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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

July 23, 1971

By the Staff
Board of Governors
of the Federal Reserve System

The Domestic Economy

Cyclical indicators. The preliminary and confidential Census composite index of leading indicators declined 0.5 per cent in June, after rising for seven months. In contrast, the leading index continued to rise in June 1968, in a comparable stage of the steel stockpiling cycle. But two volatile series--inventory change and the change in consumer instalment debt--are excluded from the preliminary calculation, and when these become available they could change the amount or even the sign of the June indication.

Contributing to the decline were a rise in initial claims for unemployment insurance and declines in new orders for durable goods, contracts and orders for plant and equipment, housing permits, industrial materials prices and stock prices. The manufacturing workweek and the ratio of price to unit labor cost rose. The preliminary coincident and lagging composites increased in June.

COMPOSITE CYCLICAL INDICATORS
(1967=100)

	12 Leading Trend Adjusted	5 Coincident	6 Lagging
1971:			
January	118.6	121.1	125.3
February	120.0	121.8	124.0
March	122.7	122.5	124.1
April	124.1	123.0	123.8
May (r)	124.5 (H)	123.8	123.4
June (prel.)	123.9	125.8 (H)	123.6

(H) Current high value.

Vacancy rates. Underscoring the strength in the demand for shelter, residential vacancy rates remained exceptionally low in the second quarter despite the recent accelerated pace of residential construction activity. For rental vacancies, the average of 4.9 per cent of all units available and fit for use in the second quarter was unchanged from the previous quarter and the lowest for any second quarter since 1957. Vacancy rates for home-owner units also held at a reduced rate during the second quarter.

RESIDENTIAL VACANCY RATES
(Percent)

	Average for second quarter of:					
	1957	1965	1968	1969	1970	1971
Rental Units	4.9	7.5	5.7	5.1	5.0	4.9
Northeast	3.0	4.8	3.5	2.9	2.7	2.8
North Central	4.4	6.6	4.8	4.8	5.6	5.0
South	5.8	7.7	7.2	6.4	6.4	6.6
West	7.5	12.0	7.6	6.4	5.4	5.4
Home-owner Units	.9	1.4	1.0	.9	.9	.9

Manufacturers' orders and shipments. New orders for durable goods declined 1 per cent in June, according to the advance report. Steel orders continued to fall off moderately and capital equipment and defense orders also were down. These declines were partly offset by increases for motor vehicles and "all other" durables, about half of which is construction materials. Excluding the steel stockpiling situation and the volatile defense series, durable goods orders were down slightly in June from May but remained above the second-quarter average, which was itself improved from the first quarter.

MANUFACTURERS' NEW ORDERS FOR DURABLE GOODS
(Seasonally adjusted)

	1971 Q I	1971 Q II (prel.)	1971 May (rev.)	1971 June (adv)	Change June from May
	Monthly Averages, Billions of Dollars				Per Cent
Durable goods, total	31.7	30.9	31.2	30.8	-1.1
Excluding steel & defense	27.0	27.2	27.5	27.4	- .4
Primary metals	5.2	4.9	5.0	4.7	-4.3
Iron and steel	2.6	2.2	2.1	2.1	-3.6
Other	2.6	2.7	2.8	2.7	-4.9
Motor vehicles & parts	4.6	4.5	4.4	4.5	2.8
Household durables	2.2	2.4	2.4	2.4	- .7
Defense products	2.0	1.5	1.5	1.4	-10.4
Capital equipment	8.8	8.5	8.7	8.5	-2.4
All other durables	8.8	9.2	9.2	9.3	1.5

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

The backlog of unfilled orders at durable goods manufacturers dropped over $2 billion in June, reflecting a $1.2 billion drop in the defense backlog, an expected drop in steel backlogs as steel shipments to stockpiling users increased, and a further decline in the capital equipment backlog. The durable goods backlog has been declining for four months and is 6 per cent below its February peak, whereas it only declined 2 per cent in the comparable stockpiling period in 1968. The defense products backlog is 11 per cent below its

February peak and 5 per cent below last June, and the capital equipment backlog is 3.5 per cent below January of this year and 8 per cent below a year earlier.

Shipments increased 2 per cent, reflecting a sharp jump in defense products and increases for steel, autos, household, and "all other" durables, partly offset by declines for capital equipment and nonferrous metals.

Consumer prices. Consumer prices rose at the rate of about 5.5 per cent in June, less rapidly than in May. However, the second quarter rate of increase was up sharply from that in the first quarter, reflecting mainly the greater stability of mortgage interest rates and a faster rise in prices of non-food commodities. Excluding home finance charges, the rate of rise in the CPI, unadjusted, was not only much higher in the second quarter than the first, but was substantially above that in either the first or the second half of 1970.

The faster rise of the CPI less mortgage costs this year compared to the last half of 1970 is in large part due to the brisk rise in food prices this year. Non-food commodity prices rose very little in the first three months of the year but accelerated over the second quarter with significant increases for used cars, new cars, apparel, and new homes. There was a drop in the rate of rise in "services less home finance" in the second quarter.

EFFECT OF MORTGAGE COSTS ON CONSUMER PRICES
(Percentage changes at annual rates, not seasonally adjusted)

	June 1970 to Dec. 1970	Dec. 1970 to March 1971	March 1971 to June 1971	May 1971 to June 1971
All items, CPI	4.9	2.4	5.8	7.2
All items, less mortgage costs 1/	4.8	3.8	6.6	7.2
Services	7.0	3.2	5.2	6.8
Services less home finance 1/ 2/	6.9	8.5	6.3	6.9

1/ Confidential.
2/ Excludes mortgage interest costs, property taxes and homeowners' insurance.

In June, gasoline prices rose after several months of decline, apparel prices levelled off after a previous large rise, new car prices failed to decline seasonally, and used car prices continued up. Food prices also rose more than seasonally, with further large increases for meats, fish and poultry--especially the latter--and fruits and vegetables. Among services, fares for airplanes, railroads and taxicabs rose rapidly.

Some of the items which have contributed heavily to the rise in consumer prices in the last few months had risen at more moderate rates some time during the last year. From June 1970 to June 1971, for example, used car prices were up about 5 per cent, a substantial rise, but less steep than the increase in new cars. Gasoline prices rose very strongly last month, but were still below June, 1970.

In June, fruit and vegetables (including processed) were up 5.5 per cent from last June 1970, but meats were at about the same level. The food index as a whole was 3.5 per cent higher than a year earlier.

CONSUMER PRICES
(Percentage changes, seasonally adjusted annual rates)

	Dec 1970 to March 1971	March 1971 to June 1971	May 1971 to June 1971	June 1970 to June 1971
All items	2.8	5.3	5.6	4.5
Food	6.0	6.3	6.3	3.5
Commodities less food	1.0	4.9	4.2	4.1
Apparel	1.0	4.4	.0	3.5
Gasoline 1/	-5.8	-3.4	10.9	-.4
New cars	4.7	3.2	5.4	7.7
Used cars 1/	-9.5	30.3	14.7	5.1
Home purchase				
Services 1/	3.2	5.2	6.8	5.6

1/ Not seasonally adjusted.

Auto sales. Seasonally adjusted sales of domestic model autos rose sharply in the second 10 days of July and for the first 20 days were at an annual rate of 9.1 million units.

The Domestic Financial Situation

Demand deposit ownership. With preliminary estimates of the ownership of gross IPC demand deposits at all commercial banks are now available for June of this year, a full year's data can now be examined. As may be seen in Table 1, gross IPC demand deposits are estimated to have increased $13.1 billion from June 1970 to June 1971, which is a somewhat greater increase than that recorded for the demand deposit component of the money stock. Growth in deposit holdings by consumers accounted for somewhat more than half of the advance in total IPC deposits over the year, while increases in deposits owned by non-financial businesses and financial businesses accounted for about one-fourth and one-eighth, respectively, of the total advance (see last columm in Table 1). Particularly given the fact that consumers owned less than a third of total IPC balances in June of last year--nonfinancial businesses owned more than half of the total and financial businesses owned about one-tenth of the total this evidence offers convincing evidence that consumers have been mainly responsible for the strength in demands for money during the past year.

With only a year's data, quarterly changes in deposit holdings are difficult to interpret, because of our inability to measure seasonal factors, but some tentative judgment can be offered. As may be seen in Table 2, consumer deposit holdings increased in each quarter of the year ending in June of this year, with expansion

Table 1

OWNERSHIP OF GROSS IPC DEMAND DEPOSITS
(Not adjusted for seasonal factors)

	Level (Billions of dollars)		Change		Per cent distribution	
	June 1970	June 1971 p	Billions of dollars	Per cent	June 1970 level	Change from June 1970 to June 1971
Gross IPC Demand Deposits	163.4	176.5	13.1	8.0	100.0	100.0
Held by:						
Financial business	16.6	18.3	1.7	10.2	10.1	13.0
Non-financial business	85.9	89.2	3.3	3.8	52.6	25.2
Consumers	49.9	57.2	7.3	14.6	30.5	55.7
Foreign	1.4	1.3	- .1	7.1	.9	- .8
All other 1/	9.6	10.5	.9	9.4	5.9	6.9
Memo:						
Money stock	207.8	223.5	15.7	7.6	--	--
Demand deposit component of money stock	160.1	172.5	12.4	7.7	--	--

p - Preliminary.
1/ Includes mainly non-profit institutions.
NOTE: All data are daily averages (some data based on averages of Wednesday dates).

over the last half of 1970 essentially equalled by the increase over the first half of 1971. A roughly equivalent statement applies to the timing of changes in financial business balances. The pattern of change in nonfinancial business deposit holdings, on the other hand, was markedly different, for, although these balances also increased in both the third and fourth quarter of last year, they dropped sharply in the first quarter of this year before rising again in the second quarter. Moreover, the second quarter increase fell well short of the first quarter decline so that on a seasonally unadjusted basis, nonfinancial businesses deposits show a fairly large net decline for the first half of this year.

Table 2

CHANGES IN THE OWNERSHIP OF GROSS IPC DEMAND DEPOSITS
(Not seasonally adjusted in $ billions)

	1970		1971		1970	1971
	Q3	Q4	Q1	Q2	2nd half	1st half
Gross IPC demand deposits	4.5	7.2	-4.3	5.7	11.7	1.4
Financial business	.4	.3	.9	.1	.7	1.0
Nonfinancial business	2.3	4.6	-6.7	3.3	6.9	-3.4
Consumers	1.5	2.2	1.1	2.5	3.7	3.6
Foreign	--	- .1	.1	- .1	- .1	--
All other	.4	.3	.2	0	.7	.1

INTEREST RATES

	1971			
	Highs	Lows	June 28	July 22
Short-Term Rates				
Federal funds (weekly averages)	5.46 (7/21)	3.29 (3/10)	4.96 (6/23)	5.46 (7/21)
3-month				
Treasury bills (bid)	5.53 (7/19)	3.22 (3/11)	4.96	5.34
Bankers' acceptances	5.62 (7/22)	3.88 (3/10)	5.50	5.62
Euro-dollars	8.00 (6/1)	4.94 (3/17)	6.87	6.33
Federal agencies	5.67 (7/22)	3.27 (2/24)	5.10 (6/25)	5.67
Finance paper	5.50 (7/22)	3.62 (3/15)	5.38	5.50
CD's (prime NYC)				
Most often quoted new issue	5.62 (7/22)	3.62 (3/24)	5.50 (6/23)	5.62
Secondary market	5.88 (7/21)	3.80 (3/17)	5.50	5.80
6-month				
Treasury bills	5.77 (7/19)	3.35 (3/11)	5.18	5.67
Bankers' acceptances	5.75 (7/22)	4.00 (3/10)	5.62 (e)	5.75 (e)
Commercial paper (4-6 months)	5.75 (7/22)	4.00 (3/29)	5.50	5.75
Federal agencies	5.91 (7/22)	3.53 (3/10)	5.59 (6/25)	5.91
CD's (prime (NYC)				
Most often quoted new issue	5.75 (7/22)	4.00 (3/24)	5.62 (6/23)	5.75
Secondary market	6.12 (7/21)	3.70 (3/3)	5.80	6.00
1-year				
Treasury bills (bid)	5.84 (6/30)	3.45 (3/11)	5.76	5.71
CD's (prime NYC)				
Most often quoted new issue	6.00 (7/22)	4.38 (3/3)	5.75 (6/23)	6.00
Prime municipals	3.55 (7/8)	2.15 (3/24)	3.40 (6/25)	3.50
Intermediate and Long-Term				
Treasury coupon issues				
5-years	6.92 (7/22)	4.74 (3/22)	6.73	6.92
20-years	6.56 (6/15)	5.69 (3/23)	6.45	6.41
Corporate				
Seasoned Aaa	7.69 (6/2)	7.05 (2/16)	7.62	7.63
Baa	8.93 (1/5)	8.28 (2/16)	8.77	8.75
New Issue Aaa	8.23 (5/20)	6.76 (1/29)	7.84 (6/23)	7.90
Municipal				
Bond Buyer Index	6.23 (6/24)	5.00 (3/18)	6.23 (6/24)	5.97
Moody's Aaa	5.80 (6/25)	4.75 (2/11)	5.80 (6/25)	5.65
Mortgage--implicit yield in FNMA auction 1/	8.23 (7/12)	7.43 (3/1)	8.22	8.23 (7/12)

1/ Yield on 6-month 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. e--estimated.

SUPPLEMENTAL APPENDIX A: THE EFFECT OF POSTAL WAGE SETTLEMENT ON THE FEDERAL BUDGET

The postal wage agreement reached on July 20 resulted in a two-year contract providing wage increases of up to $1,710 for each of 650,000 employees. The following table shows the three stages of the wage increase:

Item	Per cent Increase 1/	Date Payable	Increase Per Employee
1. Lump sum payment to those employed over 6 months	3.9	Immediately	$ 300
2. Five $250 increases	1st yr--3.2 2nd yr--3.1	July 20, 1971 through Jan. 20, 1973	1,250
3. Cost-of-living increase	Maximum--2.0	July 1972	160
			$1,710

In addition, employees were given protection against job lay-offs during the life of the contract. In return the Postal Service was given the right to introduce technological changes and to discipline workers.

The eventual annual cost to the Postal Service is estimated to be more than $1 billion--with a cost of $700 million in fiscal 1972 and an additional $400 million in fiscal 1973. The effect of the wage settlement on Federal budget is uncertain. If a postal rate increase is not sought, an additional Congressional appropriation may be necessary, and the deficit will increase.

1/ Based on the current average wage of $7,777.