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CLASS II - FOMC

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SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

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The Domestic Nonfinancial Economy

The March rise in total personal income of 7.1 per cent (annual rate) was the second monthly slowing of the rate of growth of personal income, bringing the first quarter increase to 9.6 per cent at an annual rate. The declines in the growth rates of wage and salary disbursements in February and March, which dampened the growth of total personal income, followed the general pattern of nonfarm man hours during those two months.

The first quarter increase in manufacturing wages and salaries was substantially greater than in total such disbursements. The growth in transfer payments moderated in March. During February there had been an unusually large rise in transfer payments as a result of a speed-up in the payment of veterans' life insurance dividends ($2.6 billion) and the payment of earned income tax credits ($1.1 billion).

PERSONAL INCOME
(Billions of dollars, seasonally adjusted at an annual rate; per cent changes at compound annual rates)

	Per Cent Change					1976 Level	
	Mar.75- Mar.76	75:QIV- 76:QI	Dec.75- Jan.76	Jan.76- Feb.76	Feb.76- Mar.76	Feb.	Mar.
Total personal income	10.7%	9.6%	13.1%	11.8%	7.1%	$1,325.9	$1,333.5
Wage and salary disbursements	9.5	10.2	14.0	8.2	6.1	851.6	855.8
Manufacturing	12.7	15.3	21.2	8.2	11.0	228.4	230.4
Transfer payments	13.8	14.6	12.5	31.0	8.6	188.9	190.2
Other income	11.8	6.6	15.9	9.7	8.1	338.8	341.0

Seasonally adjusted private housing starts, which had risen very sharply in February, declined 8 per cent in March to an annual rate of 1.44 million units. All of the decline was in the single-family sector; multi-family units increased but remained at a low level. For the first quarter as a whole total starts averaged 1.41 million units, 4 per cent above the preceding quarter.

The Domestic Financial Economy

New York State financing. Late Wednesday, April 14, New York State completed arrangements for its $3.7 billion financing over the April-June period. The State obtained purchase commitments from private institutional investors for $2.4 billion of notes, and from State pension funds and other State sources for $1.3 billion of notes. The commitments will be taken down in three lots: $1.1 billion on April 15, $1.0 billion on May 15, and $1.6 billion on June 15. The proceeds from the note sales will be used to make State aid payments to localities and school districts, $800 million of advance aid payments to New York City, and payments for general State functions.

The State had planned originally to sell $2.75 billion of the $3.7 billion in notes to private investors, with the remaining $940 million notes coming from State sources. However, commitments from life insurances companies and nonfinancial corporations fell substantially short of expectations, as the table shows. While this shortfall was partly offset by larger than planned purchase commitments from mutual savings banks and upstate New York commercial banks, commitments from State sources had to be increased from $940 million to $1,290 million to take up the slack. The Teachers' Retirement System, which agreed to purchase an additional $200 million notes, covered the bulk of this residual.

SOURCES OF FINANCING FOR NEW YORK STATE
($ millions)

Private Sources	Planned	Actual
Total Sources	3,690	3,690
State	940	1,290
Private	2,750	2,400
Commercial banks		
New York clearinghouse banks	1,000	1,000
Other New York State banks	150	237
Out-of-State commercial banks	700	600
New York State mutual savings banks	400	428
New York State life insurance cos.	200	135
Nonfinancial corporations	300	

With the completion of the spring financing package, New York State will not have a need to raise funds from the public again until April 1977. The State has commitments from various State sources to purchase $810 million of bonds and bond anticipation notes in the second half of this year, although it will first try to sell the securities publicly.

Mortgage market. According to the HUD (FHA) opinion survey, average interest rates on new commitments for conventional new- and existing-home mortgages declined by 5 basis points during March. These movements are consistent with the primary market series cited in the Greenbook.

AVERAGE RATES AND YIELDS ON NEW-HOME MORTGAGES
(HUD-FHA Field Office Opinion Survey)

End of Month	Primary market: Conventional loans: Level 2/ (per cent)	Primary market: Conventional loans: Spread 4/ (basis points)	Secondary market 1/: FHA-insured loans: Level 3/ (per cent)	Secondary market 1/: FHA-insured loans: Spread 4/ (basis points)	Secondary market 1/: FHA-insured loans: Discounts (points)
1975-Low	8.90 (Mar.)	-70 (Mar.)	8.69 (Mar.)	-91 (Mar.)	2.4 (Dec.)
High	9.25 (Sept., Oct.)	+15 (Jan.)	9.74 (Sept.)	+31 (Oct.)	6.2 (Aug.)
1975-June	9.00	-37	9.06	-31	4.3
July	9.00	-25	9.13	-12	4.8
Aug.	9.15	-34	9.32	-17	6.2
Sept.	9.25	-45	9.74	+ 4	5.5
Oct.	9.25	+ 3	9.53	+31	4.0
Nov.	9.20	--	9.41	--	3.1
Dec.	9.15	--	9.32	--	2.4
1976-Jan.	9.05	+39	9.06	+40	2.4
Feb.	9.00	+42	9.04	+46	2.2
Mar.	8.95	+42	n.a.	n.a.	n.a.

1/ Any gaps in data are due to periods of adjustment to changes in maximum permissible contract rates on FHA-insured loans.

2/ Average contract rates (excluding fees or points) on commitments for conventional first mortgage loans, rounded to the nearest 5 basis points.

3/ Average gross yield (before deducting servicing costs) to investors on 30-year minimum-downpayment FHA-insured first mortgages for immediate delivery in the private secondary market (excluding FNMA), assuming prepayment in 15 years.

4/ Average gross mortgage rate or yield minus average yield on new issues of Aaa utility bonds in the last week of the month. (There were no issues of Aaa bonds during the last weeks of November and December 1975).

INTEREST RATES
(One day quotes - in per cent)

	1976			
	Highs	Lows	March 15	April 15
Short-Term Rates				
Federal funds (wkly. avg.)	5.12(1/7)	4.70(2/18)	4.77(3/17)	4.77
3-month				
Treasury bills (bid)	5.25(3/2)	4.68(1/29)	4.94	4.78
Comm. paper (90-119 day)	5.38(3/22)	5.00(4/14)	5.38	5.13
Bankers' acceptances	5.53(1/5)	4.85(2/2)	5.25	4.95
Euro-dollars	5.94(3/2)	5.25(1/30)	5.56	5.31
CD's (NYC) 90-119 day				
Most often quoted new	5.38(3/3)	4.95(1/27)	5.25(3/10)	4.88(4/14)
6-month				
Treasury bills(bid)	5.69(3/4)	4.97(1/29)	5.46	5.04
Comm. paper (4-6 mo.)	5.50(3/22)	5.13(4/15)	5.38	5.13
Federal agencies	5.93(1/2)	5.31(2/2)	5.88	5.44p(4/13)
CD's (NYC) 180-269 day				
Most often quoted new	5.88(3/17)	5.35(1/27)	5.75(3/10)	5.38(4/14)
1-year				
Treasury bills(bid)	6.05(3/4)	5.27(1/2)	5.87	5.37
Federal agencies	6.45(1/2)	5.90(2/2)	6.42	5.96p(4/13)
CD's (NYC)				
Most often quoted new	6.25(3/17)	6.13(4/16)	6.25(3/10)	6.00(4/14)
Prime municipals	3.30(3/12)	3.00(1/30)	3.30(3/12)	3.10(4/9)
Intermediate and Long-Term				
Treasury coupon issues				
5-years	7.61(3/4)	7.14(4/15)	7.52	7.14
20-years	8.12(2/10)	7.77(4/14)	7.96	7.80
Corporate				
Seasoned Aaa	8.66(1/2)	8.35(4/14)	8.54	8.35(4/14)
Baa	10.34(1/2)	9.84(4/14)	9.99	9.84(4/14)
New Issue Aaa Utility	8.88(1/9)	8.43p(4/16)	8.63(3/12)	8.45p(4/16)
Municipal				
Bond Buyer Index	7.13(1/8)	6.54(4/15)	6.98(3/11)	6.54
Mortgage--average yield in FNMA auction	9.13(1/12)	8.94(4/5)	9.06(3/8)	8.94(4/5)

SUPPLEMENTAL APPENDIX A*
THE UNITED KINGDOM'S 1976-77 BUDGET

On April 6, Chancellor of the Exchequer Denis Healey presented the U.K. government's Budget to Parliament. The Budget has three basic aims: a reduction in the current account deficit, the revival of industry, and the restoration of full employment. The key requirements for accomplishing these aims, as stated in the Budget, are the control of inflation and the shift of resources into industrial investment and production for export. The Budget's outstanding feature is its offer of tax relief conditional on the size of the wage settlement to be decided upon this summer with organized labor. The Budget involves a prospective public sector borrowing requirement of £11.3-12 billion for the 1976-77 fiscal year that began on April 1. (For 1975-76, the borrowing requirement was £10-3/4 billion.)

Specific Budget Proposals

The Budget proposals can be divided into two categories; those that are conditional on the degree of wage restraint to be negotiated with organized labor this summer, and those that are independent of the wage negotiations. Of the latter, the more important include:

1. Corporation Tax. In an effort to stabilize the corporate tax environment, assurances were given that various tax concessions to business (e.g., tax relief for inventory appreciation) would continue.

2. Industrial Finance. The stamp duty on transfers of fixed interest stocks is abolished and an extra £40 million is being allocated to industrial investment schemes. In addition, the Chancellor mentioned some ways in which the supply of industrial finance may be aided, although no specific proposals were made. Most noteworthy was his statement that he is exploring the possibility of medium-term bank finance for industry that would be eligible for rediscounting at the Bank of England.

3. Employment. The temporary employment subsidy (introduced last year) is to be doubled and extended to the end of this year. This is expected to save 30,000 jobs.

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4. Social Security. State pensions are to be increased by over 15 per cent in November and family income supplement limits are to rise in July.

5. Indirect Taxes. The value-added tax rate on so-called less essential goods (mostly consumer durables, but including gasoline), which was raised from 8 per cent to 25 per cent in last year's Budget, will be halved. (The standard VAT rate is 8 per cent). The excise tax on gasoline and diesel fuel will be raised, but because its VAT rate is to be decreased, the overall increase in gasoline tax is only about a penny a gallon. Excise taxes on alcoholic drinks and tobacco (other than pipe tobacco) will be raised. The net effect is an increase in taxes of £205 million.

6. Direct Taxation. Some personal tax allowances will be raised and some administrative changes in taxation will be made that will involve a reduction in taxes of about £370 million a year.

As noted, the Budget proposes a decrease in direct taxation that is conditional on the nature of this summer's wage negotiations. The proposal involves increases in personal tax allowances and an increase in the threshold level of income for some of the higher tax rates -- a reduction in taxes of some £930 million. The full amount will be awarded (and go into effect immediately) if a pay policy is agreed to that is consistent with halving the rate of inflation in 1977 (compared with that in 1976 as measured by December over December levels). In his speech, the Chancellor expressed his belief that this goal implies a pay raise limit of about 3 per cent. (The present limit is about 10 per cent.)

Because of potential supply bottlenecks and balance-of-payments considerations, the Budget rejects a "dash for growth" strategy and opts for a more gradual upturn in economic activity, led by exports. The Budget dismisses general import controls and competitive exchange rate depreciation as desirable policy measures -- but the door is left open for selective import restrictions.

Objectives

The government has set a goal of reducing the unemployment rate to below 3 per cent by 1979. (The current rate is 5.3 per cent.) According to the Chancellor's speech, achieving this goal will require an average annual growth rate of real GDP of 5-1/2 per cent between 1977 and 1979, a rate that he claims is obtainable, although not easily so. The Budget forecasts that real GDP will grow by 4 per cent between now and mid-1977, with exports and investment leading the way; little change in consumption is foreseen, and no worsening of the current account is expected. (For 1975, the current account deficit was £1.7 billion.) The Budget states that a December 1976 over December 1975 rate of inflation of 10 per cent is achievable and that the rate for 1977 could be 5 per cent if the suggested 3 per cent pay limit is adopted. (The March 1976 over March 1975 rate of retail price inflation was 21 per cent; however, for the last six months to March, inflation was running at an annual rate of 15 per cent.)

Assessment

According to the government's White Paper on public expenditures -- issued in February -- real public spending will rise at an average annual rate of slightly over one per cent between fiscal years 1975-76 and 1979-80, with the bulk of the increase coming between 1975-76 and 1976-77. Compared with the plans stated in last year's White Paper, public expenditure in trade, industry, and employment will be larger by about £500 million (at 1975 prices) in each of the next three fiscal years; most other programs will be cut. The main emphasis of this year's White Paper is on curbing the growth of the public sector and on the regeneration of industry.

The Budget, which presents the government's revenue plans, has the same emphasis as the White Paper. The Chancellor stated that, for the fiscal year covered by the Budget, the public sector borrowing requirement (for all levels of government and for nationalized industries) is expected to be about £12 billion, assuming the conditional tax relief is granted. If none of the conditional relief is granted, then the borrowing requirement will be about £11.3 billion. (The limit agreed to in the United Kingdom's letter to the IMF in connection with its application for credit last December was £12 billion.) Last year's borrowing requirement was £10-3/4 billion, but considering the growth in nominal GDP, this year's borrowing requirement will be slightly lower as a percentage of GDP, according to the Chancellor. (It would still be over 10 per cent of GDP).

The macroeconomic implications of the £12 billion public sector borrowing requirement are not clear because there are few indications as to how it will be financed. Excessive monetization of the debt could upset the government's anti-inflation goal, but excessive borrowing could hinder industrial investment. In his Budget message, the Chancellor said that he expects and wants the rate of monetary growth (M_3) to be about the same as the growth in nominal income, which would imply perhaps a rate of around 15 per cent. (In the year since February 1975, M_3 increased by 9 per cent; M_1 by 22-1/2 per cent.) There is a hint in the Budget message that either taxes or government spending may be adjusted (to alter the deficit) if monetary growth gets out of line.

Probably the most interesting aspect of this year's Budget is the effort to use fiscal policy to extend the incomes policy adopted last summer. (Last summer, the Trades Union Congress agreed to a £6 per week limit to pay increases; an average increase of about 10 per cent.) As part of the Budget, the Chancellor, in effect, has given the unions a chance to choose among various combinations of tax relief and nominal wage increases. Which combination is ultimately chosen will affect the macroeconomic impact of the government sector during 1976-77. A moderate wage settlement would reduce wage pressures but would increase the government deficit. The government estimates that the £930 million conditional tax relief would increase the deficit by some £700 million (the difference is probably due to the reduction in the public sector's wage bill if the 3 per cent limit is adopted.) On the other hand, a larger wage settlement would increase wage pressures but reduce the deficit. The former combination is probably preferable for the U.K. economy because it might break the wage spiral that has plagued the U.K. economy for years.

Organized labor's initial reaction to the Budget's wage/tax reduction proposal has been cool, but this reaction should be discounted since each side at this time probably is establishing its bargaining position. In his speech, the Chancellor seems to have left himself some room for compromise -- particularly for some face-saving recalculation of what wage settlement is "consistent with...halving [the] inflation rate in the coming year." Moreover, the government appears to be willing to give a part of the conditional tax relief in return for a somewhat less restrictive wage agreement.

In summary, the new U.K. Budget contains some noteworthy features. Some steps have been taken to encourage industry. The Chancellor's use of the tax system in his bargaining with the unions over the next phase of the incomes policy is innovative. It remains to be seen if the innovation will succeed.