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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

June 9, 1965

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IN BROAD REVIEW

Recently available information is consistent with earlier evidence of a slowdown in the pace of economic expansion. A period of testing is apparently under way in many key areas. The sizable decline in stock market prices since mid-May is both a reflection of -- and an influence contributing to -- increased uncertainties about prospects.

The decline in the money supply in May, the moderation of loan demands in both April and May, the congested condition and higher yields in corporate and municipal bond markets are all making for less certainty with respect both to the business and financial outlook. Declining Treasury bill rates along with little change in other money markets rates are also adding to uncertainty.

On business demands, the latest official survey essentially confirms the increase in fixed capital spending this year shown by the official survey of three months earlier, rather than supporting the higher increase reported in the interim by McGraw-Hill. Inventory accumulation continues in large volume. The continued buildup in steel stocks through May has operated to maintain overall activity, but is generally interpreted as aggravating the subsequent adjustment problem. Retail sales apparently rose in May, but recent expansive strength has been mainly confined to nondurable goods; auto sales in May remained at the lower April level.

The labor market, although generally stronger with May unemployment down to 4.6 per cent, has experienced a tapering of the rate of growth in employment and, unexpectedly, in the labor force. Wage settlements recently appear to be pressing more firmly against the upper end of the range this year. Industrial commodity prices have risen a little further but the rise has remained selective. Expectations of rising prices do not appear to be a significant influence on forward buying and inventory building. But there have been marked price advances recently for livestock, meats, and fresh fruits and vegetables. Meat prices, because of reduced supplies -- particularly of pork, are likely to remain strong for some time.

A further though small U.S. payments surplus is indicated for May by partial data. Outstanding bank credit to foreigners declined by about $150 million in April. Most of the improvement in the payments balance in March and April resulted from a smaller net outflow of bank credit and from inflows of U.S. liquid funds from abroad.

The turn in the U.S. balance of payments around the beginning of March was partly matched by reduction of Continental European and Japanese payments surpluses. France, however, continued to have large surpluses in March and April.

Renewed weakness in foreign exchange markets for sterling appeared toward the end of May. On June 3, when the British Bank rate was reduced from 7 per cent to 6 per cent, requirements for minimum downpayments on instalment credit were increased.

June 8, 1965.

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SELECTED DOMESTIC NONFINANCIAL DATA

(Seasonally adjusted)

	Latest Period	Amount: Latest Period	Amount: Preced'g Period	Amount: Year Ago	Per cent change: Year Ago*	Per cent change: 2 Yrs. Ago*
Civilian labor force (mil.)	May '65	75.4	75.4	74.5	1.3	3.4
Unemployment (mil.)	"	3.5	3.7	3.8	-8.7	-18.7
Unemployment (per cent)	"	4.6	4.9	5.2	-	-
Nonfarm employment, payroll (mil.)	Apr. '65	59.9	60.0	57.8	3.6	6.3
Manufacturing	"	17.9	17.9	17.2	3.9	5.3
Other industrial	"	7.9	8.0	7.7	2.5	4.9
Nondustrial	"	34.2	34.1	32.9	3.8	7.2
Industrial production (57-59=100)	"	140.8	140.5	130.5	7.9	14.8
Final products	"	139.9	139.7	130.6	7.1	14.0
Materials	"	141.8	141.2	130.6	8.6	15.6
Wholesale prices (57-59=100)1/	"	101.7	101.3	100.3	1.4	2.0
Industrial commodities	"	101.7	101.6	100.8	0.9	1.5
Sensitive materials	"	101.6	101.4	99.3	2.3	5.3
Farm products and foods	"	100.2	99.0	97.8	2.5	2.7
Consumer prices (57-59=100)1/	"	109.3	109.0	107.8	1.4	2.9
Commodities except food	"	105.0	104.8	104.3	0.7	1.8
Food	"	107.3	106.9	105.7	1.5	2.9
Services	"	117.3	117.0	114.8	2.2	4.3
Hourly earnings, mfg. ($)	"	2.59	2.60	2.52	2.8	6.1
Weekly earnings, mfg. ($)	"	105.67	107.55	102.57	3.0	8.4
Personal income ($ bil.)2/	"	514.5	513.8	486.6	5.7	12.4
Retail sales, total ($ bil.)	"	22.9	22.8	21.4	7.1	12.9
Autos (million units)2/	May '65	8.1	8.2	7.8	4.0	12.4
GAF ($ bil.)	Apr. '65	5.2	5.2	4.9	6.0	17.2
Selected leading indicators						
Housing starts, pvt. (thous.)2/	"	1,548	1,546	1,531	1.1	-7.7
Factory workweek (hours)	"	40.8	41.4	40.7	0.2	1.7
New orders, dur. goods ($ bil.)	"	22.1	21.7	20.5	8.0	16.1
New orders, nonel. mach. ($ bil.)	"	3.1	3.1	2.9	6.9	21.7
Common stock prices (1941-43=10)1/	May '65	89.28	87.97	80.72	10.6	27.3
Inventories, book val. ($ bil.)	Apr. '65	112.0	111.3	106.4	5.3	10.5
Gross national product ($ bil.)2/	Q1-65	648.8	634.6	608.8	6.6	13.5
Real GNP ($ bil. 1964 prices)2/	"	641.5	630.6	612.9	4.7	9.3

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

SELECTED DOMESTIC FINANCIAL DATA

	Week ended June 4	Four-Week Average	Last six months High	Last six months Low
Money Market 1/ (N.S.A.)				
Federal funds rate (per cent)	4.09	4.07	4.12	2.00
U.S. Treas. bills, 3-mo. yield (per cent)	3.85	3.88	3.94	3.76
Net free reserves 2/ (mil. $)	-153	-161	256	-198
Member bank borrowings 2/ (mil. $)	518	500	572	122
Security Markets (N.S.A.)				
Market yields 1/ (per cent)				
5-year U.S. Treas. bonds	4.15	4.15	4.18	4.04
20-year U.S. Treas. bonds	4.22	4.22	4.22	4.15
Corporate new bond issues, Aaa	--	4.52	4.55	4.33
Corporate seasoned bonds, Aaa	4.45	4.44	4.45	4.41
Municipal seasoned bonds, Aaa	3.09	3.09	3.09	2.94
FHA home mortgages, 30-year 3/	5.45	5.45	5.45	5.45
Common stocks S&P composit index 4/				
Prices, closing (1941-43=10)	87.11	88.60	90.10	83.66
Dividend yield (per cent)	3.00	2.95	3.05	2.89

	Change in May	Average change-- last 3 mos.	Annual rate of change (%) 3 mos.	Annual rate of change (%) 1 year
Banking (S.A., mil. $)				
Total reserves	-46	107	5.9	6.2
Bank loans and investments: 5/				
Total	1,800	2,300	10.3	10.1
Business loans	900	900	18.4	17.6
Other loans	1,300	1,500	16.6	12.1
U.S. Government securities	-600	-600	-11.3	-3.0
Other securities	200	200	13.0	15.0
Money and liquid assets:				
Demand dep. & currency 6/	-1,100	100	0.8	3.2
Time and savings dep. 6/	1,100	1,200	11.0	14.5
Nonbank liquid assets	7/ 2,500	1,800	8.9	6.1

N.S.A.--not seasonally adjusted. S.A.--seasonally adjusted.
1/ Average of daily figures. 2/ Averages for statement week ending June 2.
3/ Latest figure indicated is for month of April. 4/ Data are for weekly closing prices. 5/ Changes based on data revised in accordance with the December 31 Call; may be subject to further revision. 6/ Based on preliminary revised data; not for publication. 7/ Change in April.

U.S. BALANCE OF PAYMENTS

	1965				1964			1964
	Apr.	Mar.	Feb.	QI	QIV	QIII	QII	Year
	Seasonally adjusted annual rates, in billions of dollars							
Balance on regular transactions				- 3.1	- 6.0	- 2.4	- 2.2	- 3.1
Current account balance					7.5	7.6	6.6	7.4
Trade balance 1/		10.4	- 0.3	3.9	7.1	6.6	5.8	6.6
Exports 1/		32.6	18.7	22.6	26.7	25.5	24.2	25.2
Imports 1/	-21.8	-22.2	-19.0	-18.7	-19.6	-18.9	-18.4	-18.6
Services, etc., net					0.4	1.0	0.8	0.8
Capital account balance					-11.8	- 9.0	- 8.7	- 9.5
Govt. grants & capital 2/					- 4.0	- 3.7	- 3.7	- 3.7
U.S. private direct inv.				(- 2.2)	- 2.6	- 2.4	- 2.2	- 2.3
U.S. priv. long-term portfolio				(- 3.0)	- 3.3	- 2.4	- 1.0	- 2.0
U.S. priv. short-term				(1.0)	- 2.2	- 1.6	- 2.2	- 2.1
Foreign nonliquid					0.5	0.8	0.5	0.5
Errors and omissions					- 1.7	- 0.7	- 0.3	- 0.9
	Monthly averages, in millions of dollars							
Deficit on regular transactions (seas. adjusted)				231	502	202	182	254
Additional seasonal element				162	- 6	- 135	- 14	---
Financing (unadjusted)	- 143	- 528	480	69	508	337	196	254
Special receipts 3/	0	0	0	19	51	1	- 10	27
Liabilities increase								
Nonofficial 4/	- 49	- 330	- 22	56	207	184	36	126
Official 5/	- 332	- 363	154	- 287	299	129	69	86
Monetary reserves decrease	238	165	348	281	- 50	23	101	14
of which: Gold sales	(159)	(354)	(215)	(277)	(57)	(- 7)	(- 24)	(10
Memo: Official financing 6/	(- 94)	(- 198)	(502)	(13)	(300)	(153)	(159)	(128

1/ Balance of payments basis which differs a little from Census basis.
2/ Net of associated liabilities and of scheduled loan repayments.
3/ Advance repayments on U.S. Govt. loans and advance payments for military exports: assumed zero in absence of information.
4/ Includes international institutions (except IMF), commercial banks and private nonbank.
5/ Includes nonmarketable bonds.
6/ Decrease in monetary reserves, increase in liabilities to foreign official institutions, and special receipts.

THE DOMESTIC ECONOMY

Industrial production. Available May production data indicate a continued high rate of output but data are too scant to determine whether the index was maintained or advanced further. A final estimate for April and a preliminary estimate of the May production indexes will probably be available late this Friday or early Monday.

Auto assemblies were at a seasonally adjusted annual rate of 9.5 million units in May compared with 9.4 million in April. June production schedules are set at the May rate. Output of trucks increased further in May to a record high and production of television sets was maintained at the April level.

In the three weeks following the interim steel agreement, steel ingot output declined 5 per cent; then in the next three weeks, ending June 5, rose 3 per cent. For May as a whole seasonally adjusted ingot production was down slightly. Among other materials, paperboard production rose to a new record and output of bituminous coal increased sharply, while output of crude petroleum and activity at refineries declined.

Consumer spending. Data for April and May suggest a moderate further increase in consumer expenditures in the second quarter. A rough estimate is $3-1/2 - $4 billion, annual rate, for goods and services, compared to the exceptional $11.5 billion reported for the first quarter. The difference is largely attributable to expenditures for automobiles, for which a decline in the vicinity of $2.5 billion is indicated in contrast to an increase of about $5.5 billion in the first quarter. Purchases of nondurable goods are showing another substantial increase although the month-to-month changes are, as usual, irregular. Altogether, the prospective increase in consumer purchases of goods is small while outlays for services are continuing their steady advance.

Revised retail sales data now show a slight increase from March to April rather than the slight decline reported earlier. In particular, April sales of nondurable goods stores were raised to about the February high. Weekly data for May indicate a significant further rise in total sales to a level close to, and perhaps exceeding, the February peak, despite the sharp reduction in auto sales since February. Sales of nondurable goods apparently rose sharply in May to a new high, with strength widespread among types of stores.

Automobiles. Unit sales of new domestic automobiles in May were at a seasonally adjusted annual rate of 8.1 million cars. This compared with 8.2 million in April and an average of 9.3 million in the first quarter. A Chevrolet dealers' contest increased sales early in May, but in the last 10-day period sales declined so that for the month sales were only 4 per cent above a year ago. In the current model year the average sales rate has been 8.3 million units. Dealer inventories of new cars at the end of May were 5 per cent larger than a month earlier and represented 42 days' supply, about average for this time of year.

Consumer credit. Consumers borrowed more heavily than usual to pay tax bills in April. Part of their borrowing took the form of personal instalment loans from banks, credit unions, and other lenders, and part of it was reflected in a sizable increase in single payment loans.

Consumers also borrowed somewhat more than they usually do in April to buy cars. The proportion of new cars bought on credit increased somewhat and this, together with higher used car sales, tended to offset the effect on total auto credit of a declining volume of new car sales. Nonauto consumer goods credit also rose in April, but in less striking fashion. Repair and modernization credit actually declined slightly.

The net effect of these changes was a record seasonally adjusted rise of $744 million in total instalment credit--and annual rate of $8.9 billion. During the first four months of 1965, instalment credit expanded at an annual rate of $8.1 billion, compared with $5.8 billion a year earlier. The April increase was a record in dollar amount only. In percentage terms, the increase ranked below several months in 1955 and 1959.

Noninstalment credit turned down in April, following sharp increases in the first three months. The reversal came about largely because of declining charge account activity which some observers linked to the pressure of tax payments. Charge accounts had been very active in the first quarter, approaching the high rates in the period immediately following the tax cut in 1964.

Delinquency rates on instalment loans at commercial banks dipped in April, according to the ABA series, following a period of gradual rise from last summer. The ratio of repayments to disposable income had increased to 14.3 per cent in the first quarter from 14.0 per cent in the final quarter of 1964. Lenders' standards, as reflected in down payments and contract maturities, have continued easier than a year or two ago, but there is little evidence of increased difficulty in collections.

Consumer buying plans. Changes in consumer spending in recent quarters are mostly attributable to the special circumstances affecting supplies of new autos. Underlying demands have been much steadier than the aggregate spending data themselves suggest.

Consumer demands for durable goods are still strong, according to the Census quarterly survey of consumer buying intentions conducted in April. Plans to buy a new car within 12 months were reported by 9.3 per cent of households in April -- the same high level as in January and moderately above the 8.9 per cent of the April 1964 survey. Reported intentions to buy used autos and houses were little changed from January and also from April 1964.

For household durable goods, 17.4 per cent of households reported intentions to buy within six months one or more of 7 major items, as compared with 16.3 per cent in January and 17.1 per cent in April 1964. The increase in demands for household durable goods were concentrated in the first half of the six-month planning period; in fact, stated intentions to buy in the second 3 months were lower than in January and in April 1964.

Business inventories. Such data as are available suggest that inventory accumulation in the second quarter is likely to remain at a high rate. These data include book value figures for April, the results of the Commerce May survey of manufacturers' inventory anticipations, and the maintenance through May of advanced levels of steel and auto output.

Book value. In April book value of nonfarm business inventories increased by $680 million, moderately below the average monthly increase of $760 million reported for the first quarter.

BUSINESS INVENTORIES
Book value changes, seasonally adjusted
in millions of dollars

	Average per month		April 1965
	Q4, 1964	Q1, 1965	
Total	568	763	680
Manufacturing	642	255	253
Durable	458	187	226
Nondurable	183	68	27
Retail	-154	308	381
Durable	-216	286	233
Nondurable	62	22	148
Wholesale	80	201	46
Durable	69	117	15
Nondurable	11	84	32

Retail stocks showed the largest advance in April with increases widespread among durable and nondurable goods lines. The rise in the automotive group amounted to $172 million.

In manufacturing, the increase of about $250 million was the same as the first quarter average and was also in line with manufacturers' anticipations for the second quarter as a whole, as reported in the Commerce survey conducted in May. Nearly all of the April rise at manufacturers was in durable goods industries, with most major groups showing increases. The major exception was the iron and steel producing industry where stocks showed a sizable decline as shipments spurted. Steel stocks held by consuming manufacturing industries again rose sharply, apparently accounting for the very sharp increase reported in stocks of materials and supplies held by durable goods industries. According to data from the Census survey, not adjusted for seasonal variation, holdings of finished steel shapes by these consumers increased 1.3 million short tons, compared with a rise of 1.2 million tons in March.

The stock-sales ratios of durable goods producers increased in April but remained low. The rise reflected a 2 per cent decline in shipments, because of a drop of 9 per cent in motor vehicles and parts, as well as the overall rise in stocks. The stock-sales ratio of non-durable goods manufacturers was unchanged from its very low March level.

Inventory anticipations. Manufacturers, on the basis of a Commerce survey conducted in May, expect their inventories to rise by about three-quarters of a billion dollars in both the second and the third quarters, seasonally adjusted. Durable goods manufacturers account for about two-thirds of the expected rise. At annual rates the anticipated total accumulation amounts to $3 billion, the same as the actual rise in the first quarter. They are also consistent with the April rate of accumulation.

Manufacturers' sales anticipations were more sanguine in May than reported in the February survey. Thus, durable goods manufacturers expected sales to be off only 1 per cent in the second quarter instead of the 3 per cent indicated earlier and then sales are expected to show a rise of 1 per cent in the third quarter. These anticipated changes are small in relation to the exceptional rise of 6 per cent realized in the first quarter because of the special developments in steel and autos. Nondurable goods manufacturers in May anticipated a rise of 2 per cent in the second quarter, compared to 1 per cent expected earlier, and they look for a further rise of 2 per cent in the third quarter. These anticipated increases are about in line with actual increases over the last year. It is below the 15 per cent increase indicated by the McGraw-Hill survey taken in late March and April. The difference is presumably due to the smaller McGraw-Hill sample which includes only the larger companies in each industry and has a more limited coverage of the "commercial and other" group.

The latest survey indicates that capital outlays will rise more rapidly in the second half of the year than in the first. As is shown in the table, however, the quarterly increases in prospect this year are considerably smaller than last year. Outlays in the fourth quarter of 1965 are indicated to be 9 per cent above a year earlier; spending in the fourth quarter of 1964 was 16 per cent above a year earlier.

NEW PLANT AND EQUIPMENT EXPENDITURES

	Quarter-to-quarter increases			
	1965		1964	
	Dollars 1/	Per cent	Dollars 1/	Per cent
1st quarter	1.25	2.6	1.35	3.3
2nd quarter	.60*	1.2	.95	2.2
3rd quarter	1.20*	2.4	2.15	4.9
4th quarter	1.30*	2.6	2.10	4.6

* Planned.
1/ In billions of dollars, seasonally adjusted annual rates.

Increases in expenditures for new plant and equipment this year are planned by all major industry groups, as shown in the following table.

EXPENDITURES FOR NEW PLANT AND EQUIPMENT

	Planned for 1965			Actual 1964	
	Dollar amount (billions)	Per cent increase		Per cent increase	
		1965 from 1964	4th Qtr. 1965 from 4th Qtr. 1964	1964 from 1963	4th Qtr. 1964 from 4th Qtr. 1963
All industries	50.4	12.2	9.1	14.5	15.9
Manufacturing	21.8	17.2	11.9	18.4	22.5
Durable goods	10.9	15.5	12.8	20.1	22.3
Nondurable goods	10.9	18.9	11.0	16.8	22.7
Mining	1.3	10.9	6.2	14.4	23.8
Railroads	1.6	15.6	17.4	28.2	14.8
Transportation, nonrail	2.6	10.9	6.2	24.0	23.8
Public utilities	6.7	7.2	5.2	10.1	9.5
Communications, commercial & other	16.4	8.1	6.9	9.5	9.0

Construction activity. The construction industry continued to be a relatively neutral factor in the economy in May. Seasonally adjusted new construction outlays changed little at a level just below the record set in March. Expenditures for residential construction remained at about the improved March rate and were only moderately below the peak for this series, reached in early 1964. Business and other private non-residential construction eased slightly in May from the record April figure but were considerably higher than a year earlier. Public construction expenditures continued unchanged at a level somewhat below earlier highs.

NEW CONSTRUCTION PUT IN PLACE

	May (billions)1/	Per cent change from	
		Month ago	Year ago
Total	$67.7	--	+ 4
Private	47.5	--	+ 4
Residential	27.0	--	+ 1
Nonresidential	20.5	-1	+ 7
Business	14.8	-1	+10
Public	20.3	--	+ 5

1/ Seasonally adjusted annual rate; preliminary.

Labor market. The job situation continued to show strength in May, although employment and the labor force since the start of the year have been exhibiting less expansive tendencies than in the comparable period last year. The May unemployment rate of 4.6 per cent was down slightly from 4.8 per cent in January. In intervening months the rate fluctuated between 5.0 and 4.7 per cent.

Employment advanced somewhat further in May but over half the increase was in farm employment. Nonfarm employment has risen only moderately in recent months, averaging about 50,000 a month since March. As shown in the table, the rise of 650,000 in total employment from January to May was considerably less than the 1.1 million gain reported in the same period last year. But the slower employment rise has been accompanied by a smaller rise in the labor force and unemployment has remained relatively low.

Over the past twelve months the labor force has increased by one million, considerably less than officially projected earlier. In

LABOR FORCE CHANGES
(Seasonally adjusted, thousands of persons)

	January to May 1965			January to May 1964		
	Labor force	Employ-ment	Unem-ployment	Labor force	Employ-ment	Unem-ployment
Total, all ages	529	653	-124	823	1,071	-248
14 to 19 years	521	491	30	239	173	66
Males 20 yrs. & over	122	234	-112	220	458	-238
Females 20 yrs. & over	-144	- 72	- 42	364	440	- 76

the twelve months ending May 1964 the labor force had increased by over 1.5 million. Only among youths have employment and labor forces gains this year been greater than earlier. The number of adult women in the labor force has declined since the start of the year and in May was only 200,000 larger than a year earlier. This compares with a rise of 800,000 over the preceding year. The sharp curtailment of women entrants into the labor force in part may be explained by the growing number of youths who are competing for the part-time or other jobs that earlier had been readily available for women. However, the combined labor force increase of adult women and youths is still well below the inflow reported in 1964 and this may reflect lessening of growth in job opportunities and some resultant withdrawal from the labor force of some marginal women workers.

On the other hand, strength of labor demand is seen in the recent sharp decline in unemployment among the long-term unemployed (15 weeks or more); their number was down to 700,000 in May, almost 300,000 less than a year ago. Unemployment in May was lower for adult men and women, and for married men unemployment remained at the relatively low rate of 2.5 per cent.

The jobless rate in May among teenagers continued in the vicinity of 15 per cent, as a rise in employment was about offset by an equivalent rise in the labor force. Both teenage employment and labor force have increased by 400,000 in the past year with little change in unemployment. By midsummer about 600,000-700,000 more youths are expected to be in the labor force than were in the labor force in mid-1964.

Prices. Over the past nine weeks, the wholesale commodity price index has increased about 1 per cent to 102.4 per cent of the 1957-59 average, a new high. Most of the increase reflects a rise of nearly 4 per cent in prices of foodstuffs brought about mainly by reduction in market supplies of fresh foods. The index for industrial commodities has edged up .2 per cent from its February-March level, and the end-of-May estimate is 1 per cent above the level around which the index fluctuated in the first nine months of last year.

The sharp rise in foodstuffs, to a point 6-1/2 per cent higher than a year ago, reflects delays in harvesting vegetables because of unfavorable weather and, more importantly, reduced marketings of livestock in response to low prices last year. Since mid-March prices of livestock have risen a fifth and those for meats more than a tenth. Government surveys of farmers' production plans indicate that reduced output and higher prices for livestock will continue for some months to come. The last comparable shift in the livestock situation occurred in 1957, and livestock prices rose about a third to a peak in the spring of 1958. The total wholesale and consumer price indexes rose appreciably in late 1957 and early 1958, provoking a certain amount of comment about "inflation in the midst of recession."

Industrial commodity price developments of recent weeks appear similar to those of last year, with rising prices for nonferrous metals and semifabricated products, stability in the average for steel mill products, increases for some types of machinery and equipment resulting in a slight upward drift in the group index, and selective and generally small changes among other industrial commodities. Thus an index for metals and machinery combined, which rose nearly 2 per cent last year, has increased .7 or .8 per cent further in the first five months of this year. An index for all other industrial commodities has remained relatively stable.

The consumer price index rose .3 per cent in April, mainly as a result of price increases for foods and gasoline along with the persistent rise for services. Apparel also edged up while used cars declined slightly and other consumer durable goods were virtually unchanged. A BLS review of the changes noted that cigarette taxes were raised in some states and that increases in college tuition were a significant factor in the April rise in services.

The April increase of .4 per cent in the retail food index reflected mainly increases for fruits and vegetables and eggs. By early in the month, when food prices are collected for the CPI, the sharp rise in livestock and wholesale meat prices had not yet been reflected in retail prices. Should retail meat prices show a rise of as much as

15 per cent from April to a summer peak, they would raise the total index by slightly more than .5 per cent.

A partial offset to the index-raising effect of meat prices would be provided by enactment of excise tax reduction on autos, appliances and some other goods and services. The effect on the total CPI, if the cuts are passed along to consumers, could be as much as .5 per cent by midsummer.

CONSUMER PRICE INDEX
1957-59 = 100

	Index April 1965	Per cent increase to April from: March 1965	Per cent increase to April from: April 1964
All items	109.3	.3	1.4
Services	117.3	.3	2.2
Food	107.3	.4	1.5
Commodities less food	105.0	.2	.7
Apparel	105.3	.3	.6
Other nondurables	107.6	.7	1.4
New cars	100.7	-.1	-.9
Used cars	120.6	-.9	-.2
Household durables	97.9	-.1	-.8

Agriculture. Reduced supplies of pork and beef in recent weeks have given a substantial boost to prices at the farm, and index of prices received by farmers in mid-May was 3 per cent higher than a month earlier and 6 per cent above mid-May 1964. Vegetables also added a fillip to farm prices but the main source of strength was in meat animals, especially hogs. Prices paid by farmers for family living, productive inputs, and overhead also increased in May, but by only 1 per cent, and the parity ratio increased to 78 (1910-14 = 100), 2 points higher than a month earlier and 3 points higher than a year earlier.

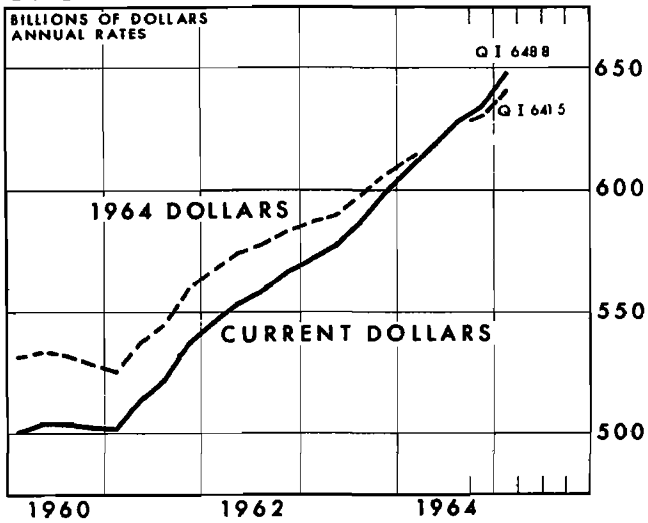
Meat animal prices are likely to continue strong throughout the year. Per capita supplies of red meat for 1965 as a whole will probably be about 3 per cent below the record supplies of last year because of sharply curtailed hog production. In the first quarter, with beef production up more than hog production was down, production of red meat averaged 1.7 per cent above a year earlier, an increase a little greater than the growth in population. In the current quarter however, beef production is not likely to quite equal to the high level of a year earlier and pork production is down sharply.

In the second half of the year, hog slaughter will continue substantially below year-earlier levels, according to inventory and pig crop data. As yet there is no evidence that hog producers are rebuilding breeding herds in response to the current favorable hog-corn price ratios. Fed beef production is likely to be about the same as in the second half of last year. In the absence of a USDA beef purchase program this year, however, fed beef available in commercial channels will probably be around 3 per cent greater. Fed cattle prices, however, should be maintained near year-earlier levels considering the high incomes of consumers, gains in population, and the relatively short supplies of pork in prospect in the second half of the year.

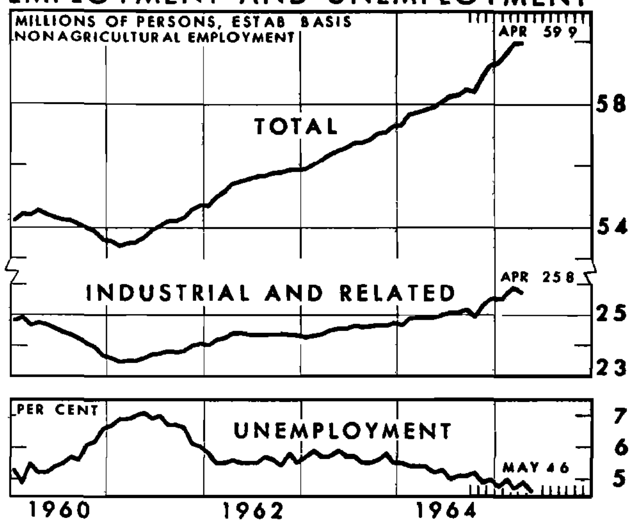
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

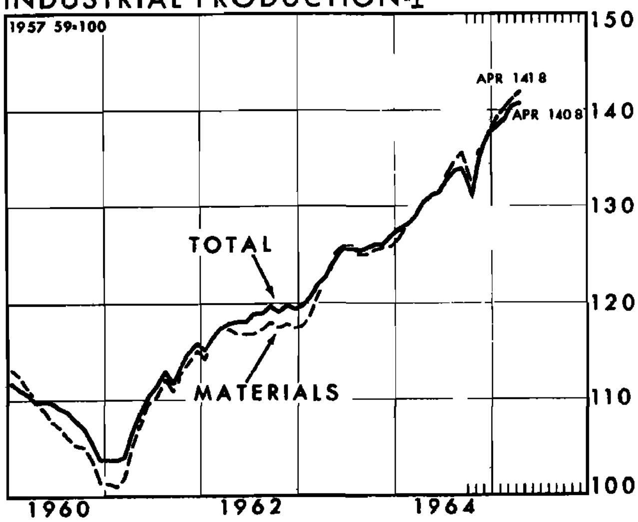
GROSS NATIONAL PRODUCT



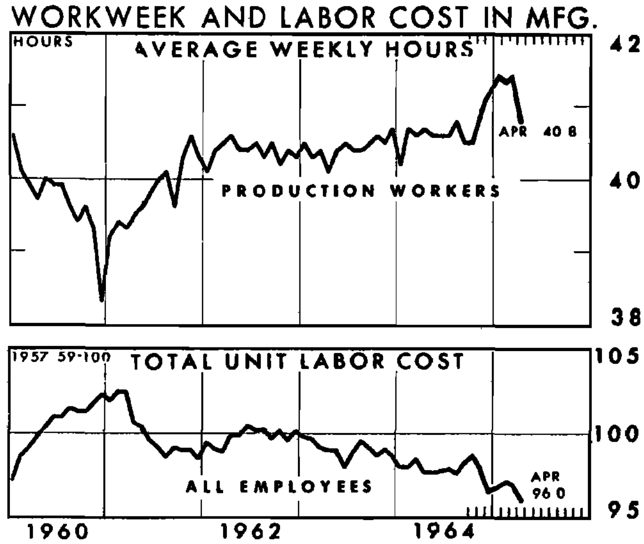
EMPLOYMENT AND UNEMPLOYMENT



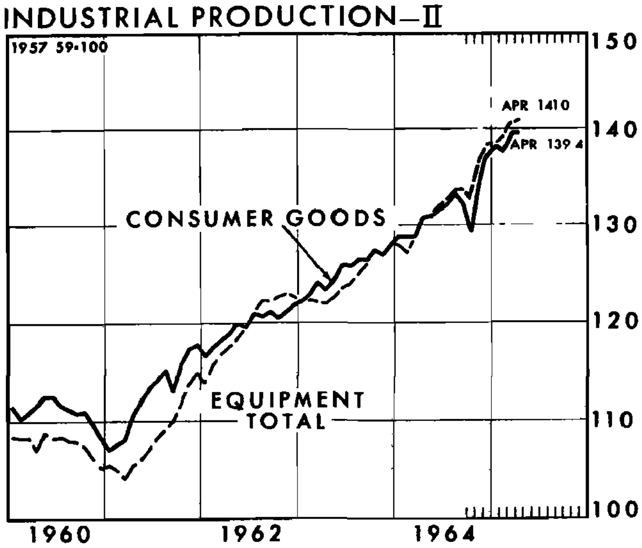
INDUSTRIAL PRODUCTION-I



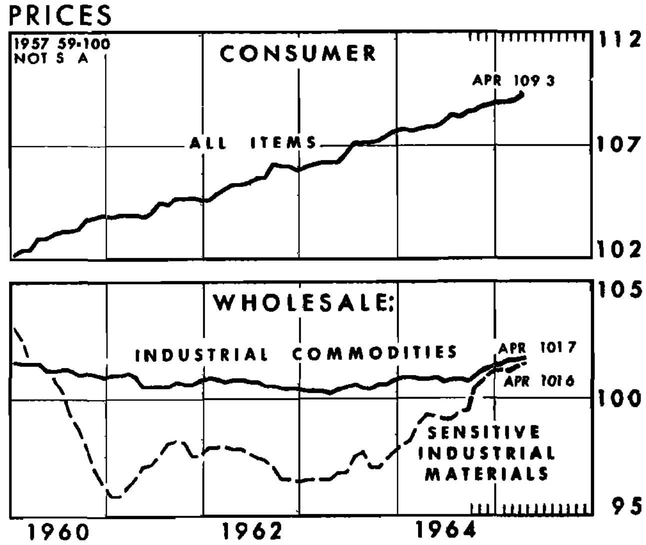
WORKWEEK AND LABOR COST IN MFG.



INDUSTRIAL PRODUCTION—II



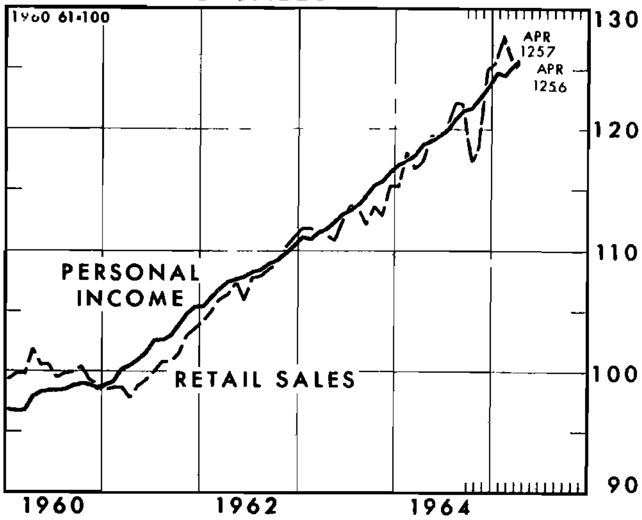
PRICES



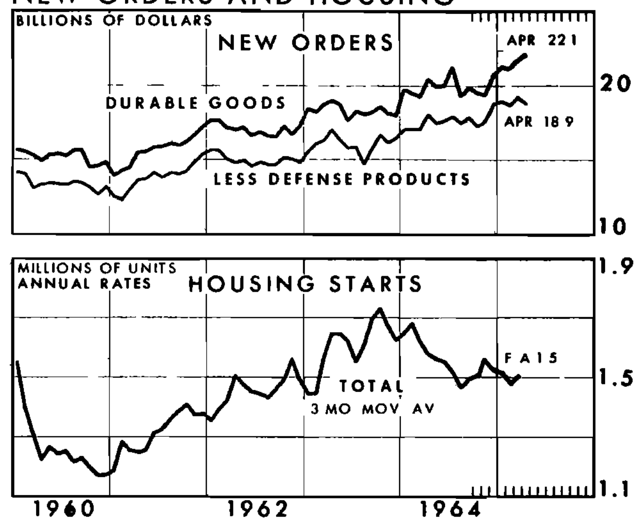
ECONOMIC DEVELOPMENTS - UNITED STATES

SEASONALLY ADJUSTED

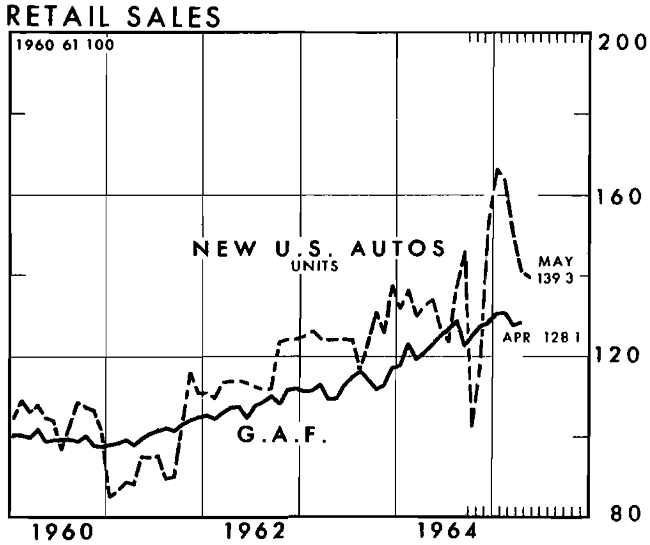
INCOME AND SALES



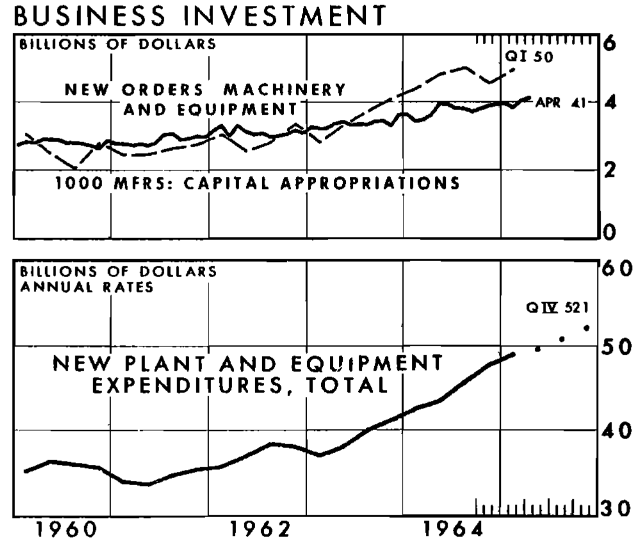
NEW ORDERS AND HOUSING



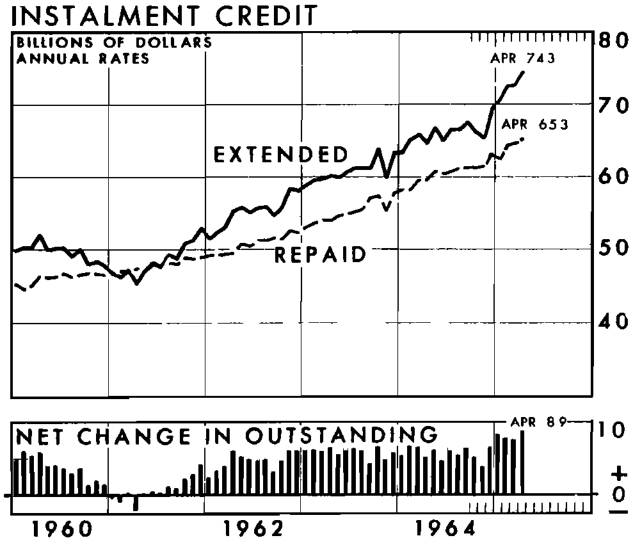
RETAIL SALES



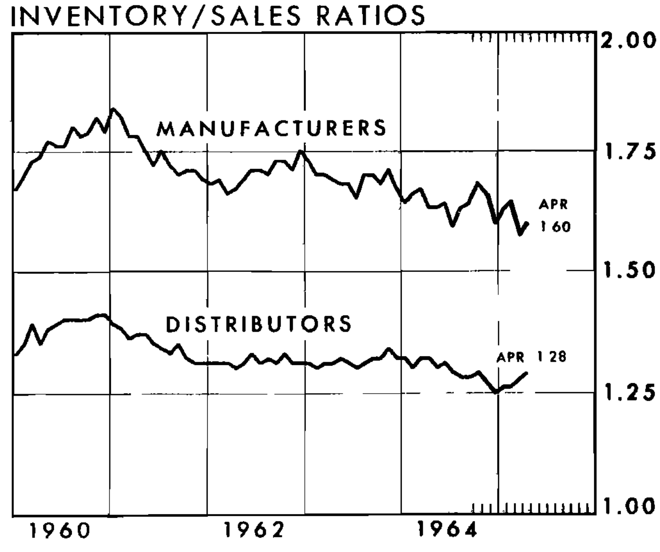
BUSINESS INVESTMENT



INSTALMENT CREDIT



INVENTORY/SALES RATIOS



DOMESTIC FINANCIAL SITUATION

Bank credit. The seasonally adjusted growth in bank credit during May was the same as in April -- $1.8 billion, as compared with a $2.8 billion average monthly increase in the first quarter. The increase of bank credit during the last two months has been at a less than 8 per cent annual rate, somewhat below the growth rate for the entire year 1964 and considerably below the unusual expansion during the first quarter of this year -- an annual rate of over 12 per cent.

The slowdown of the growth in bank credit since the first quarter has reflected a retardation in loan growth. Although the expansion of loans in May was higher than April, the annual growth rate of loans over the last two months was about the same as for 1964 as a whole -- a little less than 12 per cent -- and considerably below the 21 per cent annual rate of increase of the first quarter. Moreover, most of the April to May increase in loans occurred in financed loans.

While the unusual demands for loans in the first quarter associated with the dock strike, foreign loans, the high level of automobile sales, demands for business loans have remained high. These loans increased somewhat more rapidly in May than in April, but the increase over the two months, at an annual rate of 15.5 per cent, was considerably less than the first quarter.rate. City banks continued to show strength in loans to metals and metal products and textile firms, as well as in loans to trade and public utility companies.

Bank holdings of Treasury issues continued to decline at about the same average rate as earlier this year -- about $600 million a month -- and holdings of non-Treasury issues rose somewhat less than the average increase for March and April and much less than in January-February when time deposit inflows had accelerated.

NET CHANGES IN COMMERCIAL BANK CREDIT
(Seasonally adjusted, billions of dollars)

	May 1965 p	April 1965 p	Average monthly 1st Q 65 p	Average monthly April-May, 65 p
Total loans & investments	1.8	1.8	2.8	1.8
U.S. Gov't. securities	-0.6	-0.5	-0.6	-0.6
Other securities	0.2	1.0	0.5	0.6
Total loans	2.2	1.3	2.9	1.8
Business	0.9	0.7	1.3	0.8
Real estate	0.3	0.3	0.4	0.3
Consumer	0.3	0.5	0.3	0.4
Loans excluding security and nonbank financial	1.6	1.8	2.3	1.7
	Percentage Annual Rate of Increase			
Loans and investments	7.8	7.8	12.4	7.8
Loans	14.9	8.9	20.8	11.9
Business loans	17.2	13.5	26.1	15.5

Note: Changes are based on data revised in accordance with the December 31, 1964 call.

Money supply and time deposits. After expanding in March-April, the money stock (using the new, unpublished, seasonal factors) declined $1.1 billion to the January level of $159.5 billion. The decline was associated with a large increase in seasonally adjusted

Treasury deposits after mid-April, when tax payments were larger than usual. Projections suggest that these deposits will be drawn down sharply the first two weeks in June, contributing to an increase in the public's holdings of money. Since November, the money stock has increased less than 1 per cent (annual rate).

Time deposit growth in May slackened somewhat further from the March-April annual rate of growth of over 11 per cent to less than 10 per cent. Savings deposits at weekly reporting banks grew somewhat more rapidly than last year, but the increase in negotiable CD's outstanding was significantly less than in the same period last year, when the level of rates allowed nonprime banks to participate more heavily in this market.

Prime banks -- mainly in New York City -- were large issuers of CD's in April and early May, in part to restore liquidity, which had been depleted in meeting strong loan demands earlier in the year, as well as to anticipate further loan growth and sizable CD maturities in June. The acquisition of funds by the issue of CD's and the slowdown in loan growth improved reserve positions of prime New York City banks in April-May. This was reflected in a considerable reduction in their basic reserve deficit, their borrowings from the Federal Reserve, and their purchases of Federal funds.

Bank reserves. Average net borrowed reserves of member banks increased moderately from $132 million in April to $159 million in

May.[1/] Borrowings by member banks increased about $20 million, on the average, to $490 million in May, while excess reserves declined less than $10 million to $331 million.

The effective rate on Federal funds was 4-1/8 per cent for 13 of the 20 trading days in May and 4 per cent the remaining 7 days.

U. S. Government securities market. The most prominent development recently in the Treasury securities market was the relatively sharp decline in bill rates that followed the 1 percentage point reduction in the British bank rate on June 3. Prior to that time, bill rates had been tending to decline as continued investor demand was augmented by System purchases from dealers amounting to $562 million in the last two weeks of May (with an additional $249 million purchased from foreign accounts). With market bill demand already tending to outrun available supply at current yield levels, the reduction in the British discount rate was a critical factor which seemed to tip the market to the view that lower bill rates might prevail over the near-term.

In the weekly bill auction held on June 7, the 3-month bill was issued at average yield of 3.78 per cent, down 9 basis points from the week before. Other short-term rates--such as on CD's, bankers' acceptances, and finance company paper--did not decline along with bill rates in the recent period. For some time now, these other short-term rates have not reflected the relatively minor declines that have tended

1/ Based on the average of daily figures for all of the reserve weeks ending in the month as used in the reserve memorandum of the FOMC.

to develop in bill rates. It is not clear at this time, however, whether the most recent further widening of the spread between bill and other short-term rates will tend more to restrain declines in the former or more to put downward pressure on the latter.

While bill rates have been declining, yields on intermediate- and longer-term U. S. Treasury notes and bonds were under upward pressure for much of the period since completion of the May refunding. But so far these pressures have been relatively minor, have been tempered by official account bond purchases, and most recently have diminished.

YIELDS ON U. S. GOVERNMENT SECURITIES

Date (Closing bids)	3-month bills	6-month bills	3 years	5 years	10 years	20 years
1965						
Highs	4.00	4.05	4.16	4.18	4.24	4.22
Lows	3.76	3.86	4.00	4.08	4.17	4.17
1964-65						
December 31	3.82	3.92	4.06	4.12	4.21	4.21
May 17	3.89	3.95	4.12	4.15	4.21	4.21
May 25	3.89	3.94	4.10	4.15	4.22	4.22
June 8	3.81	3.89	4.10	4.15	4.23	4.22

In general, the Treasury bond market has been characterized by a sharp contraction of activity since mid-May as investment demand for intermediate and long-term Treasury bonds appears to have been at least temporarily satiated by the $2 billion of public exchanges into the 4-1/4's of May 1974. Also contributing to this investment apathy in the Treasury bond market has been the buildup in the corporate and Federal agency calendars and the resulting improvement in yields in those sectors of the capital market.

During the past month U. S. Government securities dealers have made no progress aside from official account buying in reducing their holdings of longer-term bonds. The dealers came out of the refunding with holdings of $851 million bonds due in more than 5 years. Through June 7 they had reduced these holdings by $159 million while the System and the Treasury purchases amounted to $172 million in this period.

System purchases in the coupon area were part of an effort to keep some downward pressures off bill rates in a period of large reserve need on the part of the banking system. In addition to coupon purchases totaling nearly $200 million in all maturities since mid-May, the System also put on over $1 billion of new repurchase agreements.

Corporate and municipal bond markets. The corporate bond market has weakened further during the past three weeks with average yields on new corporate issues rising to their highest level since early 1962. Recently, most yield series on municipal bonds have also risen as dealers' advertised inventories of unsold securities have continued to mount. Although municipal yields are at their 1965 highs, they are still 7-12 basis points below their 1964 peaks.

In mid-May, underwriters for a number of issues had been forced to break syndicate price restrictions, and yield increases of 2 to 7 basis points were required to move small, but hard-core, balances. Then at the close of the month, when a $250 million issue of capital notes by the Chase Manhattan Bank was added to the already heavy June calendar for public offerings, investment demand dried up at prevailing yields,

BOND YIELDS

	Corporate Aaa		State and local government	
	New	Seasoned	Moody's	Bond buyer (mixed qualities)
1964				
High	4.53	4.45	3.16	3.32
Low	4.30	4.35	2.99	3.12
1965				
High	4.55(5/28)	4.45(6/4)	3.09(6/3)	3.20(6/3)
Low	4.33(1/29)	4.41(3/12)	2.94(2/11)	3.04(2/11)
Week ending May 14	4.51	4.45	3.09	3.14
" " June 4	4.55 1/	4.45	3.09	3.20

1/ Week ending May 28.

and syndicate agreements on three issues with sizable unsold balances were terminated. Among these issues was the largest offering of the month--$125 million of Pacific Telephone and Telegraph Company debentures--with about $100 million in bonds still undistributed. The immediate price reaction in free market trading was sufficient to raise the yield 10 basis points, while the price adjustment in another issue recently released from syndicate raised its yield 17 basis points. The early announcement of an unexpectedly low offering yield on the Chase Manhattan Bank notes has led to some market firmness early this week as dealers expect a possible postponement or revision of the issue.

In the second quarter of 1965, public offerings of corporate bonds have exceeded private placements in the seasonally high spring quarter for the first time since 1962. The total amount of new capital raised in the current quarter is somewhat less than a year ago, but the publicly offered portion is 40 per cent above last year's small volume and somewhat above the average for other recent years. Public utilities

Public utilities account for only about one-fourth of this total, but banks and manufacturing concerns are more important than usual as borrowers in the public market. Two huge commercial bank issues will account for over two-thirds of the $725 million total public offerings for June. Since one of these is in the form of convertible notes ($267 million), the market impact of this month's financing is expected to be less than the dollar magnitude suggests. But market expectations are being influenced by the prospect of a special issue -- the $525 million FNMA participation certificates to be offered to the public on June 15 -- which is not included in the above volume figures.

In the municipal market, dealers' advertised inventories of unsold securities are currently in an all-time high range close to $900 million as a result of both a large volume of new offerings and reported less active buying by commercial banks. This inventory has already put some upward pressure on yields, although the Moody's Aaa series fails to reflect it, but further impact on the market may be dulled by the expected decline in the supply of new offerings this month.

Home mortgage markets. Contract interest rates and yields have been unusually stable this spring, as mortgage funds have generally remained ample and lender competition for mortgages has been active. In April, as in other recent months, average loan amounts for conventional first mortgages for both new and existing home purchases were above those a year earlier, reflecting mainly upgrading of purchases by borrowers. For new home loans, nonrate terms showed no further liberalization on the average as compared with a year earlier. For existing home loans, both maturities and loan-to-value ratios remained more liberal than in April of last year, but some shift toward less liberality was apparent from March averages.

AVERAGE TERMS ON CONVENTIONAL FIRST MORTGAGES FOR HOME PURCHASE

	March	April	Per cent increase in April 1965 from a year ago
New home loans			
Purchase price ($1,000)	25.3	24.9	+ 6
Loan amount ($1,000)	18.5	18.1	+ 5
Loan/price (per cent)	73.7	73.7	--
Maturity (years)	24.9	24.9	--
Existing home loans			
Purchase price ($1,000)	20.1	19.6	+ 7
Loan amount ($1,000)	14.6	14.0	+ 6
Loan/price (per cent)	72.7	71.8	+ 1
Maturity (years)	20.9	20.4	+ 3

A public offering of $525 million in certificates of participation in a pool of mortgages held by FNMA and the VA is scheduled for June 15th. This offering is being made under amendments to the National Housing Act which became effective in September of last year and reflects, in part, the success of an initial offering of $300 million of such certificates last November. As planned, about $250 million of the proceeds from the new offering will go to FNMA and about $275 million to the VA.

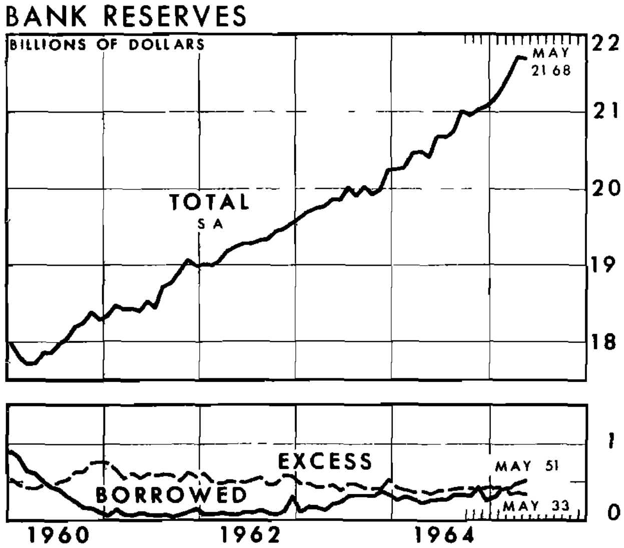
Stock market. Common stock prices (based on Standard and Poor's 500 stock price index) have continued to recede from their all-time high of 90.27 reached on May 13. The sharpest one-day drop since the assassination of President Kennedy occurred on Tuesday, June 8, with prices closing at 85.93, 5 per cent below their May high. Trading volume, which had approached the 6 million share per day level in the weeks prior to the May high, has declined. Transactions averaged 5.2 million shares per day during the latest three-week period and have been well below the 5 million level during most sessions in which have registered sharp price declines.

While the long bull market of the past three years had carried prices to a point 72 per cent above their June 1962 low, it was marked by 5 previous interruptions. The sharpest of these brought an average price decline of 6.5 per cent, but the others did not carry beyond 4 per cent. In contrast, the most recent major decline -- that during the spring of 1962 -- reduced market values by about 25 per cent.

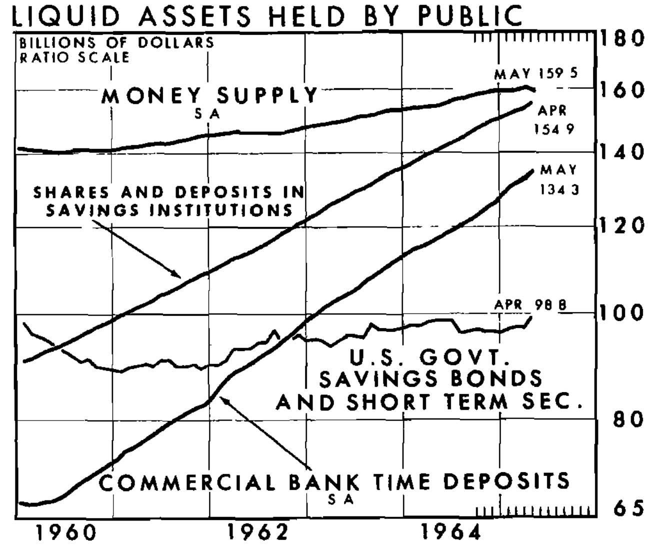
Since recent price increases have been tied rather closely to the upward trend in corporate earnings, current developments may reflect increasing sensitivity to the prospect of less favorable quarter-over - quarter earnings comparisons. At the same time, vulnerability to further decline may be limited to some extent by the fact that recent valuations of earnings have been somewhat below those associated with the market rise which peaked out in late 1961 and broke sharply in May and June 1962. The composite price-earnings ratio for the stocks in the Standard and Poor's index reached nearly 21 to 1 in late 1961, whereas the ratio in mid-May this year was 18 to 1.

FINANCIAL DEVELOPMENTS - UNITED STATES

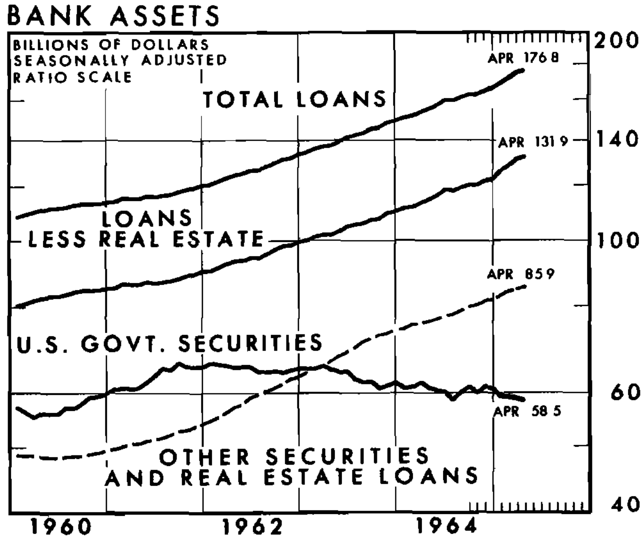
BANK RESERVES



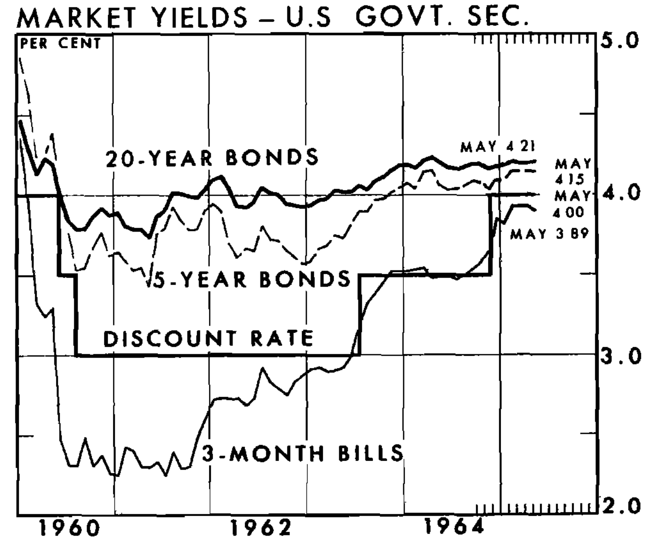
LIQUID ASSETS HELD BY PUBLIC



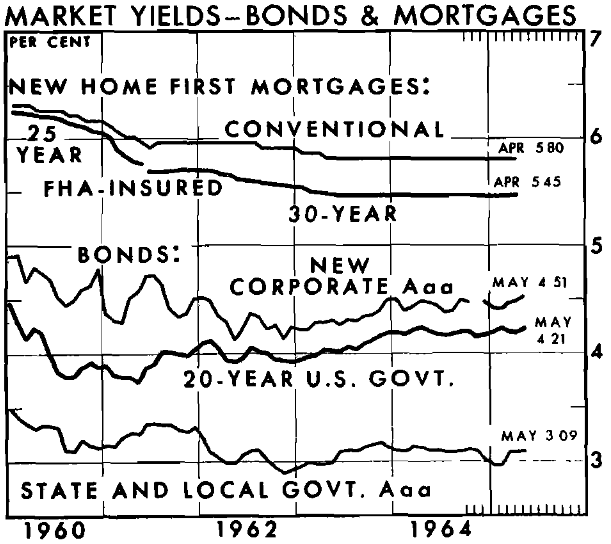
BANK ASSETS



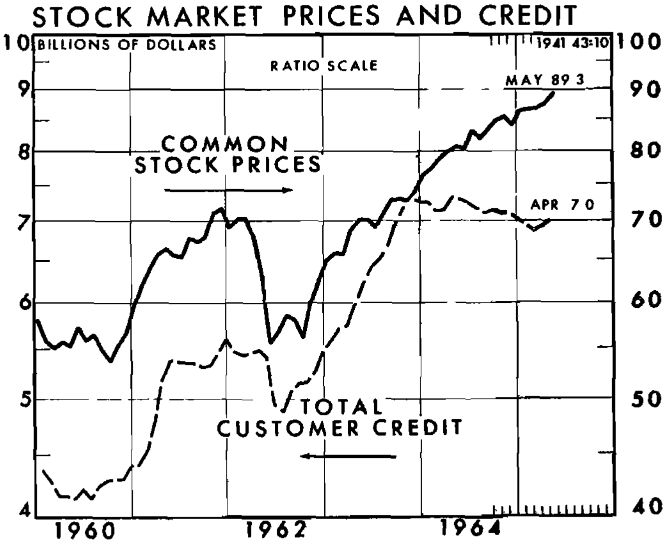
MARKET YIELDS – U.S GOVT. SEC.



MARKET YIELDS–BONDS & MORTGAGES



STOCK MARKET PRICES AND CREDIT



INTERNATIONAL DEVELOPMENTS

U.S. balance of payments. Present indications suggest a small over-all payments surplus in May of perhaps $50 million on the conventional basis. The surplus financed by official settlements may have been close to the same amount.

The over-all deficit figure for the first quarter has been somewhat reduced as a result of further revisions in data on bank-reported liabilities to foreigners. The revised deficit on regular transactions now totals $700 million, seasonally adjusted, or $2.8 billion at an annual rate. (The earlier estimate had been $3.1 billion.) The official settlements deficit remains unchanged at $2.6 billion, annual rate. The changes affected principally the months of February and March, reducing the February deficit and increasing the March surplus.

U.S. BALANCE OF PAYMENTS
(monthly averages in millions of dollars,
not adjusted for seasonal variation)

	Oct.-Feb.	Mar.-Apr.	May	Change Oct.-Feb. to Mar.-Apr.
Balance on regular transactions	-458	332	50e.	790
Increase in liquid liabilities to others than reserve holders	230	-190	?	420
Official settlements balance	-228	142	0 to 50e.	70
Selected U.S. capital transactions (outflows (-))				
Bank credit	-305	- 8	n.a.	297
Liquid funds	0	200+	n.a.	200+
Securities transactions	-139	- 75	n.a.	64

e. Estimated.

The payments surpluses in March and April resulted in large part from a reduction in the outflow of bank credit and from return flows of liquid funds, as shown in the table. The large March surplus probably also reflected abnormally large net receipts from trade, as export shipments were accelerated after the dock strike. Absence of export data for April precludes an estimate of the importance of this factor in April.

Net U.S. purchases of foreign securities in March and April were sharply reduced from the advanced levels of the preceding five months. Early indications for May also suggest only a moderate volume of such purchases. However, the calendar of new foreign issues for June is very heavy, and current estimates of U.S. purchases of such issues for the year 1965 are for a 30 per cent increase over the $1.1 billion recorded last year.

Outstanding long-term bank loans to foreigners were reduced by $96 million in April, a reduction that more than offset the further expansion of these loans in March. Almost half of the April decline reflected large repayments by Brazil but there were net decreases in outstanding loans to other countries as well. Short-term bank loans and acceptance credits to foreigners were also reduced in April, by $56 million. (Outstanding long- and short-term claims on foreigners by domestic banks within the VFCR declined by $140 million in April.)

Return flows of U.S. capital out of deposits and short-term investments abroad totaled $325 million in March and possibly a further $100 million or so in April. The bulk of these reflows have been out of dollar deposits in Canadian banks; there have also been significant reductions in holdings of Canadian finance paper. Confidential Canadian data show that Canadian banks in turn reduced their net U.S. dollar assets in the U.K. substantially in addition to reducing their dollar assets in the U.S.

Foreign commercial bank balances in this country (including those of foreign branches of U.S. banks) were reduced by nearly $500 million in March and April. About half of the reduction represented withdrawals by Canadian banks of funds invested in New York accompanying the withdrawal of U.S. capital from dollar deposits in Canada. The shift from a substantial build-up in foreign commercial bank balances from October through February to a large reduction in March and April lies behind the much smaller improvement in the official settlements balance than in the balance on regular transactions between these two periods.

Payments balances of Continental European countries. In the two-month period March-April a selected group of nine Continental European countries, including the largest reserve gainers of recent years, seem to have been close to balance in their combined external payments. A marked shift occurred in the external payments position of this group of countries around the beginning of March. In 1964 the combined surplus of these countries as shown in the table had amounted to nearly $3 billion, or a monthly average of nearly $250 million. In the last quarter of 1964 and the first two months of 1965, their combined surplus had been running at an even higher rate of almost $350 million a month (not adjusted for seasonality). The sudden change from heavy surplus to a position of near-balance coincided with the change in the U.S. position from heavy deficit to surplus.

PAYMENTS BALANCES MEASURED BY CHANGES IN
NET OFFICIAL RESERVES AND COMMERCIAL BANKS' POSITIONS[1]
(monthly averages in millions of dollars)

	March-April 1965	Oct.'64 to Feb.'65	Year 1964	March-April 1964	Oct.'63 to Feb.'64
France	97[a]	88	65	- 3	58
Germany	- 53	26	8	117	37
Switzerland[2]	- 92	38	33	26	8
Austria	4[a]	- 18	9	13	0
Belgium	27[a]	20	15	10	- 18
Netherlands	- 3[a]	55	6	- 11	- 10
Spain[2]	- 40	15	30	15	12
Sweden	- 15	16	16	- 14	14
Subtotal	- 75	239	180	154	103
Italy	50	107	67	- 65	- 148
Total	- 25	346	247	89	- 45

1/ The data available are not strictly comparable for all periods, but the inconsistencies appear to be minor.
2/ Balances measured by changes in official reserves only. Consequently, unlike the balances for other countries, these balances reflect increases in commercial bank foreign assets (outflows) and liabilities (inflows).
a/ Approximate, due to lack of April data for commercial banks.

This change in the U.S. position was due not only to the program of voluntary foreign credit restraint by U.S. banks and the activation of the Gore Amendment but also to temporary factors affecting the U.S. trade surplus and to a large reflux of U.S. corporate liquid funds, especially from Canada. Undoubtedly some of these factors also operated, directly and indirectly, to cut Continental surpluses, but other factors may also have been at work. The surpluses and deficits shown in the table have been measured in most cases by changes in gold reserve, IMF position, and short-term foreign assets less liabilities of the central bank and the commercial banks together; except for Switzerland and Spain these measures would not reflect changing flows of credit between commercial banks or of Euro-dollar deposits of nonresidents with commercial banks in the European countries.

Within the group of nine countries, only three -- France, Austria, and Belgium -- showed larger surplus payments positions on the average in March-April than in the preceding five-month period, and these changes may have been partly of a seasonal character. Sweden's shift from surplus to deficit may also have been partly seasonal. In three countries -- Germany, Switzerland, and Spain -- very large shifts from surplus to deficit occurred, contrary to the experience of a year earlier shown in the last two columns of the table. In the Netherlands, too, where large surpluses had been realized in the five months through February, a sharp shift occurred, bringing the Dutch position to near balance in March-April. Finally, in Italy, where a strong swing since the middle of last year has carried the balance from heavy deficit back to substantial surplus, the average surplus was somewhat smaller in March-April than in the immediately preceding five months.

For most of these Continental countries the very large surpluses around the turn of the year reflected in some degree the flight from sterling, as well as capital outflows from the United States. Swiss official reserves were heavily affected by such influences, as repatriation of Swiss commercial bank assets from London and increase in Swiss bank liabilities to foreigners made Swiss official reserve gains much larger than they would otherwise have been. With the cessation, or even reversal, of such inflows, underlying weakness in the Swiss current account contributed to Swiss reserve losses in March and April. For Germany, shifts in flows of long-term capital are known to have been an important factor in the shift from over-all surplus to deficit as measured in the table. An additional factor was further shrinkage in the German trade surplus.

Preliminary data indicate that both Switzerland and Germany had further deficits in May. French official reserve gains were negligible from mid-April through the third week of May. During that period the franc was slightly below its upper limit against the dollar, but it rose to its ceiling again by May 28.

Japan's payments balance. As measured by changes in gold, IMF gold tranche position, and gross official foreign exchange reserves, Japan's average monthly surplus of $22 million in the five months October-February gave place to an average deficit of $12 million a month during March-May. With allowance for changes in official liabilities and in commercial banks' positions the shift was somewhat greater than these figures indicate.

Cut in Bank rate in Britain. On June 3, Bank rate was reduced from 7 to 6 per cent and restrictions on hire-purchase credit were tightened. These measures appear to have been prompted by a desire -- based partly on political considerations -- to reallocate the impact of existing policies without affecting the over-all degree of fiscal and monetary restraint in Britain.

Information publicly available up to June 3 indicated no fundamental change in the British economic situation. Renewed weakness in exchange markets for sterling had appeared in late May, after a period of nearly two months during which the forward discount had narrowed to 1.8 per cent from its pre-Budget maximum of over 3 per cent per annum. Unemployment in May was 1.3 per cent of the labor force. Prices, even with adjustment for the impact of new excise taxes and postal charges, continued to move upward through April. Wage settlements in April and May averaged around 6 per cent, about equal to the first-quarter average but well above the 3 to 3-1/2 per cent guideline. Although the index of industrial production, seasonally adjusted, fell two points in March to 130 per cent of the 1958 average, work stoppages and the incidence of holidays were probably much more important factors than any slackening of demand; indeed, output in many industries is still hampered by supply bottlenecks.

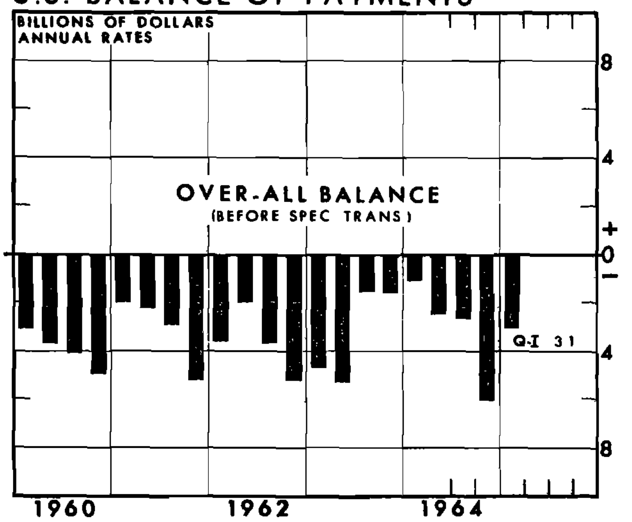
Credit restrictions and the 7 per cent Bank rate since last November have had a considerable impact on residential construction. Funds flowing into home mortgages have been sharply reduced, since building societies found it difficult to attract funds at the rates they were maintaining, while some local authorities ceased lending for new house purchases altogether because the rates they had to pay for funds were higher than their lending rates. The reduction in Bank rate may have an effect of channeling more funds into this politically sensitive sector. As an offset to this relaxation, however, minimum down-payments on hire-purchase contracts were raised by 5 percentage points -- from 20 to 25 per cent on automobiles and from 10 to 15 per cent on consumer durables; consumer expenditures on durables had been continuing to run at a high level.

Over-all bank credit expansion is being restrained by Special Deposit requirements for the banks and by the 5 per cent ceiling on increases in bank advances this year imposed in April. Seasonally adjusted bank advances fell by £76 million between mid-April and mid-May, following the record rise of £88 million in the preceding month.

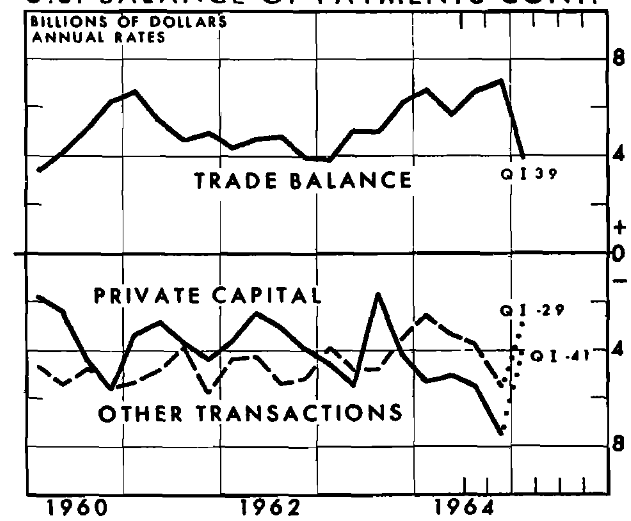
U.S. AND INTERNATIONAL ECONOMIC DEVELOPMENTS

SEASONALLY ADJUSTED

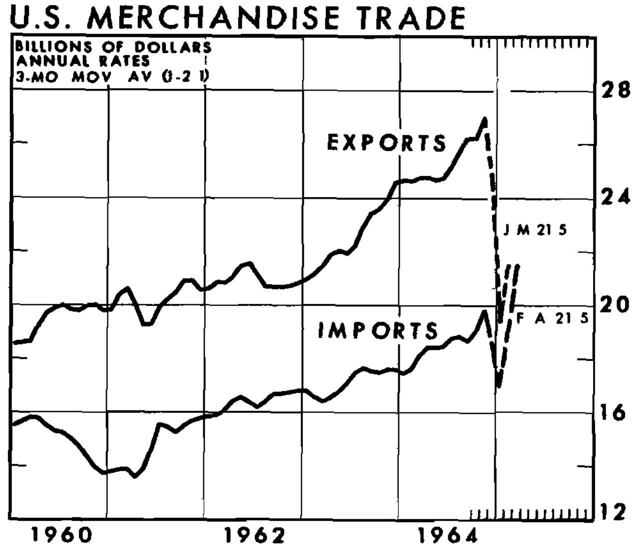
U.S. BALANCE OF PAYMENTS



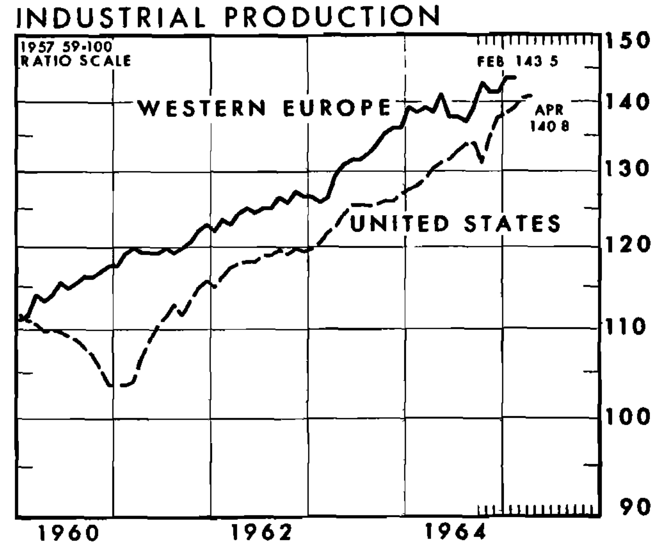
U.S. BALANCE OF PAYMENTS-CONT.



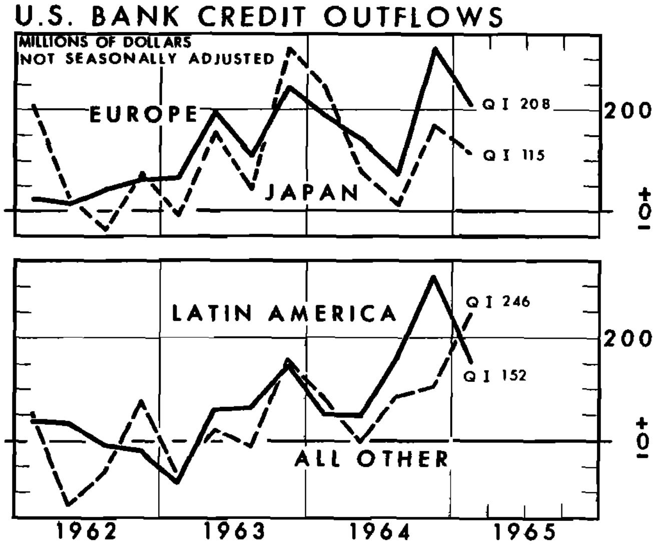
U.S. MERCHANDISE TRADE



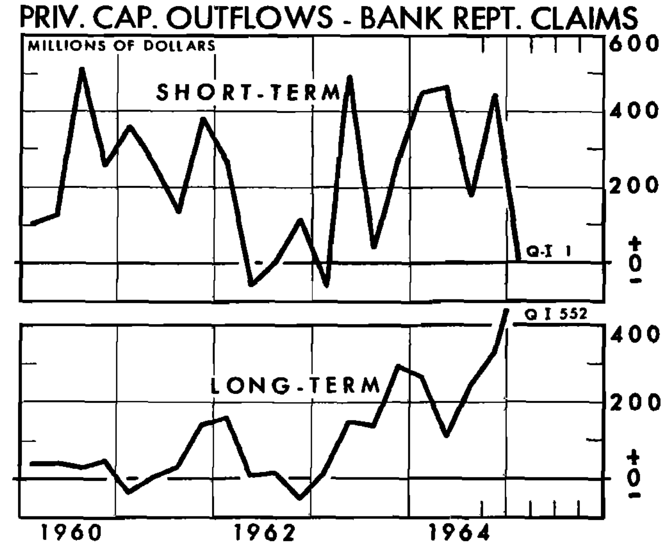
INDUSTRIAL PRODUCTION



U.S. BANK CREDIT OUTFLOWS



PRIV. CAP. OUTFLOWS - BANK REPT. CLAIMS



APPENDIX A: THE ALUMINUM AGREEMENT*

In its new 3-year contract with the major aluminum producers the United Steelworkers union appears to have gained most of its bargaining goals. The contract is valued by the union at 50.1 cents or 4.1 per cent per year (3.9 per cent compounded) based on a total hourly labor cost of $4.10. The companies have neither confirmed nor denied these cost estimates. In almost all essential provisions, the new agreements are similar to the contracts signed earlier this year between the same union and the can companies. Although the can company pact was estimated to have cost somewhat less, 3.5 per cent, the difference mainly reflects higher pension costs in the aluminum industry to provide approximately equivalent pension gains for a work force of higher average age and more years of service. Prices were raised in both industries after negotiations were concluded.

The current aluminum pact provides for somewhat higher increases in hourly compensation than the 2-1/2 per cent gains negotiated in 1962 and 1963, but are about the same as in 1960. However, the current settlement is far below the wage and fringe increase of about 8 per cent per year agreed to in 1956. Cost-of-living clauses in the industry were eliminated in 1962.

In the past, the aluminum and basic steel contracts were similar both as to terms and rates of increase. In preceding periods, however, aluminum industry settlements have generally followed steel settlements. While aluminum contracts this year again expired after those in steel, the usual course of negotiations was reversed.

In negotiations now being resumed in basic steel the union will undoubtedly demand that the aluminum contracts be accepted as a pattern for final agreement and the relationship of wages and fringe benefits gains in the two industries be maintained as in the past.

The total amount of the union's demands made this year in both the steel and the aluminum industry was based on a combination of the guidepost adjustment and prospective increases in consumer prices. Since the industry opposed an explicit cost-of-living clause, the union argued that in addition to overall productivity gains some allowance should be made to maintain "real" wages. The alternative it presented incorporated an adjustment for price increases into the amount of the package which is then distributed between wages and fringes by negotiation. The computation of the total package demanded by the union included an increase of 3.2 per cent in total hourly compensation (guidepost) plus 1.2 per cent for prospective cost-of-living increases.

*Prepared by Murray S. Wernick, Senior Economist, Division of Research and Statistics.

COST OF ALUMINUM - USW SETTLEMENT
June 1, 1965 - June 1, 1968
(Based on Union estimates)

	Estimated cost (cents per hour)	
First year beginning June 1, 1965	16.17	
Wages		
Combining grades 1 & 2		.50
Basic wage increase		10.00
Increase to maintain grade differentials		1.53
		12.03
Fringes		
20 per cent of wage increase for added cost of current fringes		2.41
Increases in group insurance and hospital benefits		1.73
		4.14
Second year beginning June 1, 1966	20.37	
Pensions		
Voluntary retirement after 30 years of service and $100 per month supplementary pay for retirement resulting from disability or layoffs		5.26
Increase in pensions to $5.00 per month for each year of service		15.11
Third year beginning June 1, 1967	13.55	
Wages		
Basic wage increase		7.00
Increase to maintain grade differentials		1.53
		8.53
Fringes		
20 per cent of wage increase for added cost of current fringes		1.71
Increased sickness and accident insurance		3.31
		5.02

Recapitulation:

Total cost (cents)	50.09
Average annual cost (cents)	16.7
Simple average increase (per cent)	4.1
Compound rate based on the year increases go into effect (per cent)	3.9

In aluminum, the union bargaining demand was for about 16.5 cents per hour per year and in steel it is 17.9 cents per year. The larger steel figure reflects a higher hourly compensation -- $4.40 per hour versus $4.10 in aluminum; the difference is mainly due to an incentive wage system prevailing in the steel industry.

The guidepost policy of 3.2 per cent (compounded) is based on trend productivity increases for the private nonfarm economy and makes no allowance for changes in consumer prices. One of the anomalies of the policy is that specific cost-of-living clauses in contracts have been ignored in evaluating the potential inflationary impact of settlements. But where an allowance for a trend price increase is included as a part of total cost, as in the aluminum contract, the cost may be higher than the guidepost on this account. It can be argued that in the first case the cost-of-living increase is not a definite cost but depends on future price movements, while in the second case it is a contracted cost. Nevertheless, experience would seem to indicate that the guidepost policy as now applied tends to favor unions that have negotiated cost-of-living clauses.

The breakdown of the 50.1 cent aluminum package is shown in the table. It includes direct wage increases averaging 12 cents the first year and 8.5 cents in the third year, and is the first time since 1961 that wage rates have been increased in the industry. Nonwage items account for about three-fifths of the total. Most important, is the sharp jump in basic pension payments. They are almost doubled to $5.00 per month for each year of service from $2.60. (In the can contract, benefits were raised to $5.50 per year of service from a higher base of $3.25. Because of the difference in age structure the cost of pension increase was greater in the case of aluminum, but the can workers continue to receive a higher basic pension allowance.) In addition, workers will now be able to retire voluntarily at full pension after 30 years of service regardless of age. Workers who are forced to retire because of disability or layoff will receive $100 in supplemental benefits until their social security payments go into effect. Increased sickness, accident and hospitalization benefits are also provided.

If the aluminum contracts do become a precedent in steel negotiations, final value of any agreement is likely to rest largely on the estimates of the cost of the pension and early retirement provisions. The interim steel agreement seems to imply at least an 11.5 cent per hour increase in wage rates in the first year compared to 12 cents in the aluminum contract. Presumably, the smaller third-year wage increase would also be acceptable. If a pension program comparable to that in aluminum were provided in the steel settlement the final cost of the contract would then be close to 3.9 per cent (compounded) since the age structure in steel is closer to the aluminum than to the can industry.

Although the steel and aluminum industries have followed a similar negotiated wage pattern in recent years, productivity development have been substantially different in the two industries, according to the Council of Economic Advisers. In aluminum, output per manhour has been rising at a rate of 6 per cent per year but in steel, only 3 per cent. Accordingly, the aluminum industry was in a position to reduce prices given the current settlement but instead increased them. A rise in steel wage costs of 4 per cent per year would be above the Council estimate of the industry and overall productivity gains and might be followed by some price increase. However, in the aluminum industry demand conditions have been such that a price increase occurred despite the guidepost arithmetic. In steel, domestic and foreign competitive conditions and a large inventory overhang may well prevent the industry from agreeing to as high a wage increase as the union desires.