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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

January 6, 1966

International Developments

The Bundesbank's discount rate has been reduced, effective January 6, from 5 per cent to 4-1/2 per cent. The rate on advances has been cut by 3/4 of 1 per cent, from 6-1/4 per cent to 5-1/2 per cent. The Bundesbank's selling rates for money market paper were reduced in two stages of 1/4 per cent each, one a week ago and one today, making the 60-to-90 day rate again equal to the discount rate, at 4-1/2 per cent.

The discount rate change was widely anticipated in Germany in view of the current weakness in the economic situation and recommendations that have come from government leaders in recent weeks. From the Bundesbank point of view the action was made easier by the commitment labor leaders gave the Economics Minister in the latter part of December, to moderate their demands for wage increases this year. However, unbalanced budgets of the Federal and State governments are still a source of concern to the Bundesbank. The half-of-one-point reduction in the rate was less than government leaders had urged.

Corrections

Page II-1.- The heading should be THE ECONOMIC PICTURE IN DETAIL, The Nonfinancial Scene.

Page III-15.- The page number is repeated but the text follows properly.

Page IV-13 - First paragraph: delete the last sentence, which takes insufficient account -- especially for the first half of 1966 -- of factors such as the replenishment of foreign central bank reserves as borrowers of Euro-dollar loans use the proceeds.

Page IV-12 - Table: in column heading, change "1950" to "1965."

SUPPLEMENTAL APPENDIX A: SURVEY OF BANK LENDING PRACTICES, DECEMBER 15, 1966*

The results of the December 15 survey of changes in bank lending practices are summarized in the following paragraphs and accompanying table. Reports have been received from 76 of the 81 banks included in the quarterly interest rate survey. The 5 reports not yet received are all for West Coast banks.

In marked contrast to other recent quarters, over half of the banks (43 out of 76 banks) indicated that loan demand was unchanged in the last quarter of 1966 and an additional 22 banks stated it was moderately weaker. "Moderate" firming of loan demand was indicated by only 11 banks, a smaller number with firmer demand than in any previous survey since September 1964, when banks began submitting this information. Aside from seasonal variation, anticipated loan demand in the first quarter of 1967 was expected to be unchanged or moderately weaker at four-fifths of the banks.

During the fourth quarter, most banks found that earlier firming in their lending practices had been adequate and that no further change was required. Among the relatively few banks that had changed specific practices on loans to business borrowers and finance companies, such as in interest rates and compensating balances, most had firmed them "moderately" and virtually none had eased. Similarly, most banks that changed practices with respect to reviewing credit lines and extending loans to new versus established customers also firmed them "moderately." However, easier policies were reported by 5 banks on loans to new customers and by 6 banks on loans to established customers, presumably reflecting in part the recent softening in loan demand.

Three-fourths of the banks reported no change in their willingness to make term loans to business, consumer instalment loans, various categories of mortgage loans, broker and dealer loans, and participations. Those banks that did report a change generally became "moderately" less willing to extend these types of credit. However, some forms of lending were more attractive than formerly. For example, 9 banks reported that they were more willing to make consumer instalment loans and 6 banks to make participation loans and single-family mortgage loans.

Among the banks that gave reasons for their policy changes, one indicated that as a result of considerable firming earlier in the

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

year, outstanding loans were down from the summer peak; and this, coupled with fewer requests for loans, put them in the position to seek new business. Other banks also indicated that the peak in lending had been reached earlier in the year and with some improvement in their liquidity, they were cautiously making increases in their loan commitments.

With respect to mortgage lending, an area in which many banks had indicated reluctance to lend in the September survey, one bank pointed out that this reluctance sprang not from the type of lending but from inability to attract savings. Several banks that reported firmer policies in this survey indicated that the run-off in their CD's had been an important factor in bringing about the change.

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QUARTERLY SURVEY OF CHANGES IN BANK LENDING PRACTICES AT SELECTED LARGE BANKS IN THE U.S. 1/
(Status of Policy on December 15, 1966, Compared to Three Months Earlier)
(Number of banks)

	Total		Much Stronger		Moderately Stronger		Essentially Unchanged		Moderately Weaker		Much Weaker	
	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.
Strength of Demand for Commercial & Industrial Loans (after allowance for seasonal variation) Compared to Three Months Ago	76	81	--	24	11	30	43	22	22	5	--	--
Anticipated Demand in Next 3 Months	76	81	1	16	14	40	50	23	11	2	--	--

	Number Answering Question		Much Firmer Policy		Moderately Firmer Policy		Essentially Unchanged Policy		Moderately Weaker Policy		Much Weaker Policy	
	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.
Lending to Nonfinancial Businesses												
Terms and conditions												
Interest rates charged	76	81	5	52	12	27	59	2	--	--	--	--
Compensating balances	76	80	6	39	19	28	51	13	--	--	--	--
Standards of credit worthiness	76	80	6	22	7	18	63	40	--	--	--	--
Maturity of term loans	76	80	5	25	9	20	50	34	2	--	--	1
Reviewing Credit Lines or Loan Applications												
Established customers	76	81	2	11	8	49	60	21	6	--	--	--
New customers	76	80	8	60	13	16	50	4	5	--	--	--
Local service area customers	75	80	2	8	8	48	61	24	4	--	--	--
Nonlocal service area customers	75	79	8	48	13	19	54	12	--	--	--	--
Factors Relating to Applicant 2/												
Value as depositor or source of collateral business	76	80	7	54	13	15	56	11	--	--	--	--
Intended use of the loan	76	80	6	44	8	22	61	14	1	--	--	--

(continued)

	Number Answering Question		Much Firmer Policy		Moderately Firmer Policy		Essentially Unchanged Policy		Moderately Weaker Policy		Much Weaker Policy	
	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.
Lending to "Noncaptive Cos.												
Terms and Conditions												
Interest rate charged	76	80	2	31	5	33	69	16	--	--	--	--
Compensating balances	76	80	5	19	10	23	61	38	--	--	--	--
Enforcement of bal. requirements	76	80	6	29	18	18	52	33	--	--	--	--
Establishing new or larger credit lines	75	79	12	60	10	6	52	13	1	--	--	--

	Number Answering Question		Considerably less willing		Moderately less willing		Essentially Unchanged		Moderately more willing		Considerably more willing	
	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.	4Q.	3Q.
Willingness to Make Other Types of Loans												
Term loans to businesses	76	80	7	45	9	24	59	11	1	--	--	--
Consumer instalment loans	75	79	--	2	6	18	60	57	9	2	--	--
Single family mortgage loans	75	78	4	17	9	28	56	32	5	1	1	--
Multi-family mortgage loans	75	77	8	39	9	17	58	20	--	1	--	--
All other mortgage loans	75	79	7	43	11	18	57	18	--	--	--	--
Participation loans with correspondent banks	76	79	2	19	4	36	64	24	6	--	--	--
Loans to brokers	75	79	6	20	8	31	60	28	1	--	--	--

1/ Survey of Lending Practices at 76 Large Banks Reporting in the Federal Reserve Quarterly Interest Rate Survey as of December 15, 1966. Reports for 5 banks that regularly report were not available.
2/ For these factors, firmer means the factors were considered more important in making decisions for approving credit requests, and weaker means they were less important.

SUPPLEMENTAL APPENDIX B: THE U.S. BALANCE OF PAYMENTS IN THE 3RD QTR. 1966*

Detailed figures for the U.S. balance of payments in the third quarter of 1966 are summarized in the tables below. The published liquidity deficit for the quarter was at an annual rate of less than $1 billion, but in the absence of a number of special official transactions, it would have been at a rate of more than $2 billion. The following notes focus particularly on items for which monthly data are not available and which have not, therefore, been covered in regular Green Book reporting.

Current account and Government capital transactions.--Military expenditures abroad increased further, reaching an annual rate of $3.7 billion, with outlays in the Far East running at an annual rate $950 million higher than before the escalation of the Viet Nam war. After deducting military sales, net military expenditures were at an annual rate of $2.9 billion in the third quarter (see Table 1).

Net payments for foreign travel (seasonally adjusted) were reduced during the third quarter; increased outlays by American tourists abroad were more than offset by the growth of travel receipts from foreigners visiting the United States. Other service outlays were, on balance, little changed from the first half of 1966. Private investment income receipts expanded, but this gain was offset by increased payments to foreigners owing to the higher level of interest rates in the United States.

In consequence mainly of the increase in military expenditures and the adverse movement of the trade balance (previously reported in the Green Book), the surplus on goods, services, pensions and remittances fell further to an annual rate of $3.8 billion from $4.5 billion in the second quarter and nearly $6.0 billion in 1965. During the third quarter, there was a slight increase in the outflow of Government grants and loans apart from the advance debt payments received from France and Italy.

U.S. private investment abroad.--Direct investment fell back from the exceptional level reached in the second quarter when there was a very large takeover transaction and when oil companies were shifting funds to their subsidiaries abroad to meet some exceptional tax payments. The annual rate of direct investment outflow in the third quarter (seasonally adjusted) was $2.8 billion, and for the first three quarters of 1966 it averaged $3.15 billion, compared with $3.4 billion for the year 1965. To be counted as an offset against this, long-term security issues and other borrowings abroad by U.S. ("Delaware") corporations to finance direct investments were at a rate of only $0.1 billion in the third quarter, compared with a three-quarter rate of $0.7 billion and a 1965 total of $0.2 billion.

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* Prepared by Thomas M. Klein, Economist, Special Studies and Operations Section, Division of International Finance.

Table 1. U.S. Balance of Payments: Summary
(In billions of dollars; seasonally adjusted annual rates)

	Year 1964	Year 1965	1966 Q-1	1966 Q-2	1966 Q-3
Balance on goods, services, pensions and remittances	7.6	6.0	5.3	4.5	3.6
Exports, f.o.b.	25.3	26.3	28.7	28.4	29.8
Imports, f.o.b.	-18.6	-21.5	-24.0	-25.0	-26.6
Trade surplus	6.7	4.8	4.7	3.4	3.1
Investment income (net)	4.0	4.2	4.4	4.6	4.4
Foreign travel (net)	-1.1	-1.2	-1.2	-1.2	-1.2
Military expenditures less sales	-2.1	-2.0	-2.6	-2.6	-2.9
All other	.1	.1	.1	.3	.2
Government grants and loans	-3.6	-3.4	-3.8	-3.9	-3.2
of which: Nonscheduled debt repayments	(.1)	(.2)	(-)	(-)	(.9)
U.S. private capital flows (net)	-6.5	-3.7	-3.7	-4.4	-2.9
Direct investment	-2.4	-3.4	-2.8	-3.9	-2.8
Foreign securities	- .7	- .8	-1.3	-	- .4
Bank-reported claims	-2.5	.1	1.1	- .5	.5
Other	- .8	.3	- .7	-	- .1
Foreign capital flow, net, excl. change in liquid dollar assets	.7	.2	1.2	3.8	1.1
Net errors and omissions	-1.0	- .4	-1.2	- .7	.5
Balance on liquidity basis	-2.8	-1.3	-2.2	- .6	- .9
Plus: Liquid liabilities to foreign commercial banks	1.4	.2	.9	2.0	4.7
Plus: Liquid liabilities to other foreign private	.3	.3	.6	.2	.3
Plus: Liquid liabilities to international organizations	- .2	- .3	- .1	-1.4	-
Less: Selected non-liquid liab. to foreign official	.3	.1	.1	1.0	.4
Balance on official reserve transaction basis	-1.6	-1.3	-1.0	- .9	3.8

Source: Survey of Current Business: December 1966.
Note: Details may not add to totals due to rounding.

In consequence of the reduction in direct investment outflow and the re-emergence of the inflows of bank-reported claims (previously reported), the net outflow of U.S. private capital after deduction of "Delaware corporation" borrowing abroad was at an annual rate of $2.7 billion, compared with $3.2 billion in the second quarter.

Foreign capital inflows.--Foreign nonliquid investment in the United States, apart from "Delaware corporation" issues, was at an $0.9 billion annual rate compared with $1.5 billion in the first half year (see Table 2). The difference was more than accounted for by special transactions shifting funds of international institutions and foreign monetary authorities from liquid to nonliquid investments.

Foreign liquid fund inflows.--Foreign commercial banks (especially foreign branches of U.S. commercial banks) increased their liquid claims on the United States by more than $1 billion in the third quarter as the result of the sterling crisis and as a consequence of active borrowing by U.S. banks in the Euro-dollar market.

Errors and Omissions.--In the preliminary accounts for the third quarter, there is a favorable shift in the errors and omissions item as compared with preceding quarters. It is believed to reflect largely a shift in unrecorded private capital inflows.

Reserve movements.--As a result of the relatively small deficit on the liquidity basis, the large build-up of funds by foreign commercial banks, and other liquid fund inflows (see bottom part of Table 1), official reserve transactions reflected a U.S. surplus in international payments. Despite this favorable result, reduction in the U.S. monetary gold stock plus drawings on the I.M.F. gold tranche came to around $500 million in the quarter, as foreign monetary authorities drew down their liquid assets in the United States (see Table 3).

Table 2. Foreign Investment in the United States other than in Liquid Dollar Assets
(In millions of dollars seasonally adjusted)

	1965	1966 Q-1	1966 Q-2	1966 Q-3
TOTAL NET INFLOW	194	289	960	263
Less: U.S. corporate borrowing abroad to finance foreign investment	206	184	310	35
NET INFLOW ON OTHER TRANSACTIONS	-12	105	650	228
1. Net purchases of non-liquid assets by international organizations and foreign official agencies 1/	168	129	573	115
2. U.K. sales of U.S. securities other than U.S. Treasury issues 1/	-520	-42	-46	-19
3. Nonconvertible Roosa bonds	-7	-53	-26	-23
4. Foreign direct investment in the U.S.	71	37	11	-135
5. All Other	276	34	138	290

Source: Survey of Current Business, December 1966.
1/ U.K. purchases of U.S. agency securities are included in line 2 rather than line 1.

Table 3. U.S. Balance of Payments: Official Reserve Transactions
(In millions of dollars)

	Changes 1965	Changes 1966*/ Q-1	Changes 1966*/ Q-2	Changes 1966*/ Q-3	Outstanding Sept. 30, 1966
Official reserve assets (increase -)					
I.M.F. gold tranche	-94	134	22	335	372
Gold	1,665	68	209	173	13,356
Convertible currencies	-349	222	-163	-426	1,148
Total	1,222	424	68	82	14,876
Liquid liabilities to:					
Foreign central banks and governments	-51	-982	40	-642	13,787
I.M.F.	34	131	18	28	1,011
Selected non-liquid liab. to foreign central monetary authorities	100	25	254	105	1,035
Total	1,305	-402	380	-427	

Source: Survey of Current Business, December 1966.
*/ Not seasonally adjusted.