MONTHLY REVIEW

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FEDERAL RESERVE BANK OF MINNEAPOLIS

APRIL 1965

The voluntary credit restraint program

With the exception of 1957 when the Suez crisis and a poor European wheat harvest helped to bring about a marked rise in merchandise exports, the United States in every year since 1949 has shown a deficit in its balance of payments with the rest of the world.* For a time these deficits were generally considered by both American and foreign policy makers to be an appropriate means of bringing about a build-up in the foreign exchange reserves of other countries, a build-up that would finally permit the resumption of free trade among all countries. In these circumstances, measures to curb the U. S. deficit were not taken. However, in the late 1950s and early 1960s the deficits became very large and pressure to reduce and eliminate them began to spread. Corrective steps were taken, but the deficits persisted. In view of the seriousness of the problem, new measures seemed necessary as a means of bringing the outflow of gold and dollars under control. In February President Johnson presented a program that was designed to achieve this result.

Background

Following World War II many countries in Western Europe retained the trade and foreign exchange restrictions that had been imposed during the war or during the turbulent 1930s. The restrictions were retained in order to force receipts from exports, loans, and grants to match or exceed their expenditures on imports of goods and services, imports that were often needed to sustain and rebuild their domestic economic systems. Had the restrictions been lifted, imports, particularly from the United States, would have surged higher to meet existing shortages, thereby creating deficits that could not have been sustained by most foreign countries because their holdings of gold and other acceptable means of international payment were insufficient.

It was agreed by both American and foreign policy makers that the restrictions on trade and exchange should be cut away as quickly as circumstances permitted. But if this goal of unhampered trade were to be achieved under the system of fixed exchange rates that had been generally accepted, it seemed clear that the official reserves of major trading nations would have to be re-built to levels that would permit them to "play the game of free trade," a game in which reserves were needed as a buffer for the times when payments exceeded receipts. Since deficits in the U. S. balance of payments lead to an outflow of gold and dollars to residents of other countries, including foreign governments and central banks, such deficits were generally looked upon in the early 1950s as welcome steps toward the goal of liberalized trade. As a result, measures to restrain the deficit were felt unnecessary.

By 1958 the nations of Western Europe, in fact, had regained and improved their productive capacity, had accumulated sufficient reserves to permit the loosening and in many cases elimination of restrictions, and had moved aggressively into competition in world markets. These developments

*Deficit on regular transactions — as measured by changes in U.S. reserve assets and in liquid liabilities to foreigners together with receipts from special U.S. Government transactions.

were applauded in the United States, for they represented the growing strength of important allies as well as a significant move in the direction of freer world trade.

Deficits continue

Largely because of the improved position of Europe, the U. S. balance of payments deficit became large: $3.5 billion in 1958 and an unprecedented $4.2 billion in 1959. The size and growth of the deficits in those years was attributed to large military commitments overseas, commitments which in earlier years many policy makers had expected

> "The state of the dollar in the world today is strong—far stronger than 3 or 4 years ago.
>
> "To assure its continued and growing strength, however, we need to take new steps to speed our progress toward balance in our external payments."
>
> **President Johnson**

to diminish in importance; to the persistence of sizable and growing outlays for economic assistance to underdeveloped countries; to the swelling magnitude of private long-term capital investment in Europe, in part stimulated by the formation of the European Common Market in which tariffs were to be eliminated among member nations while a common level of tariffs was established against imports from outsiders; and to the failure of the U. S. exports to grow fast enough, possibly because the U. S. had lost its competitive edge in world markets.

Many observers were persuaded at this point that deficits were going to be a chronic feature of the U. S. payments position for some years to come. Since gold losses induced by the deficits could not continue indefinitely without forcing a change in the dollar price of gold, a change that policy makers considered then and now to be an unacceptable development, the view gradually spread that corrective measures would have to be taken.

Several events of 1960 speeded the acceptance of this view. Exports from the U. S. showed a marked gain during the year while imports remained approximately the same as in the previous year. Despite this improvement in the current account surplus, an improvement that totaled well over $3 billion, the deficit was nearly as large in 1960 as in the previous year. The failure of the deficit to show any substantial decline was primarily the result of a sharp step-up in the outflow of private short-term capital which placed additional dollars in foreign hands. But nonofficial foreign dollar holders apparently became disturbed by the continuing outflow and, fearing a change in the external value of the dollar by the American government, sold dollars to their governments and central banks who in turn converted a large part of their dollar acquisitions into gold. The fear of an American devaluation was also reflected in the London gold market where the price of gold from October 1960 through January 1961 remained above previous levels: for a short time in October, in fact, it touched a peak of over $40 an ounce.

President Kennedy's program

In the hope of quieting the speculative rush to gold which was apparently caused by flagging confidence in the dollar, President Kennedy declared soon after taking office in early 1961 that the dollar would not be devalued. In addition, he initiated a much more intensive program to correct the balance of payments problem—a program designed to be consistent with the attainment of domestic objectives, such as full employment with stable prices, as well as to be compatible with U. S. commitments to encourage the dismantling of trade restrictions, to assist underdeveloped countries, and to maintain an effective defense system.

More specifically the President's program included but was not confined to these points:

The duty-free allowance on goods brought in by a returning traveler was reduced from $500 to $100 in order to reduce tourist expenditures. To spur exports, the most important means of acquiring additional foreign exchange, the Department of Commerce greatly expanded its efforts to inform businessmen about export possibilities; and the Export-Import Bank, in cooperation with commercial banks and insurance companies, established new arrangements within which U. S. exporters were given greater opportunities to obtain export financing and insurance. In the area of aid to underdeveloped countries, determined efforts were made to see that assistance dollars were spent within the United States for the materials and services needed. In addition, an interest equalization tax was first proposed in 1963 and finally enacted in 1964 as a means of reducing American purchases of foreign securities offered by developed countries.

These measures appeared to exert an effect. In the first half of 1964, on the basis of figures then available, many observers confidently expected that the deficit for the entire year would not exceed $2 billion, considerably less than the deficits of $3.3 billion in 1963 or $3.6 billion in 1962. But this improvement was not realized. After the passage of the interest equalization tax law in September the uncertainties that had previously existed as to the provisions of the act were removed and new foreign security sales within the U. S. surged markedly ahead. Canadian issues, which after the passage of the tax were exempted by Presidential order, were particularly important in this rise. In addition, outflows of long-term bank loans to foreigners, which had started to rise the spring of 1963 even before the tax was proposed, showed a considerable increase in the fourth quarter. These changes, together with a step-up in short-term bank loans to foreigners, brought the deficit for 1964 to a disappointing $3 billion.

President Johnson's program

As figures for the fourth quarter balance of payments became available, the Administration decided that new steps to reduce the deficit would have to be taken. These steps were outlined by President Johnson in a special message to Congress on February 10, 1965. Included were the following:

- Under authority granted by the Interest Equalization Tax Act the President announced that he had imposed the tax, effective February 11, on bank loans to foreigners. Exempted were loans with a maturity of less than one year and loans of whatever maturity to borrowers in less developed countries.
- The President called for new legislation that would extend the interest equalization tax for two years past its December 31, 1965 expiration date; broaden the tax to cover the extension of one to three year credit to foreigners by nonbank financial institutions (with an appropriate exemption for borrowers in less developed countries); reduce the duty-free tourist exemption from $100 to $50; and increase the incentives of foreigners to invest in U. S. assets.
- To further reduce the dollar outflow brought about through foreign policy programs, the President directed the responsible government officials to cut the foreign exchange costs of military and economic aid.
- As a means of reducing the outflow of capital to foreign nations, the President called upon business corporations, banks, and nonbank financial institutions to cut back voluntarily on their foreign loans and investments and on the amount of liquid assets held abroad.

Business corporations enlisted

The task of encouraging and coordinating the efforts of businessmen to curb dollar outflows was given by the President to the Secretary of Commerce. Acting promptly, the Secretary in early March sent a letter to many of the largest corporations in America asking that they work out their own program for enlarging their individual balance of payments surplus or reducing their deficit. He requested that they set up a balance of payments ledger which would show trade and capital transactions with foreign countries during 1964 as well as the estimated volume of transactions in 1965. Further, to check on the success of the voluntary program, the Secretary requested that the company ledgers be sent to him by April 15 and that quarterly confidential reports be submitted through 1966.

"Specifically, I ask the bankers and businessmen of America to exercise voluntary restraint in lending money or making investments abroad in the developed countries. This request applies with special force to short-term loans and direct investments, . . ."

President Johnson

As a means of improving individual payment balances the Secretary suggested to business corporations that they:

—expand exports

—accelerate the repatriation of income earned in developed countries

—avoid or postpone direct investment in marginal foreign projects and, when direct investment is undertaken, finance as much of each project as possible with funds raised abroad

—increase the use of American flag vessels and airlines

—cut back on the amount of dollars placed abroad to earn a higher interest return and if possible reduce liquid funds previously placed abroad.

In seeking balance of payments improvements by these means, it was indicated that the administration did not wish to see companies reduce the flow of investments to underdeveloped countries. Major improvements to be sought by corporations, thus, would have to be found in transactions with developed countries. Also, it was indicated that in reducing short-term investments previously placed abroad corporations should exercise care so as not to exacerbate the balance of payments problems of any country.

Banks recruited

Responsibility for the enlistment of the banking community in the voluntary restraint program was given by the President to the Federal Reserve System and to the Treasury. These agencies in turn asked that outstanding bank claims on foreigners (including loans, securities, acceptances, and deposits) be held during 1965 to a level not over 5 per cent above the amount outstanding on December 31, 1964. The many banking institutions which had no foreign credits outstanding at the end of 1964 were asked to refrain from granting credit during the current year.

To assist banks in curtailing foreign credit the Federal Reserve System issued guidelines. Briefly summarized, they are:

► Priority within the 5 per cent limit should be given to foreign credits that directly finance exports unless such credits are a substitute for cash sales or sales ordinarily financed from other sources. Nonexport credits should be considered of lower priority. However, within the category of nonexport credits, commercial banks should give preference to loans to less developed countries and should avoid restrictive practices which place an undue burden on Canada and Japan since they are heavily dependent on U. S. financing, or on the United Kingdom, a country that is presently attempting to reduce its own deficit.

► During the year a few banks may find that they have exceeded the 5 per cent limit because of commitments made prior to February 10 or because of the extension of export credits. In these cases, every effort should be made to reduce outstanding credits to 105 per cent of the base amount as quickly as possible. Only in the most extreme cases should the reduction be delayed beyond the end of the year.

► To stay within the 5 per cent limit commercial banks should not sell claims on foreigners to

U. S. residents. If such sales are made, the base (outstanding credit on December 31, 1964) should be reduced an equivalent amount and the 5 per cent limit then applied to the reduced base.

➤ It is to be expected that banks will not encourage their domestic customers either to place funds outside the U. S. or to extend foreign credits which they (the banks) would have extended in the absence of the program.

The Federal Reserve also asked that banks with $100,000 or over in foreign claims on December 31, 1964 report their holdings quarterly if they are not a part of the Treasury's regular reporting system. This information is to be used to determine the success of the voluntary effort and the time at which the program can be terminated.

> "I have no doubt that American bankers and businessmen will respond to the Nation's need. With their cooperation, we can block the leakage of funds abroad, without blocking the vital flow of credit to American business."
>
> **President Johnson**

A preliminary estimate indicates that outstanding bank claims on foreigners totaled approximately $10 billion at the end of December. If the 5 per cent limit is not exceeded, bank claims on foreigners should not rise by more than $500 million during the year. An increase of this amount would be a significant improvement over the $2.4 billion rise which occurred in 1964, an improvement that would make an important contribution to the elimination of the deficit in the U. S. payments balance.

Financial institutions other than banks (insurance companies, mutual savings banks, finance companies, mutual funds, pension funds, and other trusts) have also been invited to participate in the voluntary credit restraint program. It is expected that their cooperation will help to assure the success of the program as well as achieve a sharing of the burden among all institutions. Accordingly, they have been asked to limit their holdings of liquid funds held abroad to the 1964 year-end total and, if possible, gradually reduce their holdings to the level which existed at the end of 1963. (Liquid investments include dollar denominated deposits held in foreign banks, short-term securities of foreign governments, foreign commercial paper, and all other negotiable instruments that mature in one year or less.) In addition, nonbank financial institutions have been urged to keep to 5 per cent any increase in holdings of investments (other than those listed above) which have a final maturity of 5 years or less. Included are bonds, both corporate and government, mortgages, and loans. The 5 per cent ceiling is to be measured against the total of all such holdings at the end of 1964. Priorities in extending credits within these guidelines are similar to those for the commercial banks.

The need is clear

American policy makers have agreed that there is a clear need to reduce the deficit in the balance of payments, a need that in part stems from the importance of the dollar as a reserve currency. Should confidence in the dollar disappear because of continued deficits, the events that would follow defy accurate prediction, but would undoubtedly force changes generally considered by policy makers to be damaging to the defense position of the United States, to its political status and influence in the world, and possibly to its economic welfare. It was to avoid these possible consequences that the President proposed the current balance of payments program — a program that depends heavily on the voluntary cooperation of banks and businesses for its success.

Balance of payments in 1964

The high hopes engendered during the first part of 1964 that the U. S. balance of payments problem was finally on the way to being solved were dashed by developments of the fourth quarter. During the first nine months of 1964, the U. S. international payments deficit averaged nearly \$2.1 billion,[1] substantially below both the \$3.3 billion deficit sustained in 1963 and the \$3.6 billion average annual deficit extending from 1958 to 1963 (see Table 1). During the last quarter of 1964, however, the deficit jumped to \$6.0 billion; pushing the deficit for the year up to \$3.0 billion.

The two major components of the U. S. balance of payments which came into play in 1964 were *surplus of exports over imports of goods and services* and U. S. *private capital investment abroad* (net of foreign investment in U. S.). The former climbed to \$8.2 billion during the year, an increase of \$2.5 billion over 1963. At the same time, however, the latter category also expanded, the outflow of capital reaching \$5.9 billion in 1964 — almost \$2 billion higher than that of the previous year — thus preventing any significant reduction in the 1964 payments deficit.[2] Most of the increase in the surplus on goods and services took place during the early part of 1964 whereas the major portion of the increment in the outflow of U. S. private capital didn't occur until the final three months of the year — a set of circumstances which explains why the U. S. balance of payments picture looked encouraging for the greater part of the year only to darken in the final quarter.

The impressive 1964 expansion in the *surplus of exports over imports of goods and services* was due primarily to an increase in the merchandise trade balance and to a rise in the repatriation of income derived from U. S. investments abroad. Even though the threat of a dock strike late in 1964 probably inflated the 1964 trade surplus at the expense of the 1965 trade surplus, the first factor attests to the increasing competitiveness of U. S. industry in world markets due in part to the general stability of prices in the U. S. as compared to the rising level of prices among several of its trading partners. The increase in the repatriation of income from overseas investments, primarily evident in the first part of 1964, appears to have been partly inflated by inflows which ordinarily would have been recorded in the previous year, but which were delayed until the beginning of 1964 in order to receive the benefits from the reduction in the corporate income tax rates for 1964.

Major attention on capital outflow

The component that recently has drawn the major share of attention with regard to balance of payments statistics, however, is U. S. *private capital investment abroad* as well as the shifting pattern of its subcomponents. This interest has stemmed not only from the belief that the increase in such private capital outflow has been the principal reason for the persistently large deficits in recent years, but also from the belief that if a substantial and immediate reduction is to be made in the payments deficit, selective governmental policies ap-

[1] Figures throughout article referring to the balance of payments deficit are seasonally adjusted annual rate.

[2] The figures covering U. S. private capital flow do not include "errors and omissions." If this category is included, based on the widely-held belief that it mainly represents unrecorded flow of private capital, then the capital outflow in 1964 would measure \$6.8 billion—\$2.4 billion greater than that of the preceding year.

TABLE 1—SELECTED UNITED STATES BALANCE OF PAYMENTS DATA, 1958-64

(In billions of dollars)

	1958	1959	1960	1961	1962	1963	1964
Surplus of exports over imports of goods and services	2.2	.1	3.8	5.6	5.1	5.7	8.2
U S. private capital investment abroad (net of foreign investment in U. S.)	—2.9	—1.5	—3.5	—3.6	—3.3	—4.0	—5.9
Direct investment	—1.2	—1.4	—1.7	—1.6	—1.7	—1.9	—2.3
Long-term portfolio investment	—1.4	— .9	— .9	—1.0	—1.2	—1.7	—2.0
Short-term investment	— .3	— .1	—1.3	—1.6	— .6	— .7	—2.1
Deficit[1]	—3.5	—4.2	—3.9	—3.1	—3.6	—3.3	—3.0

[1] "Regular types of transactions" method.
Source: Department of Commerce.

plied in this area (such as those suggested in the recently issued "guidelines") hold the best chance for success, and, in addition, would prove the least harmful to the domestic economy and to other national policy objectives.

Several subcomponents of U. S. private investment abroad shared in the expansion of capital outflow during 1964. *Short-term investment* showed the greatest increment rising $1.4 billion during the year to an outflow of $2.1 billion; *direct investment* increased $0.4 billion to reach $2.3 billion; and *long-term portfolio investment* totaled $2.0 billion, slightly above the outflow of 1963.

Annual changes, however, often conceal current developments, the knowledge of which is essential if control over the balance of payments deficit is to be maintained. Such is the case with respect to outflows of U. S. private capital representing *investment in foreign securities,* a subcomponent of long-term portfolio investment. As may be observed from the quarterly balance of payments statistics for 1963 and 1964 set forth in Table 2, a sharp drop occurred in this subcategory from an average outflow of $2.0 billion in the first half of 1963 to less than $0.3 billion over the last half of the year. This slow pace continued throughout the first three quarters of 1964; but then in the last quarter, the outflow surged to $2.1 billion. Such a wide fluctuation is hidden when only annual figures are inspected.

The decline and subsequent rise of *investment in foreign securities* (which includes purchases of new issues, redemptions, and transactions in outstanding foreign securities) during 1963 and 1964 is generally attributed to the proposal and enactment of the interest equalization tax. The increase in this particular type of capital outflow had been fairly rapid in 1962 rising to an annual rate of $2.0 billion by the first half of 1963. To discourage any further outflow (which had helped push the deficit to $5.3 billion in the second quarter of 1963) the administration in July 1963 proposed a tax designed, generally, to reduce to Americans the yield on foreign securities which they might purchase after enactment of the tax. The tax, when enacted, was to be retroactive to the date of the proposal.

Following a sharp decline in the purchase of foreign securities which followed on the heels of the tax proposal and which continued throughout the first three quarters of 1964, a sudden increase was registered with the enactment of the tax in September. More than one-half of the increase from $0.3 billion in the third quarter to $2.1 billion in the fourth quarter was attributable to purchases of new Canadian securities. Even though all along it was generally believed that the proposed measure intended to exclude Canadian issues from the tax; still, there was enough uncertainty as to whether this "exclusion" would hold through final passage: this apparently discouraged any larger flow of Canadian issues prior to September.

An opposite pattern

Long-term bank credits extended to nonresidents, the other major subcomponent of *long-term portfolio investment,* followed a pattern during 1963 and 1964 which, to a great extent, was the exact opposite of that followed by *investment in foreign securities.* The *long-term credits* averaged only $0.4 billion during the first three quarters of 1963 but then expanded to $1.8 billion in the fourth quarter. In the early part of 1964 the pace eased somewhat but picked up during the last half of the year to bring the average outflow for 1964 to $0.9 billion, slightly above the increase in 1963.

It is interesting to note that the increase in *long-term bank credits* generally coincided with that period when the interest equalization tax was under proposal. But whether this increase represented a shift in foreign demand for long-term financing away from new issues of foreign securities subject to the tax or whether it reflected a generally increased level of demand is not known. However, most of the increase in *long-term bank credits* during 1963 and 1964 did go to economically developed countries — the very countries which might have issued securities in the U. S. market to finance their long-term needs (except for the fact that their securities would have been subject to tax and therefore less desirable to potential investors).

Short-term credits also up

Short-term bank credits extended to nonresidents—the major subcomponent of *short-term investment*—increased during 1963 and 1964 by $0.8 and $1.5 billion respectively. Its upward trend during these two years, however, was subject to erratic movements from quarter to quarter.

Part of the increase in U. S. short-term bank credits represented loans and other claims to finance imports of the borrowing countries. To the extent that these credits were used to purchase U. S. exports, the U. S. balance of payments deficit would have been reduced (once the credit was liquidated). But since the handling of these credits is complicated by the fact that they may also be used by borrowing countries to purchase exports from other industrial nations, such as those belonging to the Common Market, the outflow of U. S. capital is not always offset by U. S. exports but, instead, may be offset by a rise in foreign holdings of dollars—and thus increasing the U. S. deficit. But in any case, if not the rise in U. S. exports, increasing world trade has been a probable force tending to expand U. S. *short-term bank credits.*

TABLE 2—SELECTED UNITED STATES BALANCE OF PAYMENTS DATA QUARTERLY BASIS—1963-64
(seasonally adjusted annual rate)
(In billions of dollars)

	1963				1964			
	I	II	III	IV	I	II	III	IV
Surplus of exports over imports of goods and services	4.8	5.8	5.2	6.9	8.7	7.2	8.4	8.5
U. S. private capital investment abroad (net of foreign investment in U. S.)	—4.6	—5.6	—1.6	—4.2	—5.3	—5.1	—5.5	—7.6
Direct investment	—2.5	—1.9	— .9	—2.2	—2.1	—2.3	—2.3	—2.6
Long-term portfolio investment:								
Long-term bank credits	— .1	— .6	— .5	—1.8	—1.1	— .4	—1.0	—1.3
Investment in foreign securities	—2.0	—2.0	— .7	.2	.2	— .5	— .3	—2.1
Short-term investment:								
Short-term bank credits	.2	—2.0	— .2	—1.1	—1.8	—1.8	— .7	—1.8
Deficit[1]	—4.7	—5.3	—1.5	—1.6	—1.1	—2.5	—2.6	—6.0

[1] "Regular types of transactions" method.
Source: Department of Commerce.

TABLE 3—FINANCING THE UNITED STATES BALANCE OF PAYMENTS DEFICIT, 1958-64

(In billions of dollars)

	1958	1959	1960	1961	1962	1963	1964
Decrease in U.S. supply of gold	2.3	1.0	1.7	.9	.9	.5	.1
Increase in holdings of dollar deposits in U.S. banks and marketable U. S. Government securities by:							
Foreign governments and central banks	.7	1.2	1.4	.7	.5	1.0	.7
Foreign commercial banks and other foreign private organizations	.5	1.5	.3	1.1	.2	.6	1.5
Other		.4	.4	.5	2.0	1.2	.7
Total	3.5	4.2	3.9	3.1	3.6	3.3	3.0

Figures may not add to totals because of rounding.
Source: Department of Commerce.

Another element of *short-term bank credits* abroad is represented by liquid funds placed by bankers seeking higher yields. (This same motive also applies to *short-term investments of nonfinancial corporations* — the other subcomponent of *short-term investment* but which is not presented in the table). This element is more likely to cause the erratic quarter-to-quarter movements because of its believed response to changes in the short-term rate of interest in the U. S. relative to short-term interest rate changes abroad. The decline in the outflow of short-term capital in the third quarter of 1963, for example, has been explained as a reaction to the July 1963 increase in the rate which U. S. banks were allowed to pay for time deposits; and the increase in the outflow during the fourth quarter of both 1963 and 1964, has been attributed to the unexpectedly heavy demand for dollars on the part of foreign banks in order to dress up their end-of-year position statements.

Financing the deficit

United States used only $125 million of its gold supply to finance its $3.0 billion 1964 deficit (see Table 3). One-half of the deficit was financed by increased holdings of dollar deposits in U. S. banks and holdings of marketable U. S. Government securities on the part of foreign commercial banks and other foreign private organizations who were willing to add to their holdings in order to accommodate the increased volume of international transactions during 1964. This contrasted with the financing of the 1963 deficit where less than 20 per cent was financed in this manner. Foreign central banks and governments increased their holdings of liquid dollars and U. S. government marketable securities by $0.7 billion in 1964; in 1963, U. S. liabilities in the hands of these official organizations increased by $1 billion.

The "other" classification, for the most part, represents special agreements between the U. S. and some of its creditor countries whereby the creditor country reduces its supply of unwanted dollars by such transactions as prepaying part of its long-term debt with the U. S. or buying medium-term U. S. Government securities rather than submitting these unwanted dollar holdings to the U. S. Treasury for conversion into gold. Little use was made in 1964 of "other" means of financing the deficit compared, for example, to the experience of the two preceding years. In 1964, $0.7 billion of the deficit was financed in this manner whereas in 1963 and 1962 the comparable figures were $1.2 and $2.0 billion respectively.

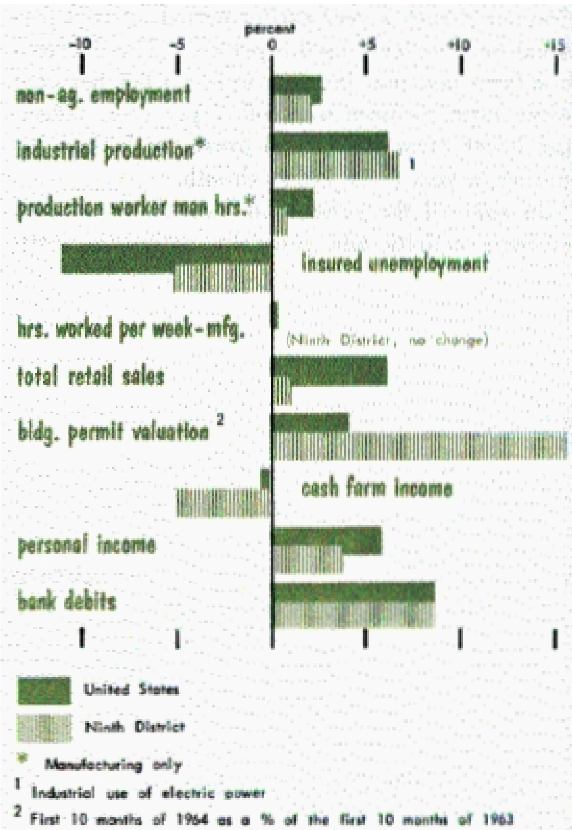
Current conditions . . .

Continuing a momentum set during 1964, economic activity in the Ninth district advanced strongly into the first quarter of 1965. Production expanded at a rate about parallel with that of the nation. Major industries reported further increases in the volume of new orders and some further inventory expansion. Regional employment security offices reported a strong demand for labor. Total retail sales as well as personal incomes exhibited a strong start.

That production continued to expand is indicated by such district measurements as (1) industrial use of electric power (up about 6 per cent in February from a year earlier), (2) the length of the work week in manufacturing (41 hours in February), and (3) production worker man hours (up about 3 per cent from a year earlier).

Factory output reports from many of the district's major industries indicated that industrial production was increasing at an even faster pace at the end of the first quarter period. Almost half of the respondents said that new orders in February and March were up substantially from January levels; and other firms reported steady to moderate gains. Only one firm reported a decline. Continuing inventory accumulation for both finished inventories and raw material stocks was also reported by most major firms during the first quarter.

CHANGES IN SELECTED ECONOMIC INDICATORS DURING 1964



The view of expanded business activity is supported by a decline in insured unemployment numbers as well as by a sharp increase in the district's "Help Wanted" advertising indexes, both in total lineage and in number of ads. Also, the demand for workers in durable goods manufacturing, in construction, and in mining was particularly strong in the first quarter. Skilled workers were in scarce supply.

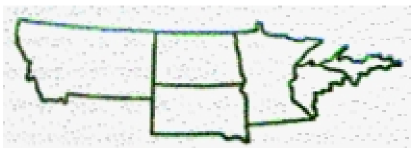
Judging by recent department store sales trends, although total retail sales started actively early in the quarter, severe snowstorms and very cold weather later in the first quarter may have retarded further expansion.

The region's most comprehensive single indicator of economic trends, personal income, is currently available only through February, but these data do show a strong upturn over December. Compared with a year earlier period, district personal incomes were up 4.8 per cent. The district's non-farm personal incomes were up 6.3 per cent while farm incomes were off 7 per cent, reflecting lower farm prices and lower marketings resulting in part from 1964's drouth.

In spite of the substantial increase in over-all business activity and generally optimistic sentiment during the first quarter, no serious price distortions have appeared. Although farm prices have strengthened somewhat, in general they have remained below year-ago levels. Average prices paid by manufacturing concerns for raw materials have remained substantially stable although more firms report slight increases than report declines. The same situation holds for average prices received for finished products.

In banking, a strong demand for loans was evident during the first quarter with commercial and industrial loans particularly strong at the city banks. The demand deposit trend, however, was relatively weak, but the weakness was offset in part by a better than seasonal trend in the time deposit categories. Despite the weakness, loan-to-deposit ratios increased slightly even though at levels a few percentage points below those of the nation.

During the first quarter, member bank borrowings expanded, but the total number of banks borrowing at any one time remained quite low—usually less than a dozen. This fact, together with relative stability in net purchases of federal funds, suggests no significant changes in total bank liquidity during recent weeks.



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