Prefatory Note

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,[1] and then making the scanned versions text-searchable.[2] Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

[1] In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

[2] A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

May 12, 1978

CONFIDENTIAL (FR)
CLASS II - FOMC

SUPPLEMENT

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

TABLE OF CONTENTS

Retail sales. Retail sales rose 2 per cent in April, after 1.1 per cent rise in March (revised down from 1.9 per cent shown a month ago), according to the advance Census Bureau estimate. More than two-thirds of the April rise was accounted for by sales by automotive products dealers, which rose 6.7 per cent from March. Sales by general merchandise stores increased 1.2 per cent for the second consecutive months, and sales by food stores rose more than 2 per cent. Sales by furniture and appliance outlets declined sharply further in April, the second month of large decline. Sales of gasoline service stations also are indicated to have declined sharply again.

Total retail sales in the first quarter are now indicated to have edged down slightly, and sales at stores other than automotive grouping and the building materials, hardware, garden supply, and mobile home dealers were about unchanged. April sales at all retail stores were 2.0 per cent above the average in the first quarter, with that increase in sales at automotive dealers, general merchandise and apparel stores, and food and eating places.

Consumer sentiment and buying conditions. Consumer sentiment in April recovered about half of the 5.5 point March decline in the University of Michigan Survey Research Center's index of consumer sentiment. This April improvement reflected improved attitudes about present and expected personal financial conditions, buying conditions for large household goods, and expected business conditions 12-months hence. Of the index questions, only evaluations of business conditions in the next 5-years deteriorated.

This survey indicated a record-high proportion of respondents reported that the present is a good time to buy large household goods, with a record-high proportion expressing a buy-in-advance-of-price-increase psychology. There was also an increase from the previous month in evaluations that the present was a good time to buy a house. The proportion thinking that buying conditions for cars are now favorable continued relatively high, although down somewhat from March.

The Domestic Financial Economy

No textual addendums to the Greenbook were required, but the usual updating of interest rate developments is contained in the table on page 3.

CORRECTIONS & UPDATES

Page III-6: Monetary aggregates table (see attached page 4).

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

	1978			
	Highs	Lows	Apr. 17	May 11
Short-Term Rates				
Federal funds (wkly avg.)	7.32(5/10)	6.58(1/11)	6.78(4/19)	7.32(5/10)
3-month				
Treasury bills (bid)	6.68(1/11)	6.09(4/24)	6.10	6.32
Comm. paper (90-119 days)	7.02(5/11)	6.63(1/6)	6.79	7.02
Bankers' acceptances	7.28(5/8)	6.70(1/6)	6.80	7.25
Euro-dollars	7.94(5/9)	7.00(2/8)	7.25	7.75
CDs (NYC) 90 days				
Most often quoted new	7.13(5/10)	6.65(1/4)	6.83(4/12)	7.13(5/10)
6-month				
Treasury bills (bid)	7.01(5/11)	6.43(1/4)	6.55	7.01
Comm. paper (4-6 mos.)	7.08(5/10)	6.66(1/5)	6.84	7.05
CDs (NYC) 180 days				
Most often quoted new	7.63(5/10)	6.85(1/4)	7.23(4/12)	7.63(5/10)
1-year				
Treasury bills (bid)	7.26(5/11)	6.53(1/4)	6.83	7.26
CDs (NYC)				
Most often quoted new	7.75(5/10)	7.05(1/4)	7.40(4/12)	7.75(5/10)
Prime municipal note	4.10(5/5)	3.55(3/3)	3.90(4/14)	4.10(5/5)
Intermediate- and Long-Term				
Treasury (constant maturity)				
3-year	8.08(5/8)	7.38(1/4)	7.74	8.07
7-year	8.25(5/8)	7.71(1/5)	7.99	8.24
20-year	8.45(5/8)	8.00(1/5)	8.27	8.43
Corporate				
Seasoned Aaa	8.66(5/10)	8.28(1/3)	8.58	8.66(5/10)
Baa	9.47(5/10)	9.09(1/3)	9.30	9.47(5/10)
Aaa Utility New Issue	8.93(4/21)	8.61(3/24)	8.88(4/14)	8.87p(5/12)
Recently Offered	8.93(5/11)	8.48(1/6)	8.84(4/14)	8.93p(5/12)
Municipal				
Bond Buyer index	5.99(5/11)	5.58(3/16)	5.74(4/13)	5.99
Mortgage--average yields in FNMA auction	9.52(5/1)	9.13(1/9)	9.44	9.52(5/1)

MONETARY AGGREGATES

(Seasonally adjusted)[1/]

	1977 QIII	1977 QIV	1978 QI	1978 Mar.	1978 Apr.e	12 months ending Apr. 78e
			Net changes at annual rates, per cent			
Major monetary aggregates						
1. M_1 (currency plus demand deposits)	8.1	7.2	5.0	3.5	19.1	7.3
2. M_2 (M_1 + time & savings deposits at CBs other than large CDs)	9.9	8.0	6.4	5.3	11.3	8.2
3. M_3 (M_2 + all deposits at thrift institutions)	11.9	10.6	7.4	6.2	9.9	9.9
Bank time & savings deposits						
4. Total	10.3	13.0	13.1	11.4	8.1	12.2
5. Other than large negotiable CDs at weekly reporting banks	11.2	8.5	7.5	6.5	5.7	8.9
6. Savings deposits	7.3	5.4	2.2	0.5	3.3	4.4
7. Individuals[2/]	9.6	7.0	3.1	1.2	4.1	5.7
8. Other[3/]	-17.1	-17.8	-8.0	-16.2	-8.2	-11.0
9. Time deposits	14.6	11.4	12.0	12.2	7.9	13.0
10. Small time[4/]	8.3	1.0	2.7	11.0	10.1	6.1
11. Large time[4/]	28.1	32.4	29.9	14.3	5.1	28.1
Deposits at nonbank thrift institutions[5/]						
12. Total	15.0	14.4	8.8	7.7	7.9	12.4
13. Savings and loans	16.2	15.4	9.0	8.0	7.9	13.1
14. Mutual savings banks	9.5	9.9	5.2	3.6	4.5	7.8
15. Credit unions	20.1	20.0	18.2	20.0	14.7	19.9
			Average monthly changes, $ billions			
MEMORANDA:						
16. Total US Govt deposits	0.2	0.2	-1.2	0.4	0.4	-0.2
17. Total large time deposits[6/]	1.7	6.2	4.5	3.7	1.8	3.5
18. Nondeposit sources of funds[7/]	1.4	1.3	1.9	0.3	-1.7	1.1

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 based on averages of current and preceding end-of-month data.
6/ All large time certificates, negotiable and nonnegotiable, at all CBs.
7/ 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, Euro-dollar borrowings and loans sold, less interbank loans.

e--estimated

APPENDIX A
REGIONAL SURVEY OF RECENT BUSINESS LENDING*

To aid in interpreting recent developments in business lending at commercial banks, a survey of individual banks was conducted in late April. Reserve Bank staffs in each District contacted a total of nine commercial banks, including three of the largest banks in their Districts, three moderately large banks, and three smaller banks.1/ Although the small sample is certainly not sufficient to produce firm conclusions on any of the issues considered, the responses are suggestive of current banking practices in each region. Issues examined include developments in term lending, below-prime short-term lending, the movement by money center banks into regional business loan markets, and several aspects of international banking that pertain to business loan developments.

Term Loans

Most respondent banks confirmed that the volume of term lending to businesses in early 1978 rose as a percentage of total commercial and industrial loans. For the most part banks did not actively seek to expand term loans, rather they responded to the demands of businesses.2/ Respondents characterized term borrowers as mainly medium to small-size firms.3/ Funds obtained through term loans were used for a wide variety of purposes, but included, in rough order of frequency, working capital, equipment, plant construction, and refinancing of debt.

Pricing of term loans varied substantially among the respondents. A majority of banks reported a narrowing in 1978 of the spread of the rate charged on typical term loans to prime customers over the prime rate on short-term loans. However, a substantial number noted no change in the spread and banks in several Districts reported a wider spread. Although fixed-rate term loans were common at most banks, the proportion of these loans to total term loans had not risen during 1978, except at some large banks in Chicago and Philadelphia.4/ Only single banks in Chicago, Dallas, and San Francisco have actively sought fixed-rate term loans.

---

* Prepared by John R. Williams, Economist, Banking Section, Division of Research and Statistics.

1/ The three largest banks contacted in each District are 416a reporters, the moderately large banks are other weekly reporters, and the smaller banks are nonweekly reporters.

2/ The exceptions included large banks in Chicago, a few banks in San Francisco, and small banks in Richmond and Atlanta.

3/ Large borrowers were the principal recipients of term loans only in San Francisco, Atlanta, and at one large bank in Chicago.

4/ Respondents reported that the proportion of term loans at fixed rates in early 1978 varied from 0 to nearly 100 per cent with a median of roughly 40 per cent. Data from the Survey of Terms of Bank Lending suggest that the proportion of term loans made at fixed rates in February at all banks was about 45 per cent, little changed from the November survey.

Most large banks stated that their term lending policy--especially fixed-rate term loans--had been affected by competition from other banks, while most small banks indicated that their policy had not been affected. Competition from nonbank lenders was considered a factor in forming term lending policy at only a few banks, primarily at large banks in San Francisco and Chicago.

Below-Prime Lending

There was substantial evidence at large banks of recent below-prime lending based on money market rates. Even in cases where large respondents were not themselves offering such loans, most banks stated that the practice was prevalent in their areas. At least one sample bank in Chicago, San Francisco, Cleveland, and Richmond confirmed that it offered some loans based on money market rates. This evidence supports data reported on the Survey of Terms of Bank Lending, indicating spreading of below-prime lending. However, the practice of basing loans on a money market rate was viewed by respondents as no more common in their Districts in early 1978 than it had been in 1977.[5/] Such below-prime lending usually is available only to large creditworthy corporations as a back-up to commercial paper borrowing, or to highly valued long-time customers. In New York, foreign international borrowers were often the beneficiaries of special lending programs.

Money Center Banks Lending in Other Regions

Large banks in every District claimed to have experienced competition from out-of-town money center banks in the past year. However, while nearly all Districts contain banks that have lost a portion of their loan business to money center banks, in most cases the losses were judged insignificant.

Responses of the money center banks were generally consistent with the statements of the regional banks. New York bankers noted that their lack of success in acquiring a substantial volume of loans from such new customers stemmed from the existence of long-time relationships between local banks and borrowers. Several San Francisco and Chicago banks aggressive in other regions noted that they made such loans only when a smaller correspondent bank in the given region was involved either as a participant in the loan or in servicing the loan.

Lending to Large Corporations

Expansion in the volume of lending to the largest corporations was mixed among the respondents in most Districts. However, a small majority of banks reported a decline in lending to such corporations as a percentage of total business loans. Such growth is consistent with

5/ Exceptions included a few large banks in Cleveland, Chicago, and San Francisco.

reports that the largest corporations continue to generate substantial amounts of internal funds, and, when necessary, to acquire external funds in large part from nonbank sources.

International Aspects of Business Loan Developments

Large banks in San Francisco, New York, and Chicago all indicated that U.S. offices of foreign banks and foreign agencies were commonly pricing commercial and industrial loans based on money market rates. At least in New York, however, such offerings apparently have been confined to U.S. affiliates of firms that are based in the foreign banks' own countries.

For the large banks sampled in New York and San Francisco, loans booked at offshore branches were reported to have increased in the last year. Reasons given include the avoidance of certain taxes as well as a response to demands of foreign borrowers. However, it was not clear whether such loans were made primarily to foreign based firms or to foreign affiliates of U.S. corporations. In no District did bankers feel that this practice had substituted for domestic loan business. Nevertheless, data show a continued increase in the stock of offshore loans by New York banks, suggesting a possible relationship with the business loan weakness at New York City banks.