Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that some material may have been redacted from this document if that material was received on a confidential basis. Redacted material is indicated by occasional gaps in the text or by gray boxes around non-text content. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

---

[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optical character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

Content last modified 6/05/2009.

CONFIDENTIAL (FR)
CLASS II - FOMC

December 12, 1975

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

TABLE OF CONTENTS

The Domestic Nonfinancial Economy

Retail sales in November were up 1 per cent from October, according to the advance estimate. Sales of many of the more discretionary types of goods figured importantly in the increase. Outlays for the automotive group and furniture and appliance stores were up for the second consecutive month. Spending for general merchandise rose by an unusually strong 3.4 per cent. Sales of the food group increased 0.4 per cent. Excluding autos and mainly nonconsumer items, the gain from October was 1 per cent, the same as for all types of stores.

More complete sample counts increased earlier estimates of sales in September and October by modest amounts. The increase in sales in the third quarter is now 3.9 per cent instead of the prerevision 3.8 per cent, a change too small to materially affect third quarter estimates. Sales in October according to current data are now 1.3 per cent above September rather than 1 per cent, and the advance estimate for November is slightly stronger than the earlier indications provided by weekly data. These revised figures, however, are not inconsistent with our projected fourth quarter total consumption outlays. To realize the fourth quarter gain now projected for goods consumption excluding automobiles, the staff assumes that retail sales for these stores will show a December gain that is quite substantially stronger than that realized in October or November.

RETAIL SALES

(Seasonally adjusted, percentage change from previous period)

	1975						
	I	II	III	Aug. to Nov.	Sept.	Oct.	Nov.
Total sales	2.5	3.4	3.9	1.6	- .8	1.3	1.0
Durable	4.7	3.9	5.8	2.7	- .4	2.1	1.1
Auto	6.1	4.6	7.4	1.7	-1.9	3.3	.4
Furniture and appliance	-.7	4.9	2.3	2.6	.5	1.3	.8
Nondurable	1.6	3.1	3.0	1.0	- .9	.9	1.0
Food Stores	2.9	1.2	2.8	1.4	-1.8	2.9	.4
General merchandise	.3	5.5	2.0	1.5	.1	-1.9	3.4
Gasoline Stations	1.2	2.7	6.6	-3.3	- .8	-2.2	-.3
Total, less auto and nonconsumption items	1.6	3.1	3.1	1.1	- .8	1.0	1.0
GAF	1.0	5.0	2.3	1.5	- .5	-1.1	3.1
Real*	.7	2.0	1.5	n.a.	- .9	.6	n.a.

*Deflated by an unpublished Bureau of Economic Affairs price measure.

Wholesale trade inventories. Book value of wholesale trade inventories rose at a $4.7 billion annual rate in October, faster than both the September growth rate of $1.5 billion and the third quarter average rate of $3.1 billion.

Merchant builder sales of new single-family homes were essentially unchanged in October from the upward revised September figure. Even so, the seasonally adjusted annual rate of 577,000 units in October was slightly above the advanced pace during the second quarter, when the impact of the 5 per cent tax credit enacted in late March was apparently strongest.

The stock of unsold new homes rose slightly further in October and by the end of the month represented 8 month's supply at the current sales rate.

Sales of existing homes continued at an exceptionally strong rate in October. The seasonally adjusted index of unit sales rose to 122 (1972=100)--3 per cent above the all-time high set last month.

HOME SALES

	New Home Sales and Stocks			Sales Indexes of Unit Volume (1972=100, seasonally adjusted)		Median Prices of Homes Sold (thou. of dol.)	
	Homes sold 1/ (thousands of units)	Homes for sale 2/ (thousands of units)	Months' supply	New homes 3/	Existing homes	New homes	Existing homes
1974							
QI	523	452	10.4	73	106	35.2	30.9
QII	550	436	9.5	77	105	35.6	32.2
QIII	490	414	10.1	68	99	36.2	32.8
QIV	417	400	11.5	58	93	37.3	32.2
1975							
QI	426	396	11.2	59	95	38.1	33.8
QII	571	378	7.9	80	108	39.0	35.4
QIII (p)	566	382	8.1	79	112	38.8	36.1
June	556	378	8.2	77	109	37.9	36.2
July (r)	553	383	8.3	77	105	38.6	35.9
Aug. (r)	574	379	7.9	80	111	38.3	36.8
Sept. (r)	579	382	7.9	81	119	39.5	35.8
Oct. (p)	577	385	8.0	80	122	40.7	35.4

1/ Seasonally adjusted annual rate.
2/ Seasonally adjusted, end of period.
3/ Converted to 1972 index for comparison with existing home sales, which are not available on any other basis.

The Domestic Financial Situation

No textual addendums to the Greenbook were required, but the usual updating of interest rate developments is contained in the table on page 5.

INTEREST RATES
(One day quotes - in per cent)

	1975 Highs	1975 Lows	Nov. 17	Dec. 11
Short-Term Rates				
Federal funds (wkly. avg.)	7.70(1/8)	5.13(5/21)	5.24(11/19)	5.26(12/10)
3-month				
Treasury bills (bid)	6.90(1/2)	4.88(6/16)	5.45	5.56
Comm. paper (90-119 day)	9.00(1/2)	5.38(6/2)	5.75	6.00
Bankers' acceptances	9.00(1/1)	5.40(5/30)	5.80	5.80
Euro-dollars	10.25(1/3)	5.69(5/21)	6.81	6.56
CD's (NYC) 90-119 day				
Most often quoted new	9.00(1/1)	5.38(6/11)	6.00(11/12)	6.00(12/11)
6-month				
Treasury bills (bid)	7.05(8/25)	5.18(6/11)	5.77	6.02
Comm. paper (4-6 mo.)	8.75(1/2)	5.38(5/23)	5.88	6.00
Federal agencies	7.67(1/2)	5.68(6/12)	6.27	6.40p
CD's (NYC) 180-269 day				
Most often quoted new	8.38(1/1)	5.75(6/18)	6.50(11/12)	6.50(12/11)
1-year				
Treasury bills (bid)	7.35(8/21)	5.37(2/5)	6.11	6.38
Federal agencies	8.00(8/25)	6.03(2/20)	6.88	6.85p
CD's (NYC)				
Most often quoted new	8.00(1/1)	6.00(3/12)	7.00(11/12)	7.00(12/11)
Prime municipals	4.35(8/15)	3.40(2/7)	3.40(11/14)	3.60(12/12)
Intermediate and Long-Term				
Treasury coupon issues				
5-years	8.56(9/16)	6.93(2/19)	7.87	7.94
20-years	8.71(9/16)	7.58(2/21)	8.29	8.37
Corporate				
Seasoned Aaa	9.02(4/30)	8.57(2/26)	8.78	8.87(12/10)
Baa	10.63(1/20)	10.27(4/3)	10.32	10.38(12/10)
New Issue Aaa Utility	9.80(4/3)	8.89(2/6)	9.11(11/13)	9.37p
Municipal				
Bond Buyer Index	7.67(10/2)	6.27(2/13)	7.43(11/13)	7.34
Mortgage--average yield				
in FNMA auction	9.95(10/6)	8.78(3/10)	9.33	9.32(12/1)

APPENDIX A*

New York City Financial Aid

A $6.8 billion plan designed to meet New York City's financing needs over the next three years is now being put into place. Any failure of this package to be fully implemented would undoubtedly lead quickly to a default by New York City, barring additional Federal aid.

The three-year financing plan was developed by Governor Carey and officials of the Municipal Assistance Corporation (MAC) in early November. The plan calls for:

1. A $2.5 billion purchase of City notes by New York City pension funds;

2. A $1.0 billion rollover of City notes at 6 per cent by banks and other institutional holders;

3. An $0.8 billion advance of aid by New York State in the second quarter of 1976;

4. A $0.4 billion reduction in debt service payments by reducing interest payments on $1.8 billion of outstanding MAC securities owned by banks and other institutions, and a reinvestment in City notes by New York City pension funds of debt service payments made to them by the City;

5. An exchange $1.6 billion of City notes held by the public into 10-year, 8 per cent MAC bonds; and

6. A three year City tax increase of $500 million ($200 million per year over the next 2-1/2 years).

In order to put this package together, the New York State legislature passed a bill in mid-November decreeing a 3-year

---

* Prepared by Christopher Taylor, Economist, Capital Markets Section, Division of Research and Statistics.

moratorium on principal payments for publicly-held City notes, and paying holders of such notes an interest rate of 6 per cent per year. Shortly thereafter, MAC initiated an offer to exchange 10 year, 8 per cent MAC bonds for NYC notes. This offer was originally good until December 10, but has been extended through December 29. The State legislature also imposed $200 million of new taxes on the City to help close the projected gap between City receipts and expenditures.

After the completion of these State actions and receipt of commitments from the various parties involved in the financial plan, President Ford announced that he would be willing to sign legislation providing for $2.3 billion of direct Federal loans to aid New York City and amending the Federal bankruptcy laws to permit an orderly default by the City (should the rescue plan fail).

In early December Congress passed the $2.3 billion loan bill, which was signed by the President on December 9.

Even so, prospects for successful completion of the total rescue plan remain cloudy. The biggest present threat to the City aid package is a suit brought by Flushing National Bank to declare the debt moratorium law unconstitutional and in violation of Federal bankruptcy statutes. The arguments in the suit reportedly will be heard on December 19 with a decision to be rendered shortly thereafter. Two other aspects of the plan may also be subject to legal challenges. Stockholders of banks may challenge the participation of their institutions in the plan, and pension fund beneficiaries may sue the trustees of New York City pension funds, charging them with violating their fiduciary responsibilities. 1/

New York State and State Agencies

The New York State legislature is being asked to take measures to eliminate sizable deficits in the State's fiscal year 76 and 77 budgets. There is considerable debate going on in Albany now about the size of the fiscal 76 budget deficit, which Governor Carey estimates at close to $700 million, but which the Republican minority feels is much less. The outcome of this debate is still uncertain. The legislature has also been requested to consider possible aid

1/ Moreover, there is some ambiguity surrounding the backing of the MAC bonds involved in the exchange offer. Standard and Poor's has refused to rate these bonds, given the legal question surrounding their revenue backing and the debt moratorium law.

measures for State agencies, two of which--the New York State Housing Finance Agency (HFA) and the New York State Dormitory Authority--face the possibility of default on December 15. Discussions are being held with several banks about the possibility of a loan to meet these agencies' needs, though no final arrangements have been made.

APPENDIX B*

THE CURRENT SERVICES BUDGET for FY 1977

Under the provisions of the Congressional Budget and Impoundment Control Act of 1974, the President is required to submit a current services budget to the Congress by November 10 of each year, beginning in 1975. In fulfilling this requirement, the Administration recently released its first current services budget for fiscal year 1977. Publication of the current services budget is a significant innovation in the budget-making process, since it provides estimates of the outlays, revenues and proposed budget authority that would be expected to develop in the next fiscal year if all programs and activities were carried on as presently budgeted, and without policy changes. In other words, it assumes continuation of the existing level of services being provided by the Federal government.

The purpose of the current services budget is to provide a base against which alternative budget totals, either Presidential or Congressional, can be measured and compared. The outlay and revenue estimates contained in the Administration's usual January budget document, reflect not only the effects of ongoing programs, but also any new spending and tax initiatives proposed by the Administration. To assess the magnitude and direction of the President's budget accurately therefore, it is useful to differentiate the expected effects of these new initiatives, from those of ongoing programs. Early submission of the current services budget also provides extra time for the Congressional budget staff to become familiar with the base budget, and in this way facilitates Congressional action on the new Administration budget once it becomes available.

Current Service Economic Assumptions

The current services budget, like any other budget, must make certain economic assumptions concerning rates of inflation, unemployment, and economic growth. The budget just presented for fiscal year 1977 uses the four sets of alternative assumptions shown in Table I.

---
* Prepared by Wayne Ayers and James Fralick, Economists, Government Finance Section, Division of Research and Statistics

TABLE I
Alternative Economic Assumptions
(billions of dollars, calendar years)

	ASSUMPTIONS 1976	1977
Path I - High inflation, high unemployment		
Nominal GNP	$1,679	$1,893
GNP deflator 1/	8.0	7.0
Real GNP growth rate 2/	6.0	5.0
Unemployment rate	7.9	7.4
Path II -High inflation, lower unemployment		
Nominal GNP	$1,699	$1,934
GNP deflator 1/	8.0	7.0
Real GNP growth rate 2/	7.3	6.0
Unemployment rate	7.4	6.8
Path III-Lower inflation, high unemployment		
Nominal GNP	$1,660	$1,835
GNP deflator 1/	6.0	5.0
Real GNP growth rate 2/	6.0	5.0
Unemployment rate	7.9	7.4
Path IV -Lower inflation, lower unemployment		
Nominal GNP	$1,680	$1,874
GNP deflator 1/	6.0	5.0
Real GNP growth rate 2/	7.3	6.0
Unemployment rate	7.4	6.8

1/ Per cent change, fourth quarter over fourth quarter.
2/ Per cent change, year over year.

On the basis of these economic assumptions, current service outlays for fiscal year 1977 are projected to range between $411 and $415 billion, as shown in Table II. Receipts however are projected to show a wider degree of variation--ranging between $361 and $381 billion--due to the greater sensitivity of revenues to alternative economic conditions.

Thus, the rather wide range of deficit estimates shown in the table--from $31 to $51 billion--is primarily a function of differences in receipts projections.

TABLE II

Fiscal Year 1977 Fiscal Aggregates - Current Services Basis
(billions of dollars)

		Receipts	Outlays	Deficit
Path I	(high inflation, high unemployment)	372.6	414.5	41.9
Path II	(high inflation, lower unemployment)	380.9	412.3	31.4
Path III	(lower inflation, high unemployment)	361.5	412.9	51.4
Path IV	(lower inflation, lower unemployment)	369.7	410.7	41.0

Budget Receipts

The Current Service estimate of receipts assumes (a) extension of most of the 1975 tax reductions, together with an extension of current withholding tax rates through 1976, (b) an increase in the maximum social security tax base from $15,300 in calendar year 1976 to $16,500 in calendar year 1977, (c) an increase in unemployment tax receipts in 1977 as states increase their contributions to the Treasury in order to rebuild the unemployment trust fund to pre-recession levels, and (d) continuation of the $2 per barrel import fee which adds $3.6 billion to receipts in 1977. The staff believes that this last assumption is particularly tenuous, given recent court challenges to the fee's legality and the fact that the energy package now under consideration in Congress provides explicitly for discontinuation of this levy.

Budget Outlays

Table III presents the major components of the increase in current service outlays from fiscal year 1976 to fiscal year 1977, as presented by the Administration. These projections are based on Path I economic assumptions, which were selected for illustrative purposes, and do not necessarily reflect the Administration's official forecast of economic activity.

TABLE III

Change in Current Service Outlays, 1976 to 1977
(Based on Path I economic assumptions, billion of dollars)

Total Current Service Outlays estimated for FY'76		$368.5
(Plus) Changes Projected for Fiscal 1977		
Non defense payment to individuals		20.4
Social security and railroad retirement	(12.1)	
Unemployment assistance	(-0.4)	
Veterans benefits	(-0.8)	
Medicare-Medicaid	(5.1)	
All other	(4.4)	
Net interest		6.5
Department of defense military		11.7
Pay raises	(4.9)	
Retired pay	(1.3)	
Purchases	(5.5)	
Major non defense construction programs		3.4
All other		4.0
(Equals) Total Current Service outlays estimated for fiscal 1977		$414.5

Non defense payments to individuals--social security, veterans benefits, medicare-medicaid and unemployment benefits--are projected to increase by $21.6 billion on a current services basis. This rise is due primarily to cost of living increases, higher earnings records for new retirees and increases in the number of beneficiaries. Approximately $1.2 billion of the rise is offset by a decline in the level of unemployment and a decrease in the number of veterans claiming benefits under the GI bill.

Table III also shows that current service outlays for the Defense Department are forecast to rise by $11.7 billion between fiscal year 1976 and fiscal year 1977. Approximately $4.9 billion of this increase is due to an 11.5 per cent pay raise for civilian and military personnel. The 11.5 per cent increase assumes a "catch up" from the October 1975 cap on pay increases, when military and civilian workers received a 5 per cent raise rather than the comparability increase of 8.66 per cent. Of course, the President may propose a "below comparability" increase for October 1976, but this action is regarded as a policy initiative and thus is excluded--by definition--from the current services budget. Without Presidential action, the existing law provides automatically for a comparability increase.

Finally, Path I interest payments are estimated to increase by $6.5 billion in fiscal 1977. This estimate assumes a budget deficit of $43 billion--as noted in Table II--and a stable level of Treasury borrowing costs geared to a 91-day bill rate of 6 per cent.[1/]

The Outlay Impact of Alternative Conceptual Approaches

The outlay estimates presented in the current services budget also depend to some extent on the conceptual definition of a "baseline budget". Essentially, the base on which the fiscal year 1977 current service totals rest is completed Congressional action as of

1/ Interest rates in the Budget are conventionally projected to be close to recently observed rates.

September 1, 1975. Consequently, the budget ignores all pending Administration and Congressional proposals as of that date, regardless of the probabilities of enactment. Moreover, the impact of inflation on the budget is built into only those programs that increase automatically with the cost of living or where the effects of inflation can be completely anticipated--as in certain defense weapons procurement programs. No similar inflation adjustment is made for other programs such as veterans pensions, and non-indexed grants to State and local governments. OMB estimates that if Congress were to make an inflation adjustment for these additional programs Path I outlays would increase by an additional $7.5 billion in fiscal 1977, as detailed in Table IV.

TABLE IV

Outlay Impact of Alternative Budget Approaches
(billion of dollars, FY 1977)

		Outlays
Additional adjustments for inflation: Total 1/		$7.5
Veterans compensation, pensions and readjustment benefits	(1.3)	
Non indexed grants	(2.4)	
Other programs not adjusted for inflation:		
Defense	(1.2)	
Non Defense	(2.6)	
Non-renewal of certain programs that expire under existing law: Total 2/		-8.0
General revenue sharing	(-3.2)	
Temporary unemployment assistance	(-2.2)	
Special and supplemental unemployment benefits	(-1.4)	
Earned income credit	(-1.2)	

1/ Based on Path I inflation assumptions. Includes only those programs not adjusted for inflation under current law.

2/ Based on Path I unemployment rate assumptions.

Finally, many Federal programs are authorized for a limited number of years but are routinely renewed. If these programs were excluded from the current services budget, outlays would be reduced considerably. Such a reduction, however, would be at the expense of budgetary realism. The Administration, therefore, has assumed that the following major programs will be renewed: general revenue sharing, temporary unemployment benefits, special unemployment assistance for previously uncovered workers, and the earned income tax credit. As shown in Table IV, if these programs were terminated, fiscal 1977 current service outlays would be reduced by $8 billion.

The President's Proposed $395 Billion Spending Ceiling

While the spending total in the recently presented current services budget projects outlays of $415 billion for fiscal 1977, the President has proposed an expenditure ceiling for that year of only $395 billion. If this ceiling is to be implemented, the Administration will have to recommend a $20 billion cut in outlays from existing programs. As noted above, there are some possibilities for placing "caps" on built-in cost-of-living increases in order to avoid what would otherwise be automatic spending increases. Savings of possibly ($3 - $4 billion) might be achieved, for example, by placing a "cap" on civilian and military pay raises. In addition, eligibility requirements in a number of social programs might tightened, although expenditure constraints of this type have met substantial Congressional resistance in the past. Of course, Congress is likely to introduce some new expenditure initiatives of its own which the President would presumably have to veto to maintain an effective lid on spending. Hence, in the absence of drastic revisions in existing programs, it appears unlikely that the Administration will have much success in achieving its $395 billion expenditure target.