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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

August 11, 1967

## SUPPLEMENTAL NOTES

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### The Domestic Economy

Retail sales in July were one per cent above the record June level and about 5.5 per cent above a year earlier, according to the Census Bureau advance estimates based on a partial sample. July sales at durable goods stores were up more than 3 per cent while sales at nondurable goods stores as a group were little changed from the record June level. All major groupings of durable goods stores registered gains, with a 3.3 per cent rise lifting sales at furniture and appliance stores to a new high and a level nearly 3.5 per cent above the second quarter average. Among nondurable goods stores, sizable advances at apparel stores and gasoline service stations offset small declines at other types of stores. Although about unchanged from June, sales at nondurable goods stores in July were .7 per cent above the second quarter average.

### The Domestic Financial Situation

Flows to nonbank depository intermediaries. Preliminary data on savings flows in July indicate a record increase for mutual savings banks and the largest July inflow in eight years for savings and loan associations. These surprisingly large inflows represent a seasonally adjusted annual growth rate of 15 per cent for S&L's, in contrast to last July when there was a sizable net outflow; for savings banks, the net inflow was at an annual rate of 9 per cent in July as

compared with a 6.7 per cent rate a year earlier. Data on the acquisitions of assets during July are not yet available for either S&L's or savings banks.

SAVINGS FLOWS TO NONBANK DEPOSITARY-TYPE  
FINANCIAL INTERMEDIARIES  
(Millions of dollars)

July	S&L's	Savings Banks
1967	163	300
1966	-1,508	195
1965	-432	212
1964	33	284
1963	- 11	136
<u>Year to date</u>		
1967	6,115	3,032
1966	580	979
1965	3,758	1,896
1964	5,443	2,218
1963	6,132	1,673

Areas in which S&L's share capital are most interest-sensitive--New York and California--experienced relatively larger inflows than the rest of the nation. The San Francisco Home Loan Bank District, primarily California, had an increase in share capital of \$100 million, compared to an outflow of \$154 million a year earlier, and the New York Home Loan Bank District, primarily New York City, had an estimated increase of \$75 million, in sharp contrast to the outflow of \$208 million in July 1966. Five of the twelve Home Loan Bank Districts did have outflows this July, but none experienced significant declines.

While potentially sharp declines in savings flows, resulting from the high level of market rates, continue to concern some industry observers, both the U.S. total and regional data indicate that interest rate spreads were not sufficiently wide during July to induce significant switching from claims on intermediaries to market instruments.

Continuing to reflect the very large savings flows relative to mortgage demands, S&L's again reduced the volume of their outstanding advances from the Home Loan Bank System. There was a contra-seasonal reduction of \$80 million during July, and this brought the volume of outstanding advances down to \$4.2 billion, compared to \$7.3 billion at the end of July last year.

During the first week of August, S&L's continued to reduce their indebtedness to the Home Loan Banks, suggesting that inflows will again be large this month. Also during the first week in August, New York City's 15 largest savings banks experienced about the same inflow as in the corresponding period a year ago. Year-to-year comparisons for savings banks, it should be noted, will not be as dramatic for the remainder of this year as they have been thus far, since savings flows to these institutions had largely recovered by last August.

Review of Flow of Funds in first half, 1967. Preliminary flow of funds estimates for the second quarter have been completed and permit a review of financial developments of the first half of the year in relation to the shifts in saving and investment since 1966. These shifts have been substantial, as indicated in Table 1 at the end of

the article, and they have been accompanied by comparably large shifts in financial flows. The changes in financial markets are quite different from those suggested by this table, however. As the bottom section of the table indicates, investment outlays by business fell more from 1966 than internal funds and tended to decrease the net financing requirements of business, while the sharp rise in Government deficits--mainly Federal--increased greatly the funds needed for Government operations. In financial markets, on the other hand, credit flows to business during the first half of 1967 were almost unchanged from the high 1966 rates, while the Federal Government reduced its debt outstanding at a \$5 billion annual rate, seasonally adjusted.

Federal Government. The contrast between these nonfinancial and financial developments arises mainly from accelerated profit tax payments by corporations, which were about triple the 1966 acceleration, and from the Treasury's heavy use of its own cash balances during the half-year, and the connections among these transactions are seen most easily by a brief review of individual sector transactions. For the Federal Government, in Table 2, the relation is straightforward: faced with a public debt rising close to statutory limits, the Treasury stayed out of credit markets and managed to cover operations from its internal resources. Acceleration of profit tax payments was of major assistance to this policy, and in Table 2 this appears as a \$12 billion reduction in a balance-sheet claim for taxes receivable, consistent with the accrual basis of tax receipts in the NIA surplus. Further help came from the loan programs, where Home Loan Banks received funds at more

than a \$6 billion rate from loan repayments and deposit inflows. Beyond these sources, the Treasury made heavy use of its cash holdings during the six months, ending the fiscal year with a balance of about \$7 billion as against \$12 billion in 1965 and 1966. By the end of June debt subject to the limit stood at \$326 billion, well below the ceiling for the period.

Business. For nonfinancial business, in Table 3, the accelerated tax payments were a \$12 billion use of funds to be financed from other sources, and while June data are not yet available for corporations it appears that the payments were matched by a comparable reduction in liquid asset holdings. Although business borrowing in credit markets held up at the 1966 rates during the first half of 1967, credit does not appear to have been an important source of tax-payment financing. A borrowing rate of \$33 billion per year is high historically, but the relation of business borrowing to net capital outlays during this six months was very close to the 1962-64 pattern and does not appear out of line for a period of relative ease in credit markets. In Table 3 it is 1966 that is severely out of line with recent history of credit flows to business.

With business borrowing at no more than a normal rate for the period, the effect of the tax acceleration has been to push down corporate liquidity ratios a further notch on the rather steep trend of 1965 and 1966, when liquid assets remained static in the face of growing short-term liabilities. Whether this further drop in liquidity

ratios is significant or not may depend on whether corporate managements think it is. To the extent that some part of liquid assets has been earmarked specifically for the purpose of paying taxes, elimination of both the asset and the liability produces an arithmetic drop in liquidity ratios that leaves corporations as well off as before for meeting other obligations. An extreme form of this viewpoint is the concept of "free liquidity"--liquid assets net of tax liabilities--and in terms of this concept the liquidity ratio remained almost unchanged over the first half of the year. Borrowing, that is, was sufficient to arrest the declining trend of the ratio but not improve it significantly. Without the extra tax payments liquid assets would have risen at roughly the \$6 billion rate that is needed to maintain the relation of liquidity to both the volume of activity and the growing level of current liabilities outstanding.

A position somewhere between the extremes of total liquidity and "free" liquidity suggests that borrowing by business was normal during the half year in terms of ordinary credit needs but might usefully have been somewhat higher to offset part of the tax payment and in any case should continue strong if any concept of liquidity ratio is to be improved.

Other sectors. Table 4, on households, shows that the rise in saving of this sector has been closely matched by an increased flow into financial markets, with capital outlays and borrowing both held back by residential construction conditions. Within the financial



investment total there is a clearly marked liquidation of the security purchases of 1966 and a transfer of funds back into deposits. State and local governments, in Table 5, also shifted to deposits, using funds from borrowing in excess of nonfinancial needs during the period.

Summary tables. Table 6 pulls together the mixed credit demands discussed above and completes the statement of total flows into and out of credit markets. As shown in the lower part of the table, private nonfinancial sectors as a group increased their total investment in deposits and securities over the 1966 rates in spite of the drop in total credit flows and in spite of the heavy tax payments. The shift out of securities and into deposits was of unprecedented proportions in terms of this table because of the extreme forms of the patterns in both 1966 and 1967 and appears to have been somewhat of an over-correction for 1966 in its effects on levels of deposit and security holdings. Taken as a sum, however, these holdings rose during the half year just about enough to keep the total closely in line with the longer run trend of private financial assets.

Table 7 on direct sources of credit shows that the shift into deposits raised the proportion of credit from intermediaries from 60 per cent of the total in 1966 to over 100 per cent in 1967. Banks did somewhat better than nonbank intermediaries despite the lack of funds from Treasury balances and supplied almost 50 per cent of the total credit flow, well above the 35 per cent average for 1962-65.

Table 1

DOMESTIC NONFINANCIAL SECTORS--  
SAVING AND INVESTMENT

	Year 1966	First half 1967, SAAR	Net Change
Net saving <sup>a/</sup>	71.6	56.3	-15.3
Households	50.0	55.2	5.2
Nonfinancial business	22.2	18.9	- 3.3
Governments	- .6	-17.8	-17.2
Net capital outlays <sup>a/</sup>	69.9	54.7	-15.2
Households <sup>b/</sup>	28.9	22.3	- 6.6
Nonfinancial business	41.0	32.4	- 8.6
Nonfinancial surplus <sup>c/</sup>	1.8	1.7	- .1
Households	21.2	33.0	11.8
Nonfinancial business	-18.8	-13.5	5.3
Governments	- .6	-17.8	-17.2

a/ Net of capital consumption allowances.

b/ Includes consumer durable goods.

c/ Saving less capital outlays.

Table 2

U. S. GOVERNMENT

	Year 1966	First half 1967, SAAR	Net Change
Saving (surplus, NIA basis)	- .9	-15.4	-14.5
Credit market borrowing	6.7	- 5.5	-12.2
Financial assets, net	5.8	-20.9	-26.7
Deposits	- .1	- 7.0	- 6.9
Taxes receivable	- .5	-12.1	-11.6
Other, net	6.4	- 1.8	- 8.2

Table 3

NONFINANCIAL BUSINESS

	Year 1966	First half 1967, SAAR	Net Change
Net saving	22.2	18.9	-3.3
Net capital outlays	41.0	32.4	- 8.6
Credit market borrowing	33.0	33.2	.2
Financial uses of funds	<u>14.2</u>	<u>19.7</u>	<u>5.5</u>
Deposits	.2	2.0	1.8
Credit market instruments	3.3	- 6.4	- 9.7
Tax liability reduction	.4	12.0	11.6
Other, net	10.3	12.1	1.8

Table 4

HOUSEHOLDS

	1966	H1/67, SAAR	Net Change
Net saving	50.0	55.2	5.2
Net capital outlays	28.9	22.3	- 6.6
Credit market borrowing	23.3	18.1	- 5.2
Financial assets	<u>44.0</u>	<u>51.0</u>	<u>6.6</u>
Deposits	21.0	45.8	24.8
Credit market instruments	11.1	- 8.6	-19.7
Other, net	12.3	13.8	1.5

Table 5

STATE AND LOCAL GOVERNMENTS

	1966	H1/67, SAAR	Net Change
Saving	.3	- 2.4	-2.7
Credit market borrowing	6.6	11.1	4.5
Financial assets, net	<u>6.9</u>	<u>8.7</u>	<u>1.8</u>
Deposits	<u>2.9</u>	<u>4.9</u>	<u>2.0</u>
Other	4.0	3.8	- .2

Table 6

SUMMARY OF TOTAL BORROWING AND SOURCES OF CREDIT

	Year 1966	H1/67, SAAR	Net Change
<u>Total borrowing in credit markets</u>	<u>71.1</u>	<u>61.9</u>	<u>- 9.2</u>
U.S. Government	<u>6.7</u>	<u>- 5.5</u>	<u>-12.2</u>
Nonfinancial business	33.0	33.2	.2
Households	23.3	18.1	- 5.2
State and local governments	6.6	11.1	4.5
Foreign	1.4	4.9	3.5
<u>Sources of credit market funds</u>	<u>71.1</u>	<u>61.9</u>	<u>- 9.2</u>
Private domestic nonfinancial sectors	<u>43.9</u>	<u>47.6</u>	<u>3.7</u>
Deposits	<u>22.5</u>	<u>56.4</u>	<u>33.9</u>
Demand deposits and currency <sup>a/</sup>	<u>2.9</u>	<u>9.7</u>	<u>6.8</u>
Time deposits at commercial banks	12.3	28.1	15.8
At savings institutions	7.3	18.6	11.3
U.S. Govt. securities	8.1	-14.7	-22.8
Other credit market instruments, net	13.4	5.8	- 7.6
Other sources of credit	<u>27.1</u>	<u>14.2</u>	<u>-12.9</u>
Market funds	<u>- .5</u>	<u>- 7.5</u>	<u>- 7.0</u>
U.S. Govt. deposits	7.5	2.3	- 5.2
U.S. Govt. loans	- .8	6.1	6.9
Foreign funds	12.8	13.5	.7
Insurance and pension reserves	8.1	- .2	- 8.3
Sources n.e.c. <sup>b/</sup>			

<sup>a/</sup> Includes mail float not allocated in preceding sector tables.

<sup>b/</sup> Part of the drop from 1966 reflects decline in bank borrowing from foreign branches and rise in deposit inflows to Home Loan Banks.

Table 7

DIRECT LENDING IN CREDIT MARKETS

	1966	H1/67, SAAR	Net Change
Total funds supplied	<u>71.1</u>	<u>61.9</u>	<u>- 9.2</u>
Financial institutions	<u>43.6</u>	<u>64.3</u>	<u>20.7</u>
Federal Reserve	3.5	3.8	.3
Commercial banks	18.2	29.8	11.6
Nonbank finance	21.9	30.7	8.8
U.S. Government	7.5	2.3	- 5.2
Foreign	-1.4	4.2	5.6
Private domestic nonfinancial	21.5	-8.8	-30.3
Commercial bank credit as per cent of total funds raised	25.6	48.1	22.5

Corrections:

Page II-6a, GROSS NATIONAL PRODUCT AND RELATED ITEMS table. Housing starts, private (millions, A.R.) projected for 1967-IV should be 1.37.

Page III-6, second paragraph. Put a period after word "weeks" and start a new sentence with "Since."

Page III-8. First line of second paragraph should read: Treasury bill rates moved up sharply, etc.

Appendix A, page A-8, Table III. July 1967 total reserves NSA should be 23,906.

Appendix A, page A-2. Table I, reproduced below, should be substituted for the one in the Greenbook. The last column of figures have been corrected.

TABLE I  
FORMER AND REVISED SEASONAL FACTORS FOR CREDIT PROXY,  
MONEY SUPPLY, DEMAND DEPOSITS AND NONBORROWED RESERVES

	Credit Proxy		Money Supply: Demand Deposit Component		Nonborrowed Reserves	
	Former	Revised	Former	Revised	Former	Revised
1966--Jan.	101.3	101.3	103.9	103.9	102.3	102.3
Feb.	99.8	99.7	100.0	99.8	99.3	99.3
Mar.	99.7	99.7	99.2	99.2	99.1	99.0
Apr.	99.8	100.1	100.8	101.0	99.6	99.7
May	99.7	99.7	97.7	97.6	99.0	99.1
June	99.9	99.9	98.3	98.6	99.6	99.6
July	100.2	100.3	98.6	98.4	100.0	100.1
Aug.	99.2	99.1	97.9	97.6	98.6	98.4
Sept.	99.7	99.6	99.2	99.4	99.7	99.7
Oct.	100.0	100.0	100.3	100.2	100.3	100.2
Nov.	99.8	99.6	101.0	100.7	100.0	99.8
Dec.	101.1	101.1	103.1	103.5	102.7	102.7
1967--Jan.	101.3	101.3	103.9	103.8	102.3	102.3
Feb.	99.8	99.7	100.0	99.6	99.3	99.3
Mar.	99.7	99.7	99.2	99.4	99.1	99.0
Apr.	99.8	100.1	101.0	101.0	99.6	99.7
May	99.7	99.7	97.6	97.7	99.0	99.1
June	99.9	99.9	98.5	98.7	99.6	99.6
July	100.2	100.3	98.5	98.4	100.0	100.1