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CONFIDENTIAL (FR)

CURRENT ECONOMIC
and
FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff

BOARD OF GOVERNORS
OF THE FEDERAL RESERVE SYSTEM

November 16, 1966

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SUMMARY AND OUTLOOK

Outlook for GNP

Since midyear, real GNP has been growing at a rate close to 4 per cent. This expansion has been accompanied by some moderation in the rate of price increases, by little change in the unemployment rate, and by mild slackening in pressures on manufacturing capacity.

The Department of Commerce has revised GNP downward for the third quarter, and now shows a rise on only $12.3 billion from the second quarter, as compared with a preliminary estimate of a $13.7 billion increase. About $1 billion of the revision resulted from a smaller-than-expected increase in inventories in September.

We are now estimating the fourth quarter rise in GNP at about $13 billion -- or, in real terms, at an annual rate of 4 per cent. The available evidence, including the large further build-up in order backlogs for machinery and other durable goods through September, indicates defense spending and business fixed investment is continuing to rise at a fast pace. With nonfarm employment resuming an upward course in October and wage rate increases continuing large, personal income is also rising strongly.

The rise projected for consumer spending, while still sizable, is somewhat below earlier estimates, however, and is not so large as in the third quarter. Some decline for the quarter in auto sales seems indicated by recent sales figures, and little, if any, rise in purchases of other durables, following appreciable increases in the third quarter. Business inventory accumulation is expected to decline moderately further, as a result of continued pressures to limit stocks of consumer goods and construction materials and equipment. The GNP deflator is expected to rise somewhat less than in the third quarter.

Looking ahead to the early months of 1967, many indications still point to continued economic expansion at close to the current rate, barring major changes in the pace of defense spending or in tax policies. In view of the backlog of orders and commitments on hand, as well as continuing strong capacity pressures in specific industries, expansion in business plant and equipment spending should taper off only gradually. This is likely to be the case even though recent reports on business capital spending plans point to a distinctly smaller increase in such outlays for the year 1967 as a whole. The possibility of rather sharp cutbacks in business accumulation of inventories cannot be ruled out, if retail sales remain sluggish. But if the current rate of expansion in government and business capital expenditures is generally maintained in the first quarter of next year, prospects are for substantial further gains in wage and salary income and for consumer demands for goods and services to continue to rise substantially.

Resource use and prices

Expansion in industrial production has slowed in recent months. Customary seasonal increases are greatest in September and October, however, and in many of the business- and defense-related industries, further expansion in output no doubt was limited by capacity or other physical resources. In other industries where capacity has not been strained -- such as steel, building materials, and most consumer durable goods -- output has leveled off or declined as a result of easing in demands. Reflecting both kinds of developments, capacity utilization rates are probably declining somewhat from recent highs. The unemployment rate has continued just below 4 per cent, and rates remain low for prime age and skill categories.

Industrial prices have been stable in recent months, as prices of a few sensitive materials have been undergoing reversal of extraordinary increases that occurred earlier and increases in other commodities have been at a slower pace. Declines in sensitive material prices may be about over, however, and without this offset, the industrial average is likely to resume its rise. The rise may be no more rapid than the 2 per cent over the past year, however, and it could be less.

Upward pressure on prices is resulting from a spreading of wage increases in excess of the gain in productivity. However, this upward pressure may be tempered by some easing in demands relative to resources in such areas as consumer durable goods, building materials, steel and some other materials and equipment, for which prices increased an average of 4 per cent over the past year, unfilled orders are high and production rates are straining facilities; but the recent survey of plant and equipment spending in 1967 suggests a coming weakening in new orders. From a buyers' point of view, moreover, prices of equipment have already been raised 7.5 per cent by suspension of the investment tax credit.

The upward push of wages will also continue to exert an important influence on prices of services, especially with the increase in the minimum wage that takes effect next February. On the other hand, the long-awaited improvement in supplies of foods is underway. For the next several months at least, therefore, retail prices of foods should decline, and the rise in the total consumer price index should moderate.

Banking prospects

Expansion in bank loans to business over the next few weeks preceding the mid-December tax period may be close to, and possibly below, the moderate October pace. The trend in business loans at city banks, after allowance for usual seasonal changes, appears to have been weaker in late October and early November than it had been in late September and early October. Weakness or moderation in borrowing has been quite general among industry categories, suggesting that this is not simply a temporary phenomenon; it probably is associated in part with some slackening in business inventory accumulation.

While there are scattered indications of some reduction in loan demands, vigorous loan rationing by big banks is continuing in response to the cumulative squeeze on liquidity that has developed as these banks have adjusted to the run-offs in CD's. Although CD run-offs moderated somewhat during recent weeks, banks do not appear to expect any marked change over the coming weeks in funds available to accommodate loan demands.

Under the circumstances, banks may have to continue liquidating investments and bidding for Euro-dollar funds if they are to support even relatively moderate loan growth. Still, at the moment, banks do not foresee a market pinch as tight as, say, late summer. This assumes monetary policy does not permit a further tightening of money market conditions as the December tax date approaches, when bill rates tend to rise, sales finance company and nonfinancial business demands on banks increase, and greater pressure would be put on banks' ability to roll over maturing CD's.

Capital markets outlook

Substantial recent additions to the forward calendar of new corporate and municipal bonds have contributed to some recovery in yields on recently offered issues in these markets during November. At the moment, it appears that the December volume of corporate public offerings may ultimately total nearly $1 billion, second only to the $1.1 billion marketed in August. And with the AT&T issue and several utility bonds already scheduled for January, volume in that month too is building up. In the municipal market, estimated December offerings are larger than a year ago; this represents a change from October-November when offerings had fallen below year-ago levels.

Yields on Treasury notes and bonds have also been moving up in recent weeks, reflecting in part some selling of outstanding issues on switches into the new notes offered by the Treasury in the November refunding. The market for Governments has also reacted to the recent additions to the corporate bond calendar and to rumors of a possible sale of FNMA participation certificates in December.

Bond yields during the coming weeks are likely to edge higher on balance. The enlarged supply of corporate and municipal securities coming to market in the weeks immediately ahead is likely to maintain upward pressures on such yields -- particularly if other near-term additions to the supply of new corporate issues are still in the offing and if the Treasury does market participation certificates in December to raise cash while remaining under the debt ceiling. The overhang of Treasury coupon issues from the November refunding may also add to market pressures. These pressures will be intensified if money market conditions remain tight, as associated high dealer financing costs make it burdensome for dealers and underwriters to carry current relatively large positions. However, over the longer run, most market participants look for steady to lower long-term rates, in view of the expected moderation of the investment boom and of a fiscal-monetary policy mix favorable to an easing of credit market pressures.

Balance of payments

So far this year, the over-all payments position has not been as unfavorable as was earlier feared, mainly because of large inflows of foreign capital. However, these inflows are vulnerable to abrupt cessation or reversal. On almost any plausible set of assumptions, a payments deficit of troublesome proportions (more than $1 billion on both bases of calculation) seems likely for next year, even if the trade surplus improves and even if voluntary programs and the I.E.T. continue to restrain outflows of U.S. capital.

Preliminary data for October and early November suggest that the deficit on the liquidity basis has continued at roughly the $2 billion annual rate that would have been registered during the first 9 months if foreign official and international institutions had not shifted funds from liquid to nonliquid U.S. assets. The actual rate for the 9 months, including such shifts, was $1.2 billion.

The balance on the official reserve transactions basis (which has been little affected by the asset shifts mentioned) was apparently near zero in October and early November, as inflows of foreign liquid funds through foreign branches of U.S. banks continued very large. During the first 9 months, there was an official settlements surplus at an annual rate of $0.8 billion, thanks largely to the unprecedented $2 billion inflow of liquid funds through the branches in that period. Cessation and partial reversal of the inflow is probably to be expected in the closing weeks of the year. Hence, the official settlements balance may revert to deficit, although it may still show a surplus for the year as a whole.

The outlook for the merchandise trade surplus in 1967 is for some improvement from 1966, particularly from the low level reached in the third quarter. U.S. Government analysts now expect exports to increase at about a 12-13 per cent annual rate, despite reduced demand from Britain, as a result of increasingly buoyant demand in Japan, France, and Italy, and continued strength in the demands of Canada and primary producing countries. They expect a marked slowing down in the expansion of imports, to an annual rate from now on of less than 10 per cent, assuming some easing of domestic demand pressures, especially for capital equipment and inventories.

Most analysts expect that outflows of U.S. private capital will not decline further from 1966 to 1967 and may increase. Even if the guidelines are tightened somewhat, there may be some renewed outflow of bank credit, in contrast to this year's reflow, and some increase in the outflow of direct investment capital (net of foreign borrowings). How large the changes in capital flow might be would depend importantly on domestic monetary conditions, on the strength of credit demands from abroad, and on the nature and effectiveness of the voluntary restraint programs.

SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount			Per cent change	
		Latest Period	Preced'g Period	Year Ago	Year Ago*	2 years Ago*
Civilian labor force (mil.)	Oct'66	77.1	77.1	75.8	1.7	3.8
Unemployment (mil.)	"	3.0	2.9	3.3	- 9.5	-23.1
Unemployment (per cent)	"	3.9	3.8	4.3	--	--
Nonfarm employment, payroll (mil.)	"	64.4	64.2	61.4	4.7	9.7
Manufacturing	"	19.3	19.2	18.2	5.7	12.1
Other industrial	"	8.0	8.0	7.9	1.3	4.0
Nonindustrial	"	37.1	36.9	35.3	5.0	9.8
Industrial production (57-59=100)	"	158.6	158.1	145.5	9.0	20.4
Final products	"	158.2	156.7	145.7	8.6	21.1
Materials	"	159.2	159.6	145.3	9.6	20.1
Wholesale prices (57-59=100)1/	"	106.2	106.8	103.1	3.0	5.4
Industrial commodities	"	104.5	104.4	102.5	2.0	3.4
Sensitive materials	"	102.6	103.1	103.0	- 0.4	2.2
Farm products and foods	"	108.8	111.5	103.6	5.0	10.8
Consumer prices (57-59=100)1/	Sept'66	114.1	113.8	110.2	3.5	5.3
Commodities except food	"	107.0	106.6	104.9	2.0	2.6
Food	"	115.6	115.8	109.7	5.4	7.8
Services	"	123.5	123.0	118.5	4.2	6.9
Hourly earnings, mfg. ($)	Oct'66	2.76	2.74	2.65	4.2	9.1
Weekly earnings, mfg. ($)	"	113.74	113.60	108.92	4.4	10.7
Personal income ($. bil.)2/	"	594.6	590.0	547.2	8.7	18.1
Corporate profits before tax ($ bil.)	QIII'66	82.1	82.8	75.0	9.5	21.1
Retail sales, total ($ bil.)	Oct'66	25.7	25.7	24.2	6.1	19.8
Autos (million units)2/	"	8.0	8.6	8.4	- 3.8	38.7
GAF ($ bil.)	"	6.1	6.1	5.6	9.4	19.6
Selected leading indicators:						
Housing starts, pvt. (thous.)2/	Sept'66	1,073	1,102	1,453	-26.2	-25.7
Factory workweek (hours)	Oct'66	41.3	41.5	41.2	0.2	1.5
New orders, dur. goods ($ bil.)	Sept'66	25.2	23.5	22.2	13.7	26.6
New orders, nonel. mach. ($ bil.)	"	3.7	3.8	3.3	11.8	26.8
Common stock prices (1941-43=10)	Oct'66	77.13	77.81	91.39	-15.6	- 9.1
Inventories, book value. ($ bil.)	Sept'66	130.7	130.0	117.9	10.9	20.0
Gross national product ($ bil.)2/	QIII'66	744.6	732.3	686.5	8.5	16.7
Real GNP ($. bil., 1958 prices)2/	"	649.3	643.5	618.2	5.0	11.0

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ending Nov. 11	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	5.75	5.54	6.25	3.00
U.S. Treas. bills, 3-mo., yield (per cent)	5.41	5.32	5.59	4.33
Net free reserves 2/ (mil. $)	- 249	- 312	- 94	- 583
Member bank borrowings 2/ (mil. $)	646	637	928	518
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	5.34	5.28	5.89	4.82
20-year U.S. Treas. bonds	4.88	4.80	5.12	4.65
Corporate new bond issues, Aaa	--	5.74	5.98	5.15
Corporate seasoned bonds, Aaa	5.35	5.37	5.42	5.34
Municipal seasoned bonds, Aaa	3.72	3.76	3.99	3.52
FHA home mortgages, 30-year 3/	6.63	6.63	6.63	6.32
Common stocks S&P composite index 4/				
Prices, closing (1941-43=10)	81.49	79.83	87.45	73.20
Dividend yield (per cent)	3.63	3.67	3.89	3.29

	Change in Oct.	Average change last 3mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $) 6/				
Total reserves	- 187	- 155	- 7.9	2.5
Bank loans and investments:				
Total	- 600	- 400	- 1.4	6.3
Business loans	700	400	6.7	11.9
Other loans	500	- 100	- 1.2	9.0
U.S. Government securities	-1,800	- 600	-14.0	- 9.1
Other securities	100	0	- 0.8	7.3
Money and liquid assets:				
Demand dep. & currency	- 900	0	0	2.7
Time and savings dep.	- 300	500	3.9	9.9
Nonbank liquid assets 5/	-1,200	600	2.5	4.6

N.S.A.--not seasonally adjusted. S.A. Seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending November 9.
3/ Latest figure indicated is for month of September. 4/ Data are for weekly closing prices. 5/ Change in September. 6/ Where necessary, comparisons shown below have been adjusted for definitional changes in June and July.

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

	1966					1965		1965
	Sept.	Aug.	QIII	QII	QI	QIV	QIII	Year (billions)
				Seasonally adjusted				
Current account balance				1,084	1,348	1,290	1,527	6.0
Trade balance 1/	235	285	725	853	1,168	1,271	1,231	4.8
Exports 1/	2,490	2,470	7,405	7,111	7,171	7,027	6,826	26.3
Imports 1/ 2/	-2,255	-2,185	-6,680	-6,258	-6,003	-5,756	-5,595	-21.5
Services, etc., net				231	180	19	296	1.2
Capital account balance				-1,175	-1,586	-1,542	-1,821	-6.9
Govt. grants & capital 3/				-961	-948	-881	-743	-3.4
U.S. private direct investment				-957	-687	-731	-569	-3.4
U.S. priv. long-term portfolio				-94	-219	-154	-363	-1.1
U.S. priv. short-term				-53	-2	-27	105	0.8
Foreign nonliquid				890	270	251	-251	0.2
Errors and omissions				-66	-268	-80	-240	-0.4
Balances, with and without seasonal adjustment (- = deficit)								
Liquidity bal., S.A.			-217	-125	-536	-332	-534	-1.3
Seasonal component			-495	-27	488	-3	-472	--
Balance, N.S.A.	112	-322	-712	-152	-48	-335	-1,006	-1.3
Official settlements bal.,			993	-198	-226	-1,158	232	-1.3
Seasonal component			-521	-182	628	33	-508	--
Balance, N.S.A. 4/	312	25	472	-380	402	-1,125	-276	-1.3
Memo items:								
Monetary reserves (decrease -)	-139	-133	-82	-68	-424	-271	-41	-1.2
Gold purchases or sales (-)	37	-94	-173	-209	-68	-119	-124	-1.7

1/ Balance of payments basis which differs a little from Census basis.
2/ Monthly figures tentatively adjusted for changes in carry-over of import documents.
3/ Net of loan repayments.
4/ Differs from liquidity balance by counting as receipts (+) increases 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. GNP was at a seasonally adjusted annual rate of $744.6 billion in the third quarter, according to the latest Commerce Department estimates. This represents a downward revision of $1.4 billion from the preliminary estimate. The rise from the second quarter now totals $12.3 billion -- only about $1 billion larger than the relatively small increase from the first to the second quarter. Downward revision in the dollar aggregate was accompanied by some upward revision in the price deflator and indicated real growth in the third quarter was lowered to a 3-1/2 per cent annual rate from the month-ago preliminary estimate of 4-1/2 per cent.

For the current quarter, we are projecting GNP at $757.5 billion, up about $13 billion from the third quarter. With price increases estimated to slow somewhat further from the peak rate reached in the second quarter, real growth is projected at the rate of 4 per cent a year.

Despite the downward revision, the third quarter picture remains one of stepped-up gains in defense spending, business fixed investment, and consumer purchases. Together gains in these sectors totaled $16 billion, double their second quarter increase. Partly offsetting gains in these lines, inventory investment was lower (the rate of nonfarm accumulation was down $1.7 billion from the second quarter -- about $1 billion larger decrease than was estimated a month ago) and residential construction activity decreased $3.2 billion, or 11 per cent, from the second quarter. Moreover, more complete figures for the quarter revealed a further decline in net exports rather than the leveling off estimated earlier.

The $13 billion rise we now estimate for the fourth quarter is nearly $1 billion less than the projection of three weeks ago, although on the evidence of new and unfilled orders through September, gains in defense spending and business fixed investment remain as large as projected earlier. On the other hand, the rise in consumer spending has been lowered about $1.5 billion. In October and early November, unit sales of new domestic autos were running about 5 per cent below year-earlier levels. Sales for the current quarter are now estimated at an annual rate of 8.2 million, 5 per cent below the fourth quarter last year and down from 8.5 million in the third quarter. With auto sales down and other durables up only slightly, total consumer purchases of durable goods are now estimated to be showing no change in the current quarter. Although spending for nondurable goods appears to be rising more rapidly in this quarter, the leveling off in durables reduces the rise in total consumer spending to about $8 billion, around $1.5 billion less than in the third quarter. Personal income, meanwhile, appears to be increasing about as fast as in the third quarter. With personal tax payments rising less, disposable income is estimated as rising more rapidly and the saving rate is estimated to move up fractionally from the low third quarter level.

Developments in the auto sector will have a bearing on prospects for a continuing decline in the rate of inventory accumulation such as is now estimated for the current quarter -- as well as on the magnitude of the rise in consumer spending. Auto stocks at the beginning of this quarter, although down from the exceptionally high mid-year levels, were still high and they appear to have increased again in October when sales declined. To achieve a further reduction in stocks for the quarter, at the sales level now posited, a sizable reduction in auto output would be required by the end of the year.

CONFIDENTIAL -- FR

November 15, 1966

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

	1964	1965	1966 Proj.	1965 IV	1966 I	1966 II	1966 III	1966 Proj. IV
Gross National Product	631.7	681.2	738.9	704.4	721.2	732.3	744.6	757.5
Final sales	627.0	627.1	728.9	694.0	712.3	720.0	734.6	748.5
Personal consumption expenditures	401.4	431.5	465.9	445.2	455.6	460.1	469.9	478.0
Durable goods	59.4	66.1	69.5	68.0	70.3	67.1	70.2	70.2
Nondurable goods	178.9	190.6	207.0	197.0	201.9	205.6	208.1	212.3
Services	163.1	174.8	189.4	180.2	183.4	187.4	191.5	195.5
Gross private domestic investment	93.0	106.6	115.5	111.9	114.5	118.5	115.0	114.0
Residential construction	27.6	27.8	26.0	27.6	28.6	28.0	24.8	22.7
Business fixed investment	60.7	69.7	79.5	73.9	77.0	78.2	80.3	82.3
Change in business inventories	4.7	9.1	10.0	10.4	8.9	12.3	9.9	9.0
Nonfarm	5.3	8.1	10.1	9.0	8.5	12.1	10.4	9.5
Net exports	8.5	7.0	4.9	6.1	6.0	4.7	4.2	4.5
Gov't purchases of goods & services	128.9	136.2	152.6	141.2	145.0	149.0	155.5	161.0
Federal	65.2	66.8	76.5	69.8	71.9	74.0	78.3	82.0
Defense	50.0	50.1	59.4	52.5	54.6	57.1	61.3	64.8
Other	15.2	16.7	17.1	17.3	17.4	16.9	17.0	17.2
State & local	63.7	69.4	76.1	71.4	73.1	75.0	77.2	79.0
Gross National Product in constant (1958) dollars	580.0	614.4	647.3	631.2	640.5	643.5	649.3	655.8
GNP Implicit deflator(1958=100)	108.9	110.9	114.2	111.6	112.6	113.8	114.7	115.5
Per cent change, annual rate								
GNP current dollars	7.0	7.8	8.5	10.4	9.5	6.2	6.7	6.9
GNP constant dollars	5.3	5.9	5.4	8.4	5.9	1.9	3.6	4.0
Implicit deflator	1.6	1.8	3.0	2.2	3.6	4.3	3.2	2.8
Personal income	496.0	535.1	580.0	552.8	564.6	573.5	585.2	596.6
Wage and salaries	333.6	358.4	392.0	370.8	380.0	387.4	396.7	404.0
Disposable income	436.6	469.1	505.0	486.1	495.1	499.9	507.8	517.1
Personal saving	24.5	25.7	25.8	28.5	26.7	26.6	24.5	25.3
Saving rate (per cent)	5.6	5.5	5.1	5.9	5.4	5.3	4.8	4.9
Total labor force (millions)	77.0	78.4	80.1	79.0	79.4	79.7	80.4	80.7
Armed forces "	2.7	2.7	3.1	2.8	2.9	3.1	3.2	3.3
Civilian labor force "	74.2	75.6	77.0	76.2	76.5	76.7	77.2	77.4
Unemployment rate (per cent)	5.2	4.6	3.9	4.2	3.8	3.9	3.9	3.9
Nonfarm payroll employment (millions)	58.3	60.8	63.8	61.8	62.8	63.6	64.1	64.6

Industrial production. Industrial production in October rose to 158.6 per cent of the 1957-59 average from 158.1 per cent in September, mainly because of a sharp rise in seasonally adjusted auto assemblies following the new model introductions and a further small gain in output of business equipment. The small increase in October followed little change in September. In October, production of consumer goods other than autos was unchanged and output of steel and some other materials declined. The total index, however, was a respectable 9 per cent above a year earlier.

Auto assemblies rose sharply in October to 178 per cent of the 1957-59 average and are scheduled to hold at this index level in November -- the highest output rate since last spring. Output of household appliances and furniture declined from the highs reached last summer. Production of television sets changed little in October but was almost 10 per cent below the early 1966 high mainly because of a continuing decline in output of monochrome sets. Production of consumer nondurable goods was little changed.

The rise in business equipment in October was only one-half per cent -- the same as in September and much less than rates of increase obtained earlier. Output of industrial and commercial machinery rose further and production of defense equipment continued to increase.

Production of iron and steel and of construction materials generally declined while that of equipment parts was unchanged. Output of textile mill products have declined steadily since June, and is now

4 per cent below the peak. Production of most other nondurable materials increased somewhat in October.

Retail sales. October sales were little changed from September but still 6 per cent above a year earlier, according to advance figures. Declines of around 3 per cent from September were reported for auto dealers, and for furniture and appliance stores; sales at durable goods stores as a whole were off 2.5 per cent.

Dealer deliveries of new domestic automobiles in October were at an annual rate of 8.0 million units, 7 per cent below the preceding month and 5 per cent below the exceptionally high rate a year ago. In the first 10 days of November sales apparently strengthened and were at a seasonally adjusted rate about 5 per cent above that in October. New car inventories on October 31, at 1.24 million units, were virtually unchanged from a month earlier but were 17 per cent above a year ago. At the October selling rate, the inventory level represented 41 days' supply, a high figure for this season.

Sales at nondurable goods stores were up 1.3 per cent, with relatively large increases reported by apparel stores, eating and drinking establishments, and gasoline service stations.

Figures for August have been revised down slightly while those for September have been raised a little. The revised estimates now show a small rise in August which continued at a slower pace in September.

Sales in the third quarter were nearly 8 per cent above a year earlier and about 2.5 per cent above the second quarter.

Consumer credit. Expansion in consumer credit has slowed markedly further this fall. In September, the latest month for which firm data are available, the increase in instalment debt amounted to only $475 million, compared to $602 million in the previous month and $686 million a year earlier. The September rise was the smallest since November 1964 when consumer borrowing to purchase automobiles was sharply curtailed because of a strike-induced shortage of new cars.

It now appears that October will be another slack month. This is the conclusion to be drawn from the instalment credit figures in the weekly reporting bank series. It is further supported by lower durable goods sales in October.

Slowing in instalment credit expansion this year can be attributed largely to demand factors, although monetary restraint has also played an important role. Last month our special Consumer Loan Survey pointed to different ways in which lenders' standards have been tightening and consumer charges increasing. Lenders have increasingly sought to augment their returns by increasing various fees and tacking special surcharges on monthly payments.

Repayments on instalment debt have continued to rise in more or less steady fashion, although at a slower pace than in 1965. The ratio of repayments to disposable income has held steady at 14.5 per cent throughout 1966, up only slightly from the 1965 ratio.

The delinquency picture continues relatively favorable, both for commercial banks and credit unions. The delinquency rate for credit unions has been below year-ago levels in 7 of the first 9 months this year. Meanwhile, confidential information received from GMAC and CIT shows that in only 2 or 3 of the past 9 months auto repossessions have been at rates above a year earlier.

Personal income. Personal income in October rose $4.6 billion -- the same as in September -- to an annual rate of $594.6 billion, 8.7 per cent higher than a year earlier. Of the October rise, $1.4 billion was in transfer payments and was due to further increases in Medicare payments. (Medicare payments had increased by nearly $1 billion in September.) Gains in wage and salary disbursements and interest income accounted for most of the balance of the October rise. Manufacturing payrolls were up $1.1 billion, the average gain in the earlier months this year. Payrolls in other major private industries and in government also rose about in line with earlier gains. Total wages and salaries in October were 9.6 per cent above a year earlier and were nearly 1.5 per cent above the average in the third quarter. Farm income declined slightly further, reflecting some erosion of farm prices.

Business inventories. Business inventory accumulation dropped sharply in September from the high rates prevailing in the spring and summer months, and mainly because of that decline third quarter accumulation -- although still large -- was nearly a fifth below the second quarter. On a GNP basis, nonfarm inventory accumulation was at an annual rate of $10.4 billion in the third quarter, as compared with $12.1 billion in the second.

Changes in book value of manufacturing and trade inventories are shown in the table for July, August, and September and, in terms of monthly averages, for the second and third quarters. (The July and August -- and second quarter -- figures for trade have been revised up since the October 26 Green Book.)

RECENT CHANGES IN MANUFACTURING AND TRADE INVENTORIES
(Book value; seasonally adjusted; $ millions)

	July	August	September	II Q (monthly averages)	III Q (monthly averages)
Total	1,130	1,329	693	1,318	1,051
Manufacturing	1,009	1,152	695	767	952
Durable goods	787	1,024	616	577	809
Motor vehicles	161	143	-168	2	45
Machinery & equipment and defense products	407	504	500	324	470
Other durables	219	377	284	251	293
Nondurable goods	222	128	79	190	143
Trade 1/	121	177	- 2	551	99
Wholesale	134	298	-166	143	89
Retail	- 13	-121	164	408	10
Auto dealers	-217	-161	183	202	- 65
Other durables	136	- 90	- 21	85	8
Nondurables	68	130	2	121	67

1/ Retail trade inventories have been revised beginning January 1965, as a result of an upward adjustment to benchmark levels at the end of 1965 and of revision in seasonals; the new June 1966 level is $730 million, or 2 per cent, higher than the old level and the amount of accumulation in the second quarter is 18 per cent larger than indicated earlier (however, first quarter accumulation was lowered). Wholesale inventories have been revised for the period 1959-1965 to make the earlier figures comparable with 1966 monthly data (revised in June 1966).

Salient features of recent inventory developments are as follows:

(1) Accumulation by manufacturers, which had increased steadily from February to August, dropped sharply in September -- to the lowest rate since March. The major cause of the decline was a shift from large accumulation in the motor vehicle industry in preparation for new models to sizable liquidation in September when new model output picked up. Another factor in September was a further slowdown in growth of stocks of nondurable goods industries, including liquidation in some textile and food industries. For the foods industry liquidation had also occurred in August.

For the third quarter as a whole, inventory accumulation by manufacturers was well above the second quarter rate, owing mainly to a further large step-up in the business and defense equipment industries where new and unfilled orders continued to expand at a rapid rate. Any slackening in the period ahead from the high third quarter rate for total manufacturing accumulation will depend importantly on developments in these industries.

(2) Wholesale inventories were revised for August to show a sharp spurt, which was followed by a sizable decline in September. For the quarter, accumulation by wholesalers was less than in the second quarter, mainly because of slower growth in durable goods -- presumably consumer items and construction materials.

(3) Liquidation of auto stocks in July and August and considerable accumulation in September dominated movement of retail inventories. For the quarter, auto stocks were reduced moderately, and accumulation of other goods -- both durable and nondurable -- slowed markedly, with the result that total retail stocks showed little change following the large second quarter run-up. With auto stocks sharply above year-earlier levels and sales no longer bouyant, pressure to reduce auto stocks is expected to become stronger. Also, with retail sales generally showing little change in recent months, retailers may extend their efforts to limit accumulation of other consumer goods.

Orders for durable goods. New orders for durable goods have been revised for September to show a rise of 7 per cent -- double the increase indicated by the advance figures. With shipments raised only fractionally, unfilled orders also were revised upward to show an exceptionally large increase of $2.3 billion -- 3.2 per cent -- for the month.

The bulk of the upward revision reflected a sharp boost in orders for the Census category, "defense products." New orders for these products now show a rise of nearly 50 per cent for the month, to a level more than 25 per cent above the previous high in June. This category, it should be noted, includes the entire aircraft industry and a significant portion of its backlog represents orders from commercial airlines.

Excluding products classified in the defense group, new orders were up slightly with increases in steel, motor vehicles, and machinery and equipment. There was a further decrease in construction materials and orders for miscellaneous durable goods were also down.

Business fixed capital investment. Plant and equipment expenditures of nonfarm business are expected to total $63.8 billion in 1967, 5 per cent more than this year, according to the McGraw-Hill fall survey. This rise compares with a 17 per cent increase indicated for this year. Fixed capital spending in 1967 reportedly would rise by more than 7 per cent were it not for the recent suspension of the investment tax credit on equipment purchases and the elimination of accelerated depreciation on buildings. Together, these actions are reported to have reduced planned outlays for 1967 by $1.5 billion.

The survey fixed capital spending estimate of $63.8 billion in 1967 would be only slightly higher than the $63.6 billion annual rate in the final quarter of this year as indicated by the August Commerce-SEC survey of business plans. (A new quarterly Commerce-SEC survey will be available in about a month.) However, other data relating to business fixed investment -- unfilled orders for machinery and equipment, the backlog of manufacturers' capital appropriations, and starts and carry-over of plant and equipment projects by manufacturers and public utilities -- suggest continuation at least into early 1967 of the recent upward trend in business capital outlays. Total outlays for 1967 only 5 per cent above those in 1966 would imply an appreciable reduction in spending rates after the early months of 1967.

PLANNED FIXED CAPITAL SPENDING

	McGraw-Hill Survey		Commerce-SEC August Survey
	Planned 1967 (billions)	1967 change from 1966 (per cent)	1966 change from 1965 (per cent)
All business	$63.8	4.9	17.1
Manufacturing	28.6	5.5	20.6
Durable goods industries	15.0	7.2	22.5
Nondurable goods industries	13.6	3.8	18.6
Nonmanufacturing	35.2	4.3	14.5
Mining	1.4	-2.7	12.3
Railroads	1.7	-13.8	13.3
Airlines	2.3	36.0	52.2
Other transportation and communications	7.8	2.6	14.0
Electric & gas utilities	9.0	10.0	17.6
Commercial	13.1	1.0	9.7

Direction of change in fixed capital outlays in the coming year always has been correctly flagged by the McGraw-Hill fall surveys. In recent years when economic activity was expanding rapidly, however, the increases reported in the fall have substantially underestimated the increases actually realized. A year ago, for example, the survey indicated an increase of 8 per cent this year; it now appears that the actual increase will be 17 per cent. In the 1964 and 1963 fall surveys, the increases were underestimated by even larger relative amounts. Although no suggestion of underestimate for 1967 was made in the body of the report itself, McGraw-Hill economists were reported as expecting capital spending "to grow at a rate somewhere between 7 per cent and 8 per cent" next year.

Among industry groups, manufacturers plan to increase plant and equipment spending by nearly 6 per cent in 1967, with producers of durable goods planning 7 per cent and nondurable goods industries 4 per cent. Increases now planned by most manufacturing industries are much smaller than those realized this year. Further sizable gains are estimated by producers of nonferrous metals, fabricated metals and instruments, and electrical machinery -- industries which recently have been operating at or above preferred operating rates. Declines are scheduled by producers of motor vehicles and parts, aerospace, and textiles. For the aerospace and textile industries the declines follow very large increases this year.

Manufacturers expect their 1967 sales, in physical volume, to be 6 per cent larger than this year. Pressures on manufacturing capacity, particularly for some durable goods industries, would apparently continue heavy next year if sales expectations and capital spending rise in line with the survey results. Manufacturing capacity, according to McGraw-Hill survey estimates, is increasing 8 per cent in 1966, with fixed capital outlays by manufacturers up an estimated 21 per cent; the increase last year was also 21 per cent and in 1964, it was 18 per cent.

Fixed capital spending by all nonmanufacturing industries combined will be up only 4.3 per cent in 1967 from this year, according to the survey. Airlines and gas and electric utilities plan large further increases; but railroads, after increases averaging nearly 25 per cent a year over the past five years, report plans to reduce spending by nearly 15 per cent. And the commercial grouping, which is relatively large in terms of total outlays, plans only a 1 per cent increase in spending next year, as compared with a 10 per cent increase this year. More than half of the estimated $1.5 billion cutback in outlays because of Federal actions regarding the investment tax credit and accelerated depreciation is concentrated in the commercial sector.

Construction activity. Total new construction activity edged down further in October and was at the lowest seasonally adjusted annual rate -- $71.8 billion -- since the summer of 1965. Residential construction expenditures, which continued downward for the eighth consecutive month, accounted for nearly all of the decline. Both public and private nonresidential expenditures were above their advanced levels in October 1965, but they were below their first quarter 1966 highs.

NEW CONSTRUCTION PUT IN PLACE

	October 1966 (billions) 1/	Per cent change from September 1966	Per cent change from October 1965
Total	$71.8	-1	- 1
Private	48.1	-1	- 4
Residential	21.8	-3	-17
Nonresidential	26.3	--	+11
Public	23.8	-1	+ 5

1/ Seasonally adjusted annual rates; preliminary.

Although October data are not yet available, staff projections indicate the seasonally adjusted annual rate of starts in the fourth quarter may average little more than 1 million units. This would be somewhat further below the already low third quarter rate and would compare with a rate of 1.5 million in the first quarter. For the year 1966, the staff estimates starts at just over 1.2 million.

Current projections -- assuming continued stringency in mortgage markets -- suggest that starts may fluctuate on average below the 1 million unit mark during the first half of next year, and that any revival that might follow thereafter might not carry the 1967 total much above 1.1 million units. Even allowing for higher prices and some further shift in the mix toward the more expensive single family units, a first half rate of less than 1 million units -- which seems also to be implied by most trade expectations -- would imply that investment in residential structures (GNP basis) would be reduced further during most of 1967 from the less than $23 billion rate -- now estimated for the fourth quarter of 1966.

The number of starts in 1967, and the possibility of a sizable recovery at some time during the year, will depend importantly on the timing and extent of improvement in the flow of mortgage funds. Even with a sharply increased flow of such funds, however, an advance in starts also would depend on the speed with which uncertainties about prevailing trends could be dispelled and dislocations in supply arrangements within both the mortgage and builder markets could be smoothed after the substantial shock to these markets which began a year ago. Currently, interest rates on mortgages as well as production costs in general, are appreciably higher than at that time. Also, land development underway is reported to have slowed in some cases and stopped altogether in others, as pressure on builders' financing has continued to increase. New commitments by some life insurance companies for permanent financing, for example, are now being deferred into 1968. Altogether, while there would undoubtedly be a fairly prompt response to an improvement in mortgage funds availability, it seems likely that a time lag of some consequence -- perhaps 6 months -- would have to be assumed before the starts rate turned up substantially, and several months thereafter before this would be reflected in an upturn in the residential construction component of GNP. In the 1958 recovery in starts -- the fastest in the postwar period -- a full nine months' period elapsed from the trough to the subsequent recovery level.

While a backlog of demand is being built up, the full impact of shortages resulting directly from the curtailment in starts this year probably will not begin to be felt until early next year. This is because completions tend to lag starts by some 6 months or more, and the level of starts, supported by earlier commitments, actually was quite high in the first two quarters of 1966.

Thus, much of the current volume of new home sales is supported by construction activity planned and started much earlier. Nevertheless, inventories of housing for sale by speculative builders this fall had already dropped to unusually low levels. Rental vacancy rates, which had not been especially high in the North Central states and the South also had been reduced appreciably further. In addition, with about one-fifth of the population moving each year, the possibility of increased pressure in specific localities from households whose demands are neither immediately postponable nor shiftable is growing. And the removal of units from the existing stock from demolition and other causes is continuing at an estimated rate of at least 500,000 a year.

Because of the relatively "overbuilt" situation which had prevailed earlier for multifamily structures, some of the initial impact of reduced supplies will continue to be absorbed by previously vacant units already on the market. If protracted, however, a reduced level of starts over the next year would probably affect demands for rental types of shelter more than on those for single-family homes. Demand for single-family units had been unusually soft through the early 1960's, even when mortgage funds had been easy, and the potential demand for single-family structures based on demographic factors alone still does not point to any marked growth over the next few years.

Although the population between the ages of 25-45 -- the major market for single-family homes -- has begun to turn upward in the present period, in contrast with an absolute decline during the first five years of the decade, a major upshift is not indicated until the 1970's; moreover, the number in the core "30-40 year" group in which single-family home demand is likely to be strongest, is still in decline.

By contrast, for those in the "20-24 year" and "45-and-over" groups, the major sources of apartment demand, the pace of expansion is growing.

ESTIMATES OF POPULATION -- 20 YEARS AND OVER
(Millions of persons)

Age	1960	1965	Projected 1970	Projected 1975
			Male	
20 - 24	5.6	6.9	8.7	9.7
25 - 45	23.2	23.1	23.9	26.8
(30 - 40)	(12.0)	(11.4)	(11.1)	(12.6)
45 and over	25.2	26.8	28.3	29.4
			Female	
20 - 24	5.6	6.8	8.6	9.6
25 - 45	23.9	23.7	24.4	27.1
(30 - 40)	(12.5)	(11.7)	(11.4)	(12.8)
45 and over	27.6	30.4	33.1	35.1

Source: Census Bureau, Series P-25, No. 329, March 1966.

Labor market. Demands for labor were strong in October as nonfarm employment resumed its upward course. The advance of nearly 200,000 from September was somewhat below the average monthly increase of 250,000 over the past year. But it was still at a rate which pressed against available experienced manpower resources. Reflecting continued shortages of skilled workers in many industries, the average workweek in manufacturing--41.3 hours--continued close to the postwar peak.

Most nonagricultural industries reported higher employment in October, but there were some exceptions. Manufacturing increased 75,000, more than recovering the September decline. In durables, the increase was somewhat below the average monthly rise over the past year. Machinery and defense related industries continued to show strength, but employment in construction material and furniture industries eased off as activity slowed and the rise in autos began to level off following the model changeover. In nondurable goods industries, employment also rose, following a decline in the previous month. In the rubber, chemical and printing industries a moderate upward trend was maintained but in textiles, employment slipped further from midsummer highs.

In trades and services, employment increased sharply in October, following two months of relatively little change. Gains in these industries last month were well above the average increases over the past year, reflecting the underlying strong demands for manpower in these areas. In contrast, construction employment declined further in October and was down 200,000 or 6 per cent from the March 1966 high and was only slightly above its year earlier level.

Declines in construction employment have begun to show up in the unemployment figures for the industry. There has been a steady upward drift since midsummer in the seasonally adjusted unemployment rate for this sector, but in Octiber it was still below a year earlier. For other industries there has been no easing in labor supply even though employment gains have moderated. In manufacturing, unemployment has declined this fall; in durable goods the rate was down to 2.6 per cent in October, as low as during the Korean conflict.

UNEMPLOYMENT RATES BY INDUSTRY OF LAST JOB
(Seasonally adjusted)

	October 1965	1966 August	1966 September	1966 October
Wage and salary workers	4.0	3.7	3.6	3.6
Manufacturing	3.6	3.4	3.2	3.0
Durable goods	3.2	2.9	2.9	2.6
Nondurable goods	4.2	4.0	3.7	3.6
Construction	9.6	8.4	9.1	9.2
Transportation and public utilities	2.6	1.8	2.0	1.7
Trade	4.7	4.6	4.3	4.4
Service industries 1/	4.1	3.8	3.6	4.0
Government	2.0	2.1	2.4	1.9

1/ Excludes private households.

Manpower supply. Continuation of a tight manpower supply situation was clearly evident in the labor market figures for October. The civilian labor force increased at a brisk rate over the year -- by 1.3 million -- and the Armed Forces absorbed about half a million men. But the usual sources of manpower supply have very nearly dried up, for the time being at least. Adult white males constitute over half of the civilian labor force, but they contributed less than 5 per cent of the additions to the manpower pool over the past year. The adult male population is growing slowly and their rate of labor force participation is fairly close to its maximum. In addition, their unemployment rate, at 2.1 per cent in October was close to minimum frictional levels.

Teenagers, who were a major source of additional manpower earlier this year, left the labor force in very large numbers with the beginning of the new school year, and last month numbered only 125,000 more than in the previous October. The major source of labor supply therefore has been adult women, who added about one million additional workers to the labor force over the past year. With the continued movement of young men into the Armed Forces or into schools, little increase in the adult male labor force is in prospect, and, hence, women will continue to provide the only substantial supply of additional civilian labor in the coming year.

Despite the tight labor market situation, which would seem to offer unique opportunities to absorb more marginal workers into employment, there has been relatively little improvement in the unemployment of either nonwhite workers or teenagers since October 1965. The unemployment rate of nonwhite adults has remained virtually unchanged at about 6 per cent, and the rate for all teenagers declined only slightly -- from about 13 to 12 per cent. Moreover, these high unemployment rates were associated with only very modest increases in the labor force for both groups. But these groups contain the only significant supply of unemployed workers who can now be drawn into jobs.

LABOR FORCE AND UNEMPLOYMENT - OCTOBER 1966

	Civilian labor force (percentage distribution)	Unemployment rate (seasonally adjusted)
Total	100.0	3.9
Total 14-19 years	10.0	11.9
Nonwhite 20 years and over	10.0	5.9
White 20 years and over	80.0	2.6

Military manpower. The half million increase in the Armed Forces during the past year has been a major drain on available manpower. These young men -- mainly 18 to 24 years of age -- have come largely from the labor force, and there appears to be at best only a modest easing of manpower demands for the military in prospect. The Secretary of Defense has announced that draft calls in the first quarter of 1967 would average about 25,000 a month; the call for January has already been set at 27,600. A first quarter total of 75,000 would be only about 25,000 less than the total for the third and fourth quarters. However, there appears to be a seasonal tendency for draft calls to be higher in the summer months when more out-of-school youths are available. The draft call for the first quarter of 1966 was about 10,000 larger than the projected first quarter 1967 total.

DRAFT CALLS

		Quarterly totals
1965 -	III	61,000
	IV	110,150
1966 -	I	85,080
	II	78,300
	III	102,400
	IV	98,900 p
1967 -	I	75,000 p

p - Projected.

Wages and collective bargaining. A number of contract settlements involving wage increases in the 4 to 5 per cent range -- along with an unusually large number of deferred wage adjustments and substantial cost-of-living increases -- are being reflected in progressively higher average earnings in manufacturing. Average hourly earnings of manufacturing production workers rose another one cent in October to $2.75, a level 4.2 per cent higher than a year earlier; in the third quarter of this year manufacturing earnings had been 4.0 per cent above year-ago levels. The annual rise in manufacturing from 1962 to 1965 had averaged 3.0 per cent.

In recent years, hourly earnings in the nonmanufacturing sectors have been rising faster than in manufacturing. These sectors tend to be less unionized, or have shorter contracts, and have been more sensitive to the tightening labor market. With the relatively sharp recent increases in manufacturing, most major industries are now showing over-the-year wage increases well above 4 per cent.

PER CENT INCREASE IN AVERAGE HOURLY EARNINGS

	1st half 1965 to 1st half 1966	October 1965 to October 1966
Manufacturing	3.5	4.2
Construction	4.3	5.0
Mining	3.9	6.1
Trade	4.9	4.8
Hotels & motels	5.0	6.6 a/

a/ September.

Wage settlements with increases of about 5 per cent continue to be the pattern in both manufacturing and nonmanufacturing sectors. The recent contracts negotiated by G.E. and Westinghouse with most of the electrical unions provided for wage and fringe increase of about 5 per cent, as did the earlier contract with the airline mechanics union. This pattern also has spread to the first of the operating railroad brotherhoods to negotiate a settlement. The railroads and 96,000 members of the trainmen's union agreed to a 5 per cent wage increase in a contract retroactive to August 12 and extending through the end of 1967. The contract provides for reopening in September 1967 when the union could present new wage demands. Similar wage gains are expected in current contract negotiations with four other operating unions covering 80,000 workers, as well as with the 400,000 members of the nonoperating railroad brotherhoods.

Prices. The wholesale price index for industrial commodities remained nearly stable in October. Changes in component indexes and other straws suggest that the industrial average may now be moving upward again, although at a "creeping" rate. Prices of foodstuffs have declined substantially (about 4 per cent) from their peak in September, reflecting expansion in supplies of most fresh foods, and have accounted for decreases in the total wholesale price index amounting to 0.6 per cent in October and perhaps another .03 or .04 per cent since then. The decreases in food prices should carry through to retail stores, with or without buyers' strikes, and a declining trend in retail prices through the fourth quarter is likely. The rise in the total consumer price index thus should slow down and could even be temporarily interrupted; through September, the latest month for the index, this year's rise in the CPI on an annual rate basis was nearly 4 per cent.

The near stability in wholesale prices of industrial commodities in October reflected a further decrease in sensitive materials, continued stability in other materials, and additional increases in both machinery and equipment and consumer finished products. The decline in sensitive materials -- which began in the spring and has represented partial reversal of extraordinary increases in hides, lumber and copper scrap -- slowed in October. The declines may be near an end for hides and lumber, and markets for copper and copper scrap have firmed again, partly because of recurring disturbances to production in Zambia. In coming months, therefore, the sensitive group will not provide such an offset to increases in other industrial commodities as it has earlier.

Prices of industrial materials other than the sensitive group were stable from August to October, following a nearly steady rise over the preceding ten months at an annual rate of 3 per cent. Some portion of that rise was associated with price increases among sensitive materials -- e.g., plumbing equipment was influenced by copper, and millwork by lumber -- and upward pressure from this source no longer exists. List prices for steel were stable in September-October at a level about 1.5 per cent higher than a year ago, and the recent increase in stainless steel, which accounts for something over 5 per cent of the value of all steel mill shipments, will raise the steel index by 0.1 per cent. Chemicals have been stable and paper and paper products leveled off in the summer after a moderate rise. For some of these materials, production has leveled off or declined in recent months, which suggests that demands may have eased and inventories may have gone somewhat beyond desired levels. For industrial materials other than the sensitive ones, therefore, a prompt return toward the 3 per cent annual rate of increase appears unlikely.

Prices of machinery and equipment over the year ending in October rose at a nearly steady rate which cumulated to 4 per cent. Changes ranged from zero for transportation equipment (not including motor vehicles), up to an average increase of 6 per cent for metal-working equipment, and they appear to be related more to particular industry and market conditions than to pervasive influences of either wage rates or costs of materials. Recent plant and equipment surveys suggest that new orders for equipment will soon level off or decline, but pricing decisions may also be influenced by the high level of unfilled orders and by a spreading of wage increases of 5 per cent or more as, for example, in the electrical machinery industry. This month, increases of 2 to 5 per cent have been announced for prices of agricultural machinery and equipment.

For consumer goods (other than foods), the annual rate of price increase has fluctuated around 2 per cent. Increases have been chiefly among nondurable goods: clothing, fuels, tobacco products, and soft drinks. Furniture prices also have increased, but major appliances have changed little. In October, the index for consumer goods was affected by elimination of seasonal rebates that had reduced auto prices in August-September. BLS has not yet indicated an evaluation of prices for the 1967 autos (and none was reflected in the October WPI), and it is likely that the auto index after adjustment for quality change will show little change. For the future, developments in the markets for textiles and hides and leather suggest at least a moderation in the rise in clothing prices. Increases have been announced for color television and for many small appliances, but reduction in demands for major appliances associated with the decline in residential construction may limit or prevent price increases. Altogether, a near-term acceleration in the rise in wholesale prices of consumer goods appears to have a low probability.

WHOLESALE PRICES

	Per cent change to October 1966 from		
	September 1966	October 1965	October 1964
All commodities	-0.6	3.0	5.4
Industrial	0.1	2.0	3.4
Sensitive materials	-0.5	-0.4	2.2
Ex. Fibers	-0.5	1.0	4.1
Other materials	--	2.6	3.7
Machinery and equipment	0.3	3.8	5.1
Consumer goods	0.3	1.8	2.8
Foodstuffs	-2.5	5.9	11.9
Livestock and products	-2.5	6.2	17.3
Crops and products	-2.6	5.4	6.0

Developments in farm credit. The accelerated rise in farm debt that began in the second half of 1965 continued through the first half of this year at an annual rate of increase in outstandings of 12 per cent. Recently, there has been some slowing of pace as a result of rising costs and tightening availability of credit.

According to Department of Agriculture estimates, total debt owed by farmers will reach a record high of $45 billion at the end of 1966 -- $23.5 billion in real estate debt and $21.6 billion in non-real-estate debt. Despite this mounting volume of indebtedness the over-all financial positions of agriculture has improved in 1966 because incomes have risen more rapidly than debts, and farm real estate and other assets have appreciated in value. But farmers' liabilities as a per cent of their assets edged upward during 1966 to an estimated 16.8 per cent as compared to 16.3 at the beginning of the year.

Further substantial expansion in demand for farm credit is expected in the coming year by respondents to a questionnaire widely circulated among people working in the field of farm credit by the Department of Agriculture in preparation for the November 14-17 Outlook Conference. In the view of these respondents, funds for expansion of farm real estate credit are likely to be limited by tight credit conditions. Nevertheless, their reports indicate that the expanded demands for short-term and intermediate-term credit are expected to be largely met.

Farm real estate debt. The 11 per cent annual increase in farm real estate debt estimated for 1966 is somewhat less than that of the two preceding years. The slackening has occurred since spring and reflects tight credit conditions.

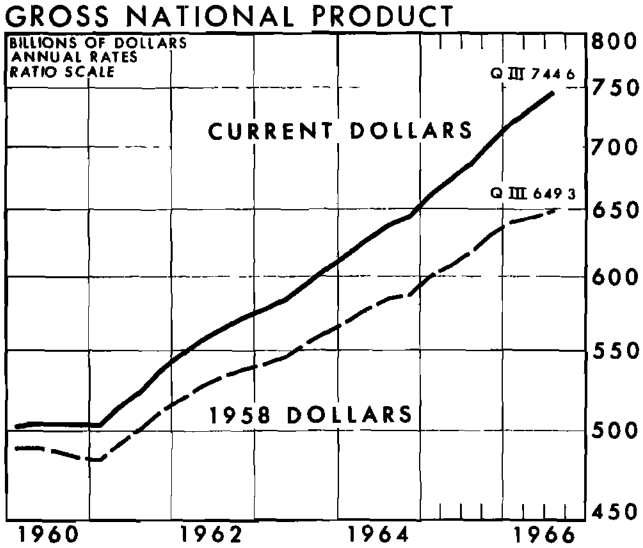
On September 30, 1966, holdings of farm debt of the two largest institutional lenders on farm real estate -- the insurance companies and the Federal Land Banks -- were up from a year earlier by 12 per cent and 17 per cent, respectively. For the insurance companies, this represented a slight deceleration; after the first quarter of 1966, they drastically reduced their commitments for the most part in response to more profitable alternative uses for their funds and also increased demands for policy loans. For the Federal Land Banks, the relatively rapid expansion in loans may reflect their interest rate of 6 per cent, which is the statutory maximum they can charge and is below the cost of their latest bond issue. The rapid expansion in Federal Land Bank loans is not likely to be sustained for the Farm Credit Administration, in line with Administration policy, has set up criteria favoring loans yielding immediate production. This will undoubtedly rule out many long-term investment loans normally made by the Federal Land Banks.

Non-real-estate debt. In contrast to the less rapid pace of expansion in farm real estate debt this year, holdings of non-real-estate debt by the principal institutional lenders are expected to increase by 13 per cent for the sharpest expansion of the 1960's. By midyear, commercial banks, the major source of farm production credit, had expanded their portfolios by approximately 11 per cent; by September 30, the Production Credit Associations had increased theirs by 15 per cent. Optimistic price and income prospects will undoubtedly spur further demands for short- and intermediate-term credit in 1967 to meet expanded production of crops and livestock. The favorable farm incomes of 1966 have increased deposits at rural banks in some areas, a development that may broaden the lending base of these banks. Also the Farmers Home Administration has more funds to lend in 1967.

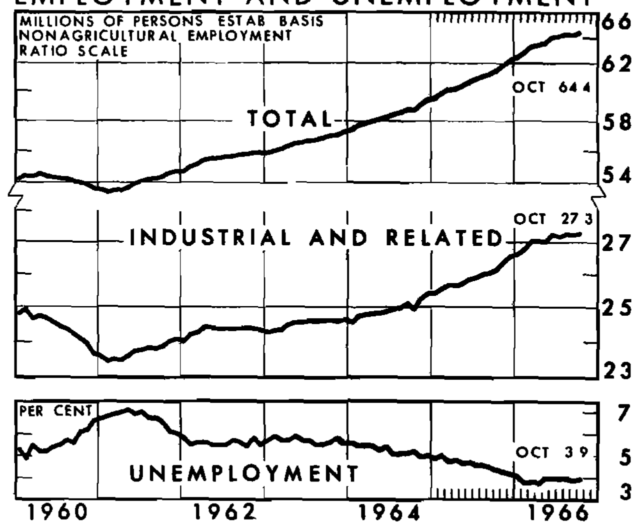
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

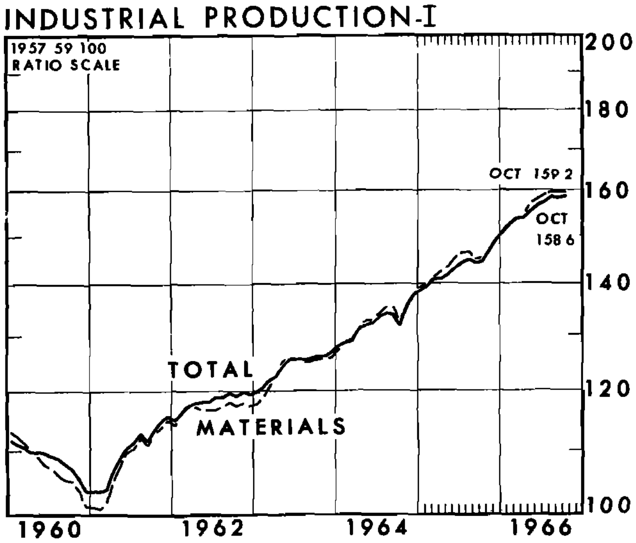
GROSS NATIONAL PRODUCT



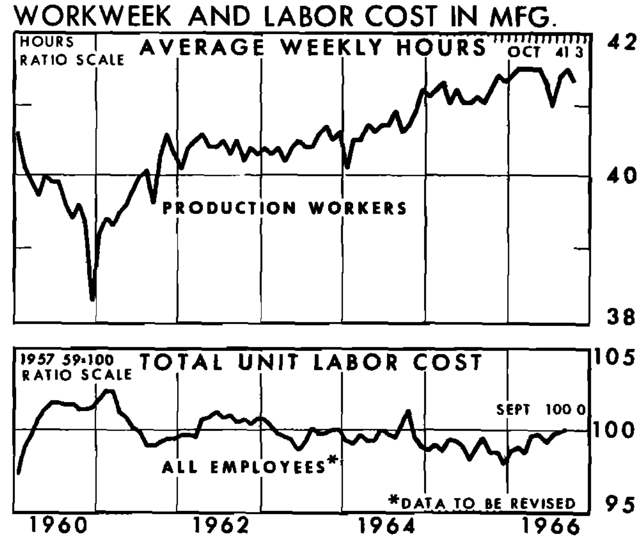
EMPLOYMENT AND UNEMPLOYMENT



INDUSTRIAL PRODUCTION-I



WORKWEEK AND LABOR COST IN MFG.



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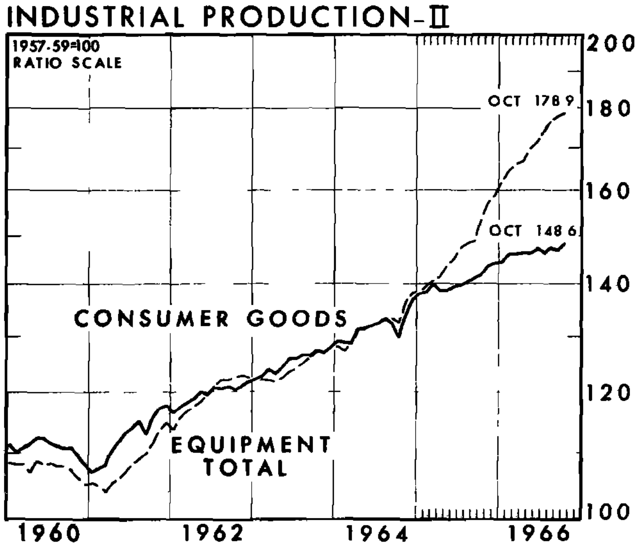
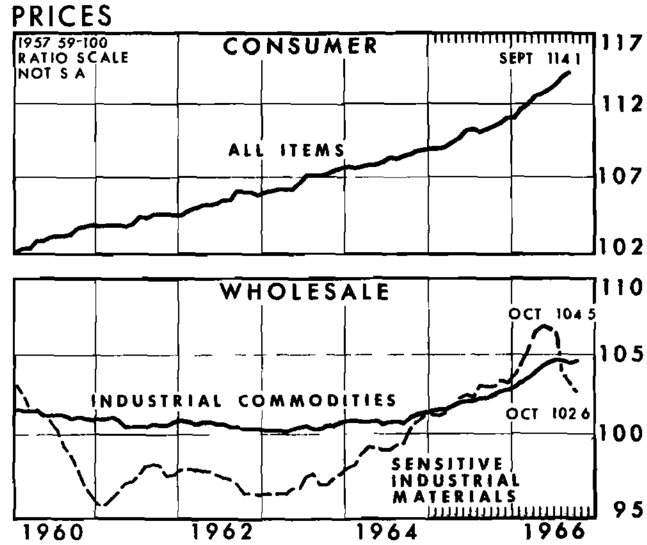


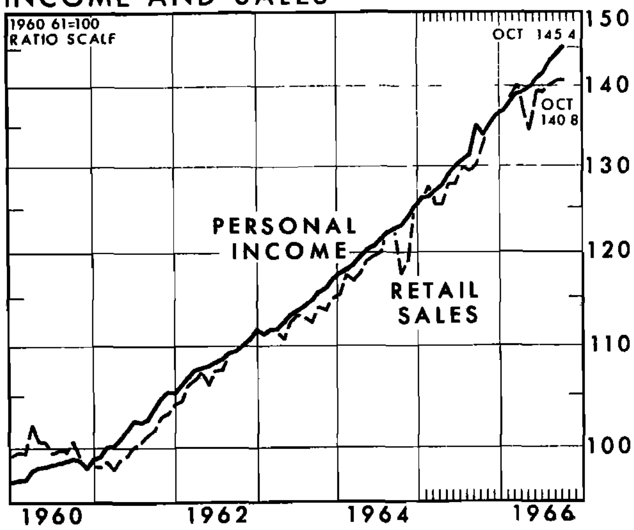
PRICES



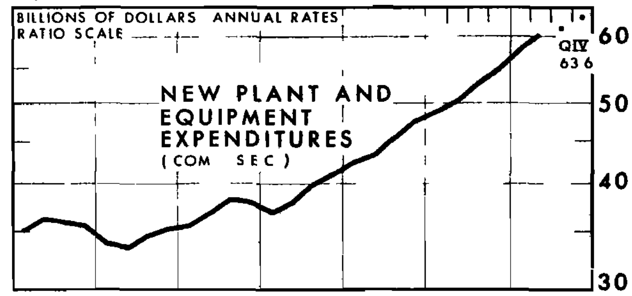
ECONOMIC DEVELOPMENTS - UNITED STATES

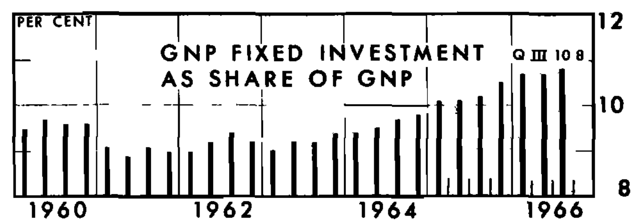
SEASONALLY ADJUSTED

INCOME AND SALES

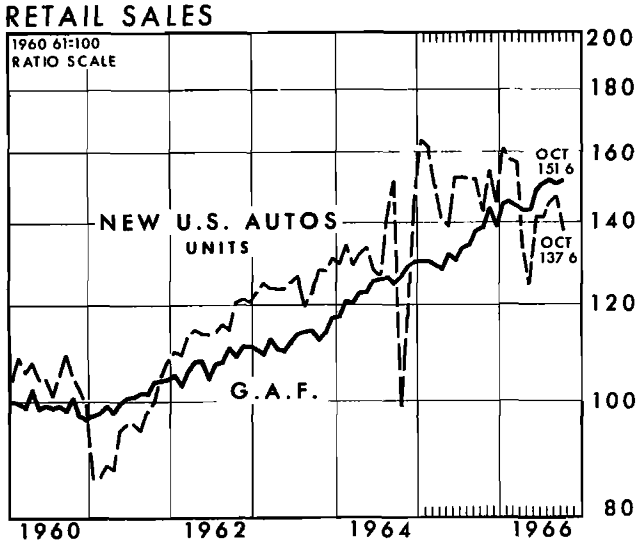


BUSINESS INVESTMENT

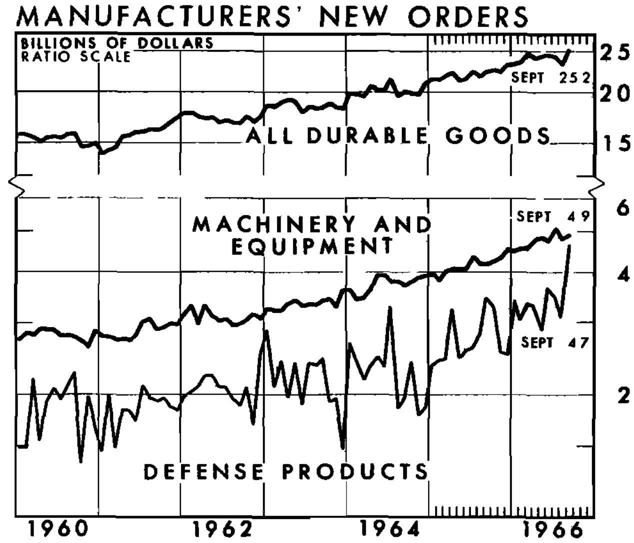




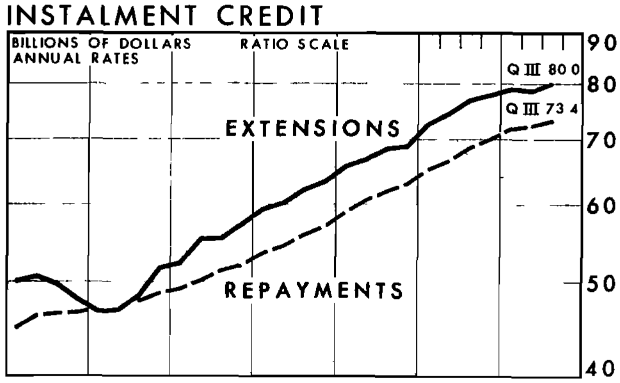
RETAIL SALES

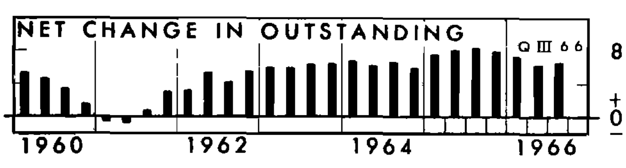


MANUFACTURERS' NEW ORDERS

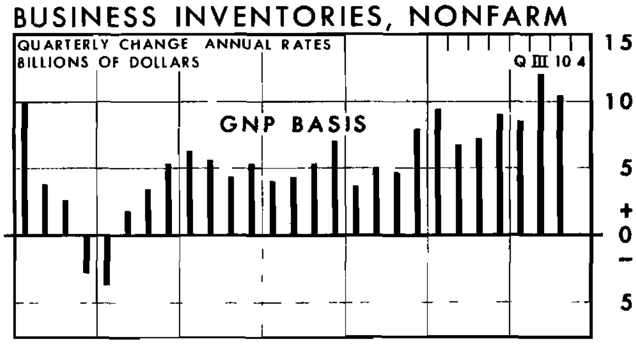


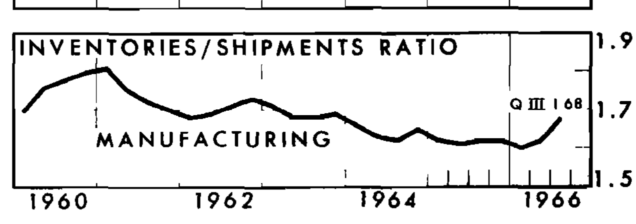
INSTALMENT CREDIT





BUSINESS INVENTORIES, NONFARM





DOMESTIC FINANCIAL SITUATION

Flow-of-funds - third quarter, 1966. Total borrowing by nonfinancial sectors was sharply down in the third quarter, dropping from an $84 billion annual rate in the second quarter to a $63 billion rate. Although U.S. Government borrowing was somewhat lower than in the second quarter, most of the $20 billion decline was in funds raised by nonfinancial business, which were reduced from a $44 billion rate in the second quarter to a $27 billion rate in the third. About half of this drop in business borrowing was in bank loans and another third in security issues. With the sharp decline in housing starts, there was also net repayment on construction loans by builders.

SUMMARY OF CREDIT MARKET BORROWING
(Billions of dollars, seasonally adjusted, annual rate)

	1965	1966			Change II to III
		I	II	III	
Total borrowing	72.1	81.6	83.5	63.1	-20.4
U.S. Government	3.5	13.3	6.0	1.3	- 4.7
Direct and guaranteed issues	1.2	8.1	-11.4	3.0	+14.4
Agency issues and loan participation	2.3	5.2	17.3	-1.7	-19.0
Foreign	2.6	2.3	2.4	1.9	- 0.5
Domestic nonfinancial sectors	66.0	65.9	75.2	59.9	-15.3
State and local	7.8	5.9	7.7	6.8	- .9
Business	29.7	36.3	43.9	26.9	-17.0
Households	28.5	23.7	23.6	26.1	+ 2.5

The drop in third-quarter business borrowing reflected to a large extent special factors that boosted business credit flows in the second quarter to exceptionally high levels relative to financing needs for capital outlays. More than $2 billion (at annual rates) of net security issues in the second quarter consists of the sale of TWA stock by Hughes Tool Company in what was essentially a secondary offering with the funds used to buy Government securities. More important, however, was the accelerated payment on corporate profit taxes, which at annual rates was about a $10 billion drain on corporate funds during the second quarter, while third-quarter payments were on the schedule that had existed since 1961. The second-quarter payments are clearly mirrored in a corporate borrowing rate that was $8 to $10 billion higher than the general level of corporate credit demands in surrounding quarters. Second-quarter borrowing by corporations can thus be seen as part of a change in structure of corporate liabilities: the shifting forward of corporate tax payments over the past 10 years has gradually reduced the relative position of taxes payable on the balance sheet, and with the further major shift forward of payments in the second quarter, there was a clear need to increase other forms of borrowings.

Comparison of borrowing with investment is consistent with this view of the second quarter. The ratio of borrowing to net investment (line 6 of the table) is high in the second quarter, but if roughly $10 billion of borrowing is excluded from the ratio as, primarily, extra "tax borrowing," in the sense indicated above, the second quarter ratio becomes about 83 per cent and is part of a trend over this year of diminished borrowing relative to investment.

BUSINESS AND HOUSEHOLDS
CAPITAL EXPENDITURES AND CREDIT MARKET BORROWING
(Billions of dollars, SAAR)

	1965	1966 I	1966 II	1966 III	1961-1965
(1) Gross capital expenditures	171.8	184.4	185.4	185.5	142.1
Sources of finance--					
(2) Capital consumption	110.1	114.2	116.0	118.1	97.6
(3) Credit market borrowing	58.2	60.1	67.5	53.1	43.6
(4) Other sources (1) - (2) - (3)	3.5	10.1	1.9	14.3	.9
(5) Net investment (1) - (2)	61.7	70.2	69.4	67.4	44.5
(6) Per cent borrowing of net investment	94.3	85.6	97.3	78.8	98.0

On the supply side of financial markets, second-quarter tax payments also distort the picture somewhat, because the Treasury used its extra tax receipts to build up its cash balances at banks and in the third quarter drew heavily on those deposits to finance spending. This action accentuated both the large growth in bank credit in the second quarter and the sharp deceleration in the third. Banks supplied almost 35 per cent of total funds advanced in the second quarter and less than 7 per cent in the third, but if, as shown in the table below, changes in Treasury balances are eliminated from both bank credit and total borrowing, the share of banks in credit supply becomes 15 per cent of the total in the third quarter, down from 30 per cent in the second quarter and 41 per cent in 1965 as a whole. This is the decline associated with a lower rate of time deposit inflow and decrease in the money supply during the third quarter, with some offset by banks' borrowing from foreign branches.

DIRECT LENDING IN CREDIT MARKETS
(Billions of dollars, SAAR)

	1965	1966			Change II to III
		I	II	III	
Total funds raised	72.1	81.6	83.5	63.1	-20.4
Less change in U.S. Govt. cash	-1.0	-3.5	9.2	-7.4	-16.6
Total less U.S. Govt. cash	73.1	85.1	74.3	70.5	- 3.8
Funds supplied directly to credit markets	73.1	85.1	74.3	70.5	- 3.8
Federal Reserve System a/	3.8	3.4	2.7	4.0	+ 1.3
Commercial banks (net) a/	29.3	19.2	21.5	10.7	-10.8
Nonbank finance (net)	27.1	25.0	14.9	19.1	+ 4.2
U.S. Government	4.7	11.3	10.4	7.5	- 2.9
Foreign	- .2	-1.5	2.2	1.8	- 0.4
Private domestic nonfinancial	8.5	27.8	22.7	27.5	+ 4.8
Households	2.7	14.8	19.2	11.8	- 7.3
Business	.9	6.0	- .1	7.7	+ 7.8
State and local governments	5.5	7.4	3.1	7.3	+ 4.2
Less net security credit	.6	.3	- .6	- .8	- 0.2

a/ Net of change in U.S. Government cash holdings.

The drop in bank share of lending was picked up partly by mutual savings banks, who recovered fairly well from their second-quarter trough, but mainly by nonfinancial investors, who through direct security purchases supplied about 40 per cent of total funds raised during the third quarter. This proportion is just about the share of direct credit from the nonfinancial public in the second quarter of 1959, which was the peak quarter for credit flows in the 1958-61 cycle, and somewhat above the high for direct lending and credit flows in early 1957. The direct supply in the third quarter this year apparently took the form of shorter-term U.S. Government securities and finance company paper purchased by business and State and local governments. Individuals bought municipal securities in large volume but were relatively inactive in Governments or corporate securities and maintained their flows into bank time deposits and savings institutions somewhat above the second-quarter rates.

Bank credit. Commercial bank credit declined $600 million further in October, following a slight net reduction in August and September. Over the three months, the reduction was at an annual rate of 1-1/2 per cent, in contrast with an increase at an 8-1/2 per cent rate over the first 7 months of the year, as shown in the following table.

CHANGES IN COMMERCIAL BANK CREDIT
(Annual rate - per cent)

	1966			1965
	Oct.	Aug.-Oct.	Jan.-July	Year
Total loans & investments	- 2.3	- 1.4	8.7	10.2
U.S. Govt. securities	-40.0	-14.0	-10.7	- 5.6
Other securities	2.5	- 0.8	9.2	15.8
Loans	7.0	1.7	14.3	14.7
Business loans	10.7	6.7	20.8	18.5

During October, banks were under strong pressure, even though loan expansion was at a much reduced pace compared with earlier this year. The pressure arose mainly from a sharp outflow of demand deposits and, in the case of large city banks, a large further run-off in negotiable CD's. In response, banks liquidated nearly $2 billion of U.S. Government securities. City bank data indicate that pressures at these banks may have continued in early November.

The October decline in holdings of U.S. Government securities was unusually large considering that banks had been allotted virtually all the $3.5 billion of nex tax bills issued by the Treasury at mid-month. So far this year, the cumulative decline in holdings of U.S. Government securities has been about $5-1/2 billion, bringing such holdings to the lowest level since early 1943, when total bank credit was less than a third its present level.

Holdings of other securities showed only a slight rise in October. While holdings at outside banks expanded, those at city banks declined much more than they usually do.

Total loans rose at an annual rate of 7 per cent in October following little change in August and a decline in September, when there was a large reduction in security loans. Through July of this year, total loans had increased at a 14 per cent annual rate. One factor limiting loan growth in October was an estimated decline of $400 million in agricultural loans. While feeder operations are believed to be requiring more borrowing than usual this fall, this increase has been more than offset by larger than usual loan repayments in those farm sectors where recent cash flow has been unusually high.

Business loans rose $700 million in October following little change in August and a $500 million rise in September. The October increase, which was at an annual rate of 11 per cent, was quite moderate considering that about $2.5 billion in payments of withheld taxes had been moved forward to that month under the acceleration program. Moreover, analysis of the pattern of weekly changes at city banks suggests that the growth rate in these loans may have slackened in late October and early November.

In view of past statistical relationships, the recent slowdown in business loan expansion would be expected to be associated with some slackening in inventory accumulation by businesses. This is indicated particularly in the metals group, where the trend in outstandings has shifted from sharp growth in the first half of this year to slackened growth in the third quarter, a sidewise movement in late September and early October, and a decline since then. In addition, a larger than usual decline in loans has occurred recently in the textiles and apparel group, where trade reports suggest that some inventory trimming may have occurred. But loan weakness also has been evident in several industry categories where inventories are an unimportant use of funds, especially in petroleum-chemicals, construction, and services. Most other industry groups recently have shown about average changes in their outstanding bank loans for this time of year.

The statistical evidence does not provide a solid basis for judging how much of the recent slowdown in business loan expansion reflects monetary restraint and how much, if any, is attributable to weakness in the economy. Nor is it possible to separate the interest-rate from the rationing effects of monetary restraint. Loan officers at large banks attribute the slowdown mainly to the restrictiveness of their policies, including the indirect effects of these policies in discouraging new loan requests. The ubiquitous character of the slowdown among industry groups and the similarity of timing would appear to be consistent with the view that restricted availability is at least one of the major contributing factors. On the other hand, some moderation in the demand for bank credit could well be occurring as a result of reduced inventory accumulation.

Bank deposits. Time and savings deposits at commercial banks, after rising at a much reduced pace in September, declined in October at more than a 2 per cent annual rate. This decline was accounted for entirely by a recent sharp drop in these deposits at reserve city banks; at other banks, growth has continued at close to an 11 per cent annual rate.

The decline at city banks was accounted for mainly by a large further run-off in outstanding negotiable CD's. From their peak on August 17 through November 2, net attrition totaled more than $2.8 billion, or 15 per cent. Most of the decline was in major financial centers; for example, it amounted to 23 per cent at New York City banks, 29 per cent at Chicago banks, but only 8 per cent at other weekly reporting banks, where customers generally seem less sensitive to interest rate differentials. In October, the competitive position of CD's improved somewhat as a result of the dip in market yields on Treasury bills. This was reflected not only in a reduced rate of attrition but also in some lengthening in the average maturity of new CD's sold.

Savings deposits at city banks also declined in October as they had in April and July, following the quarterly crediting of interest payments. However, the October decline was only $200 million as compared with $1.6 billion in April and $1 billion in July. On the other hand, savings certificates and other consumer-type time deposits rose only $165 million in October, compared with more than $1.7 billion in July. Thus, the combined total of these two categories of deposits declined slightly in October compared with a $750 million rise in July.

The reduced October outflow of savings deposits and inflow of consumer-type time deposits presumably were interrelated. Smaller transfers from passbook to other time deposits would be expected during that month in view of the ceiling rollbacks on certain time deposits in July and September and the likelihood that the more interest-sensitive funds had been transferred out of passbook accounts earlier in the year. In fact, most of the reduction in the inflow of consumer-type time deposits between July and October was in the New York, Chicago, and San Francisco Districts, which also experienced the heaviest impacts of the ceiling rollbacks. More generally, the substantial further rise in market rates of interest over this period reduced the relative attractiveness of bank time deposits as compared with market instruments.

The money supply declined $900 million in October, just offsetting the September increase. Since April, there has been a cumulative decline at an annual rate of 1-1/2 per cent; and since the shift in monetary policy last December, money has increased at an annual rate of only 2-1/2 per cent. A major factor contributing to the October decline was the large volume of investments liquidated by the banks and absorbed by the public during the month. Although yields on market instruments softened somewhat in October, they remained relatively high historically, and undoubtedly served to attract additional funds out of cash into interest-bearing investments.

Corporate and municipal bond markets. Through early November, yields on corporate and municipal bonds continued to extend the decline from their late August highs, but since then they have turned up. This week's $130 million Aaa-rated Pacific Telephone Company bond was reoffered to yield 5.95 per cent, the same rate at which a similar telephone issue was marketed in late September when yields on new corporate bonds were generally 20 basis points higher than they have been recently.

Prior to the telephone offering, syndicates were terminated on two recent utility bonds brought to market early in November. Their yields then rose 15 and 20 basis points in secondary market trading. In the municipal market too, investor response to recent offerings has been lukewarm, and yields in the more sensitive series on seasonal issues have risen 4 to 5 basis points.

BOND YIELDS
(Per cent per annum)

	Corporate Aaa			State and local Government	
	New		Seasoned		
	With call protection	Without call protection		Moody's Aaa	Bond buyer's (mixed qualities)
1965					
Low	4.33(1/29) 1/		4.41(3/12)	2.95(2/11)	3.05(2/11)
1966					
Low	4.79(1/7)	4.84(1/7)	4.73(1/7)	3.39(1/21)	3.51(1/21)
Weeks ending					
July 29	5.47	5.65	5.22	3.78	3.96
Sept. 2	5.98*	--	5.44	4.02	4.24
Oct. 28	5.60	5.93	5.37	3.75	3.83
Nov. 4	5.60	5.87	5.35	3.72	3.74
Nov. 11	--	--	5.35	3.72	3.79

1/ Issues with and without call protection averaged together.
* Includes issues with 10-year call protection.

The up-turn of yields on corporate and municipal bonds reflects the sizable recent build-up of calendars. For the corporate calendar, the estimate of publicly-offered issues for November still stands at about $575 million. But for December, the estimated volume has risen to nearly $1 billion, far above last December's volume. The timing of one large offering -- Pennzoil Corporation's $215 million short-maturity note designed to repay term loans at banks -- may be accelerated from its tentatively scheduled early December date. While this would redistribute the November-December monthly estimates, public bond issues for the two months combined are expected to total $1.5 billion, or roughly 50 per cent more than in the comparable period a year ago.

At close to $1 billion the December calendar of publicly-offered corporate bonds would rank second only to the August 1966 record. Moreover, this December figure appears to be a minimum estimate, (unless the Pennzoil issue is advanced) since $930 million has already been planned. The recent announcement by AT&T of a $250 million debenture early in January may encourage some companies which had been planning early 1967 offerings to accelerate their plans in order to get ahead of AT&T, an anticipatory pattern which has occurred at times of earlier AT&T issues.

Current estimates of corporate debt issues placed privately are always highly tenuous since they depend essentially on the extrapolation of past patterns. Thus, it may be that the recent build-up in public offerings reflects the very limited availability of private placement money. In September, however, the latest month for which data on actual takedowns are available, the volume of private placements was larger than estimated and nearly as large as a year ago. While the September figure may have reflected some speed-up in takedowns stemming from the general squeeze on financial markets in August, it does suggest that recent increases in the volume of public offerings represent more than a mere offset to the year-to-year short-fall in the volume of private placements.

CORPORATE SECURITY OFFERINGS 1/
(In millions of dollars)

	Bonds				Stocks	
	Public offerings 2/		Private placements			
	1966	1965	1966	1965	1966	1965
1st Qtr.	1,774	905	2,586	1,673	734	429
2nd Qtr.	1,941	1,864	2,083	2,259	1,090	920
3rd Qtr.	2,280e	1,575	1,725e	1,955	251e	383
4th Qtr.	2,095e	1,226	1,800e	2,264	445e	540
October	520e	287	450e	574	120e	124
November	575e	613	450e	529	175e	257
December	1,000e	326	900e	1,161	150e	159

1/ Data are gross proceeds.
2/ Includes refundings.

State and local government long-term financing for November and December is now estimated at $1.8 billion only slightly below a year ago. Nearly $350 million of this total has been added in the last two weeks. But State of California and public housing offerings, which usually occur at this time of year, account for two-thirds of the increase.

STATE AND LOCAL GOVERNMENT BOND OFFERINGS
(In millions of dollars) 1/

	1966	1965
1st Quarter	2,963	2,851
2nd Quarter	3,255	3,046
3rd Quarter	2,463	2,781
4th Quarter	2,500e	2,651
Total	11,181e	11,329
October	740e	844
November	950e	1,043
December	800e	764

1/ Data are for principal amounts of new issues.

Stock market. Common stock prices -- as measured by Standard and Poor's composite index -- have continued to advance from their October yearly low. At 81.69 on November 15, the index was up nearly 12 per cent from early October, but still about 13 per cent below the February level. The first 10 percentage points of the rise occurred in October.

During the recent market advance, investor interest -- both on the part of individuals and institutions -- has centered increasingly in stocks viewed as "blue-chip" and "defensive" issues -- including those of electric utility companies, casualty insurance companies, and banks. On the other hand, trading in low-priced and speculative stocks has fallen off drastically from the very high volume that prevailed in such issues last spring. Similarly, trading on the American Stock Exchange -- sometimes used as another measure of speculative interest -- has recently averaged only 1.5 million shares per day, down about 75 per cent from the peak rate reached last April. This contrasts with the New York Stock Exchange where trading has fallen 35 per cent over the same period. Since early October, the increase in the American Stock Exchange price index has amounted to about 8 per cent and Standard and Poor's index of 20 low-priced common stocks has advanced less than 6 per cent.

Mortgage market developments. Scattered indications suggest the possibility of some leveling in interest rates on loans for both residential and other types of real estate. Actual data for October for conventional first mortgages on homes, however, show at best a slowing in the uptrend. The advance in contract rates for conventional home loans was limited to about 5 basis points in October, compared with 10 in most other months this year. At 6.70 per cent on new homes and 6.75 per cent on existing homes, the rate levels were 85 to 90 basis points higher than prevailed little more than a year earlier.

The increase in yields has been associated with more stringent screening of borrowers for both construction transactions and permanent financing and with greater constraints in terms of loan-to-value ratios and maturities. In September, non-rate terms generally were among the tightest ever recorded by the FHLBB series, which began in late 1962. At the same time, loan amounts were below their peaks last August although holding above year-earlier levels.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASES

	1966		Per cent change from a year ago in September
	August	September	
New home loans			
Loan amount ($1,000)	20.1	19.0	5
Loan/price (per cent)	74.0	71.1	-3
Maturity (years)	25.4	24.3	-2
Existing home loans			
Loan amount ($1,000)	14.6	14.0	2
Loan/price (per cent)	70.6	69.5	-3
Maturity (years)	19.8	19.4	-3

Source: Federal Home Loan Bank Board and FDIC.

Mortgage debt outstanding increased by less than $6 billion in the third quarter of the year, based on preliminary data now available for most lender groups. This was about $2 billion under the net increase in the third quarters of each of the two preceding years when mortgage debt formation had been maintained near its third quarter 1963 peak. The year-to-year shortfall for savings and loan associations in the third quarter of this year about equaled that for all holders combined, since changes among other major groups were largely offsetting. Net growth in holdings by commercial and mutual savings banks showed year-to-year declines while year-to-year increases were reported for life insurance companies and by the Federal National Mortgage Association. For life insurance companies the gain is not expected to continue because it reflected largely the effect of commitments made some time ago when pressures on the resources of these companies were considerably easier than they have become. On the other hand, the possibility of some improvement in net inflows for savings and loan associations and a potential increase in FNMA purchases which appeared to be developing under the recently expanded authority voted by Congress, pointed toward some moderation from the third quarter trend.

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

	Amount	Increase in third quarter of			
	Sept. 1966 p	1966 p	1965 p	1964	1963
All holders	361.1	5.9	8.0	8.1	8.1
Financial institutions	277.7	3.6	6.3	6.4	6.7
Commercial banks	53.4	1.4	1.8	1.3	1.4
Mutual savings banks	46.6	.8	1.1	1.2	.9
Savings and loan assoc.	114.0	.3	2.4	2.8	3.5
Life insurance companies	63.7	1.2	1.0	1.0	.9
Federal agencies	15.2	.8	.2	.1	- .1
FNMA	6.7	.5	.1	- .1	- .2
Individuals and others	68.1	1.5	1.4	1.7	1.5

Partly reflecting the sharply reduced activity by savings and loan associations -- the major lenders on homes -- expansion in mortgage debt on 1- to 4-family homes sagged further to a seasonally adjusted annual rate of less than $10 billion, and was under the recent low in the fourth quarter of the recession year of 1960. Slowing in expansion of multifamily and commercial debt was much more moderate, but the rate in the third quarter was a four-year low.

INCREASES IN MORTGAGE DEBT OUTSTANDING
(Seasonally adjusted annual rates in billions)

	Total	1-4 family	Multifamily Commercial 1/	Farm 1/
1964 III	30.9	15.1	13.8	2.1
1965 I p.	29.7	16.0	11.6	2.1
II p.	30.3	15.9	12.4	2.1
III p.	30.3	15.9	12.1	2.3
IV p.	30.5	16.2	11.5	2.7
1966 I p.	30.5	15.5	12.7	2.3
II p.	26.3	13.1	10.9	2.2
III p.	22.4	9.8	10.3	2.3

1/ Includes estimates for holdings of individuals and others which are excluded in the flow of funds series.

Flows to financial intermediaries. During October combined savings in flows to depositary-type institutions shrank substantially further, as flows to commercial banks dropped to the lowest volume in nearly three years (even when negotiable CD's are excluded). As the table shows, the October total was 75 per cent below October 1965 compared to a much more modest 38 per cent year-to-year reduction for the first 10 months of 1966.

SAVINGS FLOWS TO MAJOR DEPOSITARY-TYPE INTERMEDIARIES
(Millions of dollars)

	Total	Commercial Banks 1/	Savings and Loan Associations	Savings Banks
October				
1966	697	+ 471	36 2/	190 3/
1965	2,295	1,543	582	170
1964	1,883	894	756	233
Year to Date				
1966	13,703	10,631	1,370	1,702
1965	22,158	13,518	5,934	2,706
1964	20,289	8,964	8,058	3,267

1/ Calculated from end-of-month data; does not include negotiable CD's at weekly reporting banks.
2/ Based on a survey of the 20 largest and 20 randomly selected S&L's in each Federal Home Loan Bank district.
3/ F.R. estimate based on data for flows to New York State institutions.

While the estimated October net inflow at Savings and Loan Associations was barely positive, this was the first quarterly reinvestment period this year in which the S&L's had not experienced a sizable net loss of share capital -- (net losses in January, April, and July had been \$77 million, \$770 million, and \$1.5 billion respectively). Even so, the October experience at the S&L's looks better only in relation to these earlier quarterly outflows. Compared with previous Octobers, it was poor. At mutual savings banks, on the other hand, the October net inflow was better than a year ago and four-fifths as large as the 1964 record.

The improvement of flows to mutual savings banks represents a continuation of the pick-up begun in July with the general move to a 5 per cent deposit rate at New York State institutions. In areas outside New York -- where the 5 per cent rate is less prevalent -- mutuals have not done so well. Thus, the past three months, the New York Banks, with 60 per cent of the savings capital, have been the recipients of nearly 80 per cent of the increase in deposits. Assuming market rates do not rise appreciably and that most of the largest mutuals continue to pay the 5 per cent rate, these institutions should soon resume a more normal pattern of mortgage acquisitions.

In the S&L industry, however, associations in New York and California continue to encounter problems. Associations in the New York Home Loan Bank district were the only ones in the country to lose savings capital continuously throughout the month of October -- even after the reinvestment period. Although they have leeway to offer higher rates than savings banks (on 5-1/4 per cent, 6 month certificates), the New York Associations have been reluctant to move in this direction since it would force them to cut into capital surplus as the savings banks are reportedly doing. Apparently they prefer to look for relief through a regula ory reduction in the maximum rate that savings banks are permitted to pay.

S&L's in California, despite their higher current dividend rate ceiling and the grandfather protection provided for rates paid on old accounts, experienced a net outflow of $185 million in October. For the first 10 months of 1966, the California associations have lost nearly $200 million in share capital, compared with a $1.4 billion net inflow over the comparable period of 1965.

U. S. Government securities market. Yields have risen in all maturity areas of the U.S. Government securities market since the latter part of October. In this period intermediate- and long-term yields have advanced around 15 to 25 basis points, thereby erasing 1/3 to 1/2 of the two-month decline which began in late August. The recent increase in Treasury bill rates has likewise offset a large part of the earlier decline, with the key 3-month bill currently some 25 basis points above its late October low.

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

Date (closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1959-1961						
Highs	4.68	5.15	5.17	5.11	4.90	4.51
Lows	2.05	2.33	3.08	3.30	3.63	3.70
1966						
Highs	5.59	5.98	6.22	5.89	5.51	5.12
Lows	4.33	4.46	4.78	4.76	4.56	4.49
1966						
Aug. 29	5.02	5.51	6.22	5.89	5.51	5.12
Sept. 21	5.59	5.96	5.90	5.53	5.21	4.97
Oct. 24	5.19	5.52	5.40	5.23	4.94	4.73
Nov. 1	5.27	5.52	5.43	5.26	4.99	4.78
Nov. 15	5.45	5.66	5.57	5.37	5.22	4.92

The recent weakness in the Treasury note and bond market has reflected in part some investor selling of outstanding issues on switches into the new 15-month and 5-year notes offered in the Treasury's November refunding. In addition, a moderate amount of selling of the new 5-year notes by speculative holders has been reported, but there has been some partly offsetting demand. Dealer holdings of notes and bonds maturing in more than 1-year have risen to nearly $1 billion, including some $600 million of the new notes acquired in the November refunding. The $1 billion total also includes about $200 million of bonds maturing in more than 5-years. Overall dealer positions in notes and bonds maturing in more than 1-year are at their highest level since May 1965.

The recent rise in Treasury bond yields also appears to have reflected a growing conviction that the earlier declines had outrun the underlying credit situation, at least for the time being. Market attitudes have also been influenced in part by recent sizable additions to the corporate bond calendar and by talk of a possible offering of FNMA participation certificates late this year.

The recent rise in Treasury bill rates has been influenced by generally tight conditions in the Federal funds market and associated increases in dealer financing costs. In addition, market demand for bills has been relatively light in recent weeks, and although it has picked up in the most recent trading sessions, dealer bill positions are still relatively large and the dealers have remained willing sellers of bills. Announcement of new cash financings by the Treasury in the bill area (discussed below) has also contributed to the upward pressure on rates. A measure of the recent movement in bill rates is given by the auction average for the 3-month issue which was at a recent low of 5.23 per cent on October 31 and advanced to 5.46 per cent on November 14.

Yields on short-term debt instruments other than bills have been generally steady since late October, as the table indicates.

SELECTED SHORT-TERM INTEREST RATES[1/]

	1966			
	June 30	Sept. 23	Oct. 31	Nov. 10
Commercial paper 4-6 months	5.625	5.875	6.00	6.00
Finance company paper 30-89 days	5.50	5.625	5.875	5.875
Bankers' Acceptances 1-90 days	5.50	5.75	5.625	5.625
Certificates of deposit (prime NYC)				
Highest quoted new issue:				
3-months	5.50	5.50	5.50	5.50
6-months	5.50	5.50	5.50	5.50
Secondary market:				
3-months	5.55	5.90	5.75	5.75
6-months	5.60	6.30	5.875	5.875
Federal Agencies (secondary market):				
3-months	5.29	5.76	5.64	5.58
6-months	5.53	6.04	5.66	5.77
9-months	5.64	5.96	5.93	5.98
Prime Municipals 1-year	3.50	4.25	3.75	3.75

1/ Rates are quoted on the offered side of the 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.

Federal Agency securities. Since early September, various Federal Agencies have retired about $570 million of securities held by private investors. These paydowns have been associated with a generally strong performance of the Federal Agency securities market, although rates have turned up most recently.

New cash needs of the Federal Agencies have been financed through purchases of new issues by the Treasury Trust Accounts. Such purchases have totaled nearly $900 million since early September.

After allowance for the $570 million paydowns of maturing issues held by private investors, the Agencies have raised net about $325 million of new money over the period.

Treasury finance. The purchases of Federal Agency securities by the Treasury Trust Funds have served to augment the already large cash needs of the Treasury over the second half of 1966. Before the end of the year, the Treasury is expected to raise around $3.0 to $3.5 billion more of new money, including a $1.2 billion auction on November 17 of a "strip" of bills in the 1-year series. The remaining cash will be obtained by an auction of tax bills in December and by continued $400 million additions to the monthly auctions of 1-year bills. As the table indicates, total cash to be raised in the second half of this year will approximate $11.0 billion, a figure last approached, but not equaled, in the second half of 1959. The Treasury will also have to return to the market for additional cash in the early weeks of 1967.

TREASURY GROSS CASH FINANCINGS
(Amounts in billions)

Year	3rd Quarter Additions to bills	3rd Quarter Other	4th Quarter Additions to bills	4th Quarter Other	Total Second half
1959	5.1	--	2.5	2.3	9.9
1960	3.0	-0.7	3.0	--	5.3
1961	5.9	--	0.8	--	6.7
1962	4.1	1.6	2.1	--	7.8
1963	2.5	--	1.8	0.4	4.7
1964	4.2	--	1.5	0.8	6.5
1965	--	--	6.5	*	6.5
1966	3.4	--	7.2 proj.	0.3	10.9 proj.

* Less than $50 million. All figures are based on payment dates.

The Federal Budget

The rapid increase in defense spending has moved the budget into a more expansive position in the second half of calendar 1966. Quarterly increases in national defense spending had averaged only about $2 billion during fiscal 1966, but the third quarter increase was $4.2 billion and the fourth quarter change may be of the same general magnitude. Transfer payments also rose by $2 billion in the third quarter--mainly because of the introduction of Medicare payments. These increases are likely to reduce the high employment surplus by almost $6 billion over the half year.

Spending on other accounts appears about as projected by the January Budget Document. The one class of exceptions are those expenditures affected by credit tightness: interest payments are higher than projected, participation sales lower, and agency lending higher. (Only the first of these items is in the National Accounts Budget, the first two are in the Administrative Budget, and all are in the Cash Budget.)

Revenues on all budgets have grown sharply throughout the year. Although this is primarily due to the rapid growth in money incomes, there is some indication that personal tax revenues have increased even more than can be accounted for by higher incomes. One possible explanation is that the Treasury underestimated the potency of the accelerated withholding measure (Tax Adjustment Act) enacted earlier in the year. Whatever the cause, the sharp growth in revenues has been a fortunate development moderating what/would have been an even more dramatic decline in the high employment surplus.

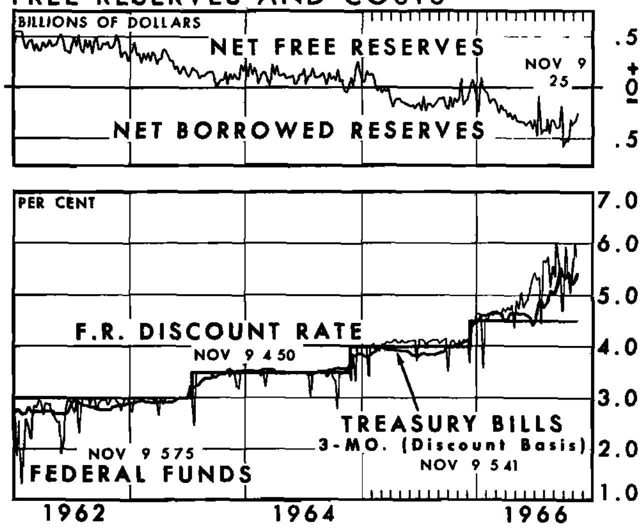
The accompanying Table gives quarterly budget information for the year, and compares it to some of the corresponding 1965 totals.

FEDERAL BUDGETS, QUARTERLY, 1965-1966
(Billions of dollars)

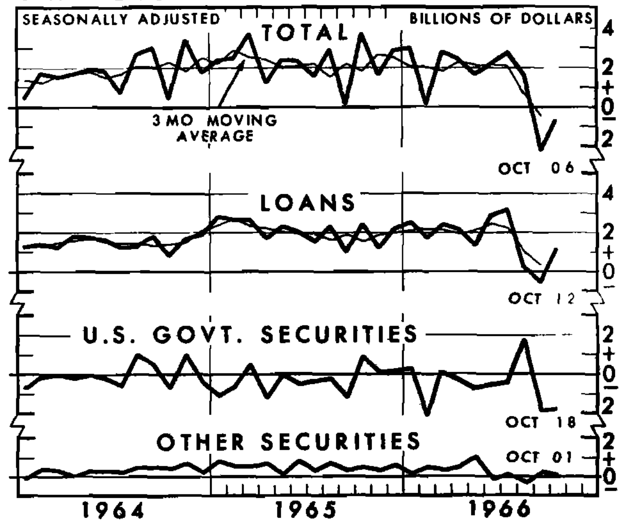
	Calendar 1965		Calendar 1966					
	III	IV	I	II	III	IV(p)	Calendar 1965	Calendar 1966
			Quarterly Totals, seasonally unadjusted					
Admin. Budget								
Receipts	22.2	21.0	26.1	35.4	25.4	23.2	96.7	110.1
Expenditures	25.7	27.3	27.2	26.8	33.2	31.8	101.4	119.0
Surplus	- 3.5	- 6.3	- 1.1	8.6	- 7.8	- 8.6	- 4.7	- 8.9
Cash Budget								
Receipts	29.2	25.8	33.3	46.1	34.6	30.9	123.4	144.9
Expenditures	33.1	34.0	34.6	36.0	41.3	40.5	127.9	152.4
Surplus	- 3.9	- 8.1	- 1.3	10.1	- 6.7	- 9.6	- 4.6	- 7.5
			Seasonally adjusted at annual rates					
NIA Budget								
Receipts	123.8	126.9	136.0	141.0	145.4	148.5	124.9	142.7
Expenditures	126.3	127.0	133.7	137.2	145.1	150.0	123.4	141.5
Surplus	- 2.5	- .2	2.3	3.8	.3	- 1.5	1.6	1.2
High Employment Budget								
Receipts	127.6	129.0	136.7	141.2	145.4	148.5	128.4	143.0
Expenditures	126.0	126.8	133.7	137.1	145.1	150.0	123.1	141.5
Surplus	1.6	2.2	3.0	4.1	.3	- 1.5	5.3	1.5
Addendum: National Defense	50.7	52.5	54.6	57.1	61.3	64.8	50.1	59.4

FINANCIAL DEVELOPMENTS - UNITED STATES

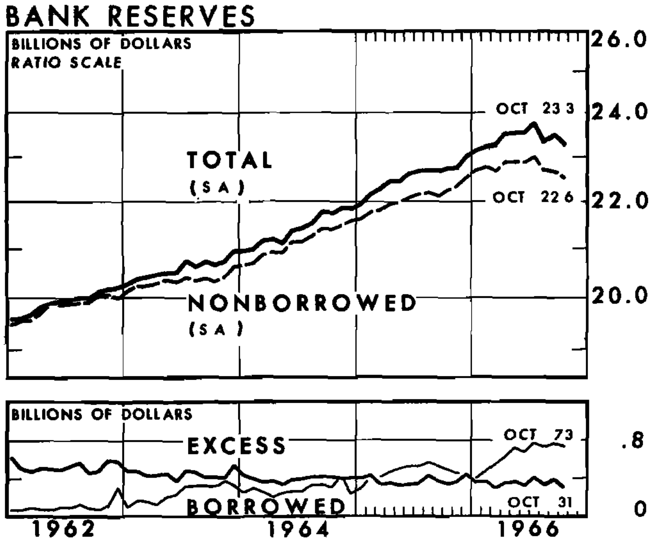
FREE RESERVES AND COSTS



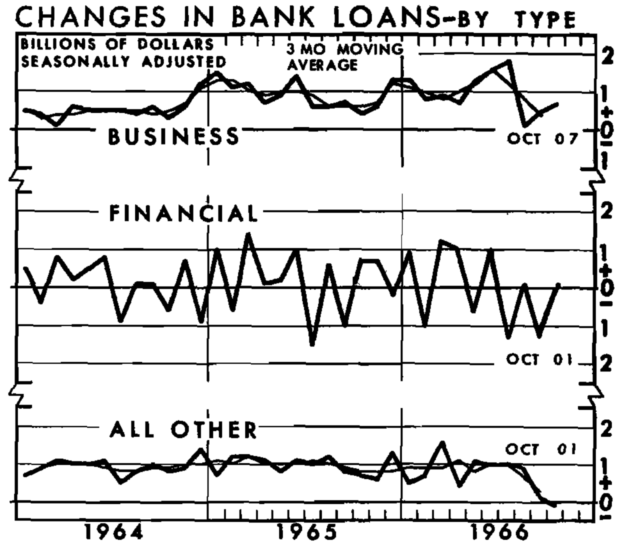
CHANGES IN BANK CREDIT



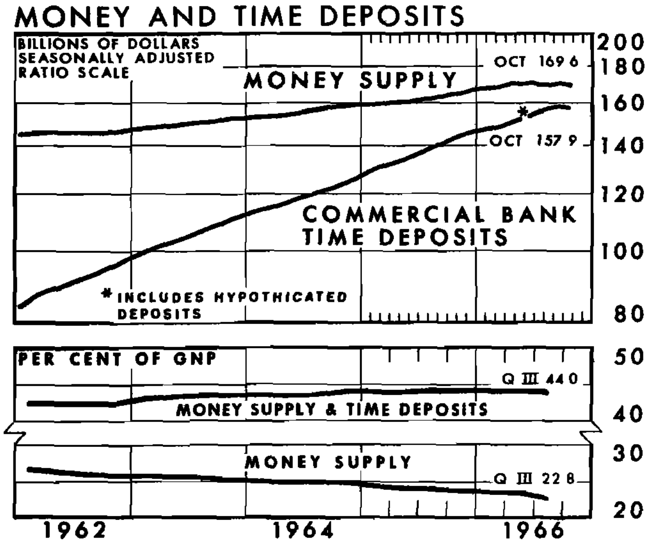
BANK RESERVES



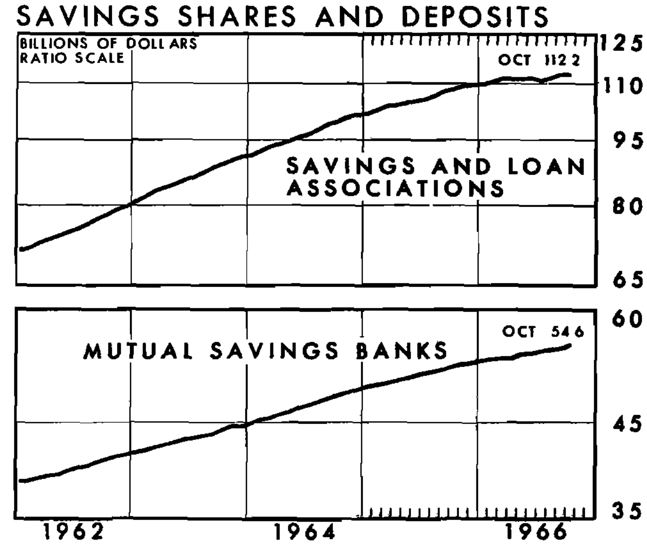
CHANGES IN BANK LOANS-BY TYPE



MONEY AND TIME DEPOSITS

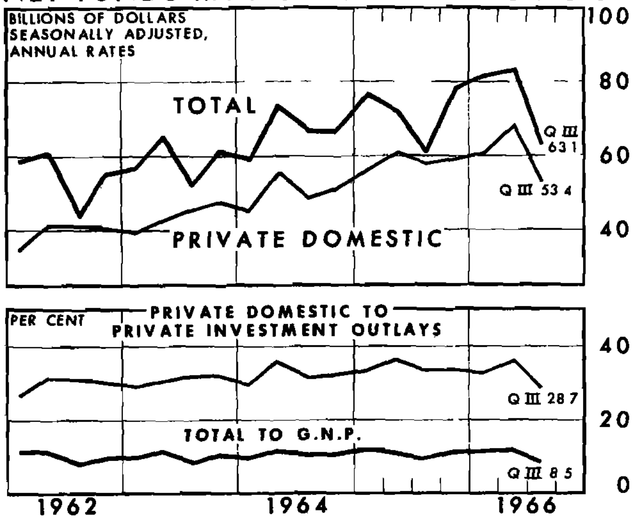


SAVINGS SHARES AND DEPOSITS

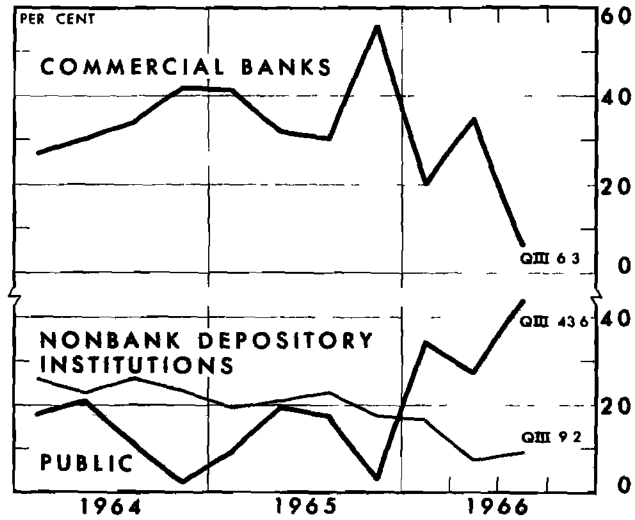


FINANCIAL DEVELOPMENTS - UNITED STATES

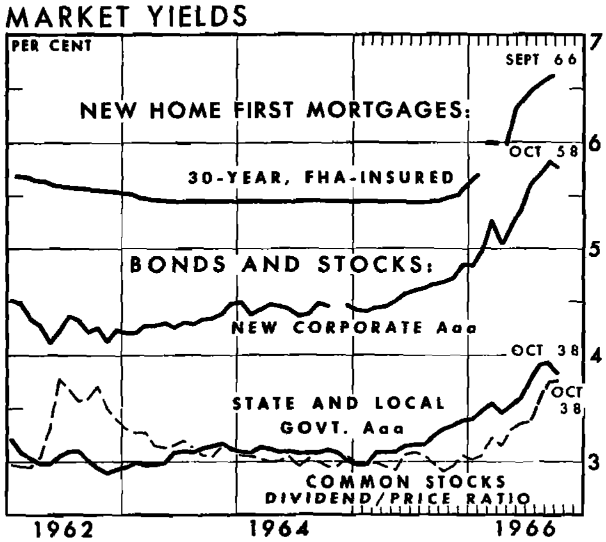
NET FUNDS RAISED-NONFINANCIAL SECTORS



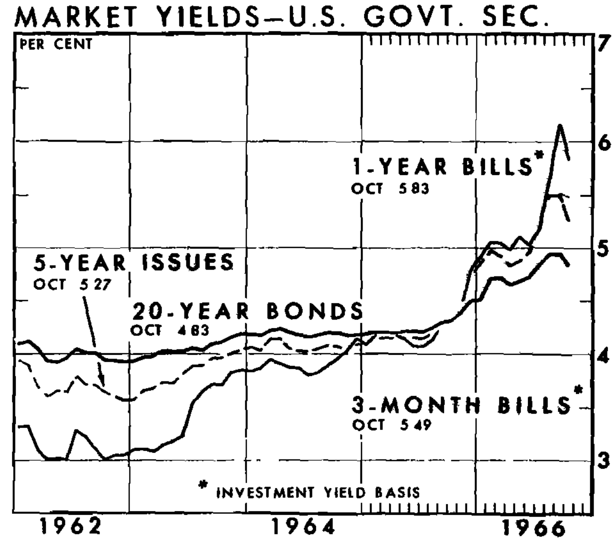
SHARES IN TOTAL CREDIT



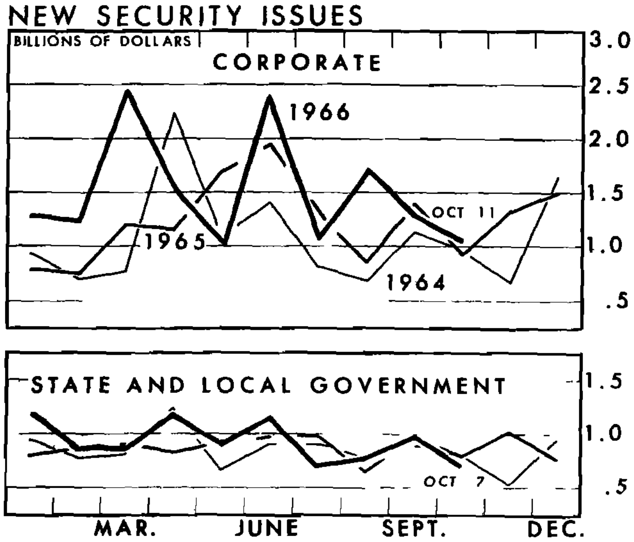
MARKET YIELDS



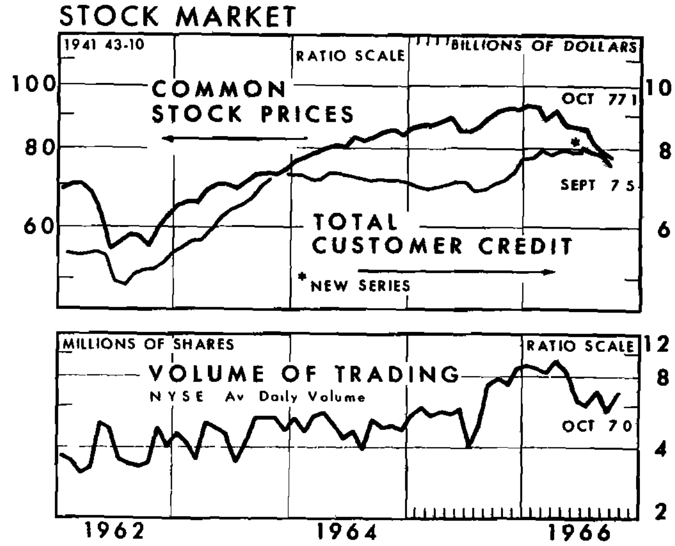
MARKET YIELDS—U.S. GOVT. SEC.



NEW SECURITY ISSUES



STOCK MARKET



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Weekly indicators show an unadjusted payments deficit on the liquidity basis for October and early November in excess of $800 million. As noted in earlier Green Books, the payments results for this period customarily appear unfavorable. However, in the corresponding 6 weeks of 1965, the deficit on the liquidity basis was less than $600 million.

The large deficit on the liquidity basis in October and early November was financed primarily by an increase in liabilities of U.S. banks to their foreign branches. These liabilities rose about $700 million in this period -- close to the peak rate of increase that had occurred in July during the height of the run on sterling -- with more than $400 million of the rise occurring in the week ending November 9. Reflecting the large inflow of foreign private funds through the branches, the payments position on official settlements was close to balance over the past six weeks.

CHANGES IN U.S. SHORT-TERM LIABILITIES TO FOREIGN COMMERCIAL BANKS
(In billions of dollars, not seasonally adjusted)

	Total	Liab. to foreign branches	Liab. to other banks
1964	+1.5	+0.3	+1.2
1965	+0.1	+0.2	-0.1
1966			
I	+0.4	+0.5	-0.1
II	+0.3	+0.3	--
III	+1.2	+1-1/4	--
Oct.1-Nov.9 est.	+0.7	+0.7	--
Total, year to date est.	+2-3/4	+2-3/4	--

In recent years, there has been some decline in U.S. banks' liabilities to branches late in the year. In 1965 these liabilities reached a peak at the end of October, and declined $500 million in the ensuing two months; in 1964, the peak was not reached until mid-December, but the decline from that point to year-end was $400 million.

The third quarter payments results which were just published show little change in the two measures of our overall payments position from the figures given in the Supplement to the last Green Book. As illustrated in the table below, special receipts in the third quarter were large, although down from the high rate of the second quarter. Debt prepayments make both measures of our payments position more favorable than they otherwise would be, whereas the two other types of special receipts shown in the table primarily benefit the balance on the liquidity basis.

U.S. BALANCE OF PAYMENTS, SELECTED ITEMS
(In millions of dollars, seasonally adjusted)

	Qtr. 1	Qtr. 2	Qtr. 3	Total, 3 Qtrs.
Balances -- on official reserve transactions (deficit -)	-226	-198	993	569
-- on liquidity basis (deficit -)	-536	-125	-217	-878
Selected Special Receipts				
Prepayments of U.S. Government debt	3	7	220	230
U.K. and International purchases (net) of U.S. securities, other than Treasury issues	34	68	9	111
Increase in long-term liabilities to foreigners, reported by banks	55	438	90	583

The partial third-quarter results currently available do provide further information on merchandise trade, and on bank-reported capital flows and securities transactions. But these transactions, together with the special receipts identified in the table above, do not fully account for the relatively favorable outcome on the liquidity basis. Other transactions (a residual, which includes both other transactions that will ultimately be recorded and errors and omissions) showed an improvement of nearly $400 million between the second and third quarters, despite continued high, and probably rising, military expenditures. It is likely that these as-yet unidentified transactions may have reflected, at least in part, tight credit conditions in this country and/or the run on sterling.

The reduction in the trade surplus in the third quarter to an annual rate of slightly less than $3 billion appears to have reflected mainly exceptional increases in imports of certain commodities. Of the total growth in imports from the second quarter ($25 billion annual rate) to the third quarter ($26-3/4 billion rate), more than one-third was attributable to unusually large increases in purchases of steel, petroleum and sugar. Continued increases in imports of these commodities are not expected in the fourth quarter. Apart from the bulge in these imports, the rise from the second quarter was about in line with the rapid increase of 4-5 per cent a quarter that has persisted since the second quarter of 1965. Imports of consumer goods and capital equipment continued their rapid advance, while imports of industrial materials other than steel and petroleum were unchanged (see chart below).

The 4 per cent increase in exports from the second to the third quarter ($29-1/2 billion annual rate on the balance of payments basis) reflected a spurt in sales of agricultural commodities, especially feed grains, wheat and cotton, and some further growth in non-agricultural exports. Non-agricultural exports have risen at an annual rate of about 5 per cent since the end of last year. As shown in the table, much of the third-quarter strength in these exports was attributable to sales to non-industrial countries (including Australia and South Africa), whereas in somewhat longer perspective there has been relatively steady growth in sales to Canada and Japan. Non-agricultural exports to Europe have shown no significant change since late last year.

U.S. EXPORTS BY AREA
(Billions of dollars; seasonally adjusted annual rates)

	Year 1965	1965 Q-3	1965 Q-4	1966 Q-1	1966 Q-2	1966 Q-3
NONAGRICULTURAL EXPORTS						
Industrial countries (excl. special categories)						
Canada	5.0	5.1	5.6	5.6	5.9	6.0
Western Europe	6.2	6.4	6.7	6.8	6.6	6.6
Japan	1.2	1.2	1.2	1.3	1.3	1.4
Total	12.4	12.6	13.5	13.7	13.9	14.0
Non-industrial countries (excl. special categories)						
Latin America	3.3	3.4	3.6	3.7	3.5	3.8
All Other	4.2	4.4	4.0	4.1	4.1	4.5
Total	7.5	7.8	7.6	7.9	7.6	8.3
Special Categories (excl. military grant aid)	0.3	0.4	0.5	0.4	0.4	0.2
Total nonagr. exports	20.2	20.8	21.6	21.9	21.9	22.4
AGRICULTURAL EXPORTS	6.3	6.8	6.8	6.8	6.9	7.4
TOTAL EXPORTS, Census basis	26.5	27.7	28.4	28.7	28.7	29.9

The third-quarter reflows of bank credits, totaling slightly more than $100 million seasonally-adjusted, consisted principally of long-term credits. New long-term loan commitments to foreigners averaged $70 million a month in the first nine months of 1966, compared to $100 million a month in the last nine months of 1965. According to preliminary figures, commitments in the third quarter declined slightly further to a rate of about $60 million a month. With commitments and disbursements down substantially this year, the repayments and amortizations of outstanding loans have resulted in a net reflow of long-term credits amounting to $175 million (seasonally adjusted) through the first nine months. Net reflows of short-term loans and acceptance credits to all areas in the third quarter (seasonally adjusted) were roughly offset by increases in collection claims outstanding for banks' own accounts or for customers; and for the first nine months the reflow of short-term loans and acceptances has also been approximately matched by increases in collection items outstanding. The third-quarter reflow of short-term loans and acceptances consisted of large reflows from Japan, partly offset by outflows to other areas, particularly Latin America.

Interest rates abroad. Since August, interest rates have leveled off or turned downward in a number of financial markets abroad where rates had been rising, with few interruptions, for more than three years. In particular, bond yields have dropped appreciably in the United Kingdom, Germany, the Netherlands, and Canada. These changes appear to have been caused largely by market forces rather than by active efforts by monetary authorities to bring about easier conditions. In contrast to the recent pattern in these countries, some firming of interest rates has occurred in France and Switzerland, and Italian rates have been stable. Rates in Japan have continued to decline.

In the United Kingdom, expectations of a general recession in economic activity have become widespread in the past two months. As a result, credit demands have diminished and long-term and short-term interest rates have declined. From a peak of 7.31 in early September, the War Loan yield moved down to 6.87 per cent as of November 10, while the Treasury bill rate, at 6.38 per cent on November 14, was down 22 basis points from its September high. Beginning in August, outstanding advances of the London clearing banks, seasonally adjusted, fell for three consecutive months. Extension of new hire purchase credit by finance houses and retailers was 23 per cent smaller in the third quarter than a year earlier.

There is apparently some apprehension in government circles that economic activity, particularly private investment spending, may be falling off more rapidly than desired. On November 1, the Bank of England pointed out that outstanding bank credit was well below the level permitted by the ceiling the Bank has set, and it voiced encouragement of lending to finance capital investment, exports, and housing for workers being relocated. At the same time, the authorities are continuing to slow down the decline in interest rates. In the last two weeks, the Bank of England has forced the discount houses to borrow from it at the discount rate, in order to maintain the bill rate near present levels.

In Germany, the composite yield on public authority bonds carrying a 6 per cent coupon has dropped more than 1/2 percentage point from its mid-July peak of 8.60 per cent, and rates for call money and 30-day interbank loans are also well below the July peaks. Although the cost of 90-day funds in the interbank loan market advanced in September-October for seasonal reasons, the rise was small in comparison with those of preceding years.

Several factors seem to have contributed to this easing of yields. Balance of payments surpluses since late last spring have been providing liquidity to the banking system. The marked slowing of the expansion of private investment expenditures this year has probably meant that business demand for funds has been rising less rapidly than before. In addition, bond prices continue to benefit from the suspension of new issues by the public authorities that was ordered in May and is expected to remain in force at least through the end of this year. Finally, during the summer the public authorities substantially increased their net indebtedness to the Bundesbank.

The Bundesbank has announced a temporary 9 per cent reduction in reserve requirements for December to offset seasonal money market tightness at the end of the year. A parallel action was taken in December 1965, but there is some feeling in financial circles that this time the Bundesbank may initiate a cautious relaxation of policy by not restoring the reserve requirements to the pre-December level in January.

Long-term rates in the Netherlands have recently been about 30 basis points below August peaks; in late October the composite yield on three government issues was 6.55 per cent. Conditions on new issues also seem to have begun to improve. The Bank for Dutch Municipalities, the largest regular borrower on the Dutch capital market, floated new bonds in May and in October with a 7 per cent coupon, but the issue price rose from 99-1/2 in May to 100 in October. Net inflows of foreign exchange contributed to an easing of the money market from mid-August to end-September. Since then, seasonal tax and other factors have caused short-term rates to rise.

The Netherlands Bank is continuing to maintain somewhat more restrictive quantitative ceilings on bank credit this year than it did last year. The latest ceilings allow an 8 per cent expansion of short- and medium-term loans to the private sector during the year to the fourth quarter of 1966. This compares with an allowed expansion of 9.4 per cent in the preceding year and an actual expansion of 8.9 per cent. Lending in excess of the prescribed ceilings increased earlier this year, but since July it has been greatly reduced by the application of stiffer penalties for such excesses, and perhaps also by some weakening of loan demand.

In France, the net export of funds by French banks, together with an adverse shift in merchandise trade, has led to higher rates in the Paris money market, and the commercial banks have increased their recourse to the Bank of France quite substantially. From the spring of 1965 through last August, the Bank of France kept call money rates from exceeding a fixed limit, almost always 4-7/8 per cent, by making sufficient end-of-month purchases of open market paper at that rate. But more recently the Bank allowed the call money rate to rise to 5-1/4 per cent over the September month-end, and to 5-3/8 per cent at the end of October.

It seems very doubtful that the authorities desire higher rates to temper the pace of economic expansion in France. Instead, rates have probably been allowed to rise in order to discourage net exports of funds by French banks. Such net lendings are thought to have been large, and to have been a prime reason for the drying up of the official reserve accruals. The French authorities have for a long time looked with disfavor on volatile flows of short-term funds between France and the rest of the world.

Yields on public sector bonds averaged 6.72 per cent at the end of September, about the same as at the end of June, but 30 or more basis points higher than in the earlier months of this year up to May, in reflection of the decision taken by the Treasury in early June to raise the yields on new public sector bond issues by 1/2 percentage point. In October the Treasury floated a 1.5 billion franc issue yielding 6.55 per cent; reportedly, it was not taken up as speedily as the 1 billion franc loan of October 1965 that yielded 6.07 per cent.

The amount of funds being raised on the French capital market continues to be disappointingly low, especially in view of the important tax measures that were adopted in the past year and one-half to encourage savers to invest in long-term securities. New funds raised in January-September were 6 per cent less than last year, and the decline for bond and share issues by private borrowers was almost 30 per cent.

Bond yields in Italy have changed very little in recent months; the composite yield covering all bonds in circulation except Treasury issues averaged 6.38 per cent in September. Italian monetary policy has remained very expansionary, inasmuch as investment expenditures have yet to regain pre-recession levels and the recovery of over-all output has not yet pressed strongly against available resources. In August, the money supply was 15 per cent greater than a year earlier. The demand for bank loans has become much stronger this year, and outstanding loans in August exceeded the year-earlier level by 13 per cent. At the same time the balance of payments surplus, rising Bank of Italy credit to the Treasury, and increasing central bank rediscounts and advances to the banking system have provided sufficient reserves to enable the banks to increase their security portfolios by 21 per cent in the past year. The Bank of Italy is continuing its policy, now a year old, of limiting its new lira/dollar swaps to those banks which still have a net debtor position with foreigners. As a result, nearly all of the external surplus has been employed as a reserve base for the acquisition of domestic assets.

The failure of interest rates to decline further, despite the rapid monetary expansion, seems to stem from heavy demands on the capital market and a large capital outflow from Italy to the rest of the world. The public sector's capital market borrowings, which rose sharply in 1965, have in all likelihood increased again this year by a large margin, partly because of a widened budget deficit. Last year the Italian balance of payments registered a net capital outflow of $458 million, including $375 million of net trade credits that do not appear from the exchange data. So far this year the capital outflow has apparently been running at a much higher level; exchange data show a net outflow of $363 million in January-August, compared with a $58 million net inflow in the first eight months of 1965.

Yields on long-term government bonds in Canada are currently 20 to 40 basis points below the peaks of late August, but Canadian short-term interest rates have been increasing again since late September. The Treasury bill rate, now 5.08 per cent, has risen from 4.84 on September 23, and is a bit above its August high of 4.97 per cent. The rate for 90-day finance company paper, which was 6-1/4 per cent during August, has been 6-3/8 per cent since late September.

A shift in investor expectations has brought long-term rates down. Until late August, Canadian economic indicators suggested that inflationary pressures would remain substantial, and it seemed that monetary policy alone would be employed to restrain demand. Since then, the government has indicated it is ready to take anti-inflationary fiscal action and signs of softening demands have appeared in certain industrial sectors. In late August the Finance Minister announced that an interim budget for the purpose of curbing inflationary pressures would be presented in the fall. Presentation of this budget has been delayed, but is now expected in December.

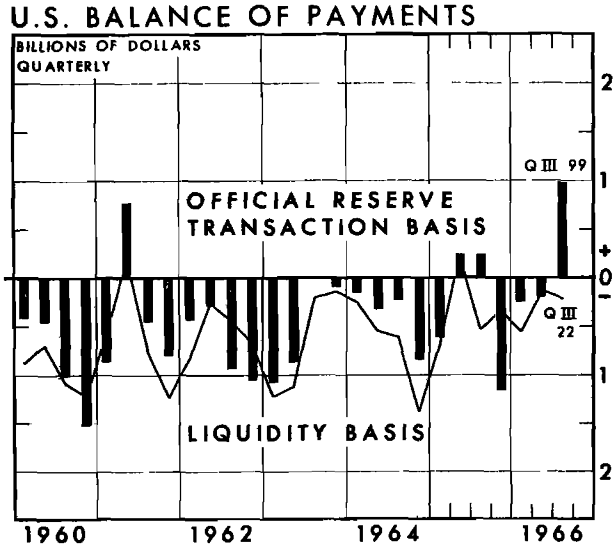
In Japan, interest rates continued to decline in general through September. The average rate on bank loans fell from 7.48 per cent in July to 7.42 per cent in September; the previous high was 7.99 per cent at the end of 1964. On October 1, the administration took steps to lower the structure of long-term interest rates. The standard rate on loans by the long-term credit banks was cut from 8.4 to 8.2 per cent, and the interest yield on one-year and five-year bank bonds was reduced from 6.2 to 6.0 per cent, and from 7.3 to 7.2 per cent, respectively. This move was reportedly taken in order to narrow the gap between long- and short-term rates which had widened with the steady decline in short-term rates.

Bank of Japan officials have indicated that because of the high interest rates in New York, Japanese Euro-dollar borrowings have increased. They also indicated that a rise of about $200 million in the outstanding level of Euro-dollar borrowings in the first 10 months of this year was partly offset by about a $100 million decrease in the level of other "Euro-money" borrowings. There has been a tendency for much of the Japanese Euro-dollar borrowing to be of an increasingly shorter maturity.

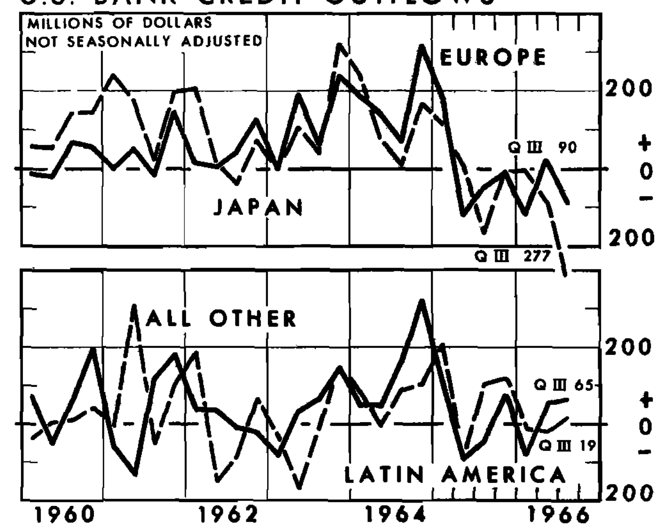
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

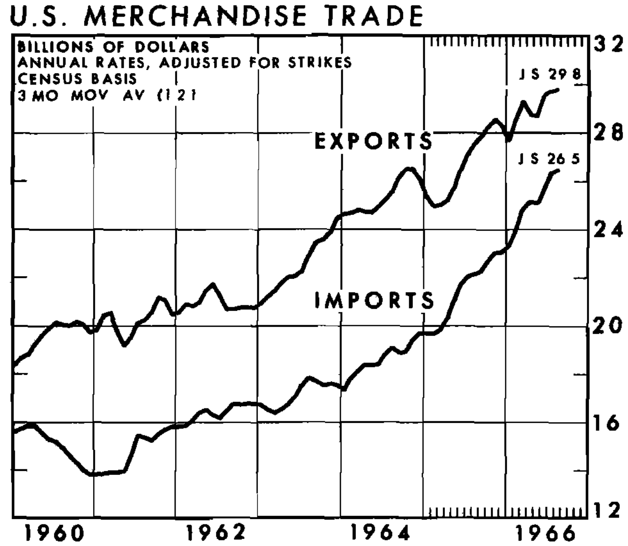
U.S. BALANCE OF PAYMENTS



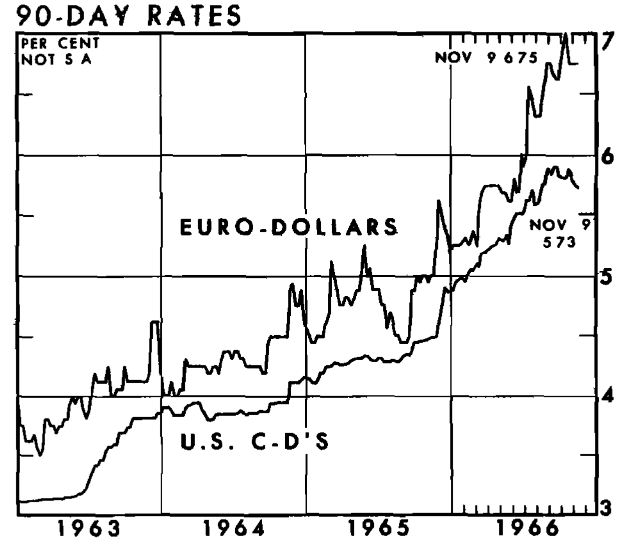
U.S. BANK CREDIT OUTFLOWS



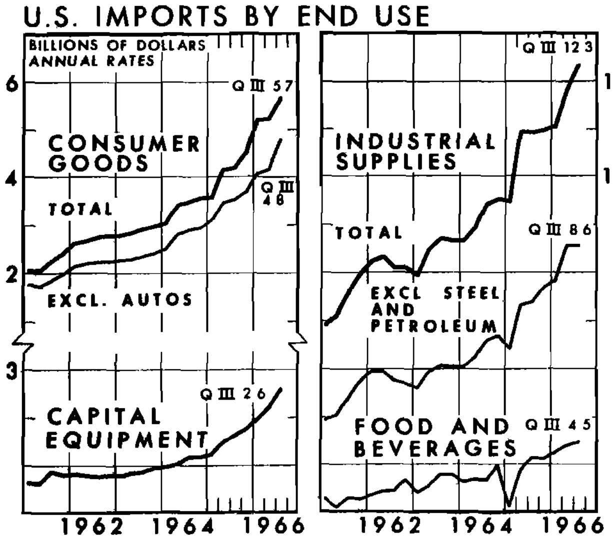
U.S. MERCHANDISE TRADE



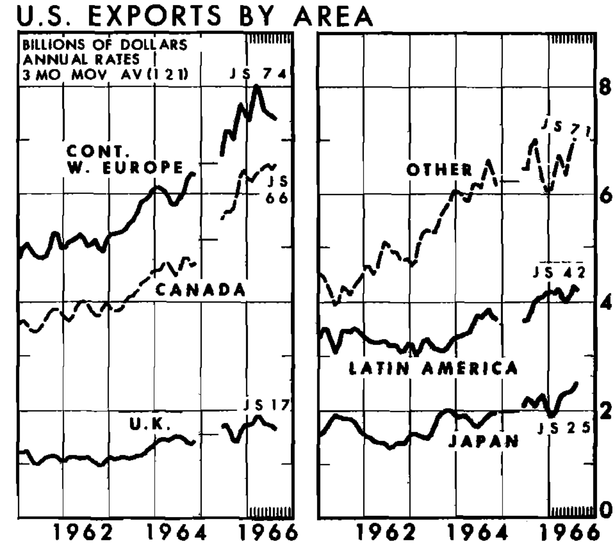
90-DAY RATES



U.S. IMPORTS BY END USE



U.S. EXPORTS BY AREA



APPENDIX A: A REVISED INDEX OF MANUFACTURING CAPACITY*

A new set of estimates of capacity utilization in U.S. manufacturing industries will be described and published in the November Federal Reserve Bulletin. The estimates are a revision of figures which have been prepared within the Federal Reserve System for the past six years. In spite of the revision, they remain crude estimates, subject to much larger measurement errors than many other time series in common use.

The method used to calculate the present capacity estimates can be summarized in a few sentences. The general level and major movements of capacity utilization in the estimates are those which emerge from McGraw-Hill surveys of capacity utilization of manufacturing companies. Dividing these utilization rates into Federal Reserve indexes of production gives the general level and trend of the capacity estimates. The final capacity estimates are extrapolated before the earliest utilization survey and beyond the most recent one through the use of capital stock estimates and McGraw-Hill survey information on yearly capacity changes. These two sources of information, finally, are also used to smooth the capacity estimates during the period of the utilization surveys.

The new estimates differ from the old for three reasons: (1) separate estimates have been prepared of capacity (and of utilization) for two subgroups of manufacturing, primary processing industries and advanced processing industries; (2) on the basis of recent evidence, it is now assumed that respondents to the McGraw-Hill surveys adjust their responses for seasonal variation; and (3) the estimates are based on additional year's data for all the time series involved, and a completely different set of data for estimates of the stock of capital goods owned by manufacturers.

The changed assumption about seasonal adjustment makes the new estimates of utilization a point or two lower than the old ones for the last ten years. Earlier we had assumed that the end-of-year utilization rates that companies reported to McGraw-Hill were not adjusted for seasonal variation; because the end of the year is, on balance, a slack season for manufacturing production, our seasonally adjusted utilization rates were above the figures reported by McGraw-Hill. Now we assume that the rates reported to McGraw-Hill are seasonally adjusted and our seasonally adjusted utilization estimates are lower than they were, and no longer above the McGraw-Hill reported rates.

*Prepared by Frank de Leeuw, Senior Economist, National Income, Labor and Trade Section, Division of Research and Statistics.

The seasonal effect is also responsible in large part for a slight widening of the gap between the old and revised series over the last 8 or 9 years, because the implicit December seasonal factor in the industrial production index has declined slightly during that period.

As for the other divergences, including a slight excess of the revised over the earlier estimates for the first few years, a great many minor changes in data are responsible and no one factor is dominant.

Estimated utilization rates for a new breakdown of total manufacturing for primary processing industries and advanced processing industries generally move in the same direction, as seen in the tables, but the two show some significant differences during peak periods. Primary processing industries reached their highest postwar utilization rate just after the outbreak of the Korean War, whereas advanced processing industries did not reach their postwar peak until near the end of that conflict. In 1965, primary processing utilization was not so high as it had been in 1955-56 but advanced processing utilization was as high as in the earlier period.

The new utilization estimates will be prepared after the end of each quarter and will be sent on a regular basis to anyone interested in obtaining them.

November 1966

TOTAL MANUFACTURING OUTPUT AS A PER CENT OF CAPACITY
(Seasonally adjusted)

	I	II	III	IV
1948	88	88	88	86
1949	82	78	78	76
1950	80	87	94	95
1951	96	95	91	90
1952	91	88	88	95
1953	96	96	95	88
1954	84	83	82	84
1955	87	90	91	91
1956	89	88	86	88
1957	87	85	84	79
1958	72	71	75	78
1959	81	85	81	80
1960	84	82	80	77
1961	75	78	80	82
1962	82	83	83	82
1963	82	84	84	84
1964	85	86	87	87
1965	89	89	89	89
1966p	91	91	91	

Note: Estimates based on data from Federal Reserve Board, Department of Commerce, and McGraw-Hill Economics Department.

p - Preliminary.

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OUTPUT OF PRIMARY PROCESSING INDUSTRIES AS A PER CENT OF CAPACITY
(Seasonally adjusted)

	I	II	III	IV
1948	89	90	89	87
1949	83	77	77	75
1950	83	91	98	99
1951	100	100	95	92
1952	92	84	87	96
1953	96	97	95	87
1954	82	82	82	85
1955	89	93	95	95
1956	93	92	86	91
1957	89	87	87	80
1958	71	71	77	80
1959	83	89	78	79
1960	86	82	79	74
1961	72	78	81	82
1962	83	82	81	81
1963	82	85	84	84
1964	86	87	88	89
1965	90	90	90	89
1966p	91	92	91	

Note: Estimates based on data from Federal Reserve Board, Department of Commerce, and McGraw-Hill Economics Department.

p - Preliminary.

November 1966

OUTPUT OF ADVANCED PROCESSING INDUSTRIES AS A PER CENT OF CAPACITY
(Seasonally adjusted)

	I	II	III	IV
1948	88	87	86	85
1949	82	79	79	77
1950	79	84	91	92
1951	93	91	88	89
1952	90	90	90	95
1953	96	96	94	89
1954	85	83	83	82
1955	85	88	88	89
1956	86	86	86	86
1957	85	84	82	78
1958	73	72	74	76
1959	79	82	83	80
1960	83	82	81	79
1961	76	78	80	82
1962	82	83	84	83
1963	83	83	84	84
1964	84	85	85	85
1965	88	88	88	89
1966p	91	91	91	

Note: Estimates based on data from Federal Reserve Board, Department of Commerce, and McGraw-Hill Economics Department.

p - Preliminary.