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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

April 6, 1966

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SUMMARY AND OUTLOOK

Outlook for GNP

The advance in business activity now appears a little stronger than indicated three weeks ago. Output has continued to rise sparked by further expansion in final outlays by consumers, business and government. Inventory accumulation, while substantial, appears to be somewhat lower than in the final quarter of last year. Over-all, we estimate a first quarter rise in GNP that will approximate the very rapid fourth quarter increase; the second quarter is expected to maintain a similarly rapid pace of expansion.

Spurred by very sharp gains in income and employment, personal consumption expenditures in the first quarter appear to have increased more than in the fourth quarter, despite the rise in social security taxes in January. Business fixed investment was up sharply from the preceding quarter, a larger increase than anticipation surveys had suggested. Substantial upward revisions in manufacturers' inventories for January point to a first quarter increase only moderately below the fourth quarter and about in line with what was projected here earlier. On the other hand, defense purchases of goods and services appear to have lagged slightly behind previous estimates.

Maintenance of the rapid pace in over-all activity in the second quarter is expected to come mainly from further large gains in consumption, business fixed investment and Federal spending. These second quarter projections do not allow for a cutback in plant spending in response to the President's request; in any event, the second quarter may be too early to expect to see a response in the aggregate figures. Neither do these projections allow for a speed-up in Federal defense spending above the pattern implied in the Economic Report; a reassessment of defense needs currently under way, however, may change prospects for this and subsequent quarters, Meanwhile, Congressional approval has been given or appears likely to be given to nondefense programs and military pay increases costing over one billion dollars more than allowed for in the Budget.

Resources and prices

Further expansion in business fixed investment continues to add to productive capacity, but final demands are rising rapidly enough to maintain and possibly intensify pressure on utilization rates. In important sectors of durable goods manufacturing unfilled order backlogs have continued to rise, even while manufacturers, as a group, have been producing at or over 92 per cent of capacity.

Demands for labor are continuing very strong. Shortages of experienced adult workers are becoming a major factor in labor market developments, and a growing proportion of current adult unemployment is of short-term duration and frictional in nature. Although unemployment rose slightly in March, as did the unemployment rate, the increase was mainly among teenagers, a group whose unemployment rate tends to fluctuate from month to month.

A decline in the unemployment rate to a second-quarter average of about 3.5 per cent is expected to accompany the projected further rapid rise in GNP; much of the decline will have to reflect increased employment in the teenage group, since adult unemployment is already about as low as during the Korean conflict.

Hourly earnings in manufacturing are continuing to rise at a rate slightly faster than in 1965. At the same time, gains in output per manhour have slowed and unit labor costs have begun to show an upward trend. In union and nonunion sectors outside of manufacturing, recent data indicate wage gains have continued to accelerate. With increases well above productivity gains, higher wage costs are contributing to upward price pressures in construction, retailing, services, and other locally oriented activities.

Even though food prices recently have tended to stabilize, industrial commodity price increases have become more widespread, and declines fewer and largely restricted to some consumer goods industries. Purchasing agents have increasingly reported some hedging against prospective shortages and further price increases. Federal actions recently have been taken to limit upward price pressures in particular cases such as hides and nonferrous metals.

Declines in food prices are in prospect for later in the year, and this should moderate the rise in the total wholesale and consumer price indexes. The weekly wholesale price measures -- which cover only a limited range of commodities -- have shown stability recently, but the pressures extent on labor and plant resources, and the projected further growth in demands, strongly suggest continued upward price pressures throughout the nonfarm economy.

Availability of lendable funds

Restrictive bank lending policies are likely to continue, and probably become more general over the next few months, as banks continue to find it necessary to liquidate securities in order to satisfy loan customers. However, there may be some respite from these pressures at very large banks, where net time deposit inflows have recently accelerated from the sharply reduced rates of earlier in the year. This turn-around appears to reflect the higher recent offering rate on both negotiable CD and other time deposits; some of the funds appear to have been diverted from smaller banks and also from nonbank financial institutions.

So long as loan demands remain strong, the more aggressive competition for funds from large banks may be expected to continue and tend to extend restraint throughout the financial system. Smaller banks and nonbank intermediaries will have to raise deposit rates or face reduced deposit growth and increased asset liquidation. Most recently, it appears as if smaller banks have reduced their municipal acquisitions, after sharply increasing them earlier in the year.

With respect to nonbank institutions, savings and loan associations and mutual savings banks, already under pressure earlier in the year, are likely to experience continued difficulty in obtaining new funds from the public. Despite reduced net inflows from the public, the total flow of funds to mortgage markets was strongly supported in the first quarter by a contraseasonal volume of advances to savings and loan associations from the Home Loan Bank System and by mortgage purchases by FNMA. These sources of support are likely to be more limited in the period ahead. Not only has FNMA taken further steps to reduce the volume of the mortgage purchases, but the Federal Home Loan Banks -- responding to the increased costs of their own borrowing -- have also raised rates on advances to record levels, in some cases as high as 5-3/8 per cent.

Outlook for credit demands

Business loans at banks expanded at about a 15 per cent annual rate in February-March. After a probable bulge over the April tax date, some slowing of the growth rate seems likely. But business loan demands may continue sufficiently strong to keep the expansion rate at about the same 10-12 per cent range as obtained in most of the second half of 1965.

Higher interest rates and credit rationing at banks may help to inhibit some business borrowers, with the result that some financing demands may be diverted to other sectors of the credit market. In the weeks just past, however, the aggregate flow of new corporate and minicipal bond offerings moderated, contributing to the recent sizable downturn in yields. Security flotations were exceptionally high in the winter, in part apparently reflecting some anticipatory borrowing.

Because of this and also the postponements of several issues as yields reached peaks, the calendar immediately ahead appears light relative to earlier in the year, although about equal to a year ago. Still, with stringency continuing at banks, capital market financing may be supported as some borrowers find the new market rate levels attractive. At the same time, the money market may have to absorb more liquid asset disposition and larger commercial and finance company paper offerings.

Looking beyond the immediate capital market calendar, projections of continued heavy capital spending by both businesses and State and local government suggest that demands for long-term funds will remain large. With interest rates presently sharply below their early March high, borrowers may be encouraged to add further to near-term offerings, which would renew upward pressures on interest rates. While there are no indications as yet of a sizable build-up in calendar, it still appears likely on balance that rates in corporate and municipal markets will rise above current levels. The mortgage market has not shared in the easing of credit conditions that have recently characterized bond markets, and present indications are for continued upward pressures on rates and terms in this sector.

Balance of payments

In the first quarter of 1966, the payments position showed neither the kind of improvement earlier hoped for by the Administration nor a renewed deterioration such as has more recently been feared.

The deficit on the liquidity basis remained at an annual rate of about $1-1/2 billion. On the official reserve transactions basis, the deficit fell very sharply from the swollen level of the previous quarter as foreigners added to their liquid dollar balances after reducing them earlier.

The merchandise trade surplus shrank to an annual rate of $4 billion in January-February, with exports down and imports up. This deterioration in trade was offset by improvements elsewhere in the balance of payments accounts that cannot yet be identified. While seasonally adjusted reflows of U.S. bank credit increased sharply from the fourth quarter to January-February as domestic credit conditions tightened, there was a nearly offsetting increase in U.S. purchases of foreign securities (mainly Canadian) newly issued in this country. Probably investment income receipts recovered from their sharp fourth-quarter dip, but data on these and on other service and capital transactions are lacking.

There is little prospect of substantial over-all improvement in the balance of payments this year. The outcome will depend importantly on domestic demand and credit developments: e.g., on whether inflationay pressures are sufficiently restrained to permit recovery of the merchandise trade surplus; on whether the continued pressure on U.S. banks leads to further reflows of bank credit; and on the extent to which direct investment outflows are held down by a squeeze on the liquidity of U.S.

corporations as well as by the Commerce Department's voluntary program. A favorable resolution of these uncertainties might hold the liquidity deficit in 1966 to a rate of about $1-1/2 billion despite increasing military expenditures in Vietnam, with the official settlements deficit somewhat lower, although not as low as in the first quarter.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per cent change: Year Ago*	Per cent change: 2 yrs. Ago*
Civilian labor force (mil.)	Mar'66	76.3	76.4	75.0	1.8	3.3
Unemployment (mil.)	"	2.9	2.8	3.5	-17.8	-27.5
Unemployment (per cent)	"	3.8	3.7	4.7	-	-
Nonfarm employment payroll (mil.)	"	62.8	62.5	59.8	5.0	8.9
Manufacturing	"	18.8	18.7	17.8	5.7	9.4
Other industrial	"	8.2	8.1	7.9	3.7	7.4
Nonindustrial	"	35.9	35.7	34.2	4.9	8.9
Industrial production (57-59=100)	Feb'66	151.3	150.1	139.2	8.7	17.8
Final products	"	151.3	149.6	138.5	9.2	17.7
Materials	"	150.9	150.1	139.7	8.0	17.5
Wholesale prices (57-59=100) 1/	"	105.3	104.6	101.2	4.1	4.8
Industrial commodities	"	103.3	103.0	101.6	1.7	2.4
Sensitive materials	"	104.4	103.8	101.2	3.2	6.3
Farm products and foods	"	109.7	107.7	98.7	11.1	11.8
Consumer prices (57-59=100) 1/	"	111.6	111.0	108.9	2.5	3.7
Commodities except food	"	105.4	105.3	104.7	0.7	1.2
Food	"	113.1	111.4	106.6	6.1	6.7
Services	"	119.7	119.5	116.9	2.4	4.7
Hourly earnings, mfg. ($)	Mar'66	2.68	2.67	2.59	3.5	6.8
Weekly earnings, mfg. ($)	"	111.33	111.05	106.82	4.2	9.6
Personal income ($ bil.) 2/	Feb'66	556.3	552.3	515.2	8.0	15.1
Retail sales, total ($ bil.)	"	e/ 25.0	25.0	23.3	7.6	16.9
Autos (million units) 2/	"	9.2	9.4	9.4	-2.3	17.6
GAF ($ bil.)	"	e/ 5.8	5.8	5.3	11.0	19.7
Selected leading indicators:						
Housing starts, pvt. (thous.) 2/	Feb'66	1,318	1,584	1,482	-11.1	-24.7
Factory workweek (hours)	Mar'66	41.6	41.6	41.3	0.7	2.5
New orders, dur. goods ($ bil.)	Feb'66	23.6	23.6	21.1	11.7	21.1
New orders, nonel. mach. ($ bil.)	"	3.3	3.4	3.1	8.3	19.5
Common stock prices (1941-43=10)	Mar'66	88.88	92.69	86.83	2.4	12.8
Inventories, book val. ($ bil.)	Jan'66	120.6	119.8	111.5	8.2	14.3
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. e/ Estimat

SELECTED DOMESTIC FINANCIAL DATA

	Week ended Apr. 1	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.65	4.57	4.75	1.00
U.S. Treas. bills, 3-mo., yield (per cent)	4.51	4.64	4.70	3.98
Net free reserves 2/ (mil. $)	- 229	220	98	- 243
Member bank borrowings 2/ (mil. $)	508	565	614	218
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.87	4.90	5.03	4.31
20-year U.S. Treas. bonds	4.61	4.69	4.81	4.30
Corporate new bond issues, Aaa	5.02	5.19	5.38	4.63
Corporate seasoned bonds, Aaa	4.99	4.94	4.99	4.53
Municipal seasoned bonds, Aaa	3.44	3.53	3.63	3.31
FHA home mortgages, 30-year 3/	n.a.	5.70	5.70	5.45
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	89.37	88.81	93.77	87.95
Dividend yield (per cent)	3.24	3.24	3.27	2.88

	Change in Feb.	Average change last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves 5/	66	89	4.8	4.3
Bank loans and investments:				
Total	100	1,900	7.7	9.2
Business loans	700	1,200	21.1	11.5
Other loans	-200	700	6.9	11.4
U.S. Government securities	-1,100	-400	-9.0	-6.5
Other securities	700	400	10.9	13.3
Money and liquid assets:				
Demand dep. & currency 5/	1,300	600	4.5	5.6
Time and savings dep. 5/	800	900	7.1	13.2
Nonbank liquid assets	-1,200	600	2.9	5.4

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending March 30.
3/ Change in contractual interest rate. 4/ Data are for weekly closing prices. 5/ Change in March.

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

	1966		1965					1965
	Feb.	Jan.	Dec.	QIV	QIII	QII	QI	Year
								(billions)
			Seasonally adjusted					
Current account balance				1,434	1,590	1,746	1,332	6.1
Trade balance 1/	330	320	430	1,274	1,235	1,320	964	4.8
Exports 1/	2,270	2,270	2,330	7,029	6,829	6,800	5,627	26.3
Imports 1/ 2/	-1,940	-1,950	-1,900	-5,755	-5,594	-5,480	-4,663	-21.5
Services, etc., net				160	355	426	368	1.3
Capital account balance (regular transactions)				-1,708	-1,957	-1,549	-2,060	-7.3
Govt. grants & capital 3/				-973	-941	-988	-795	-3.7
U.S. private direct investment				-701	-515	-891	-1,159	-3.3
U.S. priv. long-term portfolio				-111	-357	159	-679	-1.0
U.S. priv. short-term				-41	53	417	299	0.7
Foreign nonliquid				118	-197	-246	274	--
Errors and omissions				-252	-316	-81	-10	-0.7
Balances, with and without seasonal adjustment (- = deficit)								
Bal. on regular transactions, S.A.				-526	-683	116	-738	-1.8
Seasonal component				50	-454	-69	473	--
Balance, N.S.A.	78	-21	-93	-476	-1,137	47	-265	-1.8
Liquidity bal., S.A.				-384	-517	258	-658	-1.3
Seasonal component				50	-454	-69	473	--
Balance, N.S.A. 4/	55	-51	-8	-334	-971	189	-185	-1.3
Official settlements bal., S.A.				-1,226	244	247	-564	-1.3
Seasonal component				104	-516	-193	605	
Balance, N.S.A. 5/	177	295	-651	-1,122	-272	54	41	-1.3
Memo items:								
Monetary reserves (decrease -)	-263	-225	-98	-271	-41	-68	-842	-1.2
Gold purchases or sales (-)	--	5	-73	-119	-124	-590	-832	-1.7

1/ Balance of payments basis which differs a little from Census basis.
2/ Figures for December-February tentatively adjusted for changes in carry-over of import documents.
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 first quarter gain in GNP is likely to be a little larger than was indicated three weeks ago. A GNP of $712 billion is now estimated for the first quarter (data for the quarter are still quite incomplete) and is expected to be followed by a rise to $726 billion for the second quarter. The quarterly increase, $14.8 billion and $14.0 billion, respectively, are each $1 billion more than expected at the time of our last report. However, the small differences noted do not alter the over-all picture of general expansion or materially affect the anticipated level of GNP of $731 billion depicted earlier for 1966.

A rise in consumption expenditures of $9 billion (annual rate) is now indicated for the first quarter as compared with $8.5 billion in the fourth quarter. Retail sales were revised up considerably in January for both durable and nondurable goods. Available evidence for February can be interpreted as showing sales being maintained at the high January level and weekly figures for March indicate a probable further rise.

The high and rising level of consumer expenditures for goods and services largely reflects another very sharp jump in personal income in the first quarter--over 9.5 per cent on an annual rate basis for wages and salaries, and 7.5 per cent for total personal income.

While the savings rate is now estimated to fall somewhat in the first quarter this is almost entirely due to a statistical technicality in national income accounting practice. The current national income practice counts as personal contributions to social insurance at the beginning of the year the whole increase in social security taxes--i.e., that part due to the lifting of the base effective January 1, 1966, from $4,800 to $6,600 as well as that due to the higher tax rate. Since most individuals in fact will not pay taxes on the higher earnings until after midyear, less than half of the $3.0 billion, annual rate, increase in social security contributions indicated for the first quarter is likely currently to affect personal spending decisions. If allowance were make for actual timing of the increased contributions resulting from the higher wage base, the savings rate would remain about unchanged from the fourth quarter 5.6 per cent level.

Business fixed investment apparently increased somewhat more in the recent quarter than had been projected in the Commerce-SEC anticipation survey. The combined showing of large increases in nonresidential construction activity and in shipments of machinery and equipment in January and February from their fourth quarter averages suggest some underestimation in the February survey first quarter total on which our preceding estimate had been based.

Business inventory investment in the first quarter remains as estimated earlier; moderate declines are indicated from the very high fourth quarter rates for both farm and nonfarm inventory accumulation. Inventory data available for the first quarter are still quite fragmentary. The moderate decline estimated for nonfarm accumulation is based on January figures for manufacturers, recently revised upward, and distributors, and on preliminary February data for manufacturers only which are also assumed to be subject to upward revision.

Exports of goods and services in the first quarter did not increase as much as anticipated earlier according to present data, and net exports have been revised down from our earlier estimate to a level below the fourth quarter rate. In the second quarter, however, exports are expected to increase more than the relatively large rise projected for imports, with the result that net exports are projected to rebound to their fourth quarter rate.

Purchases of goods and services by Federal and by State and local governments in the first quarter are now indicated to have increased slightly less than estimated three weeks ago, which in turn had been revised down slightly from the preceding projection. Federal government expenditures (N.I.A. basis) have been increasing somewhat less rapidly than had been expected, with slight shortfall indicated for defense spending. However, it is expected that any shortfall in defense spending will be made up later. The somewhat slower-than-expected rise in State and local government purchases reflects the slower pace at which projects supported by Federal grants-in-aid are getting underway.

A further substantial expansion in economic activity is expected in the second quarter. The increases now projected for consumption expenditures and for private domestic investment take into account the upward revisions in our estimates for the first quarter. While a number of businesses, in response to the President's request, have indicated willingness to pare their capital investment projects, it is unlikely that any significant effects on expenditures will be achieved in the current quarter, although salutary psychological effects on price pressures may well result from the request. Thus, for the present, the increase in business fixed investment indicated by the February Commerce-SEC survey is incorporated in our projection for the second quarter. In addition, a rise is projected for net exports.

CONFIDENTIAL

April 5, 1966

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

	1964	1965	1965 II	1965 III	1965 IV	1966 Projected I	1966 Projected II
Gross National Product	628.7	676.3	668.8	681.5	697.2	712.0	726.0
Personal consumption expenditures	398.9	428.7	424.5	432.5	441.0	450.0	458.2
Durable goods	58.7	65.0	63.5	65.4	66.4	68.2	69.2
Nondurable goods	177.5	189.0	187.9	190.5	195.0	199.5	203.0
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	112.3	113.8
Residential construction	27.5	27.6	28.0	27.7	27.2	27.8	27.4
Business fixed investment	60.5	69.8	68.4	70.9	73.0	75.5	77.7
Change in business inventories	4.8	8.2	6.4	7.6	10.1	9.0	8.7
Nonfarm	5.4	7.9	6.6	7.0	8.9	8.0	8.0
Net exports	8.6	7.1	8.0	7.4	6.9	6.5	7.0
Gov. purchases of goods and services	128.4	134.8	133.5	135.4	139.0	143.2	147.0
Federal	65.3	66.6	65.7	66.5	69.2	72.0	74.0
Defense	49.9	49.9	49.2	49.8	52.0	54.3	55.7
Other	15.4	16.7	16.5	16.7	17.2	17.7	18.3
State and local	63.1	68.2	67.8	68.9	69.8	71.2	73.0
Gross National Product in Constant (1958) Dollars	577.6	609.6	603.5	613.0	624.4	634.0	643.6
Personal income	495.0	530.7	524.7	536.0	546.0	556.2	566.5
Wages and salaries	333.5	357.4	353.6	359.0	368.1	376.9	384.5
Personal contributions for social insurance (deduction)	12.4	13.2	13.0	13.3	13.6	16.7	16.9
Disposable personal income	435.8	465.3	458.5	471.2	480.3	488.6	497.7
Personal saving	26.3	24.9	22.4	26.8	27.1	26.1	26.7
Saving rate (per cent)	6.0	5.4	4.9	5.7	5.6	5.3	5.4
Total labor force (millions)	77.0	78.4	78.1	78.5	79.0	79.4*	79.8
Armed forces "	2.7	2.7	2.7	2.7	2.8	2.9*	3.0
Civilian labor force "	74.2	75.6	75.4	75.8	76.2	76.5*	76.8
Employed "	70.4	72.2	71.9	72.4	73.0	73.6*	74.1
Unemployed "	3.9	3.5	3.6	3.4	3.2	2.9*	2.7
Unemployment rate (per cent)	5.2	4.6	4.7	4.5	4.2	3.8*	3.5

* Actual figures for the quarter

Industrial production. Industrial production in March is estimated to have increased further but at a somewhat less rapid pace than in other recent months. Output in the first quarter of 1966 averaged about 151 per cent--3 per cent above the average for the fourth quarter of 1965 and 8 per cent above a year earlier.

The table shows estimated first quarter output for the total index and major market groupings and per cent changes from the first and fourth quarters of 1965 to the first quarter of 1966.

INDUSTRIAL PRODUCTION
1957-59=100, Seasonally adjusted

		Per cent increase from:	
	QI 1966	QIV 1965	QI 1965
Total	151	2.9	8.2
Consumer goods	145	1.4	4.4
Equipment, incl. defense	164	6.9	17.7
Materials	151	3.1	7.6

Auto assemblies increased slightly in March and were at an annual rate of about 9.4 million units compared with 9.1 million in February. A strike at General Electric, which began March 3, curtailed output of appliances. Production of color television sets, however, continued to set new records. Employment data for March indicate a further rise in both business and defense equipment. Output of trucks was maintained at a record level.

Output of iron and steel rose again in March to a level within 90 per cent of the high level reached during the strike-threat buildup last summer. Other weekly production data indicate increases in output of crude oil, refined petroleum products, and coal. Output of paperboard continued at record levels.

Consumer credit. The seasonally adjusted rise in consumer credit during February was the smallest in the 1965-66 period. There was slackening of growth in all loan categories with auto credit and home improvement loans slowing the most. Growth in total instalment credit outstanding was only $537 million for the month, or $6.4 billion on a seasonally adjusted annual rate basis. This compares with an annual rate in January of $7.5 billion and a total expansion of $8.0 billion for all of 1965. Noninstalment credit rose $120 million in February, about in line with the high level of retail sales.

Instalment credit extensions in February were below the January level with decreases evident in all loan categories. Repayments on the other hand rose slightly, owing to a substantial increase in auto credit payments; in other loan categories, repayments showed little change or declined slightly.

Manufacturers' shipments, orders, and inventories. Manufacturers' unfilled orders increased further in February and so also did inventories while shipments and new orders were little changed from high January levels. With shipments holding at the advanced January level while inventories increased, the ratio of inventories to shipments edged up further. The ratio of unfilled orders to shipments also rose further in February for durable goods producers, although shipments of such goods advanced. Increases in shipments were reported by metal producers and fabricators and transportation equipment manufacturers, while shipments by producers of other durable goods and of nearly all nondurable goods declined a little.

New orders for durable goods were unchanged from their record January level, instead of being down somewhat as indicated by the advance figures. February orders declined about 4 per cent for both electrical and nonelectrical machinery and 9 per cent for aircraft. Despite the declines, backlogs of unfilled orders in these three industries rose moderately further. New Orders received by iron and steel producers in February were a fifth larger than in the preceding month.

Manufacturers further increased their inventories in February, with most industries contributing to the rise. However, the February rise was at a slower rate than in January and in the fourth quarter.

INCREASES IN MANUFACTURERS' INVENTORIES
(In millions of dollars)

January-February (1965) average	219
July-September (1965) average	547
October-December (1965) average	582
January-February (1966) average	502
January	579
February	424

The total inventory increase in January and February was as much as manufacturers had anticipated earlier for the whole first quarter. In the last two quarters of 1965, actual inventory increases exceeded anticipated inventory increases by wide margins.

Wholesale prices. Since last autumn the total wholesale commodity price index has risen 2 per cent and it is about 4 per cent above a year ago. This has reflected in large part a sharp rise in prices of livestock and livestock products, including milk and eggs as well as meats. Since February meat prices have levelled off or declined.

The wholesale price index for industrial commodities has risen 1 per cent since last autumn and is about 2 per cent above a year ago. There was an acceleration in the rise in these prices in the monthly figures for January and February of this year with the annual rate of increases being between 2-1/2 to 3-1/2 per cent. Earlier, in

1965, about 40 per cent of the published groups were rising, another 40 per cent were unchanged and the remaining 20 per cent were declining. In January and February this year, the proportion rising increased to 53 while 32 per cent were unchanged, and 15 declined.

The BLS weekly series for the industrial component of the total index is based on a limited number of items. This series was unchanged from mid-February to mid-March. It probably does not provide an adequate advance estimate of the monthly industrial total because it does not include a number of products in which price advances have occurred or have been announced since early February, including electrical and nonelectrical machinery, fabricated metal products, nonmetallic minerals, lumber, paper, chemicals, heavy trucks, rubber, and leather goods. Reports in purchasing journals suggest some attempts at protective buying in response to expected price increases and material shortages.

Consumer prices. The consumer price index from mid-January to mid-February rose .5 per cent to 111.6 per cent of the 1957-59 average, with food accounting for about three-fourths of the increase. Meat prices rose nearly 2 per cent further; as noted earlier, at wholesale, meat prices have levelled off or declined somewhat since then. Poultry prices increased 8 per cent in February partly because of seasonally reduced supplies and also because of some shift in demand away from high priced red meats. Prices of fresh vegetables rose by over 10 per cent mainly because of adverse weather in growing areas. Food prices, which have accounted for more than one-half of the 2.5 per cent rise in the consumer index from a year ago, are expected by the Department of Agriculture to decline over the rest of 1966.

Nonfood commodities from January to February increased .1 per cent as increases in apparel and footwear were nearly offset by declines in new and used cars. Services, continuing the upward trend of about 2.4 per cent per year, rose .2 per cent with medical care increasing .3 and transportation .2 per cent.

CONSUMER PRICE INDEXES
1957-59=100

Commodity group	Index February 1966	Per cent change to Feb. 1966 from January 1966	November 1965	February 1965
All items	111.6	0.5	0.9	2.5
Food	113.1	1.5	3.1	6.1
Meats	118.8	1.9	6.7	18.8
Nonfood commodities	105.4	0.1	-0.2	0.7
Apparel	106.5	0.3	-0.7	1.5
Footwear	116.2	0.5	1.0	4.1
Household durables	96.1	0	.1	-1.7
New cars	97.2	-0.2	-1.5	-3.8
Used cars	114.0	-0.7	-4.0	-6.3
Services	119.7	0.2	0.6	2.4
Transportation	122.6	0.1	1.3	3.7
Medical care	129.9	0.3	1.1	3.5

Labor market. Employment in nonfarm establishments advanced very rapidly in March--up 320,000, a rise almost as large as the upward revised February increase of 340,000 (the preliminary report had indicated an increase of 260,000 in February). For the first quarter as a whole, gains in nonfarm employment were still accelerating. The rise of over 1 million in this quarter was even somewhat larger than in the fourth quarter of 1965. Also indicative of the current strength of demand for labor is that the first quarter rise this year significantly exceeded the rise in the first quarter of last year when, spurred on by record production of autos and large accumulation of steel inventories, output and employment moved up by what was then considered extraordinary amounts.

NONFARM EMPLOYMENT
(Seasonally adjusted, thousands)

	Change from Previous Quarter		
	IQ 1965	IVQ 1965	IQ 1966
Total	760	825	1,030
Manufacturing	305	235	360
Durable	250	150	290
Nondurable	55	85	70
Nonmanufacturing	455	590	670
Mining	0	0	5
Construction	85	110	115
Transportation and public utilities	0	25	25
Trade	160	135	200
Finance and service	105	150	125
Government	105	170	200
Federal	0	15	50
State and local	105	155	150

While the over-all increase in March in nonfarm employment about equalled the previous month, the rise of 85,000 in manufacturing, although large, was somewhat smaller than in February. In part the slowing reflected a leveling-off of employment in the machinery industry where supplies of skilled labor have become increasingly scarce. Hours of work in the industry, in contrast, continued to rise and at 44.1 hours in March were the longest workweek in the industry since World War II. Employment in other metal producing industries continued to advance fairly rapidly but the pace was somewhat slower than the previous month. Availability of experienced workers may now also be limiting employment advances in these industries. A smaller employment gain in the nondurable goods sector in March, however, can be largely attributed to the previous month's sharp rise in the apparel industry following settlement of the New York transit strike rather than to current labor shortages. Average hours of work, in manufacturing in March were maintained at the postwar record high of 41.6 hours reached in February.

Outside of manufacturing, employment gains showed no signs of moderating. Construction employment had declined in January and February from a very high year-end level but advanced again sharply in March to a level well above December and was about 200,000, or more than 6 per cent, higher than a year ago. Trade, services and Government have been able to continue to absorb large numbers of workers most of whom would apparently be inexperienced women and youth. In these industries the rate of increase in the first quarter (an annual rate of about 2 million) was sharper than in the fourth quarter of last year.

In all, 3 million workers were added to nonfarm industries in the past 12 months, the largest yearly increase in the postwar period. Interestingly, manufacturing gains have been especially rapid this past year, in contrast to the earlier employment experience, but nevertheless accounted for only one-third the total rise in nonfarm employment, about the same proportion that manufacturing employment is to total nonagricultural (payroll) employment.

Unemployment. The limited number of experienced adult workers available for jobs continues to be a dominant factor in labor market developments. Although the unemployment rate rose slightly to 3.8 per cent in March, following 6 consecutive months of decline, the rise was mainly accounted for by an increase in unemployment among teenage youth, a group whose unemployment rate has been more volatile from month to month than that for older workers. For adults--men and women 20 years of age and over who comprise 90 per cent of the civilian labor force--the unemployment rate in March was 2.9 per cent. This is the second month it has been under 3 per cent and about as low a rate for this group as during the Korean conflict. This suggests that the jobless rate for most workers in the labor force is close to what can be considered a frictional unemployment level.

Recent data from unemployment compensation programs also strikingly point up the low and diminishing supplies of available workers with past employment experience. Since the survey week (week ending March 12) for the household and establishment reports, the seasonally adjusted number of persons filing claims under the State unemployment compensation programs has declined sharply. In the last week of March new claims dropped to 160,000, the lowest number for the comparable week in any year since the end of World War II. Moreover, by the end of March less than 2.5 per cent (seasonally adjusted) of all covered workers were receiving benefits, which is about as low a rate as was reached any time during the Korean conflict.

With the unemployment rate among adult workers low, the over-all unemployment rate may be less responsive in coming months to strong demands for labor. (For men 25 years of age and over, for example, the unemployment rate has shown little change in the past 4 months.) Therefore, the elasticity of the unemployment rate in coming months will increasingly reflect (1) a rising rate of transitional unemployment and job changing, (2) the high proportion of very mobile young workers among the job seekers and (3) any inability to make important inroads in the extremely high rates of unemployment among nonwhite youths.

With labor demands continuing strong and supplies dwindling, turnover has increased in recent months, and voluntary worker mobility has speeded up. This usually happens in a tightening labor market as more workers find they can sucessfully shop around for better jobs. With a higher proportion of workers changing jobs, the rate of frictional unemployment may tend to rise. Short-term unemployment becomes a much larger proportion of total unemployment in periods of labor shortage than during periods of labor surplus.

In addition to rising cyclically, the frictional unemployment rate may now be higher secularly than in other low unemployment years, such as in the 1955-57 expansion or the Korean period. The reason can be traced to the changing demographic composition of the labor force and its effect on unemployment. Of particular significance is the higher proportion of young workers in the job market currently than a decade or so ago.

LABOR FORCE AND UNEMPLOYMENT
March of each year
(Seasonally adjusted)

	Civilian Labor Force		Unemployment		Unemployment Rate	
	1957	1966	1957	1966	1957	1966
Total	100.0	100.0	100.0	100.0	3.8	3.8
Teenagers	7.9	10.0	21.9	30.8	10.5	11.7
Adult men	62.9	58.7	49.3	39.8	3.0	2.6
Adult women	29.1	31.3	8.7	29.4	3.8	3.6

Teenagers accounted for 10 per cent of the civilian labor force in March 1966, a higher proportion than in March 1957 when the total unemployment rate was the same as currently. With more teenagers now in the work force, their share of total unemployment has increased sharply--from 22 to 31 per cent. In contrast, women accounted for only a slightly higher share of labor force and unemployment than in 1957, while the adult male fraction declined sharply. Of the three groups, however, only the jobless rate of teenagers worsened over the period, partly reflecting the pressure of large population growth.

Young workers take longer to find jobs and typically move frequently from job to job before settling in their chosen vocation. As a result, their rate of job turnover, and consequently their implied frictional unemployment rate, tends to be well above the average. Even in the tightest labor market in the postwar period, the teenage jobless rate has remained 2-1/2 to 3 times higher than the total unemployment rate. The increasing proportion of these highly mobile young workers in the current unemployment count would naturally tend to weigh up the total unemployment rate and the proportion considered frictional. Thus, current unemployment rates would tend to overstate the availability of unemployed labor resources when compared with earlier periods of low unemployment.

UNEMPLOYMENT RATES
March of each year
(Seasonally adjusted)

	1957	1965	1966
Total	3.8	4.7	3.8
White	3.4	4.2	3.4
14-19 years	9.6	12.8	10.2
Adult men	2.6	3.0	2.2
Adult women	3.6	4.1	3.3
Nonwhite	7.1	8.6	7.2
14-19 years	17.9	24.6	23.7
Adult men	6.5	6.5	5.6
Adult women	5.4	7.7	5.3

In March 1966, about one out of four nonwhite youths in the labor force were unable to find jobs, whereas one in ten white teenagers were unemployed. Over the past year the jobless rate of white youths improved, while the jobless rate of nonwhite youths remained about level. Recently, it has been the high and stable rate of unemployment among nonwhite youths that has maintained the 2-to-1 unemployment rate differential between nonwhite and white workers which has persisted for so long. Among adult nonwhite women, the unemployment rate has declined more sharply than for white workers in the past year, while for adult men it has been less rapid. However, nonwhite adult men have lower unemployment rates currently than a decade ago, even though the total rate was the same. In contrast, the teenage nonwhite rate has increased sharply.

<u>Construction activity</u>. Outlays for new construction reached a record rate this winter, reflecting mainly the continued upthrust in expenditures for business and related installations and a temporary surge in private housing starts toward the end of last year. However, in February, building contracts dipped for the second successive month, according to F. W. Dodge, and there were other indications of possible weakening in construction activity as a whole. In the residential sector, the further rise in residential construction initially reported for February will probably be revised downward because of the sharp reduction in starts reported after the expenditure release.

In the public sector, recent announcement of steps taken to reduce Federal expenditures may begin to have some effect on outlays as the year progresses. These steps were undertaken not only to dampen over-all demands but also as an example for private industry and State and local government. In recent years, public construction as a whole has accounted for 30 per cent of total construction outlays, with highways alone accounting for 10 per cent of the total. Through February of this year, public construction had been fluctuating within a narrow range just below the high level last November.

The sharp decline in private housing starts in February -- like the unusual rise in December -- apparently reflected weather influences for the most part, although firming of mortgage market was also a factor. Assuming some recovery in March, starts in the first quarter of the year may have approximated the 1.45 million annual rate of first two months of the year. If so, this would make the first quarter only moderately lower than 1965 as a whole and about the same as the recent low in the third quarter. It would also be about in line with our earlier projections for the quarter and with recently revised trade expectations for the year 1966.

A test of the viability of this rate of housing starts may come later this spring, when many commitments made before the end of 1965 will have been worked off and when financing demands will be seasonally higher, particularly in the northern states.

PRIVATE HOUSING STARTS AND PERMITS

		Jan.-Feb. 1966 (thousands of units)1/	Per cent of change from	
			QIV 1965	Year 1965
Starts	(total)	1,451	- 8	- 4
Permits	(total)	1,203	- 7	- 3
1	family	676	- 8	- 5
2-or-more	family	527	- 4	- 1
Northeast		265	--	+ 5
North Central		315	-10	- 2
South		390	- 9	- 3
West		233	- 6	-12

1/ Seasonally adjusted annual rate; preliminary.

Farm outlook. Farm production and price prospects indicate that another year of relatively favorable returns is in store for farmers. In 1965, net realized incomes of farmers rose from a seasonally adjusted annual rate of $12.5 billion in the first quarter to $14.8 billion in the second and for the whole year totaled $14.1 billion.

This was the highest net return realized by farmers since 1952. Sharply rising prices received for meat animals sparked by expanding consumer demands coinciding with cyclically low hog marketings, were largely responsible for the increased income. Production costs rose but at a slower pace than sales receipts.

It seems safe to assume that net returns were equally favorable in the first quarter of 1966. It is unlikely, however, that such returns can be sustained throughout the year in view of production prospects. Through March, the volume of marketings were somewhat larger than a year earlier and farm prices averaged 13 per cent higher. The volume of crops marketed from the record 1965 harvest was an eighth above a year earlier and average prices were off a little despite sharply higher prices received for short crops of fresh winter vegetables. Prices of livestock and products averaged 25 per cent above the relatively low prices that prevailed a year ago and the volume of marketings was approximately 3 per cent less.

In the months ahead supplies of hogs, poultry, and eggs are expected to become more plentiful as production in process reaches markets. Milk production, now running well below a year earlier because of reductions in cow numbers and lower output per cow, should increase somewhat in response to the hike in the dairy price supports announced on March 31. Beef cattle numbers are large enough to permit somewhat larger marketings than in 1965 throughout the year, but probably not at the 5 per cent higher rate of the first quarter.

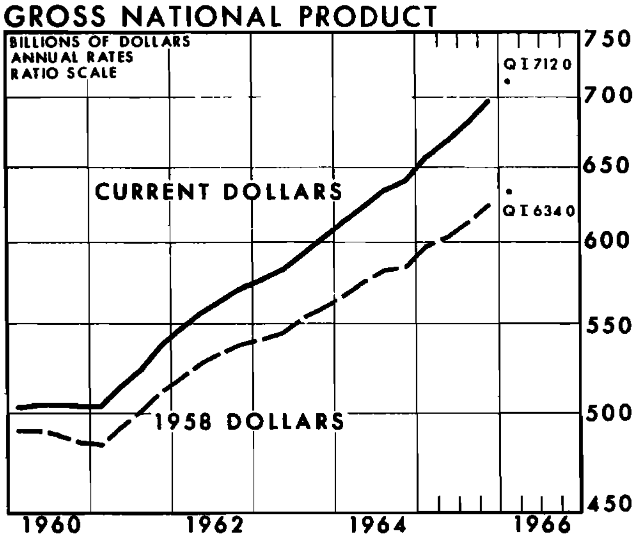
Another year of large crop output is in prospect. Farmers' planting intentions on March 1 indicated that the 1966 acreage of 17 major field crops would be about the same as the acreage actually planted to these crops in 1965. Some important shifts in acreage plans were made in response to changes in Federal programs. Rice and soybean acreages were increased, largely because of eased planting curbs, and cotton acreage was cut 23 per cent reflecting participation in the new cotton acreage diversion program. Corn farmers planned to increase acreage 2 per cent which, with favorable growing conditions, would add to surplus stocks.

March 31 announcements of an increase in the soybean price support 11 per cent above the 1965 level and an extension of the sign-up period for the feed grain program may induce farmers to shift more acreage from corn to soybeans. Such a shift would supplement a reduced cottonseed crop and avoid surplus production of corn.

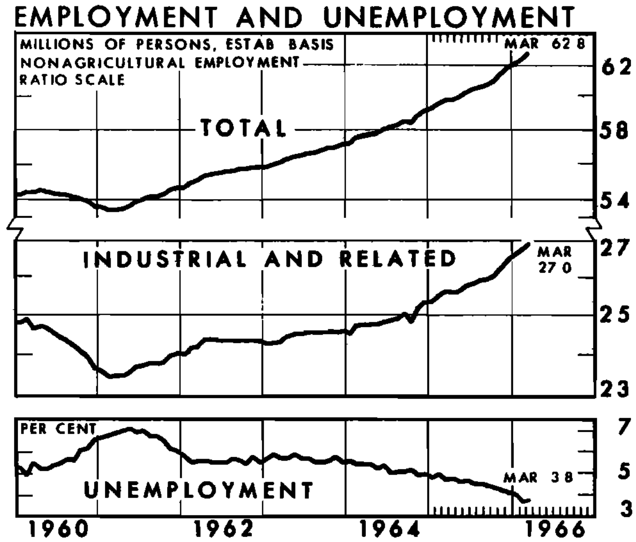
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

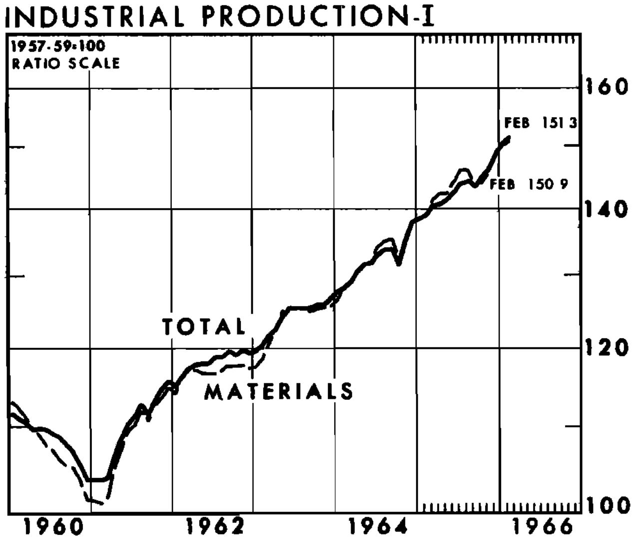
GROSS NATIONAL PRODUCT



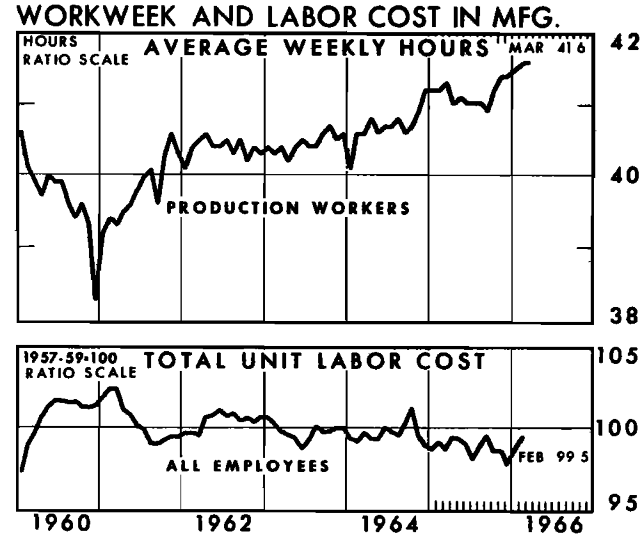
EMPLOYMENT AND UNEMPLOYMENT



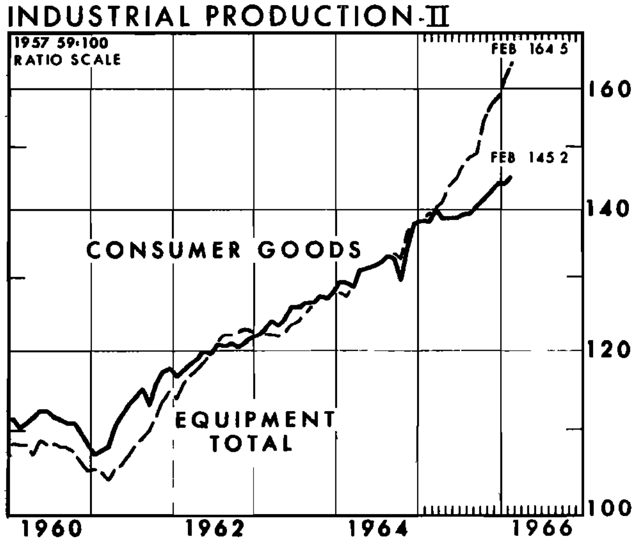
INDUSTRIAL PRODUCTION-I



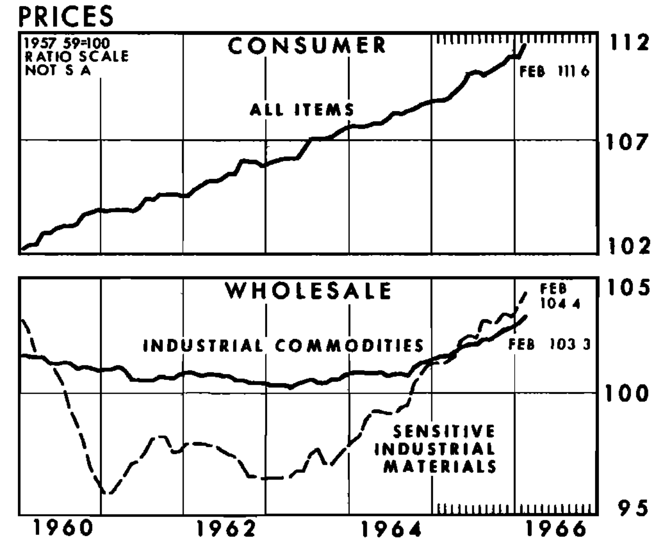
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION-II



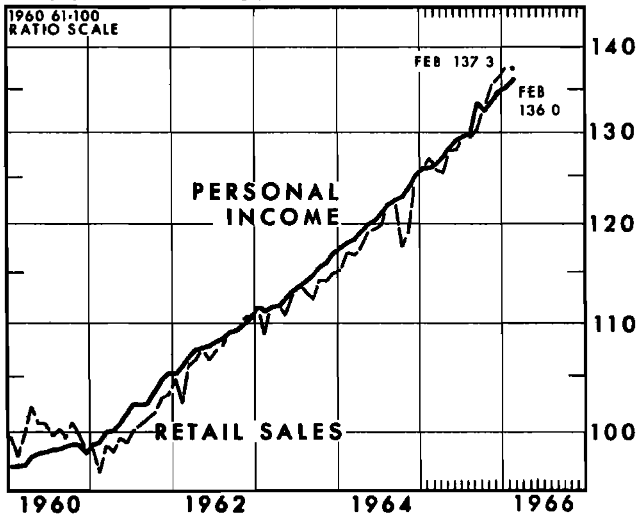
PRICES



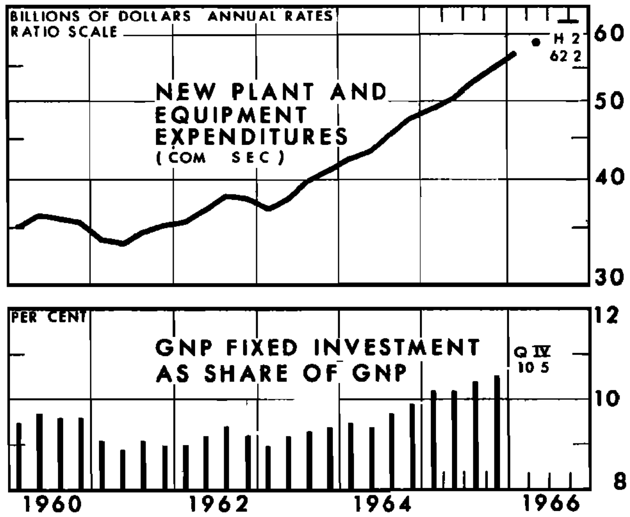
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

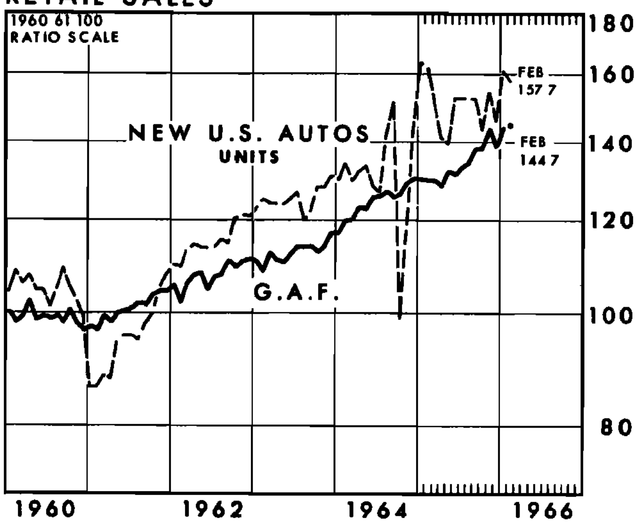
INCOME AND SALES



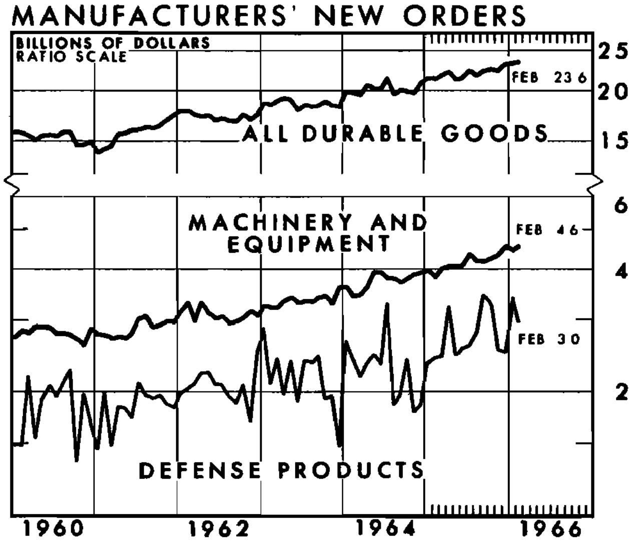
BUSINESS INVESTMENT



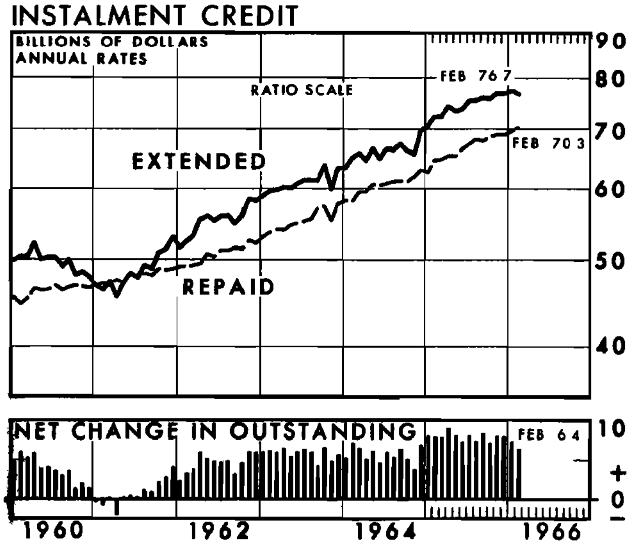
RETAIL SALES



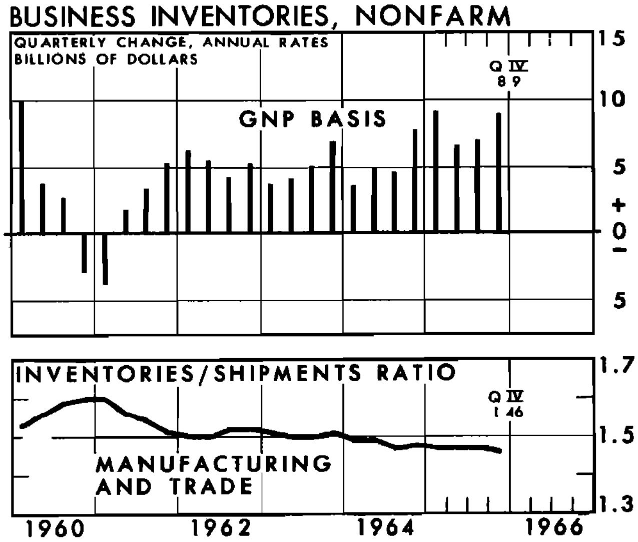
MANUFACTURERS' NEW ORDERS



INSTALMENT CREDIT



BUSINESS INVENTORIES, NONFARM



DOMESTIC FINANCIAL SITUATION

Bank credit. Loans and investments at all commercial banks, under the pressure of heavy tax-related demands, apparently expanded at a seasonally adjusted annual rate of about 10 per cent in March, following essentially no growth in February. The seesaw February-March movement reflects an unusual temporary reduction in bank credit in the last statement week of February and an unusually large increase late in March. The former decline was due mainly to large repayments of Government security dealer loans as positions were temporarily reduced, while the latter increase was due to a large rise in dealer financing needs late in the month and heavy tax borrowings by finance companies. These developments, late in each month, tend to bias February credit expansion downwards, while biasing the March data upwards.

Total loans in March rose more rapidly than in any month since last summer, mainly as a result of the above-mentioned expansion in loans to finance companies and to Government security dealers. Finance companies, with bank loans more expensive and less available, had increased their sale of commercial paper by an unusually large amount early in 1966. At the tax date, these companies faced very large maturities and consequently increased their bank loans quite sharply at midmonth, borrowing over $1 billion from weekly reporting banks alone; their subsequent repayments have been slow.

Business loan expansion also accelerated from February to March, and was especially heavy over the tax and dividend period. However, business loan growth during the past two months remained below the extremely rapid December-January pace. Loan demands have recently been strong in most industrial sectors, but especially in the metals, textiles, and miscellaneous manufacturing industries, and among trade firms.

CHANGES IN COMMERCIAL BANK CREDIT
Seasonally Adjusted Annual Rates
(Per cent)

	Total loans and investments	U.S. Government securities	Other securities	Total loans	Business loans
1965-66					
Dec. - Jan.	11.3	- 2.1	6.8	16.4	25.5
1966					
January	12.2	- 4.2	--	20.0	25.9
February	0.4	-23.0	18.7	3.0	11.8
March 1/	10.1	- 8.5	-15.9	21.5	18.4

1/ Preliminary, subject to revision.

To finance loan demand in March, banks in the aggregate had to bite deeper into their security portfolios. Liquidation of Treasury issues were smaller than in February, in part because many large banks were nearing minimum levels of such security holdings. However, bank liquidation of other securities -- mainly municipals -- was very large in March, about $600 million, seasonally adjusted. Last month's reduction in such securities was the largest month-to-month decline of the current expansion; indeed, in only one other previous month since 1961 have holdings of other securities declined. In addition, banks were forced to increase their borrowings from the Federal Reserve to an average of $550 million, from the average $470 million in February, as nonborrowed reserves declined on a seasonally adjusted basis.

Since year-end, weekly reporting banks have accounted for all of the liquidation of securities by commercial banks. Larger banks over this period have been liquidating both Treasury issues and other securities, on balance, while smaller banks -- with their loan demands less strong and their time and savings deposit inflows better maintained than was the case at larger banks -- have added to their portfolios of all securities, especially municipals.

In recent weeks, however, preliminary indications suggest that the smaller banks have also been adjusting their security portfolios -- liquidating Treasury issues and reducing their rate of acquisition of other securities -- apparently without any unusually large expansion in loans. As indicated below, this change probably reflects a shift of time and savings deposits from smaller to larger banks, a shift that tends to spread monetary restraint to a larger group of banks.

Bank deposits and the money stock. The seasonally adjusted annual rate of growth of time and savings deposits at all commercial banks in March was the same as the 6.5 per cent rate of February.

However, there were unusually large shifts in the composition and location of inflows of such deposits during the month.

City banks were able to expand their inflows of time deposits quite sharply last month; the rate of inflow of total time and savings deposits at reserve city banks more than doubled from February to March on a seasonally adjusted basis. Time deposits other than negotiable CD's rose by almost $600 million in the first four reporting weeks last month, over twice as rapidly as in the same period last year. This increased inflow apparently reflects higher rates on and more aggressive advertising of smaller denomination nonnegotiable certificates. It is likely that some of these funds were withdrawn not only from savings deposits -- which continue weak -- but also from smaller banks. For example, total time and savings deposit inflows at country banks decelerated in March, on a seasonally adjusted basis. The reduced inflow of time and savings deposits at smaller banks is an important reason for their smaller municipal purchases noted above.

Also contributing to the increased inflow of time deposits to reserve city banks was their success in attracting CD money. Despite heavy March maturities, New York banks added almost $500 million to outstanding CD's in the last two weeks of March, bringing total outstandings just short of the peak late January level. Other banks are apparently adding to their outstandings also.

New York City banks have been very aggressive in the CD market, increasing offering rates from 12 to 25 basis points. As a result, the spread of rates on 90 to 179 day CD's over the comparable bill yield rose to a record level in late March of about 60 basis points as shown in the table.

YIELDS ON NEGOTIABLE CD'S AND TREASURY BILLS
(Per cent)

	CD's 1/	Bills 2/	Spread
Average 1964-65	4.07	3.83	.24
Average mid-March to mid-June 1965 3/	4.28	3.98	.30
February 1966	4.98	4.77	.21
March 1966	5.10	4.70	.40
March 9, 1966	5.00	4.75	.25
March 16, 1966	5.125	4.76	.365
March 23, 1966	5.125	4.62	.505
March 30, 1966	5.25	4.63	.62
Previous weekly high spread (June 9, 1965)	4.30	3.89	.41

1/ Most often quoted rate on 90-179 day CD's at New York City banks.
2/ 90-day Market Treasury bill yield, adjusted to an investment base.
3/ Period of highest CD premium for that year.

It is likely that city banks, having faced difficult roll-over problems with their outstanding CD's, heavy loan demands, and increased security liquidations, have decided to raise their offering rates in order both to lengthen their CD maturities and to gain funds for loan demands. Market circumstances have also been favorable due to the recent decline in bill rates. By the end of March, the most often quoted

CD rates at New York banks were 5 per cent on less than 90 day CD's, 5-1/4 per cent for 90 to 269 day maturities, and 5-3/8 for 270 day and over money -- an increase since early March of 25 basis points for short-term CD's and 12.5 basis points for longer maturities; the highest reported rates rose 35 and 25 basis points, respectively, over the month.

Since late February, the seasonally adjusted money stock has risen sharply, increasing at an annual rate of over 9 per cent during March. Most of this increase reflected a reduction in seasonally adjusted Treasury balances about equal to the increase in private demand balances. Over the first quarter, the money stock rose at a 4.5 per cent annual rate, somewhat below that for all of 1965.

U.S. Government securities market. Yields on Treasury notes and bonds declined further in late March and early April, extending the decline which began in early March. Meanwhile, Treasury bill rates have fluctuated in a lower range since mid-March and recently the 3-month bill has been quite close to the discount rate.

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
1959-61						
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
1965-66						
Highs	4.70	4.90	5.07	5.03	5.02	4.81
Lows	3.76	3.81	4.00	4.08	4.17	4.17
1965-66						
Dec. 3	4.12	4.26	4.54	4.52	4.52	4.44
Feb. 28	4.64	4.84	5.06	5.03	5.02	4.81
Mar. 22	4.55	4.74	4.89	4.84	4.78	4.66
April. 5	4.54	4.67	4.80	4.76	4.66	4.59

The month-long decline in Treasury bond yields has served to erase 1/2 to 2/3 of the yield advance on intermediate- and long-term Treasury issues that occurred after the discount rate increase in early December. Factors contributing to recent market strength have included a growing conviction that the earlier market correction had outpaced economic developments and also a developing feeling that the Administration is moving toward a proposal to raise taxes, thereby lightening the task of monetary policy and relieving pressure on interest rates. An additional strengthening influence on Treasury bond prices has been the excellent receptions accorded many recent major corporate and municipal issues.

The main thrust of the rally in U.S. Government bond prices has come from strong dealer demand, however, rather than from investment buying. In recent weeks dealers have made strong efforts, first, to cover sizable short positions and subsequently to build up net long positions. In doing so, they have absorbed moderate investor selling at rising prices. On April 4, dealers held $115 million, net, of bonds due in over 5 years, their largest position in such issues since November, as compared with a net short position of around $40 million at the beginning of March.

Treasury bill rates, unlike other short-term rates, have been under downward pressure in recent weeks. Even though net market demand for bills has tapered off since mid-March, dealer inventories were depleted by previous strong demand and dealers' willingness to build up their inventories in recent auctions has helped to keep rates at the lower end of their recent range. In addition, the maturity of $3.0 billion March tax bills as well as the completion in late March of the Treasury's $100 million additions to the weekly bill auctions have served to reduce available supplies of bills. The Treasury is not expected to need to raise any cash through short-term debt issues in the current quarter.

Yields on short-term debt instruments other than bills have remained at their recent highs established after the prime loan rate increase or have edged a bit higher as is shown in the table.

SELECTED SHORT-TERM INTEREST RATES 1/
1965-66

	Dec. 3	Feb. 28	Mar. 22	Apr. 1
Commercial paper 4-6 months	4.375	4.875	5.375	5.375
Finance company paper 30-89 days	4.375	4.875	5.125	5.25
Bankers' Acceptances 1-90 days	4.25	4.875	5.00	5.00
Certificates of deposit (prime NYC)				
Most often quoted new issues				
3-months	4.50	5.00	5.125	5.25
6-months	4.50	5.125	5.25	5.25
Secondary market:				
3-months	4.49	5.10	5.20	5.25
6-months	4.57	5.18	5.40	5.43
Federal Agencies				
3-month	4.34	4.92	4.95	4.99
6-month	4.49	5.11	5.10	5.09

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. The next Treasury financing operation will be the regular May refunding, which will involve a relatively small amount, $2.5 billion of publicly-held maturing debt. The terms of the refunding will be announced in late April.

The Treasury is not expected to have to raise any further cash in the current fiscal year through issues of its own debt. However, consistent with the Budget Document, the Treasury's cash position may be augmented by further sales of participation certificates by the Export-Import Bank and, if necessary legislation is secured, by the Small Business Administration. In addition, other Federal Agencies are expected to continue to be sizable net borrowers of new cash in the current quarter.

Corporate and municipal bond markets. The decline of bond yields since early March has amounted to more than 1/3 of a percentage point on new corporate bond issues and to about 1/5 of a percentage point on State and local government bonds. In both markets, these declines have erased more than half of the sharp yield advances which had occurred from early December, when the discount rate was increased, to early March. Although yields on seasoned corporate bonds have moved divergently from other bond series in the past few weeks, they always show a lagged response to rapid changes in other bond series.

BOND YIELDS
(Per cent per annum)

	Corporate Aaa		State and local Government	
	New 1/	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:				
Dec. 3	4.79	4.60	3.37	3.50
Mar. 4	5.38	4.85	3.63	3.83
Mar. 18	5.27	4.93	3.56	3.73
Mar. 25	5.09	4.97	3.51	3.66
Apr. 1	5.02	4.99	3.44	3.59

1/ The movement of yields on new issues of corporate bonds has been affected substantially in the past two months by the degree of protection from early call provided for given issues. The March 4 high in the new issue series was exaggerated by lack of call protection on the issues sold that week; whereas averages for the weeks ending March 18, 25, and April 1 are biased downward because the issues offered carried call protection. Since any adjustment for variation in call protection would be highly arbitrary and would have to be altered with changing market circumstances, no such adjustment has been attempted in the new issue series presented here.

The rather abrupt reversal in direction of bond yields since early March seems to have been due more to a sense among bond market participants that interest rate increases had overdiscounted the future than to any real change in the underlying economic forces affecting the supply and demand for long-term funds. This shift in attitude itself has triggered responses among both lenders and borrowers which have substantially strengthened the technical position of both corporate and municipal bond markets, and in so doing contributed to the decline in yields.

As the historically high levels to which bond yields had moved began to seem excessive to borrowers, new issue postponements (chiefly in the municipal bond market) and less rapid additions to the forward calendar helped to moderate immediate demands of borrowers on capital markets. With the visible supply of new issues thus reduced to more moderate levels, investors bid more aggressively for this smaller volume at yields which began to run unusually attractive. At the end of March, large bellweather issues in both corporate and municipal bond markets -- the $250 million AT&T and the $100 million California offerings -- attracted particular investor interest and declined in yield on secondary trading, adding further to the general strengthening of bond markets. Most recently, however, a few new corporate issues reoffered at still lower yields have met with a reluctantly slow reception.

BOND OFFERINGS 1/
(In millions of dollars)

	Corporate				State and 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
November	613	30	529	645	1,018	578
December	326	320	1,161	1,342	768	1,078
1966						
January	480 2/	161	740	565	1,183	849
February	600	187	800	450	816	966
March	785	557	700	658	845	1,036
April	650	422	700	648	800	994

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 Croporation 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.

Because the forward calendar of new corporate bond offerings has grown less rapidly in recent weeks, the volume of new corporate issues presently expected for public offering in April is about $100 million smaller than the March volume -- which itself fell somewhat below earlier estimates. This change follows a first quarter in which corporate public offerings totaled over $1.8 billion or roughly twice the amount offered in the like period of 1965.

Two key questions now facing the corporate market are (1) the extent to which first quarter borrowing may have anticipated second quarter business requirements, and (2) whether with yields now at lower levels, new additions to the calendar will again pick up momentum. Very recently several new offerings have been added to the near-term projections that show large continuing business needs for funds. But firm answers to the two questions must await further evidence.

Municipal bond offerings in March fell well below the volume originally expected -- reflecting cancellations and postponements aggregating in excess of $600 million (offset in part by advancement of the $100 million State of California offering). With the April calendar currently estimated at about $800 million, this year's volume of offerings appears to be running well behind last year's, except for the outsized January supply. Here too, however, market participants are sensitive to the possibility that the recent drop-off in yields may encourage a pick up in new issues -- including some of those that were recently postponed.

Mortgage markets. Even though net inflows of funds to depository-type institutions have slowed further this year net expansion in mortgage debt in the first quarter is estimated to have approached the advanced level of a year earlier. This increase, if realized, would be somewhat larger than we had projected earlier. The difference reflects a sharper-than-expected expansion in holdings by the Federal National Mortgage Association, and a higher-than-anticipated rate of mortgage activity by savings and loan associations -- supported in part by a much less than seasonal reduction in borrowings from Federal Home Loan Banks.

As the quarter ended, however, such borrowing became more excessive to the associations, when virtually all the Home Loan Banks raised their rates on borrowings by amounts ranging from 1/8 to 5/8 per cent -- to levels between 5 and 5-3/8 per cent.

In February, FNMA purchases of Government-underwritten home mortgages in the secondary market soared far above a year earlier and well above the previous record in January. While offerings of eligible mortgages for purchase by FNMA slackened a bit in February, they appeared to be rising again in March. In a further attempt to discourage this tendency, FNMA in early April announced that it would limit the unpaid amount of mortgages it will buy to $15,000. This compares with potential maxima of $30,000 for FHA-insured mortgages and $21,425 for VA-guaranteed mortgages.

Trade reports continue to emphasize that the recent 1/4 per cent upward adjustment in maximum permitted rates for Government-underwritten mortgages for homes is too low to attract lenders under current market conditions. As a result, discounts have continued, especially in the West, and there is concern about the availability of mortgage funds, particularly for the sale of existing homes on which new home-purchases depend to a marked extent.

In the market for conventional home mortgages, lenders appear also to have become more selective, with some indication of tightening of nonrate terms along with insistence on higher yields, according to data now available for February. Loan amounts were appreciably higher than a year earlier, however, reflecting in part further increases in the price of properties being purchased.

AVERAGE NONRATE TERMS OF CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASE

	1966		Per cent increase in February from a year ago
	January	February	
New home loans			
Loan amount ($1,000)	18.0	18.8	7
Loan/price (per cent)	73.4	73.2	-1
Maturity (years)	24.6	24.6	-1
Existing home loans			
Loan amount ($1,000)	14.3	14.4	4
Loan/price (per cent)	72.6	72.0	-1
Maturity (years)	20.6	20.3	--

Source: FHLBB and FDIC.

The number of foreclosures of nonfarm real estate -- mainly homes -- increased slightly in the fourth quarter of last year, but the rate of 5.0 per thousand mortgaged structures was the same as in the previous quarter and, as expected, somewhat below the recent high of 5.2 per thousand reached in the second quarter of last year. For 1965, as a whole, the year-to-year increase in foreclosures was 7 per cent, which was the smallest increase since 1959. In 1964, the increase was 11 per cent.

NONFARM MORTGAGE FORECLOSURES

Year	Number (in thousands)	Rate per thousand mortgaged structures
1965	116.7	4.9
1964	108.6	4.8
1963	98.2	4.5
1962	86.4	4.2
1961	73.1	3.7
1960	51.4	2.7

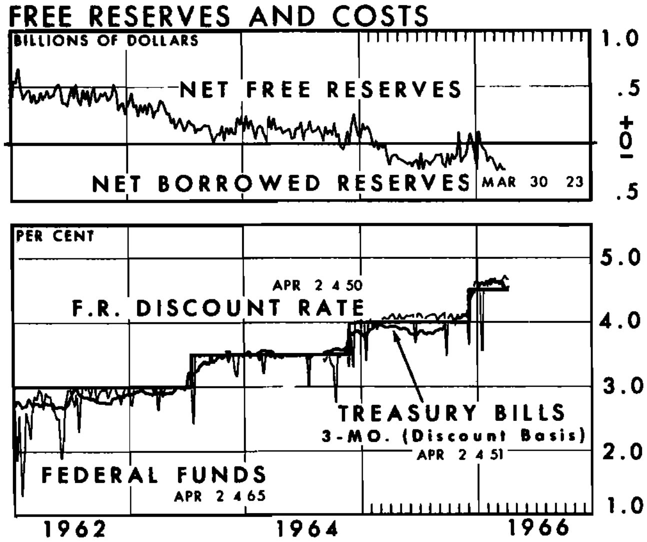
Stock market. Common stock prices -- as measured by Standard and Poor's composite index -- have risen about 5 per cent on balance from their March 15 low, recovering about two-thirds of the earlier decline from the record February 9 high. Although trading activity during most of the recovery period was at a more moderate pace (about 7.4 million shares per day), most recently volume has picked up again, averaging 9.6 million shares per day.

The price recovery associated with the period of moderate trading was a bit hesitant, reflecting continued market sensitivity to discussion of possible Federal actions on the tax and wage-price fronts. But very recently the advances have been strong with institutional investors reportedly buying blue chip stocks. Moreover, market analysts expect that March earnings statements, soon to be released, will prove to be more favorable than some had feared, adding further to general investor interest.

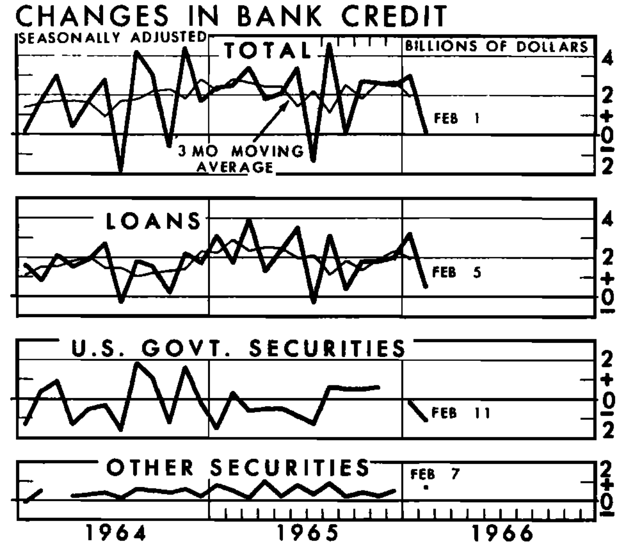
Trading in low-priced stocks and special industry stock groupings, which have consistently attracted a speculative following, continues to be quite heavy. In fact these groups have registered substantial price advances even in weeks when the broad indexes were declining; and the indexes for stocks in the electronics, air transport, radio-TV, and metal fabricating industry groupings have all moved recently to new 1965-66 highs. To a considerable extent this continued speculative activity in low-priced stocks and favored industry groupings probably explains why stock market credit reported by firms in the New York Stock Exchange margin panel showed an $88 million increase in February at a time when the popular stock market averages were showing sharp net declines.

FINANCIAL DEVELOPMENTS - UNITED STATES

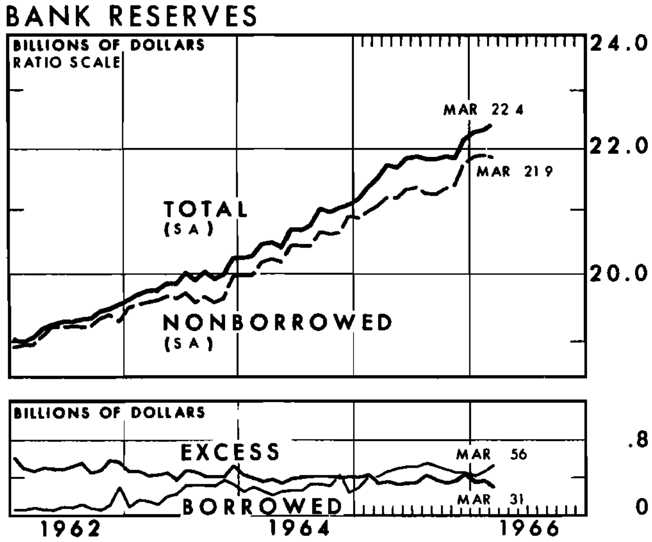
FREE RESERVES AND COSTS



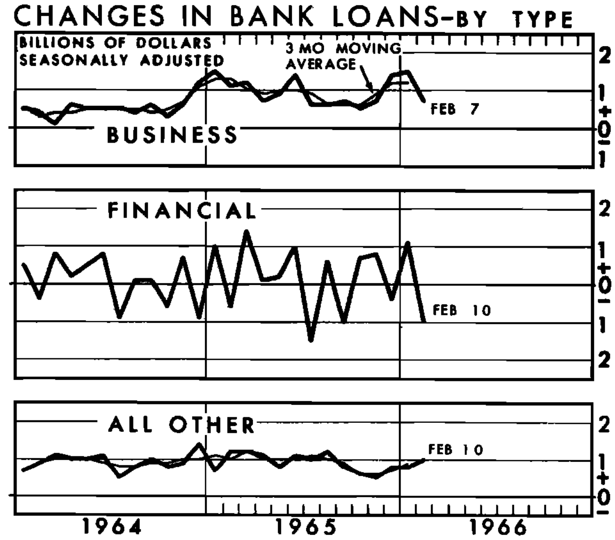
CHANGES IN BANK CREDIT



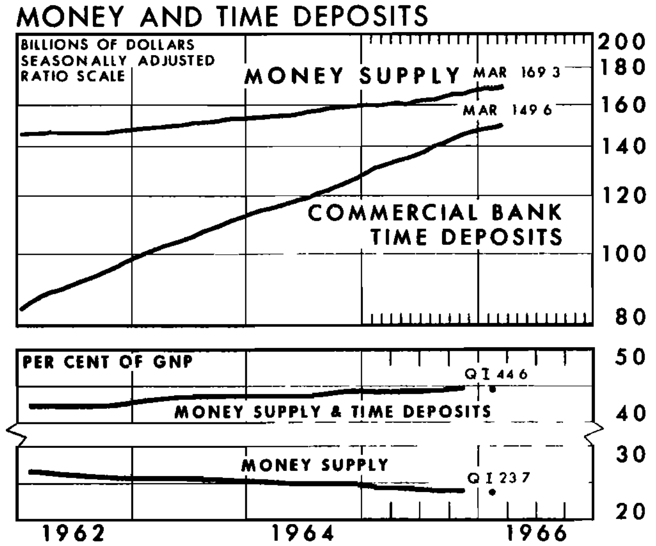
BANK RESERVES



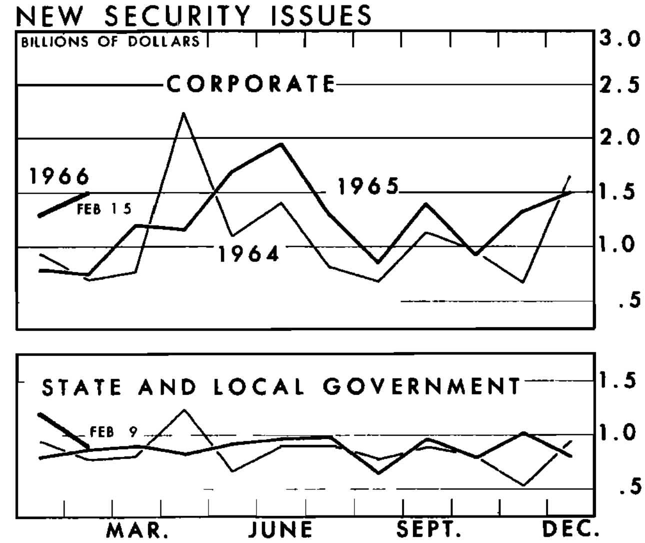
CHANGES IN BANK LOANS-BY TYPE



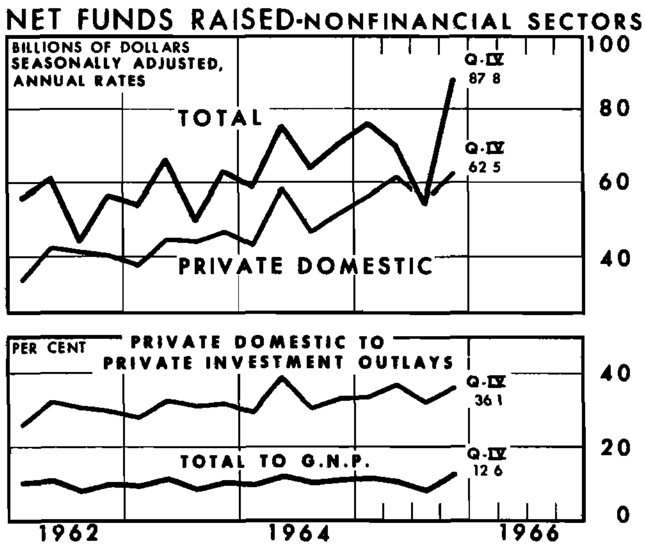
MONEY AND TIME DEPOSITS

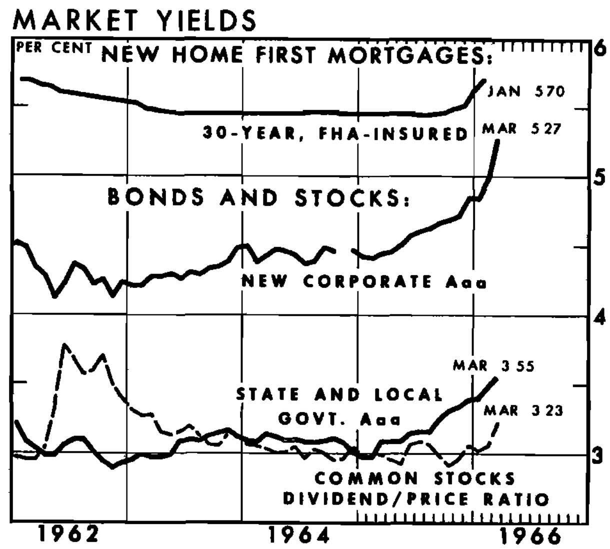


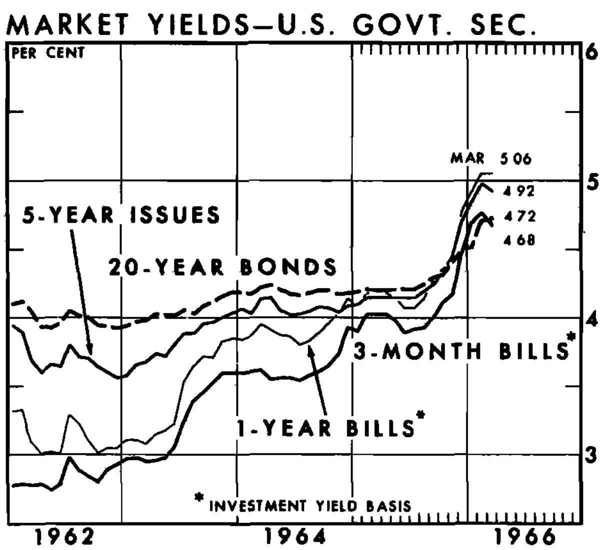
NEW SECURITY ISSUES

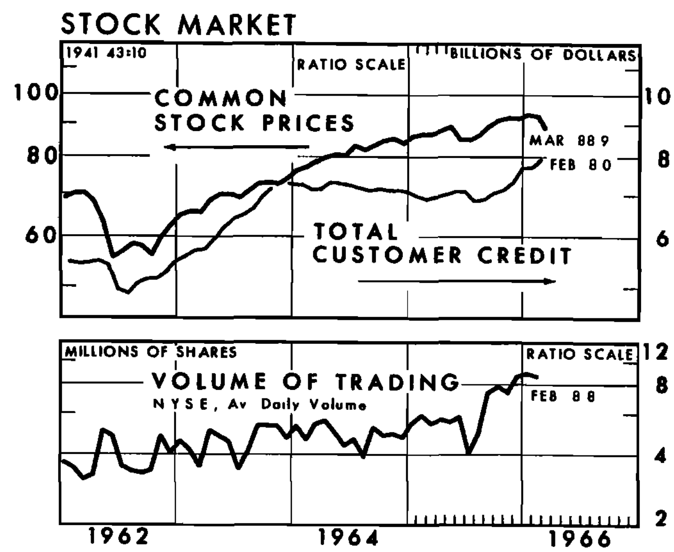


FINANCIAL DEVELOPMENTS - UNITED STATES









INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Preliminary weekly indicators for March, before seasonal adjustment, show a U.S. payments surplus on the liquidity basis of roughly $100 million for the month, following approximate balance in the 2-month period January-February. This implies a deficit for the first quarter, after preliminary seasonal adjustment, at an annual rate of about $1-1/2 billion, unchanged from the fourth quarter. However, as indicated in the March 16 Green Book, adjustments for the postponement into the first quarter of Canadian security issues and for certain other unusual developments indicate that on other transactions there was a moderate improvement from the fourth quarter.

Data presently available do not account for the improvement. While there was a substantial reflow from abroad of outstanding U.S. bank credits, this was offset by further narrowing of the trade surplus.

Merchandise imports in February continued at about the high January rate of $23-1/4 billion annually; at this level they were unchanged from the average for November-December, although up slightly from the fourth quarter. (The February import figure reflects a tentative statistical adjustment for carryover of import documents that is still subject to revision.)

Exports in February were unchanged from January; the $27-1/4 billion annual rate in these months was down 3 per cent from the fourth quarter. The decline was concentrated in non-agricultural exports; agricultural exports, seasonally adjusted, were unchanged in January-February from the fourth-quarter rate.

By geographical area, the decline in exports through January is apparently more than fully accounted for by reduced shipments to Japan and to less developed countries in Asia and Africa. In December-January (the latest data with country detail), total exports seasonally adjusted but without other adjustments were down 3 per cent from October-November. Exports to Japan were down one-sixth, possibly reflecting the seamen's strike in that country from November to January. Exports to Australia, South Africa and LDC's outside Latin America together were off about 7 per cent, and those to Continental Europe fell slightly. On the other hand, exports to Canada and the United Kingdom increased.

There were large reflows of U.S. bank credits again in February; in the first two months of the year, banks under the VFCR reported a net reduction of $385 million in claims covered by the voluntary program--not seasonally adjusted. This figure differs only slightly from the reduction in claims reported by all banks in the United States (including agencies and branches of foreign banks) both for their own account and for account of customers. With the February data, there is evidence of a more widespread geographical pattern of reflows than was apparent earlier, and hence an increased likelihood that the reflows resulted from constraints on the supply of credit. There have been sharp reductions in outstanding bank loans and acceptance credits to Europe and Latin America, as well as in credits to Japan. Much of the reduction has been accounted for by banks in the New York Federal Reserve District, and may well reflect special pressures on these banks. At the end of February, New York District banks reported outstanding claims under the VFCR below the October 31 level, while Chicago and San Francisco banks both remained about even with their positions at end October.

Additional evidence of the effects of credit restraint may be found in recent information on commitments on long-term loans. Total commitments thus far reported for the first quarter amount to $115 million -- approximately one-third of the average rate in the second half of last year. Even with some additional reports still to be received, it seems highly likely that the rate for the first quarter will prove to be under half that of the last six months of 1965. Commitments on loans to developed and to less developed countries have each been reduced proportionately; commitments for loans to finance U.S. exports have been reduced by a slightly smaller percentage than total commitments.

Foreign trade of other industrial countries. Strong upswings in imports were occurring during the second half of 1965 in Canada, in all of the Common Market countries but Germany, and in some other European countries as well. These upswings in some cases continued and intensified advances that had already been under way for periods of varying length (from January 1965 for Belgium, from mid-1964 for Italy, from early 1963 for Canada). In other cases, as in France, the Netherlands, and Switzerland, there had been pauses of 12 months or more during which imports were comparatively stable, before new upturns occurred at the middle of last year.

While it is true that total 1965 imports of Common Market countries were only 9 per cent above those of 1964 (see Appendix C), the

IMPORTS: RATES OF INCREASE
(seasonally adjusted annual rates, per cent)

Country (and magnitude of its imports)		From '64-QIV to '65-QII	From '65-QII to Sep.-Nov.	From Sep.-Oct. to Nov.-Dec.	From Sep.-Nov. to Dec.-Feb.
Acceleration after 1965-QII					
Canada	(8.5)	18	24	(35)	n.a.
Italy	(7.8)	12	21	(19)	n.a.
Belgium-Luxembourg	(6.6)	11	15	(24)	n.a.
Austria	(2.2)	9	15	(43)	n.a.
Upturn after 1965-QII					
France	(10.8)	- 2	19	(23)	16
Netherlands	(7.8)	1	19	(21)	n.a.
Switzerland	(3.7)	- 3	9	(17)	n.a.
Recent upturn					
U.K.	(16.4)	3	1	(17)	11
Japan	(8.3)	- 1	4	(8)	10
Slowdown after Nov. '65					
United States	(22.9)	24	11	(27)	4
Slowdown after Sept. '65					
Germany	(18.5)	18	16	(-8)	- 4
Downturn after July '65					
Sweden	(4.4)	21	1	(-28)	n.a.

Note: Numbers in parentheses after name of country give annual rate of imports in Sept.-Nov. 1965, in billions of dollars. Rates of increase in 3rd column, based on a 2-month interval, may be badly distorted by random fluctuations. U.S. data (on balance-of-payments basis) show post-strike effects in 1965-QII; rate of increase in 1st column is thereby magnified, in 2nd column diminished.

seasonally adjusted annual rates of increase after last May were in the 15-to-20 per cent range for all Common Market countries until September, and for all but Germany thereafter. Data available for France show a continuation of the rapid advance into 1966. The pace of Common Market import expansion since late 1964 has equalled, and since last May has exceeded the largest year-over-year rate of increase shown by Common Market imports in recent years, which was 13 per cent from 1962 to 1963.

German imports reached a peak last September which was not surpassed in the five subsequent months, though after a sharp dip in October the advance was resumed at a moderate pace. The one case in Europe of a marked downturn in imports is that of Sweden, whose imports fell almost continuously (to the year-end at least) after reaching a peak in July.

The long awaited upturn in Japanese imports has now become more clearly evident, with a sharp jump in February, possibly delayed by the Japanese seamen's strike. For 1965 as a whole Japanese imports were up only 3 per cent from 1964. In contrast, January-February 1966 imports were 10 per cent above those of the first two months of 1965.

British imports, which had been relatively level from last spring until September or October, moved up to a new high in January-February.

Data are not available on a seasonally adjusted basis to show the sources from which the various countries have been drawing their increased imports, except in the case of the United Kingdom. The expansion of British imports since last autumn has been entirely from North America (including, as we know, a sharp increase in purchases from the United States) and Continental Europe.

Export statistics indicate marked accelerations in recent months in the exports of Germany, Belgium, and the Netherlands. French exports, on the other hand, have shown a considerably slower rise from last autumn up to the latest three-month period, December-February, than France experienced earlier in 1965. An even more marked change appears to have developed in Italian exports: their uptrend, which was one of the most striking features of international trade during 1964 and the early months of 1965, came virtually to a halt after June -- though irregular month-to-month fluctuations cloud the picture somewhat. A similar leveling off occurred in Japanese exports, also after strong growth in 1964 and early 1965. However, in the latest three-month period (December-February) Japanese exports have once again shown vigorous expansion. (Distortions of Japanese export statistics due to the seamen's strike are largely removed by combining December with the following two months.)

The slowing in French and Italian export gains, coinciding as it has with upturn or acceleration in those countries' imports, reflects the growth of domestic demands described in recent Green Books. To the extent that these countries are drawing their additional imports from other Common Market countries, especially Germany, the effect is to sustain the pressures of aggregate demand upon available resources in the other countries.

Canadian exports, after rising moderately from mid-1964 to mid-1965 (when Canadian imports were sharply expanding) advanced more rapidly after last summer. Even so, with Canadian import expansion also accelerating, the trade balance deteriorated further; seasonally adjusted, exports fell short of imports in the fourth quarter for the first time since early 1962. Over the past year Canada's trade deficit with the United States especially has been rising; in relative terms Canada's exports to us have not increased as rapidly as its exports elsewhere.

EXPORTS: RATES OF INCREASE
(seasonally adjusted annual rates, per cent)

Country (and magnitude of its exports)		From '64-QIV to '65-QII	From '65-QII to Sep.-Nov.	From Sep.-Oct. to Nov.-Dec.	From Sep.-Nov. to Dec.-Feb.
Acceleration after August '65					
Canada	(8.5)	8	18	(17)	n.a.
Acceleration after October '65					
Germany	(18.1)	6	10	(41)	31
U.K.	(13.9)	2	12	(40)	19
Belgium-Luxembourg	(6.6)	2	24	(61)	n.a.
Netherlands	(6.5)	9	5	(21)	n.a.
Acceleration after December '65					
Japan	(8.4)	29	-3	(-5)	28
Recent tendencies unclear					
Sweden	(4.1)	1	13	(-4)	n.a.
Switzerland	(3.0)	15	7	(21)	n.a.
Austria	(1.6)	6	13	(7)	n.a.
Slowdown after November '65					
United States	(28.0)	3	6	(13)	-7
Slowdown after September '65					
France	(10.4)	12	13	(25)	7
Slowdown after June '65					
Italy	(7.3)	37	0	(24)	n.a.

Note: Numbers in parentheses after name of country give annual rate of exports in Sep.-Nov. 1965, in billions of dollars. Rates of increase in 3rd column, based on a 2-month interval, may be badly distorted by random fluctuations. U.S. data (on balance-of-payments basis) show post-strike effects in 1965-QII; rate of increase in 1st column is thereby magnified, in 2nd column diminished.

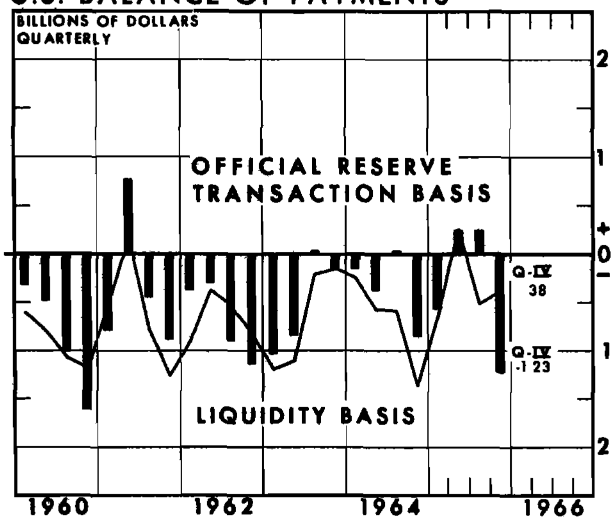
British exports, though fluctuating widely from month to month of late, have registered significant gains. Paralleling what happened on the side of British imports, the increase in exports from

September-November to December-February was entirely in shipments to Western Europe and North America. The U.K. trade deficit in these last three months was at an annual rate of $0.5 billion (seasonally adjusted balance of payments basis) compared with $0.7 billion in the preceding three months or in the full year 1965.

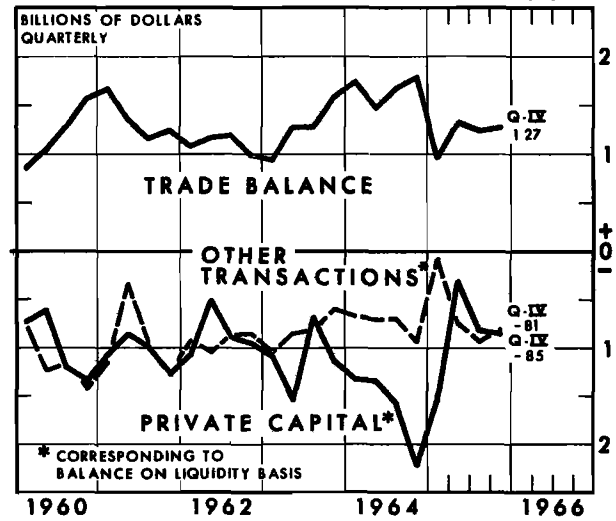
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

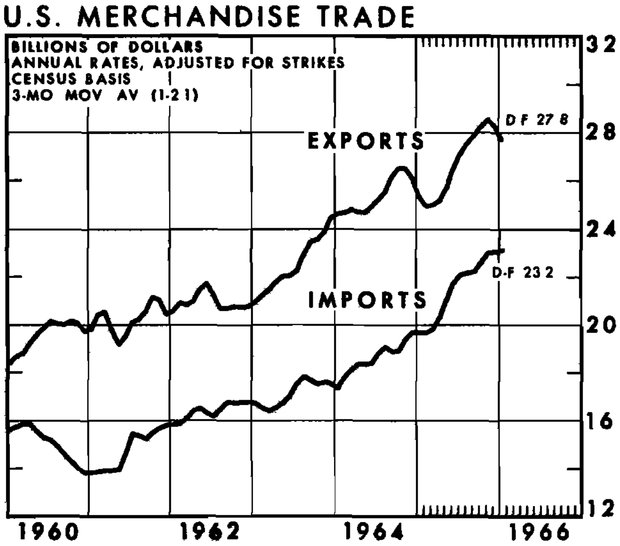
U.S. BALANCE OF PAYMENTS



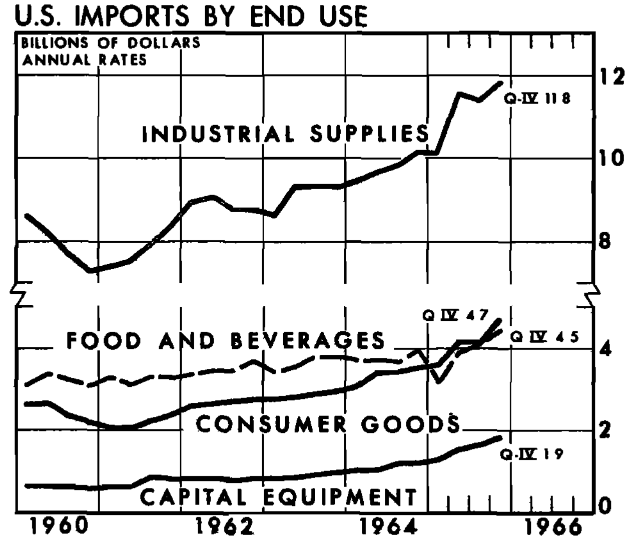
U.S. BALANCE OF PAYMENTS - CONT.



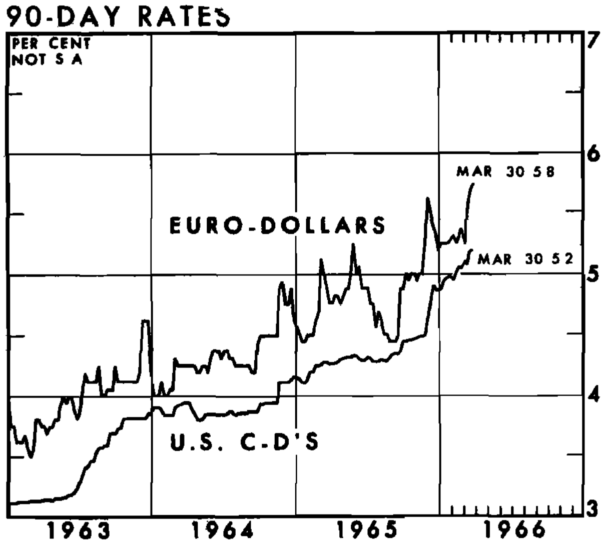
U.S. MERCHANDISE TRADE



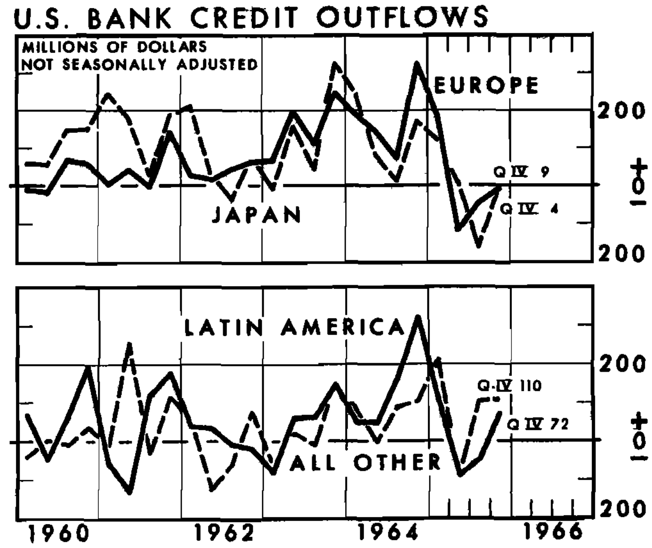
U.S. IMPORTS BY END USE



90-DAY RATES



U.S. BANK CREDIT OUTFLOWS



APPENDIX A: SURVEY OF BANK LENDING PRACTICES, MARCH 1966*

The results of the seventh quarterly survey of changes in bank lending practices are summarized in the following paragraphs and accompanying tables. Reports were received from the 81 banks included in the quarterly interest rate survey.

Over four-fifths of the respondents (67 out of 81 banks) reported a firming of loan demand in the first quarter of this year compared with the previous high of two-thirds in the last quarter of 1965. Moreover, in every aspect of lending policy, the number of banks firming their policies was at record levels for the period since the survey started (see Table 2). Only one bank (Minneapolis District) reported easing any of its policies and this occurred only with respect to intended use of loan proceeds and collateral required on business loans.

With an increase in the prime rate in early March, it is not surprising that every bank in the survey reported its policies were firmer on interest rates to business borrowers (see Table 1). Most of the respondents also firmed their requirements on compensating balances as well as their policies on customer relationship considerations and loans to new customers. Even for established customers over half of the banks had firmer lending practices. Reflecting the tightness of the situation, nearly two-thirds of the banks were less aggressive in seeking new loans and almost as many were less willing to make term loans than formerly. Perhaps reflecting in part the emphasis on making loans for productive purposes in recent speeches by Randall (FDIC) and Treiber (FRB NY), the largest increase over preceding quarters in the number of banks firming policies related to intended use of loan proceeds.

Most respondents also adopted firmer policies on loans to finance companies, particularly on interest rates and on the extension of new or larger credit lines to such companies. More than half had firmed policies on enforcement of balance requirements.

In explaining the firming of their policies, a number of banks mentioned the increased cost of money in the form of time deposits and their high loan/deposit ratios. Some banks reported that increased difficulty in replacing maturing CD's also had been a contributing factor. One large New York City bank stated that it was permitting a moderate run-off of CD's because it preferred not to pay competitive rates which it considered exorbitant.

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* Prepared by Caroline H. Cagle, Economist, Banking Section, Division of Research and Statistics.

Several banks mentioned that they were rationing credit. Some were refusing to make loans for speculative purposes and one bank stated that loan proceeds _must_ be for "useful economic, productive purposes". Several banks also pointed out that they were not taking on any new finance company lines and they were attempting to avoid term loan commitments.

Not for quotation or publication

April 5, 1966.

Table 1

U. S. Total
Survey of Changes in Bank Lending Practices
December 1965-March 1966
(Number of banks)

Lending to Nonfinancial Businesses

	Stronger	Weaker	Unchanged
1. Strength of loan demand	67	--	14
	Greater	Less	Unchanged
2. Aggressiveness of bank in seeking new loans	--	51	30
3. Factors considered in deciding whether to approve credit requests:			
	More important	Less important	Unchanged
Applicant's value to the bank as a depositor or source of collateral business	70	--	11
Applicant's intended use of loan proceeds	62	1	18
4. Practices with respect to reviewing lines of credit or loan applications of:			
	Firmer	Easier	Unchanged
Established customers	42	--	39
New customers	73	--	8
Local service area customers	42	--	38
Nonlocal service area customers	62	--	17
5. Terms and conditions of loans:			
	Firmer	Easier	Unchanged
Interest rates	81	--	--
Compensating or supporting balances	64	--	17
Standards of credit-worthiness	45	--	35
Type and amount of collateral	31	1	48
Maturity	48	--	33

6. Term loans

	More willing	Less willing	Unchanged
Willingness to make	--	45	36
	Longer	**Shorter**	**Unchanged**
Maximum maturity bank will approve	--	12	68

Years	Number of banks
2	1
3	7
5	41
6	2
7	11
8	4
10	2
n.a.	13

Lending to Finance Companies

	Firmer	Easier	Unchanged
Interest rates	76	--	5
Size of compensating or supporting balances required	35	--	46
Enforcement of balance requirements	47	--	34
Establishing new or larger credit lines	62	--	19

Source: Survey of Lending Practices at Large Banks in the Federal Reserve Quarterly Interest Rate Survey conducted as of March 15, 1966.

Table 2

Net Number of Banks Reporting Firmer Lending Policies in Lending Practices Surveys
(Number of banks reporting firmer policies less number reporting easier policies)

Item	Date of Survey						
	Mar. 1966	Dec. 1965	Sept. 1965	June 1965	Mar. 1965	Dec. 1964	Sept. 1964
Lending to nonfinancial businesses							
Aggressiveness of bank in seeking new loans	51	24	13	11	-6	-2	-2
Factors considered in deciding whether to approve credit requests:							
Applicant's value to the bank as a depositor or source of collateral business	70	53	36	33	24	34	44
Applicant's intended use of loan proceeds	61	29	16	16	20	14	25
Practices with respect to reviewing lines of credit or loan applications of							
Established customers	42	18	6	4	4	6	2
New customers	73	51	32	35	19	21	26
Local service area customers	42	15	8	8	3	7	4
Nonlocal service area customers	62	35	35	27	15	22	27
Terms and conditions of loans							
Interest rates	81	77	44	40	46	35	13
Compensating or supporting balances	64	51	39	28	29	33	22
Standards of credit-worthiness	45	29	22	22	15	22	30
Type and amount of collateral	30	15	10	12	10	14	15
Maturity	48	23	11	14	5	4	3
Term loans							
Willingness to make	45	23	14	13	6	7	7
Maximum maturity bank will approve	12	8	-	3	-2	-2	-4
Lending to finance companies							
Type of requirement:							
Interest rate	76	75	10	10	13	12	3
Size of compensating or supporting balances required	35	26	5	11	7	8	-
Enforcement of balance requirements	47	38	18	19	17	22	13
Establishing new or larger credit lines	62	47	38	23	13	16	18
Strength of loan demand (net number reporting stronger demand)	67	54	41	45	37	27	48

APPENDIX B: PRODUCTION INDEX*

The question has been raised whether the industrial production index currently may be overstating the rise in output because of the productivity factors used to adjust the monthly manhour series in the index. Any great overstatement in the manhour series, on average, would clearly have a significant effect on the index, because these series comprise half the total. The hypothesis of too much increase for these series, moreover, seems to gain support from the fact that these manhour series, as adjusted, on the whole are showing considerably more rise in production than the other series, designated here as Q series. It is clear, additionally, that in a period of high production and strong pressure on available resources important forces are at work tending to slow down increases in productivity; additional workers taken in, for example, typically are less skilled and in many plants the problem of getting products out and delivered assumes more importance than usual relative to the problem of getting the most output per dollar of production cost. Finally, in thinking about measurement problems, the difficulty of determining almost instantaneously just exactly what is happening to productivity in any particular line is evident for all to see. A discerning critic might argue that while it is important to try to measure output in equipment and other lines for which few relatively unambiguous measures are available, the manhour figures as adjusted should be scrutinized and used with special care.

Does this all add up to a persuasive case for discounting the 8 per cent rise in the index over the past year and especially the 18 per cent increase in equipment production, which is represented in large part by manhour series? Those familiar with the history of the index, with the methods by which it is currently compiled and with the results shown by alternative approaches to measurement of output in the industries represented by manhours will recognize that the case for skepticism has been greatly overstated in the preceding paragraph; no mention was made, for example, of the large volume of new labor saving equipment already installed and now coming on stream for effective use. Further, while no current figure can be expected to correspond exactly to the final figures adjusted to Census benchmarks, it can be shown (1) that the productivity factors for the manhour series--practically all in the manufacturing component--are under constant review, with special attention being given to their behavior

*--Prepared by Frank R. Garfield, Adviser, Division of Research and Statistics, and Edward A. Manookian, Economist, Business Conditions Section.

in relation to that in industries for which relatively unambiguous production figures are available to compare with manhour figures; (2) that the course of production shown by the adjusted manhour series is fairly reasonable in the light of evidence in the form of related data on shipments by manufacturers and on electric power consumption; and (3) that the rise in industrial production has been unusually rapid over the past year, almost irrespective of any alteration one might reasonably choose to make in the productivity factors affecting the manhour half of the index.

On (3) above, suppose the average productivity rise shown should be reduced from the current reduced rate of about 3 per cent per year to about 2 per cent--an action not advocated here--how much would the course of the index be affected? It would show a rise of 7-1/2 per cent rather than 8 per cent over the past year; and an average figure as low as 2 per cent for productivity increases in the manhour area would be hard to justify. The equipment series, moreover, have been showing so much more rise than the consumer goods series and the materials series (both less heavily represented by manhour series) that any change that might be made in productivity factors would have little impact on the differences; the showing would still be that output of equipment is rising very much faster than other industrial output.

On (2) above, it may be noted that while the manhour series as adjusted for productivity change have indicated a production rise of 13 per cent for their half of the index over the past year, electric power consumption in these same industries has risen 14 per cent. There is a tendency for electric power consumption to rise a little more than production but not enough to alter the substantial agreement these figures suggest.

Considering (1) above, account is taken of a wide diversity of rates of increase in output and productivity evident within both the Q series and the MH series. The individual allowances used to adjust the 60 series based on manhour data vary at present from 1-1/2 per cent per year for cereals and feeds up to 6 per cent in the case of basic chemicals, averaging about 3 per cent. The productivity factors for each manhour series over past years are derived from annual indexes based primarily on independent product data. For the current years, these factors are tentatively extrapolated in a smooth line and the rate of increase is based, in part, on the past performance of each series. But the implied changes in productivity for the whole MH area are continuously checked against the implied productivity for the total of the 150 Q series in the index. Any related data available pertaining to various parts of the MH area are also used as checks.

Dollar shipments data, for example, are studied. Eventually experience gained in relating the Federal Reserve System's new data on electric power used to the volume of output by these industries will provide additional important current checks on rates of change in productivity allowed for; already the electric power series are beginning to be useful for this purpose, still presenting problems of interpretation but not involving price adjustments for value series like shipments. After review and checking the productivity are modified somewhat if it seems necessary.

Despite the differences in composition in the Q series and the MH series, over long periods rates of change in productivity for these large groups have been about the same, with divergences occurring in certain periods and years. A discussion of the relationship between the Q series and MH series for the years 1947 through 1959 is provided in Industrial Production: 1959 Revision beginning on page 22.

Over the past five years, from 1960 to 1965, implied output per manhour for the Q series rose 22.5 per cent and for the MH series 20.0 per cent. From 1964 to 1965, productivity implied for the Q series rose 2.2 per cent and for the MH series 3.1 per cent. The slower rate of increase in the Q series reflects atypical developments in the steel and auto industries or in the statistics relating thereto, as is discussed below. Productivity in the Q series excluding these two industries increased 3.0 per cent from 1964 to 1965, about the same as productivity in the MH area.

Month to month fluctuations in output per manhour in the Q series, even after seasonal adjustment, tend to obscure the general trend. For this reason the following table covering 1964 and 1965 compares quarterly averages shown for productivity in the total Q series, the Q series excluding primary metals and motor vehicles, and the MH series.

INDUSTRIAL PRODUCTION
Output Per Manhour
1st Quarter 1964=100

		Q Series Total	Q Series excl. Primary Metals and Motor Vehicles	MH Series
1964	I	100.0	100.0	100.0
	II	101.9	101.6	100.8
	III	102.8	103.0	101.6
	IV	102.4	102.6	102.3
1965	I	103.5	104.1	103.1
	II	103.2	104.1	103.9
	III	104.8	104.6	104.7
	IV	104.1	106.0	105.5

Even on a quarterly basis, the Q series show somewhat irregular movements but the general upward trend is clearly revealed--through the third quarter of 1965 for the total, and through the fourth quarter for the total excluding primary metals and motor vehicles and parts. The productivity factors shown for the MH series indicate a steady quarter to quarter rise in this period and at the end of 1965 showed less increase over early 1964 than is indicated for the Q series excluding primary metals and motor vehicles.

Output per manhour in primary metals was unchanged, on the average, from 1964 to 1965. It increased in the first half of 1965, when steel production rose rapidly, changed little in the third quarter, and then declined sharply in the fourth quarter when steel output was sharply curtailed after the September wage contract settlement.

Implied output per manhour for motor vehicles and parts has shown an unusual decline since the second quarter of 1964. For 1965 as a whole it declined 1.3 per cent from 1964. This decline is probably statistical only. In the September 1965 revision of the employment data, implied productivity for this industry for the years 1961-1964 was raised appreciably; a similar revision in the 1965 data would change the decline in productivity from 1964 to 1965 to a rise.

Reflecting in part a marked increase in steel production from December to January the latest month for which there are fairly reliable productivity data, output per manhour implied for the total Q series increased sharply to a level above the third quarter average while the productivity rise for the MH series was .25 per cent; as noted earlier changes indicated in a single month are not necessarily similar for the MH and Q series or very significant.

Whether and by how much in the period ahead installation of new more efficient equipment at a rapid rate and various innovations in production practices will more than offset factors operating to reduce productivity are questions yet to be resolved. Unfortunately there will be a time lag in answering these questions--good estimates of changes in productivity in the Q series are two months late and the irregular nature of the month to month fluctuations does not help in signalling changes in trends. But the record of past developments suggests that except for periods of dramatic change in production levels, changes in the rate of productivity increase for any broad group of industries occur only gradually. And in thinking about the total production index changes from month to month it is to be remembered that the current productivity allowances amount to only about 1/8 of one per cent.

APPENDIX C: ANNUAL FOREIGN TRADE BALANCES OF THE EUROPEAN ECONOMIC COMMUNITY*

In 1965 the six Common Market countries had a sharply improved trade balance with the world outside the trading bloc. On the balance-of-payments basis (exports and imports both f.o.b.) the Community had an increased trade surplus estimated at $2.2 billion, compared with roughly $0.9 billion in 1964. As reported monthly, with insurance and freight included in the import valuations (c.i.f.), the balance was a deficit, but a much smaller one than in 1964. After narrowing sharply in the first half of 1965, the trade deficit widened somewhat in the second half; nevertheless, for the year as a whole it was only $1.70 billion, compared with $2.66 billion in 1964.

EEC trade balance with the rest of the world

There have been two periods in the eight years since the Common Market Treaty went into effect at the beginning of 1958 when the exports of the area as a whole to non-member countries have grown faster than its imports from outside the area. The first such period was in 1958-59. The other began in 1964.

During 1958-59 the large trade deficits (imports valued c.i.f.) of earlier years--which hit a peak of over $3 billion in 1957--turned to surplus as exports grew moderately while imports leveled out below their earlier peak. Major improvement in the trade balances of France (following the franc devaluations of 1957 and 1958) and of Italy contributed to this result. There followed two years of near balance in EEC trade accounts vis-a-vis the outside world. Then, in 1962 and 1963, growth in Common Market exports fell far short of the rise in imports--the latter mainly reflecting booming economic expansion in all the courtries of the area--and in 1963 a deficit of over $3 billion with the outside world was recorded. In 1964 and 1965, deficits diminished again--this time because exports rose especially strongly compared with imports.

From 1963 to 1964 total exports to non-EEC destinations rose 12 per cent and from 1964 to 1965 they increased 11 per cent further. On the other hand, total imports from non-members increased by 9 per cent in 1964 from 1963 and by an additional 6 per cent in 1965.

* Prepared by Carl H. Stem, Economist, Europe and British Commonwealth Section, Division of International Finance.

NOTE: Tables are at the end of the appendix.

Trade balances of individual members with non-members

The European Community's declining trade deficit with non-members over the past two years has been due mainly to the shrinking Italian deficit vis-a-vis non-EEC countries. However, from 1964 to 1965 the French deficit with non-members also diminished.

In 1965 Italian exports to destinations outside the EEC were 8 per cent above 1964 levels. Although 1965 was a year of recovery from recession in Italy, domestic demand continued at a reduced level, and robust foreign demand drew an increased volume of sales into the export sector. Italian imports from third countries, on the other hand, fell from 1963 to 1964; in 1965 imports for the year were unchanged from 1964 although they were increasing sharply during the course of the year. The Italian trade deficit with the non-EEC world dropped from $1.8 billion in 1963 and $1.2 billion in 1964 to $860 million in 1965. (However, because of sharply increased shipments to EEC partners, the overall Italian trade balance was practically in balance for the year, in contrast with deficits of $2.55 billion in 1963 and $1.27 billion in 1964.)

The improvement in the French deficit vis-a-vis non-EEC countries from 1964 to 1965, like that for Italy, reflected the absence of any net increase in French imports from non-members. On the other hand, the rise in French exports to the non-EEC world was 8 per cent, the same as for Italy but lower than for the other member countries.

Exports and imports by major external areas

Among the Common Market's major marketing areas, the sharp increase in exports to North America was the most prominent feature in 1965, compared with 1964 when exports to all external trading areas grew pretty much in line with each other. Heavy consumer and investment demand in the United States resulted in a 19 per cent increase in shipments to the United States from the six countries of the EEC, a considerable jump from the 11 per cent increase in 1964. EEC shipments to industrial Asia and the developing parts of the world were also up sharply--almost 15 per cent. On the other hand, exports to EFTA destinations grew more slowly than in 1964, probably reflecting to some extent the impact of the import surcharge in the United Kingdom.

In contrast, EEC purchases from the United States increased only 3 per cent in 1965, down from 8 per cent in 1964 and less than increases in purchases from other major trading areas.

Intra-EEC trade

Since 1958 intra-Market trade has grown at an average annual rate of 15 per cent, which is much more than the 8 per cent average rise in both exports to and imports from non-members. The 12 per cent growth in internal Common Market trade from 1964 to 1965, however, was the lowest annual increase since the beginning of the Community.

Italy's exports to EEC partners have registered the sharpest gains in both of the past two years. They increased 27 per cent between 1963 and 1964 and a further 39 per cent between 1964 and 1965. Since Italian imports from the area in 1965 totalled about the same as they had in 1963, the Italian trade balance vis-a-vis the EEC countries improved from a $720 million deficit in 1963 to a $670 million surplus in 1965.

French intra-EEC sales have also shown a pattern of vigorous growth during the past two years. Between 1963 and 1964 they increased 13 per cent and between 1964 and 1965, 18 per cent.

On the other hand, in Germany booming economic expansion has increased import demand sharply. Its 1964 imports from EEC partners were 18 per cent above 1963, and in 1965 its intra-EEC purchases skyrocketed 31 per cent above the previous year. Since sales to EEC destinations gained more moderately during the same period, the German intra-EEC trade balance turned from a surplus of $1.1 billion in 1963 to a deficit of $360 million in 1965. This was the major factor responsible for the sharp decline in the overall German trade surplus from $1.6 billion in 1963 to $310 million in 1965.

Trade balance with imports valued f.o.b.

In 1964 the over-all trade balances of the EEC countries as given in their balance of payments accounts showed a combined surplus of about $0.9 billion. Imports in these accounts are valued exclusive of insurance and freight charges, and there are various differences in statistical coverage between the data used in the balance of payments and the trade data reported monthly. The insurance and freight charges appear to have averaged, for the Community as a whole, about 8 per cent of the value of imports c.i.f. as reported in the monthly trade data (i.e., with insurance and freight charges included).

For 1965 balance of payments statements are not yet available. However, other things being equal, the improvement in the trade account of the combined EEC balance of payments from 1964 to 1965 should be greater by about $0.4 billion than the improvement in the monthly reported trade data, imports c.i.f. (This estimate is based on applying an 8 per cent insurance-and-freight ratio to the increase of about $5 billion in total EEC imports.) Since the monthly trade data show an improvement of $0.96 billion in the trade balance from 1964 to 1965, the improvement in the balance of payments trade account may be estimated at $1.36 billion. This would indicate that in 1965 the combined trade account of the EEC countries as given in their balance of payments account should show a surplus of about $2.2 billion.

Table 1

European Economic Community: Foreign Trade Balance with Non-member Countries, 1955-1965
(billions of U.S. dollars)

	Balance	Exports (f.o.b.)	Imports (c.i.f.)	Year-to-year changes (p.c.) Exports	Imports
1955	- .99	12.71	13.70		
1956	-2.38	13.64	16.02	+ 7	+17
1957	-3.31	15.29	17.78	+12	+11
1958	-0.24	15.91	16.15	+ 4	- 9
1959	+0.85	17.05	16.20	+ 7	+ 0
1960	+0.05	19.49	19.44	+14	+20
1961	-0.04	20.42	20.46	+ 5	+ 5
1962	-1.72	20.64	22.36	+ 1	+ 9
1963	-3.05	21.62	24.67	+ 5	+10
1964	-2.66	24.16	26.82	+12	+ 9
1965	-1.70	26.84	28.54	+11	+ 6

Source for Tables 1-4: EEC, General Statistical Bulletin and official individual country sources. Division between trade with non-EEC and with EEC is partly estimated for Italy in fourth quarter 1965 and for the Netherlands in December 1965.

Table 2

European Economic Community: Foreign Trade Balances of Individual Members, 1963-65
(billions of U.S. dollars)

		Exports (f.o.b.) minus Imports (c.i.f.)		
		1963	1964	1965
France:	Non-EEC	-0.61	-0.80	-0.38
	EEC	-0.03	-0.27	+0.09
	Overall	-0.64	-1.07	-0.29
Italy 1/:	Non-EEC	-1.83	-1.18	-0.86
	EEC	-0.72	-0.09	+0.67
	Overall	-2.55	-1.27	-0.19
Germany:	Non-EEC	+0.49	+0.80	+0.67
	EEC	+1.11	+0.81	-0.36
	Overall	+1.60	+1.61	+0.31
Belgium-Luxembourg:	Non-EEC	-0.52	-0.65	-0.48
	EEC	+0.25	+0.34	+0.52
	Overall	-0.27	-0.31	+0.04
Netherlands 1/:	Non-EEC	-0.56	-0.81	-0.65
	EEC	-0.43	-0.44	-0.42
	Overall	-0.99	-1.25	-1.07
Overall Balance (Non-EEC)		-3.05	-2.66	-1.70

1/ See note to Table 1.

Table 3

European Economic Community: Exports and Imports of Individual Members, 1963-65
(billions of U.S. dollars)

		1963	1964	1965	Percentage increases 1963-1964	1964-1965
Exports (f.o.b.) of:						
France:	to Non-EEC	4.99	5.50	5.94	10	8
	to EEC	3.10	3.49	4.11	13	18
Italy 1/:	to Non-EEC	3.26	3.70	4.01	13	8
	to EEC	1.79	2.27	3.15	27	39
Germany:	to Non-EEC	9.17	10.32	11.63	13	13
	to EEC	5.45	5.91	6.30	8	7
Belgium-Luxembourg:	to Non-EEC	1.90	2.09	2.42	10	16
	to EEC	2.94	3.50	3.96	19	13
Netherlands 1/:	to Non-EEC	2.32	2.58	2.84	11	10
	to EEC	2.65	3.23	3.55	22	10
Total:		37.57	42.59	47.91	13	12
	(Non-EEC)	(21.62)	(24.16)	(26.84)	12	11
	(EEC)	(15.93)	(18.40)	(21.07)	16	15
Imports (c.i.f.) of:						
France:	from Non-EEC	5.60	6.30	6.32	12	0
	from EEC	3.13	3.76	4.02	20	7
Italy 1/:	from Non-EEC	5.09	4.88	4.87	-4	0
	from EEC	2.51	2.36	2.48	-6	5
Germany:	from Non-EEC	8.68	9.52	10.96	10	15
	from EEC	4.34	5.10	6.66	18	31
Belgium-Luxembourg:	from Non-EEC	2.42	2.74	2.90	13	6
	from EEC	2.69	3.16	3.44	17	9
Netherlands 1/:	from Non-EEC	2.88	3.39	3.49	18	3
	from EEC	3.08	3.67	3.97	19	8
Total:		40.42	44.99	49.11	11	9
	(Non-EEC)	(24.67)	(26.82)	(28.54)	(9)	(6)
	(EEC)	(15.75)	(18.05)	(20.57)	(15)	(14)

1/ See note to Table 1.

Table 4

European Economic Community: Foreign Trade by Area, 1963-1965
(millions of U.S. dollars, monthly averages)

	Calendar years			First 9 months		
	1963	1964	Percentage Increase	1964	1965	Percentage Increase
Exports (f.o.b.)						
to: U.S.	214	237	11	231	275	19
EFTA	662	736	11	714	779	9
Other non-EEC	926	1,040	12	997	1,141	15
EEC	1,327	1,532	15	1,495	1,676	12
Total	3,129	3,545	13	3,437	3,870	13
Imports (c.i.f.)						
from: U.S.	421	453	8	447	459	3
EFTA	514	549	7	536	556	4
Other non-EEC	1,121	1,233	10	1,220	1,296	6
EEC	1,311	1,503	15	1,470	1,639	12
Total	3,367	3,738	11	3,673	3,949	8