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CONFIDENTIAL (FR)
CLASS II - FOMC

January 7, 1980

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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New Car Sales

Sales of new automobiles in December were at a seasonally adjusted annual rate of 10.6 million units, up from a 9.5 million unit rate in November and about that rate in the preceding month. In the third quarter sales of all new automobiles had been at a rate of 10.8 million units a year. In December, after a new discount program had been instated, sales of domestic-model cars rose to a 7.8 million unit annual rate from a 6.9 million unit rate in the preceding month. Sales of foreign-type cars rose in December to a 2.8 million unit rate from a 2.6 million unit rate in November; these rates were the highest since last spring.

Consumer Confidence and Buying Plans

According to The Conference Board's survey of consumer attitudes, consumer confidence and buying plans deteriorated somewhat in December. Consumers expected less favorable business conditions in the coming six months, fewer job opportunities, and less chances for income increase. The proportion of consumers reporting plans to buy a house, both new and previously lived in, within the next six months declined sharply further in December, and the proportion reporting plans to buy a major appliance edged down from the quite high November level. In contrast, the proportion indicating plans to buy a car edged up a bit from the somewhat reduced November level (but still above most months of 1979). The proportion of survey respondents reporting plans to take a vacation within six months rose further.

Manufacturers' Orders and Shipments

New orders for manufacturers' durable goods have been revised up and are now indicated to have been about unchanged in November instead of 1.2 percent below the October level as first published in the advance, partial-sample report. New orders for nondefense capital goods rose 1.5 percent in November, according to the full-sample estimates, rather than 1/2 percent as initially reported. Durable goods shipments are now reported to have declined 1.9 percent instead of the 2.6 percent first published, and nondefense capital goods to have declined 2.0 percent instead of 3.0 percent. Unfilled orders for durable goods at the end of November are now indicated to have been 0.9 percent above their October level and 17-3/4 percent above a year earlier.

Manufacturers' Inventories

The book value of manufacturers' inventories increased at a seasonally adjusted annual rate of $33 billion in November, following the $24 billion rate rise in the previous month. The November buildup, the largest since last June, was accompanied by a decline in shipments, in part because of strikes in the nonelectrical machinery industry. As a result, the stock-sales ratio for all manufacturers' goods rose from 1.53 in October to 1.56.

The accumulation in November was concentrated at producers of durable goods. The book value of these stocks rose at a $26 billion annual rate, about the same as in the preceding month. A substantial increase occurred in stocks of transportation equipment, where a large rise in aircraft, missiles, and parts inventories was partly offset by a decline in motor vehicle stocks. At manufacturers of nonelectrical equipment, inventories rose at a somewhat slower pace than in the first few months of 1979, but the stock-sales ratio for these producers rose considerably, reflecting a 4-1/2 percent decline in their shipments. The book value of nondurable inventories rose at a $6 billion annual rate after remaining essentially unchanged in the previous month. Stocks of both food products and chemical products rose appreciably.

By stage-of-fabrication, the November increase in inventories was concentrated in work-in-process. The increase in materials and supplies stocks was less than half the unusually large October pace; in November, finished goods inventories increased at a $9 billion annual rate after declining in October.

MANUFACTURERS' INVENTORIES: CHANGE IN BOOK VALUE
(Billions of dollars; seasonally adjusted, annual rate)

	1978	1979				
	H2	Q1	Q2	Q3	Oct.	Nov.
Total	17.6	30.2	35.0	28.3	24.4	32.6
Durable	13.4	24.2	25.7	16.9	25.4	26.3
Nondurable	4.2	6.0	9.3	11.4	-1.0	6.3
Stage of Fabrication						
Materials & Supplies	4.5	12.8	8.0	9.9	18.7	8.4
Work-in-Process	8.7	9.9	16.6	11.7	13.9	15.2
Finished Goods	4.5	7.5	10.4	6.8	-8.2	9.1

MANUFACTURERS' INVENTORY/SALES RATIOS

	1978	1979				
	H2	Q1	Q2	Q3	Oct.	Nov.
Total	1.52	1.49	1.55	1.55	1.53	1.56
Durable	1.84	1.82	1.94	1.97	1.96	2.03
Nondurable	1.14	1.11	1.11	1.10	1.08	1.07

Totals may not add due to rounding.

MONETARY AGGREGATES
(Seasonally adjusted annual rates of growth)[1]

	1979 Q1	1979 Q2	1979 Q3	1979 Q4[e]	Nov.	Dec.[e]	Dec. '78 to Dec. '79[e]	Q4 '78 to Q4 '79
Major monetary aggregates								
1. M-1	-2.1	7.6	9.7	4.9	1.0	5.7	5.4	5.1
2. Currency	9.1	8.1	11.1	8.5	4.6	5.7	9.0	9.5
3. Demand deposits	-6.2	7.5	9.2	3.4	- .4	5.3	4.0	3.5
4. M-2	1.8	8.6	12.0	8.8	6.1	5.9	8.2	8.0
5. M-3	4.7	7.9	10.5	7.8	5.5	6.4	8.0	8.0
Bank time and savings deposits								
6. Total	8.4	1.2	9.0	14.6	15.5	3.6	8.2	8.5
7. Other than large negotiable CDs at weekly reporting banks	4.5	9.3	13.6	11.5	9.6	6.0	10.2	10.1
8. Savings deposits	-9.6	-3.1	5.5	-13.4	-34.2	-10.2	-6.0	-5.1
9. Individuals [2]	-9.4	-2.9	6.3	-12.2	-32.4	-9.1	-5.4	-4.5
10. Other [3]	-13.0	-8.1	-2.7	-33.1	-60.4	-27.3	-14.0	-13.6
11. Time deposits	15.6	18.5	19.2	28.4	37.5	15.6	22.7	22.0
12. Small time [4]	16.5	36.3	26.9	30.3	45.5	28.2	32.8	30.4
13. Large time [4]	13.6	-12.1	4.5	24.3	21.3	-10.5	5.5	7.6
14. Time and savings deposits subject to rate ceilings (8+12)	2.2	15.1	15.9	8.3	6.7	10.1	11.5	10.8
Deposits at nonbank thrift institutions [5]								
15. Total	8.8	6.8	8.4	6.4	4.3	6.8	7.5	7.9
16. Savings and loan associations	11.3	7.8	9.2	8.9	8.0	9.0	9.4	9.6
17. Mutual savings banks	4.6	3.1	2.2	0.0	-2.5	-1.7	2.0	2.5
18. Credit unions	0.8	8.3	19.3	0.7	-6.3	8.5	7.2	7.4
MEMORANDA: Monthly changes in billions of $								
19. Total U.S. govt. deposits [6]	-2.0	1.5	.7	- .7	-4.5	2.6	- .1	- .4
20. Total large time deposits [7]	1.3	-6.3	2.5	3.6	5.9	-1.8	.3	.7
21. Nondeposit funds	5.3	5.0	5.2	n.a.	-5.1	n.a.	n.a.	n.a.
22. Other [8]	2.0	1.3	2.2	n.a.	-6.2	n.a.	n.a.	n.a.
23. Net due to related foreign institutions	3.3	3.7	3.0	n.a.	1.1	n.a.	n.a.	n.a.

e—estimated. n.a.—not available.

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 are based on average of current and preceding end-of-month data.
6. Includes Treasury demand deposits at commercial banks and Federal Reserve Banks and Treasury note balances.
7. All large time certificates, negotiable and nonnegotiable, at all CBs.
8. Domestic 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), and loans sold, less interbank borrowings.

COMMERCIAL BANK CREDIT
(Percent changes at annual rates, seasonally adjusted)[1]

		1979						12 months ending
		Q1p	Q2p	Q3e	Q4e	Nov.p	Dec.e	Dec.e
1.	Total loans and investments at banks [2]	13.3	11.9	15.8	2.9	-0.5	3.0	11.4
2.	Investments	7.6	5.4	8.5	3.7	3.0	2.5	6.5
3.	Treasury securities	2.1	3.8	1.7	-6.3	-12.6	-7.6	0.3
4.	Other securities	10.5	6.2	12.1	8.7	10.8	7.6	9.7
5.	Total loans [2]	15.2	14.2	18.2	2.7	-1.7	3.1	13.2
6.	Business loans	20.5	16.6	22.7	3.9	-1.6	2.9	16.8
7.	Security loans	33.0	38.1	8.7	-86.8	-128.2	0.0	-5.2
8.	Real estate loans	14.6	13.0	14.7	14.7	13.2	15.0	15.0
9.	Consumer loans	16.3	12.4	7.5	n.a.	6.0	n.a.	n.a.

SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT
(Percent changes at annual rates, seasonally adjusted)

		Q1p	Q2p	Q3e	Q4e	Nov.p	Dec.e	12 months ending Dec.e
10.	Total short- and intermediate-term business credit (sum of lines 13,14 and 15)	20.8	20.1	27.4	n.a.	0.6	n.a.	n.a.
11.	Business loans net of bankers acceptances [1]	20.4	16.6	21.7	5.1	-0.4	2.1	16.9
12.	Commercial paper issued by nonfinancial firms [3]	33.5	65.7	69.7	14.1	-33.6	64.7	53.4
13.	Sum of lines 11 & 12	21.4	20.3	25.7	6.0	-3.5	7.7	19.6
14.	Finance company loans to business [4]	16.6	17.7	9.4	n.a.	15.5	n.a.	n.a.
15.	Total bankers acceptances outstanding [4]	24.8	23.3	74.9	n.a.	5.5	n.a.	n.a.

e—estimated. p—preliminary. n.a.—not available.

1. Average of Wednesdays for domestic chartered banks and average of current and preceding ends of months for foreign-related institutions.
2. Loans include outstanding amounts of loans reported as sold outright to a bank's own foreign branches, unconsolidated nonbank affiliates of the bank, the bank's holding company (if not a bank), and unconsolidated nonbank subsidiaries of the holding company.
3. Average of Wednesdays.
4. Based on average of current and preceding ends of months.

SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT
Seasonally adjusted monthly averages[1]

	Business Loans at Commercial Banks								Total	Total
	Total Excluding Bankers Acceptances[2 3] (1)	Large Banks Excluding Acceptances[2 3] (2)	Foreign-Related Institutions Excluding Acceptances (3)	Small Banks (4)	Total Acceptances Held[4] (5)	Total Including Acceptances[2 3] (6)	Commercial Paper of Non-financial Business (7)	Business Loans at Finance Companies (8)	Bankers Acceptances Outstanding (9)	Short and Intermediate-Term Business Cr (10)
					Level in Billions of Dollars					
1978—December	241.7	128.4	25.0	88.3	6.8	248.5[4]	19.1	62.8	32.3	355.9
1979—February	251.9	132.8	26.4	92.7	7.6	259.5	19.8	64.5	33.8	370.0
March	255.1	134.1	27.2	93.8	7.2	262.3	20.7	65.4	34.3	375.5
April	258.7	137.7	27.9	93.1	7.3	266.0	22.0	66.3	34.5	381.5
May	262.1	140.2	28.5	93.4	7.3	269.4	23.5	67.2	35.1	387.9
June	265.7	142.1	29.6	94.0	7.5	273.2	24.1	68.3	36.3	394.4
July	270.2	144.7	30.9	94.6	8.1	278.3	25.8	69.7	38.1	403.8
August	274.6	147.2	32.2	95.2	8.0	282.6	27.2	70.8	41.2	413.8
September	280.1	150.1	33.6	96.4	8.6	288.7	28.3	69.9	43.1	421.4
October	283.3	151.1	34.2	98.0	8.0	291.2	28.6	69.6	43.4	424.9
November	282.5	149.6	35.1	98.5	7.6	290.8	27.8	70.5	43.6p	425.1
December[e]	283.7	149.6	35.8	98.3	7.8	291.5	29.3	n.a.	n.a.	n.a.
					Annual Percentage Rate of Change					
1973—Year	22.2	23.1	45.1	16.9	4.3	21.8	15.4	19.3	25.0	21.5
1974—Year	18.9	20.6	41.7	11.2	45.8	19.3	57.8	15.2	108.2	23.5
1975—Year	-5.1	4.8	6.2	4.4	68.6	-3.8	-22.5	5.9	1.7	-4.0
1976—Year	0.3	7.9	-3.9	8.8	32.2	1.3	21.8	13.2	17.8	4.4
1977—Year	11.1	15.9	13.4	16.1	-3.8	10.5	14.9	22.9	15.1	13.6
1978—Year	17.8	19.5	47.9	14.2	-9.3	16.3	24.0	14.8	32.4	18.3
1979—Year[e]	16.9	15.6	43.2	11.3	14.7	16.8	53.4	n.a.	n.a.	n.a.
1979—First Qtr	20.4	14.5	35.2	24.9	29.9	20.5	33.5	16.6	24.8	20.8
Second Qtr	16.6	23.9	31.3	0.9	16.7	16.6	65.7	17.7	23.3	20.1
Third Qtr	21.7	22.5	54.1	10.2	58.7	22.7	69.7	9.4	74.9	27.4
Fourth Qtr[e]	5.1	-1.3	26.2	7.9	-37.2	3.9	14.1	n.a.	n.a.	n.a.
1979—January	26.7	14.8	33.6	42.1	35.3	26.9	6.3	17.2	26.0	23.9
February	18.4	16.5	32.7	17.1	102.9	20.7	37.5	15.1	29.1	19.8
March	15.2	11.7	36.4	14.2	-63.2	12.9	54.5	16.7	17.8	17.8
April	16.9	32.2	30.9	-9.0	16.7	16.9	75.4	16.5	7.0	19.2
May	15.8	21.8	25.8	3.9	0.0	15.3	81.8	16.3	20.9	20.1
June	16.5	16.3	46.3	7.7	32.9	16.9	30.6	19.6	41.0	20.1
July	20.3	22.0	52.7	7.7	96.0	22.4	84.6	24.6	59.5	28.6
August	19.5	20.7	50.5	7.6	-14.8	18.5	65.1	18.9	97.6	29.7
September	24.0	23.6	52.2	15.1	90.0	25.9	48.5	-15.3	55.3	22.0
October	13.7	8.0	21.4	19.9	-83.7	10.4	12.7	-5.2	8.4	10.0
November	-0.4	-11.9	31.6	6.1	-60.0	-1.6	-33.6	15.5	5.5p	0.6
December[e]	2.1	0.0	23.9	-2.4	31.6	2.9	64.7	n.a.	n.a.	n.a.

n.a.—not available. e—estimated.

1. Business loan and acceptances data in columns 1-6 are monthly averages and reflect prorated averages of Wednesday data for domestic chartered banks and averages of current and previous month-end data for foreign-related institutions. Commercial paper reflects prorated averages of Wednesday data. Business loans at finance companies and bankers acceptances outstanding in columns 8 and 9 reflect averages of current and preceding month-end data.
2. Adjusted for loans sold to banks' affiliates.
3. Effective December 31, 1978, business loans were increased by $600 million as the result of a $700 million upward reclassification in loans offset in part by a $100 million decline due to balance sheet reclassifications. Effective January 3, 1979, as the result of reclassification, business loans were increased by $400.
4. Excludes acceptances held at small banks, for which no data are available. Included a small amount of commercial paper holdings.
5. Sum of columns 1, 7, 8, and 9.

SELECTED FINANCIAL MARKET QUOTATIONS
(percent)

	1974 High[1]	1978 Jan.4[1]	1979 Jan.3[1]	1979[2] FOMC Oct.5	1979[2] FOMC Nov.20	1979[2] Jan.4	Change from: Oct. FOMC	Change from: Nov. FOMC
Short-term rates								
Federal funds[3]	13.55	6.69	10.59	11.91	13.10	13.97p	2.06	.87
Treasury bills								
1-month	9.88	5.81	8.93	10.40	11.75	11.50	1.10	-.25
3-month	9.63	6.16	9.30	10.70	11.92	12.10	1.40	.18
6-month	9.75	6.45	9.49	10.63	12.02	11.97	1.34	-.05
1-year	9.54	6.55	9.68	10.28	11.42	11.04	.76	-.38
Commercial paper								
1-month	12.25	6.62	10.32	11.73	13.29	13.25	1.52	-.04
3-month	12.25	6.68	10.57	11.86	13.56	13.13	1.27	-.43
6-month	12.00	6.70	10.62	11.84	13.21	12.61	.77	-.60
Large negotiable CDs[4]								
1-month	12.58	6.62	10.37	12.09	13.66	13.35	1.26	-.31
3-month	12.64	6.76	10.93	12.50	13.95	13.52	1.02	-.43
6-month	12.30	7.01	11.51	12.80	14.02	13.63	.83	-.39
Eurodollar deposit[3]								
1-month	13.78	6.89	11.14	12.45	14.33	14.85p	2.40	-.52
3-month	14.01	7.25	11.81	12.79	15.16	14.65p	1.86	-.51
Bank prime rate	12.00	7.75	11.75	13.50	15.75	15.25	1.75	-.50
Intermediate- and long-term rates								
U.S. Treasury (constant maturity)								
3-year	8.84	7.38	9.61	10.01	11.40	10.81	.80	-.59
10-year	8.14	7.81	9.16	9.60	10.78	10.66	1.06	-.12
30-year	n.a.	8.06	8.97	9.36	10.39	10.34	.98	-.05
Municipal (Bond Buyer)[5]	7.15	5.64	6.58	6.64	7.31	7.32	.68	.01
Corporate Aaa								
New issue[6]	10.61	--	--	10.22	11.50	--	--	--
Recently offered[7]	10.52	8.48	9.51	10.25	11.41	11.41p	1.16	0
Primary conventional mortgages[7]	10.03	9.00	10.38	11.35	12.80	12.90	1.55	.10
	1974 Low[8]	1978 Jan.6[8]	1979 Jan.5[8]	FOMC Oct.5	FOMC Nov.20	Jan.4	Oct. FOMC	Nov. FOMC
Stock prices								
Dow-Jones Industrial	577.60	807.43	821.42	897.61	809.22	828.84	-68.77	19.62
NYSE Composite	32.89	51.34	54.74	63.39	59.09	61.17	-2.22	2.08
AMEX Composite	58.26	125.20	154.98	235.15	220.63	243.55	8.40	22.92
NASDAQ (OTC)	54.87	103.13	119.92	152.29	139.50	148.02	-4.27	8.52

1. Statement week averages except where noted.
2. One-day quotes except as noted.
3. Averages for statement week closest to date shown.
4. Secondary market.
. One-day quotes for preceding Thursday.
. Averages for preceding week.
7. One-day quotes for preceding Friday.
8. Calendar week averages.

International Developments:

Addendum

The table, "U.S. Merchandise Trade, International Accounts Basis", on page IV-5 of Part II of the January 3 Greenbook is reproduced on the following page.

U.S. Merchandise Trade, International Accounts Basis
(billions of dollars, seasonally adjusted annual rates)

	1978 r/	1978 r/	1979					
	Year	4Q	1Q	2Q	3Q r/	Oct. & Nov.	Oct. r*/	Nov. */
EXPORTS	142.1	157.6	165.4	171.2	189.3	205.0	207.8	202.1
Agric.	29.9	31.2	30.6	30.9	38.4	41.3	41.0	41.6
Nonagric.	112.1	126.5	134.8	140.2	150.9	163.6	166.8	160.5
IMPORTS	175.8	181.5	189.9	202.0	218.5	231.3	236.4	226.1
Petroleum	42.3	43.4	46.6	51.6	66.5	71.8	77.7	65.9
Nonpetroleum	133.5	138.2	143.3	150.4	152.0	159.5	158.7	160.3
BALANCE	-33.8	-23.9	-24.5	-30.9	-29.1	-26.3	-28.6	-24.0

NOTE: Details may not add to totals because of rounding.
r/ Revised
*/ The Monthly International Accounts figures are only rough estimates and are subject to considerable revision.

APPENDIX A*

RECENT CHANGES IN S&L LIABILITY STRUCTURE

In recent months S&Ls have increased their already heavy reliance on short-term deposits bearing market-determined interest rates. Net flows of 6-month money market certificates (MMCs) were quite strong in October and November.[1] In addition, there has been a significant increase in S&L issuance of short-term large-denomination CDs since September. These developments have contributed to a further shortening of the average maturity of S&L liabilities, which has been falling steadily for the past year and a half.

S&L borrowing activity dropped sharply in November, partly because of the relative cost of such funds. This decline, however, was preceded by a long period of increasing S&L dependence on nondeposit sources of funds. Furthermore, prospective changes in the regulatory environment of S&Ls likely will encourage them to expand their borrowings in the future, especially from sources other than the FHLB system.

The market-related sources of financing utilized by S&Ls have enabled these institutions to retain and attract funds more successfully than in past periods of high interest rates. This may, in the long run, benefit S&L earnings, as the institutions have been able to acquire additional high-yielding mortgage loans. In the short run, however, the increased reliance on high cost funds has been reflected in a considerable drop in earnings. In addition, the shortened maturity of liabilities could lead to greater term structure risk and more volatile S&L earnings in the future.

Maturity Structure of Liabilities

During the early and mid-1970s, the major innovations in S&L liability management were intended to lengthen the maturities of liabilities in order to achieve a closer match with asset maturities. The most significant development in this regard was the creation of longer-term deposit categories with a rising interest rate ceiling structure. Also, in 1972 S&Ls were allowed to issue long-term subordinated debt (a power since used only sparingly by S&Ls), and in 1973 advances of up to 10 years were offered by most FHLBs. S&L access to long-term financing was additionally enhanced by the introduction of mortgage-backed bonds in 1975.

The trend toward longer-term liabilities stopped abruptly in June 1978; the movement since then has been distinctly in the opposite direction. Liabilities with maturities of less than one year (excluding passbook accounts) at S&Ls rose from 7.3 percent (NSA) of total liabilities in June 1978 to 31.8 percent at the end of November 1979 (see

* Prepared by Frederick Furlong, Economist, Capital Markets Section, Division of Research and Statistics.

1. Available data indicate that MMCs sales at S&Ls were relatively weak in early December.

table on next page).[1] The principal factor accounting for this reversal in trend has been the MMC. This new certificate was designed to allow depositary institutions to compete for funds in periods of cyclically high interest rates. S&Ls have been quite successful in marketing MMCs, and at the end of November their MMC balances totaled $107 billion. Most of the sales of MMCs, however, have been the result of transfers from existing passbook and maturing time accounts.[2] The transfers from the longer-term time accounts--most with maturities of four years--have been the major reason for the shortened liability structure of S&Ls.

Another factor that has contributed to the shortening of S&L liabilities has been the increased issuance of short-term large CDs. Since June 1978 large CD balances outstanding have more than doubled, and at the end of November amounted to $26.2 billion (NSA). Short-term borrowings by S&Ls also increased somewhat, from 3.4 percent to 4.3 percent of liabilities between June 1978 and November 1979 (see table on next page). However, there does not appear to have been any increased emphasis on short-term borrowing relative to long-term borrowing.

On January 1, 1980, interest rate ceilings on deposits were again relaxed. Depositary institutions are able to offer time deposits with maturities of 2-1/2 years or longer at yields that will be competitive with market interest rates. These new instruments should give S&Ls greater flexibility in choosing the maturity mix of deposits, and the movement toward short-term liabilities could be tempered somewhat.[3] The capacity of S&Ls to tap the market for longer-term funds will also be enhanced by the recently acquired power to issue Euro-CDs, which will carry maturities of at least 5 years.

Other Developments in Debt Financing

Between June 1978 and November 1979, outstanding borrowings at S&Ls increased about $20 billion and by the end of November constituted 10.1 percent of total S&L liabilities. During this period borrowings from sources other than the FHLB system accounted for only about one-fourth of the change in total borrowings. However, the opportunities for outside borrowing (other than FHLB advances) by S&Ls are expanding, and in the longer run these sources are expected to play an important role in S&L financing.

Over the years, S&Ls have acquired a variety of sources of debt financing. Some of these avenues have been in the form of instruments

1. Including passbook deposits, short-term liabilities increased from 39 percent of liabilities in June 1978 to 53.4 percent in November 1979.
2. It should be noted that a large portion of the accounts that did transfer to MMCs might otherwise have left the institutions, had not the S&Ls been authorized to offer MMCs.
3. Of course, some shortening would still take place to the extent that 2-1/2 year deposits are substituted for 4 year accounts.

DEPOSITS AND BORROWINGS OF FSLIC-INSURED
SAVINGS AND LOAN ASSOCIATIONS
($ billions)

	June 1978		June 1979		November 1979	
	Amount	% of Total	Amount	% of Total	Amount	% of Total
Total liabilities	455.5	100.0	514.6	100.0	536.1	100.0
Total deposits	400.2	87.9	445.4	86.6	456.1	85.1
Passbook[1]	144.6	31.7	129.9	25.2	116.0	21.6
Small time (less MMCs)	237.8	52.2	210.4	40.9	192.8	36.0
MMCs	5.4	1.2	85.7	16.7	121.1	22.6
Large CDs	12.4	2.7	19.4	3.8	26.2	4.9
Total borrowings	33.9	7.4	46.6	9.1	53.9	10.1
FHLB advances	24.8	5.4	34.2	6.6	39.6	7.3
Outside borrowings	9.1	2.0	12.4	2.4	14.3	2.7
Mortgage-backed bonds	1.8	.4	2.3	.4	2.9[e]	.5
RPs	5.1	1.1	6.8	1.3	7.9[e]	1.5
Commercial paper	--	--	.5	*	1.1[2]	.2
Other	2.2	.5	2.8	.5	2.4	.5
Short-term borrowings	15.5	3.4	20.6	4.0	23.0	4.3
Long-term borrowings	18.4	4.0	26.0	5.1	30.9	5.8
Short-term liabilities[3]	33.3	7.3	125.7	24.4	170.3	31.8
MMCs	5.4	1.2	85.7	16.7	121.1	22.6
Large CDs	12.4	2.7	19.4	3.8	26.2	4.9
Borrowings	15.5	3.4	20.6	4.0	23.0	4.3

1. Includes NOW accounts.
2. Estimate based on a survey conducted in early November 1979.
3. Excludes passbook accounts.
e. Estimated.
* Less than .05 percent.

for long-term financing, which have helped to integrate the mortgage market with other sectors of the capital markets. These long-term instruments include mortgage-backed bonds, subordinated debentures, and longer-term bank loans. S&Ls have also obtained increased access to the money market to meet the cyclical and seasonal variation in their own demand for funds. The most important vehicle for such short-term borrowing for S&Ls has been RPs, which account for about 55 percent of all outside borrowing by S&Ls. S&Ls also borrow short-term funds in the form of bank loans. In January 1979, federal S&Ls were permitted to issue commercial paper for the first time.[1] The maturities of such commercial paper can range from 5 days to 270 days; this allows S&Ls somewhat more flexibility than they have with large CDs, which have minimum maturities of 30 days. As of November at least 24 S&Ls had issued commercial paper, and the outstanding issues amounted to more than $1 billion (NSA).

The FHLBB is planning to implement new regulations in early 1980 that would further facilitate S&L use of outside borrowing. The current regulations of the FSLIC restrict such borrowing to 10 percent of total deposits, with an additional 5 percent of outside borrowing authorized for conforming mortgage-backed bonds. The new regulation would express the limits in terms of assets rather than deposits, and S&Ls would be authorized to have outside borrowings up to 20 percent of assets.[2] The purpose of this change is to encourage S&Ls to develop their alternative sources of funds. The FHLBB does not expect the new limits to have an immediate impact on the borrowing totals at most S&Ls. However, a few large S&Ls in California, which have made extensive use of mortgage-backed bonds, will realize some relief from the higher limits.[3]

The aggregate statistics for outside borrowings can be somewhat misleading, since these liabilities are not distributed uniformly among institutions. For example, large S&Ls (assets of more than $1 billion) account for about 20 percent of total S&L assets but for more than 50 percent of the outside borrowings in the industry. Size is an important factor in determining the borrowing options available to S&Ls, since only large institutions generally have access to all forms of borrowing. This is because certain types of debt instruments--mortgage-backed bonds, subordinated debt, and commercial paper--require a certain minimum size of issue to be economical. In the case of mortgage-backed bond issues, which have ranged from $35 million to $200 million, virtually all of the securities have been sold by S&Ls with $1 billion or more in assets (see table on next page). In addition to size, there are other variables that are likely to affect the ability and willingness

1. The FHLBB also has authorized S&Ls to issue mortgage-backed short-term notes.
2. In terms of the overall industry balance sheet this would translate into a limit of about 25 percent of deposits.
3. There are apparently some large S&Ls in New York that are near the current limit as a result of their unusually high volume of RPs.

BORROWINGS BY ASSET SIZE OF FSLIC-INSURED
SAVINGS AND LOAN ASSOCIATIONS
($ billions)

	S&Ls with assets greater than $1 billion				S&Ls with assets of $1 billion or less			
	June 1978		June 1979		June 1978		June 1979	
	Amount	% of Total	Amount	% of Total	Amount	% of Total	Amount	% of Total
Total liabilities	108.6	100.0	145.2	100.0	344.4	100.0	367.5	100.0
Total borrowings	10.9	10.0	18.1	12.5	22.7	6.6	28.7	7.8
Advances	6.9	6.4	11.4	7.9	17.5	5.1	22.5	6.1
Outside borrowings	4.0	3.7	6.7	4.6	5.2	1.5	6.2	1.7
Mortgage-backed bonds	1.6	1.5	2.0	1.4	.2	.1	.3	.1
Subordinated debt	.1	.1	.1	.1	.1	*	.1	*
Commercial bank	.2	.2	.4	.3	.8	.2	.7	.2
RPs	1.7	1.6	3.0	2.1	3.4	1.0	3.8	1.0
Other	.4	.4	1.2	.8	.7	.2	1.3	.4
Short-term borrowing	4.6	4.2	7.8	5.4	11.3	3.3	14.1	3.8
Long-term borrowing	6.3	5.8	10.3	7.1	11.4	3.3	14.6	4.0

* Less than .05 percent.

of institutions to borrow funds, such as regional differences in the demand for mortgages and state usury laws.

Impact on Earnings

The growth in short-term liabilities yielding market rates of return has been reflected in the rise in the cost of funds at S&Ls.[1] For example, in the second half of 1978 the average cost of funds rose by about 25 basis points, compared to an increase of only 6 basis points in the first half of 1978 (see table on next page). This rise in cost was offset, in part, by increases in income from short-term investments and mortgage loans, so the profitability of S&Ls--as measured by the ratio of net income to average assets--increased slightly. In the first half of 1979, however, there was another sharp increase in the cost of funds, and S&L profitability fell by 14 basis points.[2] Given the continued increase in interest rates, S&L earnings are estimated to have declined again in the second half of 1979.[3]

The longer-run earnings impact of the recent alterations in S&L liabilities is uncertain. For example, any change in the average level of profits would depend partly on how much the higher direct cost of funds is offset by reduced indirect interest payments and increased income from the greater volume of mortgage loans acquired during periods of cyclically high interest rates. Also, if S&Ls continue to rely on relatively short-term liabilities to finance long-term mortgage lending these institutions could be exposed to greater interest rate risk, and possibly more volatile earnings. However, there are some innovations which allow S&Ls to avoid at least part of this risk if they choose to do so. Two alternatives widely used by S&Ls are variable rate mortgages and government-backed or conventional passthrough securities. In the future S&Ls may be permitted to reduce the effective maturity of their assets by expanded consumer lending and roll-over mortgages.

1. Initially, the greatest impact on earnings stemmed from the transfer of lower-cost passbook and time deposits into MMCs. Although many of the transferred deposits likely would have left the institutions if it were not for the MMCs, much of the growth in MMCs produced a pure increase in costs.
2. Net income fell $226 million in the first half of 1979, compared with increases of $145 million and $181 million in the first and second halves of 1978, respectively.
3. S&Ls will continue to experience downward pressure on earnings as maturing MMCs and other time deposits continue to roll over into new higher yielding MMCs. Also, to the extent that S&Ls are required to meet outflows of small denomination deposits by issuing large CDs and by increasing borrowings, their interest margins will suffer.

COST OF FUNDS AND PROFITABILITY FOR FSLIC-
INSURED SAVINGS AND LOAN ASSOCIATIONS

	Interest cost as a percent of average deposits plus borrowings[1]	Net income as a percent of average assets[1]
1972-H1	5.37	.76
H2	5.42	.78
1973-H1	5.46	.82
H2	5.72	.68
1974-H1	6.00	.60
H2	6.28	.47
1975-H1	6.31	.43
H2	6.34	.51
1976-H1	6.35	.58
H2	6.40	.68
1977-H1	6.39	.74
H2	6.48	.80
1978-H1	6.54	.81
H2	6.79	.83
1979-H1	7.23	.69
H2	n.a.	.50[e]

1. Annualized by doubling.
e. Estimated.
n.a. Not available.