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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 14, 1970

The Domestic Economy

Gross national product in the second quarter rose $11.6 billion to a seasonally adjusted annual rate of $971.1 billion, according to Department of Commerce revised estimates, as shown in the table. The rise is $1 billion more than indicated by the preliminary estimates published a month earlier. Revisions of the major GNP components were generally small. Nonfarm business inventory investment was raised by $0.5 billion, and net exports and personal consumption expenditures by even smaller amounts.

The annual rate of increase in real GNP is now indicated to be 0.6 per cent, up a little from the earlier 0.3 per cent. The annual rate of increase in the GNP implicit price deflator is now shown at 4.3 per cent, up slightly from the preliminary figure.

Revisions in the income side of the accounts were also quite small. The revised figures for personal income, wages and salary disbursements, disposable income, and personal saving are slightly lower than indicated earlier, and the personal saving rate is now 7.5 per cent rather than 7.6 per cent. The preliminary Commerce estimate of corporate profits before tax in the second quarter is $82.3 billion, seasonally adjusted annual rate. This is down $0.3 billion from profits in the first quarter and compares with the staff estimate of $83.0 billion in the August 12 Greenbook. Higher Federal government grants-in-aid to State and local governments raised total Federal expenditures on an N.I.A. basis slightly and the Federal deficit is now estimated at a $14.3 billion annual rate, compared with the $13.9 billion staff estimate in the Greenbook.

GROSS NATIONAL PRODUCT AND RELATED ITEMS

	Billions of Dollars			Change 70-I to 70-II	
		Seasonally Adjusted Annual Rates 1970			
	1969	I	II	Bil. of $	Per Cent Per Year
Gross National Product	931.4	959.5	971.1	11.6	4.8
Final purchases	922.9	957.9	968.1	10.2	4.3
Private	710.7	738.3	749.7	11.4	6.2
Excluding net exports	708.8	734.8	745.6	10.8	5.9
Personal consumption expenditures	577.5	603.1	614.4	11.3	7.5
Durable goods	90.0	89.1	91.9	2.8	12.6
Nondurable goods	245.8	258.8	262.6	3.8	5.9
Services	241.6	255.2	259.9	4.7	7.4
Gross private domestic investment	139.8	133.2	134.3	1.1	3.3
Residential construction	32.0	29.1	28.4	-0.7	-9.6
Business fixed investment	99.3	102.6	102.8	0.2	0.8
Change in business inventories	8.5	1.6	3.1	1.5	--
Nonfarm	8.0	.9	2.6	1.7	--
Net exports of goods and services	1.9	3.5	4.1	0.6	--
Gov't. purchases of goods & services	212.2	219.6	218.4	-1.2	-2.2
Federal	101.3	102.3	99.7	-2.6	-10.2
Defense	78.8	79.3	76.8	-2.5	-12.6
Other	22.6	23.0	22.9	-0.1	-1.7
State & local	110.8	117.4	118.7	1.3	4.4
Gross national product in constant (1958) dollars	727.1	723.8	724.9	1.1	0.6
GNP implicit deflator (1958 = 100)	128.1	132.6	134.0	--	4.3
Personal income	748.9	782.3	801.3	19.0	9.7
Wages and salaries	509.0	531.9	539.5	7.6	2.2
Disposable income	631.6	665.3	683.6	18.3	11.0
Personal saving	37.6	44.8	51.5	6.7	--
Saving rate (per cent)	6.0	6.7	7.5	--	--
Corporate profits before tax	91.2	82.6	82.3p	-0.3	-1.5
Federal government receipts and expenditures (N.I.A. basis)					
Receipts	200.6	195.9	196.6	0.7	1.4
Expenditures	191.3	197.7	210.9	13.2	26.7
Surplus or deficit (-)	9.3	-1.7	-14.3	-12.6	--
High employment surplus or deficit (-)	4.5	3.2	3.9	--	--

Personal income rose by $3.6 billion from June to July, to a seasonally adjusted annual rate of $801.8 billion. Despite a further decline in employment in July, wage and salary disbursements rose by $1.9 billion. Wage increases and a slightly lengthened workweek accounted for the rise, which was concentrated in the private nonmanufacturing industries. Manufacturing payrolls were unchanged over the month, and were still well below the December 1969 peak. Increases of about one-half billion dollars each in dividends, personal interest income and transfer payments accounted for almost half of the over-all rise in personal income.

PERSONAL INCOME
(Seasonally adjusted, billions of dollars)

	Average Monthly Change:		
	June '69 December '69	December '69 June '70	June '70 July '70
Total personal income	4.7	4.0	3.6
Wages and salaries	3.5	1.7	1.9
Government	1.0	.8	.3
Private	2.5	.9	1.6
Manufacturing	.7	-.4	0
Nonmanufacturing	1.8	1.3	1.6
Other sources (net)	1.2	2.3	1.7

The Domestic Financial Situation

Nonbank depositary intermediaries. Deposit growth during July at mutual savings banks is now estimated, on the basis of more complete data, to have exceeded a seven per cent annual rate which is considerably higher than the earlier six per cent estimate. Deposit growth at nonbank thrift institutions during June and July taken together is now estimated to have approached a ten per cent annual rate--an exceptional increase over past experience.

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

	Mutual Savings Banks	Savings and Loan Associations	Both
1970 - May*	6.4	5.6	5.9
June* p/	6.0	7.9	7.3
July*	7.1 r/	14.3 e/	12.0
Memo: June & July p/	6.6	11.2	9.6

p/ Preliminary.
r/ Revised, though still preliminary.
e/ Estimate based upon sample data.
* Monthly patterns may not be significant because of difficulties with seasonal adjustment.

Large savings banks in New York City had deposit inflows during the first week of August that continued their pattern of recent months of being larger than last year but smaller than in 1967 and 1968. Apparently, those institutions could identify no impact from the reportedly heavy individual subscriptions to the recent Treasury issue; payment date is not until August 17, but there have been scattered reports in the news media of thrift institutions elsewhere in the country that claimed to have already experienced outflows as a result of the low-minimum-denomination offering.

The Federal Home Loan Bank Board has just issued regulations, to be effective September 14, to permit depositors in Federal savings and loan associations to authorize third-party payments from their accounts. This action, which implements a provision of the Housing and Urban Development Act of 1968, provides that the payments authorized are neither transferable nor negotiable and hence, according to the FHLBB, are not like checks drawn on bank accounts.

Mortgage rates. During July, average returns on conventional new-home mortgages increased slightly in the primary market, mainly reflecting higher rates permitted under recent upward revisions in usury ceilings in such States as Pennsylvania, Kentucky, and South Dakota (in July) and New Jersey (in April). In the West, where usury ceilings have not posed a market barrier, conventional home-loan rates edged down further in July to a level 25 basis points below the record high posted early this year. Meanwhile, average yields declined slightly in the secondary market for FHA-insured home mortgages, which are ordinarily exempt from usury limits. Despite a sharp improvement during July in the unusually-depressed yield spread of mortgages over new issues of high-grade corporate bonds, both conventional and Government underwritten home loans continued to offer no net investment incentive for diversified lenders.

AVERAGE RATES AND YIELDS ON SELECTED NEW-HOME MORTGAGES

	Primary market: Conventional loans		Secondary market: FHA-insured loans		
	Level (per cent)	Yield spread (basis points)	Level (per cent)	Yield spread (basis points)	Discount (points)
1969					
Low	7.55 (Jan.)	-40 (Dec.)	7.85e (Jan.)	-13 (Dec.)	2.8e (Jan.)
High	8.35 (Nov.,Dec.)	69 (Feb.)	8.62 (Dec.)	108 (Feb.)	8.7 (Dec.)
1970					
January	8.55	9	9.25e	79e	5.7e
February	8.55	25	9.29	99	6.0
March	8.55	-5	9.20	60	5.3
April	8.55	-5	9.10	50	4.6
May	8.55	-55	9.11	1	4.7
June	8.55	-56	9.16	5	5.0
July	8.60	-3	9.11	48	4.7

Note: FHA series; interest rates on conventional first mortgages (excluding additional fees and charges) are rounded to the nearest 5 basis points. On 8-1/2 per cent FHA loans, a change of 1.0 points in discount is associated with a change of 13 to 15 basis points in yield. Gross yield spread is average mortgage return, before deducting servicing fees, minus average yield on new issues of high grade corporate bonds with 5-year call protection.
e/ Estimated.

Government securities market. More complete data indicate that dealer awards of the new notes in the mid-August refunding totaled $1.67 billion, about $400 million more than indicated in the Greenbook. Awards of the 7-year issue are estimated at $789 million, of the 3-1/2 year issue $530 million, and of the 18-month issue $355 million.

INTEREST RATES

	1970			
	Highs	Lows	July 20	August 13
Short-Term Rates				
Federal funds (weekly averages)	9.39 (2/18)	6.82 (8/12)	7.59 (7/15)	6.82 (8/12)
3-months				
Treasury bills (bid)	7.92 (1/6)	6.08 (3/24)	6.37	6.53
Bankers' acceptances	8.75 (1/13)	7.13 (3/30)	7.88	7.50
Euro-dollars	10.50 (1/9)	8.00 (4/20)	8.80	8.33
Federal agencies	8.30 (1/9)	6.50 (7/24)	6.53 (7/17)	7.01
Finance paper	8.19 (1/30)	7.25 (4/28)	7.75	7.75
CD's (prime NYC)				
Highest quoted new issue	6.75	6.75	6.75	6.75
Secondary market	9.25 (1/23)	6.75 (4/10)	7.94	7.75
6-month				
Treasury bills (bid)	7.99 (1/5)	6.18 (3/23)	6.47	6.64
Bankers' acceptances	8.88 (1/13)	7.25 (3/30)	7.63	7.38
Commercial paper (4-6 months)	9.13 (1/8)	7.88 (3/30)	8.25	8.00
Federal agencies	8.50 (1/28)	6.91 (4/17)	7.14 (7/17)	7.32
CD's (prime NYC)				
Highest quoted new issue	7.00	7.00	7.00	7.00
Secondary market	9.15 (1/7)	7.25 (4/17)	7.88	7.80
1-year				
Treasury bills (bid)	7.59 (1/9)	6.20 (4/13)	6.60	6.64
Prime municipals	5.60 (1/9)	3.80 (3/27)	4.80 (7/16)	4.20
Intermediate and Long-Term				
Treasury coupon issues				
5-years	8.30 (1/7)	7.05 (3/25)	7.59	7.62
20-years	7.73 (5/26)	6.55 (2/27)	6.94	7.12
Corporate				
Seasoned Aaa	8.60 (6/24)	7.78 (3/10)	8.46	8.10
Baa	9.45 (7/8)	8.57 (3/10)	9.40	9.43
New Issue Aaa				
No call protection	--	--	--	--
Call protection	9.29 (6/17)	8.20 (2/27)	8.58	8.53
Municipal				
Bond Buyer Index	7.12 (5/28)	5.95 (3/12)	6.60 (7/16)	6.30
Moody's Aaa	6.95 (6/18)	5.75 (3/12)	6.50 (7/16)	6.10
Mortgage--implicit yield in FNMA auction 1/	9.36 (1/2)	9.04 (4/20)	9.21 (7/13)	9.03 (8/10)

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.

International Developments

U.K. merchandise trade. British merchandise trade in July, according to the official statistics released Thursday, recorded a huge surplus of £137 million, balance of payments basis. This result reflects the effects of the dock strike in the latter half of July in conjunction with the fact that the statistics cover different periods for exports and imports.

Because of lags in the filing of documents, the trade figures report export deliveries not for the calendar month but for the month up to, approximately, the 20th. Imports, on the other hand, are reported more promptly, and the import statistics are thus for the calendar month. The export figures for July, therefore, were far less affected by the dock strike than the import figures. Exports, as officially reported, were virtually unchanged from June, but imports declined by 25 per cent.

The trade balance in August will almost certainly record an abnormally large deficit, since the export statistics will include most of the period when the dock strike was in progress.

It is thus clear that neither the July trade figures, nor the August figures to come, can be at all useful in assessing the underlying condition or direction of merchandise trade. In fact, the after effects of the dock strike--even when timing differences in recording exports and imports have ceased to matter--are likely to distort the trade results to some degree for several months.

British trade in the first six months of the year is discussed in the Greenbook, in the section on foreign trade of major industrial countries.

Reserve requirements in Germany. The German central bank last Wednesday imposed severe marginal reserve requirements, indicating thereby that it intends to maintain its restrictive monetary policy. It had been thought in July, when the Bundesbank reduced the discount rate from 7-1/2 per cent to 7 per cent, that the tighter fiscal policy the Government had just adopted might allow monetary policy to relax somewhat. However, in its meeting this week, the Bundesbank Council concluded that continuing demand and price pressures in Germany warrant maintaining a tight monetary policy. The increase in reserve requirements was decided on in order to offset additions to domestic liquidity caused by flows of funds from abroad.

The new marginal requirements are 40 per cent on increases in sight and time liabilities and 20 per cent on increases in savings deposits over the average level in April, May and June of this year. Added to regular reserve requirements, this means that the large German banks will have to hold 52 per cent cash reserves against increases in sight deposits, 48 per cent against increases in time liabilities, and 26 per cent against increases in savings deposits.[1/]

The limited availability and relatively high cost of credit in German financial markets since late last year has caused large-scale

1/ However, average reserve requirements cannot exceed 30 per cent against sight deposits, 20 per cent against time deposits and 10 per cent against savings deposits.

capital imports by German banks and non-banks, which together with a continuing large trade surplus have generated very substantial over-all balance of payments surpluses. Last March, marginal reserve requirements against additions to the banks' liabilities to non-residents were imposed. Inflows to Germany continued, however, and after Bundesbank reserves rose by over $900 million during the first two weeks of June alone, over-all reserve requirements were raised 15 per cent, effective July 1. Since then, however, the net foreign assets of the Bundesbank have increased by about $900 million more--mainly before the end of July. Purchases of foreign exchange by the Bundesbank of course create reserve funds for the German banks. It was to prevent such additions to bank reserves from undermining the tight credit policy that the Bundesbank announced the new marginal reserve requirements. These requirements apply to liabilities to both residents and non-residents and replace those imposed in March against increases in liabilities to non-residents alone. The March measures have had only limited effect because of direct borrowing abroad by German non-banks.