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March 25, 1988

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

THE DOMESTIC NONFINANCIAL ECONOMY	Page
Personal income and consumption.....	1
Sales of domestic autos and light trucks	3
<u>Tables</u>	
Personal income, consumption, and saving.....	4
Sales of domestic autos and light trucks.....	5
THE FINANCIAL ECONOMY	
<u>Tables</u>	
Monetary aggregates	6
Commercial bank credit and short- and intermediate- term business credit.....	7
Selected financial market quotations.....	8

SUPPLEMENTAL NOTES

THE DOMESTIC NONFINANCIAL ECONOMY

Personal Income and Consumption

Total personal income increased at a \$33.9 billion annual rate in February, following a \$10.6 billion increase in January. Both figures were affected by the timing of farm subsidy payments and other special factors; excluding these factors, personal income increased \$25.2 billion in February and \$18 billion in January. Wages and salaries posted a gain of \$15.4 billion in February, up slightly from the average pace of the past several months.

Preliminary estimates for February showed nominal personal consumption spending increasing 0.7 percent, after a rise of 0.1 percent in January. Spending on motor vehicles and parts accounted for about one-fifth of the overall rise during February, apparently reflecting a strong response to the widespread availability of manufacturers' incentives on domestically produced cars and trucks. Spending on services moved up sharply for the second month in a row in February, while outlays for nondurable goods edged up 0.2 percent from the January level.

With data on spending and income now in hand for a period of four months since the stock market crash, it perhaps is appropriate to offer a very tentative assessment of the wealth effect on consumption. Household net worth fell sharply relative to disposable personal income last October, and as a result, the staff projection for consumer spending relative to income was revised down in the October Greenbook.

The drop in stock prices prompted the staff to raise the forecast for the saving rate by roughly 3/4 percentage point from 1988Q1 on. This increase in the saving rate was based on a judgement by the staff that only about one-half to two-thirds of the peak-to-trough reduction in the value in the stock market should be reflected in the forecast. Several factors argued against a larger revision in the saving rate: first, the stock market had not been near its peak for very long, and there had been a sense of skepticism in the markets about the sustainability of the high levels reached. This was interpreted by the staff to mean that consumers might not have incorporated fully the previous run-up in stock prices into their spending behavior. Second, the stock market already had declined \$200 billion from its peak value by the time of the September Greenbook, so that some of the overall decline in wealth had been reflected in the previous forecast. Third, interest rates fell in the wake of the stock market crash, boosting the value of fixed-income financial assets.

In the period since the crash, the personal saving rate indeed has increased from the historically low levels of mid-1987. Consumption growth has been a bit stronger than expected, but income growth also has been more rapid than anticipated in our October forecast. The personal saving rate, which had averaged 4 percent in 1986Q4 and 1987Q1 and fallen to about 3 percent during 1987Q2 and Q3, has moved up to an average of 4-3/4 percent in the past four months. In part, the increase in the saving rate reflects a variety of special factors. For example, farm subsidy payments provided a temporary boost to personal income in

October, and to a lesser extent in December and February; swings in such payments are not thought to have large immediate effects on spending. Also, auto incentive plans accelerated some consumer spending into August and September, somewhat depressing the saving rate relative to the underlying trend. Such considerations suggest that some caution is appropriate in stating the "before" and "after" saving rates, and, of course, many forces other than the stock market decline have affected consumer behavior. Nonetheless, at this point the saving rate rise that has occurred does seem to be prima facie evidence of a significant wealth effect, one at least as large as was incorporated in the staff forecast.

Sales of domestic autos and light trucks

Sales of domestically produced autos were 6.7 million units at annual rate in mid-March, down substantially from the average of 7.9 million units in February and early March. Sales likely were affected by the timing of incentive programs. In particular, programs originally had been scheduled to end for General Motors cars at the end of February, boosting sales late in that month, and to end at Ford on March 8, boosting sales in early March. Both incentive programs have now been extended until the end of April. Sales of domestically produced light trucks also fell in mid-March, to 3.8 million units from a 4.4 million unit rate early in the month. Incentives also have affected the timing of these sales.

PERSONAL INCOME, CONSUMPTION, AND SAVING

	1987	1987		1988	
		Q3	Q4	Jan.	Feb.
-Average monthly change, billions of dollars-					
Total personal income	21.7	22.6	28.6	10.6	33.9
Wages and salaries	12.2	13.6	13.8	13.3	15.4
Farm proprietors	.2	-.7	2.6	-8.2	8.5
Other	9.3	9.7	12.2	5.5	10.0
--Percent change*--					
Nominal PCE	5.7	9.5	1.5	.1	.7
Durables	-1.6	30.1	-20.1	-.6	1.8
Nondurables	5.0	1.8	2.7	-.8	.2
Services	8.3	9.5	7.4	.8	.8
<u>Memo:</u>					
Personal saving rate (percent)	3.7	2.8	4.8	4.8	5.2

*Changes for periods longer than one month are at annual rate; one-month changes are at monthly rate.

SALES OF DOMESTIC AUTOS AND LIGHT TRUCKS
(Millions of units at annual rate, FRB seasonals)

	1-10	11-20	21-30	Month
<u>January</u>				
Total	9.107	11.207	11.700	10.924
Cars	5.773	7.460	7.657	7.129
Trucks	3.334	3.747	4.043	3.795
<u>February</u>				
Total	12.597	11.496	13.106	12.226
Cars	8.042	7.443	8.508	7.925
Trucks	4.555	4.053	4.598	4.301
<u>March</u>				
Total	12.212	10.503		
Cars	7.843	6.678		
Trucks	4.369	3.825		

SALES OF DOMESTIC AUTOS BY MAKER
(Millions of units at annual rate, FRB seasonals)

	1988					
	February				March	
	1-10	11-20	21-29	Month	1-10	11-20
General Motors ¹	4.092	3.775	4.398	4.052	3.530	3.253
Ford	2.316	2.143	2.105	2.160	2.550	1.912
Chrysler	1.201	1.156	1.292	1.207	1.284	1.087
Volkswagen	.040	.041	.065	.049	.029	.036
Honda	.302	.210	.499	.337	.315	.257
Nissan	.049	.057	.067	.058	.072	.066
Toyota	.028	.042	.050	.040	.041	.041
Mazda	.015	.020	.031	.022	.021	.026
Total for all auto makers	8.042	7.443	8.508	7.925	7.843	6.678
(BEA seasonals)	(8.091)	(7.260)	(8.347)	(7.929)	(7.526)	(6.942)

1. Includes some autos produced in cooperation with Toyota.

Note: Domestic autos and trucks include some units produced in Canada and in Mexico for General Motors, Ford, and Chrysler.

MONETARY AGGREGATES
(Based on seasonally adjusted data unless otherwise noted)

	1987			1988		Growth Q4 87 - Feb. 88p	
	1987<1>	Q3	Q4	Dec.	Jan.		Feb.
---Percentage change at annual rates---							
1. M1	6.3	0.8	4.0	-2.9	12.8	1.1	3.3
2. M2	4.0	2.8	4.0	1.8	9.7	8.7	6.7
3. M3	5.4	4.5	5.5	1.4	8.2	10.2	7.0
Selected components							
4. M1-A	2.8	-1.6	4.0	-4.1	9.5	-2.4	494.5
5. Currency	8.7	7.3	9.9	9.2	11.6	6.0	199.4
6. Demand deposits	-1.0	-7.5	0.1	-13.6	7.9	-8.7	287.8
7. Other checkable deposits	13.6	5.2	4.0	-0.9	19.0	7.7	265.1
8. M2 minus M1<2>	3.3	3.5	4.0	3.6	-8.5	11.4	2187.2
9. Overnight RPs and Eurodollars, NSA	4.0	18.9	7.5	-25.6	63.2	-79.0	76.6
10. General purpose and broker/dealer money market mutual fund shares, NSA	6.3	4.6	13.7	7.1	21.6	31.8	232.2
11. Commercial banks	2.5	1.9	3.5	4.1	6.3	10.1	933.6
12. Savings deposits, SA, plus MMDAs, NSA<3>	1.8	-1.7	-4.2	0.2	3.1	4.9	540.0
13. Small time deposits	3.5	7.4	14.8	9.4	10.6	17.3	393.6
14. Thrift institutions	3.5	3.0	3.4	6.6	7.2	13.3	947.6
15. Savings deposits, SA, plus MMDAs, NSA<3>	0.8	-4.3	-11.6	-9.7	-7.7	-5.4	398.8
16. Small time deposits	5.6	9.3	16.0	19.4	18.6	27.3	548.9
17. M3 minus M2<4>	10.8	10.9	11.1	-0.3	2.4	15.9	771.9
18. Large time deposits	8.5	7.8	14.4	10.5	-5.0	14.4	488.5
19. At commercial banks, net<5>	11.2	6.8	10.5	4.5	-12.6	13.1	323.6
20. At thrift institutions	3.4	9.9	22.2	23.5	10.4	17.0	164.9
Institution-only money market mutual fund shares, NSA	3.0	2.9	20.2	1.3	64.3	54.7	98.7
Term RPs, Net NSA	29.9	25.6	-4.1	-36.4	2.3	37.5	108.9
Term Eurodollars, Net NSA	13.5	16.1	10.2	-25.7	-78.9	-9.8	84.6
MEMORANDA:<6>							
---Average monthly change in billions of dollars---							
24. Managed liabilities at commercial banks (25+26)	6.1	3.7	5.3	5.6	0.2	2.5	569.1
25. Large time deposits, gross	3.5	0.3	5.4	2.2	-0.1	5.3	394.5
26. Nondeposit funds	2.6	3.4	-0.1	3.4	0.3	-2.8	174.6
27. Net due to related foreign institutions, NSA	2.9	4.5	1.0	7.3	-7.0	-6.3	1.9
28. Other<7>	-0.3	-1.1	-1.0	-3.9	7.3	3.5	172.7
29. U.S. government deposits at commercial banks<8>	0.3	-0.7	0.4	-9.6	-7.5	4.0	22.6
. Amounts shown are from fourth quarter to fourth quarter.							
. Nontransactions M2 is seasonally adjusted as a whole.							
. Commercial bank savings deposits excluding MMDAs increased during January and February at rates of 5.4 percent and 13.4 percent, respectively. At thrift institutions, savings deposits excluding MMDAs decreased during January and February at rates of 3.6 percent and 0.5 percent, respectively.							
. The non-M2 component of M3 is seasonally adjusted as a whole.							
. Net of large-denomination time deposits held by money market mutual funds and thrift institutions.							
. Dollar amounts shown under memoranda are calculated on an end-month-of-the-quarter basis.							
. Consists of borrowings from other than commercial banks in the form of federal funds purchased, securities sold under agreements to repurchase, and other liabilities for borrowed money (including borrowings from the Federal Reserve and unaffiliated foreign banks, loan RPs and other minor items). Data are partially estimated.							
. Consists of Treasury demand deposits and note balances at commercial banks.							
--preliminary.							

COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT¹
 (Percentage changes at annual rates, based on seasonally adjusted data)

	1986:Q4	1987			1988		Levels bil. \$ Feb. ^P
	to 1987:Q4	Q3	Q4	Dec.	Jan.	Feb. ^P	
----- Commercial Bank Credit -----							
1. Total loans and securities at banks	7.9	7.0	2.9	-1.0	5.9	8.4	2257.7
2. Securities	5.0	6.0	3.1	4.1	-2.7	3.6	529.7
3. U.S. government securities	9.1	12.4	2.2	7.2	3.2	-0.4	334.0
4. Other securities	-1.3	-4.5	4.7	-1.2	-12.9	10.5	195.7
5. Total loans	8.8	7.3	2.8	-2.5	8.5	9.8	1727.9
6. Business loans	7.5	3.4	4.7	5.1	6.2	3.0	569.9
7. Security loans	1.0	19.1	-108.5	-174.0	110.7	166.8	41.8
8. Real estate loans	18.1	13.5	14.5	12.1	9.1	11.2	592.4
9. Consumer loans	4.9	5.8	4.5	3.7	6.3	8.8	330.2
10. Other loans	-2.3	1.0	-12.2	-42.2	-0.1	-2.4	193.6
----- Short- and Intermediate-Term Business Credit -----							
Business loans net of bankers acceptances	7.6	2.9	5.4	5.4	5.8	3.2	566.6
12. Loans at foreign branches ²	-4.1	25.3	-38.1	-127.1	134.2	92.3	18.2
13. Sum of lines 11 & 12	7.2	3.5	4.2	1.5	9.1	6.0	584.9
14. Commercial paper issued by nonfinancial firms	-1.6	-5.1	24.4	58.4	-2.7	-1.3	90.2
15. Sum of lines 13 & 14	6.0	2.3	6.8	8.9	7.7	4.8	675.1
16. Bankers acceptances: U.S. trade related ^{3,4}	13.3	19.8	7.1	-20.5	-13.9	n.a.	34.9 ⁵
17. Line 15 plus bankers acceptances: U.S. trade related	6.3	3.2	6.9	7.7	6.3	n.a.	707.3 ⁵
18. Finance company loans to business ³	16.6	14.2	14.5	7.2	16.8	n.a.	202.7 ⁵
19. Total short- and intermediate- term business credit (sum of lines 17 & 18)	8.4	5.5	8.6	7.6	8.6	n.a.	910.0 ⁵

1. Average of Wednesdays.

2. Loans at foreign branches are loans made to U.S. firms by foreign branches of domestically chartered banks.

3. Based on average of data for current and preceding ends of month.

4. Consists of acceptances that finance U.S. imports, U.S. exports, and domestic shipment and storage of goods.

5. January data.

n.a.--not available

III-T-1
SELECTED FINANCIAL MARKET QUOTATIONS 1/
(percent)

	1987		1988		Change from:		
	Jan-Feb lows	2/ Oct 16	FOMC Dec 16	FOMC Feb 10	Mar 24	2/ Oct 16	FOMC Feb 10
Short-term rates							
Federal funds 3/	5.95	7.59	6.71	6.57	6.56	-1.03	-0.01
Treasury bills 4/							
3-month	5.30	6.93	5.94	5.61	5.79	-1.14	0.18
6-month	5.31	7.58	6.40	5.83	6.04	-1.54	0.21
1-year	5.35	7.74	6.71	6.10	6.40	-1.34	0.30
Commercial paper							
1-month	5.81	7.94	8.22	6.41	6.58	-1.36	0.17
3-month	5.73	8.65	7.93	6.45	6.65	-2.00	0.20
Large negotiable CD's 4/							
1-month	5.85	7.92	8.09	6.46	6.59	-1.33	0.13
3-month	5.80	8.90	7.81	6.51	6.67	-2.23	0.16
6-month	5.78	9.12	7.81	6.57	6.89	-2.23	0.32
Eurodollar deposits 5/							
1-month	6.00	7.79	8.41	6.71	6.70	-1.09	-0.01
3-month	6.00	8.69	8.13	6.81	6.75	-1.94	-0.06
Bank prime rate	7.50	9.25	8.75	8.50	8.50	-0.75	0.00
Intermediate- and long-term rates							
U.S. Treasury (constant maturity)							
3-year	6.34	9.52	8.15	7.28	7.66	-1.86	0.38
10-year	7.01	10.23	9.00	8.11	8.51	-1.72	0.40
30-year	7.29	10.24	9.14	8.35	8.77	-1.47	0.42
Municipal revenue 6/ (Bond Buyer index)	6.92	9.59	8.47	7.76	8.27	-1.32	0.51
Corporate—A utility Recently offered	8.78	11.50	10.59	9.66	10.04	-1.46	0.38
Home mortgage rates 7/							
Fixed-rate	9.10	11.58	10.69	9.84	9.92	-1.66	0.08
ARM, 1-year	7.52	8.45	7.99	7.61	7.49	-0.96	-0.12
	1986	1987		1988		Percent change from:	
	Year end	Record highs	Lows	FOMC Feb 10	Mar 24	Record highs	FOMC Feb 10
Stock prices							
Dow-Jones Industrial	1895.95	2722.42	1738.74	1962.04	2023.87	-25.66	3.15
NYSE Composite	138.58	187.99	125.91	144.42	149.00	-20.74	3.17
AMEX Composite	263.27	365.01	231.90	272.65	297.30	-18.55	9.04
NASDAQ (OTC)	348.83	455.26	291.88	349.32	375.60	-17.50	7.52

- 1/ One-day quotes except as noted.
 2/ Last business day prior to stock market decline on Monday Oct. 19, 1987.
 3/ Average for two-week reserve maintenance period closest to date shown except Jan-Feb. low which is one-week average ending Feb. 25. Last observation is average for maintenance period ending Mar. 23, 1988.

- 4/ Secondary market.
 5/ Average for statement week closest to date shown.
 6/ One-day quotes for closest Thursday.
 7/ Quotes for week ending Friday closest to date shown.