=100)1/	"	104.6	104.1	101.0	3.6	3.6
Industrial commodities	"	103.0	102.8	101.5	1.5	2.1
Sensitive materials	"	103.7	103.2	101.3	2.4	5.8
Farm products and foods	"	107.6	106.5	98.1	9.7	7.9
Consumer prices (57-59=100)1/	Dec.'65	111.0	110.6	108.8	2.0	3.2
Commodities except food	"	105.7	105.6	104.9	0.8	1.1
Food	"	110.6	109.7	106.9	3.5	4.9
Services	"	119.3	119.0	116.2	2.7	4.6
Hourly earnings, mfg. ($)	Jan.'66	2.66	2.65	2.57	3.5	6.4
Weekly earnings, mfg. ($)	"	110.40	109.50	106.16	4.0	9.9
Personal income ($ bil.)2/	"	551.6	550.9	515.4	7.0	14.6
Retail sales, total ($ bil.)	"	24.9	25.1	22.9	8.4	18.2
Autos (million units)2/	"	9.4	8.5	9.6	-1.5	24.2
GAF ($ bil.)	"	5.8	5.7	5.2	9.8	21.7
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	"	1,537	1,763	1,442	6.6	-13.5
Factory workweek (hours)	"	41.4	41.4	41.2	0.5	3.2
New order, dur. goods ($ bil.)	"	23.6	23.3	21.3	10.9	19.5
New orders, nonel. mach. ($ bil.)	"	3.4	3.5	3.1	9.8	20.9
Common stock prices (1941-43=10)1/	"	93.32	91.73	86.12	8.4	22.1
Inventories, book val. ($ bil.)	Dec.'65	119.7	118.5	110.5	8.3	13.8
Gross national product ($ bil.)2/	QIV'65	697.2	681.5	641.1	8.8	15.5
Real GNP ($ bil., 1958 prices)2/	"	624.4	613.0	584.7	6.8	11.5

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

February 23, 1966.

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SELECTED DOMESTIC FINANCIAL DATA

	Week ended Feb. 18	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.58	4.56	4.63	1.00
U.S. Treas. bills, 3-mo., yield (per cent)	4.66	4.62	4.70	3.77
Net free reserves 2/ (mil. $)	-122	-95	98	-243
Member bank borrowings 2/ (mil. $)	453	432	627	218
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.99	4.96	5.01	4.13
20-year U.S. Treas. bonds	4.75	4.64	4.75	4.20
Corporate new bond issues, Aaa	5.02	4.94	5.02	4.63
Corporate seasoned bonds, Aaa	4.79	4.76	4.79	4.51
Municipal seasoned bonds, Aaa	3.51	3.42	3.51	3.17
FHA home mortgages, 30-year 3/	5.70	5.70	5.70	5.45
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	93.01	93.27	94.06	86.56
Dividend yield (per cent)	3.06	3.03	3.07	2.88
	Change in Jan.	Average change Last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	123	137	7.4	5.2
Bank loans and investments:				
Total	3,000	2,700	11.2	10.2
Business loans	1,500	1,200	21.4	12.2
Other loans	1,700	1,100	11.3	12.2
U.S. Government securities	-200	100	2.8	-4.2
Other securities	0	200	6.4	12.9
Money and liquid assets:				
Demand dep. & currency	1,100	1,000	7.0	5.3
Time and savings dep.	1,000	1,500	12.3	14.9
Nonbank liquid assets	1,900	1,200	5.5	6.2

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending February 16.
3/ Latest figure indicated is for month of January . 4/ Data are for weekly closing prices.

U.S. BALANCE OF PAYMENTS
(In millions of dollars)

	1965								1964
	Dec.	Nov.	Oct.	QIV	QIII	QII	QI	Year	Year
				Seasonally adjusted					
Current account balance					1,567	1,746	1,327		7.7
Trade balance 1/	364	490	449	1,303	1,237	1,320	963	4.8	6.7
Exports 1/	2,336	2,388	2,321	7,045	6,832	6,800	5,626	26.3	25.3
Imports 1/ 2/	-1,972	-1,898	-1,872	-5,742	-5,595	-5,480	-4,663	-21.5	-18.6
Services, etc., net					330	426	364		1.0
Capital account balance (regular transactions)					-1,975	-1,528	-2,070		-9.7
Govt. grants & capital 3/					-943	-974	-803		-3.6
U.S. private direct investment					-515	-891	-1,159		-2.4
U.S. priv. long-term portfolio				30e	-356	100	-679		-2.0
U.S. priv. short-term					49	424	297		-2.1
Foreign nonliquid					-210	-186	274		0.4
Errors and omissions					-287	-87	17		-1.2
Balances, with and without seasonal adjustment (- = deficit)									
Bal. on regular transactions, S.A.				-664	-695	131	-726	-2.0	-3.1
Seasonal component				50	-450	-67	467	--	--
Balance, N.S.A.	-93	-137	-320	-614	-1,145	64	-259	-2.0	-3.1
Liquidity bal., S.A.				-390	-531	267	-647	-1.3	-2.8
Seasonal component				50	-450	-67	467	--	--
Balance, N.S.A. 4/	-8	-12	-320	-340	-981	200	-180	-1.3	-2.8
Official settlements bal., S.A.				-1,249	218	230	-581	-1.4	-1.2
Seasonal component				104	-512	-191	599	--	--
Balance, N.S.A. 5/	-645	-401	-99	-1,145	-294	39	18	-1.4	-1.2
Memo items:									
Monetary reserves (decrease -)	-98	-91	-82	-271	-41	-68	-842	-1.2	- .2
Gold purchases or sales (-)	-73	-58	12	-119	-124	-590	-832	-1.7	- .1

1/ Balance of payments basis which differs a little from Census basis.
2/ Figures for October-December tentatively adjusted for changes in carry-over of import documents. Third-quarter imports not adjusted by months.
3/ Net of associated liabilities and of scheduled loan repayments.
4/ Differs from balance on regular transactions by counting as receipts (+) debt prepayments, advances on military exports, and net sales of non-convertible Roosa bonds.
5/ Differs from liquidity balance by counting as receipts (+) increase in liquid liabilities to commercial banks, private nonbanks, and international institutions (except IMF) and by not counting as receipts (+) increase in certain nonliquid liabilities to foreign official institutions.

THE ECONOMIC PICTURE IN DETAIL

The Nonfinancial Scene

Gross National Product. The Department of Commerce has revised its estimates of fourth quarter GNP to a level of $697.2 billion, up $2.6 billion from the estimate available 4 weeks ago. The upward revision was due to higher estimates for inventory accumulation and consumption expenditures, offset in part by lower net exports and "other" Federal purchases. The new level is $15.7 billion above the third quarter. We are projecting a similar rise in the first quarter, to $713 billion, and a rise almost as large in the second quarter.

The increases in GNP now estimated for the fourth quarter and projected for the first quarter represent a pronounced step-up from the $12 billion average gain in the second and third quarters of 1965. In large part this step-up has come from a sharp acceleration in Federal defense spending in support of expanded operations in Vietnam -- for equipment of all kinds and for the direct cost of the growing number in the Armed Forces. Defense purchases, which increased at an average quarterly rate of only $0.5 billion in the second and third quarters, rose an estimated $2.2 billion in the fourth quarter, and according to Budget Bureau projections are expected to rise by $2.5 billion in the current quarter. In the second and ensuing quarters of 1966, however, the Budget Bureau is projecting a marked slowdown in the rise in defense spending; the gain shown for the second quarter is only $1.2 billion.

This slowdown, incorporated in the staff projections shown in the attached Table, contributes to the smaller rise now projected for GNP in the second quarter.

The accelerating defense program, on top of high and rising private final demands, has stimulated a faster rate of growth in industrial output and employment since last autumn, and has fostered expectations of supply shortages and larger price increases. In this situation an unexpectedly high rate of inventory investment occurred in the fourth quarter, and business inventory demands are expected to remain strong in the first half of this year.

The fourth quarter inventory rate represented a new high for this expansion period, exceeding the previous high of $8.8 billion reached in the first quarter 1965 when steel and auto stocks were expanding at a rapid rate. The fourth quarter rate was as high as the temporary peak reached in early 1960 just before the 1960-61 recession and it also just about equalled the average rate for the year 1951 during the Korean War (although it was well below the quarterly peaks of $15 billion reached in late 1950 and again in early 1951). However, in those earlier periods, inventory accumulation represented a much larger proportion of GNP.

Despite the large run-up in stocks in late 1965, the stock-sales ratio for manufacturing and trade was at a new low for this expansion period in December. With steel liquidation ending, total nonfarm inventory accumulation is projected to hold at the fourth quarter rate in the first half of 1966. If, as appears likely, business sales show less than the very sharp fourth quarter run-up, stock-sales ratios might be expected to rise somewhat, but they would still remain low by standards applicable to previous cyclical expansion periods. Accumulation of farm stocks, which speeded up so much in the last half of 1965, is expected by the Department of Agriculture to start receding in the current quarter, and, with the decline in the rate of accumulation of farm stocks, over-all inventory investment is projected at a slightly lower rate in the first half of this year.

With gains in personal income running larger in late 1965, consumption expenditures speeded up somewhat. It might be noted that retail sales -- now available on a revised sample basis -- showed a very sharp run-up in late 1965 (they increased as much from September to December as they had in the preceding nine months) but part of this rise has been judged by Commerce to be an aberration due to the shift in samples and has not been incorporated in their fourth quarter consumption estimates.

Following the sharp run-up in late 1965, retail sales have changed little thus far in 1966 at a level moderately higher than the fourth quarter average. While some slowing of the rise in consumption expenditures was expected in the current quarter as the social security tax boost slows the rise in personal income, presently available retail sales figures may be exaggerating the current slackening just as fourth quarter figures apparently exaggerated the rise. In January, social security tax increase -- from extension of the wage base as well as from the upping of rates -- was debited against personal income and the income rise was quite small. In February, it is expected that large increases in income will be resumed, and renewed expansion in retail sales should also soon develop. Whether consumer spending expands more than now projected will depend partly on the course of war in Vietnam, including the possibility that consumer anticipations of shortages of certain consumer goods might develop. There is little evidence as yet of much, if any, scare-buying in the current situation.

Business fixed investment has been providing a strong underpinning to growth in GNP. The large increases in this sector estimated for the fourth quarter and projected for the first two quarters of this year are based primarily on business plans for new plant and equipment spending as reported in the Commerce-SEC survey conducted last November. In confirmation of these plans, unfilled orders for machinery and equipment have expanded further since November as have pressures on capacity. A capacity utilization rate of 92 per cent in December and January would be expected to support, if not augment, manufacturers' earlier plans for a large further expansion in plant and equipment outlays in the first half of this year. A new official reading on business fixed investment plans -- this time for the entire year 1966 -- will be available shortly.

February 24, 1966

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Expenditure and income figures are billions of dollars, seasonally adjusted annual rates)

	1964	1965	1965			1966 -Proj.	
			II	III	IV	I	II
Gross National Product	628.7	676.3	668.8	681.5	697.2	713.0	726.5
Personal consumption expenditures	398.9	428.7	424.5	432.5	441.0	448.3	456.5
Durable goods	58.7	65.0	63.5	65.4	66.4	67.0	68.0
Nondurable goods	177.5	189.0	187.9	190.5	195.0	199.0	202.5
Services	162.6	174.7	173.1	176.7	179.6	182.3	186.0
Gross private domestic investment	92.9	105.7	102.8	106.2	110.3	112.8	114.5
Residential construction	27.5	27.6	28.0	27.7	27.2	27.9	27.6
Business fixed investment	60.5	69.8	68.4	70.9	73.0	75.0	77.3
Change in business inventories	4.8	8.2	6.4	7.6	10.1	9.9	9.6
Nonfarm	5.4	7.9	6.6	7.0	8.9	8.9	8.9
Net exports	8.6	7.1	8.0	7.4	6.9	7.5	8.0
Gov. purchases of goods and services	128.4	134.8	133.5	135.4	139.0	144.4	147.5
Federal	65.3	66.6	65.7	66.5	69.2	72.5	74.0
Defense	49.9	49.9	49.2	49.8	52.0	54.5	55.7
Other	15.4	16.7	16.5	16.7	17.2	18.0	18.3
State and local	63.1	68.2	67.8	68.9	69.8	71.9	73.5
Gross National Product in Constant (1958) Dollars	577.6	609.6	603.5	613.0	624.4	635.0	642.7
Personal income	495.0	530.7	524.7	536.0	546.0	556.0	565.3
Wages and salaries	333.5	357.4	353.6	359.0	368.1	376.5	383.8
Personal contributions for social insurance (deduction)	12.4	13.2	13.0	13.3	13.6	16.6	16.8
Disposable personal income	435.8	465.3	458.5	471.2	480.3	488.4	497.7
Personal saving	26.3	24.9	22.4	26.8	27.1	27.6	28.3
Saving rate (per cent)	6.0	5.4	4.9	5.7	5.6	5.7	5.7
Total labor force (millions)	77.0	78.4	78.2	78.5	78.9	79.6	80.1
Armed forces "	2.7	2.7	2.7	2.7	2.8	2.9	3.0
Civilian labor force "	74.2	75.6	75.5	75.8	76.1	76.7	77.1
Employed "	70.4	72.2	71.9	72.4	72.9	73.8	74.3
Unemployed "	3.9	3.5	3.6	3.4	3.2	2.9	2.8
Unemployment rate (per cent)	5.2	4.6	4.7	4.4	4.2	3.8	3.6

Industrial production. In January, industrial production rose to 149.9 per cent of the 1957-59 average, a rise of 1.0 per cent over December and of 8.2 per cent over a year earlier. Output of industrial materials rose 1.2 per cent from December. Business and defense equipment increased by nearly the same proportion as materials, but output of consumer goods did not change. Consequently, the increase in total final products was only 0.5 per cent.

Auto assemblies declined slightly to an annual rate of 9.2 million as one manufacturer suspended production for part of January. Output of television sets, household appliances and furniture continued to expand, but apparel production was curtailed by the transit strike in New York City. Increases in production of machinery were widespread.

Iron and steel output rose more than 3 per cent in January, continuing upward from the low point set in November. However, it remained about 13 per cent below the levels of last spring and summer. At the end of December, inventories of steel mill products at manufacturing consumers were down nearly a fourth from their peak in August and totaled 13.1 million tons -- equivalent to about 2-1/3 months' supply at 1965 consumption rates. In January, production of most other materials also advanced.

Retail sales. With a new reporting sample in effect, Census figures on retail sales have been revised upward substantially beginning last October. The new figures show a rise of 4.3 per cent from September to December, whereas the advance figures (available 4 weeks ago) had indicated an increase of only 2.2 per cent. Both durable and nondurable goods shared in this upward revision, as indicated in the table below.

PERCENTAGE INCREASE FROM SEPTEMBER TO DECEMBER 1965

	Old series	Revised series
Total retail sales	2.2	4.3
Durable goods	4	6
Automotive	2	6
Furniture and appliances	5	1
Lumber and hardware	10	8
Other durables	9	8
Nondurable goods	1	4
Apparel	2	-1
Drugs	3	5
Eating & drinking places	2	2
Food	3	7
Gas	-3	1
General merchandise	0	1
Other nondurables	1	5

Following the sharp run-up now indicated for late 1965, retail sales were down slightly in January, according to advance figures, but in early February, weekly figures indicate slight increases for both durable and nondurable goods. In January, total retail sales were reported to be up 8 per cent from a year earlier, with sales of durable goods up 6 per cent and of nondurable goods up 10 per cent.

The sample revision, which has resulted in substantially higher levels of retail sales in recent months, was designed, according to the Census Bureau, "both to improve the reliability of the estimates and to bring them more closely in line with the 1963 Census of Business results." The old figures were tied into the 1958 Census.

Unit auto sales and stocks. Sales of new domestic automobiles rose to an annual rate of 9.4 million units in January, a gain of 10 per cent over December, and were nearly as high as the record rate a year earlier when sales were boosted by a backlog of demand from the auto strike period. Dealer deliveries in the first 20 days of February were down more than seasonally from their level in early January and pointed toward a rate of less than 9.0 million for the month as a whole. At the end of January, dealer inventories of new cars were down a little from a month earlier and represented about 58 days' supply, a somewhat higher ratio than is usual for this season.

Consumer credit. Consumers added $8 billion to their instalment debt in 1965. This was by far the largest dollar increase on record, but in percentage terms it ranked well behind such years as 1955 and 1959.

Auto credit, which dominated the movement in the total even more than usual, rose $3.7 billion, more than 45 per cent of the total increase. While much of the expansion in auto credit was a direct reflection of the rise in unit auto sales, some of it resulted from the gradual upcreep in size and length of instalment contracts and in the proportion of new cars sold on credit. The proportion was up 1 percentage point in 1965. Meanwhile, the average note for new cars was nearly $50 higher than in 1964. As to maturities, perhaps the most significant development in 1965 was the continued steady rise in the proportion of new car contracts written for 36-months, the typical maximum maturity. By the end of the year, three-fourths of all contracts fell in this category, an increase of about 2 percentage points from a year earlier.

Other consumer goods credit rose about $2 billion in 1965, with much of it coming from increased sales of television sets, appliances, and other home goods. Personal loans outstanding also rose $2 billion, with the sharpest increases coming early in the year at tax time.

The pace of instalment debt growth was faster during the first half of the year because of a rising volume of auto and personal loans, and a little slower in the second half. The December rise was at a $7.8 billion annual rate and, based on an early report from the commercial banks, the January increase was probably about the same. There was a sharp rise in auto credit in December and a further sharp rise would seem likely for January, given the usual relationship between credit extensions and sales.

Orders for durable goods. New orders for durable goods, which had increased sharply in December, rose somewhat further in January as large gains in aircraft and electrical machinery more than offset moderate declines for steel, fabricated metals, and machinery and equipment. For the latter three industries, new order gains had been large in late 1965.

Shipments of durable goods rose more than new orders in January -- shipments of machinery and equipment showed an especially large rise -- but unfilled orders expanded substantially further. The ratio of unfilled orders to shipments, at 2.8, was about unchanged from other recent months but was slightly higher than a year ago.

Total durable new orders in January were up 11 per cent from a year earlier. Shipments were up by the same amount, while unfilled orders were up 17 per cent.

Business inventories. The pace of inventory accumulation in manufacturing and trade accelerated during the fourth quarter, starting with $685 million in October -- about the third quarter rate -- and ending with nearly $1.2 billion in December. The December rate about equalled last March, the peak month of the first half steel and auto stock build-up.

For the entire fourth quarter the book value increase totaled $2.7 billion, moderately above the first quarter. However, on a GNP basis, after allowing for larger price increases in the fourth quarter and a lower rate of accumulation in industries not covered by the monthly book value figures total, nonfarm inventory accumulation in the fourth quarter was at a seasonally adjusted annual rate of $8.9 billion, slightly lower than the $9.2 billion rate in the first quarter. Including farm stocks, total inventory accumulation in the fourth quarter was $10.1 billion, a new high for this expansion period.

The fourth quarter inventory build-up -- at a rate much higher than had been expected -- was widely dispersed throughout the manufacturing and trade sectors. In marked contrast to the three earlier quarters of the year, steel inventories were being liquidated at a very fast pace from October on. Nevertheless, inventory accumulation by durable goods producers in the fourth quarter about equalled the average rate for the first three quarters of the year.

A special feature of fourth quarter developments was a marked upturn in accumulation by nondurable goods producers -- with much of it concentrated in December. However, this followed relatively low rates of accumulation during the first three quarters and was accompanied by a sharp rise in shipments; the stock-sales ratio in December was below the average for the year. A similar spurt in inventories and shipments in the fourth quarter 1964 was followed by a slowdown in early 1965.

The fourth quarter increase in trade inventories was sharply higher than the third quarter increase but it was well below the record first quarter rise. Accumulation of auto stocks -- which proceeded throughout the year -- was at a much less rapid rate than earlier in the year but nevertheless accounted for nearly a third of the final quarter increase. A large rise in stocks at retail food stores accounted for another third of the trade inventory increase in the fourth quarter; earlier in the year food stocks had shown no change. The spurt in book value of retail food stocks accompanied a very sharp increase in sales (7 per cent between September and December), and both reflected in part a run-up in food prices.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES
(Quarterly totals, seasonally adjusted, millions of dollars)

	1964	1965			
	Fourth quarter	First quarter	Second quarter	Third quarter	Fourth quarter
Manufacturing & trade, total	2,031	2,497	2,017	1,918	2,713
Manufacturing	1,925	764	917	1,642	1,624
Durable goods	1,375	560	979	1,349	877
Nondurable goods	550	204	- 62	293	747
Trade	106	1,733	1,100	276	1,089
Wholesale	239	603	346	245	182
Retail	- 133	1,130	754	31	907

Construction activity. New construction put in place rose 3 per cent in January to a seasonally adjusted annual rate of $74.1 billion, based on data incorporating revised series now being introduced by the Census Bureau. (See appendix note.) Altogether, the total was 8 per cent above a year earlier and moderately above the previous peak reached last September. Residential expenditures, benefiting from a recent upturn in starts, rose appreciably further in January, to nearly the March 1964 high. Expenditures for private nonresidential construction also advanced, while public construction changed little.

Seasonally adjusted housing starts, which spurted one-fourth from October to December, lost about half of that advance in January. A decline had been expected in view of the unusually high annual rate -- 1.76 million -- reached in December when weather conditions in the North Central states were particularly favorable. On a three-month moving average basis, starts in the November-January period were at an annual rate of 1.62 million, only 5 per cent below the recent peak reached in the first quarter of 1965.

Seasonally adjusted building permits also dropped in January, particularly for multifamily structures which had accounted for all of the rise in permits in the previous two months. Except in the West, where activity has been unusually low, all regions shared in the January decline in both permits and starts.

PRIVATE HOUSING STARTS AND PERMITS

	January 1/ (thousands of units)	Per cent change from	
		Month ago	Year ago
Starts (total)	1,537	-13	+ 7
Permits (total)	1,214	- 8	- 5
1 family	716	- 3	- 3
2-or-more family	498	-16	- 9
North East	241	- 4	+ 1
North Central	341	-20	- 2
South	387	-13	- 7
West	245	+20	-12

1/ Seasonally adjusted annual rate; preliminary.

Personal income. Personal income rose $700 million in January to a seasonally adjusted annual rate of $551.6 billion. The rise was checked by a $2.8 billion increase in personal social insurance contributions. The increase in social insurance taxes was from 3.625 per cent to 4.2 per cent of taxable wages for both employees and employers and the taxable earnings base rose from $4,800 to $6,600; both of these changes were effective at the beginning of the year. Personal income would have risen $3.5 billion (annual rate) in January if social security taxes had remained unchanged. This about equals the average monthly increase last year.

Labor market. Demands for labor continued very strong in January. Employment again rose sharply with gains widespread. If allowance is made for the New York transit strike, increases in nonfarm employment in January were close to the extremely high rates of November and December. Over the past three months more than 1.1 million jobs have been added to nonfarm activities, an annual rate of increase of 7 per cent.

Almost all industries showed advances in January. In durable goods manufacturing, employment gains were as large as in the two previous months and the workweek rose to a new postwar record of 42.4 hours -- .2 above December. (During the Korean War average hours in durable goods were never above 42.0 hours.) Most nondurable goods industries showed further gains but they were largely offset by a decline of 16,000 in the apparel industry because of the New York strike. The workweek was also sharply curtailed in the apparel industry causing the nondurable group total to decline somewhat. Thus, except for the strike, average hours of work in manufacturing would have been at a new high, instead remaining at the November and December level.

Employment continued to advance at a fast pace in trade and Government. Federal civilian employment which has been rising steadily since early summer increased by 17,000 in January. At 2.4 million, Federal employment was 70,000 above a year earlier; in contrast, Federal employment had shown no change in the two previous years. After rising sharply at the end of last year, construction employment leveled off in January at close to the high December level.

The total employment rise in January was again larger than the increase in the labor force and the unemployment rate declined to the 4.0 per cent interim target. Significantly, the proportion of short-term job seekers, (those seeking work less than 4 weeks) accounted for over one-half the total unemployed, the first time the proportion has been this high since early 1957.

UNEMPLOYMENT RATES
(Seasonally adjusted)

	January			
	1953	1956	1965	1966
Total, all ages	2.9	4.0	4.8	4.0
Males				
14-19 years	6.2	9.3	16.0	11.4
20-24 years	4.1	6.5	7.1	4.2
25 years & over	2.5	3.1	3.1	2.5
Females				
14-19 years	7.2	10.7	17.0	12.8
20-24 years	3.9	5.9	7.5	7.1
25 years & over	2.5	3.6	4.0	3.3

Substantial inroads have been made over the past year in unemployment rates for all groups. Relatively, the sharpest declines have been among men 20-24 years of age, reflecting the impact of expanding draft calls on unemployment. Not only have draft calls been met mainly from this age group, but they have also apparently induced larger college enrollments than had been anticipated. The teenage unemployment rate has been declining noticeably in recent months and, although still high, it is significantly below a year ago.

Current unemployment is much more heavily concentrated among young inexperienced workers than in earlier periods of low unemployment. This reflects the change in population structure in recent years, with much of the increase in working age population now in the early age groups. Among adult men, whose population has been relatively stable in recent years, unemployment rates are now well below those in the 1956-1957 expansion. In fact, for all male groups, except the teen-agers, unemployment rates have been reduced to close to those during the Korean conflict when the over-all rate fell below 3 per cent.

Wages. As the available supplies of labor have diminished wages have moved up more rapidly and increases spread more widely. Most industries show higher rates of increase from the fourth quarter of 1964 to the fourth quarter of 1965 than they did on average for the year 1965 as a whole.

AVERAGE HOURLY EARNINGS

	Annual per cent increases			QIV 1964-
	1951-52	1955-56	1964-65	QIV 1965
Manufacturing	5.8	4.8	3.2	3.5 1/
Construction	5.4	4.9	3.7	4.2
Retail trade	4.4	4.5	4.0	4.9
Telephone	6.7	2.2	3.1	3.3
Telegraph	9.2	5.3	3.6	4.7
Banking	n.a.	n.a.	3.9	4.0
Laundries	n.a.	n.a.	4.9	5.0

1/ Quarterly average is November, December and January.

Even in manufacturing, where employment pressures were slow to develop, an upward drift in wages now appears to be getting underway with the rate of increase in the past three months somewhat higher than the average for 1965. Apparently, higher overtime pay, upgrading of some jobs and wage scales to limit turnover of skilled workers, and more rapid increases in wages in the nonunion sector have pushed up hourly earnings somewhat, despite the relatively few new union contracts signed in the period.

Wholesale prices. The industrial commodity price index rose .2 per cent from mid-December to mid-January, and is estimated to have increased .1 per cent further into late February. The index, estimated for late February at 103.1 per cent of the 1957-59 average, was up .4 per cent from 3 months ago and .8 per cent from 6 months ago, and thus is rising at an annual rate of slightly over 1.5 per cent. Average prices of foodstuffs rose an additional 2 per cent in January and February, largely as a result of short market supplies of livestock and weather damage to vegetable and fruit crops. The estimated total wholesale price index has increased nearly 1 per cent further since December, and is almost 4 per cent above a year ago.

From mid-December to mid-January, 58 per cent of the industrial commodity subgroups exhibited price increases (compared with 48 per cent in each of the two months previous), 27 per cent were unchanged, and 15 per cent declined. Prices of hides and leather in January rose sharply further to a level more than 10 per cent above a year ago. Leather footwear also rose further, following the rise in material costs, and was 5 per cent above the previous year. Lumber rose nearly 1 per cent, in part because of favorable weather for construction in many parts of the country, and paper products also increased. Machinery prices rose further, led by metal working machinery which was up .4 per cent. Metals increased again, mainly as a result of the continuing upward drift in steel scrap, copper scrap, and copper tubing. Man-made fiber textile products again declined and some declines also occurred among organic chemicals.

A continuing series of strikes in Chile has accentuated the worldwide copper shortage. While the domestic producer price is 36 cents a pound and the foreign producer price is 42 cents, the price in the London "free" market has risen to 84 cents, and the domestic scrap price to nearly 50 cents. Most domestic copper users are paying varying weighted averages of the several prices -- probably in the range from 38 to 45 cents a pound.

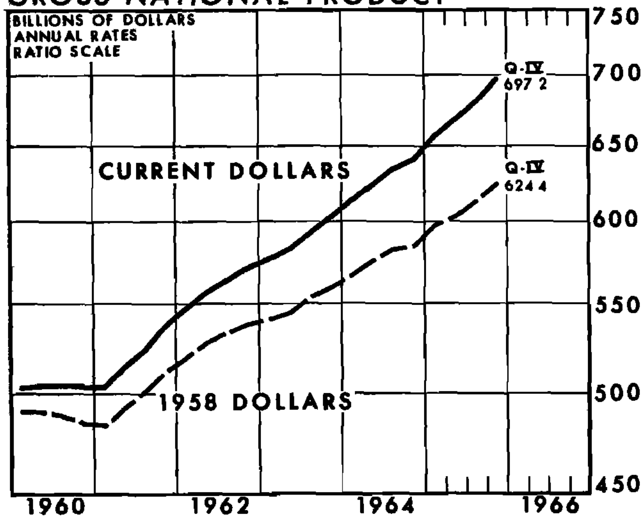
WHOLESALE PRICE INDEXES
1957-59 = 100

Commodity Group	Per cent increase to January 1966 from			Index January 1966
	Jan. 1960	Jan. 1965	Dec. 1965	
	(72 months)	(12 months)	(1 month)	
Total index	4.1	3.6	0.5	104.6
Industrial commodities	1.4	1.5	0.2	103.0
Industrial materials	0.7	1.7	0.2	102.3
Industrial products	1.9	1.1	0.1	103.6
Consumer nonfood	1.2	1.0	0.1	102.4
Producer goods	3.4	1.1	0.1	106.0
Foodstuffs	12.8	9.9	1.2	109.1
Livestock and products	17.0	18.5	0.9	111.6
Crops and products	8.1	1.5	1.6	106.3
Addendum:				
Industrial commodities:				
Less metals & machinery	0.3	1.4	0.2	101.1
Metals and machinery	2.9	1.5	0.3	105.7
Nonferrous metals	10.8	6.0	0.9	118.2

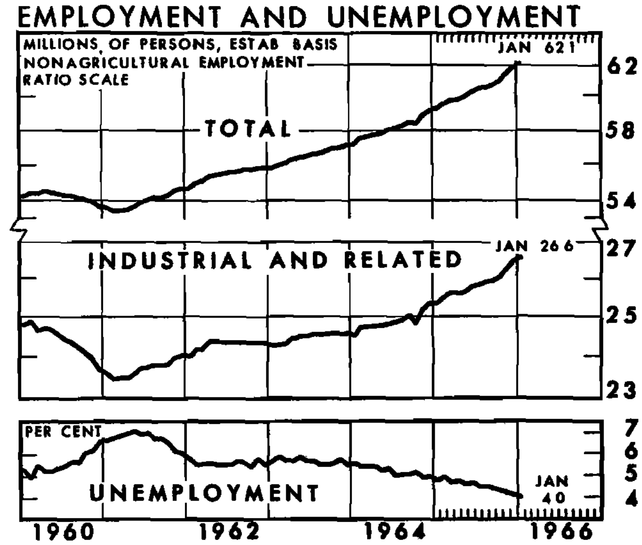
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

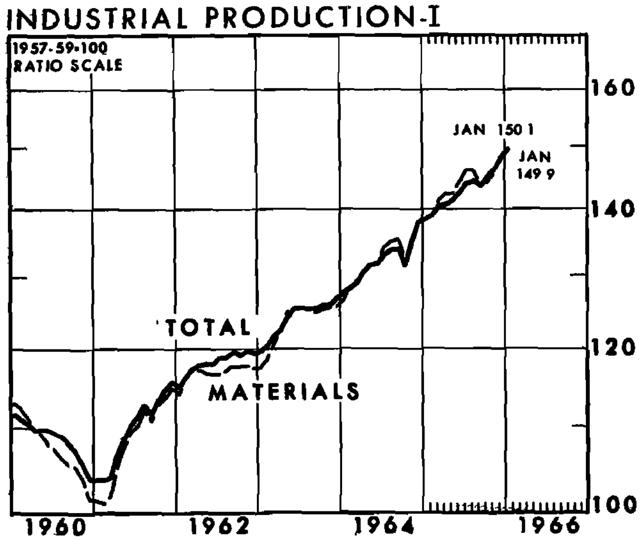
GROSS NATIONAL PRODUCT



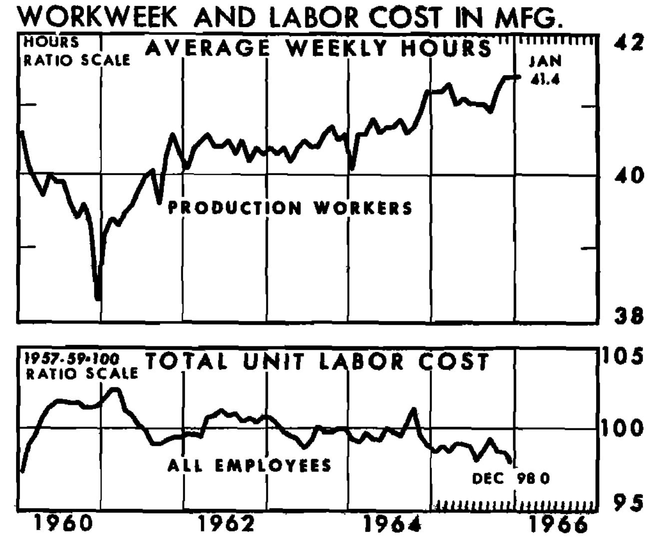
EMPLOYMENT AND UNEMPLOYMENT



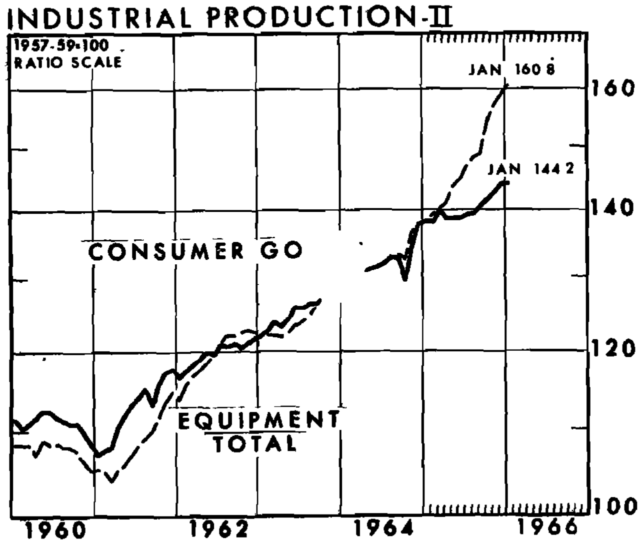
INDUSTRIAL PRODUCTION-I



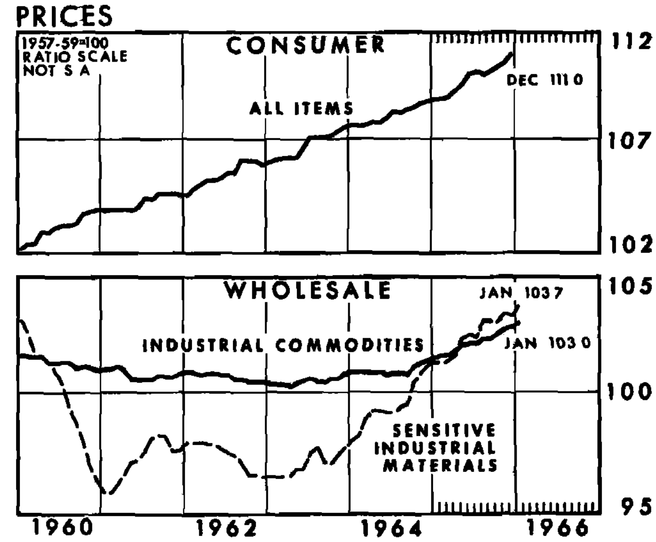
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



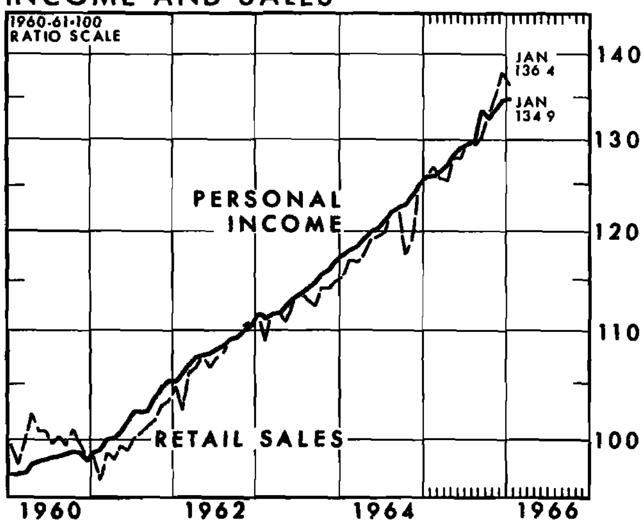
PRICES



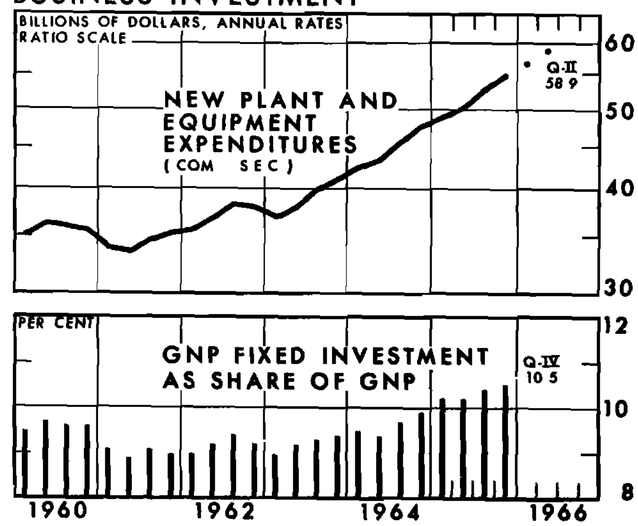
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

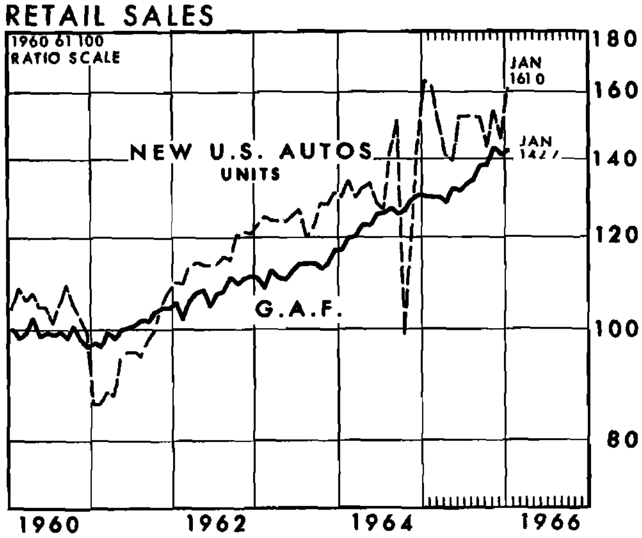
INCOME AND SALES



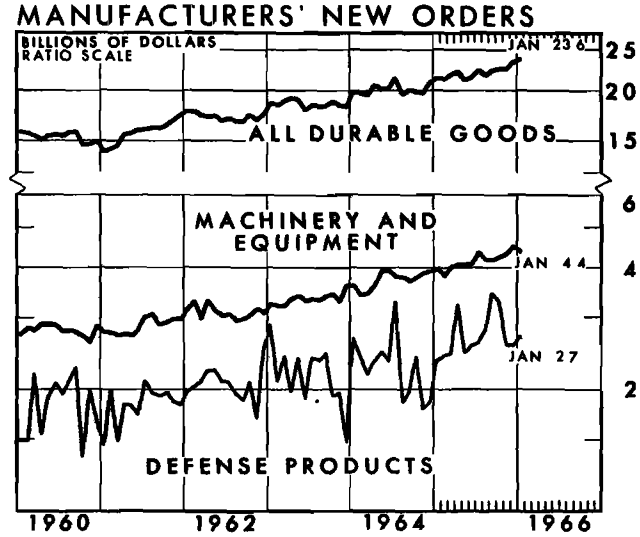
BUSINESS INVESTMENT



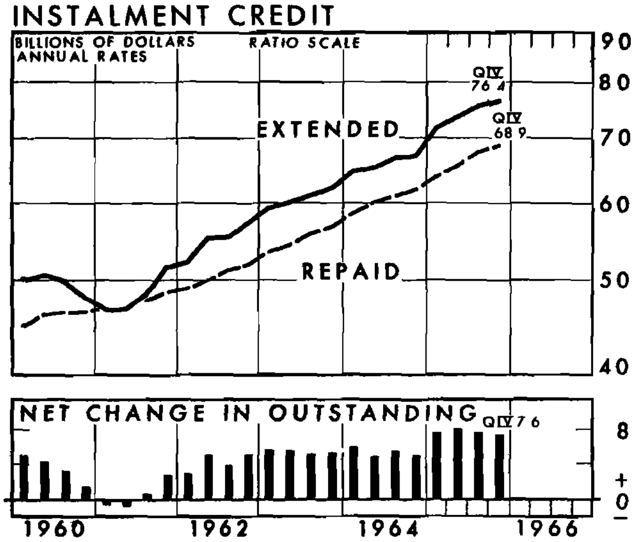
RETAIL SALES



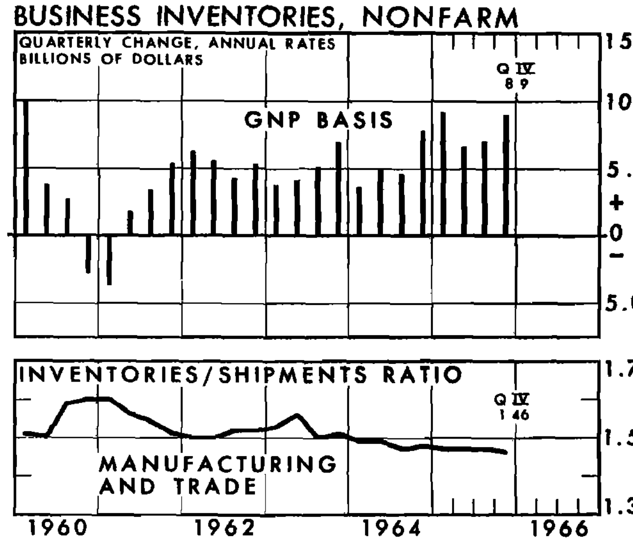
MANUFACTURERS' NEW ORDERS



INSTALMENT CREDIT



BUSINESS INVENTORIES, NONFARM



DOMESTIC FINANCIAL SITUATION

Bank credit. Total loans and investments at city banks declined substantially in late January and early February, as these banks remained under pressure. Although loan expansion moderated in recent weeks, city banks continued to make substantial reductions in holdings of U.S. Government securities and their holdings of other securities rose much less than usual. At banks outside leading cities, funds continued to be readily available in January; they added nearly $1 billion to their holdings of Governments and also made additions to their holdings of municipal and agency issues. In the first half of February, however, credit at these banks showed a small contraseasonal decline.

In the four weeks ending February 16, total loans at city banks rose much less than usual, mainly reflecting a large drop in security loans. Broker loans declined sharply, presumably in large part in response to firmer lending policies--the rate charged on these loans was raised to 5-1/4 per cent in late January--and increased participations with correspondent banks. Loans to Government securities dealers also declined as dealers reduced trading positions in response to increased financing costs and expectations of further advances in market yields.

Business loan demand moderated in recent weeks from the accelerated pace in December and early January. Nevertheless, the rate of growth has continued fairly rapid, after allowance for usual seasonal changes, possibly at about the November level. The industries accounting for the growth in business loans are fairly widely distributed. But with the exception of public utilities, they are not industries in which estimated plant and equipment expenditures, seasonally adjusted, show a large rise from the fourth quarter of 1965 to the first half of 1966. Thus, the increased borrowing presumably is associated with inventory accumulation and other expanded working capital requirements, although it could also reflect some anticipatory borrowing as well as delayed financing of some fourth quarter investment outlays.

The recent slackening in business loan expansion is believed to be temporary. With liquidity of corporations already thin, their needs for bank loans are expected to rise substantially in March and further in April. Assuming that the proposed legislation for acceleration of corporate tax payments is enacted, those payments in the second quarter are estimated to total $11.3 billion, or $3 billion more than in the same period last year.

Bank deposits and the money supply. The money supply declined substantially over most of January after reaching a peak in the week of January 5, but it edged up somewhat in the first half of February. Assuming only seasonal movements over the remainder of the month, the increase for February would be nominal and mainly in currency. This reaction to the December-early January surge in money growth was similar to those that occurred after growth spurts in the past. Moreover, with increasingly attractive yields available on other financial assets, particularly marketable securities, there could have been some transfers of funds from demand deposits into other financial assets.

Growth in time deposits at commercial banks slackened further in late January and early February to an annual growth rate of about 6 per cent, less than half the fourth quarter rate. The slowdown was concentrated at city banks, where a substantial part of the time deposit inflow in recent years has been from depositors, particularly large corporations, that have relatively uneven funds flows, are highly interest-sensitive, and have a variety of alternative outlets for their funds. At country banks, where savings inflows are mainly of local origin, personal, and less interest-sensitive, time deposit growth recently has accelerated. These inflows help explain the large January rise in holdings of investments at these banks.

Notwithstanding further advances in offering rates, city banks continue to encounter difficulty in attracting and holding CD funds. Following past quarterly tax period run-offs, these banks generally had reattained the pre-tax period peak of outstandings in about a month. After the December 1965 run-off, outstandings did not approach the earlier peak until late January at New York City banks and early February in Chicago, and in the week of February 16, reflecting in part recent shortening of maturities, New York City banks experienced run-offs three-fifths as large as those during the December tax and dividend period. At banks outside these cities, outstandings have recovered less than three-fourths of the December decline.

The outflow of savings deposits at city banks, which had been substantial in early January, slackened late in the month and appears to have been reversed in early February. This turnaround presumably reflects completion of adjustments in savings stocks in response to changes in interest rates and in savings instruments which became effective at many institutions at the turn of the year. In some areas, however, the 4 per cent ceiling on savings deposits may have become an impediment to effective competition with other savings institutions, and savings deposits are continuing to decline. While city banks have been attracting sizable amounts of funds on savings certificates and other nonpassbook instruments, their total inflows of time and savings deposits in recent weeks have been less than one-third as large as those in the comparable weeks last year.

U.S. Government securities market. Yields on U.S. Government securities have continued to move higher in recent weeks and are currently above their peaks of late 1959--early 1960 in the longest maturities. The 3-month bill rate advanced to a new record high of 4.70 per cent in mid-February and has fluctuated just below that level recently.

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

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1959-1961						
Highs	4.68	5.15	5.17	5.11	4.90	4.51
Lows	2.08	2.33	3.08	3.30	3.63	3.70
1965-1966						
Highs	4.70	4.89	5.08	5.01	4.95	4.76
Lows	3.76	3.81	4.00	4.08	4.17	4.17
1965-1966						
Dec. 3	4.12	4.26	4.54	4.52	4.52	4.44
31	4.49	4.67	5.00	4.88	4.65	4.52
Feb. 8	4.64	4.77	4.98	4.97	4.72	4.65
16	4.70	4.89	5.08	5.00	4.90	4.75
23	4.69	4.89	5.08	4.98	4.95	4.76

The continuing rise in yields on Treasury notes and bonds has occurred against a background of continuing talk of inflationary developments in the domestic economy, discussions of possible tightening of monetary policy, and heavy current and prospective demands on the credit markets. Bond market participants apparently have decided that interest rates are likely to work higher before a new trading level is reached. In the circumstances, dealers have been reluctant to take on bonds, and while investment demand has not been stimulated by rising yields on intermediate- and long-term Treasury bonds, investment selling has also remained relatively light. Market sentiment was further weakened recently by the poor reception accorded the $700 million Export-Import Bank issue of participation certificates for which subscriptions totaled only $360 million. In addition, a $410 million offering of 1-15 year participations certificates by FNMA scheduled for mid-March was expected to place further pressure on the Treasury bond market.

There has been some investment demand for shorter-term coupon issues, including the new 5's of November 1970 which are currently trading at a small premium. Dealer positions in the new 5's had reached minimal levels on the February 15 payment date, owing in part to Treasury investment account purchases of the new issue. The System bought about $44 million of short-term coupon issues on February 17, its first purchases outside the bill area since early September 1965.

Treasury bill rates have risen in recent weeks, especially rates on the longer maturities which have encountered considerable competition from rising new issue rates on CD's and on Federal agency issues. Demand for bills has been seasonally strong but has tended to favor shorter maturities where reinvestment demand from the proceeds of recent capital issues has been concentrated. Dealer positions in bills remain at relatively low levels.

The recent advance in yields on selected short-term debt instruments is indicated in the table:

SELECTED SHORT-TERM INTEREST RATES 1/
1965-66

	Dec. 3	Jan. 28	Feb. 23
Commercial paper 4-6 months	4.375	4.875	4.875
Finance company paper 30-89 days	4.375	4.875	4.875
Bankers' Acceptances 1-90 days	4.25	4.75	4.875
Certificates of deposit (prime NYC)			
Most often quoted new issues			
3-months	4.50	4.90	5.00
6-months	4.50	5.00	5.125
Secondary market:			
3-months	4.49	5.00	5.07
6-months	4.57	5.13	5.20
Municipal Note 1-year	2.70	2.85	3.05
Federal Agencies 6-month	4.49	4.90	5.03

1/ Rates are quoted on offered side of market; rates on commercial paper, finance company paper, and bankers' acceptances are quoted on a bank discount basis while rates on the other instruments are on an investment yield basis.

Treasury finance. With the completion of its combination refunding and pre-refunding operation in mid-February, the Treasury has substantially accomplished its financing program for the current fiscal year apart from a possible cash financing of perhaps $1/2 billion in late March or early April and a routine refunding in May. The Treasury is also expected to continue its $100 million additions to the weekly 3-month bill auctions until the end of the current quarter.

The Treasury will experience a large seasonal drain in its cash operating balances during the first half of April

and these balances will probably be drawn down to very low levels even with a projected $1/2 billion cash borrowing in the market. Thereafter, strong seasonal receipts will serve to rebuild the Treasury's cash balances until the next period of sustained cash drains in July.

Corporate and municipal bond markets. The further general advance of interest rates since the latter part of January has amounted to nearly 20 basis points in the market for new corporate bonds and to 12 basis points in the market for highest quality seasoned municipal securities. These increases have extended the more general yield advance which began in these markets about a year ago, to 70 basis points for new corporate issues and to nearly 60 basis points for municipal issues. Much of the recent further stimulus to yields has come from the heavy immediate volume of new security issues. But the sharpness of the advance has also reflected market expectations that future demands for long-term funds will substantially exceed the supplies available from usual institutional sources.

BOND YIELDS
(Per cent per annum)

	Corporate Aaa		State and local Government	
	New	Seasoned	Moody's Aaa	Bond buyer (mixed qualities)
Previous Postwar High	5.13(9/18/59)	4.61(1/29/60)	3.65(9/24/59)	3.81(9/17/59)
1965 Low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(2/11)
Weeks ending:				
July 23	4.56	4.48	3.16	3.25
Dec. 3	4.79	4.60	3.37	3.50
Jan. 21	4.84	4.74	3.39	3.51
Feb. 18	5.02	4.79	3.51	3.70

Public offerings of corporate bonds have continued in record volume during February and are expected to remain so in March when a $250 million AT&T issue is scheduled for offering late in the month. With corporate private placements reportedly also continuing at an unusually high level and offerings of State and local government bonds expected to average more than $1 billion a month--thanks in part to the $400-600 million New Jersey Turnpike issue scheduled for March--the gross volume of first quarter bond offerings in both markets may total nearly $7 billion. This would be the largest combined supply of bonds ever offered in these markets in <u>any</u> quarter, exceeding the next largest total for the usually light <u>first</u> quarter by nearly $2 billion. Add to this the recent and prospective sales of Federal agency participation certificates and the magnitude of immediate- and near-term market pressures on interest rates becomes clear.

To some extent the unprecedented first quarter volume of corporate financing in capital markets appears to reflect shifts in the timing of offerings prompted by interest rate considerations. Near the end of 1965, planned financings by domestic corporations--estimated to total more than $500 million (including private placements as well as public offerings)--were reportedly deferred in the hope of obtaining more favorable terms after the turn of the year. In early 1966, however, indications that interest rates would rise further, caused many of the postponed corporate issues to come back in, and other business borrowers moved to anticipate their 1966 financing requirements. It is difficult to judge how much of the 1966 business need for funds is being met by anticipatory borrowing. But given the projected further rise in business outlays relative to internal sources of funds, and given the usual second quarter build-up of new issues in both corporate and municipal security markets, new bond offerings are generally expected to exert continuing pressures on yields as the spring progresses.

BOND OFFERINGS 1/
(In millions of dollars)

	Corporate				State & local Govt.	
	Public Offerings		Private Placements			
	1965-66	1964-65	1965-66e/	1964-65	1965-66e/	1964-65
1965						
Yearly Average	474	300	707	604	938	904
October	287	181	574	642	867	852
November	613	30	529	645	1,018	578
December	326	320	1,161	1,342	768	1,078
1966						
January	430 2/	161	700	565	1,170	849
February	575	187	600	450	1,000	966
March	650	557	700	658	1,200	904

1/ Includes refundings--data are gross proceeds for corporate offerings and principal amounts for State and local Government issues.
2/ Excludes $600 million of U.S. Steel Corporation bonds, converted from preferred stock on a "rights" basis early in January. While some holders of the preferred stock "rights" may have sold them to other investors through the market, the volume of such transfers is not known.

In the latest calendar week, however, the corporate bond market exhibited a somewhat better tone. A 5.05 per cent reoffering yield on a triple-A rated corporate utility bond attracted a quick sell-out and other offerings were quite well received. With underwriters unsold balances of new issues at a low level and with the volume of new public offerings scheduled for the current and immediately subsequent weeks below the 1965 weekly average, it is possible that corporate bond yields, following their sharp recent rise, are approaching at least a temporary equilibrium. On the other hand, spreads between yields on U.S. Treasury bonds and those on both new and seasoned corporate bonds have recently narrowed. Hence yields in the corporate bond market are particularly vulnerable to renewed market pressures.

In the municipal bond market, last week's 12 basis point yield adjustment was the largest for any week since August 1958. The size of this advance represented a belated response by the municipal bond market to developments already underway for several weeks in other bond markets. As yields had risen in other bond markets, the advertised inventories of municipal dealers had also grown, and when the slow receptions accorded last week's two largest new offerings threatened a further inventory build-up, dealers began to reduce prices in order to cut-back their holdings of older issues.

Home mortgage markets. Upward pressures on mortgage rates are continuing this year, although apparently at a slower pace than at the end of last year. In early February, following two successive downward revisions in FNMA secondary market prices designed to stem the tide of offerings from private investors, the Federal Housing Administration raised the permissive contract rate on new FHA-insured home mortgages from 5-1/4 per cent to 5-1/2 per cent. Such a move had long been anticipated, although, according to the trade, the extent of the rise was still insufficient to meet competitive requirements, particularly in the West where discounts tend to be large.

In January, yields on 5-1/4 per cent FHA-insured home mortgages sold in the secondary market had already moved 8 basis points higher to an average of 5.70 per cent. This was 26 basis points above the average just six months earlier and the highest since November 1961.

Contract interest rates on conventional mortgages for new-home purchase held at their advanced December level in January--6.00 per cent, 20 basis points more than a year earlier and the highest in nearly five years. Comparable rates on mortgages for existing home-purchase were also unchanged in January, at 6.05 per cent. These averages, as reported by the Federal Housing Administration, are rounded to the nearest five basis points.

Corporate profits. After-tax profits of manufacturing corporations, based on data now available for about 600 large companies, appear to have been 18 per cent larger in the fourth quarter of last year than in the same quarter of 1964. This compares with year-to-year increases in the first three quarters of 21, 18 and 16 per cent respectively. Part of the year-to-year gain in the fourth quarter reflects the fact that profits in the fourth quarter of 1964 were held down by strikes in the auto industry.

An increase of 18 per cent in reported profits after taxes would mean an increase of 17-18 per cent in manufacturing profits (before taxes) and inventory valuation adjustment, as presented in the Department of Commerce national income accounts. Department of Commerce estimates for the fourth quarter are not yet available; full-year estimates imply a fourth quarter level (annual rate, seasonally adjusted) of $38.3 billion for the manufacturing sector, 18 per cent above the fourth quarter of 1964. The implied fourth quarter estimate for nonmanufacturing industries is $37.1 billion--a year-to-year increase of 14 per cent, which seems reasonable.

A recent survey conducted by McGraw-Hill indicated that more than 8 out of 10 corporations expect their profits before taxes to be larger in 1966 than in 1965 and 5 out of 6 expect profit margins to stay the same or increase. In the light of these expectations, and considering both the recent level of profits and anticipated further expansion in economic activity this year, the expected rise in total profits before taxes shown by the survey--only 6 per cent--seems small. It would mean an average for this year only 2-1/2 per cent above the implied fourth quarter 1965 level.

Stock market. Stock prices have fluctuated rather widely on very active trading so far this year, as stock traders have exhibited a high degree of sensitivity to the numerous cross-currents that have recently clouded the outlook for corporate earnings and stock prices. After advancing 2.7 per cent from early December to a new high in mid-January, Standard and Poor's composite index of 500 stocks dropped about 2 per cent in the latter half of January, only to rise to another new high on February 9. Since then, the index has dropped off again, by more than 2 per cent, nearly to the level that prevailed in early December. Trading volume in the most recent decline has averaged 8.8 million shares a day, almost as high as in the preceding advance.

While forecasters are generally assuming a further growth of 6 to 10 per cent in corporate profits during 1966--which at prevailing price earnings ratios (17.5 in the Standard and Poor's composite index) would seem to justify some further general rise in stock prices--stock traders have apparently become sensitive to developments which might change this outlook. Each new rumor of peace possibilities in Vietnam is reflected in stock price declines. But at the same time, the inflationary implications of possible further escalation in the war also create worries--about higher business taxes, higher costs, and official restraints on prices--and these also contribute to price weakness. Finally, on top of these war uncertainties, the sharp further widening of spreads between stock and bond yields, the mark-up in costs of call money, and rumors that an increase in margin requirements may be imminent have created further hesitancy among stock traders.

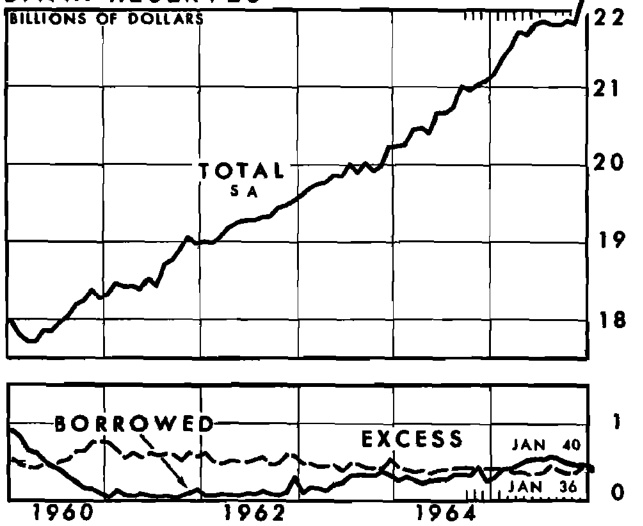
Customer credit in the stock market rose only $21 million in January despite the continued heavy volume of trading, falling well behind the monthly credit increases of $190 million and $400 million which occurred in November and December. A moderate increase in customers' net debit balances with brokers more than accounted for the January growth, as bank purpose loans declined slightly. Adding the January increase in customer net debit balances to the earlier increases experienced since stock market credit turned-up in August, the total expansion for the full period amounts to nearly $700 million. This has carried total CNDB's to within $35 million of the $5.6 billion record reached in November 1963.

The sharp drop in the rate of stock market credit growth from December to January was partly attributable to the impact of transactions undertaken to defer the realization of capital gains taxes into the new calendar year. Thus, investors with large potential profits in glamour stocks, wishing to realize these gains in the strong year-end market without having to pay the gains tax until 1966, could achieve both ends by borrowing additional stocks of the same company and selling them short. In this way the investor established a hedged position, protected against further price variation; but he could avoid the capital gains tax liability until the new tax year when the short position would be covered with the stock already held.

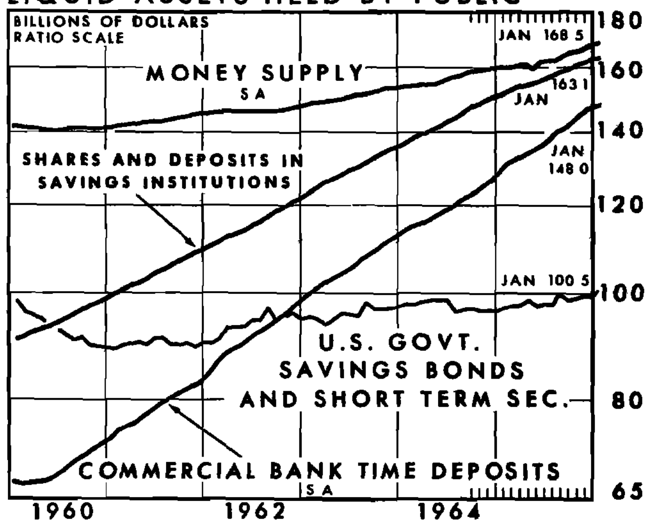
Due in large measure to this practice, short-sales of stock on the New York Stock Exchange rose to a record 11.7 million shares in December, and then declined to 10.1 million shares in January, as short positions were covered. Since short-sales require a 70 per cent margin under Federal Reserve regulations, this December-January build-up and decline was sharply reflected in the volume of outstanding margin debt; that is, the December increase was inflated and the January increase deflated. Averaging the two months together, total stock market credit rose $210 million per month, slightly more than in November.

FINANCIAL DEVELOPMENTS - UNITED STATES

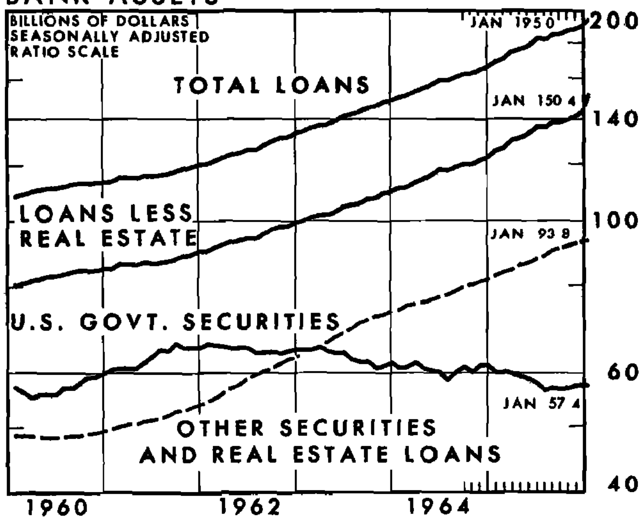
BANK RESERVES



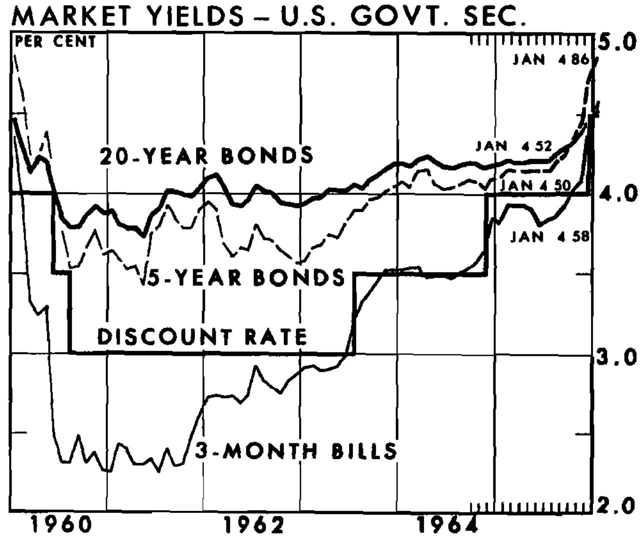
LIQUID ASSETS HELD BY PUBLIC



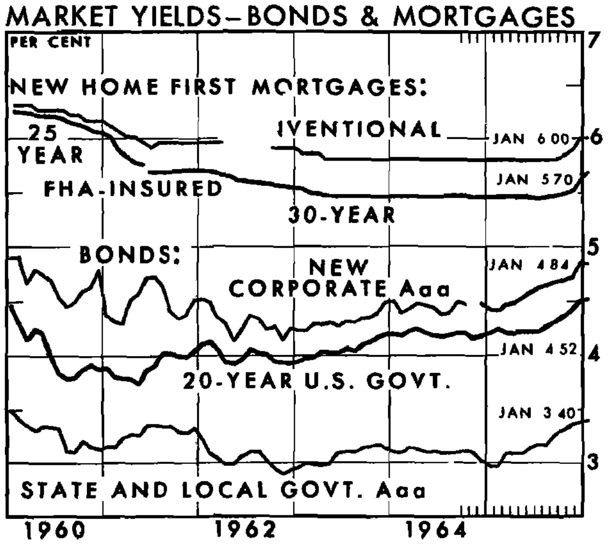
BANK ASSETS



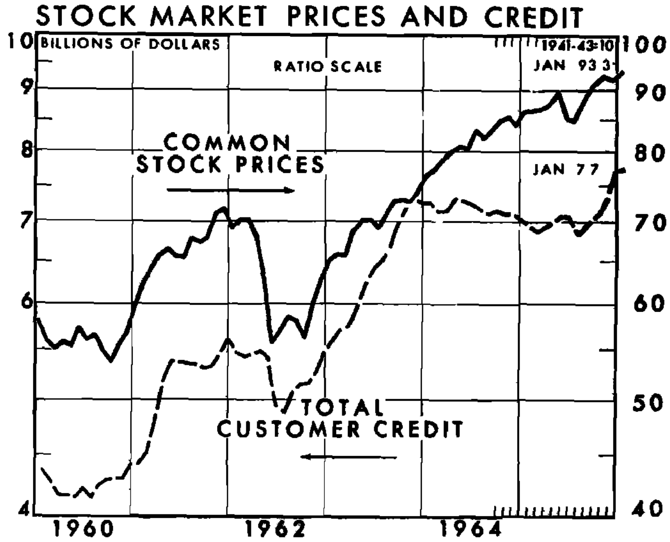
MARKET YIELDS – U.S. GOVT. SEC.



MARKET YIELDS–BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Preliminary indicators show a deficit in January of $100 million on the liquidity basis, without seasonal adjustment, and small weekly surpluses in part of February. After some allowance for seasonal influences -- which are strongly favorable in the first quarter taken as a whole, and are probably favorable in this part of it -- the balance for this month and a half appears to be a moderate deficit. The balance was adversely affected by payments in January of $146 million for new Canadian security issues postponed from 1965 and by the conversion in January and early February of $53 million of nonconvertible Roosa bonds into liquid liabilities. On the other hand the balance was favorably affected by official Canadian purchases in January of $40 million of Canadian securities from U.S. holders.

Balances owed by American banks to their foreign branches rose by nearly $500 million in the seven weeks to February 16, following a drop of nearly $400 million in the two weeks to December 29. In large part this swing reflected the return of funds of European commercial banks to the Euro-dollar market after the year-end. Italian banks, for example, had borrowed dollar funds and drawn down dollar deposits by a total of about $330 million in December, and are believed to have returned a somewhat smaller amount to the Euro-dollar market in January. Without seasonal adjustment, the U.S. payments balance on basis of official reserve transactions was in surplus by about $300 million in January, according to preliminary data. This surplus, resulting as it does from movements of commercial bank funds, must be regarded as mainly or entirely seasonal.

The recent movements of American bank branch balances at their head offices have been of roughly the same magnitude as in corresponding weeks at the end of 1964 and beginning of 1965.

U.S. banks' foreign assets under the VFCR declined by $210 million in January, substantially more than the normal seasonal drop for that month.

New issues of foreign securities -- almost entirely Canadian -- are expected to amount to nearly $500 million in the first quarter, including about $180 million of Canadian issues postponed from 1965. Without the postponed issues the total would be about $300 million. Canadian issues during all of 1965, plus the postponed issues, were about $900 million.

U.S. EXPORTS 1/
(in billions of dollars)

	1963	1964	1965	1965 2/ III	1965 2/ IV
Nonagricultural:	16.7	19.3	20.2	20.9	21.6
Canada	3.6	4.3	5.0	5.1	5.6
Western Europe	5.6	6.3	6.4	6.7	7.0
Latin America	2.8	3.3	3.3	3.4	3.6
All others	4.6	5.4	5.5	5.6	5.4
Agricultural:	5.6	6.3	6.2	6.7	6.8
Under Govt. programs	1.6	1.8	1.4	n.a.	n.a.
Other	4.0	4.5	4.8	n.a.	n.a.

1/ Including special category exports, destinations of which are not available except for the four broad areas shown. Military grant-aid exports are excluded.

2/ Seasonally adjusted annual rates; area distribution of nonagricultural exports in December based on December area totals minus agricultural exports distributed proportionately to October-November data.

Nonagricultural exports to Canada rose sharply in the fourth quarter, and shipments to Europe also advanced strongly. Exports to Australia and South Africa fell off, Total agricultural exports edged up further from the advanced level reached in the third quarter. For the year 1965 as a whole, a drop in agricultural exports under Government programs was largely offset by an increase in commercial sales.

U.S. IMPORTS
(amount in billions of dollars)

	Fourth quarter 1965 1/		Year 1965	
	Annual rate seasonally adjusted	Increase from Q-III (per cent)	Total	Increase for 1964 (per cent)
Industrial supplies:	11.54		11.11	
Petroleum	2.10	0	2.10	10
Steel	1.21	-14	1.27	53
Nonferrous metals	1.76	7	1.58	25
Other materials	6.47	3	6.16	7
Capital equipment	1.81	7	1.59	37
Consumer goods:	4.52		4.11	
Autos and parts	1.12	23	.90	20
Other	3.39	4	3.21	22
Foods and beverages	4.18	1	3.83	1
All other	.82	9	.73	24
Total	22.87	3	21.37	14

1/ 1965 Q-IV and Q-III data are after preliminary correction for statistical carryover; percentage changes in column two are subject to possible errors of 1 to 3 per cent.

The further rise in U.S. imports from the third quarter to the fourth occurred in all major categories except petroleum and steel, as the second column of the table shows. Steel imports fell off further in December; in the third quarter they had been 70 per cent above the 1964 average, and by December they were down to about 130 per cent of the 1964 average. The unusually steep jump in imports of autos and parts in the fourth quarter resulted in part from the elimination of tariffs under the U.S.-Canadian automobile agreement. Accelerated advances in imports of industrial materials other than steel reflected heavy U.S. demands for use and for inventory. Imports of capital equipment rose further, at an annual rate of nearly 30 per cent.

Interest rates in the Euro-dollar market. The seasonal tendency toward rise and fall of rates over the year-end -- due in large part to temporary withdrawals of funds from the market by commercial banks in various European countries -- was superimposed this year on a rise closely in line with U.S. money market rates. The seasonal peak in 30-day rates and in those for longer terms was reached early in December, after a quick upsurge in the first half of the month. But the subsequent dip was followed by a rise in January for most rates, a highly unusual development at that time of year. A slight easing, thus far unexplained, occurred in mid-February.

From mid-November to February 24, bid rates for Euro-dollar deposits of various maturities rose by a little under 1/2 of 1 percentage point for the longer terms, and by 3/4 of a point for call and 7-day money. The latter rates then stood at 5 and 5-1/8 per cent, respectively. The 90-day bid rate was 5-3/8 per cent.

Yields on new issues of dollar bonds in Europe by U.S. corporation subsidiaries in January and February were 40 to 50 basis points higher than on comparable issues in October and December.

European national financial markets. Rates in interbank loan markets on the Continent eased seasonally in January. The underlying tendency in short-term rates was perhaps still upward in Germany and Switzerland, but much less so than it was in the Euro-dollar market. A turn has occurred in the German bond market, where the banks made heavy support purchases at the end of December, while new issues have been limited. Italian bond yields have come down again in recent months. In Britain both short and long interest rates have risen somewhat further in February.

The German public authorities have been following a program to ration their bond market borrowings; for its part, the Federal government has planned a lower budget deficit in 1966. New public authority bond issues in January were less than one-half the amount floated a year earlier. The turn in the market began in late December when German banks bought heavily in order to drive prices up and cut their bond valuation losses for the year. In early February, public authority bond yields were down about 50 basis points from the record 8 per cent set in mid-December.

Upward adjustments were made in the rates on some money-market instruments in January. On January 7 the Bundesbank raised the rates at which it stands ready to buy and sell Treasury bills and non-interest-bearing Treasury bonds of various maturities up to 2 years. The 2-year selling rate was raised by 1/2 of 1 per cent, to 5-1/4; the 90-day rate was moved up by 1/8, to the level of the Bundesbank's discount rate, 4 per cent. This action followed the introduction by the Dresdner Bank several days earlier of its own notes bearing higher yields for similar maturities, and later in January the Dresdner Bank raised its rates.

In the Swiss short-term money market, developments have resembled those in Germany, with a seasonal easing after the year-end but upward adjustments in certain rates including those on bankers' acceptances and on one of the categories of savings deposits.

In Italy, bond yields were reduced in the fourth quarter; from September to December, the monthly average composite yield on all bonds except Treasury bonds declined 17 basis points. The Italian commercial banks continued to increase their bond portfolios rapidly as the external surplus supplied reserves while domestic loan demand was still rising only slowly. The heavy additions to banks' bond holdings helped to bring yields down by 40 basis points in the 12 months ending in December. The volume of new bond issues reportedly increased in 1965 (only annual data are published).

In France, the money market eased seasonally after the first of the year. However, the Treasury's outstanding borrowings from the Bank of France remain significantly below earlier levels, tending to hold down the supply of reserve funds to the banking system. Consequently, when the monetary authorities raised the banks' liquid assets reserve requirement in January for seasonal reasons, they kept the increase in the requirement ratio smaller than it would have been otherwise.

In Britain, the U.S. discount rate increase ended any hope of an early decline in money market rates. In the following two weeks the U.K. Treasury bill rate advanced 12 basis points, and the yield on War Loan rose by the same amount. In February there have been further increases. The rise from December 3 to February 18 amounted to 18 basis points for Treasury bills and again the same for War Loan.

The recent rise in short-term rates reflects in part the seasonal squeeze on liquidity of the banks and discount houses, related to tax collections, and in part official determination to bring the balance of payments into equilibrium. Weakness in the bond market may be due in part to growing realization that the authorities will have to take further action to achieve balance by the end of 1966. Recovery of confidence in sterling was partly self-reinforcing last autumn, but psychological momentum now seems to have been lost.

Continued strength of aggregate demand for goods and services in Britain, despite earlier credit measures, led to adoption of new restrictive monetary measures in early February. Installment credit regulations were tightened: the minimum downpayment was raised from 15 to 25 per cent (except on automobiles, on which it was already 25 per cent), and the maximum repayment period was shortened from 30 to 27 months.

In addition, the Bank of England announced a new and more restrictive ceiling on bank credit supply. The new request to the banks asks that, for an indefinite period, bank credit to the private sector (except for seasonal purposes) not rise above 105 per cent of the amount outstanding in March 1965. From March 1965 to January 1966, bank loans rose at a seasonally-adjusted annual rate of only 3 per cent; this rise compares with 12 per cent in the year-earlier period, and was in fact slower than the 5 per cent expansion limit allowed for the 12 months ending March 1966. From June to November 1965, installment credit increased less than 1 per cent, at an annual rate, compared to a 7 per cent annual rate rise during the same period in 1964.

However, the private sector made increasing use of other credit sources during the closing months of 1965. In September-December, net new security issues by U.K. companies ran at a monthly average double that of the previous eight months, and mortgage lending by the building societies advanced sharply in the fourth quarter.

Japanese financial markets. While the Bank of Japan's discount rate has been unchanged since its reduction last June, and the principal rate for call loans has not changed since October 1, average rates on commercial bank loans and discounts have continued to decline gradually. In December the average was 7.61 per cent, compared with 7.99 per cent a year earlier. The large city banks were charging their best customers 5.66 per cent in December.

With the rise in U.S. short-term interest rates, Japanese domestic sources of import financing have become more competitive with U.S. sources. The cost of foreign borrowing was increased on December 9 when Japanese foreign exchange banks raised the principal rate of U.S. dollar import acceptance bills from 7.00 to 7.25 per cent. Concerned that an extensive shift from external to domestic import financing would affect the payments balance adversely, the Japanese authorities in January temporarily suspended the preferential arrangements for import financing known as the "import bill system." (Under this arrangement, yen-based credit for imports had been available to Japanese foreign exchange banks from the Bank of Japan at a rate of 5.84 per cent with a maximum two-month maturity.)

Precise comparisons of the interest rate differential on Japanese import financing between Japan and the United States are difficult because the rates vary, depending on such factors as the size or credit standing of the borrower and the cost of cover in the forward exchange market. According to recent information from the Bank of Japan, financing by Japanese companies of the highest credit standing is about 0.4 percentage points cheaper in Japan, for the next category of importer the cost is about the same in the two markets, and for the smaller companies it remains cheaper to finance in the U.S. market.

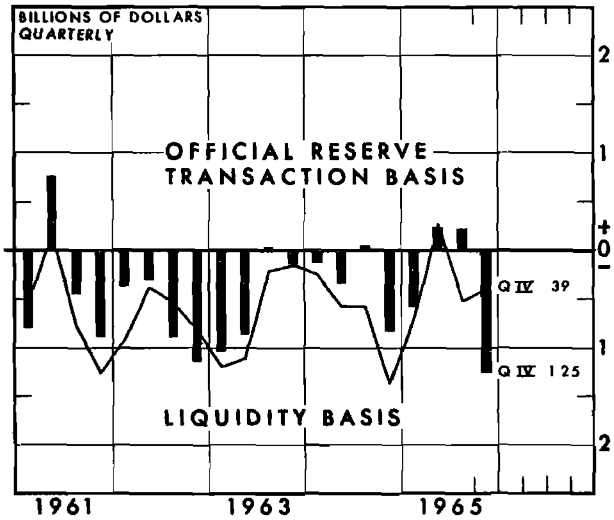
Foreign bond flotations have also become increasingly unattractive to private Japanese business firms. Currently Japanese sources estimate that Japanese securities exempt from the I.E.T. would have to be floated in the United States at a minimum yield of 6.3 per cent to subscribers. In Germany the rate would have to be 7.2 per cent. Comparable domestic securities in Japan would carry a nominal rate of 7.3 per cent, and a 8.5 per cent cost to the issuer. Although this appears to make foreign borrowing still relatively attractive, other considerations -- including possibly the lower cost of short-term funds in Japan -- have reportedly discouraged private Japanese companies from any further borrowing abroad for the present.

Canadian financial markets. The Canadian Treasury bill yield has moved up nearly 1/2 per cent since early December. The rate for 90-day finance company paper, which had risen sharply in October-November, has advanced only 1/8 of 1 per cent further. Canadian bond yields rose in the first two weeks after the discount rate increases here and in Canada. Since then, rates on longer issues have moved sharply higher in early February. The yield on a representative 17-year issue was higher by 24 basis points on February 16 than at the beginning of December. With U.S. long-term rates up more than this, there has been some reduction in the spread between Canadian and U.S. bond yields, which had been unusually large last autumn.

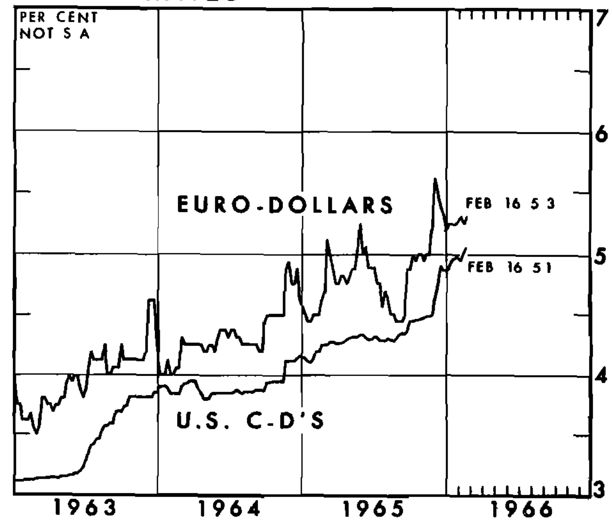
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

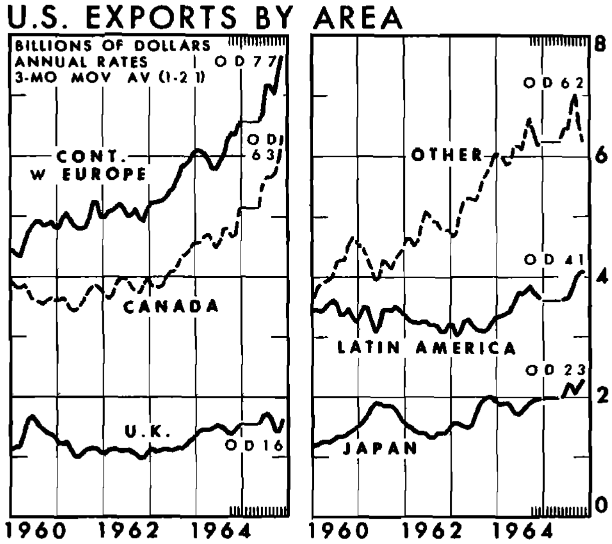
U.S. BALANCE OF PAYMENTS



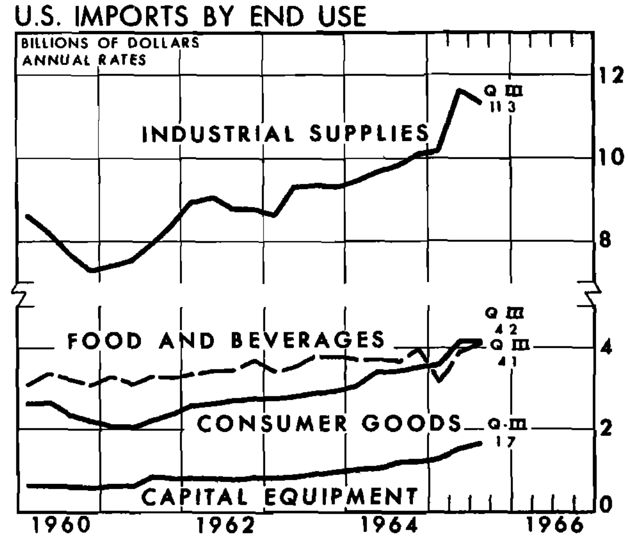
90-DAY RATES



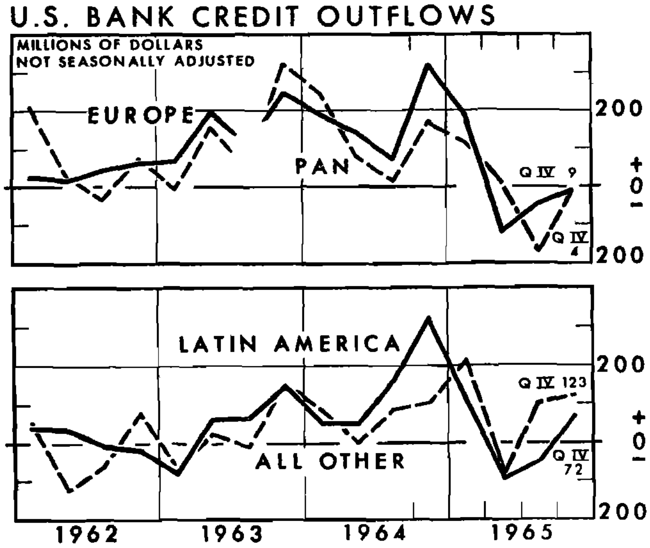
U.S. EXPORTS BY AREA



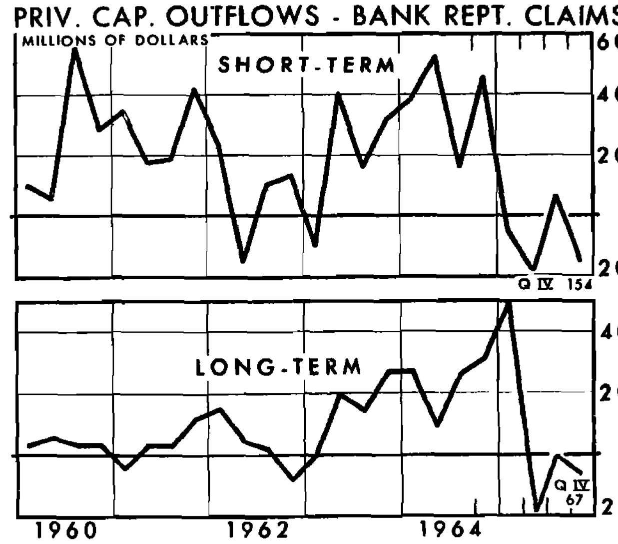
U.S. IMPORTS BY END USE



U.S. BANK CREDIT OUTFLOWS



PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



APPENDIX A: REVISION IN CONSTRUCTION ACTIVITY SERIES*

New data just released by the Census Bureau show that the increase in value of new construction put in place last year was substantially larger in total and for private nonresidential and public construction than had been estimated earlier on the basis of procedures now being superseded. For earlier years, however, except for offsetting changes between 1963 and 1964 for business construction, annual levels were not materially altered from those previously reported. The residential expenditures series were not involved in this revision.

REVISED NEW CONSTRUCTION PUT IN PLACE

	1965 p	Per cent increase			
	$ Billions	1962	1963	1964	1965 p
Total					
New series	71.3	8	6	5	8
Old series	68.1	7	5	5	3
Private					
New series	49.6	9	4	5	8
Old series	47.9	9	5	5	4
(Residential 1/	26.6	12	6	3	1)
Nonresidential					
New series	23.0	5	2	9	18
Old series	21.2	5	3	8	10
Business					
New series	16.6 2/	4	1	11	20 2/
Old series	15.6	4	4	8	13
Public					
New series	21.7	(4) 1/	8	5	7
Old series	20.2	(4)	6	5	2

1/ Not involved in recent revision.
2/ Estimate based on first ten months only.

* Prepared by Bernard Freedman, Economist, Capital Markets Section, Division of Research and Statistics.

Altogether, as shown by the new series in the table, the sluggishness in residential construction expenditures in 1965 was considerably more than offset by further increases in public expenditures and particularly in expenditures for private nonresidential construction -- mainly business -- as these are now being measured. As a result, the year-to-year advance in total construction last year approximated 8 per cent -- except for 1962, the highest in recent years.

In 1957-59 dollars, the year-to-year advance in 1965 was 4 per cent. This compared with no change shown by the old series, and with increases of about 3 per cent in each of the previous two years for the new series.

Nearly all of the increase in level between the new and old series for 1965 reflected a much sharper upsurge than had been previously estimated in late 1964 and the early months of 1965 in the seasonally adjusted monthly data. Measured in current dollars, business construction put in place expanded 18 per cent in that period, while all other private nonresidential and public construction rose 8 per cent respectively. After March, the level of total construction activity had remained relatively stable during 1965, as some uptrend by business construction was offset elsewhere.

Introduction of the new series with the January data marks the first major procedural change since responsibility for monthly construction statistics was taken over by the Census Bureau in mid-1959. The new series are based on direct measurement through regular sample surveys of work actually put in place in lieu of the mechanical application of monthly progress patterns to reported value figures on construction awards, permits and related data. For private nonresidential construction as defined by the Census Bureau, data based on the new procedures carry back to mid-1962; for State and local construction, the related revisions go back to January 1963.

The new series have been adjusted to the level of the old series in some cases but because of the changed compilation procedures, the monthly data are not strictly comparable with those for the earlier periods. Also, because of reporting lags and sampling problems, current estimates for some components will be available only with a longer than accustomed time lag. In the case of certain components of private nonresidential construction, for example, the lag may be as much as three months or more; in the case of public construction, where direct use of quarterly reporting on State and local expenditures is now involved, firm estimates for a recent month may not be available over a period as long as five or six months from the current month.

Introduction of the new series was delayed until release of the January 1966 preliminary estimates. However, the effect of the revisions is already reflected in the Office of Business Economics estimates for private nonresidential structures and also State and local expenditures in the GNP accounts currently available for all quarters in 1965.

APPENDIX B: 1967 BUDGET FOR AGRICULTURE*

The Federal Budget provides for a small net increase in the scope of Department of Agriculture activities in fiscal 1967, mostly in the direction of providing more assistance to rural people as a whole. Expansion in these activities is to be offset in part by paring expenditures on a few selected activities. Budgets of most of the old-line agencies of the Department will permit levels of activity not greatly different from those of recent years. Although outlays of the Department are expected to be somewhat larger than in fiscal 1966, net budget expenditures are expected to be substantially lower.

Larger scale activities are projected for programs to expand and to coordinate efforts to develop the economies of rural areas; to distribute food to the needy by means of the Food Stamp Program and child feeding; to expand insurance by the Farmers Home Administration (FHA) of loans of private lenders to individuals and communities in rural areas for housing, water and sewer facilities; to provide special watershed and conservation projects in problem areas; to promote farm exports and related activities; and to get underway the recently authorized Cropland Adjustment program.

Expenditures are to be pared by shelving some low priority research projects, and by reducing subsidy payments to the States for cooperative research projects, for the special school milk programs, and for the school lunch program. A substantial portion of the permanent appropriation for surplus removal buying is to be redirected to the Food Stamp program. Reductions in expenditures of the Commodity Credit Corporation for income stabilization and foreign assistance are to be achieved without reducing the scale of activity of these programs. The International Wheat Agreement (IWA), eliminated in the 1967 budget, will have to be reinstated because the U.S. has recently announced approval of a 1-year extension through June 1967.

Despite somewhat larger operations programmed for the Department of Agriculture in the 1967 Budget, the projected expenditure is scaled down to $5.8 billion from an actual expenditure of $7.3 billion in 1965 and an estimated expenditure of $6.9 billion in the current year. To finance operations in 1967 on a 15 per cent smaller budget, the Department is to rely chiefly on the substitution of private for Treasury financing. Net expenditures will be reduced

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*--Prepared by Wilellyn Morelle, Economist, Business Conditions Section, Division of Research and Statistics.

in four principal ways: (1) sale to the public of participation certificates in the amounts of $600 million and $400 million, respectively, by the FHA and the CCC; (2) a change in budget procedures of the REA to permit relending of collections ($200 million in 1967) from loans previously made which would lower the net expenditure shown in the Budget by this amount; (3) requiring packers and processors to pay for meat and poultry inspection services, an annual saving of $60 million; and (4) reduction of about $225 million in expenditures of the CCC on the foreign assistance programs because of lower prices paid for wheat and cotton, higher repayments of Title IV loans by foreign governments, and the elimination of the IWA expenditures.

Realization of the proposed reductions in expenditures outlined above depends on many unknowns. Three reductions, amounting to $860 million, are contingent on enactment of new legislation providing for: (1) a change in FHA authority to permit sales of certificates of participation in a pool of direct loans to the public, beginning in 1967; (2) a shift by the REA to a revolving loan account so that collections may be used to finance new loans beginning in 1966; and (3) a shift of meat and poultry inspection services to a users' fee basis. The proposed reductions in State funds for research, school milk and lunch programs will undoubtedly be resisted in Congress. The ability of the CCC to sell certificates of interest will depend on the liquidity of banks.

Because of the new provisions of the Food and Agriculture Act of 1965, the most significant unknown may be the proposed reduction in the expenditures of the CCC for price support and income stabilization. These expenditures are projected at $2,172 million after a deduction is made for an increase (a receipt) of $400 million in price support loans to be financed by banks. Reductions in expenditures in 1967 are projected for feed grains and cotton. Feed grain expenditures, which amounted to $1.5 billion in 1966, present the biggest question, a question that is being answered now in the Corn Belt during the feed grain acreage diversion program sign-up period which ends in April.

The $200 million reduction in feed grain expenditures in the 1967 budget is based on the expectation that production will be reduced, an expectation that may not be realized. The 1966 feed grain diversion sign-up is going slowly according to early indications, partly because of changes in the program and partly because of bullish expectations of producers concerning U.S. efforts to meet world food needs. Corn prices are now far enough above the loan rate for the CCC to be able to sell some corn for domestic use at its minimum resale levels. Still "free supplies" of corn, estimated at 3.1 billion bushels on January 1, are larger than expected disappearance for domestic use and export of 2.9 billion bushels in the January-September period. Any readjustment in feed grain expectations will have direct implications for the 1967 budget of the CCC.

The 1967 budget of the Commodity Credit Corporation will be the first to fully reflect a change in method of stabilization in which payments to farmers are the principal means of income stabilization and the price support mechanism is designed to let prices of our major export crops settle to world price levels. The Act of 1965 extended to cotton, beginning with the 1966 crop, this policy which had already been applied to feed grains and wheat. Expenditures on cotton stabilization in 1967 are projected at about $650 million, down $200 million from 1966. Acreage diversion and price support payments to farmers will be larger than the equalization payments made to the mills in 1966, but farmers are required to cut their acreage by an eighth in order to qualify for the payments. Wheat expenditures will be larger in 1967 because supplementary payments to farmers formerly financed entirely by the tax on users of wheat were increased by the Act of 1965 with the increment to be paid out of Treasury funds.

APPENDIX C: VETERANS' READJUSTMENT BENEFITS ACT OF 1966*

The new "G.I." Act, signed into law by the President this week, could have a considerable impact in the coming year on college enrollments, available manpower resources and residential construction. Its major features include educational allowances, similar to those in effect during the Korean War, and housing loans either through guarantees to private lenders or direct loans by the Veterans' Administration when private financing is not available. Education allowances will be payable beginning June 1, 1966. The other provisions became effective when the act was signed.

In contrast to the previous "G.I." Acts which applied only to veterans who had been in service during a major conflict, the current Act is retroactive to January 31, 1955 (the expiration date of service eligibility under the Korean "G.I." bill). Thus, all veterans with a minimum of 180 days service discharged since then as well as those now in service will be eligible. In all, there is a backlog of about 4 million eligible veterans. Discharges are currently estimated at 500,000 a year and will go somewhat higher in the near future as a result of the current expansion in the armed forces.

A veteran will be eligible for one month of education allowance for each month of active service up to a maximum of 36 months (equivalent of 4 years of schooling). For full-time training the allowance is $100 a month for a single veteran, $125 if he has one dependent and $150 if he has more than one dependent. Proportionate rates are paid for less than full-time training. The allowance can be used for tuition, equipment and subsistence. Educational training must be completed within 8 years of date of discharge or by June 1, 1974 for veterans already discharged. The dollar amounts provided are $10 less in each category than for Korean veterans. This Act is thus a somewhat less generous program in both dollar amounts and in "real" terms since it takes no account of the increase in educational costs and subsistence since 1955.

The housing loan program provides for a guarantee up to $7,500 for loans made by private lenders. Where private financing is not available, direct loans of up to $17,500 (previously $15,000) are authorized. The maximum interest rate established by the Administrator can not be in excess of the rate of the home loan insurance program of the National Housing Act.

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* Prepared by Jane Moore, National Income Section, Division of Research and Statistics.

Cost estimate. Estimates of cost are extremely difficult to make because there is no way of knowing the number of veterans who have been out of service since early 1955 who will take advantage of the new opportunities. About 55 per cent of the veterans of World War II and 45 per cent of those in the Korean conflict entered training and two out of three who took training had dependents.

In preparing the bill it was estimated that the cost for education for the first full year would be $327 million, and a medical care provision would cost an additional $20 million. (This is about $200 million more than was included in the Administration's 1967 Budget, since the new Act provides larger benefits than were originally proposed by the Administration.) This cost estimate is based on the assumption that an average of 240,000 veterans will receive education benefits during the first full year. Moreover, it is also assumed that there will be no increase in enrollments. One-half of the estimated total is expected to be veterans already enrolled full-time in college. Of the remaining number, there would be those resuming training upon discharge.

The estimate apparently makes no allowance for any increase in full-time enrollments of veterans who otherwise would not have gone to school. Under the earlier bills large number of veterans, especially those in the lower income groups who could not afford college training, did take advantage of the benefits of the G.I. training provision. It seems likely that some of the large pool of veterans eligible under the new Act, even though the allowances provided are smaller, would avail themselves of the new opportunity for further education. The cost estimate thus appears to be low. If an increase in enrollments does take place, as seems likely, the supply of available manpower in these age groups will be further reduced.

Other provisions of the Act include medical care for eligible veterans with non-service-connected disabilities if the veteran would otherwise be unable to pay for the cost of needed care; this is the same basis provided for veterans of other wars. Job counseling and job placement assistance is also provided as under the Korean bill and so is preference in Federal employment. Unlike the Korean bill, no allowances are payable for on-the-job training.