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Confidential (FR) Class II FOMC

Part 2

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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

CONFIDENTIAL (FR)

February 12, 1975

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

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DOMESTIC NONFINANCIAL SCENE

SELECTED DOMESTIC NONFINANCIAL DATA
AVAILABLE SINCE PRECEDING GREENBOOK
(Seasonally adjusted)

	Latest Data			Per Cent Change From		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year Earlier
				(At Annual Rates)		
Civilian labor force	Jan.	2-7-75	92.1	3.8	1.1	1.8
Unemployment rate (per cent)	Jan.	2-7-75	8.2	7.2 1/	6.0 1/	5.2 1/
Insured unemployment rate (%)	Jan.	2-7-75	5.5	4.8 1/	3.6 1/	3.1 1/
Nonfarm employment, payroll (mil.)	Jan.	2-7-75	77.3	-6.8	-8.0	- .8
Manufacturing	Jan.	2-7-75	18.7	-28.1	-25.4	-7.6
Nonmanufacturing	Jan.	2-7-75	58.6	.2	-2.0	1.6
Private nonfarm:						
Average weekly hours (hours)	Jan.	2-7-75	36.1	36.4 1/	36.6 1/	36.7 1/
Hourly earnings ($)	Jan.	2-7-75	4.40	2.7	4.6	8.6
Manufacturing:						
Average weekly hours (hours)	Jan.	2-7-75	39.1	39.4 1/	40.1 1/	40.4 1/
Unit labor cost (1967=100)	Dec.	1-31-75	137.9	-2.6	7.7	10.0
Industrial production (1967=100)	Jan.	1-14-75	113.7	-42.7	-35.6	-9.3
Consumer goods	Jan.	1-14-75	119.8	-34.1	-26.2	-7.3
Business equipment	Jan.	1-14-75	121.1	-55.7	-33.0	-4.5
Defense & space equipment	Jan.	1-14-75	83.6	-4.3	-2.4	2.7
Materials	Jan.	1-14-75	111.5	-49.5	-51.8	-14.0
Consumer prices (1967=100)	Dec.	1-21-75	155.4	7.9	9.8	12.2
Food	Dec.	1-21-75	170.4	8.5	13.8	12.2
Commodities except food	Dec.	1-21-75	143.5	5.0	7.1	13.3
Services 2/	Dec.	1-21-75	160.0	10.6	10.5	11.3
Wholesale prices (1967=100)	Dec.	1-15-75	172.6	-5.9	12.8	21.0
Industrial commodities	Dec.	1-15-75	166.5	.0	7.9	25.6
Farm products & foods & feeds	Dec.	1-15-75	188.6	-29.8	20.3	11.0
Personal income ($ billion) 3/	Dec.	1-15-75	1189.7	5.3	4.0	7.5
				(Not at Annual Rates)		
Mfrs. new orders dur. goods ($ bil.)	Dec.	1-31-75	37.9	-12.1	-18.2	-7.5
Capital goods industries	Dec.	1-31-75	11.8	-9.3	-12.9	-5.1
Nondefense	Dec.	1-31-75	10.1	-4.8	-14.6	-7.6
Defense	Dec.	1-31-75	1.7	-29.6	-1.3	14.2
Inventories to sales ratio:						
Manufacturing and trade, total	Nov.	1-15-75	1.60	1.54 1/	1.48 1/	1.44 1/
Manufacturing	Dec.	1-31-75	1.88	1.71 1/	1.66 1/	1.62 1/
Trade	Nov.	1-15-75	1.48	1.43 1/	1.32 1/	1.33 1/
Ratio: Mfrs.' durable goods inventories to unfilled orders	Dec.	1-31-75	.752	.722 1/	.687 1/	.723 1/
Retail sales, total ($ bil.)	Jan.	2-10-75	45.1	.9	-16.3	4.9
GAF	Jan.	2-10-75	11.4	- .2	-2.8	.5
Auto sales, total (mil. units) 3/	Jan.	2-5-75	8.1	12.5	1.0	-13.5
Domestic models	Jan.	2-5-75	6.6	8.6	2.9	-14.1
Foreign models	Jan.	2-5-75	1.5	33.8	-6.9	-10.7
Housing starts, private (thous.) 3/	Dec.	1-17-75	868	-12.3	-24.5	-38.1
Leading indicators (1967=100)	Dec.	1-31-75	160.3	-2.4	-7.2	-3.2

1/ Actual data. 2/ Not seasonally adjusted. 3/ At annual rate.

DOMESTIC NONFINANCIAL DEVELOPMENTS

Economic activity has weakened substantially further over recent months. In January production and employment again fell sharply and the unemployment rate rose to a record postwar level. It is now clear that we are experiencing the most severe recession since before World War II. However, the outlook for an upturn in economic activity later this year has been enhanced by indication of a more active fiscal policy. In addition, there continues to be improvement evident on the inflation front, with recent data pointing toward further moderation in both wage and price pressures.

In January, the index of industrial production is tentatively estimated to have fallen by 3.6 per cent, following the 3.1 per cent (revised) cut in December. Since its recent September high, industrial production has been reduced by nearly 10 per cent. Declines in output were widespread among final products and materials, including consumer durable and nondurable goods, business equipment, and in construction products. Auto assemblies were reduced 10 per cent further to a seasonally adjusted annual rate of 4.8 million units comparedto a 5.4 million unit rate in December, and they are not scheduled to rise much above this rate for the balance of the quarter.

Production curtailments also occurred in most materials industries, with sizable cutbacks indicated in chemicals, paper, textiles, and steel. Capacity utilization in major materials industries again declined sharply to an estimated 71.5 per cent in January, a drop of 23 percentage points since its peak in July 1973.

The deterioration of the labor market continued at a rapid pace in January as the unemployment rate jumped a full percentage point to 8.2 per cent, with increases among all labor force groups. The number of persons working part-time for economic reasons also rose substantially further and the duration of unemployment lengthened markedly. Although total employment dropped sharply, the divilian labor force increased by 300,000 after four months of little change. Women and teenagers accounted for all of this growth.

Nonfarm payroll employment dropped 440 thousand in January following the huge 1.1 million decline over the two previous months--the sharpest three month contraction in the postwar period. Employment cutbacks were again concentrated in manufacturing where they were widespread among durable and nondurable goods industries--reducing factory jobs 1.5 million below a year ago.

Auto sales have responded to the temporary rebate program, with sales of domestic units for January now estimated at 6.6 million, annual rate, up from 6.1 million units in December, but still well below the depressed level of January a year ago. Sales increased markedly to a 7.4 million unit rate in the last 10 days of January, when the rebate program was in full effect. Sales of foreign autos increased to a 1.5 million unit annual rate in January, up from a 1.1 million rate in December. The rebate program was particularly geared to small domestic cars where excess supply has been greatest. In response, January sales of small cars were 38 per cent above the December level, while large car sales fell 6 per cent.

Retail sales ex autos and nonconsumer items rose by 0.8 per cent in January--probably little changed in real terms from December. Most of the current dollar increase was in the nondurable sector, particularly in food and gasoline. However, furniture and appliances were down sharply.

Some near term stimulus to consumer sales may be provided by rebate plans recently announced by some appliance manufacturers. Additionally, auto finance companies have been offering longer term maturities and a number of commercial banks have recently announced reductions in new car loan rates--generally described as temporary in conj"nction with the rebate plans offered by auto manufacturers.

There have been further indications of declining business demand that affect the near-term outlook for activity. Total new orders for durable goods fell 12.1 per cent in December (p)(not at an annual rate). Except for a steel-strike-affected month in 1956, the December drop was the largest in more than 20 years. This was the fourth consecutive month of decline, and these orders are now down by almost a quarter from their August 1974 peak.

The outlook for capital spending has also continued to deteriorate. Constant dollar orders for nondefense capital goods dropped 6.5 per cent in December (p); for the fourth quarter the decline was 19.4 per cent (also not at an annual rate). Unfilled orders also decreased further in December for both total durables as well as nondefense capital goods. Floor space contracted for commercial and industrial buildings fell 7 per cent further in December to a level 46 per cent below its 1973 peak--a much sharper erosion than the 29 per cent drop that occurred in the 1957-58 recession.

Finally, the price assumptions of respondents to the November-December Commerce plant and equipment survey imply a decline in real plant and equipment outlays in the vicinity of 8 per cent for 1975 as a whole. Prices of new construction and capital goods purchased were expected to rise by about 13 per cent in 1975, but current dollar outlays were expected to increase by only about 4½ per cent.

In December, the book value of manufacturers' inventories rose at a $35.1 billion annual rate, only slightly below the third quarter rate of accumulation. But continued production cutbacks and some reductions in prices at retail should have begun to cut excess stocks in January. Auto inventories were reduced somewhat during January from their record year-end levels, but there is no direct evidence as yet on other industries.

Private housing starts may have hit their low at a seasonally adjusted annual rate of 990,000 units in the fourth quarter. The volume of new mortgages commitments is now rising, additional Federal subsidy support has been announced, and the decline in mortgage interest rates has accelerated. Other factors improving the outlook for housing starts include the elimination of materials shortages, some softening in prices of construction materials and land, and a further improvement in markets for modern rental units in some areas of the country. However, the response to these developments will likely be limited in the near term not only due to the usual lags, but also due to the exceptionally large inventory of completed and uncompleted housing units of all types. Also, field reports to date indicate continued buyer resistance, due mainly to the relatively high mortgage rates which still prevail in most areas as well as economic uncertainties.

Recent data appear to confirm an easing of wage pressures. In the fourth quarter, private nonfarm compensation per manhour increased at a 9.1 per cent annual rate, down from 10.2 per cent and 11.3 per cent in the two previous quarters. However, with the continued record decline in nonfarm productivity in the fourth quarter, unit labor costs again rose sharply.

The average hourly earnings index for private nonfarm production workers rose at an annual rate of 6.8 per cent in January, well under the 9.7 per cent rate of the fourth quarter. Moderation was most evident in manufacturing as wages climbed sharply in services, construction and trade.

Although most prices continued to rise at rapid rates, available data through December indicate easing of inflationary pressures at both the wholesale and retail levels. More recent data for January suggest further moderation of farm prices. In addition, discounting and other price concessions at both wholesale and retail have been widely reported.

The wholesale price index has shown a significant improvement recently, declining at a 6 per cent annual rate in December. The industrial commodities component, which had shown a marked deceleration in the rate of increase in October and November, was unchanged in December--the first break in the upward trend in over two years. Lower prices were widespread among the farm and food products group.

Reduced demand and slowing of prices at wholesale have resulted in some moderation in consumer price increases. Most non-food commodity groups showed smaller rates of increase in December and lower prices were reported for apparel and fuel. However, service costs continued to climb rapidly with substantial increases for gas and electricity, medical services and for public transport. Food prices, while rising quite rapidly, showed the smallest increase in 5 months in December. Recent declines in wholesale prices for sugar and sugar-based products, fats and oil should soon be reflected in the retail price index.

Rebates to consumers on auto purchases, announced in January will be reflected to some extent in the January CPI but will have a larger impact on February data. Since an unusually large proportion of 1974 models cars were sold in December, the shift in mix toward 1975 models will tend to raise the January new car component and may offset the impact of the rebates in that month.

The staff is currently expecting the Federal budget to show significantly larger deficits in FY 75 and FY 76 than was thought likely a month ago, as spending estimates have been revised upward and receipts estimates downward. A detailed reconciliation of the staff's current projections with those contained in the Administration's budget is presented in Appendix A in conjunction with a general review of the budget.

In light of Congressional resistance, we continue to omit the various components of the President's energy program from our projections. But we now assume enactment of the tax reduction proposals tentatively adopted by the House Ways and Means Committee. Altogether, this involves a tax reduction of $20.2 billion in 1975, or about $4.0 billion more than the President's proposal. The Ways and Means Committee proposes an $8.0 billion tax rebate on calendar year 1974 personal tax liabilities--which would be paid around mid-year--and an $8.4 billion cut in 1975 personal withholding, concentrated in the last half of the year. Corporate taxes would be reduced by $3.8 billion, mainly in the form of an increase in the investment tax credit to 10 per cent, and partly by way of an extension of the 22 per cent tax rate to the first $50,000 (rather than $25,000) of corporate profits. We have assumed that these tax cuts, apart from the rebate, will continue in 1976. In addition to different assumptions on tax revisions, we have also lowered our receipts projections because of the weaker economy now projected.

On the spending side, we now expect that outlays (NIA basis, at annual rates) will be about \$13½ billion higher in the last half of the current fiscal year and \$15 billion higher in fiscal year 1976, than assumed in the last Greenbook. These upward revisions are based on a detailed examination of spending projected in the new Budget Document, as well as on an assessment that only about \$6 billion out of the \$17 billion of spending cuts proposed by the President will receive Congressional approval. In addition, larger outlays are being projected in response to the weaker outlook--particularly for unemployment compensation and other transfers. Most of this expected increase in transfer payments represents a cushioning of income losses in the private economy rather than new Federal spending initiatives. Increases in expected fiscal year 1976 outlays include higher levels for Federal purchases (\$3 billion), transfer payments (\$8 billion) and grants and interest payments on the growing debt (\$4 billion).

On a High Employment Budget basis, fiscal policy is expected to move in the direction of greater fiscal stimulus. The full employment budget shows a shift from a CY'74 surplus of approximately \$21 billion to a \$10 billion deficit in CY '75.*

* The Staff's calculation of the high-employment budget now includes actual and projected inventory profits in the corporate tax base. Formerly, only "normal long-run" inventory gains had been incorporated. The new treatment more accurately differentiates actual and high-employment receipts because the taxes actually paid on extraordinary inventory profits now appear in the high-employment measure as well. About \$5 billion of the shift between CY '74 and CY '75 in the full-employment budget reflects movement toward lower inventory profits.

Table 1

SELECTED UNEMPLOYMENT RATES
(Seasonally adjusted)

	1974			1975
	January	July	December	January
Total	5.2	5.3	7.2	8.2
Men 20 years and over	3.4	3.5	5.3	6.0
Women 20 years and over	5.1	5.2	7.2	8.1
Teenagers	15.5	16.2	18.1	20.8
Household heads	2.9	3.0	4.6	5.2
White	4.7	4.8	6.4	7.5
Negro and other races	9.2	9.4	12.5	13.4
White collar workers	3.2	3.3	4.1	4.6
Blue collar workers	5.9	6.1	9.3	11.0

Table 2

CHANGES IN NONFARM PAYROLL EMPLOYMENT

	Employment (Jan. 1975)	Average Monthly Change Dec. 1974-Jan. 1975	July 1974-Jan. 1975	Jan. 1974-Jan. 1975
Total nonfarm	77,295	-438	-197	-53
Goods-producing	23,212	-407	-259	-150
Construction	3,803	+3	-20	-25
Manufacturing	18,711	-448	-243	-129
Service-producing	54,083	-31	+61	+97
Trade	16,876	-57	-39	+2
Services	13,769	+41	+42	+44
State and local government	11,880	+20	+62	+48

Table 3

NEW ORDERS FOR DURABLE GOODS
(Percentage change from previous period)

	Total Durables	Motor Vehicles and Parts	Primary Metals	Household Durables	Nondefense Capital Goods
1974:QIII	4.3	20.5	6.0	-7.0	2.0
QIV p	-12.1	-14.0	-17.5	-1.8	-11.9
1974:July	1.8	16.1	-6.1	-1.9	6.6
Aug.	3.7	3.5	14.7	-1.6	-7.8
Sept.	-6.2	-3.2	-14.0	- .2	.2
Oct.	-2.8	-3.1	-2.7	5.3	-3.8
Nov.	-4.2	-8.7	-6.1	-7.2	-6.7
Dec. p	-12.1	-14.8	-19.5	-4.4	-4.8

Table 4

INVENTORY RATIOS

	1973		1974	
	Nov.	Dec.	Nov.	Dec. (p)
Inventory to sales				
Manufacturing and trade	1.44	1.49	1.59	n.a.
Manufacturing, total	1.55	1.62	1.71	1.88
Durable	1.89	2.01	2.14	2.39
Nondurable	1.16	1.18	1.24	1.34
Trade, total	1.33	1.36	1.48	n.a.
Wholesale	1.13	1.13	1.24	1.22
Retail	1.49	1.54	1.68	n.a.
Inventories to unfilled orders				
Durable manufacturing	.717	.723	.722	.752

Table 5

BUSINESS INVENTORIES
(Change at annual rates in seasonally adjusted
book values, $ billions)

	1974				
	QII	QIII	QIV(p)	Nov.	Dec.(p)
Manufacturing and trade	42.8	59.2	n.a.	42.9	n.a.
Manufacturing	28.2	37.7	28.3	24.9	35.1
Durable	17.4	23.3	17.8	13.3	22.1
Nondurable	10.8	14.5	10.6	11.6	13.0
Trade, total	14.7	21.4	n.a.	18.0	n.a.
Wholesale	7.7	8.6	5.9	6.8	-2.8
Retail	7.0	12.8	n.a.	11.1	n.a.
Auto	-1.0	4.0	n.a.	12.1	n.a.

Table 6

NEW HOUSING UNITS
(Seasonally adjusted annual rates, in millions of units)

	1970 1/	1974				Per cent change in December from:	
	QI	QIII	QIV	Nov. (r)	Dec. (p)	Month ago	Year ago
Permits	1.10	.91	.77	.73	.80	+ 10	- 38
Starts	1.24	1.21	.99	.99	.87	- 12	- 38
1-family	.69	.87	.75	.79	.68	- 14	- 12
2- or more-family	.55	.34	.24	.20	.19	- 6	- 70
Under construction 2/	.89	1.37	n.a.	1.26	n.a.	- 5 3/	- 24 3/
Completions	1.41	1.56	n.a.	1.62	n.a.	- 2 3/	- 17 3/
MEMO:							
Mobile home shipments	.37	.36	.23	.22	.22	- 1	- 53

1/ Previous cyclical trough.
2/ Seasonally adjusted, end of period.
3/ Per cent changes based on November.

Table 7

HOURLY EARNINGS INDEX*
(Seasonally adjusted; per cent change, annual rates)

	Dec. 1974-Jan. 1975	July 1974-Jan. 1975	Jan. 1974-Jan. 1975
Total private nonfarm	6.8	9.5	9.6
Manufacturing	6.2	9.8	10.5
Mining	13.9	12.6	12.9
Trade	10.0	8.3	9.3

* Excludes the effects of fluctuations in overtime premium in manufacturing and shifts of workers between industries.

Table 8

PRICE BEHAVIOR
(Percentage changes, seasonally adjusted annual rates)1/
CONSUMER PRICES

	Relative importance Dec. 1973	Dec. 1973 to Dec. 1974	Dec. to June 1974	June to Sept. 1974	Sept. to Dec. 1974	Nov. to Dec. 1974
All items	100.0	12.2	12.3	14.2	10.1	7.9
Food	24.8	12.2	10.9	12.3	14.6	8.5
Commodities (nonfood)	38.6	13.2	14.9	16.2	7.3	5.0
Services	36.6	11.3	10.1	13.9	10.9	10.6
Addendum						
All items less food and energy 2/3/	68.8	11.3	10.2	15.3	9.6	6.5
Petroleum products 2/	4.0	22.8	58.8	-4.1	-5.9	-3.5
Gas and electricity	2.4	19.6	22.0	20.2	14.2	19.5

WHOLESALE PRICES

	Relative importance Dec. 1973	Dec. 1973 to Dec. 1974	Dec. to June 1974	June to Sept. 1974	Sept. to Dec. 1974	Nov. to Dec. 1974
All commodities	100.0	20.9	18.2	35.2	13.4	-5.9
Farm and food products	31.7	11.0	-11.5	59.2	21.9	-29.8
Industrial commodities 4/	68.3	25.6	34.0	28.3	8.2	0.0
Materials, crude and intermediate	43.5	28.1	38.7	31.7	6.3	-.7
Finished goods:						
Consumer nonfoods	17.6	20.5	26.8	18.5	10.6	4.9
Producer	8.5	22.6	20.0	31.8	18.7	6.2
Consumer foods	14.3	13.0	-1.1	29.4	29.1	-14.7

1/ Not compounded for one-month changes.
2/ Confidential -- not for publication.
3/ Energy items excluded: gasoline and motor oil, fuel oil and coal, and gas and electricity
4/ Stage of processing components do not add to the total because they include some items found in farm and food products group.

TABLE 9
FEDERAL BUDGET AND FEDERAL SECTOR IN NATIONAL INCOME ACCOUNTS
(In billions of dollars)

	Fiscal 1975e/		Fiscal 1976e/		Calendar Years		F.R.B. Staff Estimates Calendar Quarters				
	Budget Document	F.R. Board	Budget Document	F.R. Board	1974 Actual	1975 F.R.B. e/	1974 IV*	1975 I	II	III	IV
Federal Budget							Unadjusted data				
Surplus/deficit	-34.7	-37.0	-51.9	-77.7	-10.9	-65.0	-12.0	-17.8	-5.7	-18.5	-23.0
Receipts	278.8	280.1	297.5	278.9	280.5	269.5	66.8	64.2	76.0	65.5	63.8
Outlays	313.4	317.1	349.4	356.6	291.4	334.5	78.9	82.0	81.7	84.0	86.8
Means of financing.											
Net borrowing from the public	43.5	47.2	63.5	87.2	11.8	79.7	10.3	18.5	13.9	21.1	26.2
Decrease in cash operating balance	3.1 2/	3.2	-.4 2/	--	4.5	.9	2.8	1.4	-1.5	1.0	--
Other 1/	-11.9 2/	-13.4	-11.2 2/	-9.5	-5.4	-15.7	-1.1	-2.1	-6.8	-3.6	-3.2
Cash operating balance, end of period	6.0 2/	6.0	6.4 2/	6.0	5.9	5.0	5.9	4.5	6.0	5.0	5.0
Memo: Sponsored agency borrowing 3/	14.0	12.3	7.8	n.e.	7.7	n.e.	3.4	.1	1.1	n.e.	n.e.
National Income Sector							Seasonally adjusted annual rates				
Surplus/deficit	-36.1	-37.8 4/	-55.9	-77.3 4/	-7.4 e/	-74.5	-21.8 e/	-49.0	-74.3	-95.2	-79.4
Receipts	287.6	288.1 4/	305.1	290.9 4/	291.3 e/	275.9	295.5 e/	286.5	269.9	260.3	286.8
Expenditures	323.7	325.9	361.0	368.2	298.6	350.4	317.3	335.5	344.2	355.5	366.2
High Employment surplus/deficit (NIA basis) 2/5/	n.a.	11.8	n.a.	-12.3	20.8	-10.4	19.4	8.3	-8.3	-25.6	-16.0

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

1/ Outlays of off-budget Federal agencies, checks issued less checks paid, accrued items, and other transactions.
2/ Estimated by F.R. Board Staff.
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 \$.9 billion for fiscal 1976 due to spreading of wage base effect over calendar year.
5/ As discussed in a footnote in the text, the high-employment budget estimates now fully incorporate taxes on inventory profits beginning in 1973.

DOMESTIC FINANCIAL SITUATION

III-T-1

SELECTED DOMESTIC FINANCIAL DATA

(Dollar amounts in billions)

Indicator		Latest data Period	Level	Net change from Month ago	Three months ago	Year ago
Monetary and credit aggregates				SAAR (per cent)		
Total reserves		January	37.0	10.2	9.7	6.6
Reserves available (RPD's)		January	34.5	1.8	9.0	8.5
Money supply						
M1		January	281.5	-9.7	-.3	3.9
M2		January	615.3	2.7	4.9	6.9
M3		January	958.9	5.1	6.2	6.5
Time and savings deposits (Less CDs)		January	333.8	13.4	9.4	9.6
CDs (dollar change in billions)		January	92.9	2.6	6.7	26.5
Savings flows (S&Ls + MSBs)		January	343.6	9.5	8.3	5.7
Bank credit (end of month)		January	690.7	12.8	-.2	7.5
Market yields and stock prices			Percentage or index points			
Federal funds	wk. endg.	2/5/75	6.46	-1.24	-3.17	-2.67
Treasury bill (90 day)	"	2/5/75	5.62	-1.06	-2.14	-1.54
Commercial paper (90-119 day)	"	2/5/75	6.60	-1.83	-2.40	-1.65
New utility issue Aaa	"	2/7/75	8.90	-.72	-.10	.77
Municipal bonds (Bond Buyer)	1 day	2/6/75	6.34	-.74	-.32	1.18
FNMA auction yield (FHA/VA)		2/10/75	8.98	-.39	-.95	.45
Dividends/price ratio (Common stocks)	wk. endg.	1/31/75	4.79	-.58	-.24	1.14
NYSE index (12/31/65=50)	end of day	2/4/75	41.26	3.91	2.73	-8.66

Credit demands		Net change or gross offerings: Current month 1974	Current month 1973	Year to date 1974	Year to date 1973
Consumer instalment credit outstanding	December	-.8	.4	8.7	20.1
Mortgage debt outst. (major holders)	November	2.3	4.0	40.9	53.5
		1975	1974	1975	1974
Business loans at commercial banks	January	1.1	2.1	1.1	2.1
Corporate bonds (public offerings)	January	3.7e	2.1	3.7e	2.1
Municipal long-term bonds (gross offerings)	January	2.1e	2.3	2.1e	2.3
Federally sponsored Agcy. (net borrowings)	January	5.7	-2.9	5.7	-2.9
U.S. Treasury (net cash borrowing)	February	3.2e	-.2	6.8e	-.9
Total of above credits		17.3	7.8	69.0	76.3

e - Estimated

DOMESTIC FINANCIAL DEVELOPMENTS

In recent weeks, downward pressures on interest rates were sustained by indications of further easing in monetary policy and continued moderation of short-term credit demands. Since the January meeting, the Federal funds rate has declined more than 75 basis points, while most other short-term rates have fallen 50 to 100 basis points. The continued easing in short-term markets contributed to moderate declines in long-term yields after mid-January--the first significant decline in such rates since November. The reduction in long rates occurred despite an unusually large volume of public and private bond offerings, as corporations financed capital expenditures and restructured their debt and governments sought to finance expanding deficits. Upward rate pressures on Treasury issues resulting from the Administration's projection of exceptionally large Federal borrowing were more than compensated for by the general easing in money markets and strong demands for high quality instruments. Accompanying the improvement in debt markets, stock prices have moved considerably higher in recent weeks, with volume at record levels.

M_1 declined in January as transactions demands for money contracted sharply further, along with the marked slowdown in economic activity. But M_2 and M_3 expanded at modest rates, buoyed by growth in interest-bearing consumer-type deposits. With deposit inflows continuing strong at nonbank financial institutions and demands for home mortgage credit limited, declines in mortgage market interest rates accelerated in January and early February.

SELECTED SECURITY MARKET QUOTATIONS

	Aug. FOMC Aug. 20	Dec. FOMC Dec. 17	Dec. 30	Jan. FOMC Jan. 21	Feb. 4	Feb. 11
			(Per cent)			
Short-term						
Federal funds (weekly average)	12.23	8.72	7.35	7.17	6.46	6.27 2/
Treasury bills						
3-month	9.05	6.77	7.11	6.24	5.60	5.70
6-month	9.13	6.90	7.08	6.24	5.61	5.72
1-year	8.86	6.57	6.70	6.25	5.56	5.61
Commercial paper						
1-month	12.00	9.50	9.75	7.00	6.63	6.38
3-month	11.88	9.25	9.38	7.00	6.63	6.38
Large neg. CD's 1/						
3-months	12.35	9.15	9.25	7.00	6.55	6.50
6-months	12.15	8.63	8.75	7.15	6.65	6.50
Federal agencies						
1-year	9.65	7.38	7.64	7.11	6.58	n.a.
Bank prime rate	12.00	10.50	10.50	9.75	9.25	9.00
Long-term						
Corporate						
New AAA	10.26	9.51	--	9.45	9.00	8.90p
Recently offered	10.28	9.59	9.67	9.47	9.21	9.08p
Municipal (Bond Buyer)	6.73	7.08	7.08	6.59	6.54	6.34
U.S. Treasury (20-year constant maturity)	8.58	7.82	7.92	7.80	7.70	n.a.
			(Index points)			
Stock prices						
Dow-Jones	726.85	597.54	603.25	641.90	711.44	707.60
N.Y.S.E.	39.32	35.58	35.35	37.71	44.54	41.77

1/ Highest quoted new issues.
2/ Average for first 6 days of statement week ending February 5.
p/ Preliminary.

Short-term markets. Since the last Committee meeting, most short-term interest rates have fallen 50 to 100 basis points, continuing the sharp downtrend in such rates since year-end. Recent declines have brought private market rates 2-1/2 to 3 percentage points below year-end levels, while yields on Treasury bills have fallen close to 1-1/2 percentage points. The most recent declines are attributable to the continuation of weak demands for short-term credit accompanied by further indications of monetary easing--including continued declines in the Federal funds rate, the cut in reserve requirements announced January 20, and the further reduction in the discount rate to 6-3/4 per cent. In response to the sharp drop in money market rates and the weakness in loan demand, most large banks have lowered their prime rates to 9 per cent.

Interest rates in the Treasury bill and other short-term markets were not noticeably affected by the Administration's announcement of projected large Federal borrowing over the remainder of fiscal 1975 and in fiscal 1976. Although the Treasury recently has resumed and enlarged its additions to the regular weekly and monthly bill auctions to the $300-$400 million range, any upward rate pressures associated with this increase in supply apparently were offset by the general easing in money market conditions and strong demand for Treasury issues, particularly from foreign official accounts and quality-conscious investors. Foreign official accounts, using oil proceeds and dollars acquired in foreign exchange market intervention, made net purchases of close to $2.2 billion of bills between mid-January and mid-February, an amount slightly larger than net new issues by the Treasury during this period.

Long-term markets. Rate reductions in corporate bond markets have been substantial. For example, yields on new- and recently-offered Aaa utilities have decreased approximately one-half percentage point since the last meeting, in the face of corporate bond offerings during January that totaled almost $3.7 billion, the second highest monthly total on record. In addition, over $400 million of non-corporate Canadian and international issues were sold publicly, boosting the combined total to $4.1 billion.

Approximately three-fifths of the new-issue calendar in January were issues of industrial corporations, with utilities accounting for the remainder. Telephone issues dominated the utility sector, in large part reflecting a $600 million financing by AT&T, postponed from last November.

SECURITY OFFERINGS
(Monthly or monthly averages, in millions of dollars)

	1974			1975		
	Year e/	QIII	QIV e/	Jan. e/	Feb. f/	Mar. f/
			Gross offerings			
Corporate securities:						
Total	3,159	2,504	3,981	5,255	3,870	4,575
Public bonds	2,112	1,675	2,874	3,657	2,500	3,000
Privately placed bonds	513	397	506	900	800	1,000
Stocks	534	432	601	698	570	575
State and local gov't securities						
Long-term	1,894	1,400	1,958	2,050	2,000	2,300
Short-term	2,454	2,383	2,474	2,100	2,300	2,600
			Net offerings, total			
U.S. Treasury 1/	982 2/	1,499	3,433 2/	3,600	3,200	11,700
Sponsored Federal agencies	1,399	2,552	1,133	567	-1,206	482

e/ Estimated.
f/ Forecast.
1/ Includes Federal Financing Bank.
2/ Actual.

Although the tone of bond markets has improved in recent months, the worsening economic contraction has led investors to show an increasing preference for high quality issues. Consequently, yield spreads between high- and low-rated issues have widened. Seasoned corporate bonds carrying A or Baa ratings are currently posting yields that are 90 to 180 basis points, respectively, above Aaa rated issues--spreads significantly larger than 1969-1973 averages. Also, while investors are willing to lengthen the maturity of their portfolios, their preference has been for intermediate- rather than long-term securities; over half the bonds issued in January carried maturities of 15 years or less, compared to approximately 30 per cent in 1974.

Municipal markets also have improved substantially since mid-January with yields declining 40 to 50 basis points. Municipal bond underwriters attribute the recent price rally in part to increased demand by municipal bond funds, selected casualty insurance companies, and some regional banks. In addition, the market regained a firmer tone following abatement of New York City's financial problems which surfaced in early December. Moreover, with long-term rates substantially higher than short-term rates, State and local governments are continuing to rely heavily on short-term financing.

CORPORATE BOND YIELD SPREADS
(Monthly averages in basis points)

Period	A less Aaa	Baa less Aaa
1969 - 1973:		
Average	48	95
High	84	148
Low	28	64
1974:		
July	63	83
August	61	77
September	66	88
October	83	114
November	97	158
December	87	164
1975:		
January	92	179

The easing in short-term credit markets contributed to a slow, steady firming in the Treasury coupon market. Since the January FOMC meeting, Treasury coupon yields have fallen 10 to 20 basis points, despite the current and prospective supply pressures generated by the mid-February refunding and the exceptionally heavy Treasury net borrowing expected over the next 18 months. In the February refunding, three new coupon issues totaling $5.6 billion were offered to refinance the $3.6 billion of maturing issues and raise $2.0 billion of new money. These issues attracted strong interest, as dealers distributed their initial holdings at steadily rising prices. All three issues are now trading well above average auction prices.

Projected financing by the Treasury for the second half of fiscal 1975 has been revised upward to $32 billion. The revision reflects an increase in FRB staff estimates of the Treasury's deficit in fiscal 1975 from $34 to $37 billion and a large increase in borrowing necessary to finance various off-budget agencies. Close to $6 billion of the second-half total has already been raised, and another $18 billion will be needed by mid-April. The remainder of the needed funds will likely be obtained through auctions designed to tap all maturity areas of the Treasury market. Partly offsetting the heavy Treasury borrowing, it now appears that sponsored agencies will raise only $1 billion in net new money over the remainder of the current fiscal year, compared to $1.8 billion per month in the second half of 1974.

Stock prices have advanced substantially in recent weeks, and volume has surged to record levels. From January 6 to February 3, NYSE issues advanced about 12 per cent while AMEX and NASDAQ issues moved up 19 and 16 per cent, respectively. Most of the advance occurred in the final week of January, when daily volume averaged above 29 million shares compared with less than 15 million shares on average in 1974. Subsequently, stock prices receded a little, and currently (NYSE index) are about 27 per cent above their 1974 trough, but remain 36 per cent below their 1973 highs.

Monetary and deposit aggregates. M_1 declined at close to a 10 per cent annual rate in January (preliminary) following a small increase in December. The decline was associated with a sharp and broadly distributed reduction in demand deposits. However, with prices still rising, the demand for currency continued to expand steadily although at a slower rate than in 1974.

Because of M_1's sharp decline in January, M_2 and M_3 expanded at only moderate rates, even though time and savings deposits other than large CD's at banks and thrift institutions showed substantial growth in response to declining market interest rates. At commercial banks, other time deposits rebounded from the unexplained slow growth in December to a 13 per cent annual rate in January. Inflows of thrift institutions exceeded their fourth quarter pace, though expanding slightly less rapidly than in December. The sharp acceleration in

MONETARY AGGREGATES
(Seasonally adjusted changes)

	1974 QII	1974 QIII	1974 QIV	1974 Nov.	1974 Dec.	1975 Jan.pe
	Per cent at annual rates					
M_1	6.5	1.6	4.3	6.8	2.1	-9.7
M_2	7.7	4.6	6.8	9.5	2.5	2.7
M_3	6.4	4.0	6.8	8.6	4.7	5.1
Adjusted bank credit proxy	20.4	6.6	4.3	5.2	7.6	3.2
Time and savings deposits						
At commercial banks:						
a. Total	21.3	9.2	12.6	7.6	15.9	18.0
b. Other than large CD's	8.6	7.3	9.0	11.8	2.9	13.4
At savings and loans 1/	5.2	3.3	9.3	8.8	12.4	11.3
At mutual savings banks 1/	1.8	.4	5.2	6.6	5.9	4.5
Combined 1/	4.2	2.5	8.1	8.1	10.5	9.2
	Billions of dollars 2/					
Memoranda:						
a. U.S. Government demand deposits	.7	.3	-1.5	.9	-2.8	-1.0
b. Negotiable CD's	4.4	1.2	1.8	-.7	4.8	2.6
c. Nondeposit sources of funds	.3	.1	-.1	-.3	.8	-.8

1/ Based on month-end series.
2/ Change in average levels month-to-month or average monthly change for the quarter, measured from last month in quarter to last month in quarter, not annualized.
pe/ Partially estimated.

deposit growth at S&L's in December may have been bolstered by additions to Keogh plan accounts, as self-employed individuals sought to take advantage of these recently liberalized income tax shelters before year-end.

Outstanding CD's have been running off slowly since the second week of January, although the January average was substantially above that in December.[1/] With credit demands remaining weak, banks also reduced their use of nondeposit sources of funds in January, but, with other time deposits expanding rapidly, the adjusted credit proxy showed a small increase on balance.

Credit developments. Commercial bank loans and investments rose moderately in January following a sharp decline in December. However, since the seasonal factors for this series, which are currently under review, appear to accentuate the December decline and the January increase, attention should be focused on the December-January averages.

1/ Commercial banks sold a large volume of CD's and substantially reduced net Federal funds purchases in late December for window-dressing of their financial statements. Net Federal funds purchased by large banks rose in January, but have not yet returned to the late November-early December levels.

COMMERCIAL BANK CREDIT
(Seasonally adjusted changes at annual percentage rates) 1/

	1974					1975	1974-75
	QII	QIII	QIV	Nov.	Dec.	Jan.p	Dec. & Jan.p
Total loans and investments 2/	12.0	5.6	-2.8	4.5	-12.8	8.2	-2.3
U.S. Treasury securities	--	-29.8	-26.1	-9.7	-12.2	2.5	-4.9
Other securities	10.8	--	6.5	7.8	--	5.2	2.6
Total loans 2/	13.8	11.2	-2.9	5.0	-16.4	9.6	-3.4
Business loans 2/	22.9	14.0	0.4	5.8	-15.5	7.2	-4.2
Real estate loans	14.2	6.0	5.0	4.7	7.5	5.6	6.5
Consumer loans	4.4	7.2	-3.3	-4.3	-7.1	-7.2	-7.1
Memo:							
Business loans plus non-financial commercial paper	24.9	18.1	2.5	9.7	-18.0	10.4	-3.9

1/ Last-Wednesday-of-month series except for June and December, which are adjusted to the last business day of the month.

2/ Includes outstanding amounts of loans reported as sold outright by banks to their own holding companies, affiliates, subsidiaries, and foreign branches.

p/ Preliminary.

The small contraction of total bank credit in the December-January period mainly reflects the slowing in short-term credit demands and continued cautious bank policies--as evidenced by the relatively high cost of bank loans and the reported maintenance of tight nonprice terms of lending. To restrict loan growth and improve profits, banks have not lowered their prime rates in step with declining short-term market rates of interest. The prime rate recently has been declining 1/4 of a percentage point a week and is currently 3 percentage points below its summer high of 12 per cent. Prime commercial paper rates, on the other hand, have fallen almost 6 percentage points from their summer highs--dropping 300 basis points in January alone.

In response to the resulting rate disparity, some prime nonfinancial corporations have been borrowing in the commercial paper market and repaying bank loans; however, nonprime customers still are having difficulty selling paper and in addition are facing restrictive bank lending policies. Total business short-term credit demands, however, have eased further as corporations continue to substitute long-term for short-term debt, and apparently have begun to liquidate inventory.

Consumer credit demands also have weakened further. Outstanding instalment credit dropped at a record $9.8 billion seasonally adjusted annual rate in December--twice the record decline in the previous month. Although all types of consumer borrowing were down, a large part of recent declines have centered in auto credit, particularly at commercial banks. During January, seasonally adjusted consumer loans at banks are estimated to have contracted for the third consecutive month with a sustained decline of this magnitude not seen since 1961.

Personal bankruptcies rose sharply in the fourth quarter to a new high, with new filings nearly 50 per cent higher than in the fourth quarter of 1973. Scattered reports from various Federal court districts indicate a further substantial increase in filings in January. The sharp rise of 23 per cent for the full year 1974 followed a cumulative decline of 16 per cent between 1970 and 1973, when filings fell to a record low of about 158 thousand.

Conditions in the mortgage market have continued to improve slowly. In December, new commitments at S&L's registered their first noticeable rise in almost a year, and the uptrend is believed to be continuing. However, demand for mortgage financing remains weak, due in large part to buyer concern with high home prices and

CONSUMER INSTALMENT CREDIT

	Credit flows				New car finance rates
	Net change in outstanding (SAAR, $ billions)	Extensions			
		Total (SAAR, $ billions)	Bank share (Per cent)	Open-end share* (Per cent)	New car APR Finance companies (Per cent)
1973 - I	23.7	162.4	42.5	25.9	11.85
II	20.2	164.2	41.8	27.3	11.94
III	21.0	170.1	42.3	27.1	12.28
IV	15.3	164.4	42.3	28.5	12.42
1974 - I	8.8	164.3	41.9	29.2	12.29
II	14.0	172.9	41.5	30.0	12.50
III	14.1	172.5	42.3	30.6	12.84
IV	-3.2	155.7	41.1	33.2	13.10
- Oct.	4.8	163.5	41.1	32.8	12.97
Nov.	-4.8	151.3	42.8	34.4	13.06
Dec.	-9.8	152.4	39.5	32.7	13.10

*Open-end credit consists of extensions on bank credit-card and check credit plans, and retail "other consumer goods" credit extensions.

the uncertain state of the economy. Institutions have used savings inflows to rebuild liquidity and pay down high-cost borrowing--in January, S&L's repaid more than $1 billion in advances from the Federal Home Loan Banks. With limited demand for mortgage credit and increased deposit inflows, mortgage interest rates have come under increased downward pressure. Based on survey data, average rates on conventional home mortgages at selected S&L's had fallen to 9.19 per cent in early February, down 40 basis points since the beginning of the year. Yields in the secondary market have dropped even more rapidly. In line with these developments, the FHA/VA ceiling rate was reduced 1/2 percentage point to 8-1/2 per cent in January.

CONVENTIONAL HOME MORTGAGES AT
Selected S&L's

		Average going rate on 80% loans (Per cent)	Basis point change from month or week earlier	Spread 1/ (Basis points)	Federal Home Loan Bank districts with funds in short supply
1974--High		10.03 (9/27, 10/18)	--	97 (11/15)	12 (May, July-Oct.)
Low		8.40 (3/15, 3/22)	--	-106 (7/12)	0 (Feb. -Mar.)
Dec.	6	9.71	- 4	21	12
	13	9.65	- 6	6	10
	20	9.61	- 4	9	9
	27	9.59	- 2	n.a.	9
1975--Jan.	3	9.59	0	n.a.	9
	10	9.50	- 9	-12	5
	17	9.44	- 6	6	3
	24	9.33	-11	-12	2
	31	9.29	- 4	29	3
Feb.	7	9.19	-10	29	2

1/ Average mortgage return, before deducting servicing costs, minus average yield on new issues of Aaa utility bonds paying interest semi-annually and with 5-year call protection.

FNMA AUCTION RESULTS
HOME MORTGAGE COMMITMENTS

Date of auction	Government-underwritten Amount (In $ millions) Offered	Government-underwritten Amount (In $ millions) Accepted	Government-underwritten Average yield	Conventional Amount (In $ millions) Offered	Conventional Amount (In $ millions) Accepted	Conventional Average yield
1974--High	1,155 (3/25)	333 (3/25)	10.59 (9/9)	164 (4/18)	63 (4/8)	10.71 (9/9)
Low	26 (11/18)	18 (11/18)	8.43 (2/25)	14 (10/21)	7 (11/18)	8.47 (3/11)
Oct. 7	46.6	29.7	10.32	26.1	23.3	10.46
21	34.5	26.0	10.11	14.1	12.2	10.27
Nov. 4	47.8	24.7	9.93	20.4	12.1	10.11
18	25.7	17.6	9.81	20.6	6.8	9.92
Dec. 2	52.5	23.3	9.61	24.0	12.0	9.80
16	49.6	43.3	9.52	20.1	18.5	9.72
30	35.7	31.8	9.47	17.2	10.1	9.59
1975--Jan. 13	25.3	21.2	9.37	17.9	14.9	9.50
27	41.4	28.6	9.12	11.1	10.6	9.39
Feb. 10	24.6	18.1	8.98	14.8	9.1	9.20

NOTE: Average secondary market yields are gross before deduction of the fee of 38 basis points paid for mortgage servicing. They reflect the average accepted bid yield for home mortgages assuming a prepayment period of 12 years for 30-year loans, without special adjustment for FNMA commitment fees and FNMA stock purchase and holding requirements on 4-month commitments. Mortgage amounts offered by bidders relate to total bids received.

INTERNATIONAL DEVELOPMENTS

U.S. International Transactions
(in millions of dollars; seasonally adjusted)

	1974P					
	YEAR	1H	3Qr	4Q	NOV.*	DEC.*
Goods and services, net 1/		2,727	-332			
Trade balance	-5,763	-1,691	-2,550	-1,522	-396	-960
Exports	97,074	46,350	24,615	26,109	8,857	8,639
Imports	102,837	48,041	27,165	27,631	9,253	9,599
Net service transactions		4,418	2,218			
Remittances and pensions		-857	-468			
Gov't grants and capital, net		-2,073	-776			
Bank-reported private capital, net change	-3,420	-4,961	2,173	-632	-627	-1,117
Claims on foreigners (inc. -)	-18,419	-12,680	-1,855	-3,884	-2,174	-1,992
Liquid	-4,927	-3,468	-320	-1,139	-591	-808
Other	-13,492	-9,212	-1,535	-2,745	-1,583	-1,184
Liabilities to foreigners (inc. +)	14,999	7,719	4,028	3,252	1,547	875
Liquid liabilities to:	15,000	7,537	4,048	3,415	1,562	935
Commercial banks abroad	11,991	6,588	2,949	2,454	1,203	535
(of which liab. to branches) 2/	(1,301)	(2,402)	(-459)	(-642)	(2,027)	(-850)
Other private foreigners	2,939	1,242	878	819	283	462
Int'l. & regional organizations	70	-293	221	142	76	-62
Long-term liabilities	-1	182	-20	-163	-15	-60
Private transactions in securities, net	-936	147	-131	-953	-298	-351
U.S. purchases (-) of foreign securities	-1,995	-959	-300	-736	-54	-343
(of which: New bond issues)	(-2,336)	(-1,150)	(-416)	(-770)	(-75)	(-399)
Foreign purchases (+) of U.S. securities	1,059	1,106	169	-217	-244	-8
Stocks	307	388	84	-165	-70	-13
Bonds	752	718	86	-52	-174	5
U.S. direct investment abroad, (inc. -)		-2,184	-1,971			
Foreign direct investment in U.S., (inc. +)		2,958	-50			
Nonbank reported: liquid claims, (inc. -)		-277	610		-272	
: other claims, (inc. -)		-2,552	-146			
: liabilities, (inc. +)		779	187			
Changes in liab. to foreign official agencies	9,394	4,051	1,351	3,992	1,230	1,322
OPEC countries (inc. +) 2/ 3/	9,370	3,359	3,926	2,085	917	450
Other countries (inc. +)	24	692	-2,575	1,907	313	872
Changes in U.S. reserve assets (inc. -)	-1,434	-568	-1,003	137	91	16
Gold	--	--	--	--	--	--
Special drawing rights	-172	-29	-123	-20	--	-12
Reserve position in the IMF	-1,265	-453	-728	-84	-59	-10
Convertible currencies	3	-86	-152	241	150	38
Errors and omissions		2,810	556			
Memo:						
Official settlements balance, S.A.		-3,483	-348	-4,129		
N.S.A.	-7,960	-2,610	-1,604	-3,746	-1,321	-1,338
O/S bal. excluding OPEC, S.A.		-124	3,578	-2,044		
N.S.A.	1,410	749	2,322	-1,661	-404	-889

* For monthly data, only exports and imports are seasonally adjusted.

1/ Differs from "net exports" in the GNP account by the amount of special military shipments to Israel (excluded from GNP net exports).

2/ Not seasonally adjusted.

3/ Partly estimated.

Foreign exchange markets. The steady decline of the dollar's exchange value over the past few months was arrested, at least temporarily, in early February. Heavy central bank intervention purchases of dollars and an associated easing of some European interest rates appear to have been the chief factors behind this development.

After a weekend meeting between Chairman Burns, President Klasen of the Bundesbank, and President Leutwiler of the Swiss National Bank, at which the three agreed to more forceful intervention on a concerted basis, the three central banks entered the market on Monday, February 3 with large-scale purchases of dollars. The dollar immediately firmed sharply, and continued to move higher following public confirmation of this intervention by officials of the three central banks. From its lows in early European trading on Monday to the close in New York that same day the dollar appreciated by 1.1 per cent against both the mark and the Swiss franc.

The dollar continued to advance on Tuesday and early Wednesday, but then began to drop back, so that on Friday afternoon, February 7, the dollar showed net gains of about one per cent against the mark and the Swiss franc, somewhat less against other European currencies. Total net purchases of dollars by the System and major foreign central banks amounted to about $650 million for the first week of February. (By way of contrast, net dollar intervention by major central banks was about zero in January, and for the previous four month period had involved net dollar sales in excess of $2 billion.)

In the current week, the dollar has held steady or tended to firm slightly against European currencies. Intervention by the System, the Bundesbank, and the BNS has been much lower than in the previous week. Reflecting the effects of the previous week's intervention, however, as well as a discount rate reduction, German interest rates have fallen sharply in recent days. The three-month interbank loan rate in Frankfurt, for example, was quoted at 6.2 per cent on February 12, compared to 7.5 per cent on January 31. Meanwhile, U.S. money market rates have steadied or firmed, so that interest rate considerations have tended to provide some support for the dollar.

While European currencies have held steady or eased slightly against the dollar in the current week, the yen has firmed sharply, and there are indications that the Bank of Japan may have purchased a substantial amount of dollars. The yen appears to be benefitting from a rapidly growing Japanese export surplus as well as from public reiterations of official determination to maintain tight credit conditions in Japan.

Euro-currency market. Rates on Euro-dollar deposits have continued to decline sharply in line with falling rates in the U.S. money market. The 3-month Euro-dollar rate has come down about 1-1/2 percentage points in the past four weeks, averaging 7.1 per cent in the week of February 12. The overnight rate is down more than a full percentage point, about as much as the drop in the Federal funds rate. The cost of overnight Euro-dollars to U.S. banks was about 1/3 percentage point above the cost of Federal funds in the latest week.

SELECTED EURO-DOLLAR AND U.S. MONEY MARKET RATES

Average for month or week ending Wednesday	(1) Over-night Euro-$	(2) Federal Funds	(3) Differ-ential (1)-(2)(*)		(4) 3-month Euro-$ Deposit	(5) 60-89 day CD rate	(6) Differ-ential (4)-(5)(*)	
1974-Oct.	9.77	10.06	-0.27	(0.56)	10.95	9.40	1.45	(1.68)
Nov.	9.22	9.45	-0.23	(0.57)	10.08	8.88	1.20	(1.31)
Dec.	8.48	8.53	-0.05	(0.69)	10.28	8.96	1.32	(1.64)
1975-Jan.	7.16	7.13	0.03	(0.65)	8.49	7.45	1.04	(1.78)
1975-Jan. 1	8.40	7.35	1.05	(1.78)	10.23	9.00	1.23	(1.55)
8	8.07	7.70	0.37	(1.07)	9.72	7.88	1.84	(2.19)
15	7.24	7.22	0.02	(0.65)	8.66	7.38	1.28	(1.56)
22	6.85	7.17	-0.32	(0.28)	8.09	6.75	1.34	(1.61)
29	7.09	6.99	0.10	(0.72)	8.01	6.25	1.76	(2.06)
Feb. 5	6.07	6.46	-0.39	(0.14)	7.25	6.00	1.25	(1.50)
12p/	6.10	6.30	-0.20	(0.33)	7.10	6.00	1.10	(1.33)

*/ Differentials in parentheses are adjusted for the cost of required reserves.
p/ Preliminary.

SELECTED EURO-DOLLAR AND U.S. COSTS FOR PRIME BORROWERS
(1975; Friday dates)

	Jan. 10	Jan. 24	Feb. 7	Feb. 11d/
1) 3-mo. Euro-$ loan a/	9.75	9.25	8.19	8.56
2) 90-119 day com'l. paper b/	7.75	6.62	6.50	6.50
3) U.S. bank loan:				
a) predominant prime rate	10.25	10.00	9.00	9.00
b) with 15% comp. bal's. c/	12.06	11.76	10.59	10.59
c) with 20% comp. bal's. c/	12.81	12.50	11.25	11.25
Differentials:				
(1) - (2)	2.00	2.63	1.69	2.06
(1) - (3a)	-0.50	-0.75	-0.81	-0.44
(1) - (3b)	-2.31	-2.51	-2.40	-2.03
(1) - (3c)	-3.06	-3.25	-3.06	-2.69

a/ 1-1/8 per cent over deposit bid rate.
b/ offer rate plus 1/8 per cent.
c/ prime rate adjusted for compensating balances.
d/ Tuesday.

The decline in U.S. banks' Euro-dollar borrowings that began in mid-December has persisted in recent weeks as bank loan demand and money market rates have eased in the United States. Banks' gross liabilities to their foreign branches fell to an average of $2.4 billion in the week ending February 5, down from $4.2 billion in the week of December 18.

The cost of short-term loans in the Euro-dollar market relative to the cost of commercial paper or short-term bank loans in the United States has changed little in the past month, as shown in the accompanying table. For prime nonbank borrowers maintaining required compensating balances of 15 or 20 per cent, the cost of bank financing in the United States has been 2 to 3-1/4 per cent above the cost of comparable credit from the Euro-dollar market.

In the fourth quarter of 1974, completions of publicized medium-term Euro-currency loans declined further to $3.6 billion, compared with $4.5 billion in the third quarter and $19.2 billion in the first half. There was some further shortening of average maturities. Loan-deposit spreads widened further in the fourth quarter, and generally were about 1/2 per cent wider than in the first quarter. For 1974 as a whole, countries where borrowers contracted for $3/4 billion or more were Britain ($5.7 billion), France ($3.2 billion), Italy ($2.2 billion), Mexico ($1.5 billion), Brazil ($1.4 billion), the United States ($1.4 billion), Spain ($1.1 billion), and the Philippines ($0.9 billion).

In the <u>Euro-bond market</u>, the volume of new issues and secondary market trading picked up sharply in November and has continued at the higher levels in response to declining interest rates. New issues in November-January were more than double the monthly average for January-October 1974, according to Morgan Guaranty Trust compilations. But maturities have remained much shorter than before 1974, ranging from five to nine years on almost all issues. The 1974 new issue volume of $2.1 billion was one-half the 1973 volume because of high interest rates and the end of U.S. capital controls.

U.S. international transactions. Slackening world economic activity left its mark on the U.S. international accounts in the closing months of 1974. Nonagricultural exports fell in real and nominal terms during November and December; fourth quarter nonfuel imports fell as well. The balance on nonfuel imports and nonagricultural exports declined in November and December to a deficit of $2.4 billion (seasonally adjusted annual rate) in December; the merchandise balance (balance of payments basis) fell in November and December to a deficit of $11.4 billion (seasonally adjusted annual rate) in December. A relatively rapid decline in U.S. real income, combined to some degree with ease in U.S. monetary policies, led to a relative decline in U.S. interest rates and to a sharp increase in U.S. short-term lending and purchases of new foreign bonds. These movements were probably a major factor in depressing the trade-weighted dollar exchange rate by about 3.2 percent during the fourth quarter and by another 2.4 percent in January.

Foreign official holdings of U.S. dollars increased by $4.0 billion (seasonally adjusted) during the fourth quarter, $2.6 billion more than the third quarter (see table on p.). OPEC members' official holdings of dollars in the United States rose in the fourth quarter by an estimated $2.1 billion (not seasonally adjusted). One-quarter of the increase in OPEC countries' reserves was placed in the United States during the fourth quarter, almost the same as the second and third quarters; however, this ratio declined throughout the fourth quarter to about 11 percent in December. This may indicate some change in the location of OPEC members' funds, consistent with market reports indicating some switch out of dollars by OPEC members.

Bank-reported U.S. private lending rose to $3.9 billion (seasonally adjusted) in the fourth quarter, high by customary standards but below the extraordinarily large $6.4 billion quarterly rate of the first half of 1974. The increase in U.S. lending was concentrated largely in claims on Latin America ($1.9 billion), with Europe and Canada accounting for another $1.5 billion. Increased lending to Asia, primarily Japan, accounted for about $7.9 billion of the $18.4 billion in U.S. lending for the year, but only for about $500 million of fourth quarter lending. Bank-reported borrowing by the United States from foreigners was about $800 million less than the third quarter. On balance, there was a net outflow of funds of about $600 million in the fourth quarter, reversing the inflow of $2.2 billion in the third quarter, but substantially less than the outflow of $2.5 billion, at a quarterly rate, in the first half of 1974.

U.S. purchases of foreign securities of about $750 million (seasonally adjusted) during the fourth quarter were concentrated in new foreign bond issues, largely Canadian, during the month of December. Preliminary figures for January indicate that U.S. purchases of new bonds reached a record monthly level of $1 billion, of which about 60 percent were issues by the World Bank and the Inter-American Development Bank, with the balance largely Canadian. There is some indication that declining U.S. interest rates are attracting borrowers that have not been in the New York market since the imposition of the Interest Equalization Tax in July 1963. Sales of foreign bonds in the United States are expected to reach $500 million or more in February, including a $150 million flotation by the European Coal and Steel Community. Foreigners were net sellers of about $200 million of both U.S. stocks and bonds during the fourth quarter, after being net purchasers for the first three quarters of 1974.

U.S. merchandise trade. In December, a sharp increase in imports coupled with an export decline led to a much larger trade deficit than in the two preceding months. For the fourth quarter of 1974 as a whole, however, the trade balance of $6.1 billion at a seasonally adjusted annual rate (balance of payments basis) was smaller than in the third quarter.

U.S. MERCHANDISE TRADE, 1974
(billions of dollars, seasonally adjusted annual rates)

	I	II	III	IV	YEAR	Percent change 1973 to 1974	
						Value	Volume
EXPORTS	89.1	96.3	98.5	104.4	97.1	+38	+8
Agric.	23.6	22.8	20.5	22.3	22.3	+25	-9
Nonagric.	65.6	73.4	78.0	82.1	74.8	+43	+14
IMPORTS	89.4	102.8	108.7	110.5	102.8	+47	-1
Fuels	20.4	28.2	30.1	29.9	27.1	+210	-3*
Nonfuels	69.0	74.5	78.6	80.7	75.7	+24	-3
BALANCE	-0.3	-6.5	-10.2	-6.1	-5.8		

Note: Details may not add to totals because of rounding.
* Based on actual quantity data for petroleum and products.

U.S. exports increased 6 percent in the fourth quarter over July-September 1974 in value but were unchanged in volume.

U.S. EXPORTS: PERCENT CHANGES FROM PRECEDING QUARTER

1974	I	II	III	IV
Value	+10.2	+8.0	+2.3	+6.1
Volume	+1.9	+4.3	-4.1	--
Price*	+8.2	+3.6	+6.6	+6.2

* As measured by the unit value index.

Exports of nonagricultural products -- which accounted for nearly four-fifths of the U.S. export total in 1974 -- rose 5.3 percent in nominal terms in the fourth quarter over the third but showed virtually no growth in volume. Without a huge gain in aircraft deliveries, the volume of nonfarm exports would have declined, as they did in the preceding quarter. Shipments of industrial supplies were especially weak, dropping by about one-tenth despite a step-up in coal exports in October and November in anticipation of the strike by coal miners. This weakness reflected the contraction in real output abroad, as evidenced by an estimated drop of 3 percent in the trade-weighted industrial production index of seven major foreign countries between the fourth quarters of 1973 and 1974.

Machinery exports expanded again in October-December but virtually the entire increase was due to higher prices as the export volume leveled off following strong gains in the two preceding quarters.

New export orders have also slowed in recent months ad investment outlays abroad are being curtailed. Shipments of autos and parts increased in value but showed no change in quantity.

Higher prices lifted the value of agricultural exports 9 percent above the third quarter level but the volume dropped slightly. Price rises were especially steep for wheat and soybeans. A large decline was noted in cotton exports as foreign demand softened.

The value of U.S. imports climbed 1.7 percent in the fourth quarter but fell in volume terms by about the same percentage from the preceding quarter.

U.S. IMPORTS: PERCENT CHANGES FROM PRECEDING QUARTER

1974	I	II	III	IV
Value	+17.6	+15.0	+5.7	+1.7
Volume	+1.0	+1.0	-.9	-1.8
Price*	+16.4	+13.9	+6.7	+3.5

* As measured by the unit value index.

The value of nonfuel imports rose 2.7 percent in October-December but the volume dropped for the third consecutive quarter as U.S. economic activity declined and demand was dampened by rapidly rising foreign prices. The weakness of import demand was widespread. Consumer goods fell in value and volume as did imports of automotive vehicles from both Canada and overseas. Although imports of industrial supplies increased in both nominal and quantity terms, all of the expansion was in steel, reflecting excess production capacity abroad and, possibly, stockbuilding here in anticipation of the coal strike.

Imports of fuel remained essentially unchanged from the third quarter as the high December total compensated for the relatively low import levels in the two previous months. Unit values for petroleum and products averaged $11.41 per barrel, slightly below levels in the two preceding quarters. The volume of imports averaged 6.8 million barrels per day, also somewhat lower than in the third quarter.

Current account positions of major foreign industrial countries. During 1974 the main factor affecting the trade balances of foreign industrial countries was the increase in the price of oil. Although the impact of the rise in oil prices was offset to some extent by greater than expected increases in export volumes, the combined trade balance of six major foreign countries -- France, Germany, Italy, the United Kingdom, Japan and Canada -- declined by nearly $13 billion, from a surplus of close to $10 billion in 1973 to a deficit of about $3 billion in 1974. The combined current account balance declined even more -- from a deficit of almost $2 billion in 1973 to a deficit of approximately $21 billion in 1974. Other OECD countries (excluding the United States) also recorded a large decrease in their combined current account balance; it shifted from a surplus of nearly $4 billion in 1973 to an estimated deficit of $12 billion in 1974. Thus the OECD countries taken together (excluding the United States) recorded a shift from a current account surplus of about $2 billion to a deficit of approximately $33 billion.

The large increases in the total trade and current account deficits were distributed very unevenly among the six countries. (See table.) The German trade and current account surpluses increased substantially in 1974, while most of the other countries experienced larger deficits. The figures for 1974 as a whole, however, conceal substantial shifts in the latter part of the year. The most extreme case is Japan, where the trade and current account deficits recorded in the first half of the year changed to surpluses in the second half.

Current Accounts of Six Major Foreign Industrial Countries[a]
(billions of dollars)

France[b]

	1973	1974	1973 H1	1973 H2	1974 H1	1974 H2
Trade Bal.	0.8	-4-1/2[e]	0.6	0.2	-2.5	-2[e]
Services & Transfers	-1.6	-2-3/4[e]	-0.5	-1.1	-1.0	-1-3/4[e]
Current Acct. Bal.	-0.8	-7-1/4[e]	0.1	-0.9	-3.5	-3-3/4[e]

Germany[c]

	1973	1974	1973 H1	1973 H2	1974 H1	1974 H2
Trade Bal.	12.7	19.6	5.0	7.7	10.3	9.3
Services & Transfers	-7.9	-10.4	-3.2	-4.7	-5.0	-5.4
Current Acct. Bal.	4.8	9.2	1.8	3.0	5.3	3.9

Italy[b]

	1973	1974	1973 H1	1973 H2	1974 H1	1974 H2
Trade Bal.	-3.9	-8-1/2[e]	-1.8	-2.1	-5.0	-3-1/2[e]
Services & Transfers	1.5	1/2[e]	0.4	1.1	-0.2	1/2[e]
Current Acct. Bal.	-2.4	-8[e]	-1.5	-0.9	-5.1	-3[e]

United Kingdom[c]

	1973	1974	1973 H1	1973 H2	1974 H1	1974 H2
Trade Bal.	-5.7	-12.1	-1.9	-3.9	-6.3	-5.9
Services & Transfers	2.8	3.4	0.9	1.9	1.6	1.8
Current Acct. Bal.	-2.9	-8.7	-1.0	-2.0	-4.7	-4.1

Japan[b]

	1973	1974	1973 H1	1973 H2	1974 H1	1974 H2
Trade Bal.	3.7	1.7	1.7	2.0	-2.6	4.3
Services & Transfers	-3.8	-6.2	-1.6	-2.2	-3.0	-3.2
Current Acct. Bal.	-0.1	-4.5	0.1	-0.2	-5.6	1.1

Canada[c]

	1973	1974	1973 H1	1973 H2	1974 H1	1974 H2
Trade Bal.	2.2	3/4[e]	1.3	1.0	1.0	-1/4[e]
Services & Transfers	-2.7	-2-3/4[e]	-1.3	-1.3	-1.4	-1-1/4[e]
Current Acct. Bal.	-0.4	-2[e]	-0.1	-0.4	-0.4	-1-1/2[e]

e= estimate
a/ Figures are from national sources and were converted to U.S. dollars using average quarterly exchange rates. Details may not add to totals due to rounding.
b/ Half-yearly data not seasonally adjusted.
c/ Half-yearly data seasonally adjusted.

The net oil bill of the six countries combined is estimated to have risen by about $36 billion from 1973 to 1974. Apart from the increases in expenditures on imported oil, the combined current account surplus for the six countries grew by an estimated $17 billion last year. Germany and Japan showed major gains, accounting for more than the total increase. The adjusted balances for Italy, the United Kingdom, and France were approximately unchanged compared with 1973, and the Canadian balance declined somewhat.

One factor which helped to reduce the effect of the oil price increases on the trade balances of major industrial countries was the slowdown in economic activity in 1974, which slowed the growth of both oil and non-oil imports. Another factor which partially offset the effect of higher petroleum costs was extremely buoyant demand from the non-industrial countries -- both from OPEC countries and non-oil producers. Exports of the six foreign industrial countries to OPEC appear to have increased by about $6 billion in 1974 from their 1973 level of approximately $10 billion. In addition, the six countries' trade surplus with the non-oil developing countries showed some increase. This latter group of countries managed to finance both a higher oil bill and an increase in their deficit with major industrial countries in 1974. However, it is likely that this year, with prices of many of their commodity exports falling and credit lines already strained, they will have to cut back the volume of their imports from the industrial countries.

<u>Germany</u> recorded extremely large surpluses on both trade and current accounts in 1974. The German trade surplus increased by $7 billion from 1973 to 1974, despite a large increase in oil import expenditures. The increase in the oil bill was held down somewhat by an approximate 10 per cent decrease in the volume of German oil imports in 1974. The average unit value of German exports in 1974 increased by an estimated 15 per cent compared to 1973, while import unit values rose by about 25 per cent, both in terms of DM. In dollar terms, the rise in the average unit value of German exports was even greater because of the appreciation of the DM throughout the year. The volume of German exports rose by approximately 13 per cent from 1973 to 1974, while the volume of imports declined by about 1 per cent.

A number of factors have contributed to the persistently strong German trade surplus. In particular, the domestic downturn curtailed import growth and freed resources for exports. The commodity composition of German exports has also been an important factor. In value terms, exports of most product groups, except agricultural and forestry products, rose from 1973 to 1974. While exports of investment goods (about one-half of total exports) increased by about one-fifth, exports of industrial materials (about one-third of total exports) rose by over 50 per cent. Thus, it appears that Germany not only benefited from a strong demand for its investment goods, but also from the recent materials and commodity boom in world trade.

In the United Kingdom, France, and Italy, there were sharp increases in the deficits on trade and current accounts from 1973 to 1974. In the latter part of 1974, however, the non-oil trade balances improved in all three countries. For 1974 as a whole, the volume of exports in each country rose relatively rapidly, while the volume of imports rose much more slowly, reflecting primarily weakening economic activity, and in Italy, reflecting the effects of the import deposit measure as well. In the United Kingdom, the trade balance in value terms was helped by an improvement in the terms of trade in the second half of the year. However, this improvement was due mainly to an increase in export prices associated with the high level of domestic inflation which, in turn, is raising doubts about the future competitiveness of British exports.

Japan's trade surplus declined from 1973 to 1974 by only $2 billion, despite a substantial increase in its oil import bill. The increase in the current account deficit was more than double the amount of the decline in the trade balance because of a large increase in the deficit on services and transfers, partly due to higher net transportation payments, as well as a net increase in investment income payments.

Although Japan's trade balance was in deficit in the first half of 1974, there was a sharp turnaround to a substantial surplus in the second half of the year. (However, some of the increase shown in the table may be seasonal.) For the year as a whole, the volume of Japanese exports increased by about one-sixth over 1973, compared to a negligible increase in the volume of imports. A major factor was the decline in domestic demand which damped down imports and encouraged domestic producers to seek export outlets. As a result of price increases of one-third or more for certain major export commodities such as steel, fertilizers and chemicals, export unit values rose substantially in 1974.

Canada's trade and current account balances deteriorated significantly from 1973 to 1974, but in contrast to the situation in the other countries, a primary factor was the decline in economic activity in the United States rather than the oil price increases. The decline in Canada's trade position occurred mainly in the second half of the year; by the fourth quarter, Canada's trade surplus, which averaged about $1/2 billion per quarter during 1973 and the first half of 1974, turned into a small deficit.

Recent Financial Developments Abroad. The decline in interest rates abroad reported in the January Greenbook has continued through the early part of February. In the past four weeks reductions in short-term interest rates of 100 basis points or more have been recorded in Germany, France, Italy, Canada and Belgium. Long-term rates have generally shown smaller declines. In the United Kingdom, however, the rate on government bonds dropped by some 187 basis points between January 10 and February 7 from the exceptionally high rates recorded in the final months of 1974. Equity markets abroad in recent weeks have shown signs of recovering from the sharp declines experienced last year. The most dramatic rebound has occurred in the United Kingdom; by February 11 the Financial Times industrials index had risen by nearly 80 per cent from the 20-year low reached on January 6. The decline in interest rates abroad reflects the weakness of credit demand associated with the continuing slowdown in economic activity, as well as the further reductions in U.S. interest rates and, in several instances, official policy actions.

Continuing recent moves towards easing its restrictive policy, the Bundesbank on January 24 raised the rediscount quotas of commercial banks by DM 2.5 billion for a period extending through March 31. On February 6 the Bundesbank lowered the discount rate and Lombard rate by one-half percentage point each to 5-1/2 and 7-1/2 per cent respectively. This follows two one-half percentage point reductions in these rates in October and December 1974. The Belgian discount rate was reduced by one-half percentage point on January 29. During the past month, the Bank of England reduced the Minimum Lending Rate in three successive one-quarter point steps to 10.75 per cent.

THE FEDERAL BUDGET FOR 1976*

The major features of the President's budget proposals are discussed in this Appendix. In addition, the President's budget projections are compared with FRB staff projections in the final section.

In his budget message the President indicated that he is now expecting the budget deficit for fiscal year 1975 to amount to $34.7 billion, more than $30 billion higher than the Administration was projecting late last Fall, and is expecting an even more substantial deficit of $51.9 billion in fiscal year 1976. (Deficits for these years measured on an NIA basis are of roughly similar magnitude). These deficits, the highest on record since World War II, reflect first, the impact on receipts and expenditures of continued rapid inflation accompanied by a sharp slowdown in economic activity, and second, the President's tax reduction proposals for economic stimulus. As may be seen in the top half of Table I, the deficit widens over fiscal year 75 and fiscal year 76 because growth in outlays accelerates while growth in receipts slackens.

Despite the substantial size of the deficits in fiscal year 1975 and fiscal year 1976, it is doubtful that the budget as proposed by the Administration will provide any major net stimulus to the economy. An examination of the full employment budget presented in the lower half of Table I supports this interpretation. As may be seen, the full employment surplus actually rises slightly in fiscal year 1975, and, the decline in the surplus in fiscal year 1976 is not large in terms of present magnitudes. 1/ The continuation of relatively high full employment surpluses can be traced to further strong gains in full employment receipts which occur despite the tax reductions proposed by the Administration. Full employment expenditures, however, do rise sharply in each fiscal year.

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1/ It should be stressed that these full employment projections assume adoption of the President's program on energy, tax relief and expenditure restraint. As pointed out in the Greenbook text, on the other hand, if staff assumptions on these proposals prove correct, the full employment budget will be significantly more stimulative.

It may also be noted that stimulative actions in the President's program are concentrated in calendar year 1975, so that a fiscal year comparison will not bring out the maximum timing of the stimulative impact.

TABLE I

MAJOR FISCAL INDICATORS
(Fiscal Years)

	1973	1974	1975e	1976e
Unified budget				
Receipts	232.2	264.9	278.8	297.5
Outlays	246.5	268.4	313.4	349.4
Deficit (-)	-14.3	-3.5	-34.7	-51.9
NIA budget				
Receipts	243.3	273.6	287.6	305.1
Expenditures	255.1	278.3	323.7	361.0
Deficit (-)	-11.8	-4.7	-36.1	-55.9
Per cent increase in				
Receipts:				
Budget	11.3	14.1	5.2	6.7
NIA	13.9	12.5	5.1	6.1
Outlays:				
Budget	6.3	8.9	16.7	11.5
NIA	9.4	9.1	16.3	11.5
Full employment budget				
Receipts	243.0	282.0	323	352
Outlays	245.0	267.0	306	340
Surplus Deficit (-)	2	15	17	12
Per cent increase in				
Receipts	5.2	16.0	14.5	8.9
Outlays	9.6	8.9	14.6	11.1

It might be noted that this year's budget document has several new features, which are mandated by the Congressional Budget and Control Act of 1974. Briefly, these include the following:

(a) An explicit 5-year projection of receipts and outlays together with projections of income and other economic conditions which underline these budget figures.

(b) Separate budget estimates for the 3rd quarter of calendar year 76, the quarter designated for transition to the new fiscal year that will run from October 1 to September 30.

(c) Tax expenditure budget estimates--data showing revenue losses resulting from various provisions of the law which provide for preferential tax treatment of specified activities.

Expenditure Estimates

Underlying the President's outlay projections are some important programatic assumptions. Apart from an increase in defense spending and an expansion of outlays embodied in the President's energy program, the budget contains no new expenditure initiatives. Indeed, a moratorium on new spending programs is proposed. In addition, the budget proposes a 5 per cent ceiling on Federal pay increase, as well as on other programs such as social security and military retirement pay that are tied to movements in the Consumer Price Index. Furthermore, a variety of other actions designed to reduce spending are also proposed as summarized in Table II. It should be stressed that the great bulk of these reductions require Congressional action.

TABLE II
Proposed Budget Reductions
($ billions)

	Effect on Outlays	
	1975	1976
Action proposed last year that are still pending	-3.0	-8.1
New actions proposed in current Budget	-.3	-8.9
Total	-3.3	-17.0
Of which		
Rescissions 1/	-.5	-.8
Deferrals 1/	-.7	-1.8
New Legislation	-1.2	-12.3
Administrative Action	-.8	-2.1

1/ Under the provision of the Congressional Budget and Impoundment Control Act of 1974 rescissions require a Congressional vote of concurrence, and deferrals can be overturned.

As indicated earlier, despite these various measures designed to retard the growth of outlays, expenditures have been rising very substantially in the current fiscal year and are expected to continue rising substantially, even if more moderately in FY1976. As can be seen in Table III this growth in expenditures, viewed on a functional basis, is dominated by outlays for income security, although fairly sizable increases are also proposed for National Defense.

The income security category includes Social Security and various other retirement and disability programs, as well as other items such as unemployment insurance and public assistance. The Administration estimates that outlays for this function will rise about $22.0 billion in FY 75 and will grow an additional $12 billion in FY 1976. This growth principally reflects (a) increased outlays arising from higher unemployment levels, (b) expansion of the benefit payments that increase automatically with the Consumer Price Index, and (c) the Federalizing of the supplemental security income program which replaces State operated programs for the aged, blind and disabled. Price level adjustments alone account for about one-third of the estimated increase in FY 1976. This assumes, however, Congressional approval of the proposed 5 per cent limit on price level adjusted benefit increases. If this limit is disallowed, income security outlays are estimated to increase by additional $3.8 billion.

Although expenditures for income security represent the largest single, absolute increase in total outlays, it is interesting to note that the Administration projects a significant change in expenditure allocation between functional areas. Income security accounts for only one-third of the $36.1 billion increase in 1976, as compared with 1975 when this category accounted for nearly 50 per cent of the increase in outlays. In contrast, spending for national defense accounts for nearly 25 per cent of the increase for 1976, as compared with a 14.7 per cent share in 1975. The bulk of the increase in defense spending, it might be noted, reflects the expected strengthening of general purpose or conventional forces as well as pay raises.

Receipts Estimates

The budget for 1976 assumes enactment of the President's energy and tax relief proposals. As outlined in the State of the Union message, these proposals have a two-fold objective: to stimulate economic activity, and to reduce energy consumption. The economic stimulus proposal consists of a one-time, temporary tax reduction of $16.3 billion, of which $12 billion will go to individual taxpayers and the remainder to businesses. This is the same 3 to 1 ratio that individual income taxes bear to corporate income taxes.

TABLE III
BUDGET OUTLAY BY FUNCTION
($ billion)

	1974	1975e	1976e	Change In $ billion 74-75	75-76	Per cent of increase 74-75	75-76
National defense and international affairs	86.3	94.3	104.9	8.0	10.6	17.7	29.4
National defense	78.6	85.2	94.0	6.6	8.8	14.7	24.4
International affairs	3.6	4.9	6.3	1.3	1.4	2.9	3.9
General science space and technology	4.1	4.2	4.6	.1	.4	.2	1.1
Human resources	131.5	163.4	177.0	31.9	13.6	70.8	37.7
Income security	84.4	106.7	118.7	22.3	12.0	49.6	33.2
Health	22.1	26.5	28.1	4.4	1.6	9.8	4.4
Education manpower social services	11.6	14.7	14.6	3.1	-.1	6.8	-.2
Veterans benefits and services	13.4	15.5	15.6	2.1	.1	4.7	.3
Physical resources	26.6	27.7	31.4	1.1	3.7	2.4	10.3
Agriculture	2.2	1.7	1.8	-.5	.1	-1.1	.3
Natural resources and environment	6.4	9.4	10.0	3.0	.6	6.6	1.7
Commerce and transportation	13.1	11.8	13.7	-1.3	1.9	-2.9	5.3
Community and regional development	4.9	4.8	5.9	-.1	1.1	-.2	3.0
Revenue sharing	6.7	7.0	7.2	.3	.2	.6	.5
Other 1/	17.1	20.8	28.8	3.7	8.0	8.2	22.2
Total Budget Outlays	268.2	313.2	349.3	45.0	36.1	100%	100%

1/ This includes energy tax equalization payments of $.5 billion for 1975 and $7.0 billion for 1976.

The energy package has three parts; (1) an import fee increase together with the impositions of an excise tax on domestic crude oil, (2) decontrol of crude oil prices coupled with a windfall profits tax and (3) price decontrol of new natural gas combined with an excise tax on all natural gas. The additional revenues generated by this program would be returned to the economy through permanent reductions in individual and corporate income taxes, and through energy equalization payments. This program is intended to effect a reduction in energy consumption without, at the same time, reducing aggregate purchasing power in the economy. The estimated changes in budget receipts due to the Administration program are presented in Table IV.

In past recessions, the individual income tax has been an important source of built-in stability, since the fall in income is cushioned by the automatic fall in tax receipts. In the presence of inflation, however, this built-in stability is lessened substantially. Since the income tax is progressive in nominal terms, the marginal or additional dollar of income is taxed at a higher rate than the average dollar. Consequently, a given percentage increase in before-tax income implies a smaller percentage increase in after-tax income. Thus, if it is assumed that before-tax incomes exactly match the rate of inflation, after-tax income will rise by less the rate of price increase. That is, taxpayers suffer a reduction in real, after-tax income, since inflation increases the effective tax rate.

Table V presents some measures of the impact of inflation on receipts. Between 1973 and 1974, personal income minus government transfer payments increased by 7.8 per cent. Prices, as measured by the personal consumption expenditure deflator increased by 11.3 per cent. Personal tax receipts, however, increased by 15.2 per cent. Ideally, receipts would have fallen in response to a decline in real income.

Comparison of Administration and FRB Staff Projections

Given Congressional resistence to most of the Presidents proposed budget reductions, the staff is assuming that no more than $6.5 billion will ultimately be realized. At the same time, however, it appears very likely that the President's energy program will not be adopted, and thus the compensating payments for rising energy prices embodied in that program will not be made. In addition, the staff has incorporated several other different assumptions, such as larger unemployment levels, larger defense spending in FY 75 and more payments for public employment in FY 76. Table VI provides a reconciliation between Staff and Administration projections of outlays on both a unified budget and NIA basis. This shows that on an overall basis the staff expects spending to be $3.7 billion more in FY 75 and $7.2 billion in FY 76.

TABLE IV
CHANGES IN BUDGET RECEIPTS
(In billions of dollars)

	1974 Actual	1975 Estimate	1976 Estimate
Total receipts under existing legislation	264.9	283.8	303.6
Changes due to tax proposals:			
Energy-related proposals:			
Excise tax and import fee on oil and excise tax on natural gas	--	+4.3	+19.0
Windfall profits tax	--	--	+16.3
Individual income tax reductions:			
Increase in minimum standard deduction	--	-0.6	-8.1
Changes in rate structure	--	-0.8	-16.3
Residential energy conservation credit	--	--	-0.5
Corporation income tax rate reduction	--	-1.8	-6.6
Subtotal, energy related 1/	--	+1.1	+3.8
Economic stimulus tax proposals:			
Temporary investment tax credit of 12%:			
Individual	--	-0.2	-0.6
Corporation	--	-1.0	-2.3
Individual income tax rebate of 12% on calendar year 1974 liability	--	-4.9	-7.3
Subtotal, economic stimulus	--	-6.1	-10.2
Other:			
Write-off of silver certificates	--	--	+0.2
Other	--	--	+0.1
Total receipts from existing and proposed legislation	264.9	278.8	297.5

1/ Does not include energy equalization payments which show up on the outlay side.

TABLE V 1/

	Level		Per cent Change
	1973	1974	1973 - 1974
Personal Income Minus Transfers ($ billions)	942.0	1015.8	7.8
Personal Comp. Expenditure Deflator	145.9	162.4	11.3
Personal Tax and Nontax receipts ($ billions)	106.8	123.1	15.2

1/ These data do not permit calculation of the income elasticity of personal taxes because part of the tax payments are related to the previous year's tax liability.

On the receipt side, staff projections for fiscal 1976 are lower than presented in the Administration Budget for three reasons. First, if the President's energy program is not adopted, tax collections will be about $4.0 billion lower. Second, we have assumed that Congress will adopt the tax cut proposal of the Ways and Means Committee rather than the President's tax relief proposal, and this further depresses our receipts projection by $10.0 billion. Finally, our receipt projection for FY 76 is lower, because the staff's projection of economic activity is weaker than that embodied in Administration estimates.

TABLE VI

RECONCILIATION OF ADMINISTRATION AND STAFF ESTIMATES
(In billions of dollars)

NIA Expenditures Administration estimate	323.7	361.0
Energy Equalization Payments	-.5	-7.0
Additional Public Employment Funds	--	2.4
Difference in unemployment rate and benefits	--	1.8
Higher defense outlays	2.3	--
Budget Reduction not approved by Congress	.9	10.4*
Other differences	-.5	-.4
NIA Expenditures FRB Estimate	325.9	368.2
Derivation of unified Budget	-8.7	-11.6
Unified Budget Outlays	$317.1	$356.6

* The President has proposed budget reductions totaling $17.0 billion for FY 76. This estimate includes a $6.0 billion decline in outlays due to a 5 per cent ceiling on pay increases and programs tied to the CPI, and $11.0 billion in other deferral, rescissions and other Administrative actions. The staff estimates that only $6.6 billion of these cuts will be realized.

Table VII presents a reconciliation of Administration and staff estimates for receipts.

TABLE VII

RECEIPTS ESTIMATES

	1975	1976
Staff	280.1	278.0
Budget	278.8	297.5
Difference	1.3	-19.5
Due to tax law assumptions	1.1	-13.3
Due to level of economic activity 1/	.2	-6.2

1/ Includes also some differences due to different tax rate assumptions.