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CLASS II - FOMC

June 13, 1975

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

SUPPLEMENTAL NOTES

The Domestic Nonfinancial Economy

Merchant builder sales of new single-family homes jumped to a seasonally adjusted annual rate of 580,000 units in April--25 per cent above the upward revised March figure and the highest level since July 1973. While new home sales had been rising steadily since December, the unusually steep increase in April reflected, in part, the effects of the 5 per cent tax credit enacted in late March, as well as continued improvement in mortgage market conditions and in consumer confidence. The stock of unsold new homes declined more than 2 per cent from March and the end of April level represented a reduction from 10 to 8 months' supply at the current sales rate. The median price on the mix of units sold rose to \$39,500--nearly \$3,000 above the median price of unsold units.

In the existing home market, sales advanced 6 per cent further in April, the third consecutive month-to-month increase. As was the case for new units, the median price of used homes sold rose and was a tenth above a year earlier.

HOME SALES

New Home Sales and Stocks			Sales Indexes of Unit Volume		Median Prices of Homes Sold		
Homes sold ^{1/}	Homes for sale ^{2/}	Months' supply	(1972=100, seasonally adjusted)		New homes	Existing homes	
(thousands of units)			New homes ^{3/}	Existing homes	(thou. of dol.)		
<u>1974</u>							
QI	523	452	10.4	72	106	35.2	30.9
QII	550	436	9.5	76	105	35.6	32.2
QIII	490	414	10.1	58	99	36.2	32.0
QIV	417	400	11.5	58	99	37.3	32.2
<u>1975</u>							
QI (r)	427	395	11.1	59	95	37.9	33.8
Jan. (r)	404	404	12.0	56	87	37.2	33.2
Feb. (r)	412	409	11.9	57	97	38.0	33.9
Mar. (r)	464	395	10.2	64	100	38.7	34.2
Apr. (p)	530	386	8.0	80	106	39.5	34.9

^{1/} Seasonally adjusted annual rate.

^{2/} Seasonally adjusted, end of period.

^{3/} Converted to 1972 index for comparison with existing home sales, which are not available on any other basis.

Inventories. Book value of retail inventories decreased at an annual rate of \$3.2 billion in April following a \$7.7 billion rate of decrease in March and a first quarter average rate of decrease of \$10.4 billion. Retail auto inventories rose at a \$1.2 billion rate in April following the \$2.2 billion March rate of decrease and the \$8.5 billion first quarter average rate of decrease.

For manufacturing and trade the rate of decrease was \$23.0 billion in April, slightly faster than the March rate of decrease of \$22.4 billion and significantly sharper than the first quarter average annual rate of decrease of \$11.4 billion. The manufacturing and trade inventory-sales ratio fell in April to 1.65 from 1.70 in March.

The Domestic Financial Situation

Interest rates. Securities markets strengthened generally during the week ending June 13. In the Treasury sector, yield declines ranged from 10 to 35 basis points on bills, and from 10 to 25 basis points on longer maturity coupon issues. In other markets, the Board's index for new Aaa-rated corporate utility issues dropped nearly 50 basis points, to 8.92 per cent; the series for recently offered corporate bonds declined about 30 basis points, to 9.24 per cent; and the municipal Bond Buyer series dropped 25 basis points, to 6.80 per cent.

The decline in corporate bond yields is particularly impressive since May's new issue calendar was the second largest on record and the June Calendar is expected to be at least as large. New issue volumes in the weeks ending June 6 and 13 aggregated \$1.0 billion and \$1.3 billion, respectively.

The rally in the Treasury bill market was abetted by market anticipation of sizable net Treasury redemptions in late June, and by the downward adjustment of forecasts for Treasury borrowing in July. Factors contributing to the rally in bond markets also include the apparent resolution of New York City's current fiscal crisis, and a growing belief in market circles that the economic recovery will be sufficiently moderate to permit significant further progress in dampening inflation.

CORRECTIONS:

Page III-9. Security offerings table. Long-term State and local government securities total for QII should be 2,420.

INTEREST RATES
(one day quotes - in per cent)

	1975			
	Highs	Lows	May 19	June 12
<u>Short-Term Rates</u>				
Federal funds (wkly. avg.)	7.70(1/8)	5.13(5/21)	5.13(5/21)	5.15(6/11)
3-month				
Treasury bills (bid)	6.90(1/2)	4.94(5/14)	5.11	4.89
Comm. paper (90-119 day)	9.00(1/2)	5.75(5/15)	5.63	5.50
Bankers' acceptances	9.00(1/1)	5.40(5/30)	5.65	5.55
Euro-dollars	10.25(1/3)	5.69(5/21)	6.00	5.75(6/11)
CD's (NYC) 90-119 day				
Most often quoted new	9.00(1/1)	5.38(6/11)	5.75(5/14)	5.38(6/11)
6-month				
Treasury bills (bid)	6.97(1/2)	5.36(2/18)	5.45	5.19
Comm. paper (4-6 mo.)	8.75(1/2)	5.38(5/23)	5.88	5.63
Federal agencies	7.67(1/2)	5.75(2/19)	5.98	na
CD's (NYC) 180-269 day				
Most often quoted new	8.38(1/1)	5.88(6/11)	6.25(5/14)	5.88(6/11)
1-year				
Treasury bills(bid)	6.69(1/2)	5.37(2/5)	5.76	5.40
Federal agencies	7.60(1/2)	6.03(2/20)	6.45	na
CD's (NYC)				
Most often quoted new	8.00(1/1)	6.00(3/12)	6.75(5/14)	6.50(6/11)
Prime municipals	4.35(1/3)	3.40(2/7)	3.55(5/16)	3.70(6/13)
<u>Intermediate and Long-Term</u>				
Treasury coupon issues				
5-years	8.17(4/28)	6.93(2/19)	7.62	7.23(6/11)
20-years	8.47(4/28)	7.58(2/21)	8.14	7.85(6/11)
Corporate				
Seasoned Aaa	9.02(4/30)	8.57(2/26)	8.84	8.74
Baa	10.63(1/20)	10.27(4/3)	10.47	10.40
New Issue Aaa Utility	9.80(4/3)	8.89(2/6)	9.54(5/15)	8.92p
Municipal				
Bond Buyer Index	7.09(5/28)	6.27(2/13)	6.88(5/15)	6.80
Mortgage--average yield				
in FNMA auction	9.47(1/13)	8.78(3/10)	9.29(5/7)	9.14(6/2)

SUPPLEMENTAL APPENDIX A*
RECENT WAGE PRESSURES: ALTERNATIVE MEASURES

Incoming data indicate a moderation in wage inflation in the last two quarters. However, an assessment of recent wage pressures is complicated by the fact that several widely used measures of wage change have recently shown substantially different degrees of moderation. For example, the rate of change of compensation per manhour declined from 9.8 to 9.3 per cent from 1974 III to 1975 I while that of average hourly earnings decreased from 11.0 to 4.7 per cent over the same period. Such differences in the behavior of these wage change measures result from their varied coverage of workers and types of labor income. Each one of the wage series gives us distinct information about inflationary pressures resulting from wage change. This Appendix defines the major wage series, assesses their appropriate use and describes the factors responsible for their recent differing behavior.

Definitions

A. Broad based measures

1. Average Hourly Earnings (AHE) measure hourly earnings of production and nonsupervisory workers. Since they are calculated on a "gross" basis, they reflect not only changes in basic hourly and incentive wage rates, but also factors such as premium pay for overtime and late shift work and changes in output of workers paid on an incentive basis. AHE do not measure total labor costs because they exclude: irregular bonuses, retroactive items, payments of welfare benefits, payroll taxes, and earnings of supervisory and nonproduction workers.

2. Average Weekly Earnings (AWE) are derived by multiplying AHE by average weekly hours. They are therefore affected by the length of the workweek. In addition, they vary with monthly changes in the proportion of parttime workers, work stoppages, absenteeism for which no pay is received as well as labor turnover which occurs during the survey week. AWE and spendable earnings (see below #5) are commonly used as measures of purchasing power.

3. The Hourly Earnings Index (HEI) measures the per cent change in AHE for the private nonfarm sector, after adjustment to exclude the effect of fluctuations in overtime premiums (for manufacturing only),

*Prepared by Susan B. Vroman, Economist, National Income, Labor Force, and Trade Section.

employment shifts between low-and high-wage industries, and seasonal variation. After these adjustments are made the index more closely reflects underlying wage rate movements than do other available monthly measures. It is constructed by weighting AHE in each 3-digit SIC industry by manhours in that industry in 1967. The monthly weighted average is compared with the 1967 level of earnings. These monthly indexes are available beginning in 1964.

4. Compensation Per Manhour (COMP) is available only quarterly. It is more comprehensive than any of the other three measures because it includes both wages and supplements and covers production and non-production workers, private household employees, self employed persons, and unpaid family workers. Since it measures wages and salaries and supplements, COMP more closely represents labor costs than the other series and is used in calculating unit labor costs. Along with AHE and AWE, it is affected by changes in employment among industries and changes in overtime. It is also affected by changes in fringe benefits such as employer contributions for social insurance, private pensions and welfare funds.

5. Real Wage Measures. All of the above series are available in real terms (deflated by the CPI). In addition, real net spendable earnings, which is commonly used to measure real purchasing power, is also available. It is derived from AWE by deducting a constructed estimate of the Federal income and social security taxes paid by a worker with three dependents who took the standard deduction and had total income equal to 52 times AWE. As a measure of family purchasing power, this series has several limitations. First, it assumes that the spouse and other dependents had no wages and it excludes income other than earnings. Second, it is based on AWE which covers only production and nonsupervisory workers and includes earnings of workers other than family heads. Finally, the Federal income tax estimates assume workers take the standard deduction yet nearly half of the tax returns use itemized deductions. Although the use of itemized deductions is most widespread among the higher income classes, which are not represented in this measure, taxes paid by the group represented are still probably overstated. Hence the level of real net spendable earnings appears to be understated.

B. Wages in Major Collective Bargaining Agreements

There are several available quarterly series measuring wage change in major collective bargaining agreements. These series cover production and nonsupervisory workers in the private nonfarm economy who are associated with collective bargaining situations covering 1000 or more workers; 1 out of 9 members of the civilian labor force. Two of the most commonly used of these series are first year wage settlements and the effective wage change.

The first-year settlements series covers wage changes scheduled to go into effect within 12 months of the contract's effective date. This series has several limitations. By covering only the first year of contracts, it tends to overstate union wage gains as most contracts are front loaded. It is downward biased in inflationary periods because it excludes wage gains generated under cost of living clauses. Further it refers only to those workers who agreed on contracts during the period of measurement and therefore its coverage changes from period to period. Finally, this series does not measure wage changes which took place during the period. Some of the wage increases negotiated during the period will take effect in the future, and wage increases which take place during the period as a result of past settlements are not included.

The effective wage change series, which avoids these limitations, is also available quarterly. It measures wage changes made effective in a given period as a result of current settlements and deferred and cost of living increases from past settlements. This series is more consistent with the changes in AHE than the first-year settlement series. The effective wage series covers all workers under major collective bargaining agreements, i.e. those receiving wage boosts as well as those not receiving them. It, therefore, has a consistent base from period to period but it is pulled down by workers not receiving pay increases in the period.

Recent Behavior Wage Measures

Table I shows the recent behavior of the wage series defined above. The three broad based earnings measures (AHE, AWE and HEI) show the same basic pattern. They increase over the first three quarters of 1974 and then decrease. AWE shows more variation than AHE over this period because of variations in the workweek. Table I gives the per cent change in average weekly hours. It is clear that the lower rate of growth in AWE in the past two quarters is due to the large decrease in the workweek.

The Hourly Earnings Index shows a pattern of wage change similar to AHE over this period. In the first quarter of this year, however, the HEI increased significantly faster than AHE, reflecting the large drop in manufacturing overtime hours and shifts in the distribution workers toward lower wage industries. Since these are cyclical phenomena, the index is generally regarded as a more accurate measure of the underlying wage pressure than average hourly earnings.

Compensation per manhour has shown a slightly different pattern over the past five quarters. It peaked in the second quarter of 1974 rather than the third quarter and did not drop off as much in the first quarter of this year. This discrepancy reflects the different coverage of this series as well as different data sources. Throughout

this period supplements have increased. Their highest rates of growth were in 1974 QI and 1975 QI. This is largely accounted for by the increases in employer contributions for social security which are introduced at the beginning of the year. As noted earlier another element which causes compensation per manhour to differ from the earnings measures is the earnings of supervisory and nonproduction workers. This category showed significant increase in 1974 QI, QII and 1975 QI. It showed a decrease in 1974 QIII. Finally there was an increase in minimum wages in the first quarter of 1975, which tends to have a larger impact on compensation per manhour with its broader coverage of affected workers.

Turning to the collective bargaining measures, the percentage increase in first year wage changes rose in 1975 QI probably reflecting labor unions' attempts to recoup real income losses. However, a relatively small number of workers were covered by collective bargaining settlements in this quarter. The effective wage series indicates some moderation in union wages in the last two quarters. This partly reflects the small number of workers who negotiated in these two quarters. With a forecast moderation in inflation in the coming months, lower cost of living adjustments can be expected to contribute to further moderation in the effective wage series.

Table I
Alternative Measures of Wage Change

<u>A. Private Nonfarm Earnings Measures</u>						
(Per cent change from previous quarter seasonally adjusted, compound annual rate)						
	<u>74I</u>	<u>74II</u>	<u>74III</u>	<u>74IV</u>	<u>75I^P</u>	<u>Year to date</u>
Average hourly earnings	6.1	8.1	11.0	9.7	4.7	4.4 ^{3/}
Average weekly earnings	3.1	8.0	11.4	5.5	.5	1.7 ^{3/}
Hourly earnings index	6.3	9.7	10.8	9.7	8.2	7.0 ^{3/}
Compensation per manhour (all persons)	8.8	11.4	9.8	9.4	9.3	
Real net spendable earnings	-8.5	-3.9	-2.1	-6.7	-7.0	-5.4 ^{4/}
<u>B. Wages in Collective Bargaining Agreements</u>						
(Per cent change)						
First year wage adjustments ^{1/}	7.1	9.2	11.2	10.3	12.5	
Effective wage change ^{1/ 2/}	1.3	3.0	3.4	1.6	1.5	
<u>C. Addendum</u>						
Average weekly hours	-2.1	-.7	+3	-3.2	-4.0	-2.6 ^{3/}
(Per cent change from previous quarter, seasonally adjusted, compound annual rate)						

^{1/} 1,000 or more workers

^{2/} This series is not at a compound annual rate. Annualizing implies a possibility of the same rate of change in each quarter. Conceptually it is incorrect to assume that collective bargaining wages will grow at a constant rate over the year because of the varying quarterly settlement schedule and the different timing of unions' cost of living adjustments.

^{3/} Per cent change from December to May at a compound annual rate.

^{4/} Per cent change from December to April at a compound annual rate.

SUPPLEMENTAL APPENDIX B*
QUARTERLY SURVEY OF BANK LENDING PRACTICES
JUNE 13, 1975

Responses to the Survey of Bank Lending Practices conducted on May 15, 1975 suggest that although loan demand is still weak at most banks, the situation may be stabilizing. Slightly over half of the 123 large banks reporting in the May survey indicated that demand for commercial and industrial loans had weakened further since the February survey period but only about one-fifth of the respondents expected loan demand to deteriorate further over the next three months, in contrast to the two-thirds of the respondents which had held such expectations in mid-February. A sizable majority of the banks reporting in May anticipated that loan demand would remain essentially unchanged through mid-August.

As in the previous survey, most banks reported that lending practices were essentially unchanged over the interval between surveys, but a significant minority of banks--ranging from 5 to 15 per cent--still reported further tightening of both price and nonprice terms of lending. Since most banks had indicated firming of lending practices throughout much of 1974, the current posture clearly remains restrictive.

There are, however, clear indications in the most recent two surveys of an emerging trend to less restrictiveness, particularly with respect to interest rates. One-third of the banks reporting in the May survey indicated that they had eased practices with respect to interest rates charged on loans to nonfinancial businesses, and about 60 per cent reported no change in such practices. It is likely, too, that many of the respondent banks considered the lagged downward movement of the prime rate to be somewhat restrained relative to the softness of loan demand during the interval between the February and May surveys and thus did not view the decline as a significant liberalization in interest rate charges.

There has also been some easing in practices relating to the reviewing of credit lines, including applications from new customers. Most banks reported that there has been no change since the February survey in their willingness to make loans other than short-term business loans. However, over one-quarter of the banks indicated a greater willingness to make consumer instalment loans, a substantially larger proportion than the 13 per cent reported in the previous survey. Preliminary results from the most recent Quarterly Survey of Bank Lending Practices with Respect to Credit Use, which was sent to the same panel of banks

*Prepared by Eleanor M. Pruitt, Economist, Banking Section, Division of Research and Statistics.

in March, indicate that demand for consumer loans was significantly smaller than usual in both December 1974 and March 1975. In those surveys only about 2 per cent of the banks had approved a larger-than-usual proportion of consumer loan applications. A comparison of the results of the Lending Practices and Credit Use surveys suggests that banks may have become more willing to make consumer loans in recent months but, at least through March, they may have found that a number of loan applicants did not meet their credit standards.

As in the previous Lending Practices survey, most of the banks reported no substantial change in nonprice terms of lending such as compensating balances, maturities, or credit standards, after several quarters of tightening. In light of the past trend, current bank policies are clearly restrictive. Apparently banks have been more willing to ease price terms of lending than nonprice terms as loan demand softened. During the interval between the February and May surveys, the prime rate declined by about 200 basis points, and the spread between the prime rate and commercial paper rates narrowed somewhat. A number of survey respondents commented that, with loan demand weak, they were actively seeking out new business. But most stressed that they had not relaxed credit standards and were interested mainly in short-term, high-quality loans.

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TABLE 1

QUARTERLY SURVEY OF CHANGES IN BANK LENDING PRACTICES
 AT SELECTED LARGE BANKS IN THE U.S. 1/
 (STATUS OF POLICY ON MAY 15, 1975 COMPARED TO THREE MONTHS EARLIER)
 (NUMBER OF BANKS & PERCENT OF TOTAL BANKS REPORTING)

	TOTAL		MUCH STRONGER		MODERATELY STRONGER		ESSENTIALLY UNCHANGED		MODERATELY WEAKER		MUCH WEAKER	
	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT
STRENGTH OF DEMAND FOR COMMERCIAL AND INDUSTRIAL LOANS (AFTER ALLOWANCE FOR BANK'S USUAL SEASONAL VARIATION)												
COMPARED TO THREE MONTHS AGO	123	100.0	0	0.0	12	9.8	43	34.9	64	52.0	4	3.3
ANTICIPATED DEMAND IN NEXT 3 MONTHS	123	100.0	0	0.0	17	13.8	77	62.6	28	22.8	1	0.8
LENDING TO NONFINANCIAL BUSINESSES												
TERMS AND CONDITIONS:												
INTEREST RATES CHARGED	123	100.0	1	0.8	6	4.9	73	59.3	39	31.7	4	3.3
COMPENSATING OR SUPPORTING BALANCES	123	100.0	2	1.6	12	9.8	106	86.2	3	2.4	0	0.0
STANDARDS OF CREDIT WORTHINESS	123	100.0	3	2.4	15	12.2	103	83.8	2	1.6	0	0.0
MATURITY OF TERM LOANS	123	100.0	1	0.8	10	8.1	105	85.4	7	5.7	0	0.0
REVIEWING CREDIT LINES OR LOAN APPLICATIONS												
ESTABLISHED CUSTOMERS	123	100.0	0	0.0	6	4.9	97	78.9	18	14.6	2	1.6
NEW CUSTOMERS	123	100.0	1	0.8	18	14.6	80	65.1	24	19.5	0	0.0
LOCAL SERVICE AREA CUSTOMERS	123	100.0	0	0.0	7	5.7	95	77.2	21	17.1	0	0.0
NONLOCAL SERVICE AREA CUSTOMERS	123	100.0	1	0.8	17	13.8	94	76.5	11	8.9	0	0.0

1/ SURVEY OF LENDING PRACTICES AT 123 LARGE BANKS REPORTING IN THE FEDERAL RESERVE QUARTERLY INTEREST RATE SURVEY AS OF MAY 15, 1975.

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TABLE 1 (CONTINUED)

	ANSWERING QUESTION		MUCH FIRMER POLICY		MODERATELY FIRMER POLICY		ESSENTIALLY UNCHANGED POLICY		MODERATELY EASIER POLICY		MUCH EASIER POLICY	
	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT
FACTORS RELATING TO APPLICANT 2/												
VALUE AS DEPOSITOR OR SOURCE OF COLLATERAL BUSINESS	123	100.0	8	6.5	18	14.6	93	75.6	4	3.3	0	0.0
INTENDED USE OF THE LOAN	123	100.0	2	1.6	10	8.1	104	84.6	7	5.7	0	0.0
LENDING TO "NONCAPTIVE" FINANCE COMPANIES												
TERMS AND CONDITIONS:												
INTEREST RATES CHARGED	123	100.0	0	0.0	2	1.6	104	84.6	16	13.0	1	0.8
COMPENSATING OR SUPPORTING BALANCES	123	100.0	0	0.0	7	5.7	116	94.3	0	0.0	0	0.0
ENFORCEMENT OF BALANCE REQUIREMENTS	123	100.0	1	0.8	14	11.4	108	87.8	0	0.0	0	0.0
ESTABLISHING NEW OR LARGER CREDIT LINES	123	100.0	6	4.9	20	16.3	88	71.5	8	6.5	1	0.8
	ANSWERING QUESTION		CONSIDERABLY LESS WILLING		MODERATELY LESS WILLING		ESSENTIALLY UNCHANGED		MODERATELY MORE WILLING		CONSIDERABLY MORE WILLING	
	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT	BANKS	PCT
WILLINGNESS TO MAKE OTHER TYPES OF LOANS												
TERM LOANS TO BUSINESSES	123	100.0	1	0.8	7	5.7	93	75.6	22	17.9	0	0.0
CONSUMER INSTALMENT LOANS	122	100.0	0	0.0	3	2.5	85	69.6	30	24.6	4	3.3
SINGLE FAMILY MORTGAGE LOANS	121	100.0	3	2.5	5	4.1	103	85.1	10	8.3	0	0.0
MULTI-FAMILY MORTGAGE LOANS	120	100.0	6	5.0	11	9.2	102	85.0	1	0.8	0	0.0
ALL OTHER MORTGAGE LOANS	119	100.0	5	4.2	11	9.2	97	81.6	6	5.0	0	0.0
PARTICIPATION LOANS WITH CORRESPONDENT BANKS	123	100.0	1	0.8	5	4.1	101	82.1	16	13.0	0	0.0
LOANS TO BROKERS	122	100.0	2	1.6	8	6.6	101	82.7	8	6.6	3	2.5

2/ FOR THESE FACTORS, FIRMER MEANS THE FACTORS WERE CONSIDERED MORE IMPORTANT IN MAKING DECISIONS FOR APPROVING CREDIT REQUESTS, AND EASIER MEANS THEY WERE LESS IMPORTANT.