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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

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## SUPPLEMENTAL NOTES

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### The Domestic Nonfinancial Economy

Industrial production increased an estimated 1 per cent in December following a rise of 0.4 per cent in October and an upward revised 0.5 increase in November. At 118.5 per cent of the 1967 average, the total index is about 8 per cent above the April low and 9 per cent below September 1974. Gains were strong and widespread among consumer goods, business equipment, and materials.

**Final products.** Output of durable consumer goods increased further in December reflecting some rise in autos and continued strength in home goods such as appliances and household furnishings. Auto assemblies were at an annual rate of 7.8 million units in December and production in the first quarter of 1976 is currently scheduled to be raised to an 8.0 million unit annual rate. Output of nondurable consumer goods declined more in this cycle than usual, but has more than recovered the 5 per cent loss. Production of business equipment also rose strongly in December, but the level remains only slightly above the springtime low. Output of construction producers is estimated to have advanced further in December.

**Materials.** Production of durable goods materials including steel increased in December from a November level which was revised upward substantially. Nondurable goods materials advanced further and have now recovered most of the 20 per cent decline which ended in March 1975. The textile, paper, and chemical group has advanced an

estimated 30 per cent since the spring low. With the recent recovery in materials, inventory reduction of these goods has apparently ended and some accumulation is underway in selected industries.

INDUSTRIAL PRODUCTION  
(Seasonally adjusted)

Indexes, 1967=100	1975				Per cent changes		
	Sept.	Oct.	Nov. (p)	Dec. (e)	Month ago	Year ago	QIII to QIV
Total	116.2	116.7	117.3	118.5	1.0	.9	2.9
Products, total	116.9	117.0	117.8	118.9	.9	.2	1.6
Final products	116.9	116.9	117.6	118.6	.9	.3	1.3
Consumer goods	126.8	127.2	128.3	129.6	1.0	5.0	1.9
Durable goods	118.3	118.0	118.6	120.1	1.3	9.1	1.8
Nondurable goods	130.2	130.6	132.0	133.2	.9	3.7	1.9
Business equipment	115.6	115.5	116.2	117.2	.9	-7.8	1.3
Intermediate products	116.6	117.2	118.4	120.0	1.4	-.4	2.7
Construction products	112.0	112.4	113.1	114.5	1.2	-3.2	3.2
Materials	115.1	116.4	116.7	117.9	1.0	2.7	5.3

p--preliminary.

e--estimated.

Merchant builder sales of new single-family homes increased 9 per cent further in November from the upward revised October figure. At a seasonally adjusted annual rate of 660,000 units, new home sales were the highest in nearly 3 years and more than 70 per cent above the recent low last December. The rise in November may have been due, in part, to the closeness of the year-end expiration date of the 5 per cent tax credit.

The stock of unsold new homes declined 2 per cent and by the end of the month represented about 7 months' supply at the November sales rate.

Existing home sales continued at a record pace in November. The seasonally adjusted index of unit sales volume rose to 124 (1972=100)--2 per cent above a month earlier.

HOME SALES

	New Home Sales and Stocks			Sales Indexes of Unit Volume (1972=100, seasonally adjusted)		Median Prices of Homes Sold	
	Homes sold <u>1/</u> (thousands of units)	Homes for sale <u>2/</u> (thousands of units)	Months' supply	New homes <u>3/</u>	Existing homes	New homes (thou. of dollars)	Existing homes (thou. of dollars)
<u>1974</u>							
QI	523	452	10.4	73	106	35.2	30.9
QII	550	436	9.5	77	105	35.6	32.2
QIII	490	414	10.1	68	99	36.2	32.8
QIV	417	400	11.5	58	93	37.3	32.2
<u>1975</u>							
QI	426	396	11.2	59	95	38.1	33.8
QII	571	378	7.9	80	108	39.0	35.4
QIII(r)	568	383	8.1	79	112	38.8	36.1
Aug. (r)	576	379	7.9	80	111	38.2	36.3
Sept. (r)	574	383	8.0	80	119	39.6	35.8
Oct. (r)	604	386	7.7	84	122	40.7	35.4
Nov. (p)	660	377	6.9	91	124	40.8	35.7

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 trade inventories fell at an annual rate of \$9.6 billion in November, having risen at a \$19.1 billion rate in October and at a \$8.8 billion average annual rate in the third quarter. Wholesale trade inventories also dropped in November, at a \$2.7 billion annual rate, after rising in October at a \$1.1 billion annual rate and averaging a \$3.1 billion annual rate of increase in the third quarter.

For manufacturing and trade the rate of inventory decline in November was \$9.9 billion following increases at a \$21.4 billion annual rate in October and at a \$5.4 billion average annual rate in the third quarter. Nevertheless the manufacturing and trade inventory-sales ratio edged up to 1.53 in November from 1.52 in October.

The Domestic Financial Economy

Mortgage market. According to the HUD (FHA) opinion survey, average interest rates on new commitments for conventional new- and existing-home mortgages declined during December by 5 basis points. Yields on FHA-insured new-home mortgages for immediate delivery in the private secondary market fell by 9 basis points to 9.32 per cent. These rate movements are generally consistent with the primary and secondary market yields cited in the Greenbook.

AVERAGE RATES AND YIELDS ON NEW-HOME MORTGAGES  
(HUD-FHA Field Office Opinion Survey)

End of Month	Primary market		Secondary market 1/		
	Conventional loans		FHA-insured loans		
	Level 2/ (per cent)	Spread 4/ (basis points)	Level 3/ (per cent)	Spread 4/ (basis points)	Discounts (points)
1974-Low	8.55 (Feb.)	-66 (Sept.)	8.54 (Feb.)	- 8 (Sept.)	2.3 (Feb)
High	9.80 (Sept.)	45 (Feb.)	10.38 (Sept.)	44 (Feb.)	6.3 (July, Sept)
1975-June	9.00	-37	9.06	-31	4.3
July	9.00	-25	9.13	-12	4.8
Aug.	9.15	-34	9.32	-17	6.2
Sept.	9.25	-45	9.74	+ 4	5.5
Oct.	9.25	+30	9.53	+31	4.0
Nov.	9.20	--	9.41	--	3.1
Dec.	9.15	--	9.32	--	2.4

- 1/ Any gaps in data are due to periods of adjustment to changes in maximum permissible contract rates on FHA-insured loans.
- 2/ Average contract rates (excluding fees or points) on commitments for conventional first mortgage loans, rounded to the nearest 5 basis points.
- 3/ Average gross yield (before deducting servicing costs) to investors on 30-year minimum-downpayment FHA-insured first mortgages for immediate delivery in the private secondary market (excluding FNMA), assuming prepayment in 15 years.
- 4/ Average gross mortgage rate or yield minus average yield on new issues of Aaa utility bonds in the last week of the month. (There were no issues of Aaa bonds during the last week of November and December.)

CORRECTION:

Page II-10, line 2: "highest" should read "second highest".



INTEREST RATES  
(One day quotes--in per cent)

	1975		1976	
	Highs	Lows	Dec. 15	Jan. 15
<u>Short-Term Rates</u>				
Federal funds (wkly. avg.)	7.70( 1/8)	5.13(5/21)	5.17(12/17)	4.76(1/14)
3-month				
Treasury bills (bid)	6.90( 1/2)	4.88(6/16)	5.56	4.84
Comm. paper (90-119 day)	9.00( 1/2)	5.38( 6/2)	6.00	5.13
Bankers' acceptances	9.00( 1/1)	5.40(5/30)	5.80	5.05
Euro-dollars	10.25( 1/3)	5.69(5/21)	6.63	5.50
CD's (NYC) 90-119 day				
Most often quoted new	9.00( 1/1)	5.38(6/11)	6.00(12/10)	5.00(1/14)
6-month				
Treasury bills (bid)	7.05(8/25)	5.18(6/11)	5.95	5.10
Comm. paper (4-6 mo.)	8.75( 1/2)	5.38(5/23)	6.13	5.25
Federal agencies	7.67( 1/2)	5.68(6/12)	6.40	n.a.
CD's (NYC) 180-269 day				
Most often quoted new	8.38( 1/1)	5.75(6/18)	6.50(12/10)	5.38(1/14)
1-year				
Treasury bills (bid)	7.35(8/21)	5.37( 2/5)	6.30	5.44
Federal agencies	3.00(8/25)	6.03(2/20)	6.95	n.a.
CD's (NYC)				
Most often quoted new	8.00( 1/1)	6.00(3/12)	7.00(12/10)	6.25(1/14)
Prime municipals	4.35(8/15)	3.40( 2/7)	3.70(12/12)	3.20
<u>Intermediate and Long-Term</u>				
Treasury coupon issues				
5-years	8.56(9/16)	6.93(2/19)	7.87	7.41(1/14)
20-years	8.71(9/16)	7.58(2/21)	8.30	7.99(1/14)
Corporate				
Seasoned Aaa	9.02(4/30)	8.57(2/26)	9.85	8.59
Baa	10.63(1/20)	10.27( 4/3)	10.38	10.35
New Issue Aaa Utility	9.80( 4/3)	8.89( 2/6)	9.37(12/11)	8.53p
Municipal				
Bond Buyer Index	7.67(10/2)	6.27(2/13)	7.34(12/11)	7.09
Mortgage--average yield in				
FNMA auction	9.95(10/6)	8.78(3/10)	9.31	9.13(1/12)

SUPPLEMENTAL APPENDIX A\*  
HIGHLIGHTS OF THE REVISION OF THE INCOME AND PRODUCT ACCOUNTS

Revised estimates of the national product and income accounts have now been released by the Department of Commerce. These revised estimates incorporate new statistical data of three types: (1) new benchmark data provided by the 1963 and the 1967 census of business; (2) new or revised data underlying the GNP and related figures for the period 1971 through 1974 which normally would be incorporated in the accounts in the usual July annual revision; and (3) revisions in some other underlying series extending back further than just three years.

Besides the statistical revisions, revisions were made because of definitional and classificational changes in the accounts. The purpose of these conceptual revisions is to better measure economic developments and to permit clearer analysis of these developments. In some cases these conceptual changes make the components of the accounts more consistent with underlying data. Altogether, twenty definitional or classificational changes were incorporated in the revision. Some of these are controversial, and some changed earlier estimates of components significantly.

While complete information on these revisions is not yet available, some general comments can be made that may be useful. First, the broad pattern of economic developments indicated by the revised estimates is not appreciably different than that depicted by the former estimates, but the growth in real activity since the mid-1960's is a trifle less than indicated earlier and cyclical fluctuations--including the most recent one--have been toned down a bit.

The overall effects of the revision raised nominal GNP for the third quarter of 1975 by \$24.1 billion, or 1.6 per cent, in annual rate terms. For 1974 as a whole the upward revision was \$9.7 billion, with \$2.6 billion from statistical changes and \$7.1 billion from definitional and classificational changes. Most of this upward revision occurred in the recent quarters. In 1972 and 1973 the statistical changes accounted for more than half the total upward revisions.

One of the more significant statistical revisions is a shift in the base for the implicit price deflator to 1972 average prices from 1958 prices. Deflation of expenditures is now being made on a more detailed basis, and this should improve the measurement of changes in real activity as well as the measurement of over-all price movements. Because of the change of base, the revised GNP implicit price

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\*Prepared by J. Cortland G. Peret, Assistant Adviser, Division of Research and Statistics.

deflator, of course, is lower than the former one. Quarter-to-quarter changes in the two series do vary considerably at times, but for longer periods they indicate about the same relative increase in average GNP prices. From the third quarter of 1972 to the third quarter of 1975--the period of particularly sharp price increases--both deflators indicate almost an identical increase of 27.0 per cent. The fixed-weighted price indexes will not be available for two to three weeks.

The more recent price base has lifted the revised level of real GNP. As noted, real growth since the mid-1960's is now indicated to have been slightly less than indicated before, and the amplitude of recessions has been reduced a bit. Quarter-to-quarter per cent changes in real GNP are shown for selected periods in the attached table. The decline in real GNP from 1973-IV to 1975-I is at an average annual rate of 5.3 per cent compared with a decline of 6.3 per cent indicated by earlier estimates of real GNP; from 1974-III to 1975-I the rates of decline are 8.4 per cent and 10.2 per cent, respectively. The rate of increase since the 1975-I low is now indicated at a 7.5 per cent annual rate, the same as by the former estimates with the second quarter rise now shown to be a little faster (3.3 per cent compared with 1.9 per cent) and the third quarter a little slower (11.9 per cent per year, instead of 13.4 per cent).

Statistical revisions were also made to inventory investment. The recent accumulation of inventories is now indicated to have been larger and to have come earlier than shown by the former estimates; furthermore, the swing from accumulation to liquidation is now indicated to have been sharper.

Several of the definitional and classificational changes made in the revision affect some of the more important expenditure and income components you hear about regularly, and brief comments about some of them might be of particular interest.

Expenditures for mobile homes, \$3.3 billion in 1974, have been transferred from consumer durable expenditures to residential structures. The rental value of these units will be counted as consumer service expenditures, a treatment which parallels that for other types of housing. Additionally, the allocation of autos and light trucks between consumer and business expenditures has been modified so as to more accurately reflect recent trends in these items.

Net interest paid by the Federal government to foreigners-- which amounted to \$3.2 billion in 1974--has been shifted from government purchases (or sales) and imports (or exports) to transfer payments. This shift does not affect total GNP, but the net exports component of GNP will no longer be, conceptually, a balance of payments equivalent.

Another important conceptual change is the consistent measurement of depreciation of all capital goods in terms of current replacement prices of the capital goods depreciated. Consistency in depreciation measurement is obtained by basing service lives of all depreciable capital goods on IRS Bulletin F schedules and then calculating depreciation on these capital goods by the straight line method rather than by a combination of methods. And this depreciation is based on the estimated value of the capital goods in terms of current replacement costs in the period. Measuring depreciation consistently and basing depreciation estimates on current replacement costs introduces a new item in the accounts called capital consumption adjustment. This capital consumption adjustment item includes (1) an amount equal to the difference between depreciation on a consistency basis and a depreciation figure consistent (conceptually) with IRS tax depreciation (which is a component of the capital consumption allowance)--both based on historical costs of the capital goods, and (2) the difference between depreciation (consistency basis) on a replacement cost basis and historical cost basis. This new procedure is intended to provide better measures of gross net product, gross net income, and equity incomes from ownership of capital. This capital consumption adjustment item affects estimates of personal income through proprietors' income--both farm and nonfarm and rental income. For 1974 it was rather large--a \$10.3 billion reduction. Personal income in 1974 was not reduced by that amount because a \$16.0 billion upward statistical adjustment for that year due largely to higher compensation more than offset the reduction from the capital consumption adjustment.

The estimates of some concepts of corporate profits are affected by the capital consumption adjustment. The new profits series which takes account of this adjustment is called corporate profits with inventory valuation and capital consumption adjustments. This concept of profits is sometimes referred to as economic profits. Book profits vis-a-vis economic profits are augmented by a negative amount of either of them. The new figures indicate an even larger decline than before in the profit share from 1965 through 1974, but also more recovery since late 1974.

**REAL GNP**  
Per cent change at annual rates

	Revised Estimates	Former Estimates
Quarter-to-Quarter Changes		
1971:III	2.8	2.8
IV	3.5	6.5
1972:I	7.6	6.4
II	7.9	8.4
III	5.3	6.0
IV	8.5	8.3
1973:I	8.8	9.5
II	.2	2.2
III	2.7	1.6
IV	1.4	2.4
1974:I	-3.9	-7.0
II	-3.7	-1.6
III	-2.3	-1.9
IV	-7.5	-9.0
1975:I	-9.2	-11.4
II	3.3	1.9
III	11.9	13.4
Changes in Selected Periods		
1970:IV to 1973:I	6.2	6.7
1973:I to 1973:IV	1.4	2.1
1973:IV to 1975:I	-5.3	-6.3
1975:I to 1975:III	7.5	7.5