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June 16, 1978

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CLASS II FOMC

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

Industrial production increased 0.6 per cent in May. This advance followed two months of exceptional increases--revised to 1.4 per cent in April and to 1.2 per cent in March, both of which included rebound effects from the weather- and strike-reduced production in early 1978. More than half of the May increase was in output of materials. Auto and truck production declined after substantial increases in the three preceding months but remained at a high level. Moderate increases occurred in output of most other products. Industrial production in May was almost 5 per cent higher than a year ago.

Output of total consumer goods was unchanged in May, despite increases of 0.7 per cent and 0.5 per cent, respectively, in production of home goods and nondurable consumer goods. Auto and utility vehicle production was reduced, as auto assemblies declined 4 per cent to an annual rate of 9.4 million units. Business equipment output advanced 0.6 per cent further in May, reflecting widespread increases for industrial, commercial, and transit equipment.

Output of materials rose sharply again in May. Large increases occurred in production of durable goods materials, mainly steel and equipment parts, and in energy materials. A more moderate increase was recorded in output of nondurable materials, reflecting gains for containers, textiles, and paper.

Capacity utilization in manufacturing increased by an estimated 0.2 percentage point in May to 83.6 per cent. The May increase followed

larger gains in March and April that partly reflected the recovery of production from the effects of the coal miners' strike and severe winter weather. The utilization rate in the primary processing sector rose by 0.7 percentage point in May to 86.0 per cent; sizable increases in production of metals contributed to this gain. The operating rate in the advanced processing sector was unchanged at 82.4 per cent, as a decline in production of motor vehicles and parts held down the utilization rate for this sector. In the previous 3 months, large gains in output by the motor vehicle industry had contributed to increases in the advanced processing utilization rate.

Utilization of capacity for industrial materials production increased by an estimated 0.6 percentage point in May to 84.2 per cent. Gains in operating rates in the production of durable goods materials and of energy materials accounted for the over-all rise. Capacity utilization in the nondurable goods materials sector was about unchanged.

Operating rates in manufacturing and in the materials sector in May were the highest since before the 1974-75 recession in industrial production. Utilization rates in most major industry or materials groups are near their historical average values and are well below previous peak figures.

The book value of total manufacturing and trade inventories increased at an annual rate of \$46.2 billion in April, well below the phenomenal March rate of accumulation of \$65.3 billion, yet still slightly above the first quarter gain. In April total inventory investment was about evenly divided between durable and nondurable goods. Despite the relatively large increase in book value inventories in April, the ratio of inventories to sales declined to 1.40, definitely low on an historical basis, reflecting sizable growth in sales (3.2 per cent).

The book value of retail trade inventories increased at a seasonally adjusted annual rate of \$10.4 billion, down considerably from the very high March rate of \$17.5 billion; April accumulation was almost 30 per cent above the first quarter rate. The ratio of inventories to sales at all retail stores fell to 1.41 in April, a bit low on an historical basis, from the March level of 1.42.

Stocks held by durable goods retail stores increased at an annual rate of \$4.3 billion, more than double the March rate. Most of the accumulation of these stocks was fairly evenly divided among the major industries. Inventories of nondurable goods rose at an annual rate of \$6.1 billion, sharply below the \$15.6 billion March pace. As in March, most of the increase in nondurable goods stocks was at general merchandisers; inventories held by food stores declined slightly after a large rise in the preceding month.

BUS INESS INVENTORIES
(Change at annual rates in
seasonally adjusted book value; billions of dollars)

	1976		1977			1978		
	QIV	QI	QII	QIII	QIV	QI	Mar.	Apr.
Manufacturing and trade	19.3	31.0	28.3	25.2	17.8	44.2	65.3	46.2
Manufacturing	9.8	10.6	15.7	10.2	2.8	16.6	17.6	18.7
Trade, total	9.4	20.4	12.6	15.0	14.9	27.6	47.7	27.5
Wholesale	3.5	12.0	2.6	4.7	7.5	19.5	30.3	17.1
Retail	6.0	8.4	10.0	10.3	7.4	8.1	17.5	10.4
Durable	4.4	3.7	3.8	5.1	3.9	3.9	1.8	4.3
Auto	2.7	.8	2.2	1.5	2.8	.9	.2	1.1
Nondurable	1.6	4.7	6.2	5.2	3.5	4.1	15.6	6.1

INVENTORY/SALES RATIO

	1976		1977			1978		
	QIV	QI	QII	QIII	QIV	QI	Mar.	Apr.
Manufacturing and trade	1.50	1.46	1.46	1.48	1.44	1.46	1.42	1.40
Manufacturing	1.67	1.60	1.60	1.61	1.56	1.55	1.52	1.49
Trade, total	1.33	1.33	1.32	1.35	1.33	1.36	1.33	1.30
Wholesale	1.24	1.24	1.21	1.24	1.23	1.27	1.24	1.20
Retail	1.41	1.41	1.43	1.45	1.42	1.45	1.42	1.41

Privately-owned new housing units started in May, at a seasonally adjusted annual rate of 2.075 million units, were 4.9 per cent below the April rate, which was up 6.9 per cent from the preceding month. Starts of single-family units declined 0.8 per cent and multi-family unit starts declined 1.38 per cent. Starts declined appreciably in the Northeast area of the country and moderately in the North Central and West.

Permits issued for new housing units in May, at an annual rate of 1.587 million units, were 8.8 per cent below those in the preceding month. About two-thirds of the May decline was in permits for single-family units, which declined 3.6 per cent.

The Domestic Financial Economy

No textual addendums to the Greenbook were required, but the usual updating of the interest rate developments and monetary aggregates tables are contained on pages 6 and 7, respectively.

CORRECTIONS

Part I: Pages I-19 and I-20 are misnumbered. Page I-20 should precede--rather than follow--page I-19.

Part I: Page I-4 line 10 should read: Outlays are \$452 billion for FY 1978 and \$498 for FY 1979--each about \$1-1/2 billion below last month.

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

	1978			
	Highs	Lows	May 15	June 15
<u>Short-Term Rates</u>				
Federal funds (wkly avg.)	7.49(6/14)	6.58(1/11)	7.34(5/17)	7.49(6/14)
3-month				
Treasury bills (bid)	6.68(1/11)	6.09(4/24)	6.25	6.66
Comm. paper (90-119 days)	7.64(6/15)	6.63(1/6)	7.06	7.64
Bankers' acceptances	7.70(6/14)	6.70(1/6)	7.33	7.70(6/14)
Euro-dollars	8.38(6/15)	7.00(2/8)	7.88	8.38
CDs (NYC) 90 days				
Most often quoted new	7.58(6/14)	6.65(1/4)	7.13(5/10)	7.58(6/14)
6-month				
Treasury bills (bid)	7.17(6/15)	6.43(1/4)	6.98	7.17
Comm. paper (4-6 mos.)	7.77(6/15)	6.66(1/5)	7.12	7.77
CDs (NYC) 180 days				
Most often quoted new	8.00(6/14)	6.85(1/4)	7.63(5/10)	8.00(6/14)
1-year				
Treasury bills (bid)	7.47(6/15)	6.53(1/4)	7.30	7.47
CDs (NYC)				
Most often quoted new	8.10(6/14)	7.05(1/4)	7.75(5/10)	8.10(6/14)
Prime municipal note	4.20(6/9)	3.55(3/3)	4.15(5/12)	4.20(6/9)
<u>Intermediate- and Long-Term</u>				
Treasury (constant maturity)				
3-year	8.20(5/31)	7.38(1/4)	8.05	8.19
7-year	8.35(6/16)	7.71(1/5)	8.25	8.35
20-year	8.51(5/26)	8.00(1/5)	8.44	8.47
Corporate				
Seasoned Aaa	8.79(6/2)	8.28(1/3)	8.68	8.70(6/14)
Baa	9.64(6/5)	9.09(1/3)	9.49	9.59(6/14)
Aaa Utility New Issue	9.04(6/9)	8.61(3/24)	8.87(5/12)	9.02p(6/16)
Recently Offered	9.10(5/26)	8.48(1/6)	8.92(5/12)	8.96p(6/16)
Municipal				
Bond Buyer index	6.19(6/1)	5.58(3/16)	5.99(5/11)	6.16
Mortgage--average yields in FNMA auction	9.86(6/12)	9.13(1/9)	9.63	9.86(6/12)

MONETARY AGGREGATES 1/
(Seasonally adjusted) 1/

	1 9 7 7		1 9 7 8			12 mos ending May
	QIII	QIV	QI	April	May	
<u>Net changes at annual rates, per cent</u>						
<u>Major monetary aggregates</u>						
1. M ₁ (currency plus demand deposits)	8.1	7.2	5.0	18.7	6.3	7.7
2. M ₂ (M ₁ + time & savings deposits at CBs other than large CDs)	9.9	8.0	6.4	11.1	6.8	8.3
3. M ₃ (M ₂ + all deposits at thrift institutions)	11.9	10.6	7.4	9.6	6.9	9.8
<u>Bank time and savings deposits</u>						
4. Total	10.3	13.0	13.1	8.1	13.8	12.5
5. Other than large negotiable CDs at weekly reporting banks	11.2	8.5	7.5	5.7	7.2	8.8
6. Savings deposits	7.3	5.4	2.2	3.3	1.6	4.1
7. Individuals ^{2/}	9.6	7.0	3.1	4.1	1.7	5.5
8. Other ^{3/}	-17.1	-17.8	-8.0	-8.2	0.0	-12.7
9. Time deposits	14.6	11.4	12.0	7.9	12.4	13.2
10. Small time ^{4/}	8.3	1.0	2.7	10.1	8.6	5.1
11. Large time ^{4/}	28.1	32.4	29.9	5.1	17.9	30.7
<u>Deposits at nonbank thrift institutions^{5/}</u>						
12. Total	15.0	14.4	8.9	7.1	7.2	11.9
13. Savings and loans	16.2	15.4	9.0	7.6	7.9	12.6
14. Mutual savings banks	9.5	9.9	5.8	3.6	3.6	7.4
15. Credit unions	20.1	20.0	18.2	14.7	12.1	19.6
<u>Average monthly changes, \$ billions</u>						
<u>MEMORANDA:</u>						
16. Total U.S. Govt deposits	0.2	0.2	-1.2	0.4	-1.0	-0.3
17. Total large time deposits ^{6/}	1.7	6.2	4.5	1.8	5.1	3.9
18. Nondeposit sources of funds ^{7/}	1.4	1.3	1.9	-1.4	1.9	1.2

r—revised

1/ Quarterly growth rates are computed on a quarterly average basis.

2/ Savings deposits held by individuals and nonprofit organizations.

3/ Savings deposits of business, government and others, not seasonally adjusted.

4/ Small time deposits are time deposits in denominations less than \$100,000.
Large time deposits are time deposits in denominations of \$100,000 and above excluding negotiable CDs at weekly reporting banks.

5/ Growth rates computed from monthly levels based on averages of current and preceding end-of-month data.

6/ All large time certificates, negotiable and nonnegotiable, at all CBs.

7/ Nondeposit borrowings of commercial banks from nonbank sources include Federal funds purchased and security RPs plus other liabilities for borrowed money, including borrowings from the Federal Reserve, Eurodollar borrowings and loans sold, less interbank loans.

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SWAP ARRANGEMENTS BETWEEN THE SYSTEM
AND FOREIGN CENTRAL BANKS
June 14, 1978

Listed below as of June 14, 1978, are the swap arrangements concluded on behalf of the Federal Reserve System with foreign banks.

<u>Foreign Bank</u>	<u>Amount of Agreement (millions of dollars)</u>	<u>Maturity of latest authorized renewal</u>
Austrian National Bank	250	December 4, 1978
National Bank of Belgium	1,000	December 20, 1978
Bank of Canada	2,000	December 29, 1978
National Bank of Denmark	250	December 29, 1978
Bank of England	3,000	December 4, 1978
Bank of France	2,000	December 29, 1978
German Federal Bank	4,000	December 29, 1978
Bank of Italy	3,000	December 29, 1978
Bank of Japan	2,000	December 4, 1978
Bank of Mexico	360	December 4, 1978
Netherlands Bank	500	December 29, 1978
Bank of Norway	250	December 4, 1978
Bank of Sweden	300	December 4, 1978
Swiss National Bank	1,400	December 4, 1978
B.I.S.	1,850 (600) _{1/} (1,250) _{1/}	December 4, 1978 December 4, 1978
Total	22,160	

1/ This reciprocal arrangement provides for swaps of dollars against authorized European currencies other than Swiss francs.

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As of June 14, 1978, drawings on the above arrangements are outstanding in the amounts indicated below:

<u>Arrangements with</u>	<u>Drawings Outstanding on Swaps</u>		
	<u>Initiated by System (millions of dollars equivalent)</u>	<u>Initiated by foreign bank</u>	<u>Date since facility has been in continuous use</u>
Swiss National Bank (Special Arrangement)	330	--	May 19, 1971
German Federal Bank	1,128	--	October 5, 1977
Total	1,458		

APPENDIX A

EXPERIENCE WITH THE NEW 6-MONTH CERTIFICATES*

The newly authorized 6-month ("money market") certificates apparently attracted a sizable volume of deposits in early June, according to regulatory agency surveys, field reports, and press accounts. Flows into the money market certificates at S&Ls and MSBs were quite strong, prompting a moderate acceleration in total deposit growth at these institutions.^{1/} Data on funds attracted by commercial banks are not yet available, but qualitative information, including various accounts in the Redbook, suggests that banks have promoted the new certificates less vigorously than thrift institutions and have taken in less money. More than 90 per cent of all institutions offering the money market certificates are paying the maximum rates, according to survey results for all three major types of depositary intermediaries.

Data collected from a sample of large S&Ls (roughly the 20 largest associations in each FHLB District, holding among them about two-fifths of industry deposits) show that these institutions received about \$1 billion in the new accounts during the first week in June. This represents about 0.7 per cent of outstanding deposits at the associations surveyed. Respondents estimated that 40 to 45 per cent of the deposits in money market certificates represented new funds to the institutions, with the balance having been transferred from existing accounts; these estimates agreed with FHLBB staff estimates based on total deposit flows for the first 10 days of June.^{2/} Approximately 93 per cent of the S&Ls surveyed were offering the new accounts.

* Prepared by Edward McKelvey of the Capital Markets Section with the assistance of other economists in the Division of Research and Statistics.

^{1/} Deposit growth for S&Ls and MSBs combined is projected to be 8-1/2 per cent for June, in comparison to an average 6.7 per cent for the first five months of 1978. The acceleration from May to June is less pronounced, perhaps because some depositors had transferred funds into thrifits in May in anticipation of the new offerings.

^{2/} Estimates by individual institutions of percentages of funds shifted from existing accounts must be used with care. On the one hand, funds transferred to a money market certificate from a passbook account at the same institution may only recently have been deposited for the express purpose of buying the new certificate. On the other hand, funds newly deposited at one institution may have been withdrawn from existing accounts at another institution.

More detailed survey results for MSBs, provided by the National Association of Mutual Savings Banks, are generally in line with the results for S&Ls, although a greater percentage of funds taken into the new accounts is estimated to have been shifted from existing accounts. Of the 466 MSBs questioned in the industry-wide survey, 312 responded (67 per cent) and 200 of these said they were offering the new certificates (64 per cent of the respondents). These institutions received about \$650 million in the money market certificates during the first week of June, a figure that, in relation to total deposits at these institutions, is roughly comparable to the 0.7 per cent results for S&Ls. Only 20 per cent of this inflow was estimated to be new money. The MSBs in New York State accounted for a large part of the new funds (\$450 million), reflecting the predominance of this State in the MSB industry and the greater interest-sensitivity of depositors at these institutions.

As noted earlier, data on funds placed in the new accounts are not yet available for commercial banks. Partial survey results from six Reserve Banks (Boston, New York, Philadelphia, Cleveland, Richmond, and Kansas City) indicate that at least 70 per cent of the banks sampled (STSD sample) were offering the new certificates, and that virtually all of these institutions were paying the highest permissible rate. Reports in the Redbook suggest that the money market certificates may not have sold as well at banks as at thrifts. Preliminary data on over-all deposit flows for commercial banks indicate a weakening in savings deposits and a pick-up in small time deposits, suggesting some shifting between accounts but no net deposit gains as a result of the new accounts.^{3/}

Press accounts generally agree with the preliminary results of the surveys reported here. They also indicate that average balances in the money market certificates exceed \$10,000 by a significant margin at many of the institutions contacted. Additionally, it has been suggested that sales of the new certificates may increase markedly in early July. Among the reasons cited for this is that some purchases are being postponed until interest or dividends credited on a quarterly basis are received at the end of June. Also, early July may be an important reinvestment period because a significant proportion of time certificates reportedly expire on June 30.

^{3/} Of course over-all deposit growth would likely have been weaker in the absence of the new accounts.

Table 1

Total Loans and Investments 1/2/
(Dollar changes in billions; annual rates in percent)

	Old Seasonally Adjusted Series	Changes Due To:		New Seasonally Adjusted Series	Annual Rates	
		Benchmark	Seasonal Factor		Old	New
1977--May	8.2	-	1.0	9.2	12.0	13.5
	June	6.6	-		9.6	9.6
	July	6.6	.6		9.5	12.8
	August	8.6	.6		12.3	10.5
	September	2.7	.6		3.8	7.2
	October	9.6	.4		13.5	12.9
	November	8.5	1.0		11.8	9.2
	December	-.5	1.5		-.7	6.3
	Year	81.8	4.7		10.4	11.0
	1st Half	46.3	-		11.7	11.3
	2nd Half	35.5	4.7		8.5	10.0
	1st Quarter	20.9	-		10.6	10.3
1978	2nd Quarter	25.4	-	20.3	12.6	12.1
	3rd Quarter	17.9	1.8		8.6	10.3
	4th Quarter	17.6	2.9		8.3	9.5
	January p/	8.8	-1.1		12.1	13.6
	February p/	7.4	.1	9.9	10.1	7.9
	March p/	6.7	-.1	5.8	9.1	7.4
	April p/	16.0	-.1	5.5	21.5	18.4
	1st Quarter p/	22.9	-1.1	13.8	21.2	10.5
						9.7

1/ Last Wednesday of month series

2/ Includes loans sold outright to banks' own foreign branches, nonconsolidated nonbank affiliates of the bank, the banks' holding company (if not a bank), and nonconsolidated nonbank subsidiaries of the holding company.

p/ Preliminary

Table 2

Total Loans 1/2/
(Dollar changes in billions; annual rates in percent)

	Old Seasonally Adjusted Series	Changes Due To:		New Seasonally Adjusted Series	Annual Rates	
		Benchmark	Seasonal Factor		Old	New
1977—May	5.4	-	1.3	6.7	11.5	14.2
June	6.3	-	.1	6.4	13.3	13.4
July	6.7	0.4	-	7.1	13.9	14.8
August	8.0	0.4	-.4	8.0	16.5	16.4
September	5.1	0.5	.5	6.1	10.4	12.3
October	10.4	0.2	-1.8	8.8	20.9	17.6
November	9.0	0.7	-.4	9.3	17.8	18.4
December	1.9	2.2	1.5	5.6	3.7	10.9
Year	74.8	4.4	-	79.2	13.8	14.6
1st Half	33.7	-	.6	34.3	12.4	12.6
2nd Half	41.1	4.4	-.6	44.9	14.3	15.5
1st Quarter	14.2	-	.7	14.9	10.5	11.0
2nd Quarter	19.5	-	-.1	19.4	14.0	13.9
3rd Quarter	19.8	1.3	.1	21.2	13.7	14.7
4th Quarter	21.3	3.1	-.7	23.7	14.3	15.8
1978—January p/	9.4	-1.8	.2	7.8	18.3	15.0
February p/	2.8	.1	.2	3.1	5.4	5.9
March p/	7.9	-.1	.4	8.2	15.1	15.5
April p/	11.5	-.1	-1.6	9.8	21.6	18.3
1st Quarter p/	20.1	-1.8	.8	19.1	13.0	12.3

1/ Last Wednesday of Month series

2/ Includes loans sold outright to banks' own foreign branches, nonconsolidated nonbank affiliate of the bank, the banks' holding company (if not a bank), and nonconsolidated nonbank subsidiaries of the holding company.

p/ Preliminary

Table 3

U.S. Treasury Securities ^{1/}
(Dollar changes in billions; annual rates in percent)

	Old Seasonally Adjusted Series	Changes Due To:		New Seasonally Adjusted Series	Annual Rates	
		Benchmark	Seasonal Factor		Old	New
1977—May	1.9	-	-.6	1.3	22.0	15.3
June	.1	-	.1	.2	1.1	2.3
July	-1.6	.1	2.2	.7	-18.3	8.1
August	-.5	.2	-1.4	-1.7	-5.8	-19.6
September	-3.0	-	1.3	-1.7	-34.9	-19.9
October	-2.3	.2	.8	-1.3	-27.6	-15.5
November	-2.8	.1	-.4	-3.1	-34.3	-37.4
December	-1.5	.7	.1	-0.7	-18.9	-8.7
Year	-3.8	1.3	.1	-2.4	-3.9	-2.4
1st Half	7.9	-	-2.5	5.4	16.2	11.0
2nd Half	-11.7	1.3	2.6	-7.8	-22.2	-15.1
1st Quarter	6.5	-	-2.2	4.3	26.7	17.6
2nd Quarter	1.4	-	-.3	1.1	5.4	4.3
3rd Quarter	-5.1	.3	2.1	-2.7	-19.4	-10.4
4th Quarter	-6.6	1.0	.5	-5.1	-26.4	-20.3
1978—January	p/	-1.0	-.6	.7	-12.8	8.8
February	p/	5.0	-	2.7	64.9	33.6
March	p/	-1.0	-	-3.4	-12.3	-41.2
April	p/	1.9	-	2.0	23.6	25.1
1st Quarter	p/	3.0	-.6	-2.4	-	12.8

^{1/} Last Wednesday of Month series

Table 4
Other Securities ^{1/}
(Dollar changes in billions; annual rates in percent)

	Old Seasonally Adjusted Series	Changes Due To:		New Seasonally Adjusted Series	Annual Rates	
		Benchmark	Seasonal Factor		Old	New
1977--May	.9	-	.3	.9	7.1	9.4
June	.2	-	-.2	-	1.6	-
July	1.5	.1	-.5	1.1	11.8	8.6
August	1.1	-	-	1.1	8.5	8.5
September	.6	.1	-	.7	4.6	5.4
October	1.5	-	.2	1.7	11.5	13.0
November	2.3	.2	-1.1	.4	17.5	3.0
December	-.9	-1.4	2.0	-.3	-6.8	-2.3
Year	10.8	-1.0	-	9.8	7.3	6.6
1st Half	4.7	-	.4	5.1	6.3	6.9
2nd Half	6.1	-1.0	-.4	4.7	8.0	6.1
1st Quarter	.2	-	.9	1.1	.5	3.0
2nd Quarter	4.5	-	-.5	4.0	12.1	10.7
3rd Quarter	3.2	.2	-.5	2.9	8.4	7.5
4th Quarter	2.9	-1.2	.1	1.8	7.4	4.6
1978--January	p/ .4	1.3	-.3	1.4	3.0	10.6
February	p/ -.4	.1	.3	-	-3.0	-
March	p/ -.2	-	.9	.7	-1.5	5.3
April	p/ 2.6	-	-.6	2.0	19.6	15.0
1st Quarter	p/ -.2	1.4	.9	2.1	-0.5	5.3

1/ Last Wednesday of Month series

p/ Preliminary

Table 5

Business Loans 1/2/
(Dollar changes in billions; annual rates in percent)

	Old Seasonally Adjusted Series	Changes Due To:		New Seasonally Adjusted Series	Annual Rates	
		Benchmark	Seasonal Factor		Old	New
1977—May June	1.5	-	.3	1.8	9.5	11.4
	2.0	-	.1	2.1	12.6	13.2
	July	2.2	-	2.0	13.7	12.4
	August	2.2	-.1	1.9	13.5	11.7
	September	.5	-.3	1.5	3.0	9.1
	October	4.3	-.4	2.6	26.1	15.7
	November	2.5	-.3	1.6	14.8	9.5
	December	1.1	-.5	1.6	6.4	9.5
	Year	23.9	-1.6	22.3	13.1	12.2
	1st Half	11.1	-	11.1	12.2	12.2
	2nd Half	12.8	-1.6	11.2	13.3	11.6
	1st Quarter	5.2	-	5.1	11.4	11.2
1978--January February March	2nd Quarter	5.9	-	6.0	12.6	12.8
	3rd Quarter	4.9	-.4	5.4	10.2	11.2
	4th Quarter	7.9	-1.2	5.8	16.0	11.7
	April	p/	.1	2.2	12.8	12.9
1st Quarter	February p/	2.4	-.1	2.0	13.9	11.6
	March p/	3.8	-.1	4.1	21.7	23.6
April p/	3.5	-	-.4	3.1	19.7	17.5
1st Quarter p/	8.4	-.1	-	8.3	16.4	16.3

1/ Last Wednesday of Month series

2/ Includes loans sold outright to banks' own foreign branches, nonconsolidated nonbank affiliates of the bank, the banks' holding company (if not a bank) and nonconsolidated subsidiaries of the holding company.

p/ Preliminary

Table 6

Real Estate Loans ^{1/}
(Dollar changes in billions; annual rates in percent)

	Old Seasonally Adjusted Series	Changes Due To:		New Seasonally Adjusted Series	Annual Rates	
		Benchmark	Seasonal Factor		Old	New
1977—May June	2.2	-	-	2.2	16.8	16.8
	2.4	-	-	2.4	18.1	18.1
	July	.2	-.2	2.2	16.4	16.4
	August	.2	-	2.7	18.3	19.8
	September	.3	.2	2.5	14.4	18.0
	October	.1	-	2.1	14.3	14.9
	November	.7	.2	3.1	15.5	21.8
	December	.5	-.3	2.3	14.6	15.9
	Year	25.4	2.0	27.3	17.0	18.3
	1st Half	12.4	-	12.4	16.6	16.6
	2nd Half	13.0	2.0	14.9	16.1	18.5
	1st Quarter	5.6	-	5.6	15.0	15.0
1978—January February March	2nd Quarter	6.8	-	6.8	17.6	17.6
	3rd Quarter	6.7	.7	7.4	16.6	18.3
	4th Quarter	6.3	1.3	7.5	15.0	17.8
	April	p/	.1	2.2	13.7	14.9
1st Quarter	February p/	1.8	.5	2.5	12.2	16.8
	March p/	2.6	-	2.4	17.5	15.9
1st Quarter	April p/	2.4	-.1	2.3	15.9	15.0
	1st Quarter p/	6.4	.6	7.1	14.7	16.1

1/ Last Wednesday of Month series

p/ Preliminary

Table 7

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	July	841.1	842.6	103.6	104.1	154.4	154.4	583.1	584.1	195.2	195.2	163.6	163.6	
		849.7	850.0	103.1	102.4	155.5	155.5	591.1	592.1	197.4	197.1	166.1	166.3	
		852.4	855.1	100.1	100.7	156.1	156.2	596.2	598.2	197.9	198.6	168.1	168.8	
	October	862.0	864.3	97.8	99.4	157.6	157.9	606.6	607.0	202.2	201.2	170.1	170.9	
		870.5	870.9	95.0	96.3	159.9	158.3	615.6	616.3	204.7	202.8	172.3	174.0	
		870.0	875.5	93.5	95.6	159.0	158.0	617.5	621.9	205.8	204.2	174.4	176.6	
	January	p/	878.8	885.4	92.5	96.3	159.4	159.4	626.9	629.7	207.7	206.4	176.7	178.8
		p/	886.2	891.2	97.5	99.0	159.0	159.4	629.7	632.8	210.1	208.4	178.5	181.3
		p/	892.9	896.7	96.5	95.6	158.8	160.1	637.6	641.0	213.9	212.5	181.1	183.7
	April	p/	909.3	910.5	98.4	97.6	161.4	162.1	649.5	650.8	216.7	215.6	183.5	186.0

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 revisions in seasonal factors and benchmarking to the December 31, 1977, Call Report.

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*

Bank Credit Revision

The seasonally adjusted series on commercial bank credit and its major components have been revised. The revised data were used in this month's analysis of financial developments. The revision included the updating of seasonal adjustment factors and the usual benchmark revision that incorporates the latest Call Report data, December 31, 1977, for nonmember banks. Revisions in seasonal factors affected the seasonally adjusted data from 1971 to date, with principal changes in the more recent years. The benchmark revision covered the July 1977 to April 1978 period.

In summary, over the recent period, the principal effects of the combined benchmark and seasonal revisions were to raise the level of total bank credit and to smooth the pattern of growth somewhat. In the second half of 1977, the seasonally adjusted annual rate of growth in total bank credit was raised 1.5 percentage points to 10 per cent. Over the January-April 1978 period, growth increased somewhat to a 12 per cent rate but this was considerably below the rate of acceleration previously estimated. Expansion in total loans was a little faster over the July-December 1977 period than preliminary data had indicated but in the early months of 1978, revised data indicated a slight slowing in the growth rate compared with a slight expansion on the old basis. The revised data indicate less liquidation of U.S. Treasury securities in the second half of 1977, but net acquisitions in the first four months of 1978 also are much smaller after revision than previously estimated. In contrast, "other securities" increased somewhat less on the new basis in the second half of 1977 but then rose somewhat more in early 1978. Growth in business loans was slightly lower in the second half of 1977 than previous figures had indicated--11.6 per cent compared with 13.3 per cent, although the revised data continue to indicate rapid acceleration in these loans in early 1978. Real estate loans expanded faster on the revised basis over the 10 months since mid-1977, with the pace of growth falling off somewhat in early 1978 as previously estimated.

Changes between old and revised data for major bank credit components are shown in detail in Tables 1 through 6 at the end of this Appendix. Outstanding data on the two bases are shown on Table 7.

Revisions in the original not seasonally adjusted monthly estimates reflect three sources of error, as discussed below.

* The revised seasonal factors were prepared by Edward R. Fry and Mary F. Weaver, and the benchmark revisions by Mary Jane Harrington, Banking Section, Division of Research and Statistics.

1. Nonmember bank credit estimates. Data from the December Call Report suggest that total credit at nonmember banks (including loans to domestic commercial banks) increased by \$2 billion more than previously estimated between June 30, 1977 and December 28, 1977.^{1/} Loans were \$0.8 billion higher. By historical standards, these revisions were much smaller than those for any other recent Call date and indicate a fairly comparable rate of growth for small member banks and nonmember banks. In most recent years, growth rates have been larger at nonmember banks. Estimates of U.S. Treasury security holdings were raised \$0.8 billion and those for "other securities," \$0.4 billion. Reflecting the December benchmark corrections, nonmember estimates were revised for earlier months back to June 30, 1977--i.e., to the previous Call Report benchmark. Also, the revised levels were carried forward from December 1978 into the current monthly estimate. Revisions of levels for the most recent months, as usual, had little effect on estimated changes in not seasonally adjusted bank credit for those months.

In addition to the benchmark revisions in nonmember estimates, outstandings for total loans and investments, loans, and business loans were also affected by reclassifications of loans sold to the banks' own foreign branches, affiliates, etc. The reclassifications, which occurred in April 1978, increased total loans sold by \$400 million and reduced business loans sold by \$700 million. These changes were distributed over the July 1977-March 1978 period to avoid discontinuities in the series. About \$300 million of the increase in total loans and \$600 million of the reduction in business loans were reflected in the second half of 1977. In the tables shown in this Appendix, changes due to the loan sale reclassifications have been included with the benchmark revisions.

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 December 1977 Call, the total change as in the three previous December Calls. This reduction in interbank loans raised estimated loans to nonbanks by a like amount.

Because of their extreme volatility , interbank loans are difficult to estimate, and these estimates frequently are a major source of error in

^{1/} Initial estimates for nonmembers 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 non-member amounts to the amounts reported by the smaller member banks. Previous estimates reflected Call Report relationships as of June 30, 1977.

bank credit estimates. For example, in the second half of 1977, revisions in interbank loans and in total loans (including interbank) were in opposite directions. Thus, the upward revision in loans adjusted (excluding interbank), the concept used in the bank credit series, was somewhat larger than the revision in total loans (including interbank)--\$2.8 billion versus \$0.8 billion.

3. "Window-dressing" estimates. When the last-Wednesday current reporting date differs from the Call Report date, as usually happens, an estimate of the change in levels between these two dates is included in the initial bank credit figures for the June 30 and December 31 Call dates. The change between the Wednesday and Call dates is termed "window dressing." Frequently in the past, errors in estimating this change have contributed substantially to benchmark revisions. However, in December 1977, the actual change in total bank credit between December 28 and December 31 (\$9.1 billion) was only moderately above the amount of change included in the initial estimate (\$8.5 billion). "Window dressing" estimates were \$1.4 billion too low for total loans but \$0.9 billion too high for total investments, with the latter reflecting a substantial contra-seasonal reduction in "other securities" in the last three days of December. With the exception of security loans, errors in "window dressing" estimates for major loan categories were relatively small. Security loans increased \$2.6 billion between the last Wednesday of December and the Call date, or \$0.9 billion less than anticipated. The large increase in security loans in the last three days of December appears to be associated with heavy runoffs of System repurchase agreements. The effects of similar runoffs at the end of December 1976 were taken into account in the 1977 "window dressing" estimates, but the effect on security loans was overestimated.

"Window-dressing" errors affect only the December levels and changes involving December and surrounding months. Thus, the upward revision in total loans due to December "window-dressing" washes out in the January change. Similarly, the large decline in "window-dressing" for "other securities" in December was followed by an increase in January.

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 December 31, 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.

Actual data for loan categories are available on a current basis only for large weekly reporting banks. Estimates for other commercial banks are made largely on the basis of the movement of total loans at the smaller banks, the trend of business and other loans as indicated by the most recent Call Report and patterns for previous years established in the monthly benchmarking of the series. Taking account of revisions in nonweekly reporting bank estimates, "window-dressing" estimates, and seasonal factor changes, the net effects on major loan categories varied considerably over the late 1977 and early 1978 periods.

Business loans increased \$1.6 billion less than estimated in the second half of 1977--\$11.2 billion compared with an estimated \$12.8 billion. The difference was due entirely to benchmark changes including a downward revision of \$600 million in loan sales. The \$1.0 billion benchmark error alone was comparable with the average error on other recent December Calls. While seasonal factor revisions did not affect the half-year change, they added \$0.9 billion to the third quarter level and subtracted \$0.9 billion from the fourth quarter level. Growth in the first four months of 1978--\$11.4 billion--was somewhat smaller than estimated initially with revisions in seasonal factors accounting for most of the change.

Real estate loans were \$2 billion higher at the end of December than estimated--a somewhat larger benchmark error than average for this series and the estimated January-April 1978 increase was raised by \$600 million. Changes in seasonal factors reduced the second-half 1977 increase slightly and added slightly to the early 1978 rise.

Agricultural loans were estimated at a level \$1.1 billion too high in December 1977--an unusually large error for this series. The revised data indicate little change, on a not seasonally adjusted basis, over the second half of 1977 compared with increases of \$1.1 billion in corresponding periods of the two previous years. In most prior years, however, changes in the second half had been much smaller. In addition, Production Credit Association loans declined in the closing months of 1977. These recent shifts in agricultural loan patterns appear to be associated with four factors: (a) recovery in farm prices and income from the low point of mid-1977, (b) special Federal payments to wheat producers disbursed around mid-year, (c) Federal disaster loans to farmers in drought areas, and (d) storage of large amounts of grain under Federal price support loans. However, in the first four months of 1978, data now available indicate that agricultural loans increased substantially compared with little change on the earlier estimates. The seasonal factor revision had no effect on agricultural loan levels.

The level of security loans was \$600 million lower than estimated on December 31, 1977, and that of nonbank financial loans \$500 million higher. In the first four months of 1978, security loans increased somewhat more than estimated due to the December-January "window-dressing" pattern discussed earlier. Revisions in seasonally adjusted levels due to changed seasonal factors were small for both series over the late 1977-early 1978 period.

Consumer loans, which are derived from consumer credit survey reports, were not affected by the benchmark revision on a not seasonally adjusted basis. However, changes in seasonal factors were relatively large and lowered the seasonally adjusted level by \$800 million over the second half of 1977 and increased it by \$400 million over the first four months of 1978. The consumer loan series will be benchmarked to the December Call shortly, and it is expected that these revisions will indicate considerably larger growth than previously estimated. This, in turn, will reduce the large upward revision in "all other loans" on December 31, 1977, of \$4.5 billion.

APPENDIX C*

PROPOSITION 13 AND ITS RAMIFICATIONS

The passage of Proposition 13 is likely to result in major changes in California's fiscal structure. Both tax relief and tax "reform" will be one outcome. Total revenue growth for the public sector will slow, and property taxes will become less important. Expenditure growth is also likely to be slower, but cuts in spending will be cushioned by accumulated surpluses at the state level. Despite the general tone of fiscal conservatism across the nation, the unique combination of high property taxes and large state budget surpluses in California makes it difficult to judge to what extent similar developments will spread to other parts of the country. Some effects are bound to be evident, however.

WHAT PROPOSITION 13 DOES

Proposition 13 requires major changes in the collection of state and local revenues in California. It restricts property tax collections in the fiscal year starting July 1, 1978 to 1 per cent of the market value of a home or business property three years ago. Further, it will sharply limit property tax increases thereafter. The measure also erects formidable barriers to increasing other taxes whether by local governments or the State legislature.

The key elements of Proposition 13 are currently being challenged in the courts and, thus, might never be fully implemented. In particular, a suit has been filed that contests the section that allows a house that is sold to be fully reassessed while a similar unit that does not change hands would have a much lower assessment. The provisions that tax increases must be approved by two-thirds of all members of the Legislature or two-thirds of local "qualified electors" is also being questioned.

WHAT WAS THE BASIS FOR VOTER SUPPORT?

Citizens of California--like those all across the Nation--are apparently suffering from heightened doubts over the value of local government services. However, the approval of Proposition 13 in California clearly reflects more than this general feeling.

The Tax Structure. The tax burden borne by Californians must be judged a contributing factor in their decision. Property taxes have increased sharply in California--albeit not as starkly, on average, as many accounts would suggest. Table 1 shows that for the last two fiscal years for which we have complete data (1975 and

*Prepared by James Freund, Economist, National Income Section, Division of Research and Statistics.

1976), California was among the states where property tax revenues grew most rapidly.^{1/} More current data covering tax receipts in large metropolitan counties suggest that California has continued to be among the areas with the most rapid increases through the current fiscal year. Part of the above-average rate of increase reflects inflation in home prices and decisions by elected officials to keep statutory rates high.

These increases would not have been quite so irksome to voters had Californians not already been bearing relatively heavy property tax burdens. Table 2 shows that California ranks fourth in terms of per capita tax burden. An alternative measure--local property taxes as a per cent of personal income--also shows that households and businesses in California have high burdens relative to the national average. California is eighth from the top in this regard. Part of the explanation for this heavy property tax burden is that in the past California has relied quite extensively on the property tax vis-a-vis other revenue sources. In 1976 local property taxes in California accounted for 41 per cent of all state and local tax levies--the national average was 35 per cent. Only eight states were proportionally more dependent on this source of revenue.

Another motivating factor in the vote for Proposition 13 could have been the perception of a high over-all tax burden. In terms of total state and local taxes per capita, California ranks only behind New York. When measured as a proportion of income, on average Californians rank eighth in total tax burden.

The Effects of Inflation. The problems experienced by California have been heightened by the effects of inflation. Higher housing values have led to rising assessments and to larger tax bills.^{2/} Some homeowners are apparently having difficulty paying property taxes

1/ It should be noted that in fiscal year 1974 property tax receipts actually declined slightly in California. If that year is averaged with 1975 and 1976, 30 states had higher property tax increases.

2/ Of course, it is not necessary that higher property tax receipts must follow higher house prices. Tax rates can be adjusted downward to obtain any rate of increase in effective tax rates desired.

out of current income.^{3/} While such inflationary effects are a nationwide phenomena, they have been magnified in California by very rapid increases in housing prices and by relatively efficient reassessment procedures.

At the same time that California's heavily-burdened property taxpayers were asked to pay for higher costs of local services through increased property taxes, the State treasury was garnering windfall gains from inflation. Like the Federal tax system, California's state income tax is progressive. As nominal incomes increase with inflation, taxpayers move to higher effective tax rates and pay proportionally more.

WHAT IS LIKELY TO HAPPEN IN CALIFORNIA?

If court challenges to Proposition 13 are unsuccessful, major changes will take place in the system of taxation in California. For the fiscal year starting July 1, 1978, an estimated \$7 billion will be cut from a previously-expected \$12 billion in property tax receipts. (It is noteworthy that a substantial majority of property taxes are paid by business property owners.) The latest data available show that total property tax receipts account for almost 40 per cent of local revenues; thus, on average about one-fourth of a local unit's receipts have been taken away.

Other Sources of Funds are Available. It is likely that offsetting increases in other taxes will be enacted in some communities despite the new two-thirds rule. Increased use of fees and charges is also likely. However, clearly the most important replacement for lost property taxes in the fiscal year about to start will be grants from the State of California to local governments. Recently-revised estimates show that by spending over \$2 billion less than its receipts in the fiscal year just ending, the state has raised its cash balances to over \$3 billion. If these funds--along with the additional surplus of about \$2 billion now projected for the upcoming fiscal year--were transferred by the legislature to local governments, a substantial portion of next year's \$7 billion shortfall in local receipts could be offset. Thus, it is quite possible that drastic cuts in total spending may not be immediately necessary. It is likely, however, that

3/ In theory, homeowners could borrow against these unrealized capital gains to improve their liquidity.

spending will not grow as rapidly as it might have; this is particularly true in the short-term because of the substantial uncertainties felt by individual units as to the amount of state funds they will eventually receive. Moreover, in future fiscal years when the state government does not have a large accumulated cash balance on hand, reduced spending may have to bear more of the burden.

Disruptions and Redistribution Questions. There are undoubtedly going to be short-term disruptions in services as well as layoffs and salary freezes before the adjustments to Proposition 13 are completed. These problems may be prolonged for some time since longstanding issues will have to be dealt with before state resources can be fully distributed to local governments. ^{4/} Should state revenues be distributed in proportion to property taxes lost? Or should special consideration be given to areas that are property-poor but have great financial needs? Since it seems inevitable that any plan adopted will not replicate the distribution of receipts from property taxes, some localities will have to make adjustments in spending.

Capital Markets. Proposition 13 may affect the ability of the State of California and its localities to market some of its long-term debt instruments. The Proposition specifically excludes from its purview taxes needed to pay the principal and interest for existing general obligation bonds. Further, it is generally thought that--after a period of uncertainty--new general obligation bonds will not have serious trouble in being sold (although perhaps at a somewhat higher rate). A possible exception is governmental units for which a new state aid formula would mean substantially reduced revenues.

Conversely, tax allocation bonds --and other instruments specifically tied to future property tax revenue growth--probably will not be marketable until new fiscal arrangements for future tax revenue growth are settled. Both Moody's and Standard & Poor's have suspended ratings on such issues which comprise about \$2 billion of California's \$18 billion outstanding debt.

SPILLOVER TO OTHER STATES

There already is a generally conservative attitude regarding state and local finances across the nation, but the success of the "taxpayers' revolt" in California may strengthen these feelings. In particular, new constraints on taxation and spending may be enacted in other states, but it is not clear to what extent this will occur. There are obstacles to transferring California's experiment to other jurisdictions.

^{4/} The political question of how to distribute the state surplus is a longstanding one. In fact, some commentators feel if the state legislature had successfully dealt with the problem at an earlier date, it would have cleared the path to lower property tax rates without Proposition 13.

The Full Consequences are Unknown. Most of the ramifications of Proposition 13 may not be felt for several years. Among the questions that will determine the desirability of such actions elsewhere is taxpayer reaction to lost services. While many apparently wish that welfare payments and "fat in the budget" would be the areas that are cut back, an extended period of local government budget constraint probably can be achieved only by also cutting educational and protective services--the two largest budget items. Further, the desirability of cuts in property taxes will depend on acceptance of increases in other revenues. For instance, will taxpayers be willing to pay additional fees and charges? Many Federal grants depend on local matching funds or local tax efforts. If the loss of local revenues has a multiplier effect through loss of grants and causes even more spending cuts, such actions may be less popular. On the other hand, any compensatory Federal aid that might result from reduced local services will encourage similar actions elsewhere.

California is Different. More important, perhaps, is the fact that the preconditions for Proposition 13 were in many ways specific to California. Obviously, the initiative procedure facilitated political action that is normally difficult. But on top of that, the combination of a heavy reliance on property taxes and a high level of total local tax burden exist only in several other states. In addition, no other state--with the possible exception of Texas--has experienced surpluses like those in California. The juxtaposition of high taxes and substantial unused revenues has been avoided in other states.

Table 1

STATES WITH THE HIGHEST RATES OF INCREASE IN LOCAL
PROPERTY TAX REVENUE IN RECENT PERIODS

	<u>Average rate of increase (per cent)</u>	
	Fiscal Years: 1975 and 1976	Fiscal Years: 1977 and 1978
<u>U.S. total</u>	<u>8.7</u>	<u>n.a.</u>
1. Wyoming	24.0	n.a.
2. Alaska	22.4	n.a.
3. Colorado	17.2	6.3
4. Oregon	17.0	11.8
5. Georgia	15.3	6.9
6. Florida	14.7	17.4
7. Texas	14.2	12.6
8. Idaho	13.7	n.a.
9. Arizona	13.5	16.1
10. Utah	13.3	12.1
11. South Carolina	13.2	15.6
12. New Hampshire	13.2	n.a.
13. North Dakota	13.1	n.a.
14. Virginia	12.7	4.9
15. Tennessee	12.6	7.0
16. Hawaii	12.5	1.4
17. CALIFORNIA	12.0	12.2

Source: Governmental Finances 1974-75, 1975-76 (Bureau of the Census, U.S. Department of Commerce) and Quarterly Summary of State and Local Tax Revenue, 1974-75, 1976-77 (Bureau of the Census, U.S. Department of Commerce).

Note: Changes are calculated as an average of the per cent changes in the two individual years. Data for fiscal years 1977 and 1978 derived from data for major metropolitan counties only; 1978 collections estimated from data for the first half of the fiscal year.

Table 2
PROPERTY TAX BURDENS IN FISCAL YEAR 1976

Property taxes per capita ^{1/}		Property taxes as a proportion of income ^{1/}	
<u>U.S. average</u>	\$255	<u>U.S. average</u>	3.96%
1. New Jersey	\$436	1. Massachusetts	6.54%
2. Massachusetts	\$431	2. New Jersey	6.01%
3. New York	\$411	3. South Dakota	6.01%
4. CALIFORNIA	\$397	4. Montana	5.86%
5. Connecticut	\$370	5. New York	5.78%
6. New Hampshire	\$339	6. New Hampshire	5.71%
7. Wyoming, Oregon	\$332	7. Vermont	5.60%
8. Montana	\$327	8. CALIFORNIA	5.55%
9. Michigan	\$310	9. Oregon	5.26%
10. Vermont	\$306	10. Connecticut	5.00%

^{1/} Ratios constructed by dividing fiscal year 1976 property tax receipts by population and personal income in calendar year 1976.

Sources: Governmental Finances 1975-76 (Bureau of the Census, U.S. Department of Commerce and Survey of Current Business (Bureau of Economic Analysis, U.S. Department of Commerce).