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SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

March 28, 1969

The Domestic Financial Situation

Bank credit. Total loans and investments at all commercial banks are now estimated to have declined in March, bringing the annual rate of increase for the first quarter as a whole to 1.2 per cent. Continued liquidation of banks holdings of U.S. Government securities and a decline in total loans more than offset a small increase in holdings of other securities. The reduction in loans reflected large declines in security and nonbank financial loans and sharply reduced business loan growth, while real estate and consumer loans continued to expand at close to the advanced pace of recent months.

NET CHANGE IN BANK CREDIT
All Commercial Banks
(Seasonally adjusted annual rates, in per cent)

	1968	1969			
	4th Q.	1st Q.	Jan.	Feb.	Mar.1/
Total loans & investments2/	10.4	1.2	2.5	4.4	- 3.1
U.S. Gov't. securities	-14.4	-29.8	-25.3	-51.7	-14.5
Other securities	20.9	5.1	8.5	--	6.8
Total loans	13.9	7.8	7.1	19.4	- 3.3
Business loans	12.2	13.9	22.8	14.9	3.7
All other loans	15.0	4.1	- 2.3	22.1	- 7.5

1/ All March figures are preliminary estimates based on incomplete data and are subject to revision.
2/ Last-Wednesday of the month series.

Business loan expansion during the first half of March continued at about the rapid rate of recent months, but was much less than usual during the following tax week. The light business borrowing

during that week probably reflected, among other things, pre-tax date borrowing to get funds ahead of the prime rate increase, a transfer of domestic loans by one bank to its foreign branch, large loan repayments by a large utility out of the proceeds of a capital market financing, and the run-off of liquid asset holdings.

CHANGES IN SELECTED BALANCE SHEET ITEMS AT
ALL WEEKLY REPORTING BANKS OVER THE MARCH TAX & DIVIDEND PERIOD[1/]
(Millions of dollars, not seasonally adjusted)

Item	1966	1967	1968	1969
Business loans	1,309	1,261	1,135	841
Government security dealer loans	125	891	- 397	- 116
Finance company loans	1,039	469	264	- 135
Treasury bill holdings	161	1,381	- 447	- 392
Negotiable CD's	- 429	125	- 455	- 788
Total bank financing	3,063	3,877	1,010	986
Corporate income tax payments (1969 estimated)	7,244	6,728	4,439	5,423
Ratio of business loans to tax payments (per cent)	18	19	26	16
Ratio of total bank financing to tax payments (per cent)	42	58	23	18
Memo:				
Tax bills outstanding	3,009	2,006	2,003	2,015
Tax bills turned in for taxes (1969 estimated)	2,157	1,124	884	817
Ratio of bills turned in for taxes to tax payments (per cent)	30	17	20	15

1/ Reporting weeks including March 10 and 15.
2/ A decline in CD's is considered as a source of financing and is *added* to the other components to obtain the total bank financing.

KEY INTEREST RATES

	1968	1969		
	Lows	Highs	March 4	March 27
Short-Term Rates				
Federal funds (weekly average)	4.56 (1/3)	6.88 (3/26)	6.43 (2/26)	6.88 (3/26)
3-months				
Treasury bills (bid)	4.82 (1/29)	6.25 (1/7)	6.19	5.94
Bankers' acceptances	5.25 (3/7)	6.75 (3/12)	6.62	6.62
Euro-dollars	5.43 (2/2)	8.62 (3/18)	8.21	8.48
Federal agencies	5.00 (2/9)	6.51 (2/21)	6.44	6.08
Finance paper	5.13 (3/7)	6.50 (3/27)	6.38	6.50
CD's (prime NYC)				
Highest quoted new issue	5.25 (2/8)	6.00	6.00	6.00
Secondary market	5.20 (1/31)	6.70 (3/27)	6.55	6.70
6-months				
Treasury bills (bid)	4.98 (1/29)	6.42 (1/7)	6.37	6.07
Bankers' acceptances	5.38 (3/7)	6.88 (3/12)	6.75	6.75
Commercial paper	5.50 (3/7)	6.75 (3/14)	6.75	6.88
Federal agencies	5.25 (2/9)	6.59 (1/3)	6.60	6.41
CD's (prime NYC)				
Highest quoted new issue	5.50 (3/7)	6.25	6.25	6.25
Secondary market	5.45 (1/31)	6.85 (3/27)	6.65	6.85
1-year				
Treasury bills (bid)	5.05 (8/1)	6.39 (2/27)	6.39	6.16
Prime municipals	2.72 (8/8)	4.55 (3/21)	4.25	4.50
Intermediate and Long-Term				
Treasury coupon issues				
5-years	5.42 (1/12)	6.45 (3/17)	6.45	6.40
20-years	5.16 (8/1)	6.32 (3/18)	6.17	6.24
Corporate				
Seasoned Aaa	5.95 (9/5)	6.99 (3/27)	6.69	6.99
Baa	6.77 (10/3)	7.63 (3/27)	7.30	7.63
New Issue Aaa				
With call protection	6.13 (8/29)	7.46 (3/27)	6.93	7.46
Without call protection	6.29 (2/2)	7.27 (3/7)	--	--
Municipal				
Bond Buyer Index	4.07 (8/8)	5.30 (3/27)	5.04	5.30
Moody'a Aaa	3.80 (8/8)	5.02 (3/27)	4.80	5.02
Mortgage--implicit yield in FNMA weekly auction 1/	7.12 (5/6)	8.17 (3/3)	8.14 (2/24)	8.09 (3/24)

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

New figures on U.S. balance of payments results in February are available. The liquidity balance for February is now given as a deficit of $773 million, compared with the $544 million "flash" report figure used in the Greenbook analysis (none of these figures are seasonally adjusted). This raises the January-February liquidity deficit to $1,043 million instead of the $800 million figure given on page IV - 1. However, the Greenbook estimate for March through the 19th may have been correspondingly too high; it was based on weekly figures and may include some large deficit days at the end of February. The seasonally adjusted liquidity deficit for January and February would be nearly $1.5 billion, and the estimated deficit range for the first quarter is still $1-1/2 to $2 billion.

On the official settlements basis the February balance was a small surplus of $27 million (not seasonally adjusted), which is a somewhat better result than assumed in the Greenbook. The seasonally adjusted surplus on this basis through March 19 is still estimated to be near $1 billion.

U.S. foreign trade data for February are shown below with comparative figures for earlier periods, all in millions of dollars.

	1968 Monthly average	1968-69 Seasonally adjusted Nov.	Dec.	Jan.	Feb.
Census basis:					
Exports	2,841	3,000	2,886	2,082	2,313 1/
Imports	2,771	2,830	2,957	1,967	2,674 1/
Balance	+ 70	+ 170	- 70	+ 116	- 362 1/
Balance of payments basis: 2/					
Exports	2,781	2,945	2,810	1,980	2,250
Imports	2,773	2,815	2,940	1,970	2,680
Balance	+ 9	+ 130	- 130	+ 10	- 430

1/ Released March 27.
2/ Monthly adjustments from Census basis to balance of payments basis are our estimates. A major element in the adjustments is exclusion of military export sales. (Military aid exports are excluded from both series.) In the balance of payments, military sales appear as a separate component of goods and services.

Corrections

Page II - 5. The next to last sentence should read "Real growth in the second half of the year" would average . . . , etc.

The page reference given on page IV - 11 should have been to page IV - 27 rather than to page IV - 12. Also, on page IV - 11, in the next line, insert French before francs.

SUPPLEMENTAL APPENDIX A: LIFE INSURANCE COMPANIES IN 1968*

Investment patterns of the life insurance industry during 1968 reflected the impact of high and rising interest rates and general inflationary expectations. As a result, there were effects on cash flows and industry expectations for future cash flows, the volume of new commitments--absolutely as well as relative to expected investable funds--and the composition of investment allocations.

Cash Flows Available for Commitments

The volume of loanable funds continued to be moderated by policy loan drains and by reduced optional mortgage repayments. Consequently, funds available for investment during 1968 were equivalent to the fairly modest 1967 volume, and information now available indicates that the industry expects this pattern to continue through the first half of 1969.

LIFE INSURANCE COMPANIES*

	Funds for investment ($ millions)		
	First half	Second half	Year
1965	5,263	6,360	11,623
1966	6,216	4,602	10,818
1967	5,284	5,881	11,165
1968 1/	5,400	5,800	11,200
1969, 1/ industry projection	5,700	--	--

Six-Month Projections 2/
Commitment Takedowns as Per Cent of Funds for Investment

	I	II	III	IV
1965	76	82	82	89
1966	89	89	89	84
1967	75	74	74	79
1968	79	75	72	75

* Companies represent approximately two-thirds of industry assets.
1/ Partially estimated to exclude the effect of increased sample size.
2/ This represents what the reporting companies project in takedowns of commitments and in funds available for investment.

* Prepared by Mrs. Barbara Negri Opper, Economist, Capital Markets Section, Division of Research and Statistics.

In 1968, the industry--as it has since 1966--also maintained considerably more leeway between its scheduled commitment takedowns and its projected cash flow, leaving uncommitted a larger share of projected loanable funds in the event that they prove unavailable. The prevailing reason for this "cushion" apparently is the recognition that cash flow is not as stable as once was thought.

New Commitments

As a result of factors associated with cash flow, new commitment volume has shown very little growth. Commitments during 1968 were about $1 billion less than 1967, and remain below the 1964-65 pace.

LIFE INSURANCE COMPANIES[1/]
New Commitment Activity

	Total New Commitments ($ billions)	As per cent of total		
		Securities	Mortgages	Real Estate
1963	10.7	35	63	2
1964	12.0	35	63	2
1965	13.8	41	56	3
1966	10.9	42	54	4
1967	12.4	45	51	4
1968	11.3*	38	56*	6

1/ Companies account for approximately two-thirds of industry assets.
* Includes commitments under the "$1 Billion" program to invest funds in inner-city areas.

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Although the industry had been favoring securities over mortgages since 1964, during 1968 securities commitments suffered the largest cutback. In part, this change reflects the industry's "Billion Dollar Program" to invest in inner-city projects, a large share of which was committed as mortgages. Additionally, however, a growing share of income-property mortgages--which are by far the largest proportion of total mortgage commitments--included "contingent interest" clauses. These "equity kicker" clauses permit the mortgagee to enjoy a yield higher than the contract interest rate by participating in the property's future earnings. Although little data are available on the nature or extent of these clauses, we do know that they were included in at least one-fifth of the dollar volume of income property mortgage commitments

made during the fourth quarter of 1968. Although the historic contract yield premium on mortgages had been so small during 1968 as to favor securities, the potential yield on mortgages with contingent interest features is not only higher, but is expected to provide an inflation hedge.

LIFE INSURANCE COMPANIES
Average Contract Interest Rates on New Forward Investment Commitments

	Mortgages 1/	Direct Placements 2/	Differential
1965 - III	5.91	5.36	.55
IV	5.93	5.48	.45
1966 - I	6.08	5.70	.38
II	6.25	5.97	.28
III	6.63	6.28	.35
IV	7.01	6.56	.45
1967 - I	6.88	6.51	.37
II	6.79	6.39	.40
III	6.90	6.64	.26
IV	7.06	6.73	.33
1968 - I	7.35	7.14	.21
II	7.58	7.36	.22
III	7.84	7.60	.24
IV	7.87	7.60	.27

1/ Commitments on multifamily and nonresidential properties of $100,000 and over made by 15 companies that represent 57 per cent of industry assets. Average is weighted by loan amount.
2/ Average, weighted by amount, of commitments on straight debt placements on which the issues correspond to publicly-offered quality grades of Aaa-Baa.

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At the same time as the volume of securities commitments were reduced, there also was a distinct shift in its composition. Although total direct placement commitments were $1 billion below the 1967 volume, higher-quality issues ("classified") actually dropped by $1.5 billion. The emphasis--as with the mortgage contingent interest clauses--was away from fixed-income yields into issues with warrants and convertible features which permit "sharing in the action".

VOLUME OF NEW DIRECT PLACEMENT COMMITMENTS
Life Insurance Companies 1/
($ millions)

	Total	Unclassified		Classified 2/	
		Warrants and convertibles	Total	Dollar	As per cent of total
1966	4,061	153	953	3,108	77
1967	4,647	291	1,053	3,594	77
1968	3,587	451	1,492	2,095	58
January-February total:					
1966	821	21	306	515	63
1967	383	35	100	283	74
1968	499	89	140	359	72
1969	453	133	253	200	44

1/ Companies represent two-thirds of industry assets.
2/ "Classified" consists of U.S. corporate straight-debt issues for which the quality of the issuer corresponds to the top form quality grades of publicly-offered bond issues.
3/ Includes acquisitions by companies not included in the sample reporting commitments, but these companies should represent a constant share of total activity.

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Investments

While commitments to acquire securities moderated in 1968, the industry's acquisitions of securities increased. Indeed, for the first time in many years, the volume of securities acquired from previous commitments was as large as the mortgage volume; as recently as 1966, securities acquired from prior commitments were nearly $2 billion less than mortgages similarly acquired.

But acquisitions from commitments reflect investment decisions made earlier--sometimes as much as several years in the past. A picture of current investment allocations is given not only by new commitment activity, which is very responsive to changed conditions, but also by acquisitions from the "open market" (as distinguished from the commitment process). The table below presents derived estimates of the pattern of securities acquisitions made outside of the commitment process. Between 1963 and 1966, a constant volume--as shown by the insignificant changes

since 1963--was acquired from the combined long-term public market and those companies outside of the commitments sample. A large increase in 1967, followed by another of similar magnitude in 1968, suggests that the industry became more active in the long-term publicly-offered securities market.[1]

LIFE INSURANCE COMPANIES[1]
Long-Term Securities Acquired
In Addition to Commitment Takedowns
($ billions)

Year	$ billions
1963	4.1
1964	4.3
1965	4.2
1966	4.0
1967	5.3
1968	6.3

1/ Industry data for gross acquisitions from which was subtracted takedowns of securities commitments of a sample representing two-thirds of industry assets. Data exclude U.S. Government securities and issues maturing in one year or less; included are U.S. and foreign corporate, State and local issues.

The increase in open market securities acquisitions represents an important shift in life insurance investment policies. For many years, direct placements represented practically the only source of long-term securities acquired. There are probably several reasons for the industry having turned to the public bond market, not the least of which is the added marketability publicly-offered issues are thought to have. Another reason probably stems from the previously mentioned cautious industry attitude toward their commitments relative to expected future cash flow; since 1966, only about three-fourths of projected six-months cash flow has been allocated to forward investment commitments, indicating

1/ It is less likely that those companies representing the one-third of the industry not included in the commitments sample suddenly accounted for a much larger share of total securities acquisitions; if they did so, it was in spite of their having gained only their proportionate share of industry assets.

the leeway the industry has programmed for possible future disruptions in investable funds. The public bond market thus offered an alternative long-term investment outlet for uncommitted cash flow as it was received. With the record yields available on publicly-offered long-term debt--and the narrowing of the historic yield advantage of private placements over public issues--the industry thus acquired flexibility at probably little additional marginal loss of yield. (Thus, the $1.5 billion decrease in "classified" direct placements was probably compensated for by the industry's public acquisition of issues in this quality range.)

The industry's emphasis on equity is also demonstrated by the volume of common stock acquired. Probably the most important influence on the pattern of common stock acquisitions is the growth of separate accounts.2/ But in the competition for funds, both within the industry and of the industry versus other "saving" media, the rate of investment return and the ability to keep pace with inflation has been the crucial variable; thus, companies with leeway have also turned to common stock investments for their own portfolio, as distinguished from the separate account portfolio.3/

LIFE INSURANCE COMPANIES*
Gross Acquisitions of Common Stock
($ millions)

Year	$ millions
1963	530
1964	807
1965	1,043
1966	997
1967	1,676
1968	2,979

* Entire industry data.

2/ Separate accounts are the vehicle by which life insurance companies offer variable annuities. They are invested primarily in common stocks, and thus they do not carry a typical insurance guarantee. Benefits are paid according to the performance of the separate account. These accounts are distinguished from the life company in that they--as separate entities--are registered with the SEC. But these assets and liabilities are included in industry data.

3/ Excluding separate account funds, life insurance companies may hold (generally) only up to 5 per cent of their assets in common stock.

Summary

In 1968--and to a lesser extent in 1967--the life insurance industry has taken several new turns in response both to the pattern of interest rates during the period and to their acknowledgment of the inflationary trend.

There have been noticeable changes in the type of investments acquired and programmed to be acquired through new commitments. The direction appears to be away from fixed-income obligations, as witnessed by the growing importance of contingent interest clauses on mortgages and of securities with warrants or convertible features. The strong growth in common stock acquisitions also testifies to this change as it relates both to life company portfolios and to the growth of separate accounts.

Moreover, investable funds continue to show very little growth, primarily as a result of depressed mortgage return flows and the continued policy loan volume. More than that, the industry appears to have learned to work with its recent recognition that fund flows are subject to significant disruption. New forward investment commitments not only reflect the lack of growth in loanable funds, but their growth has been inhibited further by the industry's recent policy of committing a smaller portion of projected funds for investment.

There is evidence that the industry, counter to long-run trend, has been acquiring long-term bonds from the public market. This seems a logical outgrowth of their commitments-to-cash flow leeway, for it provides a method of investing long term with little advance planning; in this way, as and if additional funds are realized, they are directed to the public market. One additional feature cited as a benefit of purchasing bonds from the public market is the added marketability they are thought to have within the long-term framework.