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CONFIDENTIAL (FR)

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

March 3, 1967

The Domestic Economy

Domestic automobile sales figures for General Motors, Ford and Chrysler released on March 2 indicate that the seasonally adjusted annual sales rate for February was about 7 million units, 10 per cent below the 7.8 million January rate, and 24 per cent below a year earlier. Excluding the strike-influenced sales decline in late fall of 1964, the 7 million rate for February is the lowest since August 1963.

Inventories held by manufacturers increased by $1 billion in January, the same as the upward revised December increase and the average monthly gain in both the third and fourth quarter of last year. The fourth quarter increase in manufacturers' inventory book value is now indicated to be at an annual rate of $12.1 billion rather than the $11.2 billion incorporated in the present $17.6 billion (annual rate) GNP estimate of change in nonfarm business inventories.

Inventories of durable goods increased $590 million in January--somewhat less than the average monthly increases in the last two quarters of 1966, and the build-up was largely concentrated in areospace, machinery and equipment and consumer durable goods industries--the same sectors in which accumulation has been heavy in recent months. In durable goods industries, work-in-process (mainly aircraft and parts) accounted for nearly two-thirds of the book value increase, with materials and supplies and finished goods (mainly in machinery) accounting for the balance. The increase of $430 million in nondurable goods industries was considerably larger than in December and nearly three times the average increase in the preceding six months. Accumulation was especially large in the chemicals and petroleum and coal products industries.

The ratio of manufacturers' inventories to shipments increased sharply in January after showing a decline in December. Stock-sales ratios rose for both durable goods and nondurable goods producers. Only for producers of electrical machinery, textile mill products, and paper and allied products did the ratio remain unchanged or declined slightly.

New orders for durable goods declined 6.7 per cent in January from an upward revised December figure. The January decline now shown is somewhat more than the 5.1 per cent indicated by the advance report based on a partial sample. January new orders for machinery and equipment, according to the new preliminary figures, were down only 1 per cent from December--half the decline indicated earlier. But the declines now shown for other industries are larger than the earlier figures, and the gain in electrical machinery (apparently consumer durables, which are shown to have been up 3.5 per cent in January) is smaller. Unfilled orders for durable goods as a group declined considerably. In defense products industries (mainly aircraft and parts), unfilled orders leveled off after rising sharply over the preceding year and a half, and the order backlog declined moderately for machinery and equipment.

The Domestic Financial Situation

Following the enactment of legislation raising the Treasury debt ceiling from $330 billion to $336 billion, the Treasury announced on March 1 a $2.7 billion auction of additional June tax bills. The auction date was set for March 7 and payment date will be March 13. The Treasury also indicated that it plans no further borrowing of new money for the balance of this fiscal year.

Complete figures covering non-insured as well as insured savings and loan associations indicate that the net inflow for all associations during January was $350 million, rather than the partially estimated $370 million total previously reported. Additional detail indicate that only three Home Loan Bank Districts were substantial gainers; San Francisco with $259 million, Greensboro with $62 million and Little Rock with $42 million. Five Districts experienced outflows in January.

Net change in mortgage debt held by savings and loan associations--normally the dominant mortgage-lending group--was slightly negative in January. While net mortgage generation tends to approach a seasonal low at this time, this marked the third month out of the past four in which total mortgage holdings for this group had shown some decline. Net mortgage debt formation by commercial banks continued below year-earlier levels in January. That for mutual savings banks, however, strengthened somewhat.

NET CHANGE IN MORTGAGE HOLDINGS
January 1964-67
(Millions of dollars)

	1964	1965	1966	1967
Total, inc. FNMA	1,523	1,512	1,669	n.a.
Private only	1,551	1,508	1,453	n.a.
Savings and loan associations	606	533	380	-78 p
Mutual savings banks	345	328	276	291
Commercial banks	300	200	300	100
Life insurance companies	300	447	497	n.a.
FNMA	-28	4	216	152

Corrections:

Section III - page 6, line 5, should read "still remained."

SUPPLEMENTAL APPENDIX A

Current and Prospective Mortgage Market Conditions as Reported in Special Surveys by the Federal Reserve Banks and the Federal Home Loan Banks*

With institutional savings and cash flows generally expected to be more abundant during the next three months, new mortgage lending will probably pick up moderately--but not dramatically--from recently depressed levels, judging from the results of 432 lender interviews held by the Federal Reserve Banks and the Federal Home Loan Banks in February. While new mortgage lending may increase somewhat more than seasonally, its rise seems likely to be limited by continued hesitancy on the part of certain lenders and borrowers in making commitments, at least during the next few weeks, pending further clarification of liquidity positions and mortgage market conditions.

Although the interviews were held at a time when lending activity is usually at a seasonal low, the results confirm the fact that some easing had already taken place by last month in both primary and secondary mortgage markets, reflecting improved institutional savings and cash inflows since late 1966. While the immediate outlook is for further easing, the horizon remains clouded by some lender uncertainty about the sustainability of the recent improvement in savings and cash inflows. Mainly, however, uncertainty relates to the future strength of demands for mortgage credit which have been restrained so far this year by seasonal influences, a wait-and-see attitude on the part of some knowledgeable borrowers expecting still easier conditions, a lack of awareness by certain others that the period of stringency has ended, and other factors.

The results tabulated at the end of this report are based on Federal Reserve Bank interviews with 129 commercial banks, 67 mortgage companies, 54 life insurance companies, and 27 mutual savings banks as well as Federal Home Loan Bank interviews with 155 savings and loan associations, as summarized by the Federal Home Loan Bank Board. While the Federal Reserve Banks followed a questionnaire similar to one already being used in the field by the Federal Home Loan Banks, the Reserve Bank

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* Prepared by Robert M. Fisher, Senior Economist, Capital Markets Section on the basis of reports from the Federal Reserve Banks to the Board wire of February 15, 1967, and a summary prepared by the staff of the Federal Home Loan Bank Board based on a similar survey conducted by the Home Loan Banks of savings and loan associations.

survey included an amplification of several items and a separate question on construction lending. The findings, of course, reflect only the viewpoints of lenders, since real estate brokers and builders were not surveyed.

Current levels of mortgage commitments. New mortgage commitments were being made during February in below-normal volume in all Districts and by all types of lenders. Lending on homes was even more depressed than lending on income-producing properties within most Districts and among most lender groups. One reason, cited by the Atlanta Federal Reserve Bank, was that "the principal limiting factor in present volume of new home mortgage commitments in this District appears to be associated with typical time lags involved in gearing up new home production to higher levels. Spot loan volume [usually involving existing houses] has improved considerably in most markets."

Life insurance companies appeared to have cut back the most below normal lending activity, with very few companies reporting even a "normal" volume of business. Although banks, savings and loan associations, and mortgage companies still were typically lending in a "moderate and somewhat subnormal" volume, roughly a fourth of the respondents within each of these lender groups reported normal lending or better on home properties. A third or more of the banks and mortgage companies indicated a normal or above-normal volume of new commitments on the combined category of multifamily and commercial properties. (Savings and loan associations were not asked to respond on this subject.)

Terms being offered on new mortgage commitments during February were somewhat easier than those prevailing around the end of last year, according to several reports. The Kansas City Federal Reserve Bank, for example, noted that "interest rates on conventional mortgages recently have declined about 1/4 of 1 per cent and terms have been eased somewhat. Discounts on Government-underwritten mortgages have dropped to 3 or 4 points presently, down from 6 to 7 points last fall." The Chicago Federal Reserve Bank wrote of "indications [during recent weeks] of a return to 80 per cent conventional and 90 per cent FHA home lending."

Outlook for savings and cash flows. Banks and savings and loan associations expected their net savings inflows during the next 90 days to be normal or better in the majority of cases in all Districts and for two-thirds or more of the members of each lender group. Commercial banks and savings banks appeared to be a little more optimistic than savings and loan associations, although some lenders of each type looked for continued subnormal savings gains.

In the Atlanta Federal Reserve District where the possibility of a "fairly rapid rebound in construction. . . .appears good," "all respondents indicate availability of money is no longer the principal inhibition" to prospective home mortgage lending. Somewhat less optimistic lenders in the Philadelphia District, however, suggested that "it is too early to be sure improved net savings inflows will continue. . ."

Among savings and loan associations, future net savings inflows appear to be relatively adequate in many cases. According to the Federal Home Loan Bank Board report, "comments by associations indicate that some are discontinuing advertising of [savings] certificates in order to hold down the growth in savings to a more reasonable level. Where savings flows are expected to be subnormal, the reason in at least some cases is reported to be noncompetitive dividend rates."

For life insurance companies, prospective cash flows (adjusted for expected changes in policy loans) were generally reported to be somewhat less buoyant. Barely more than half of all companies interviewed anticipated that their cash flows would be normal or better over the next three months, although considerably better results were cited within several Federal Reserve Districts. And for the vast majority of companies interviewed, future cash flows were expected to provide no significant excess of funds beyond what was needed to take down outstanding loan commitments in the period ahead.

Outlook for mortgage commitments. Prospective strength in lending on new and existing home properties was noted in nearly all Districts. On new commitments for home mortgages--where lending was recently most depressed--seven-tenths or more of all savings and loan association and bank respondents looked for some moderate increase or better over the next 90 days. For life insurance companies with a generally less optimistic outlook on cash flows and a growing preference for income-producing property loans, a more-than-normal increase in new commitments on home mortgages was anticipated in only two-fifths of all cases. In this respect, the Minneapolis Federal Reserve Bank commented that "one life insurance company noted that the absence of any expected pickup in commitments in the next 3 months stems in part from their policy of keeping mortgage rates above market because they are now fully committed for the remainder of 1967."

Prospects for construction loans also appeared relatively favorable in nearly all Federal Reserve Districts. Three-fourths of all commercial banks and mortgage company respondents anticipated a more-than-normal increase in new commitments for all types of construction. For the Salt Lake City area, however, the report was made that "many small speculative builders and some of the larger tract builders are not in a position to resume operations as they have suffered serious financial reverses, owing to an inability to sell their existing [completed] homes. . . ."

New mortgage commitments on multifamily and commercial properties seem less likely to pick up as much, in part because recent lending has remained relatively more active. Generally less than three-fifths of banks, life insurance companies, and mortgage companies expected some moderate increase or better during the next 3 months. Only in the case of life insurance companies was the prospect better for new mortgage commitments on income-producing properties than on homes.

The outlook for new lending on all types of properties, however, needs to be interpreted with some caution, partly because of lender difficulties in estimating usual loan volume during a period when demands rise sharply under normal conditions. The Dallas Federal Reserve Bank suggested, in fact, that "because many respondents had some difficulty in conceptualizing their 'normal' loan volume for any particular time of the year and because the abnormalities of 1966 distorted their views of normal, the statement [that new commitments will increase more than usual over the next 90 days] should be interpreted in its weakest sense, i.e., only that lenders expect the volume of new commitments to rise in the near future."

Some lender hesitancy in making new mortgage commitments was reported to be continuing in a number of Districts. Hesitancy reportedly stemmed to a minor degree from uncertainties about future savings or cash inflows. Three large insurance companies interviewed in the Boston Federal Reserve District, for example, were "still very pessimistic about the availability of mortgage funds. Even though policy loans have abated and in spite of the fact that the fall 'crunch' was past, they seemed to be very hesitant about making new commitments now and in the immediate months ahead. Rebuilding of liquidity and investments are to be the first items of business."

In the Philadelphia Federal Reserve District, "another factor [inhibiting loan volume] is an uneasiness about pending Government action. Some [lenders] said new high yield Treasury bonds [recently announced] would drain off money that might otherwise flow to mortgage lenders. Still others [in the Philadelphia area] felt premature action on lowering the FHA statutory rate will push discounts back up again thus killing hopes for a spring revival."

The Richmond Federal Reserve Bank echoed a sentiment reported in number of other areas. "Our survey suggests some recent relaxation in the District's mortgage markets, with further easing expected in the [immediate] future, although the degree of optimism we found among mortgage lenders was rather less marked than we expected."

Borrower demands. Few or only a moderate number of prospective homebuyers were seeking mortgage loans in February, according to nearly all banks, life insurance companies, and mortgage companies. Relatively slack demand during a seasonally inactive period apparently explained in part the reduced volume of recent home-mortgage commitment activity.

Interest rates and discounts were generally considered to be important limiting influences on demand by only a sixth of all respondents, but they were considered a moderately important factor by half of them. Other terms, such as downpayments or prepayment penalties, were typically felt to be less influential, although not in all areas.

Lenders in numerous Districts seemed to be puzzled about the prospective strength of demand for credit, whether influenced by mortgage terms or other factors. The Philadelphia Federal Reserve Bank noted that "there are no unmistakable signs that demand for mortgages is either unusually weak or strong." Repeated references were made throughout the country about a wait-and-see attitude of some prospective home borrowers and builders expecting that terms would ease further in the near future. The Philadelphia Bank indicated that certain local builders were "waiting perhaps for another couple of weeks. Then they will have time to line up commitments and start work around April 1."

Because the mortgage market had eased only quite recently and in some areas only to a modest extent, many respondents commented that some potential borrowers were staying away presumably because they were still unaware that funds had become more available on better terms. Greater publicity given to easier conditions might thus be expected to produce additional borrowers. Perhaps with this possibility in mind, the Kansas City Federal Reserve Bank reported the heretical finding that "surprisingly, a couple of institutions think that [mortgage] rates might advance, as they foresee the possibility that demand for mortgage loans will recover so sharply that it will exceed the inflow of funds at savings and loan associations."

TABULATION OF AVAILABLE REPLIES

1A. What do you expect your net savings inflows (i.e., new savings minus withdrawals) to be over the next 90 days, after allowance for usual seasonal influences? (For banks, include consumer or personal-type savings; exclude large negotiable CD's. Normal is during last 3 years.)

	Commercial banks	Savings banks	Savings & loans	Total
(a) substantially below normal	2	1	17	20
(b) somewhat below normal	23	8	39	70
(c) normal	63	6	53	122
(d) somewhat above normal	39	10	(46	(99
(e) substantially above normal	2	2	(	(
Total replies	129	27	155	311

1B. (For insurance companies) What do you expect your cash flow (adjusting for expected net changes in policy loans) to be over the next 90 days, after allowance for usual seasonal influences?

(a) substantially below normal	5
(b) somewhat below normal	20
(c) normal	26
(d) somewhat above normal	2
(e) substantially above normal	--
Total replies	53

Do you expect this cash flow to provide more funds than are needed to meet anticipated takedowns on outstanding loan commitments over the next 90 days? (Yes, 16; No, 10.) Is any expected excess (or shortfall) considered to be significant in amount? (Yes, 3; No, 12.)

2. How would you best characterize your present volume during past 3 or 4 weeks of new commitments (not outstandings) on mortgage loans, taking into account usual volume at this time of year?

ON HOME PROPERTIES	Commer-cial banks	Savings banks	Ins. cos.	Mortgage cos.	S & Ls*	Total
(a) no or few mortgage loan commitments are being made	14	1	16	3	6	40
(b) a still very subnormal volume of mortgage loan commitments is being made	29	6	15	18	42	110
(c) a moderate and somewhat subnormal volume of mortgage loan commitments is being made	44	12	17	26	72	171
(d) a normal volume of mortgage loan commitments is being made	21	4	3	10	28	66
(e) an above average volume of mortgage loan commitments is being made	5	3	--	5	7	20
Total replies	113	26	51	62	155*	407

ON MULTIFAMILY AND COMMERCIAL PROPERTIES	Commer-cial banks	Savings banks	Ins. cos.	Mortgage cos.	S & Ls*	Total
(a) no or few mortgage loan commitments are being made	16	6	5	9	--	36
(b) a still very subnormal volume of mortgage loan commitments is being made	29	2	13	10	--	54
(c) a moderate and somewhat subnormal volume of mortgage loan commitments is being made	28	5	20	21	--	74
(d) a normal volume of mortgage loan commitments is being made	30	10	6	17	--	63
(e) an above average volume of mortgage loan commitments is being made	14	3	4	5	--	26
Total replies	117	26	48	62	--	253

* Savings and loan associations were not asked to respond separately for homes and for income-producing properties. All their replies are tabulated under the home-property category.

3. Taking into account your expectations as to the availability of loanable funds, how do you expect your new mortgage loan commitments to change over the next 90 days, after allowance for usual seasonal influences?

ON HOME PROPERTIES	Commercial banks	Savings banks	Ins. cos.	Mortgage cos.	S & Ls *	Total
(a) unchanged from the present	27	1	25	8	44	105
(b) some moderate increase	76	21	12	42	87	238
(c) a substantial increase	7	3	3	9	24	46
(d) a decrease is in prospect	1	1	2	--	**	4
Total replies	111	26	42	59	155	393
ON MULTIFAMILY AND COMMERCIAL PROPERTIES						
(a) unchanged from the present	47	8	21	24	--	100
(b) some moderate increase	62	18	19	28	--	127
(c) a substantial increase	8	3	3	7	--	21
(d) a decrease is in prospect	2	--	1	1	--	4
Total replies	119	29	44	60	--	252

* Savings and loan associations were not asked to respond separately for homes and for income-producing properties. All their replies are tabulated under the home-property category.

** Not asked.

4A. How would you evaluate the present desire of prospective home buyers to seek mortgage loans?

	Commer-cial banks	Savings banks	Ins. cos.	Mortgage cos.	S & Ls *	Total
(a) a large number are seeking mortgage loans	6	3	5	5	*	19
(b) a moderate number are seeking mortgage loans	51	14	20	28	*	113
(c) relatively few are seeking mortgage loans	38	6	11	17	*	72
Total replies	95	23	36	50	*	204

4B. What, in your judgment, is the impact on mortgage loan demand of present levels of interest rates and discounts being charged on mortgages?

	Commer-cial banks	Savings banks	Ins. cos.	Mortgage cos.	S & Ls *	Total
(a) an important factor discouraging many prospective home buyers	19	2	8	13	15	57
(b) discouraging to some prospective home buyers	46	8	19	21	81	175
(c) a relatively unimportant consideration	32	13	9	17	59	130
Total replies	97	23	36	51	155	362

4C. What, in your judgment, is the impact on mortgage loan demand of other terms and conditions of mortgage loans?

	Commer-cial banks	Savings banks	Ins. cos.	Mortgage cos.	S & Ls *	Total
(a) an important factor discouraging many prospective home buyers	18	6	1	2	*	27
(b) discouraging to some prospective home buyers	36	10	13	16	*	75
(c) a relatively unimportant consideration	38	10	22	32	*	102
Total replies	92	26	36	50	*	204

* Not asked.

5A. (For commercial banks) Taking into account your expectations as to the availability of loanable funds, how do you expect your new construction loan commitments to change over the next 90 days, after allowance for usual seasonal influences?

(a) unchanged from the present	26
(b) some increase	77
(c) a substantial increase	14
(d) a decrease is in prospect	4
Total replies	121

5B. (For mortgage companies) Taking into account your expectations as to the availability of funds to finance construction lending activities, how do you expect your own new construction loan commitments to change over the next 90 days, after allowance for usual seasonal influences?

(a) unchanged from the present	13
(b) some increase	31
(c) a substantial increase	13
(d) a decrease is in prospect	1
Total replies	58