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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

April 9, 1965

SUPPLEMENTAL NOTES

The Domestic Economy

Further strengthening in the labor market was confirmed by the establishment data for March. Nonfarm employment, average hours of work and earnings in manufacturing industries all advanced.

Nonfarm employment rose 225,000 to 59.9 million and was at a level 2.1 million higher than a year earlier. Manufacturing employment rose further to 17.8 million, but the gain of 45,000 was lower than in other recent months in part because of the can strike. Transportation equipment showed a rise of 25,000 and machinery and electrical equipment accounted for most of the rest of the increase in manufacturing. Gains slowed somewhat in construction and State and local government but continued strong in trade and services.

The average factory workweek increased 0.2 hour to 41.5 hours (seasonally adjusted) reflecting more overtime in the durable goods sector, particularly at automobile plants. Average hourly earnings in manufacturing advanced 1 cent to $2.60 and were 3-1/2 per cent higher than a year earlier. Weekly earnings rose to $107.38.

Following the announcement of the British budget on Tuesday, the tone of markets for both corporate and municipal bonds strengthened. The two new utility issues were well received at an average yield--adjusted to Aaa basis--of 4.44, up 1 basis point from last week. Reception of Wednesday's issue--80 per cent sold the first day--focused investor interest on other recent offerings and unsold balances still in syndicate were reduced. Dealers also succeeded in moving from inventory large portions of recently issued bonds of State and local governments. This trend was probably reinforced by the surprise cut in the French bank rate on Thursday.

On Thursday, common stock prices responded favorably to President Johnson's Viet Nam speech, closing at 87.04--up .49, the largest daily advance since February 24. Trading volume, which had been declining, reached 5.8 million shares, the highest daily total since March 15.

International Developments

The U.K. budget presented on April 6 imposes some restraint on the expansion of domestic demand. Whether it is sufficiently restrictive to restore confidence in sterling is not yet clear. Immediate reactions in the foreign exchange market to the budget speech were not unfavorable. The Chancellor's speech was designed to get a good press, and did.

Toward the objective of improving the balance of payments on current and long-term capital account, taxes are raised and certain measures are being taken in the exchange control field.

Increases in alcohol and tobacco taxes, motor vehicle license fees, and postal rates, estimated to bring in about £200 million, are counted on--together with tax changes already announced last October--to benefit the balance of payments by restraining consumer spending.

The most important measures of exchange control appear to be the following. (1) In providing foreign exchange for direct investment abroad, the authorities will use stiffer criteria of the balance-of-payments benefits. (2) U.K. residents will be required to convert into stering 25 per cent of foreign currency proceeds from sale of foreign securities and of direct investments. The Chancellor estimated that these and the other control measures should reduce net capital outflows by £100 million ($200 million) in the current fiscal year.

Toward the Government's second major objective--that of ensuring steady economic growth--the Chancellor avoided any increase in taxes on consumer durables. Past experience has indicated that increasing those taxes would have undesirable effects on investment and planning in the capital goods sector. However, the Chancellor asked for extension of power to raise "regulator" taxes--including purchase tax on durables--and served notice that this power would be used later in the year if conditions required.

Despite the tax increases, the over-all budget deficit was put at £657 million for 1965-66; expenditure estimates published earlier were not much altered. This is a fairly sizeable deficit. Last year's original estimate for 1964-65 was £791 million, but the rise in GNP and revenues reduced the actual deficit to £386 million in the fiscal year just ended. A substantial part of the increase now estimated for the current year results from shifting £130 million of local authority financing from the market to the Exchequer. Another £64 million reflects year-end debt payments to the U.S. and Canada, waived last year.

Longer-run policies of the British Government aim at keeping costs down by an effective "incomes policy," and at encouraging domestic private investment by changes in the tax structure. The new company tax, which first applies to company fiscal years ending after December 31, 1965, moves toward the U.S. system of taxing corporations on their entire income while taxing stockholders on dividends; the change is designed to encourage ploughing back of earnings. On the other hand, changes in the taxation of U.K. companies operating abroad will force additional repatriation of earnings to pay U.K. tax; future benefits to the balance of payments from this and other features of the new company tax are put at £100 million a year.

The Bank of France's basic discount rate was reduced from 4 to 3-1/2 per cent on April 8. Whereas the recent cut in taxation of dividends was primarily a long-range stimulant to investment, the discount rate reduction is viewed as an anti-recession measure. Internationally, it is a timely gesture of cooperation, but French exchange controls and other regulations severely limit the possible effects on flows of funds.

Sweden's discount rate has been increased from 5 to 5-1/2 per cent effective April 9. This is the fourth increase since credit policy was tightened in mid-1963. Inflationary pressures in the Swedish economy are still troublesome. The Bank of Sweden has now warned Swedish commercial banks that it will require them to hold non-interest-bearing deposits in the central bank if they act to circumvent the domestic credit squeeze by borrowing abroad.