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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

June 19, 1970

The Domestic Economy

New orders for durable goods. New orders for durable goods rose 3 per cent in May, according to the advance report. The April level revised down slightly further and was about unchanged from March. The April-May average is unchanged from the first quarter. Shipments increased and the backlog declined another 1 per cent.

MANUFACTURERS' NEW ORDERS
Seasonally adjusted, monthly averages, billions of dollars

	1970			
	QI	April-May average	April	May Advance
Durable goods, total	29.1	29.1	28.7	29.5
Primary metals	4.6	4.8	4.9	4.7
Iron and steel	2.0	2.1	2.2	2.1
Other primary metals	2.6	2.7	2.7	2.6
Motor vehicles and parts	3.6	3.8	3.8	3.8
Household durable goods	2.0	1.9	1.9	1.9
Defense products	1.7	1.7	1.5	2.0
Capital equipment	8.5	8.3	8.2	8.3
Machinery and equipment	6.3	6.2	6.1	6.3
All other durable goods	8.7	8.6	8.4	8.8

The major factors in the May increase were substantial increases for the fabricated metal products and aerospace industries; the latter was apparently mainly from defense orders. Orders for autos and other consumer durables were unchanged. Orders for machinery and equipment rose, but the average for the second quarter so far is still below that for the first quarter.

Personal income. Personal income declined by $7.8 billion in May, reflecting a reduction of about the same magnitude in transfer payments. In April, personal income had risen by $18 billion, with a rise of $12.7 billion in transfer payments. The erratic movements were primarily a result of a nonrecurring, retroactive increase in social security payments, which amounted to $8 billion annual rate. Exclusive of the boost and decline caused by the retroactive feature of the social security increase, personal income rose by $10 billion between March and May. The Federal pay raise in April also was retroactive, with the extra payment spread about evenly between April and May; there will be a small offsetting decline in Federal payrolls in the June personal income figures.

PERSONAL INCOME, 1970
Seasonally adjusted annual rates, billions of dollars

	March	April	May
Total	$783.3	$801.3	$793.5
Transfer payments	71.3	84.0	76.1
Wages and salaries	535.1	540.3	539.9
Government	110.5	117.1	117.5
Private	424.6	423.2	422.4
Manufacturing	160.4	159.4	158.4
Other sources	176.9	177.0	177.5

Wages and salaries declined slightly in May, primarily reflecting another cut of $1 billion in manufacturing payrolls, to a level $2.6 billion lower than in December 1969. The May drop in factory payrolls reflected the further decline of employment and average weekly hours. Construction payrolls also declined in May, mainly because increased strike activity kept many workers off the job. In other private sectors payrolls continued to rise but at slower rates than in 1969.

In the first five months of 1970, personal income averaged 7-3/4 per cent higher than in the comparable period of 1969; in the previous year, the rise amounted to 9 per cent over the comparable time period.

Consumer prices. The consumer price index rose 0.4 per cent in May, a decline from the 0.6 per cent posted in April as smaller increases for most services and for nonfood goods were reported in May. But allowing for seasonal changes, the CPI increased 0.5 in both April and May.

CONSUMER PRICES
(Percentage change over previous month, seasonally adjusted)

	1969		1970				
	November	December	January	February	March	April	May
All items	0.6	0.6	0.6	0.5	0.4	0.5	0.5

Price increases for durable commodities, reflecting large increases for used cars and houses, accounted for about one-third of the over-all rise in May. Among nondurable, nonfood commodities, prices for gasoline declined sharply but were more than offset by increases for apparel and housekeeping supplies. Grocery store prices rose 0.3 per cent.

The cost of services rose 0.5 per cent, the smallest increase since last November, and accounted for about one-third of the over-all increase in the CPI. Medical care services showed the smallest increase since last November, as the slower rate of increase in hospital rates offset a faster rate of rise in physicians' fees. Further marked increases in transportations costs reflected increases in costs of local transit fares and automobile insurance and repairs.

The Domestic Financial Situation

Commercial paper. The preliminary regular monthly release on outstanding commercial paper indicates a considerably larger seasonally adjusted increase in May than was suggested by the new, and apparently not yet entirely reliable, weekly series that was available at the time of preparation of the Greenbook. For May, the monthly series shows, as did the weekly data, a large increase in commercial paper issued by bank affiliates (seasonally unadjusted). Nonbank related paper, seasonally adjusted, did increase less rapidly than in April, but this reflected a reduction in directly-issued commercial paper and a sharp increase in dealer-placed paper. The weekly series had suggested a much slower increase in dealer-placed paper other than bank-related and this was reflected in the Greenbook, particularly where it was cited as a partial explanation of the large May increase in business loans at banks.

COMMERCIAL AND FINANCE COMPANY PAPER
(End-of-month data, in millions of dollars)

	March	April	May
		Amounts outstanding	
Total commercial and finance paper 1/	36,406	38,276	39,652 p/
Bank related 2/	6,433	6,542	7,465
Nonbank related 3/			
Placed through dealers 4/	12,096	12,161	12,674
Placed directly 4/	17,877	19,573	19,513 p/
		Net Change	
Total commercial and finance paper 1/	476	1,870	1,376 p/
Bank related 2/	466	109	923
Nonbank related 3/			
Placed through dealers 4/	279	65	513
Placed directly 4/	-269	1,696	-60 p/

p/ Preliminary.
1/ Combines seasonally adjusted nonbank-related paper and seasonally unadjusted bank-related paper.
2/ Seasonally unadjusted.
3/ Seasonally adjusted.
4/ This table is different in format from past Greenbook tables in that the lines "placed through dealers" and "placed directly" in this table exclude bank-related paper.

Nonbank depositary intermediaries. Deposit growth during May at S&L's showed considerable moderation from the March and April pace, and was not as strong as had been estimated earlier. At 5.4 per cent, however, the preliminary seasonally adjusted annual rate of deposit growth during May was still above the rates in early 1970 and all but the first quarter of 1969.

DEPOSIT GROWTH AT NONBANK THRIFT INSTITUTIONS
(Seasonally adjusted annual rate, in per cent)

	Mutual Savings Banks	Savings & Loan Associations	Both
1969 - QI	6.1	6.0	6.0
QII	4.3	3.7	3.9
QIII	2.0	2.1	2.1
QIV	3.3	.4	1.4
1970 - QI	2.6	1.5	1.9
March*	4.4	9.1	7.5
April p/*	6.4	8.9	8.1
May p/*	6.0	5.4	5.6
Memo:			
April and May p/	6.2	7.2	6.8

* Monthly patterns may not be significant because of seasonal adjustment difficulties.
p/ Preliminary.

Portfolio adjustments made by S&L's during May tended to follow the same pattern evident in previous months. Their net increase in mortgage acquisitions showed modest, roughly seasonal, improvement from April but remained well below the year-ago pace. Acquisitions of liquid assets continued to be emphasized; in the two months since March, such holdings had increased by over $900 million, which contrasts with a net decrease during the same period last year.

New commitments to acquire mortgages showed a sharp seasonally adjusted increase in May for the second consecutive month and presage a sizable step-up in mortgage acquisitions--and probably a corresponding de-emphasis on liquid asset holdings. Maintenance of the recent pace of new commitment activity will depend somewhat upon future deposit receipts and especially upon experience during the reinvestment period that will begin in a week. Dependence upon savings flows will be moderated, however, by the recently-developed liquid asset cushion and by the availability of FHLB advances.

OUTSTANDING MORTGAGE COMMITMENTS1/
Insured Savings and Loan Associations
(Millions of dollars, seasonally adjusted)

1969	
QI, end of period	6,887
QII, "	6,877
QIII, "	6,262
QIV, "	5,748
1970	
QI, "	5,094
April	5,371 p/
May	5,720 p/

1/ Includes loans in process.
p/ Preliminary.

Bond markets. Reflecting the pace of offerings and announcements, the staff has raised its estimate of corporate bond volume in the public market for June and July by about $200 million for each month. These higher estimates still assume that a considerable volume of announced offerings will ultimately be postponed. Recent data have also led to an upward revision of $150 million in estimated tax-exempt issues for June and $100 million for July.

SECURITY OFFERINGS1/
(Monthly or monthly averages, in millions of dollars)

	Corporate				
	Bonds				State and local bonds
	Public offerings	Private placements	Stock	Total	
1969e/	1,061	468	700	2,229	990
1970					
QI	1,526	418r/	716r/	2,660r/	1,350
QII*e/	2,270	365	465	3,100	1,226r/
May* e/	3,000	300	200	3,500	1,000
June e/	1,800 r/	400	600	2,800r/	1,050r/
July e/	1,700 r/	300	500	2,500r/	1,100r/

1/ Data are gross of underwriting expenses.
e/ Estimated.
r/ Revised.
* "Public Bonds" and "Total" include AT&T rights offering of $1.5 billion in May.

INTEREST RATES

	Late 1969	1970		
	Highs	Lows	May 25	June 18
Short-Term Rates				
Federal funds (weekly averages)	9.32 (12/11)	7.45 (3/25)	7.84 (5/20)	7.80 (6/17)
3-months				
Treasury bills (bid)	8.08 (12/29)	6.08 (3/24)	7.01	6.73
Bankers' acceptances	9.00 (12/31)	7.13 (3/30)	8.00	7.88
Euro-dollars	11.56 (12/18)	8.00 (4/20)	9.06	9.55
Federal agencies	8.39 (11/20)	6.80 (4/10)	7.22 (5/22)	7.26
Finance paper	8.25 (12/3)	7.25 (4/28)	7.63	7.75
CD's (prime NYC)				
Highest quoted new issue	6.00	6.75	6.75	6.75
Secondary market	9.05 (12/31)	7.19 (4/3)	8.12	8.15
6-month				
Treasury bills (bid)	8.09 (12/29)	6.18 (3/23)	7.30	6.97
Bankers' acceptances	9.00 (12/31)	7.25 (3/30)	8.12 e/	8.00 e/
Commercial paper (4-6 months)	9.25 (12/31)	7.88 (3/30)	8.13	8.25
Federal agencies	8.58 (11/20)	6.91 (4/17)	7.52 (5/22)	7.66
CD's (prime NYC)				
Highest quoted new issue	6.25	7.00	7.00	7.00
Secondary market	9.15 (12/31)	7.00 (4/1)	8.32	8.20
1-year				
Treasury bills (bid)	7.86 (11/24)	6.20 (4/13)	7.32	7.20
Prime municipals	6.25 (12/12)	3.80 (3/27)	5.20 (5/22)	5.40
Intermediate and Long-Term				
Treasury coupon issues				
5-years	8.33 (12/29)	7.05 (3/25)	8.08	7.96
20-years	7.14 (12/29)	6.55 (2/27)	7.52	7.38
Corporate				
Seasoned Aaa	7.91 (12/31)	7.78 (3/10)	8.18	8.57
Baa	8.91 (12/31)	8.57 (3/10)	9.06	9.28
New Issue Aaa				
No call protection	--	--	--	--
Call protection	8.85 (12/5)	8.20 (2/27)	9.05 (5/22)	9.29
Municipal				
Bond Buyer Index	6.90 (12/19)	5.95 (3/12)	7.02 (5/21)	7.03
Moody's Aaa	6.57 (12/26)	5.75 (3/12)	7.03 (5/21)	6.95
Mortgage--implicit yield in FNMA auction 1/	8.87 (12/29)	9.04 (4/20)	9.18	9.30 (6/15)

1/ Yield on 6-month forward commitment after allowance for commitment fee and required purchase and holding of FNMA stock. Assumes discount on 30-year loan amortized over 15 years.

e--estimated

International Developments

Yesterday, June 18, the Central Bank Council of the Deutsche Bundesbank decided to raise the minimum reserve requirement of German banks by between 10 and 20 per cent, effective July 1. The size of the increase will be determined at the Council's next meeting on July 1 and will depend on whether deflationary action is taken by the Government. The Council's action is designed to offset the impact of the recent capital influx (see page IV - 9) on the liquidity of the German banking system, as well as to underline the Bundesbank view (page IV - 13) that there is no sign of slowing in the German expansion and that the situation continues to require restrictive policies.

Corrections:

Section I, page 8. In line 8 substitute favorable for probable.

Section II, page 6. The high employment surplus for QI 1971 and again for QII 1971 should be $15.5 billion, instead of $12.8 billion shown for each period.

Section IV, page 3. In the fourth line from the bottom of the page, the year should read 1969, not 1970.

SUPPLEMENTAL APPENDIX A: REAL ESTATE INVESTMENT TRUSTS*

The combination of excess demand for mortgage credit and borrower difficulty in tapping traditional sources of funds to finance real estate have fostered a rebirth of the real estate investment trust (REIT). Although these trusts still supply only a small proportion of the total funds to the mortgage market, they have themselves been a significant borrower in other sectors of the capital markets, especially in the stock market.

New equity issues by real estate investment trusts in 1969 represented about 10.5 per cent of total corporate stock offerings in that year. Combined gross equity and debt offerings by these financial intermediaries were approximately $975 million in 1969. In the first six months of 1970, the industry raised about $650 million in the capital markets, out of an anticipated $1 billion for 1970 as a whole.

NEW SECURITY ISSUES BY REAL ESTATE INVESTMENT TRUSTS
(Amounts in millions of dollars)

		Equity Issues		Bond Issues	
		Amount	Per cent of Total New Stock Issues	Amount	Per cent of Total Public Bond Issues
1969 -	QI	34.0	1.7	--	--
	QII	148.6	6.6	20.0	0.6
	QIII	208.9	11.6	63.9	2.0
	QIV	488.0	21.2	11.5	0.3
	Year	879.5	10.5	95.4	0.8
1970 -	QI	151.0	7.0	207.0	4.2
	QII	170.0	12.0	110.0	1.7

Source: FRB.

*Prepared by Miss Eleanor Pruitt, Economist, and Mr. Rodney Gross, Research Assistant, Capital Markets Section, Division of Research and Statistics.

A real estate investment trust is an investment company which pools the funds of individual investors and institutions and places them largely in mortgage, construction, and development loans or investments in real property. The REIT is similar to a mutual fund in that the trust is simply a conduit through which income from investments flows through to the shareholders.[1/] Like a drilling fund or a cattle fund, ownership in the trust takes the form of shares of beneficial interest.

There are basically two types of REITs. Equity-oriented trusts invest in real property, primarily income-producing property such as apartments, shopping centers, and commercial buildings. Mortgage investment trusts, on the other hand, invest in loans secured by real property, with the mix of short-term and long-term mortgages varying considerably among firms. Some trusts are hybrids, which invest in both real property and mortgages. Recent changes in Federal income tax legislation and the greater flexibility of the hybrids have resulted in a new trend toward formation of hybrids and conversion of existing equity trusts. There are probably over 125 trusts in existence at the present time, of which only about 25 or 30 appear to be predominantly equity oriented.

The older, established mortgage investment trusts formed in the early 1960's still maintain a fair proportion of their assets in

1/ In order to maintain its freedom from corporate taxes, at least 90 per cent of the trust income must be distributed to shareholders.

permanent long-term mortgages. Most of the second generation trusts founded in 1969, in contrast, tend to concentrate on shorter-term first mortgage loans, primarily construction and development loans on income-producing property. However, it is believed by some industry observers that interim financing will become less important as an investment outlet for the funds of the real estate trust industry in a few years, and most REITS in their investment policy statements admit the possibility of acquiring long-term VA and FHA mortgages at some future time.

The leverage necessary for the growth of the second generation mortgage trusts comes from long-term debt issues, bank loans, and, in the case of a few trusts, issuance of commercial paper.[3/] Banks which lend to REITs have tended to insist on a minimum investment in long-term mortgages, which are considered to provide more stable cash flow and to be less risky than interim financing, particularly construction and development loans. Such loans are quite vulnerable in periods of depressed economic activity. Moreover, should financial conditions ease over the next few years and currently high interest rates decline somewhat, the REITs might find permanent mortgage financing relatively more attractive than at the present time.

Net flows of funds from REITs into the residential mortgage market were less than $200 million annually until 1969, when their net

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3/ As of mid-1970, there were only some seven or eight trusts which had issued commercial paper, and the outstanding volume was estimated at about $200 million, an insignificant fraction of the total $38 billion for all issuers.

acquisitions of single and multi-family mortgages jumped to about $900 million. It is estimated that the 1970 total will be only slightly higher, about $1 billion. Their acquisitions of home mortgages amounted to about $100 million in 1969, or less than 1 per cent of the total $15.4 billion net change in outstanding home mortgage debt. The mortgage trusts put an estimated $1.2 billion into multi-family and commercial mortgages, accounting, therefore, for about 12 per cent of the 1969 net change in such debt outstanding.[1/] The REITs have undoubtedly served builders by providing a broad-based source of supply for loans on apartments and commercial buildings, especially construction and development loans, in a period when commercial banks and other traditional mortgage lenders were unable to meet all the demand.

The mortgage investment trust industry has grown very rapidly and attracted a good deal of investor attention as well as a number of prestigious entrants, but the future is not without some potential problems. Many smaller REITs, particularly the equity trusts, are not sufficiently diversified, and an economic slowdown, even if it were only regional, could mean a serious drop in earnings. Management problems may also plague some of the smaller, weaker members of the industry, and a failure by any REIT would probably slow down future

1/ The $1.2 billion, of which $0.8 billion was in multi-family mortgages, includes retirements and is, therefore, a maximum estimate of REITs' contribution to the net change in mortgage debt.

expansion of these funds. There is a potential conflict of interest, too, between the trusts and the advisory services which select and manage their real estate investments. Regulation of REITs is, at present minimal, being confined almost entirely to the issuance of securities. As with all financial intermediaries, the earnings of REITs depend on the differential between the cost at which they can borrow and the returns on their investments. If there should be a decline in the current high yields on construction and development loans or if the market should become saturated as competition increases, some of them could face difficulties.

For the balance of this year, the REITs will probably continue to be an important factor in the equity market, both in terms of new issues and in secondary market activity. Over time, the larger trusts may also be fairly frequent visitors to the bond market. A number of large financial institutions are now setting up REITs, which have the ability to tap the capital markets directly for mortgage money as a competitive move. It may well be that in the 1970's the industry will be dominated by the trusts set up by large banks and insurance companies, which will presumably have the management expertise to succeed in this field. At the same time, the trusts will enable these institutions to channel funds into certain areas of the mortgage market from investors who might not be attracted to ordinary thrift investments.

SUPPLEMENTAL APPENDIX B: TREASURY FINANCING IN THE SECOND HALF OF CALENDAR 1970*

The volume of Treasury financing in the second half of calendar 1970 is expected to be large. Since market participants generally view this prospective financing as a major factor in the near-term outlook for interest rates, it is useful to consider more explicitly what its dimensions are likely to be and how they compare with borrowing totals in the July-December periods of other recent years.

Relative dimensions of prospective Treasury borrowing

Even in years when there has been a sizable budget surplus, the Treasury has usually been a net borrower in the second half of the calendar year mainly due to the seasonal pattern in tax receipts. This year seasonal borrowing needs will be augmented by the effects of sluggish economic activity on tax receipts as well as by the recently enacted tax reform and relief measures which include the expiration of the surtax in July.

Table 1 compares staff estimates of Treasury borrowing requirements in the third and fourth quarters of this year with actual borrowing totals in recent years. As column 1 of the table shows, net cash borrowing for the second half of this year is estimated to total about $12.5 billion, more than $4 billion larger than in the same period a year ago but $6 billion smaller than in the second half of 1967, which was part of the record deficit year of fiscal 1968.1/ In the third

1/ The fiscal 1968 budget deficit of $25.2 billion compares with a $7.3 billion deficit for fiscal 1971, now projected by the staff.

* Prepared by William Beeman, Government Finance Section, Division of Research and Statistics.

Table 1

RECENT PAST AND PROJECTED TREASURY FINANCING
IN SECOND HALF OF CALENDAR YEARS
(Billions of dollars)

Calendar year	Net borrowing from public 1/ (1)	Memo: Net borrowing by Government-sponsored agencies 2/ (2)	Total columns (1)+(2) (3)	Refunding: maturing coupon issues publicly-held (4)	Gross cash offerings of marketable Treasury issues 3/ (5)
1967 - Q3	8.5	--	8.5	3.6	7.9
Q4	10.4	--	10.4	2.6	9.2
HII	18.9	--	18.9	6.2	17.1
1968 - Q3	7.7	.0	7.7	3.6	8.1
Q4	3.4	.5	3.9	4.7	5.3
HII	11.1	.5	11.6	8.3	13.4
1969 - Q3	3.2	2.7	5.9	3.2	5.6
Q4	5.1	2.9	8.0	5.9	8.3
HII	8.3	5.6	13.9	9.2	13.9
1970 - Q3e	5.9	1.9	7.8	5.6	8.8
Q4e	6.7	1.1	7.8	6.0	7.6
HIIe	12.6	3.0	15.6	11.6	16.4

e - Estimated by Board staff.
1/ New money raised from public.
2/ Prior to 1968 net borrowing by all government-sponsored agencies was included in the published figure on net borrowing from the public, shown in column (1); starting in 1968 with the shift over to the unified budget concept, activities of some Federal agencies began to be excluded from the budget and were taken out of the net borrowing total. In 1968 the borrowing of the Federal Home Loan Bank Board and the Farm Credit Administration were excluded from net borrowing by the Treasury and that of FNMA was excluded in the fourth quarter of 1968. The amount of net borrowing by these agencies in the periods following their exclusion from the unified Budget is shown in column (2).
3/ Marketable securities issued by the Treasury for cash other than roll-overs of Treasury bills in weekly and monthly auctions, and roll-overs of coupon issues in cash refinancings.

quarter alone, net cash borrowing--at an estimated $6.0 billion--is nearly double that for the third quarter a year ago, though significantly smaller than in the same quarters of 1967 and 1968. However, when comparing projected net cash needs for the current year with figures for years prior to 1969, it is necessary to include borrowing by Federally-sponsored agencies, since the net borrowing of these agencies were incorporated in the cash budget totals and in the net borrowing series of prior years. The net borrowing of these agencies for the periods after their exclusion from the budget are shown in column (2) of Table 1. After allowance is made for agency borrowing, Federal financing needs in the second half of calendar 1970 are only about $3.3 billion less than in 1967 but $4.0 billion more than in 1968, as shown in column (3) of Table 1. Because agency borrowing was unusually high in 1969, total net borrowing by the Treasury and the agencies in the second half of this year is expected to be about $2.0 billion larger than in 1967.

Participants in financial markets tend to focus more on the dimensions of the Treasury's expected gross cash financing than on its net borrowing. In addition to net new money needs, these gross totals include borrowing required to finance cash debt repayment arising from such things as attrition in refundings, and maturities of tax bills but they exclude turnover of bills and coupon issues. On this basis, as shown in column (5) of the table, the estimated nearly $16.5 billion of second half 1970 borrowing looks more formidable relative to earlier years. This is partly attributable to the rather large volume of cash redemptions projected for the August and November refinancings on the assumption that pressures on securities markets, while possibly moderating somewhat as the year progresses, will, nevertheless, remain significant. In addition, $1.8 billion of maturing Treasury tax bills must be refinanced in September this year, whereas in the other years shown (except 1969) there were no maturing tax bills in the second half of the year.

In addition, the volume of publicly-held coupon issues scheduled to mature in August and November (shown in column 4 of the table) amounts to $11.6 billion, and is significantly larger than in any other recent year. The steady growth in refinancing volume from 1967 through 1970 reflects the persistent shortening in overall maturity of the debt that has occurred as a result of generally tight credit conditions and interest limitations on debt lengthening imposed by the 4-1/4 per cent interest rate ceiling on Treasury bonds.

Nature and timing of financings

Table 2 makes more explicit the expected timing of Treasury gross debt offerings during the July-December period. The heaviest concentration occurs in July and August. It is assumed that a part of the gross cash need will be met by continuing the $100 million increments to weekly bill auctions now under way through the rest of the bill cycle--i.e., through the first three weeks of August. Altogether possibly $7 billion of the gross cash requirement for July and August may be met through regular and tax bill financings. This would leave nearly $2 billion of cash need and around $4.5 billion of refinancing need (after allowance for attrition) to be met in the coupon market.

Table 2

ESTIMATE OF SELECTED TREASURY FINANCING
ACTIVITIES IN SECOND HALF OF CALENDAR 1970
(Billions of dollars)

	July	August	September	October	November	December
Additions to weekly bill auction 1/	.5	.3	--	--	--	--
Unspecified gross cash offering 1/	4.3	3.7	--	3.9	3.7	--
Maturing publicly-held coupon issues	--	5.6	--	6.0	--	--

1/ Staff estimate.