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CONFIDENTIAL (FR)
CLASS II - FOMC

September 16, 1977

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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The Domestic Nonfinancial Economy

Industrial production declined 0.5 per cent in August to 138.2 per cent of the 1967 average. This reduction in output was concentrated in auto production and electric utility power generation--both of which had increased very sharply in July, but declines in output were widespread among other products and materials. The drop in production, the first since the weather-related reduction in January 1977, was largely associated with the declines in employment and a generally shortened workweek in manufacturing industries in August and, to a limited extent, with effects of increased strike activity.

Output of consumer goods declined markedly last month. Production of durable goods fell 1.7 per cent, as auto assemblies seasonally adjusted, dropped to a 9.4 million unit annual rate after allowance for model changeover; this drop followed the very high 10.0 million unit annual rate of assemblies in July. Production of home goods such as appliances and furniture decreased slightly in August. Output of consumer nondurables declined 0.7 per cent, following a large rise in the preceding month. Production of business equipment last month was reduced 0.4 per cent, after several months of relatively large advances.

Output of durable goods materials declined slightly in August, as small increases in raw steel and equipment parts were more than offset by strike-reduced iron ore production. Nondurable materials production was almost unchanged.

INDUSTRIAL PRODUCTION
(seasonally adjusted)

Indexes, 1967=100	1977 May	June	July (p)	Aug. (e)	Per cent changes Month ago	Year ago	QI to QII
Total	137.0	137.9	138.9	138.2	- .5	5.3	2.5
Products, total	136.5	137.5	138.8	137.9	- .7	6.0	2.0
Final products	134.7	135.5	136.9	135.7	- .9	6.0	2.2
Consumer goods	143.1	143.7	145.5	144.1	-1.0	5.2	1.5
Durable goods	152.2	155.5	158.1	155.5	-1.7	7.8	3.4
Nondurable goods	139.5	139.0	140.5	139.5	- .7	3.9	.7
Business equipment	148.9	150.3	151.6	151.0	- .4	9.7	3.7
Intermediate products	143.5	144.5	145.9	145.8	- .1	5.3	1.1
Construction supplies	138.7	139.2	140.4	140.6	.1	4.2	1.7
Materials	137.8	138.5	138.9	138.7	- .2	4.3	3.4

p -- preliminary e -- estimated

Capacity utilization in manufacturing declined in August to 82.7 per cent from a revised 83.2 per cent in July, the first monthly reduction since January. Most of the decline reflects curtailments of production in the advance processing sector, particularly in non-electrical machinery and transportation equipment. Slowdowns in primary processing industries producing nondurable goods also contributed to the over-all decline.

The materials capacity utilization rate decreased marginally in August to 82.7 per cent. This rate now stands about 1 percentage point above its level one year earlier and remains about 10 percentage points below its 1973 peak.

Personal income rose $8.0 billion, or at a 6-1/4 per cent annual rate, in August to a seasonally adjusted annual rate of $1,547.2 billion. Wage and salary disbursements rose at a 2.6 per cent annual rate last month; this was a considerably smaller rise than in recent months and reflects the smaller increase in employment and the generally shortened workweek in August. Payrolls in manufacturing declined because of the cutbacks in employment and workweek. A sizeable increase in government payrolls reflected a rise in public service employment at the State and local level.

Rental income increased sharply last month, following the decline in July because of losses from flood damage. Income of farm proprietors declined sharply because of lower prices for farm products.

The book value of retail trade inventories rose at a $14.7 billion annual rate in July (p)--fractionally above the June rate and up a bit from the almost $12 billion rate of increase in the first half of the year. Durable goods stocks increased at a $13.3 billion annual rate in July--triple the June pace and considerably above the $4.9 billion January-June rate. Automotive store inventories rose $8.7 billion in July--the most rapid gain since last August; excluding automotive, durables were up at a $4.6 billion annual rate--about double the pace of the first half. The rate of accumulation at nondurable goods stores slowed sharply in July ($1.4 billion) following the very rapid rates of increase in the spring.

The book value of <u>all manufacturing and trade inventories</u> rose at a $23.0 billion annual rate in July, appreciably less than the $32.7 billion rate in the first half of the year. Nondurable goods stocks which had been growing quite rapidly in the February-May period declined at a $3.0 billion annual rate in July; this decline was mainly in the wholesale farm products for which prices have been dropping for the last four months. The ratio of inventories to sales increased to 1.49 in July from 1.47 in June, largely reflecting a decline in total business sales. This ratio remains well below the 1966-76 average of 1.55 and the very high levels seen in 1974-75, although it has been rising steadily since reaching an eleven year low point in March.

<u>The Domestic Financial Economy</u>

No textual addendums to the Greenbook were required, but the usual updating of interest rate developments is contained in the table on page 5.

<u>ERRATA</u>

Part I: Page I-1, line 10: "two-fifths" should read "one-fifth."

Part II: Page II-3: The following should follow the last line on the page--"further declines in farm proprietors' income. However, gains in wage and"

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

	1977		1977	
	Highs	Lows	Aug. 15	Sept. 15
Short-Term Rates				
Federal funds (wkly. avg.)	6.05(9/14)	4.47(1/5)	5.94(8/17)	6.05(9/14)
3-month				
Treasury bills (bid)	5.90(9/13)	4.39(4/28)	5.54	5.87
Comm. paper (90-119 days)	6.20(9/15)	4.63(1/10)	5.88	6.20
Bankers' acceptances	6.20(9/14)	4.66(1/3)	5.99	6.20(9/14)
Euro-dollars	6.75(9/14)	4.88(1/5)	6.50	6.63
CD's (NYC) 90 days				
Most often quoted new	6.00(9/14)	4.50(1/5)	5.65(8/10)	6.00(9/14)
6-month				
Treasury bills (bid)	6.10(9/13)	4.54(1/3)	5.93	6.05
Comm. paper (4-6 mos.)	6.25(9/15)	4.63(1/7)	5.90	6.25
CD's (NYC) 180 days				
Most often quoted new	6.40(9/14)	4.65(1/5)	5.98(8/10)	6.40(9/14)
1-year				
Treasury bills (bid)	6.20(9/12)	4.66(1/3)	6.09	6.13
CD's (NYC)				
Most often quoted new	6.45(9/14)	5.00(1/5)	6.10(8/10)	6.45(9/14)
Prime municipals	3.30(8/19)	2.65(1/7)	3.20(8/12)	3.10(9/16)
Intermediate- and Long-Term				
Treasury (constant maturity)				
3-year	6.89(8/16)	5.73(1/3)	6.88	6.82
7-year	7.35(5/11)	6.50(1/3)	7.33	7.20
20-year	7.80(5/11)	7.20(1/3)	7.72	7.56
Corporate				
Seasoned Aaa	8.13(3/14)	7.87(1/5)	8.00	7.89(9/14)
Baa	9.18(2/25)	8.77(9/9)	8.81	8.79(9/14)
Aaa Utility New Issue	8.34(5/18)	7.90(1/5)	8.07(8/12)	8.09p(9/16)
Recently Offered	8.33(5/4)	7.95(1/5)	8.05(8/12)	8.07p(9/16)
Municipal				
Bond Buyer Index	5.93(2/2	5.55(6/16)	5.63(8/11)	5.51
Mortgage--average yield in FNMA auction	8.79(5/31)	8.46(1/12)	8.75(8/8)	8.74(9/5)

APPENDIX A*
CHANGES IN BANK LENDING PRACTICES

According to nearly half of the 121 senior lending officers of large banks that responded on the Lending Practices Survey taken in August, business loan demand had strengthened over the three months ending in August, fulfilling the expectations expressed on the previous survey taken in May. A majority of respondents (55 per cent) anticipated that business loan demand would strengthen further in the coming months, somewhat lower than the two-thirds of respondents expecting stronger loan demand in the spring survey. Changes in price and non-price terms of lending were mixed, but on balance the survey suggests a continuation of the easing in nonprice terms which began early in 1976.

The prime rate charged by major banks was raised shortly after both the May and August surveys and in a climate of rising rates, almost one-fifth of the panel in August reported firmer policies on interest rates charged. However, some of the bankers (10 per cent) reported easier rate policies, presumably meaning that the spread between the prime rate and loan rates to nonprime borrowers was lowered. Some firming of rates on loans to finance companies was also reported.

On nonprice terms, 13 per cent of the respondents reported less stringent compensating balance requirements for their business customers, continuing the trend toward ease which became quite pronounced in the fourth quarter of last year when business demand for bank loans began to turn up. However, the most recent survey of lending practices shows that 5 per cent of the major banks are pressing business borrowers and finance companies a little harder for compensating balances. A similar pattern is apparent in bank policies regarding the maturity of term loans; most of the changes in policy in the August survey were in the direction of easing but a noticable minority of the lending officers reported that their banks were becoming more restrictive on the maturity of term loans.

For established customers in the respondents' market area, almost all the respondents indicated that policies toward commitments and loan applications were either unchanged or were changed toward increased accommodation. Same easing was also reported toward new customers and borrowers located out of the banks' usual service area, but an appreciable minority of banks--more than those reporting easing--indicated that they had tightened approval standards for loans and commitments from new or nonlocal customers.

Consumer instalment and single family mortgage lending remain very popular uses of funds at the survey banks, and some 15 per cent of the respondents reported that their banks had allocated more funds toward such lending. Participation loans with correspondents were also cited by 10 per cent of the respondents as loans toward which their banks had become more favorably disposed.

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*Prepared by Paul W. Boltz, Economist, Banking Section, Division of Research and Statistics.

The results of the August Lending Practices Survey were, then, in broad outline similar to those taken over the preceding year, except that in previous surveys there were few, if any, signs of tightening of nonprice terms of lending. The most recent survey confirms a continuation of unchanged or easier lending policies at the large majority of banks, but a few banks took some moves toward firming of lending practices.

QUARTERLY SURVEY OF CHANGES IN BANK LENDING PRACTICES
AT SELECTED LARGE BANKS IN THE U.S. 1/
(STATUS OF POLICY ON AUGUST 15, 1977 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	121	100.0	1	0.8	54	44.6	59	48.8	7	5.8	0	0.0
ANTICIPATED DEMAND IN NEXT 3 MONTHS	121	100.0	1	0.8	66	54.5	54	44.7	0	0.0	0	0.0

	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
LENDING TO NONFINANCIAL BUSINESSES												
TERMS AND CONDITIONS:												
INTEREST RATES CHARGED	121	100.0	1	0.8	21	17.4	87	71.9	12	9.9	0	0.0
COMPENSATING OR SUPPORTING BALANCES	121	100.0	1	0.8	6	5.0	98	81.0	16	13.2	0	0.0
STANDARDS OF CREDIT WORTHINESS	121	100.0	1	0.8	3	2.5	115	95.0	2	1.7	0	0.0
MATURITY OF TERM LOANS	121	100.0	1	0.8	6	5.0	98	81.0	15	12.4	1	0.8
REVIEWING CREDIT LINES OR LOAN APPLICATIONS												
ESTABLISHED CUSTOMERS	121	100.0	0	0.0	1	0.8	115	95.1	5	4.1	0	0.0
NEW CUSTOMERS	121	100.0	0	0.0	8	6.6	108	89.3	5	4.1	0	0.0
LOCAL SERVICE AREA CUSTOMERS	121	100.0	1	0.8	0	0.0	113	93.4	7	5.8	0	0.0
NONLOCAL SERVICE AREA CUSTOMERS	121	100.0	0	0.0	11	9.1	101	83.5	8	6.6	1	0.8

1/ SURVEY OF LENDING PRACTICES AT 121 LARGE BANKS REPORTING IN THE FEDERAL RESERVE QUARTERLY INTEREST RATE SURVEY AS OF AUGUST 15, 1977.

	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	121	100.0	0	0.0	11	9.1	105	86.8	5	4.1	0	0.0
INTENDED USE OF THE LOAN	121	100.0	0	0.0	1	0.8	120	99.2	0	0.0	0	0.0
LENDING TO "NONCAPTIVE" FINANCE COMPANIES												
TERMS AND CONDITIONS:												
INTEREST RATES CHARGED	121	100.0	1	0.8	8	6.6	110	90.9	2	1.7	0	0.0
COMPENSATING OR SUPPORTING BALANCES	121	100.0	0	0.0	3	2.5	115	95.0	2	1.7	1	0.8
ENFORCEMENT OF BALANCE REQUIREMENTS	121	100.0	0	0.0	7	5.8	110	90.9	3	2.5	1	0.8
ESTABLISHING NEW OR LARGER CREDIT LINES	121	100.0	1	0.8	2	1.7	115	95.0	3	2.5	0	0.0

	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	121	100.0	0	0.0	3	2.5	96	79.3	22	18.2	0	0.0
CONSUMER INSTALMENT LOANS	120	100.0	0	0.0	1	0.8	101	84.2	18	15.0	0	0.0
SINGLE FAMILY MORTGAGE LOANS	120	100.0	0	0.0	5	4.2	96	80.0	16	13.3	3	2.5
MULTI-FAMILY MORTGAGE LOANS	119	100.0	0	0.0	5	4.2	110	92.5	3	2.5	1	0.8
ALL OTHER MORTGAGE LOANS	120	100.0	0	0.0	4	3.3	105	87.6	10	8.3	1	0.8
PARTICIPATION LOANS WITH CORRESPONDENT BANKS	121	100.0	1	0.8	0	0.0	106	87.7	13	10.7	1	0.8
LOANS TO BROKERS	121	100.0	1	0.8	7	5.8	102	84.3	10	8.3	1	0.8

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.