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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

January 12, 1973

By the Staff
Board of Governors
of the Federal Reserve System

The Domestic Economy

Industrial production. Industrial production rose 0.8 percent further in December and at 119.3 percent was 10.4 percent above a year earlier. As in recent previous months the gains in output were widespread among consumer goods, business equipment, and materials. Production of defense and space equipment, however, continued unchanged. (Very confidential until release Monday afternoon.)

INDUSTRIAL PRODUCTION
(1967=100, seasonally adjusted)

	1971 Dec.	1972 r.Oct.	p.Nov.	e.Dec.	Percent change from Nov. to Dec.	A year ago
Total index	108.1	117.3	118.4	119.3	.8	10.4
Consumer goods	118.0	125.5	126.7	127.9	.9	8.4
Business equip.	98.0	108.3	109.0	110.4	1.3	12.7
Defense equip.	75.6	78.5	79.4	79.4		5.0
Materials	108.4	120.0	120.6	121.1	.4	11.7
Steel	83.1	114.1	114.4	115.6	1.0	39.1
Auto assemblies*	8.6	9.1	9.6	10.3	7.3	19.8

*Seasonally adjusted annual rate, millions of units.

Retail sales. The advance retail sales estimate for December indicated the sales advance from November was a modest 0.3 percent. On a quarterly basis, however, the three month period was strong with a gain for all types of stores of 3.4 percent, with a 4.8 percent gain for durables and a 2.7 percent advance for nondurables. Compared with a year earlier, sales in December were up 11.6 percent; the final quarter of 1972 was 10.9 percent higher than a year ago.

RETAIL SALES
(Percentage change from previous period)

	1972					
	II Q	III Q	IV Q	Oct.	Nov.	Dec.
All retail stores	3.3	2.6	3.4	3.6	- .7	.3
Durable	4.2	3.9	4.8	4.4	.7	.4
Auto	6.4	4.6	4.7	4.7	.1	1.7
Furniture & appliance	- .5	2.0	3.9	5.5	.8	-1.6
Nondurable	2.9	1.9	2.7	3.2	-1.4	.2
Food	3.6	1.7	1.7	2.5	- .3	-2.0
General merchandise	2.7	2.6	1.6	3.4	-3.2	- .4
GAF	2.4	1.9	2.5	4.3	-2.7	- .6
Total, less auto & nonconsumer items	2.9	1.9	2.9	3.3	-1.1	.1
Real*	2.7	1.6	n.a.	3.6	-1.1	n.a.

*Deflated by SA all commodities CPI.

Inventories. In November, book value of retail trade inventories rose at the fastest pace in more than a year, accelerating at automotive and other durable goods outlets. The change in total manufacturing and trade inventories was at a $17.5 billion rate, surpassing the October rate of $14.6 billion and the third quarter average rate of $13.3 billion.

CHANGE IN BOOK VALUE OF BUSINESS INVENTORIES
(Seasonally adjusted annual rate, $ billions)

	1972			
	Q II	Q III	Oct. (Rev.)	Nov. (Prel.)
Manufacturing and trade	8.7	13.3	14.6	17.5
Manufacturing, total	4.2	7.7	6.8	6.1
Durable	3.3	5.6	6.0	5.3
Nondurable	.9	2.1	.9	.9
Trade, total	4.5	5.5	7.8	11.3
Wholesale	1.9	4.1	4.5	2.7
Retail	2.6	1.5	3.3	8.7
Durable	.0	-.2	.8	6.7
Automotive	-1.4	-.6	-.2	3.9
Nonautomotive	1.4	.4	1.0	2.8
Nondurable	2.7	1.7	2.5	2.0

NOTE: Detail may not add to totals because of rounding.

Because of the slight decline in retail sales in November, the retail inventory-sales ratio increased, but it is still at a reduced level. This was offset by the decline in the manufacturing ratio, and the overall ratio declined further to 1.46, the lowest since early 1966.

INVENTORY RATIOS

	1971		1972	
	Oct.	Nov.	Oct. (Rev.)	Nov. (Prel.)
Inventories to sales:				
Manufacturing & trade	1.61	1.57	1.47	1.46
Manufacturing, total	1.82	1.77	1.64	1.60
Durable	2.20	2.14	1.92	1.89
Nondurable	1.38	1.34	1.28	1.23
Trade, total	1.40	1.37	1.31	1.32
Wholesale	1.25	1.24	1.20	1.20
Retail	1.49	1.46	1.38	1.41
Durable	2.06	2.01	1.80	1.83
Automotive	1.72	1.65	1.39	1.43
Nonautomotive	2.58	2.57	2.40	2.41
Nondurable	1.21	1.18	1.17	1.19
Inventories to unfilled orders:				
Durable manufacturing	.953	.944	.876	.869

Homes sold. Seasonally adjusted sales of new homes by merchant builders were at an annual rate of 715,000 units in November. While the rate was down sharply from the record (although downward revised) pace for October, the average for the two months combined was nearly 770,000--well above the third quarter average. Even so, with merchant builders' stocks of new homes up further, the stocks level turned upward to 6.3 months' supply at the October-November rate of sales, about as high as last June-July. The median price of homes sold in November held at $28,700, and remained above the still rising median price of homes for sale. (Confidential until Tuesday morning.)

Existing homes sold in November were at a median price of $27,180--up seasonally from October and 8 percent above a year earlier.

NEW SINGLE FAMILY HOMES SOLD AND FOR SALE

	Homes Sold1/	Homes for Sale2/	Median price of Homes Sold	Median price of Homes for Sale
	(Thousands of units)		(Thousands of dollars)	
1971				
QIV	682	284	25.5	25.9
1972				
QI	701	318	26.2	26.1
QII	686	355	26.8	26.5
QIII (r)	717	385	27.9	27.1
July	692	361	27.7	26.7
August (r)	767	384	28.1	27.0
September (r)	755	385	28.1	27.1
October (r)	823	394	28.7	27.6
November (p)	715	401	28.7	27.8

1/ SAAR.
2/ SA, end of period.

NOTE: Current and revised data beginning August are Confidential until Tuesday morning, January 16.

The Domestic Financial Situation

Mortgage rates. The average return on home mortgages remained virtually stable in December, according to HUD (FHA). In the primary market for conventional first mortgages, the contract interest rate on new and existing home loans remained at 7.70 and 7.75 percent respectively. In the secondary market, average yields on FHA-insured mortgages edged down one basis point to 7.56 percent. (Confidential until January 17.)

AVERAGE RATES AND YIELDS ON NEW-HOME MORTGAGES

		Primary market: Conventional loans		Secondary market: FHA-insured loans		
		Level (percent)	Spread (basis points)	Level (percent)	Spread (basis points)	Discounts (points)
1971 -	Low	7.55	-36	7.32	-27	2.5e
	High	7.95	52	7.97	31	7.8
1972 -	Low	7.55	15	7.45	5	3.7
	High	7.70	61	7.57	48	4.7
	July	7.65	27	7.54	16	4.4
	Aug.	7.65	28	7.55	18	4.5
	Sept.	7.70	30	7.56	16	4.6
	Oct.	7.70	32	7.57	19	4.7
	Nov.	7.70	61	7.57	48	4.7
	Dec.	7.70	55	7.56	41	4.6

NOTE: FHA series: interest rates on conventional first mortgages (excluding additional initial fees and charges) are rounded by FHA to the nearest 5 basis points. On FHA loans carrying the 7 percent ceiling rate in effect since mid-February 1971, a change of 1.0 points in discount is associated with a change of 12 to 14 basis points in yield. Gross yield spread is average mortgage return, before deducting servicing costs, minus average yield on new Aaa utility bonds.

e/ Estimated.

INTEREST RATES

	1972			1973
	Highs	Lows	Dec. 18	Jan. 11
Short-Term Rates				
Federal funds (wkly. avg.)	5.38 (12/20)	3.18 (3/1)	5.29 (12/13)	5.66 (1/10)
3-month				
Treasury bills (bid)	5.19 (12/19)	2.99 (2/11)	5.17	5.23
Comm. paper (90-119 day)	5.63 (12/29)	3.75 (2/29)	5.50	5.63
Banker's acceptances	5.63 (12/29)	3.75 (2/23)	5.50	5.75
Euro-dollars	6.31 (12/5)	4.62 (3/8)	5.94	5.94
CD's (prime NYC)				
Most often quoted new	5.50 (12/27)	3.50 (2/23)	5.25 (12/13)	5.63 (1/10)
6-month				
Treasury bills (bid)	5.39 (12/29)	3.35 (1/10)	5.37	5.51
Comm. paper (4-6 mo.)	5.63 (12/29)	3.88 (3/3)	5.50	5.63
Federal agencies	5.64 (12/29)	3.79 (2/17)	5.51	5.70
CD's (prime NYC)				
Most often quoted new	5.63 (12/27)	3.88 (2/23)	5.50 (12/13)	5.75 (1/10)
1-year				
Treasury bills (bid)	5.55 (9/22)	3.57 (1/8)	5.22	5.49
Federal agencies	5.86 (12/26)	4.32 (1/17)	5.79	5.91
CD's (prime NYC)				
Most often quoted new	5.75 (12/27)	4.62 (1/19)	5.63	5.85 (1/10)
Prime municipals	3.20 (12/27)	2.35 (1/12)	3.10	3.25
Intermediate and Long-term				
Treasury coupon issues				
5-years	6.32 (9/14)	5.47 (1/13)	6.18	6.31
20-years	6.22 (4/14)	5.71 (11/15)	6.00	6.85 2/
Corporate				
Seasoned Aaa	7.37 (4/24)	7.05 (12/7)	7.10	7.13
Baa	8.29 (1/3)	7.89 (12/29)	7.93	7.89
New Issue Aaa Utility	7.60 (4/21)	7.08 (3/10)	7.21	7.25
Municipal				
Bond Buyer Index	5.54 (4/13)	4.99 (1/13)	5.03 (12/14)	5.03
Mortgage--implicit yield				
in FNMA auction 1/	7.72 (10/16)	7.54 (3/20)	7.67 (12/11)	7.68

1/ Yield on short-term forward commitment after allowance for commitment fee and required purchase and holding of FNMA stock. Assumes discount on 30-year loan amortized over 15 years.

2/ This rate now reflects the yield on the Treasury's new 20-year, 6-3/4 per cent bond that was auctioned on January 4.

International Developments

U.S. foreign trade. Prices (unit-values) of U.S. exports rose very sharply in November--about 4 percent higher than in November. The increase in prices of finished manufactures was particularly large; smaller increases were reported for foodstuffs (wheat, rice) and for crude materials. Prior to November month-to-month price movements in exports had been relatively small. For September-November the export unit-value index for total exports averaged about 5 percent higher than a year earlier; for finished manufactures the increase was 3-1/2 percent.

Unit-values of total imports rose only slightly in November; prices of foodstuffs continued to rise but the unit-value index for finished manufactures changed very little from the relatively high October level. However, import unit-values (total and finished manufactures) had been steadily moving up throughout 1972. For September-November the unit-value index for total imports was about 8-1/2 percent higher than in the year-earlier period; the rise in finished manufactures was 9-1/2 percent.

Bundesbank raises discount rate. In its continuing campaign against inflation, the Bundesbank raised its discount and Lombard rates by a half a point each, effective January 12, to 5 and 7 percent, respectively. It was the fourth time these rates had been increased since October 8, when the discount rate stood at 3 percent, the Lombard rate at 4 percent. Rediscount quotas of German commercial banks with the Bundesbank were reduced by 10 percent, effective April 1. These quotas had been lowered in December, effective February 1, also by 10 percent. The Bundesbank described its latest actions as being directed against "the very marked expansion of credits and of the volume of money."

CORRECTIONS:

Page I-2, line 4 of Outlook should be: $250 billion in fiscal 1973, rather than the $252 billion shown in the December Greenbook.

APPENDIX A: RESULTS OF TELEPHONE SURVEY OF COMMERCIAL BANKS CONCERNING THE IMPACT ON M_1 OF THE RECENT CHANGE IN REGULATION J AND THE IMPLEMENTATION OF REGIONAL CHECK PROCESSING CENTERS*

Pursuant to the request at the last FOMC meeting, a telephone survey of selected commercial banks was conducted through the Reserve Banks in late December and early January to attempt to determine to what extent, if any, the accelerated growth of M_1 during November and December might be attributable to the recent change in Regulation J and/or the concommitant implementation of a number of regional check processing centers (RCPCs). For purposes of investigating a possible Regulation J effect, approximately 125 large (generally $200 million or more in total deposits) member banks that formerly remitted to the Federal Reserve for cash letters on a deferred basis (i.e., that remitted on the first business day after the day on which the cash letters were received) were contacted and were asked whether deposit customers (corporations in particular) had been requested to increase their balances in order to offset the effects of faster remittance by the bank for checks drawn on it by its customers. If such requests had been made and were honored by customers, the banks were asked to provide a rough estimate of the amount by which this factor had increased their gross demand deposits since the change in Regulation J took place. With respect to the effect of RCPCs, Reserve Banks contacted varying numbers of banks included in new RCPC arrangements and raised similar questions.

In general, the responses to the survey suggest that very little, if any, of the recent accelerations in M_1 growth can be attributed to the effects of either the change in Regulation J or the implementation of RCPCs. In all Reserve Districts the response from all banks contacted was virtually unanimous that deposit customers had not been requested to increase their balances as a result of the change in Regulation J. One exception to the general rule occurred in upstate New York where a bank indicated it had notified affected customers of the change in Regulation J and while no specific request was made for additional balances, the notification statement appeared to carry the weight of a request and some additional balances evidently were obtained. Another exception occurred in Idaho, where specific requests for more funds were tendered, but the bank indicated that thus far they had elicited little response.

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* Prepared by Anton S. Nissen, Senior Economist, Division of Research and Statistics.

While virtually no commercial banks had requested additional balances up to the time of the survey, a number did indicate they were either considering the possibility of so doing or intended to do so, but that additional time and analysis would be required before any action could be taken. Thus, it seems at least possible that such actions may tend to exert some upward influence on M_1 growth rates in the future. It should be noted, however, that banks cited a number of factors that would militate against higher deposit requests, and these would tend to limit their importance.

First, of course, part of the need for higher deposit balances has been offset by the Reserve Banks passing faster credit on some items presented to them for collection at the same time they are obtaining faster remittance on items presented by them for payment. In the aggregate, the amount on which the Reserve Banks are passing faster credit probably averages slightly more than half of the amount on which they are obtaining faster remittance, so the offset is not complete. Second, the general reduction in reserve requirement ratios under Regulation D also has tended to offset part of the need for higher balances. In analyzing the profitability of depositors' business, it appears that banks frequently take into account the maintenance of reserves against their balances. Thus, the increased profitability attendant to the general reduction in required reserve ratios tends partially to offset the effects of losses of funds realized through faster remittance.

A third factor tending to inhibit requests for higher deposit balances is the competitive situation among banks. All banks were not equally affected by the change in Regulation J and to the extent that some sort of equilibrium existed between competing institutions before this change, the banks more heavily influenced by the change may be unable to demand higher balances without losing customers. Finally, there is the existence of an alternative to higher balances in the form of increased service charges where accounts have been rendered less profitable by the Regulation J change.

The survey responses with respect to the impact of RCPCs are less detailed, but the general view is that the advent of such arrangements also has, at least up to this point, generated few, if any, requests by banks for higher deposit balances.