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Confidential (FR)

Part 1

January 15, 1975

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

Prepared for the Federal Open Market Committee
By the staff of the Board of Governors of the Federal Reserve System

CONFIDENTIAL (FR)

January 15, 1975

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary and outlook. Recent statistics indicate a substantial further drop in aggregate demand and in real activity. Production and employment fell more in December than they had in November, and unemployment jumped again. It now appears that real GNP declined at a 9 per cent annual rate in the fourth quarter, equaling the sharpest reduction for any quarter in the post-World War II period. Consumer markets have been very weak, and real business investment outlays have declined further, as has residential construction activity. Moreover, the outlook for early 1975 now also looks weaker because business capital spending plans have been reduced substantially, and a further backup of undesired stocks of finished goods has occurred in response to sharply declining sales.

Fortunately, prices have begun to respond to weakening markets. There is some evidence that the moderation of price increases evident earlier in primary commodity markets has moved forward to other prices along the production process. Indeed, wholesale prices of industrial commodities showed no change in December, and improvement in price performance was evident in most major commodity groups. The momentum of wage rate increases has also slowed somewhat in the last few months.

Industrial production fell by 2.8 per cent further in December, following a 2.5 per cent decline in November. Reductions were widespread, affecting virtually all sectors. The capacity utilization index for major materials declined sharply to a level a fifth below the peak in mid-1973.

Employers continued to make major job cuts in December, resulting in the largest 2 month decline in nonfarm payroll employment during the postwar period. The unemployment rate rose another six-tenths, to 7.1 per cent. Moreover, numerous additional layoffs have been reported since the December survey week and initial claims for unemployment benefits at year-end reached record levels, portending a further rise in unemployment this month.

Consumer markets have taken a buffeting in recent months. There was a large and widespread downward revision of estimated November retail sales, and sales in December showed virtually no recovery from the depressed November level. For the fourth quarter as a whole, current dollar retail sales were down by 3.2 per cent from the third quarter. Unit sales of domestic autos were up slightly in December but dropped off again in early January; sales of foreign models have also been declining sharply since September.

Real outlays for business fixed investment appear to be continuing the decline that began around mid-year. Orders for non-defense capital goods fell sharply further in November, and construction contract awards for commercial and industrial buildings (the floor space series) were also off further. The Commerce survey indicates that business has cut its spending plans markedly, and a substantial real decline in spending in 1975 now seems likely.

Outlook. Our GNP projection this month incorporates a new set of policy assumptions. The President recently set forth a new fiscal program that includes a one time $16 billion tax cut to stimulate the economy and an energy program that would generate $30 billion of taxes which, in turn, are to be returned to the private economy in various forms. We have incorporated in our projection the $16 billion tax reduction--that is, the 12 per cent rebate of 1974 individual income tax liabilities and the increase in the investment tax credit to 12 per cent for 1975. We have also raised somewhat our estimates of budget outlays to $309 billion for FY 1975 and to $343 billion for FY 1976. This expenditure projection does not incorporate the 5 per cent ceiling on social security benefits. Also, we have not incorporated the President's proposed energy program, the disposition of which seems highly uncertain.

On the monetary side, we now assume a 6 per cent growth rate of M_1 during this and the next five quarters. With economic activity expected to remain weak until mid-year 1975, interest rates are projected to decline somewhat further in the near-term and then to turn up again as economic activity recovers in the second half.

A turnup in economic activity later this year now seems more certain than it did last month because of the assumed stimulative tax actions. The 12 per cent rebate on 1974 income taxes should have its major impact in the late summer and fall, supporting a recovery in real consumer outlays, and the first significant stimulative effects of the investment tax credit should begin to be felt at about the same time. The brighter outlook for consumer spending and business investment should, in turn, prompt efforts to rebuild inventories--though there may be some lag in the response of production to rising sales, so that substantial outright liquidation of inventories may occur in both the second and third quarters.

Toward the end of 1975 and on into 1976, however, the pace of recovery is expected to moderate. The major impact of the tax rebate on consumer spending would be largely dissipated by year-end, and while the effects of the investment tax credit would carry over into 1976, its stimulus would not be sufficient to sustain a strong pace of economic growth. Also, the recovery in residential construction that is expected to begin around mid-year is likely to be impeded by reduced fund availability and rising interest rates. Thus, given these fiscal and monetary assumptions, we foresee a retardation of economic growth by the spring of 1976, with the economy still well below its growth potential. The unemployment rate would therefore be expected to remain very high, or even to increase somewhat in 1976, after rising sharply to around an 8 per cent level by mid-1975.

The price picture, as noted earlier, has been showing greater signs of improvement than we had been expecting, reflecting in part the competitive price cutting associated with efforts to liquidate excess inventories. We expect this recent trend to continue. We also expect to see the results at the consumer level of the recent easing of farm prices, and the dissipation of the price bulge that resulted from the OPEC rise in petroleum and the ending of price controls. Continued moderation is likely over the projection period, because of the substantial slack expected in labor and product markets. However, the greater economic strength now expected for the second half of this year may slow progress slightly on the inflation front. We now project a rate of increase in the fixed weighted GNP price index of about 6 per cent by the end of 1975, and 5-1/2 per cent by mid-1976, about the same as a month ago.

STAFF GNP PROJECTIONS

	Changes in nominal GNP ($ billions)		Per cent change, annual rate: Real GNP		Per cent change, annual rate: Gross private product fixed weighted price index		Unemployment rate (per cent)	
	12/11/74	1/15/75	12/11/74	1/15/75	12/11/74	1/15/75	12/11/74	1/15/75
1971 1/	77.8	77.8	3.3	3.3	4.3	4.3	5.9	5.9
1972 1/	103.1	103.1	6.2	6.2	3.3	3.3	5.6	5.6
1973 1/	136.9	136.9	5.9	5.9	6.3	6.3	4.9	4.9
1974	102.3	100.8	-2.0	-2.1	11.5	11.4	5.6	5.6
1975	85.1	79.7	-2.9	-3.1	9.6	8.9	7.8	8.0
1973-III 1/	31.0	31.0	1.6	1.6	8.4	8.4	4.7	4.7
IV 1/	35.1	35.1	2.3	2.3	9.1	9.1	4.7	4.7
1974-I 1/	14.8	14.8	-7.0	-7.0	14.1	14.1	5.2	5.2
II 1/	25.0	25.0	-1.6	-1.6	12.3	12.3	5.1	5.1
III 1/	31.6	32.5	-2.1	-1.9	13.8	13.8	5.5	5.5
IV	15.6	7.7	-6.5	-9.0	11.9	10.4	6.5	6.5
1975-I	14.5	9.0	-4.0	-5.2	8.8	7.9	7.3	7.6
II	16.0	17.3	-3.0	-2.1	7.9	7.2	7.7	8.0
III	31.5	37.4	1.0	3.6	7.6	6.9	8.0	8.2
IV	36.5	42.8	2.8	5.0	6.5	6.1	8.1	8.1
1976-I	33.5	38.0	3.0	4.2	5.9	5.8	8.2	8.1
II	32.5	32.1	3.0	2.8	5.4	5.6	8.3	8.2
Change:								
73-IV to 74-IV	87.0	80.0	-4.3	-4.9	12.9	12.5	1.8	1.8
74-II to 75-II	77.7	66.5	-3.9	-4.6	10.4	9.6	2.6	2.9
74-IV to 75-IV	98.5	106.5	- .8	.2	7.7	7.0	1.6	1.6
75-II to 76-II	134.0	150.3	2.5	3.9	6.3	6.1	.6	.2

1/ Actual.

FEDERAL BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS
(In billions of dollars)

	Fiscal Year 1974*	Fiscal 1975 e/ Adm. Est. 11-26-74 1/	Fiscal 1975 e/ F.R. Board	Fiscal 1976 FRB e/	Calendar Years 1973 Actual	Calendar Years FRB e/ 1974	Calendar Years FRB e/ 1975	F.R.B. Staff Estimates Calendar Quarters 1974 III*	1974 IV	1975 I	1975 II
Federal Budget								Unadjusted data			
Surplus/deficit	- 3.5	- 9.2	- 29.0	- 48.2	- 7.9	- 10.9	- 45.1	- 1.6	-11.9	-12.6	- 2.9
Receipts	264.9	293.0	280.0	294.7	250.4	280.1	278.8	72.9	66.5	65.4	75.1
Outlays	268.4	302.2	309.0	342.9	258.3	291.0	323.9	74.5	78.4	78.0	78.0
Means of financing:											
Net borrowing from the public	3.0	n.a.	30.2	n.e.	7.9	11.8	48.7	4.5	10.3	11.3	4.1
Decrease in cash operating balance	3.4	n.a.	2.8	n.e.	.7	- 4.5	- .1	.5	2.8	--	- .5
Other 2/	- 2.9	n.a.	- 4.0	n.e.	- .7	- 5.4	- 3.5	- 3.4	- 1.2	1.3	- .7
Cash operating balance, end of period	9.2	n.a.	6.4	n.e.	10.4	5.9	6.0	8.7	5.9	5.9	6.4
Memo: Sponsored agency borrowing 3/	14.8	n.a.	14.9	n.e.	16.3	16.2	n.e.	7.7	3.0	1.8	2.4
National Income Sector								Seasonally adjusted, annual rates			
Surplus/deficit	- 5.4 p/	n.a.	- 24.8	- 43.8	- 5.6	- 5.8	- 45.0	- 1.9	-15.6	-23.8	-55.3
Receipts 4/	272.6 p/	n.a.	292.7	309.1	258.5	291.6	291.0	302.8	296.7	299.9	273.8
Expenditures	278.0 p/	n.a.	317.5	352.9	264.2	297.4	336.0	304.7	312.3	323.7	329.1
High Employment surplus/deficit (NIA basis) 5/ p/	8.1	n.a.	8.5	18.3	1.9	10.7	5.9	8.9	15.8	14.6	- 5.3

* Actual e--projected n.e.--not estimated n.a.--not available p--preliminary

1/ Estimates presented in the President's Message on Budget Restraint. $302.2 billion outlay total assumes favorable Congressional action on $4.6 billion of proposed reductions.

2/ Includes such items as deposit fund accounts and clearing accounts.

3/ Federally-sponsored credit agencies, i.e., Federal Home Loan Banks, Federal National Mortgage Assn., Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.

4/ Quarterly average exceeds fiscal year total by $.6 billion for fiscal 1975 and $1.2 billion for fiscal 1976 due to spreading of wage base effect over calendar year.

5/ Estimated by F.R. Board Staff.

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income figures are billions of dollars, with quarter figures at annual rates.)

	1974		1975				1976	
	III	IV	I	II	III	IV	I	II
Gross National Product	1416.3	1424.0	1433.0	1450.3	1487.7	1530.5	1568.5	1600.6
Final purchases	1407.6	1409.0	1431.5	1459.4	1494.7	1529.0	1561.3	1591.3
Private	1095.3	1089.8	1105.0	1127.4	1155.3	1180.0	1203.8	1225.9
Excluding net exports	1098.4	1087.6	1102.1	1124.7	1154.5	1181.7	1207.0	1229.1
Personal consumption expenditures	901.3	897.5	912.0	930.8	955.6	975.6	995.0	1012.7
Durable goods	136.1	122.5	121.5	123.5	128.5	132.5	135.5	138.5
Nondurable goods	389.0	390.0	397.0	405.8	417.1	425.1	433.5	440.2
Services	376.2	385.0	393.5	401.5	410.0	418.0	426.0	434.0
Gross private domestic investment	205.8	205.1	191.6	184.8	191.9	207.6	219.2	225.7
Residential construction	46.2	39.6	37.3	39.9	43.7	47.7	49.9	51.9
Business fixed investment	150.9	150.5	152.8	154.0	155.2	158.4	162.1	164.5
Change in business inventories	8.7	15.0	1.5	-9.1	-7.0	1.5	7.2	9.3
Nonfarm	6.6	14.5	1.5	-8.5	-7.0	1.0	7.0	9.0
Net exports of goods and services 1/	-3.1	2.2	2.9	2.7	.8	-1.7	-3.2	-3.2
Exports	143.6	148.9	147.3	146.9	147.3	148.5	151.3	155.6
Imports	146.7	146.7	144.4	144.2	146.5	150.2	154.5	158.8
Gov't. purchases of goods and services	312.3	319.2	326.5	332.0	339.4	349.0	357.5	365.4
Federal	117.2	119.7	122.5	123.2	125.2	129.5	132.5	136.0
Defense	78.4	80.3	82.5	82.7	84.1	87.1	88.9	91.4
Other	38.8	39.4	40.0	40.5	41.1	42.4	43.6	44.6
State & local	195.1	199.5	204.0	208.8	214.2	219.5	225.0	229.4
Gross national product in constant (1958) dollars	823.1	803.9	793.3	789.0	796.0	805.7	814.1	819.7
GNP implicit deflator (1958 = 100)	172.1	177.1	180.6	183.8	186.9	189.9	192.7	195.3
Personal income	1168.2	1182.8	1200.8	1222.7	1254.4	1284.9	1310.6	1336.6
Wage and salary disbursements	763.0	767.5	776.5	789.9	806.7	827.7	846.6	864.7
Disposable income	993.1	1004.4	1019.7	1062.4	1088.8	1086.8	1109.1	1131.1
Personal saving	65.5	80.4	80.9	104.5	105.6	83.2	85.6	89.0
Saving rate (per cent)	6.6	8.0	7.9	9.8	9.7	7.7	7.7	7.8
Corporate profits & inventory val. adj.	105.8	99.5	97.1	84.5	92.4	99.7	104.1	106.3
Corporate profits before tax	157.0	132.0	127.0	112.0	116.5	119.5	121.0	121.0
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	302.8	296.7	299.9	273.8	275.4	314.8	323.3	327.7
Expenditures	304.7	312.3	323.7	329.1	341.2	350.1	356.9	363.4
Surplus or deficit (-)	-1.9	-15.6	-23.8	-55.3	-65.8	-35.3	-33.6	-35.7
High employment surplus or deficit (-)	8.9	15.8	14.6	-5.3	-6.2	20.5	27.8	30.9
State and local government surplus or deficit (-), (N.I.A. basis)	2.1	-.3	-1.9	-3.1	-2.4	-.4	-.8	-.5
Total labor force (millions)	93.6	94.0	94.2	94.4	94.7	94.8	95.0	95.3
Armed forces "	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Civilian labor force "	91.4	91.8	92.0	92.2	92.5	92.6	92.8	93.1
Unemployment rate (per cent)	5.5	6.5	7.6	8.0	8.2	8.1	8.1	8.2
Nonfarm payroll employment (millions)	78.7	78.3	77.6	77.4	77.5	77.6	77.8	78.0
Manufacturing	20.1	19.6	18.7	18.4	18.3	18.3	18.4	18.4
Industrial production (1967 = 100)	125.4	121.6	118.8	117.6	119.2	121.5	123.7	124.9
Capacity utilization, mfg. (per cent)	79.4	79.6	73.6	72.1	72.4	73.1	73.7	73.7
Major materials (per cent)	88.5	80.6	76.9	74.4	74.9	76.3	77.3	77.6
Housing starts, private (millions, A.R.)	1.21	1.04	1.10	1.25	1.50	1.56	1.61	1.50
Sales new autos (millions, A.R.)	10.03	7.38	7.50	7.75	8.50	9.00	9.50	9.50
Domestic models	8.48	6.05	6.25	6.35	7.00	7.50	8.00	8.00
Foreign models	1.55	1.33	1.25	1.40	1.50	1.50	1.50	1.50
1/ Net exports of g. & s. (Bal. of Paymts.)	-1.4 2/	3.9 2/	4.6 2/	4.4 2/	2.5	.0	-1.5	-1.5
Exports	146.4 2/	151.7 2/	150.1 2/	149.7 2/	150.1	151.3	154.1	158.4
Imports	147.8	147.8	145.5	145.3	147.6	151.3	155.6	159.9

2/ Includes shipments of military equipment and supplies to Israel which are not included in GNP exports; amounts are: 1974-III, \$.3 billion; 1974-IV, \$.4 billion, 1975-I and II \$.3 billion.

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1974		1975				1976	
		Projection						
	III	IV	I	II	III	IV	I	II
	Billions of Dollars							
Gross National Product	32.5	7.7	9.0	17.3	37.4	42.8	38.0	32.1
Inventory change	-4.8	6.3	-13.5	-10.6	2.1	8.5	5.7	2.1
Final purchases	37.3	1.4	22.5	27.9	35.3	34.3	32.3	30.0
Private	29.4	-5.5	15.2	22.4	27.9	24.7	23.8	22.1
Net exports	-1.6	5.3	.7	- .2	-1.9	-2.5	-1.5	.0
Excluding net exports	31.0	-10.8	14.5	22.6	29.8	27.2	25.3	22.1
Personal consumption expenditures	32.2	-3.8	14.5	18.8	24.8	20.0	19.4	17.7
Durable goods	6.6	-13.6	-1.0	2.0	5.0	4.0	3.0	3.0
Nondurable goods	13.2	1.0	7.0	8.8	11.3	8.0	8.4	6.7
Services	12.4	8.8	8.5	8.0	8.5	8.0	8.0	8.0
Residential fixed investment	-2.6	-6.6	-2.3	2.6	3.8	4.0	2.2	2.0
Business fixed investment	1.5	- .4	2.3	1.2	1.2	3.2	3.7	2.4
Government	7.9	6.9	7.3	5.5	7.4	9.6	8.5	7.9
Federal	2.9	2.5	2.8	.7	2.0	4.3	3.0	3.5
State and local	5.0	4.4	4.5	4.8	5.4	5.3	5.5	4.4
GNP in constant (1958) dollars	-4.0	-19.2	-10.6	-4.3	7.0	9.7	8.4	5.6
Final purchases	11.3	.4	6.5	8.0	10.0	9.5	8.7	7.9
Private	11.5	-2.0	5.7	8.4	10.3	8.8	8.3	7.5
	In Per Cent Per Year 1/							
Gross National Product	9.7	2.2	2.6	4.9	10.7	12.0	10.3	8.4
Final purchases	11.3	.4	6.5	8.0	10.0	9.5	8.7	7.9
Private	11.5	-2.0	5.7	8.4	10.3	8.8	8.3	7.5
Personal consumption expenditures	15.7	-1.7	6.6	8.5	11.1	8.6	8.2	7.3
Durable goods	22.0	-34.4	-3.2	6.7	17.2	13.0	9.4	9.2
Nondurable goods	14.8	1.0	7.4	9.2	11.6	7.9	8.1	6.3
Services	14.3	9.7	9.1	8.4	8.7	8.0	7.9	7.7
Gross private domestic investment	-10.9	-1.4	-23.8	-13.5	16.3	37.0	24.3	12.4
Residential structures	-19.7	-46.0	-21.3	30.9	43.9	42.0	19.8	17.0
Business fixed investment	4.1	-1.1	6.3	3.2	3.2	8.5	9.7	6.1
Gov't. purchases of goods and services	10.8	9.1	9.5	6.9	9.2	11.8	10.1	9.1
Federal	10.5	8.8	9.7	2.3	6.7	14.5	9.6	11.0
Defense	9.7	10.1	11.4	1.0	6.9	15.1	8.5	11.7
Other	12.2	6.3	6.2	5.1	6.1	13.3	11.8	9.5
State and local	10.9	9.3	9.3	9.7	10.8	10.3	10.4	8.1
GNP in constant (1958) dollars	-1.9	-9.0	-5.2	-2.1	3.6	5.0	4.2	2.8
Final purchases	- .4	-11.3	- .8	1.9	2.5	1.8	1.8	2.0
Private	- .5	-12.8	-1.5	2.4	2.7	2.0	1.9	1.9
GNP implicit deflator 3/	11.9	12.3 2/	8.2 2/	7.2	6.9	6.7 2/	5.9 2/	5.5
Private GNP fixed weighted index	13.8	10.4	7.9	7.2	6.9	6.1	5.8	5.6
Personal income	12.4	5.1	6.2	7.5	10.8	10.1	8.2	8.2
Wage and salary disbursements	9.9	2.4	4.8	7.1	8.8	10.8	9.5	8.8
Disposable income	11.5	4.6	6.2	17.8	10.3	- .7	8.5	8.2
Corporate profits before tax	62.8	-50.0	-14.3	-39.5	17.1	10.7	5.1	.0
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	21.2	-7.8	4.4	-30.5	2.4	70.7	11.2	5.6
Expenditures	19.2	10.4	15.4	6.8	15.5	10.8	8.0	7.5
Nonfarm payroll employment	1.6	-2.0	-3.5	-1.0	.5	.5	1.0	1.0
Manufacturing	- .4	-9.6	-17.1	-6.3	-2.2	.0	2.2	.0
Industrial production	-.1	-11.8	-8.8	-4.2	5.6	8.1	7.3	3.9
Housing starts, private	-64.7	-45.4	25.2	66.8	107.4	17.0	13.4	-24.7
Sales new autos	41.1	-70.8	6.7	14.0	44.7	25.7	24.1	.0
Domestic models	29.5	-74.2	13.9	6.6	47.7	31.8	29.5	.0
Foreign models	38.1	-46.1	-22.0	57.4	31.8	.0	.0	.0

1/ Percentage rates are annual rates compounded quarterly.
2/ Excluding Federal pay increases rates of change are: 1974-IV, 11.7 per cent; 1975-I, 8.0 per cent; 1975-IV, 6.0 per cent; and 1976-I, 5.7 per cent.
3/ Using expenditures in 1967 as weights.

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GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income figures are billions of dollars, with quarter figures at annual rates.)

	1969	1970	1971	1972	1973	1974	1975
						---Projected---	
Gross National Product	930.3	977.1	1054.9	1158.0	1294.9	1395.7	1475.4
Final purchases	922.5	972.6	1048.6	1149.5	1279.6	1382.2	1478.7
Private	712.5	753.1	814.4	893.8	1003.2	1074.2	1141.9
Excluding net exports	710.6	749.5	814.6	899.8	999.3	1071.9	1140.8
Personal consumption expenditures	579.5	617.6	667.1	729.0	805.2	877.1	943.5
Durable goods	90.8	91.3	103.9	118.4	130.3	128.0	126.5
Nondurable goods	245.9	263.8	278.4	299.7	338.0	379.8	411.3
Services	242.7	262.6	284.8	310.9	336.9	369.4	405.8
Gross private domestic investment	139.0	136.3	153.7	179.3	209.4	208.3	194.0
Residential construction	32.6	31.2	42.8	54.0	57.2	45.8	42.2
Business fixed investment	98.5	100.6	104.6	116.8	136.8	149.0	155.1
Change in business inventories	7.8	4.5	6.3	8.5	15.4	13.5	-3.3
Nonfarm	7.7	4.3	4.9	7.8	11.4	11.2	-3.3
Net exports of goods and services 1/	1.9	3.6	- .2	-6.0	3.9	2.2	1.2
Exports	55.5	62.9	65.4	72.4	100.4	140.6	147.5
Imports	53.6	59.3	65.6	78.4	96.4	138.3	146.3
Gov't. purchases of goods and services	210.0	219.5	234.2	255.7	276.4	308.1	336.7
Federal	98.8	96.2	97.6	104.9	106.6	115.7	125.1
Defense	78.4	74.6	71.2	74.8	74.4	77.8	84.1
Other	20.4	21.6	26.5	30.1	32.2	37.9	41.0
State & local	111.2	123.3	136.6	150.8	169.8	192.4	211.6
Gross national product in constant (1958) dollars	725.6	722.5	746.3	792.5	839.2	821.2	796.0
GNP implicit deflator (1958 = 100)	128.2	135.2	141.4	146.1	154.3	170.0	185.3
Personal income	750.9	808.3	864.0	944.9	1055.0	1149.5	1240.7
Wage and salary disbursements	509.7	542.0	573.0	626.8	691.7	750.8	800.2
Disposable income	634.4	691.7	746.4	802.5	903.7	978.7	1064.4
Personal saving	38.2	56.2	60.5	52.6	74.4	75.5	93.6
Saving rate (per cent)	6.0	8.1	8.1	6.6	8.2	7.7	8.8
Corporate profits & inventory val. adj.	79.8	69.2	78.7	92.2	105.1	104.7	93.4
Corporate profits before tax	84.9	74.0	83.6	99.2	122.7	140.9	118.8
Federal government receipts and expenditures, (N.I.A. basis)							
Recepits	197.3	192.0	198.5	227.2	258.5	291.6	291.0
Expenditures	189.2	203.9	220.3	244.7	264.2	297.4	336.0
Surplus or deficit (-)	8.1	-11.9	-21.9	-17.5	-5.6	-5.8	-45.1
High employment surplus or deficit (-)	8.8	6.2	2.6	-3.4	1.9	10.7	5.9
State and local government surplus or deficit (-), (N.I.A. basis)	.7	1.8	3.4	12.3	9.2	1.8	-2.0
Total labor force (millions)	84.2	85.9	86.9	89.0	91.0	93.3	94.5
Armed forces "	3.5	3.2	2.8	2.4	2.3	2.2	2.2
Civilian labor force "	80.7	82.7	84.1	86.5	88.7	91.1	92.3
Unemployment rate (per cent)	3.5	4.9	5.9	5.6	4.9	5.6	8.0
Nonfarm payroll employment (millions)	70.4	70.9	71.2	73.7	76.8	78.3	77.5
Manufacturing	20.2	19.3	18.6	19.1	20.1	20.0	18.4
Industrial production (1967 = 100)	110.7	106.7	106.8	115.2	125.6	124.3	119.3
Capacity utilization, mfg. (per cent)	86.5	78.3	75.0	78.6	83.0	79.0	72.8
Major materials (per cent)	90.0	86.2	85.3	89.6	93.0	87.4	75.6
Housing starts, private (millions, A.R.)	1.47	1.43	2.05	2.36	2.05	1.36	1.35
Sales new autos (millions, A.R.)	9.57	8.40	10.24	10.93	11.44	8.87	8.19
Domestic models	8.46	7.12	8.68	9.32	9.67	7.45	6.78
Foreign models	1.11	1.28	1.56	1.61	1.77	1.42	1.41

	1969	1970	1971	1972	1973	1974	1975
1/ Net exports of g. & s. (Bal. of Paymts.)	1.3	2.9	- .2	-6.0	4.4 2/	3.4 2/	2.9 2/
Exports	55.0	62.3	65.4	72.4	101.0 2/	142.9 2/	150.3 2/
Imports	53.6	59.4	65.6	78.4	96.6	139.5	147.4

2/ Includes shipments of military equipment and supplies to Israel which are not included in GNP exports; amounts are 1973, $.6 billion; 1974, $.325 billion; and 1975, $.150 billion.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1969	1970	1971	1972	1973	Projected 1974	Projected 1975
	--------------Billions of Dollars--------------						
Gross National Product	66.1	46.8	77.8	103.1	136.9	100.8	79.7
Inventory change	.7	-3.3	1.8	2.2	6.9	-1.9	-16.8
Final purchases	65.4	50.1	76.0	100.9	130.1	102.6	96.5
Private	55.0	40.6	61.3	79.4	109.4	71.0	67.7
Net exports	- .6	1.7	-3.8	-5.8	9.9	-1.7	-1.0
Excluding net exports	55.6	38.9	65.1	85.2	99.5	72.6	68.9
Personal consumption expenditures	43.3	38.1	49.6	61 8	76.2	71.9	66.4
Durable goods	6.8	.5	12.6	14.5	11.9	-2.3	-1.5
Nondurable goods	15.1	17.9	14.6	21.6	38.3	41.8	31.5
Services	21.4	19.9	22.2	26.1	26.0	32.5	36.4
Residential fixed investment	2.5	-1.4	11.6	11.2	3.2	-11.4	-3.6
Business fixed investment	9.7	2.1	4.0	12.2	20.0	12.2	6.1
Government	10.4	9.5	14.7	21.5	20.7	31.7	28.6
Federal	.0	-2.6	1.4	7.3	1.7	9.1	9.4
State and local	10.4	12.1	13.3	14.2	19.0	22.6	19.2
GNP in constant (1958) dollars	19.0	-3.1	23.8	46.2	46.7	-18.0	-25.2
Final purchases	18.7	- .4	-22.5	-44.4	43.0	-15.7	-14.2
Private	20.6	6.2	18.5	46.1	45.2	-16.8	-14.3
	--------------Per Cent Per Year 1/--------------						
Gross National Product	7.6	5.0	8.0	9.8	11.8	7.8	5.7
Final purchases	7.6	5.4	7.8	9.6	11.3	8.0	7.0
Private	8.4	5.7	8.1	9.7	12.2	7.1	6.3
Personal consumption expenditures	8.1	6.6	8.0	9.3	10.5	8.9	7.6
Durable goods	8.1	.6	13.8	14.0	10.1	-1.8	-1.2
Nondurable goods	6.5	7.3	5.5	7.7	12.8	12.4	8.3
Services	9.7	8.2	8 5	9.2	8.4	9.6	9.9
Gross private domestic investment	10.3	-1.9	12.8	16.7	16.8	- .5	-6.9
Residential structures	8.3	-4.3	37 2	26.2	5.9	-19.9	-7.9
Business fixed investment	10.9	2.1	4.0	11.7	17.1	8.9	4.1
Gov't purchases of goods & services	5.2	4.5	6.7	9.2	8.1	11.5	9.3
Federal	.0	-2.6	1.5	7.5	1.6	8.5	8.1
Defense	.1	-4.8	-4.6	5.1	- .5	4.6	8.0
Other	- .5	5.9	22.7	13.6	7.0	17.7	8.2
State and local	10.3	10.9	10.8	10.4	12.6	13.3	10.0
GNP in constant (1958) dollars	2.7	- .4	3.3	6.2	5.9	-2.1	-3.1
Final purchases	2.7	- .1	3.1	6.0	5.5	-1.9	-1.7
Private	3.7	1.1	3.9	6.7	6.5	-2.5	-2.1
GNP implicit deflator	4.8	5.5	4.6	3.4	5.6	10.2	9.0
Private GNP fixed weighted index 2/	4.7	4.8	4.3	3.3	6.3	11.4	8.9
Personal income	9.0	7.6	6.9	9.4	11.7	9.0	7.9
Wage and salary disbursements	9.6	6.3	5.8	9.3	10.4	8.5	6.6
Disposable income	7.3	9.0	7.9	7.5	12.6	8.3	8.8
Corporate profits before tax	-3.1	-12 8	13.0	18.7	23.7	14.8	-15.7
Federal Government receipts and expenditures (N.I.A. basis)							
Receipts	12.7	-2.7	3.4	14.5	13.8	12.8	-.2
Expenditures	4.2	7.8	8.0	11.1	8.0	12.6	13.0
Nonfarm payroll employment	3.7	.7	.4	3.5	4.2	2.0	-1.0
Manufacturing	2.0	-4.1	-4.0	2.8	5 0	- .5	-8.0
Industrial production	4.7	-3.6	.1	7.9	9.0	-1.0	-4.1
Housing starts, private	-2.7	-2.3	43.2	14.9	-13.2	-33.7	- .7
Sales new autos	- .6	-12.3	21.9	6.7	4.7	-22.5	-7.7
Domestic models	-1.8	-15.9	21.9	7 4	3.7	-23.0	-9.0
Foreign models	9.0	15.5	21.8	3.3	9.8	-19.8	- .7

1/ Percentage rates are annual rates compounded quarterly.
2/ Using expenditures in 1967 as weights.

DOMESTIC FINANCIAL SITUATION

<u>Summary</u>. After rising in late December, short-term interest rates declined sharply in the early weeks of 1975 and are currently about 1¼ to 2 percentage points below levels prevailing at the time of the last Committee meeting. The decline in rates reflected the ½ percentage point reduction in the discount rate, weak short-term credit demands, and a substantial decline in the Federal funds rate. The late December back-up in rates had developed as a result of market disappointment over the relatively small decline in the funds rate in the first two weeks after the December Committee meeting and because of unusually aggressive efforts of borrowers and lenders to improve the appearance of year-end financial statements. For banks, this took the form of record sales of short-dated CD's to increase deposit totals, reduced borrowings in the Federal funds market and from the Federal Reserve, and continued efforts to retard loan growth.

In line with the continued decline in real economic activity, business demands for short-term credit at banks and in the commercial paper market have moderated further, and the outstanding volume of such debt actually declined in December (seasonally adjusted). The moderation in part reflects business efforts to restructure balance sheets, with heavy borrowing in long-term markets replacing short-term financing. With consumer purchases of durables, especially automobiles, continuing to be sluggish, outstanding consumer credit has also declined. Expansion in outstanding mortgage debt outstanding continued to be quite weak.

Commercial banks in December reduced both their total loans and security holdings (end of month basis), although the daily average credit proxy rose at a 7.5 per cent annual rate. From the end of November to the end of December, Treasury deposits declined sharply, private demand deposits showed little net change, and time and savings deposits other than large CD's grew at a surprisingly slow rate. Partly to offset weakness in these deposits and partly for window-dressing purposes, banks increased their outstanding CD's over December by $6.5 billion--the largest increase on record. After the turn-of-the year, CD sales slowed markedly.

Thrift institution inflows continued to expand in December, with the new funds largely used to repay debt and build portfolio liquidity. Given the limited availability of new mortgage instruments, these institutions also were reported to be increasingly interested in buying mortgages from mortgage companies, and they have increased their purchases of GNMA-guaranteed mortgage-backed securities. Home mortgage rates have declined about 15 basis points in both the primary and secondary markets since the last FOMC meeting.

Bond yields have fluctuated in a narrow range since the December Committee meeting. The very large recent and prospective bond offerings of corporations and expectations of large Treasury cash needs are the major reasons why such rates have not declined significantly, despite the decline in short-term yields. Since the summer highs, short-term yields have declined from 3 to 5 percentage points, but the yield on high-grade corporate bonds is only a little over 1 percentage point below its peak and municipal bonds have declined only about 15 basis points on balance. While the tone of tax-exempt markets has improved recently, the market is still being adversely affected by the deteriorating financial position of State and local governments and the reduced rate of purchases by banks.

Outlook. The public sectors are expected to be large borrowers in the months ahead. Not only are State and local governments likely to step-up their short-term borrowing to cover widening deficits, but the Treasury's borrowing is projected to expand sharply. Including $2 billion already raised in early January, the staff now projects that Treasury borrowing from the beginning of the year to mid-April will total around $16 billion--about $5 billion above the volume expected at the time of the last Greenbook and about three times as large as the average of Treasury borrowing over similar periods of the last seven years. Treasury cash needs will remain large in the second quarter if the President's tax refund proposal is enacted.

With regard to private borrowers, corporate bond offerings are expected to continue to be substantial in the months ahead. On the other hand, mortgage formation is projected to moderate further as construction slows; consumer credit is expected to contract even more than in the fourth quarter; and long-term municipal offerings are expected to edge downward. Short-term business borrowing is likely to show only modest growth this quarter.

Commercial banks can be expected to continue facing credit demands from necessitous business borrowers that do not leave the alternative of capital or money market financing. But the net growth of business loans at banks will likely be modest as lending policies remain relatively tight, as credit demands abate with declines in economic activity, and as larger firms repay short-term debt from the proceeds of capital market financing. Moreover, banks do not appear anxious to increase their reduced participation in the long-term tax-exempt bond market. Thus, with bank credit demands easing and banks attempting to improve liquidity positions, issuance of CD's is likely to be on the slow side and banks probably will use a larger proportion of available funds to acquire Treasury issues and perhaps short-term tax-exempt notes.

Thrift institutions, with their savings inflows expanding and mortgages in short supply, can also be expected to acquire Treasury issues and repay debt over the next few months while their outstanding commitments to acquire mortgages expand. Given slack borrower demands, thrift instutions' efforts to make new lending commitments are likely to lead to further reductions in mortgage rates.

Despite the likely willingness and ability of banks and other financial institutions, as well as OPEC countries, to acquire a share of the Treasury's new offerings, the greatly increased size of the expected Treasury deficit will tend to retard declines in interest rates in the near-term and could well reverse the downtrend later this spring or summer. In addition, the sustained volume of corporate longer-term offerings also is likely to slow yield declines in bond markets, even if short-term rates continue their downtrend in the near-term.

INTERNATIONAL DEVELOPMENTS

Summary and outlook. The exchange value of the dollar has declined further in recent weeks. Since mid-September, when the decline began, the depreciation has amounted to about 5-1/2 per cent, bringing the depreciation from the May 1970 parity to about 19 per cent (on a weighted average basis). Probably the main factor in the recent weakness has been the sharp downturn in U.S. interest rates relative to those in other major countries, though some other countries are adopting somewhat easier monetary policies. There remains a striking contrast between the stronger foreign currencies -- especially the German mark and several other continental European currencies -- and sterling, the yen and the lira. Though there has been considerable intervention by Germany, and more recently by Switzerland, to moderate the appreciation of their currencies, sales of dollars to support the weaker currencies have been larger -- with the net effect of depressing the average rate of the dollar.

Resumption of gold purchases by U.S. citizens, and the Treasury auction on January 6, do not appear to have affected exchange markets significantly. There had been large U.S. imports of gold coins, and bullion for industry, throughout 1974, totaling over $1 billion for the year.

Bank lending to foreigners rose sharply in November to about $1.5 billion, accounted for mainly by the U.S. agencies of foreign banks. These agencies also reduced their foreign liabilities by about $2.3 billion in the month. However, this large net outflow in November by agencies of foreign banks was about offset by increased borrowing from abroad by other U.S. banks. In December banks' liabilities to private foreigners apparently continued to rise moderately, but weekly data for early January indicate that such liabilities were again being reduced. Very partial weekly data for December suggest that banks have increased further their claims on foreigners, and there may have been a resumption of large-scale borrowing by Japan and other oil-consuming countries preparing to meet their 1975 oil bills.

Sales of foreign bonds in the U.S. market were up in December because of large Canadian borrowings and in January the total of Canadian, World Bank, and other foreign issues will probably exceed $800 million. According to the latest data available, foreigners were net sellers of U.S. corporate securities in November.

Changes in official foreign holdings of U.S. assets continue to be dominated by OPEC investments, though they appear to have become somewhat erratic. In November OPEC direct placements in the United States amounted to about $1 billion, largely at the New York FRB; in December any increase would have been entirely at commercial banks, and the amount is still unknown.

A smaller than expected trade deficit was registered in November, with the trade deficit for October-November combined holding at about a $3 billion annual rate, compared to a $10.2

billion deficit rate in the third quarter. Both agricultural and other exports increased, while imports of fuels leveled off and other imports rose only moderately.

In foreign industrial countries the incoming data show a general weakening in economic activity and rising unemployment, with rates of price increase still high in most countries. Recognizing the severity of recessionary tendencies, and the potential impact of the very marked drop in U.S. activity, these countries are shifting gradually to more expansionary policies, but several, notably Japan and Italy, where inflation rates are high and improvement in the balance of payments is a prime objective, continue to be relatively restrictive.

In the period ahead the U.S. balance of payments will be responding to the sharp drop in domestic economic activity -- much sharper than is being experienced in most other industrial countries -- and shifts in relative interest rates. These developments should lead to somewhat smaller deficits in the goods and services balance than had been anticipated, and a small surplus is possible even if there is not a significant reduction in imports of fuel. However, this will perhaps be accompanied by a resumption of larger than usual net private capital outflows as countries position themselves to deal with oil and other deficits in the year ahead.