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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

October 11, 1974

The Domestic Economy

Industrial production is confidentially estimated to have risen 0.3 percent in September and at 125.5 percent of the 1967 average was 1.0 percent below a year earlier. The September increase in output mainly reflected settlements of work stoppages in electrical machinery, nonferrous metals, and mining.

Auto assemblies declined 2.5 percent and were at an annual rate of 7.7 million units, as strikes continued in parts supplying industries. Output of other durable consumer goods, mainly appliances and furniture, and nondurable consumer goods also declined. Production of business equipment rose 0.6 percent from the reduced August level because of settlement of a work stoppage. Output of construction products declined further.

Production of durable goods materials rose 1.3 percent as output of copper mining and fabricating recovered from strikes. Among nondurable goods materials, output of the textile, paper, and chemical group was further reduced.

INDUSTRIAL PRODUCTION
(Seasonally adjusted)

	Indexes 1967=100			Percent changes				
	1974					Annual rate		
	July (r)	Aug (p)	Sept (e)	Month ago	Year ago	QI	QII	QIII
Total	125.6	125.1	125.5	.3	-1.0	-6.6	1.9	- .3
Products, total	124.1	123.0	122.7	- .2	-1.3	-5.8	2.6	- .6
Final products	123.0	121.7	121.5	- .2	- .7	-6.5	3.0	.7
Consumer goods	130.1	129.4	128.4	- .8	-2.9	-11.5	2.5	- .6
Durable goods	132.0	130.4	128.0	-1.8	-7.4	-26.6	14.7	-7.0
Nondurable goods	129.3	129.0	128.5	- .4	-1.2	-5.2	-2.2	1.6
Business equipment	131.2	128.0	128.8	.6	2.4	.6	7.2	- .6
Intermediate products	128.0	128.1	127.5	- .5	-2.7	-4.6	1.2	- .4
Construction products	128.2	127.5	127.0	.4	-5.9	-5.1	-2.7	-8.6
Materials	128.0	128.7	129.8	.9	-1.1	-6.4	- .3	- .3

r - revised
p - preliminary
e - estimated

Confidential until release, probably October 16.

Wholesale prices. The wholesale price index for September rose only 0.1 percent, seasonally adjusted, the smallest monthly increase in nearly a year, to a level 19.7 percent above a year earlier.

The index of industrial commodities increased 1.0 percent, seasonally adjusted, as price advances were large and widespread. Higher prices for machinery and equipment, chemicals, furniture and household durables, nonmetallic minerals, metals, and transportation equipment accounted for most of the rise. Lumber and wood products declined for the fifth consecutive month, and the fuels and power group was also lower as a result of reduced prices for propane gas and residual fuels. Although the

September increase is substantially below the average of the previous 8 months when monthly increases were 2 percent or larger and is the smallest increase since last November, it is still an exceptionally large rise.

The index of farm and food products fell 1.9 percent, seasonally adjusted, chiefly as a result of lower prices for manufactured animal feeds, grains, livestock, and meats.

WHOLESALE PRICES
(Percent changes at seasonally adjusted compound annual rates) 1/

	Dec.1972 to June '73	June 1973 to Dec. 1973	Dec.1973 to June '74	June 1974 to Sept.1974	Aug.1974 to Sept.'74	Sept.1973 to Sept.1974
All commodities	20.2	10.9	18.2	35.2	1.1	19.7
Farm products	45.8	10.4	-11.5	59.2	-23.0	3.2
Industrial commodities	10.6	10.9	34.0	28.3	12.4	27.9
Crude materials	23.0	40.4	44.3	29.1	0.0	42.7
Intermediate materials	12.2	11.7	38.0	32.2	9.9	31.1
Finished goods	6.3	7.1	24.5	22.7	18.0	20.3
Producer	5.4	5.3	20.0	31.8	25.6	19.2
Consumer, excl. food	6.7	8.1	26.8	18.5	14.3	20.9
Nondurable, excl. foods	8.5	11.3	35.6	19.1	7.8	27.2
Durable	4.5	2.8	13.2	15.6	18.8	10.9
Consumer finished foods	27.0	18.5	-1.1	29.4	-3.6	8.1

Note: Farm products include farm products and processed foods and feeds.

1/ Not compounded for one-month changes.

Merchant builder sales of new single-family homes declined a tenth further in August from July and were within 7 percent of the recent low in December 1973. At the reduced August sales rate builder backlogs of unsold homes, which are still quite high, represented a near-record of more than 11 months' supply. Although the median price of new homes sold in August edged down--to $35,700--it still remained above the rising median price of unsold units. Existing home sales continued below their year earlier level in August, at a median price more than a tenth above a year earlier.

SALES, STOCKS AND PRICES OF NEW SINGLE FAMILY HOMES

	Homes sold1/	Homes for sale2/	Months' Supply	Median price of: Homes sold	Median price of: Homes for sale
	(thousands of units)			(thousands of dollars)	
1973					
QI	726	426	7.0	30.4	29.4
QII	680	436	7.7	32.7	31.2
QIII	566	453	9.6	33.5	32.1
QIV	483	446	11.1	34.0	32.9
1974					
QI	525	453	10.4	35.2	34.0
QII (r)	569	435	9.2	35.5	35.0
May (r)	599	441	8.8	35.7	34.7
June (r)	537	435	9.7	35.2	35.0
July (r)	514	431	10.1	36.8	35.3
Aug. (p)	464	432	11.2	35.7	35.5

1/ Seasonally adjusted annual rate.
2/ Seasonally adjusted, end of period.

Retail sales declined 1.3 percent in September from August, according to the advance Census estimate. This was somewhat weaker than indicated by the incomplete weekly data. There was appreciable weakness in the automotive group--off 5 percent from August--and a decline in the sales of furniture and appliances and general merchandise. Compared with a year earlier, September sales were up 8.6 percent and the third quarter average was 4.1 percent above the second of 1974. This was the largest quarterly increase in sales in a year and a half.

RETAIL SALES
(Seasonally adjusted, percentage change from previous period)

	1974		1974		
	QII	QIII	July	Aug.	Sept.
Total sales	2.9	4.1	4.0	.9	-1.3
Durable	4.4	-6.5	6.5	2.3	-3.7
Auto	5.5	11.9	9.4	5.1	-5.0
Furniture and appliance	3.7	.4	4.7	-2.6	-2.4
Nondurable	2.3	3.1	2.8	.2	- .1
Food	1.7	4.2	3.1	.9	.4
General merchandise	2.0	.1	1.2	- .6	- .7
Gasoline	8.8	5.0	.9	1.3	.5
Total, less auto and nonconsumption items	2.6	2.8	2.8	.2	- .3
GAF	1.6	.8	2.3	-1.2	- .9
Real*	.1	n.a.	3.4	- .6	n.a.

*Deflated by all commodities CPI, seasonally adjusted.

Retail inventories in August rose at a seasonally adjusted annual rate of $10.3 billion in terms of book value. The bulk of the increase was at durable goods outlets with the automotive group accounting for two-thirds of the total rise. The August inventory expansion was only a little less than in July when there was no increase at automotive stores.

Seasonally adjusted book value of combined inventories at retail and wholesale outlets increased at an $18 billion annual rate in July and August. With manufacturing stocks rising at a $34.8 billion annual rate in July and August, the 2-month increase was at a $52.9 billion annual rate, as compared with a $40.4 billion rate in the second quarter. However, because of the recent very rapid rise in prices, the July-August rise in book values probably represents only a moderate growth in physical stocks. (Confidential until release, October 15.)

INTEREST RATES

	1974 Highs	Lows	Sept. 19	Oct. 10
Short-Term Rates				
Federal funds (wkly. avg.)	13.55(7/3)	8.81(2/27)	11.64(9/4)	10.43(10/9)
3-month				
Treasury bills(bid)	9.74(8.23)	6.93(2/6)	9.15	7.80
Comm. paper (90-119 day)	12.25(7/17)	7.75(2/22)	11.75	9.75
Bankers' acceptances	12.50(8/15)	7.75(2/26)	11.50	9.75
Euro-dollars	14.38(7/16)	8.25(2/18)	13.06	11.00
CD's (NYC) 90-119 day				
Most often quoted new	12.00(9/4)	7.88(2/20)	11.38(9/4)	9.50(10/9)
6-month				
Treasury bills(bid)	9.86(8/23)	6.80(2/19)	9.18	7.90
Comm. paper (4-6 mo.)	12.13(7/10)	7.50(2/22)	11.63	9.50
Federal agencies	10.63(8/28)	7.16(2/19)	10.20	8.49(10/9)
CD's (NYC) 180-269 day				
Most often quoted new	11.90(8/21)	7.50(2/27)	10.50(9/4)	9.25(10/9)
1-year				
Treasury bills(bid)	9.65(8/23)	6.37(2/15)	8.68	7.63
Federal agencies	10.18(8/26)	7.01(2/19)	9.82	8.58(10/9)
CD's (NYC)				
Most often quoted new	9.75(7/17)	7.00(2/27)	9.00(9/4)	9.00(10/9)
Prime municipals	6.50(7/12)	3.70(2/15)	5.90(9/6)	4.90(10/11)
Intermediate and Long-Term				
Treasury coupon issues				
5-years	8.79(8/23)	6.72(2/14)	8.49	7.99
20-years	8.72(8/26)	7.40(1/4)	8.57	8.44
Corporate				
Seasoned Aaa	9.40(10/8)	7.73(1/2)	9.38	9.37
Baa	10.40(10/9)	8.54(1/2)	10.40	10.39
New Issue Aaa Utility	10.31(9/4)	8.05(2/13)	10.27(9/11)	-- (10/9)
Municipal				
Bond Buyer Index	6.95(7/10)	5.16(2/6)	6.79(9/11)	6.52(10/9)
Mortgage--average yield in FNMA auction	10.59(9/9)	8.43(2/25)	10.59	10.32(10/7)

SUPPLEMENTAL APPENDIX A*
SURVEY OF BUSINESS LOAN GROWTH
THIRD QUARTER, 1974

In the last three or four months there has occurred a moderate but noticeable weakening in business loan growth at commercial banks relative to the very rapid rate of growth in such loans in the first half of the year. Aggregate data indicate that this slowing has been fairly widely spread among Federal Reserve Districts, with no concentrated weakness in any single area or any specific group of banks. In order to shed light on the changing bank credit conditions, Federal Reserve Banks were asked to contact a sample of commercial banks in their districts and obtain the banks' judgments as to the major reasons for the recent slowing and particularly to distinguish between supply and demand related factors.

Almost without exception the contacted banks attributed a significant share of the slower loan expansion to supply conditions, and specifically enumerated their own bank's more stringent lending policies over the spring and summer months. Weakness in the demand for funds was cited as a factor by banks in New York City, but only a few banks in other districts noted any lessening in business credit demands. Reference was made by these latter banks to diminished loan demands in construction and housing-related industries, with one respondent reporting fewer loans to finance inventory accumulation.

Although a number of banks indicated a drop off in credit demands by small manufacturers who had previously been turned down or discouraged by the high cost of funds, this apparently reflects the impact of tight lending policies rather than a slowdown due to weakening in general business activity. Indeed, while many banks thought that overall aggregate demands were probably slowing, the majority of the respondents suggested that the demand for loans at their bank was as strong or stronger than earlier in the year, with borrowing continuing heavy by utilities and large manufacturing firms. A few regional banks mentioned requests from national borrowers for increased lines of credit which may have reflected turn-downs by the large business lenders in the major money markets.

Credit restraint policies practiced by the canvassed banks vary from programs to slow the growth of new credit to policies designed to reduce the current level of loans outstanding. Such policies entail extending no new lines of credit, refusing requested increases in lines to existing customers, and more careful screening of individual customer requests. Relatively drastic measures of restraint were reported by more than one respondent, including a bank in Tennessee that--because of the State's 10 percent usury ceiling--has stopped investigating new loan

*Prepared by Martha Scanlon, Economist, Banking Section, Division of Research and Statistics.

prospects entirely. Another bank (in Minneapolis) reports that every dollar of new commitments must be matched with a $2 decline in existing commitments; another instructs its loan officers to consider a loan application only if he can show that one of his other loans has made equivalent repayments or that he is willing to cancel a line outstanding to a present customer.

However, despite the reported tightening, the stock of unused commitments at the 138 large banks reporting on the Monthly Survey of Loan Commitments advanced at a rapid pace during August, the most recent month available. Since large banks have been able to attract funds through sales of money market instruments, the tightening of terms of lending and specifically commitments policy may be most extreme at small and medium sized banks.

Most of the banks surveyed in September responded that tighter lending policies were being enforced across the board and not directed at particular industries. The lending guidelines cited, however, would make it difficult if not impossible to justify loans for so-called 'non-productive' or 'speculative' purposes. Types of loans that are less likely to be accommodated include: term loans, interim construction loans (because of the uncertainty of construction firms in arranging final financing), REIT's, mobile homes, and certain 'speculative' inventory loans.

When asked the reason for the credit restraint policies, respondents frequently indicated they wished to build up their capital or liquidity positions. One bank implied that the current high cost of money market funds was a prime deterrent to increased lending at this time.

SUPPLEMENTAL APPENDIX B
THE PRESIDENT'S FISCAL POLICY PROPOSALS*

The new fiscal policy proposals are listed below in two separate categories, the first showing programs that are already reflected in staff economic assumptions, and the second those that so far have not been incorporated in staff projections.

I. Proposals that have been previously incorporated as assumptions in the staff projections

1. Budget outlays. A spending total for FY1975 of just under $300 billion.

2. Extended Unemployment benefits. An additional 13 weeks of benefits which would begin if the unemployment rate averages 6 per cent or more for three months. NOTE, however, that the President has also proposed to extend the coverage of unemployment benefits to some previously ineligible workers. This latter proposal is not incorporated in the staff assumptions and would cost $1.7 billion a year, assuming a 6.5 per cent unemployment rate.

3. Public Service Employment. An expanded public service employment program. NOTE, that the size of the recommended program (around $2 to $3 billion) is somewhat smaller than what had been assumed in staff projections where total outlays rise to $4 billion by the end of 1975. To be eligible for the President's Community Improvement Corps, an individual must have exhausted all available unemployment insurance benefits.

4. Housing credit. Authorization of $3 billion for GNMA to make commitments to purchase conventional mortgages. Equivalent assumptions of increased Federal housing credit are incorporated in our housing start projections.

5. Increased oil taxes. A windfall tax on high-priced oil and a phasing out of depletion allowances have been included in the staff forecast. These measures are included in the House Ways and Means Committee tax bill. The President has advocated the windfall tax and he has endorsed removal of depletion allowances if price controls on oil are removed.

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* Prepared by James Fralick, Economist, & Helmut F. Wendel, Assistant Adviser and Chief, Government Finance Section, Division of Research and Statistics.

II. Proposals not incorporated in staff assumptions

1. Tax surcharge. A 5 per cent surcharge on corporate income taxes and on individual income taxes applicable to incomes above $15,000 (or $7,500 for single persons). This tax would be levied during calendar year 1975 and would yield $2.1 billion from corporations and $2.6 billion from individuals.

2. Investment tax credit. An increase in the investment tax credit to 10 per cent both for utilities and other industries. A liberalization of credits for investments with relatively short useful lives, but the tax credit must be removed from the cost of the asset before calculating the depreciation deduction.

3. Preferred stock dividends. Treatment of dividends on preferred stocks issued after 1974 as a business cost for tax purposes.

4. Pending tax reform bill. The President, as previously mentioned, has endorsed legislation relating to increased oil taxes. The other features of this reform package include tax relief for low income individuals (amounting to $1.6 billion), a liberalization of capital gains taxation, a recasting of the minimum tax, and other tax reforms.