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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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SUPPLEMENTAL NOTES

The Domestic Nonfinancial Economy

Auto sales. Sales of new domestic-model autos in the first ten days of December were at an 8.6 million unit annual rate. This is up from the November rate of 8.3 million per year but still below the 8.9 million rate in the third quarter.

Business inventories. The book value of manufacturing and trade inventories increased at a \$14.3 billion annual rate in October (p), off sharply from the \$31.9 billion rate now indicated for September and the \$26.4 billion rate during the third quarter as a whole. (Revised figures for trade establishments for September have lifted these gains from the \$22.9 billion annual rate and \$23.4 billion rate gains indicated by the preliminary estimates for September and the third quarter, respectively.) The overall inventory-sales ratio for all manufacturing and trade in October edged down to 1.46 from 1.47 in September.

The book value of inventories held by retail and wholesale trade establishments in October increased at a \$6.3 billion annual rate with somewhat more than half at merchant wholesalers handling durable goods. This moderate October buildup followed a \$19.2 billion rate rise in September when about two thirds of the advance was in stocks of wholesalers. Stocks of retail stores have increased only modestly compared with gains at both manufacturing and wholesale trade.

BUSINESS INVENTORIES
(Change at annual rates in seasonally
adjusted book value\$ billions of dollars)

	1976				1977			
	QII	QIII	QIV	QI	QII	QIII	Sept.	Oct. (p)
Manufacturing and trade	33.8	29.5	11.4	34.2	32.1	26.4	31.9	14.3
Manufacturing	14.2	15.4	6.5	11.2	17.8	9.4	12.7	8.0
Durable	6.8	6.7	6.4	7.8	10.9	5.5	4.0	3.5
Nondurable	7.5	8.6	.0	3.3	6.8	3.9	8.7	4.5
Trade, total	19.6	14.1	4.9	23.0	14.3	17.1	19.2	6.3
Wholesale	11.6	4.1	3.5	12.0	2.6	4.7	12.3	3.5
Retail	8.0	10.1	1.5	11.1	11.8	12.4	6.9	2.8
Auto	.1	4.8	1.3	2.2	2.4	1.3	-7.1	2.1

INVENTORY RATIOS

	1976		1977				
	QIII	QIV	QI	QII	QIII	Sept.	Oct. (p)
<u>Inventory to sales:</u>							
Manufacturing and trade	1.51	1.49	1.46	1.46	1.48	1.47	1.46
Manufacturing	1.67	1.66	1.58	1.58	1.59	1.57	1.57
Durable	2.04	2.04	1.94	1.94	1.93	1.91	1.90
Nondurable	1.27	1.25	1.20	1.20	1.22	1.21	1.21
Trade, total	1.36	1.34	1.34	1.34	1.37	1.37	1.35
Wholesale	1.24	1.24	1.24	1.21	1.23	1.24	1.24
Retail	1.47	1.42	1.43	1.45	1.48	1.48	1.44
<u>Inventories to unfilled orders:</u>							
Durable manufacturing	.640	.632	.635	.631	.640	.640	.629

The Domestic Financial Economy

No textual addendums to the Greenbook were required, but the usual updating of interest rate developments is contained in the table on page 6.

International Developments

German monetary policy and capital control measures.

On December 15, the Bundesbank announced its monetary growth target for 1978, reductions in its discount and Lombard rates, and several measures restricting inflows of foreign capital to Germany.

The target growth rate for central bank money^{1/} (CBM) for 1978 is 8 per cent, in annual average terms. This is the fourth successive year the Bundesbank has announced an 8 per cent CBM growth target (and for the last three the target has been stated in terms of annual average growth). The 8 per cent target for 1978 is higher than the figure recommended by the government's council of economic experts (6-7 per cent).

Actual CBM growth has exceeded the 8 per cent target rate in each of the three years a target has been in effect: by 1.6 per cent in 1975, 1.2 per cent in 1976, and a projected 1 per cent in 1977. For 1977 the Bundesbank also announced an additional guideline, that between the fourth quarter of 1976 and the fourth quarter of 1977, CBM should not grow by more than 6-7 per cent. The projected growth

^{1/} Central bank money in Germany is defined as currency in circulation plus minimum reserves (at January 1974 reserve ratios) on banks' domestic liabilities.

rate for the fourth quarter of 1977 over a year earlier is 9.5 per cent.

Effective December 16, the German discount and Lombard rates are cut by 1/2 percentage point each, to 3 and 3.5 per cent, respectively. This is the first change in the discount rate since September, 1975, when it was reduced from 4 to 3.5 per cent. It is reported that the rate cuts, in conjunction with the capital controls announced December 15, are meant to help moderate the upward pressure on the Deutsche mark exchange rate.

The measures restricting foreign capital inflows announced December 15 constitute a reimposition of several of the capital controls removed in 1974 and 1975. Reserve ratios on banks' foreign liabilities, which are currently the same as those on domestic liabilities, are to be raised effective January 1 (with the reserve ratio for sight deposits rising from 12.75 to 20 per cent, and the ratios for less liquid deposits rising by smaller amounts). A special 100 per cent minimum reserve requirement is to be imposed, also effective January 1, on the growth of banks' foreign liabilities (growth will be measured against the average level of foreign liabilities from September 16 to December 15, 1977). Effective immediately, the Bundesbank will refuse permission for foreign purchases of German securities with maturities of two to four years.

Higher reserve ratios for foreign bank deposits than for domestic deposits were last in effect from June 1, 1971, to August 1, 1975. A special reserve requirement on the growth of foreign liabili-

ties was last in effect from April 1, 1970, to January 1, 1974. Foreign purchases of German bonds were not permitted by the Bundesbank from June 29, 1972, to August 19, 1975.

INTEREST RATES
(One day quotes--in per cent)

	1977		1977	
	Highs	Lows	Nov. 14	Dec. 15
<u>Short-Term Rates</u>				
Federal funds (Wkly avg.)	6.58(11/9)	4.47(1/5)	6.42(11/16)	6.49(12/14)
3-month				
Treasury bills (bid)	6.36(10/13)	4.39(4/28)	6.09	6.01
Comm. paper (90-119 days)	6.63(12/15)	4.63(1/10)	6.56	6.63
Bankers' acceptances	6.73(11/3)	4.66(1/3)	6.58	6.55
Euro-dollars	7.44(10/13)	4.88(1/5)	7.06	7.13
CD's (NYC) 90 days				
Most often quoted new	6.70(12/14)	4.50(1/5)	6.60(11/9)	6.70(12/14)
6-month				
Treasury bills (bid)	6.55(10/13)	4.54(1/3)	6.39	6.36
Comm. paper (4-6 mos.)	6.75(10/18)	4.63(1/7)	6.59	6.64
CD's (NYC) 180 days				
Most often quoted new	6.92(11/9)	4.65(1/5)	6.92(11/9)	6.85(12/14)
1-year				
Treasury bills (bid)	6.64(10/13)	4.66(1/3)	6.50	6.48
CD's (NYC)				
Most often quoted new	7.08(12/14)	5.00(1/5)	7.00(11/9)	7.08(12/14)
Prime municipal note	3.65(10/14)	2.65(1/7)	3.55(11/10)	3.60(12/16)
<u>Intermediate- and Long-Term</u>				
Treasury (constant maturity)				
3-year	7.34(11/2)	5.73(1/3)	7.18	7.27
7-year	7.58(11/1)	6.50(1/3)	7.38	7.57
20-year	7.86(12/15)	7.20(1/3)	7.72	7.86
Corporate				
Seasoned				
Aaa	8.19(12/14)	7.87(1/5)	8.08	8.19(12/14)
Baa	9.18(2/25)	8.77(9/9)	8.96	8.97(12/14)
Aaa Utility New Issue	8.36(12/16)	7.90(1/5)	8.92(11/11)	8.36p(12/14)
Recently Offered	8.37(12/16)	7.95(1/5)	8.26(11/11)	8.37p(12/14)
Municipal				
Bond Buyer Index	5.93(2/2)	5.45(11/17)	5.51(11/10)	5.55
Mortgage--average yields in				
FNMA auction	8.89(12/12)	8.46(1/12)	8.86	8.89(12/12)

APPENDIX A*
BANK CREDIT REVISION

The commercial bank credit figures used in this month's analysis of financial developments reflect revisions based on the June 30, 1977, Call Report. This appendix explains the effects of these revisions on previous estimates of loans and investments.

June Call Report data indicated that growth in commercial bank credit was somewhat larger over the first half of 1977 than the previous partially estimated data had indicated. The seasonally adjusted annual rate of growth in total loans and investments over that period was 1.3 percentage points higher than estimated—11.8 per cent after revision compared with 10.5 per cent before revision as shown in Table I. The new higher level for total bank credit reflected an upward revision in loans, offset in part by small downward revisions in holdings of U.S. Treasury securities and other securities.

The level of the total bank credit series was raised \$5.0 billion as of June 1977, and the level of the total loan series was raised by \$5.4 billion as shown in Table II. The revisions in total loans and in total investments were considerably smaller on the June 1977 Call date than on either of the two Calls in 1976, but were somewhat larger than the average revision of the 1974 and 1975 Calls. For loans, however, the smaller revision in 1977 was due in large part to offsetting errors in estimated components. Levels of U.S. Treasury securities and "other securities" were lowered by \$0.1 billion and \$0.3 billion, respectively—considerably less than the average revisions of other recent years.

Revisions in the original monthly estimates reflect three sources of error, as discussed below.

1. Nonmember bank credit estimates. Data from the June Call Report suggest that total credit at nonmember banks (including loans to domestic commercial banks) increased between December 31, 1976 and June 29, 1977 by \$8.7 billion more than previously estimated.^{1/} Loans were

*Prepared by Mary Jane Harrington, Economist, and Edward R. Fry, Senior Economist, Banking Section, Division of Research and Statistics.

^{1/} Initial estimates for nonmember banks are for the last-Wednesday of each month. These estimates are based on data reported weekly by the smaller member banks, using ratios derived from Call Reports that relate nonmember amounts to the amounts reported by smaller member banks. Previous estimates reflected Call Report relationships as of December 31, 1976. Data for member banks are reported weekly.

\$3.1 billion higher. By historical standards, these revisions are very large (only those for June 1976 were larger) and they indicate comparatively much stronger growth at nonmember banks than might be suggested by their share of outstanding bank credit in December 1976. Estimates of U.S. Treasury security holdings were raised \$0.5 billion while those for "other securities" were unchanged. Nonmember estimates were revised for earlier months back through January 1977--i.e., to the previous Call Report benchmark. Also, the revised levels were carried forward from June 1977 into the current monthly estimates. Revisions of levels for recent months, however, had little effect on changes in bank credit for those months.

2. Estimates of domestic interbank loans. The bank credit series measures credit extended to the nonbank public and thus excludes loans to domestic commercial banks. Such interbank loans, including Federal funds transactions as well as other loans to banks, are estimated on the basis of data reported each Wednesday by member banks. Nonmember estimates rely on data reported by small member banks and Call Report ratios of nonmember to small member interbank loans. Based on the June 1977 Call, the total interbank loan estimate was raised \$3.4 billion, the largest revision that has occurred in this series. Interbank loans at small member banks declined substantially between December 31, 1976, and June 30, 1977, and those at insured nonmember banks also declined somewhat. However, loans at noninsured banks grew relatively rapidly. The latter growth reflected in large part expansion in loans at U.S. branches of foreign commercial banks. On balance, these diverse changes resulted in an increase in the ratio of interbank loans at nonmember banks to those at small member banks from 107 per cent in December to 143 per cent in June, a new high. While this ratio is extremely volatile, estimates since June assume that nonmember interbank loans will continue high. In the third quarter, reports of U.S. branches of foreign banks indicate that interbank loans increased sharply further.

Because of their extreme volatility, interbank loans are difficult to estimate, and these estimates frequently are a major source of error in bank credit estimates. However, in the first half of 1977, revisions in interbank loans and in total loans (including interbank) were in the same direction. Thus, the upward revision in loans adjusted (excluding interbank), the concept used in the bank credit series, was considerably smaller than the revision in total loans.

3. "Window-dressing" estimates. When the last-Wednesday current reporting date differs from the Call Report date, as usually happens, an estimate of the difference in levels between these two dates is included in the initial bank credit estimates for the June 30 and December 31 Call dates. The change between the Wednesday and Call dates is termed "window dressing," and, frequently in the past, estimates of this change have contributed substantially to benchmark revisions. However, the actual

change in total bank credit between June 29 and June 30 (\$4.4 billion) was close to the estimated change (\$4.6 billion). The estimated "window-dressing" change in total loans, was low--\$3.5 billion compared with an actual \$4.2 billion--while that in investments was too high--\$1.1 billion compared with an actual \$0.2 billion. Among loan categories, "window dressing" for business loans was overestimated by \$0.5 billion and for loans to nonbank financial institutions by \$0.9 billion. "Window dressing" was underestimated by small amounts for real estate and security loans, but by a substantial \$1.7 billion for "other loans."

"Window-dressing" errors affect only the June levels and monthly changes involving June--e.g., the upward revision, on this account, in total loans in June lowered the increase in July by a corresponding amount. Or, conversely, in the case of business loans, the smaller "window-dressing" increase in June added to the increase in July. Changes in other months were not affected by this factor.

There is an additional source of error that may be involved in original monthly estimates but which cannot be measured directly in the case of the June 30, 1977 Call. Errors in the original reported member bank data which are incorporated directly into the credit series and the indirect effects on estimates for nonmember banks can only be determined when the last-Wednesday reporting date coincides with a Call date. Such reporting errors sometimes have been substantial in the past when it was possible to cross-check reports for the same date.

Taking account of both revisions in nonmember bank and "window-dressing" estimates, the net effects on major loan categories varied considerably. Both business loans and real estate loans were \$2.0 billion higher on June 30 than previously estimated, relatively large revisions for both these components. Consumer loans, which were revised to the June 30 benchmark level previously in conjunction with revision of the Consumer Credit series, were increased by \$0.9 billion. The level of security loans was raised by \$0.8 billion, about half due to the "window-dressing" error. Agricultural loans and loans to nonbank financial institutions were both lowered--by \$0.5 and \$1.9 billion, respectively. The large downward revision in loans to nonbank financial institutions reflected in part a substantial "window-dressing" error; these loans actually declined rather than increasing, as estimated, between June 29 and June 30. The level of "other loans" was \$2.1 billion higher on June 30 than estimated.

For the July-October 1977 period, the higher nonmember bank estimating ratios established from the June Call Report were used to derive revised estimates for nonmember banks. Accordingly, the estimated level of the commercial bank credit series was raised in all of these months. After July, however, monthly changes differed little from previous estimates. As noted earlier, "window-dressing errors" affect levels only for June, but this, of course, affects third quarter growth rates.

On balance, the most significant effects of this benchmark revision were to confirm and raise the already strong estimated growth rates in business, real estate, and consumer loans over the first half of 1977.

Table I
 COMMERCIAL BANK CREDIT^{1/}
 COMPARISON OF OLD AND REVISED RATES OF GROWTH^{2/}
 (Seasonally adjusted changes at annual percentage rates)

	<u>Total Loans & Investments^{3/}</u>		<u>US Treasury Securities</u>		<u>Other Securities</u>		<u>Total Loans^{3/}</u>		<u>Business Loans^{3/}</u>		<u>Real Estate</u>	
	<u>Old</u>	<u>Revised</u>	<u>Old</u>	<u>Revised</u>	<u>Old</u>	<u>Revised</u>	<u>Old</u>	<u>Revised</u>	<u>Old</u>	<u>Revised</u>	<u>Old</u>	<u>Revised</u>
1977--1st half	10.5	11.8	16.4	16.2	6.7	6.3	10.4	12.4	10.1	12.2	14.1	16.8
1st quarter	9.5	10.6	25.9	26.7	.5	.5	9.1	10.5	8.1	11.4	12.6	15.0
2nd quarter	11.2	12.6	6.6	5.4	12.9	12.1	11.5	14.0	11.9	12.6	15.1	17.9
3rd quarter ^{p/}	8.5	8.6	-22.0	-19.4	7.3	8.4	14.4	13.7	7.5	10.2	16.1	16.3
1977 January	3.7	4.7	-4.9	-3.7	4.9	5.7	4.9	6.0	3.3	7.3	12.1	14.5
February	14.7	15.9	57.0	58.1	5.6	5.6	9.7	11.2	9.2	11.8	12.8	13.5
March	10.0	10.9	24.8	24.8	-8.8	-9.6	12.5	14.0	11.8	14.9	12.6	16.5
April	14.0	15.7	-9.3	-6.9	28.3	27.5	14.5	16.8	13.6	15.4	14.1	17.1
May	10.3	12.0	21.0	22.0	6.3	7.1	9.4	11.5	6.4	9.5	13.1	16.8
June	8.9	9.6	8.0	1.1	3.9	1.6	10.4	13.3	15.3	12.6	17.6	18.9
July ^{p/}	9.3	9.5	-27.4	-18.3	9.4	11.8	16.0	13.9	8.2	13.7	14.3	15.6
August ^{p/}	12.3	12.3	-3.5	-5.8	7.8	8.5	16.4	16.5	12.5	13.5	16.4	18.3
September ^{p/}	3.7	3.8	-36.3	-34.9	4.6	4.6	10.4	10.4	1.9	3.0	16.9	14.4
October ^{p/}	13.6	13.5	-27.7	-27.6	12.3	11.5	20.9	20.9	24.0	26.1	13.7	14.3

^{1/} Last-Wednesday-of-month series except for June and December which are adjusted to the last business day of the month.

^{2/} Data revised to reflect adjustments to June 30, 1977 Call Report benchmarks.

^{3/} Includes outstanding amounts of loans reported as sold outright by banks to their own foreign branches, nonconsolidated nonbank affiliates of the banks holding company (if not a bank) and nonconsolidated nonbank subsidiaries of holding companies.

p/--Preliminary.

Table II

SEASONALLY ADJUSTED COMMERCIAL BANK CREDIT^{1/}
 COMPARISON OF OLD AND REVISED LEVELS^{2/}
 (In billions of dollars)

	Total Loans & Investments		US Treasury Securities		Other Securities		Total Loans ^{3/}		Business Loans ^{3/}		Real Estate	
	Old	Revised	Old	Revised	Old	Revised	Old	Revised	Old	Revised	Old	Revised
1977--January	790.6	791.3	96.9	97.0	148.8	148.9	544.9	545.4	182.4	183.0	150.5	150.8
February	800.3	801.8	101.5	101.7	149.5	149.6	549.3	550.5	183.8	184.8	152.1	152.5
March	807.0	809.1	103.6	103.8	148.4	148.4	555.0	556.9	185.6	187.1	153.7	154.6
April	816.4	819.7	102.8	103.2	151.9	151.8	561.7	564.7	187.7	189.5	155.5	156.8
May	823.4	827.9	104.6	105.1	152.7	152.7	566.1	570.1	188.7	191.0	157.2	159.0
June	829.5	834.5	105.3	105.2	153.2	152.9	571.0	576.4	191.1	193.0	159.5	161.5
July ^{p/}	835.9	841.1	102.9	103.6	154.4	154.4	578.6	583.1	192.4	195.2	161.4	163.6
August ^{p/}	844.5	849.7	102.6	103.1	155.4	155.5	586.5	591.1	194.4	197.4	163.6	166.1
September ^{p/}	847.1	852.4	99.5	100.1	156.0	156.1	591.6	596.2	194.7	197.9	165.9	168.1
October ^{p/}	856.7	862.0	97.2	97.8	157.6	157.6	601.9	606.6	198.6	202.2	167.8	170.1

^{1/} Last-Wednesday-of-month series except for June and December which are adjusted to the last business day of the month.

^{2/} Data revised to reflect adjustments to June 30, 1977 Call Report benchmarks.

^{3/} Includes outstanding amounts of loans reported as sold outright by banks to their own foreign branches, nonconsolidated nonbank affiliates of the banks holding company (if not a bank) and nonconsolidated nonbank subsidiaries of holding companies.

p/--Preliminary.

APPENDIX B*
CHANGES IN BANK LENDING PRACTICES

Of the 121 senior lending officers at large banks responding to the Lending Practices Survey taken in mid-November, about 40 per cent reported that business loan demand was moderately stronger than three months before. About 45 per cent of the respondents anticipated strengthening demand in the coming months, somewhat lower than the 55 per cent expecting stronger loan demand at the time of the August survey. While changes in loan policies appear somewhat mixed, moves toward a firming of price and nonprice terms of lending noted in the August survey are more apparent in the latest survey.

During 1977 expectations of stronger business loan demand have been consistently high and justified by subsequent loan growth, in contrast to the generally lackluster tone set both by expectations and subsequent expansion of loans last year. In at least one of the surveys this year, over 80 per cent of the respondents considered their loan demand to have strengthened and over 90 per cent expected further strengthening. The cumulative number of respondents reporting weakness or expecting weaker demand was less than 15 per cent in the four surveys.

Between the August and November surveys, the prime rate charged by major banks was increased from 6-3/4 per cent to 7-3/4 per cent in four increments. About one-third of the panel in November reported that interest rate terms at their banks were firmer than three months before, somewhat higher than the one-fifth of respondents in August reporting a firming on interest rates. A number of banks reported easier rate policies, and virtually all of these were from banks with over \$1 billion in deposits. These very large money center banks have in many cases not shared in the growth of business loans this year, and a few have been the subject of recent press reports concerning more aggressive competition for business borrowers and new loan programs with interest rates below prime.

On nonprice terms, there are still more respondents reporting an easing of compensating balance requirements than are reporting firmer requirements, but the number of banks showing firmer policies has been growing. The banks reporting firmer requirements generally tended to be banks under \$1 billion, while those reporting easier compensating balance terms were the very largest banks. Nearly all respondents reported that standards of creditworthiness were essentially unchanged and that there were no changes in their policies regarding credit lines or loan applications. A small but noticeable number of banks appears to be easing moderately their policies regarding the maturity of term loans to businesses.

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About the same number of lending officers indicate more willingness to make term business loans in the November survey as did in August; however, a larger number of respondents report some reluctance to lend to businesses for maturities greater than one year. The pattern of responses concerning other categories of loans appears about in line with other recent surveys, with respondents showing an increasing disposition to make loans to households--both mortgages and consumer loans--and to engage in participation loans with correspondents.

