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CONFIDENTIAL (FR)

August 10, 1977

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Principal indicators of economic activity indicate that the economy continued to advance in July. Payroll employment rose substantially further, retail sales apparently increased and a tentative estimate suggests that industrial production rose in July at close to the June pace. In addition, data through June suggest continued growth in business fixed investment. Activity in real estate markets, however, appears to have lost some of its upward momentum. Retail prices rose significantly further in June, but at a slower rate than during the first quarter.

Nonfarm payroll employment rose by more than a quarter of a million in July, half again as much as in June, as factory jobs rose by 70,000. In contrast, after rising by 2-1/4 million between December and June, total employment declined as agricultural jobs contracted sharply. The labor force also fell, almost wholly among teenagers, and the unemployment rate declined 0.2 percentage point in July, returning to the May level of 6.9 per cent.

Judging from weekly data, retail sales excluding autos and mainly nonconsumer items rose about 1 per cent in July after two months of little change. Sizeable advances apparently were recorded for general merchandise, apparel and furniture. However, auto sales fell to a 10.8 million unit annual rate last month, well below the near-record June pace. Sales of new domestic models, at an 8.7 million

unit annual rate, were off 600,000 units from the first half average. Sales of foreign models, at a 2.1 million unit annual rate, eased from their record second quarter pace.

Businesses have been making prompt adjustments to evidence of developing inventory imbalances. Manufacturers of nondurable goods and nondurable goods merchant wholesalers reduced their stocks (book value term) in June; their reduction came after earlier large accumulations. The June reduction by manufacturers was quite small but that by wholesalers was relatively large and was the second month of liquidation. Durable goods were accumulated at relatively high rates by both manufacturers and wholesalers in June--the second month of rapid build-up by both. Inventory sales ratios for manufacturers and wholesalers in June continued at relatively low levels.

In real estate markets, activity appears to be showing less ebullience. Sales of new homes declined between the first and second quarter, and starts generally have remained on a high plateau since late last year. In June, total private housing starts fell somewhat from their advanced May pace to a 1.83 million unit annual rate; both single- and multi-family starts declined.

Real business fixed investment increased at a 9 per cent annual rate in the second quarter, with the largest gains in non-electrical machinery and commercial and industrial structures. Commitments data indicate continued strength in this sector--contracts and orders for plant and equipment measured in constant

dollars rose sharply further in the second quarter to a level about one-fifth above a year earlier. New orders for nondefense capital goods increased by nearly 5 per cent in June and by 4-1/2 per cent for the second quarter as a whole.

State and local government outlays also increased sharply in the second quarter. Both value of construction put-in-place and employment rose significantly in June, and these measures should be further bolstered by additional Federal grants for public works and public employment programs. Other Federal government spending also has been increasing, although at a pace somewhat below earlier budget indications.

The Consumer Price Index rose 0.6 per cent in June--the same as in May. The rise for commodities except food slowed to 0.2 per cent, but the services and food groups each rose 0.3 per cent. The Wholesale Price Index declined in June reflecting a sharp reduction in the farm products and foods group, providing a potential for some deceleration in retail food prices in the coming months. The average hourly earnings index rose at a 6-1/2 per cent annual rate in July, close to the average rate over the past year and a half.

Outlook. Fiscal policy assumptions underlying the staff projection are only slightly changed this month. The estimated fiscal 1977 deficit has been reduced around \$2 billion to \$43 billion mainly due to a further shortfall of Federal spending. Assumptions

on the energy program and other fiscal initiatives remain unchanged and we now anticipate a \$58 billion deficit for FY 1978. Monetary policy assumptions have been slightly modified; M_1 is now assumed to advance along a 5-1/4 per cent growth path from 1977-II to 1978-II--a quarter of a point below our prior assumptions. Short-term interest rates are still expected to move up moderately, especially in the early part of the projection period; long-term rates, on the other hand, are projected to drift upward only a bit by the second half of next year.

Staff projections of economic activity over the next six quarters are little changed from last month. Real GNP is projected to rise at an annual rate of about 5-1/2 per cent over the last half of 1977--appreciably below the exceptional pace of the first half of the year. Inventory investment is expected to contribute further to growth in the second half but by considerably less than in the first half. Final sales are projected to increase at about 4-3/4 per cent annual rate--the same pace as in the first half. The net export deficit is projected to average less than in the first half, when oil imports were particularly large.

Output growth is expected to moderate further during 1978--averaging less than 5 per cent annual rate for the four quarters--as support to economic activity from inventory accumulation weakens and real housing outlays edge down late in the year. However, sustained growth is anticipated in business fixed investment and State

and local government purchases and consumption expenditures are expected to reflect these developments. After rising above 6 per cent by late 1977, the savings rate is projected to average around 6-1/2 per cent during 1978.

With output growth averaging about 5 per cent over the projection period, employment should rise at a pace sufficient to reduce the unemployment rate to about 6-1/4 per cent by the end of 1978. Unit labor cost increases are expected to be somewhat larger in 1978 than in the current year in part because of a large minimum wage increase (in 1978-I), which coincides with a step-up in employer social security and unemployment insurance taxes. Thus, cost pressures on prices are not expected to ease. During the four quarters of 1978, price increases for gross business product are expected to average about 6-1/4 per cent on a fixed weighted basis.

Details of the staff projection are shown in the tables that follow.

STAFF GNP PROJECTIONS

	Per cent changes, annual rate							
	Nominal GNP		Real GNP		Gross business product fixed weighted price index		Unemployment rate (per cent)	
	7/13/77	8/10/77	7/13/77	8/10/77	7/13/77	8/10/77	7/13/77	8/10/77
1974 ^{1/}	8.2	8.1	-1.7	-1.4	10.2	10.4	5.6	5.6
1975 ^{1/}	7.3	8.2	-1.8	-1.3	9.3	9.5	8.5	8.5
1976 ^{1/}	11.6	11.6	6.1	6.0	5.2	5.4	7.7	7.7
1977	11.6	11.1	5.3	5.1	6.5	5.9	7.0	7.0
1978	11.8	11.7	5.3	5.3	6.2	6.2	6.4	6.4
1977-I ^{1/}	13.0	13.2	6.9	7.5	6.5	6.8	7.4	7.4
1977-II	14.6	13.5	6.7	6.4	7.6	7.0	7.0	7.0
1977-III	12.3	12.0	5.5	5.3	5.9	5.9	6.9	6.8
1977-IV	12.7	12.4	5.6	5.6	5.9	5.9	6.7	6.7
1978-I	11.8	11.7	5.4	5.4	6.3	6.4	6.6	6.6
1978-II	10.9	10.7	5.0	5.0	6.0	6.2	6.5	6.5
1978-III	10.7	11.0	4.5	4.7	6.2	6.2	6.4	6.4
1978-IV	11.4	11.6	4.5	4.5	6.3	6.4	6.3	6.3
Change:								
76-II to 77-II	11.1	10.5	5.0	4.7	5.9	6.0	-.4	-.4
76-IV to 77-IV	13.2	12.8	6.2	6.2	6.5	6.4	-1.2	-1.2
77-II to 78-II	11.9	11.7	5.4	5.3	6.0	6.1	-.5	-.5
77-IV to 78-IV	11.2	11.3	4.9	4.9	6.1	6.3	-.4	-.4

^{1/} Actual

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

	1977				1978			
	I	II	III	IV	Projected			
					I	II	III	IV
Gross National Product	1810.8	1869.0	1922.5	1979.7	2035.4	2088.0	2143.3	2202.7
Final purchases.	1797.0	1849.3	1900.5	1951.7	2011.4	2056.8	2111.1	2169.5
Private	1422.1	1459.2	1498.1	1535.5	1584.4	1618.4	1661.1	1707.2
Excluding net exports	1430.3	1467.3	1503.5	1543.4	1587.5	1630.2	1673.5	1719.1
Personal consumption expenditures	1172.4	1194.0	1219.0	1247.9	1281.2	1314.8	1349.2	1386.0
Goods	643.6	654.4	667.8	683.7	703.0	722.6	742.5	764.1
Services	528.8	539.6	551.2	564.2	578.2	592.2	606.7	621.9
Gross private domestic investment	271.8	293.0	306.5	323.5	330.3	346.6	356.5	366.3
Residential construction	81.0	90.0	95.5	100.5	105.0	107.5	109.5	111.0
Business fixed investment	177.0	183.3	189.0	195.0	201.3	207.9	214.8	222.1
Change in business inventories	13.8	19.7	22.0	28.0	24.0	31.2	32.2	33.2
Nonfarm	14.1	20.4	22.0	28.0	24.0	31.2	32.2	33.2
Net exports of goods and services ^{1/}	-8.2	-8.1	-5.4	-7.9	-3.1	-11.8	-12.4	-11.9
Exports	170.4	175.4	178.6	184.4	191.4	197.7	203.7	208.7
Imports	178.6	183.5	184.0	192.3	194.5	209.5	216.1	220.6
Gov't. purchases of goods and services	374.9	390.1	402.4	416.2	427.0	438.4	450.0	462.3
Federal ^{2/}	136.3	143.3	147.7	154.0	157.2	160.9	164.9	169.7
State and local	238.5	246.7	254.7	262.2	269.8	277.5	285.1	292.6
Gross national product in constant (1972) dollars	1311.0	1331.6	1348.8	1367.2	1385.4	1402.3	1418.4	1434.0
Personal income	1476.8	1520.1	1559.5	1604.6	1646.0	1687.4	1734.1	1782.9
Wage and salary disbursements	951.3	981.0	1004.0	1033.0	1062.3	1088.3	1115.3	1145.7
Disposable income	1252.4	1295.2	1331.6	1368.6	1409.6	1442.6	1474.9	1513.5
Saving rate (per cent)	4.1	5.5	6.1	6.5	6.8	6.5	6.2	6.1
Corporate profits with I.V.A. and C.C. Adj.	125.4	132.6	143.3	151.5	148.4	153.8	159.3	165.6
Corporate profits before tax	161.7	166.3	175.5	183.5	180.7	186.3	191.8	198.1
Federal government surplus or deficit (-) (N.I.A. basis)	-39.8	-45.4	-52.4	-54.4	-52.9	-49.0	-41.7	-37.2
High employment surplus or deficit (-)	9.5	.8	-11.0	-15.7	-13.2	-10.6	-4.9	-2.3
State and local government surplus or deficit (-) (N.I.A. basis)	27.3	25.6	27.7	28.9	28.7	27.8	26.5	25.1
Excluding social insurance funds	11.9	9.7	11.2	11.8	11.2	9.8	8.0	6.1
Civilian labor force (millions)	96.1	97.2	97.7	98.2	98.8	99.4	100.0	100.6
Unemployment rate (per cent)	7.4	7.0	6.8	6.7	6.6	6.5	6.4	6.3
Nonfarm payroll employment (millions)	80.9	81.9	82.6	83.3	84.0	84.6	85.2	85.8
Manufacturing	19.3	19.6	19.8	20.0	20.2	20.5	20.8	21.0
Industrial production (1967=100)	133.5	137.5	140.5	143.5	146.6	149.3	151.9	154.4
Capacity utilization: all manufacturing (per cent)	81.0	83.1	83.5	84.7	85.8	86.8	87.7	88.4
Materials (per cent)	80.3	82.7	83.1	84.4	85.5	86.5	87.2	87.8
Housing starts, private (millions, A.R.)	1.76	1.89	1.94	1.98	2.00	2.00	1.95	1.90
Sales new autos, (millions, A.R.)	11.12	11.70	11.20	11.60	11.65	11.80	11.80	11.80
Domestic models	9.28	9.34	9.20	9.70	9.75	9.90	9.90	9.90
Foreign models	1.84	2.36	2.00	1.90	1.90	1.90	1.90	1.90

^{1/} Balance of payments data and projection underlying these estimates are shown in the International Developments section of this part of the Greenbook.

^{2/} Components of purchases and total receipts and total expenditures are shown in the Federal Sector Accounts table which follows.

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1977				1978			
	I	II	III	IV	Projected			
					I	II	III	IV
	----- Billions of dollars -----							
Gross National Product	55.4	58.2	53.5	57.2	55.7	52.6	55.3	59.4
Inventory change	14.7	5.9	2.3	6.0	-4.0	7.2	1.0	1.0
Final purchases	40.7	52.3	51.2	51.2	59.7	45.4	54.3	58.4
Private	35.8	37.1	38.9	37.4	48.9	34.0	42.7	46.1
Net exports	-11.2	.1	2.7	-2.5	4.8	-8.7	-.6	.5
Excluding net exports	47.0	37.0	36.2	39.9	44.1	42.7	43.3	45.6
Personal consumption expenditures	33.4	21.6	25.0	28.9	33.3	33.6	34.4	36.8
Goods	18.5	10.8	13.4	15.9	19.3	19.6	19.9	21.6
Services	14.9	10.8	11.6	13.0	14.0	14.0	14.5	15.2
Residential fixed investment	4.3	9.0	5.5	5.0	4.5	2.5	2.0	1.5
Business fixed investment	9.4	6.3	5.7	6.0	6.3	6.6	6.9	7.3
Government	4.9	15.2	12.3	13.8	10.8	11.4	11.6	12.3
Federal	2.1	7.0	4.4	6.3	3.2	3.7	4.0	4.8
State and local	2.7	8.2	8.0	7.5	7.6	7.7	7.6	7.5
GNP in constant (1972) dollars	23.6	20.6	17.2	18.4	18.2	16.8	16.2	15.6
Final purchases	12.0	17.8	16.2	14.5	18.9	12.7	15.5	14.9
Private	13.3	11.3	11.4	11.3	15.9	9.1	12.3	13.4
	----- In Per Cent Per Year ^{1/} -----							
Gross National Product	13.2	13.5	12.0	12.4	11.7	10.7	11.0	11.6
Final purchases	9.6	12.1	11.5	11.2	12.8	9.3	11.0	11.5
Private	10.7	10.9	11.1	10.4	13.4	8.9	11.0	11.6
Personal consumption expenditures	12.2	7.6	8.6	9.8	11.1	10.9	10.9	11.4
Goods	12.4	6.9	8.4	9.9	11.8	11.6	11.5	12.2
Services	12.0	8.5	8.9	9.8	10.3	10.0	10.2	10.4
Private domestic investment	55.5	35.1	19.7	24.1	8.7	21.2	11.9	11.5
Residential structures	24.2	52.9	26.8	22.6	19.1	9.9	7.7	5.6
Business fixed investment	24.5	14.9	13.0	13.3	13.6	13.8	14.0	14.3
Gov't. purchases of goods and services	5.4	17.2	13.2	14.4	10.8	11.1	11.0	11.4
Federal	6.6	22.2	12.9	18.2	8.6	9.8	10.3	12.2
State and local	4.7	14.5	13.6	12.3	12.1	11.9	11.4	10.9
GNP in constant (1972) dollars	7.5	6.4	5.3	5.6	5.4	5.0	4.7	4.5
Final purchases	3.8	5.6	5.0	4.4	5.7	3.8	4.6	4.3
Private	5.3	4.4	4.4	4.3	6.1	3.4	4.6	4.9
GNP implicit deflator ^{2/}	5.3	6.6	6.4	6.5	6.0	5.5	6.0	6.8
Gross business product fixed-weighted price index ^{3/}	6.8	7.0	5.9	5.9	6.4	6.2	6.2	6.4
Personal income	13.1	12.3	10.8	12.1	10.7	10.5	11.5	11.8
Wage and salary disbursements	12.7	13.1	9.7	12.1	11.8	10.2	10.3	11.4
Disposable income	10.1	14.4	11.7	11.6	12.5	9.7	9.3	10.9
Corporate profits before tax	19.1	11.9	24.0	19.5	-6.0	13.0	12.4	13.7
Nonfarm payroll employment	4.2	4.9	3.6	3.3	3.2	2.9	3.1	2.6
Manufacturing	5.3	6.4	3.7	5.4	3.8	6.9	4.0	4.0
Nonfarm business sector								
Output per hour	5.0	-.4	2.9	2.6	2.5	2.1	2.2	2.0
Compensation per hour	11.7	7.4	7.7	7.7	11.1	7.8	7.9	7.9
Unit labor costs	6.3	7.9	4.8	5.1	8.6	5.7	5.7	5.9
Industrial production	5.6	12.5	9.0	8.7	8.9	8.0	7.1	6.6
Housing starts, private	-2.6	33.2	11.7	8.5	4.1	.0	-9.6	-9.9
Sales new autos	53.4	22.5	-16.1	15.1	1.7	5.3	.0	.0
Domestic models	55.1	2.6	-6.0	23.6	2.1	6.3	.0	.0
Foreign models	45.2	170.5	-48.5	-18.5	.0	.0	.0	.0

1/ Percentage rates are annual rates compounded quarterly.

2/ Excluding Federal pay increases rates of change are: 1977-I, 5.3 per cent; 1977-IV, 5.9 per cent; 1978-I, 5.9 per cent; 1978-IV, 6.8 per cent.

3/ Using expenditures in 1972 as weights.

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GROSS NATIONAL PRODUCT AND RELATED ITEMS
 (Expenditures and income figures are billions of dollars)

	1971	1972	1973	1974	1975	1976	1977	1978
Gross National Product	1063.4	1171.1	1306.6	1412.9	1528.8	1706.5	1895.5	2117.3
Final purchases	1057.1	1161.7	1288.6	1404.0	1540.3	1693.1	1874.6	2087.2
Private	823.4	908.6	1019.1	1101.3	1201.4	1331.7	1478.7	1642.8
Excluding net exports	821.8	911.9	1012.0	1095.3	1181.0	1323.9	1486.1	1652.6
Personal consumption expenditures	668.2	733.0	809.9	889.6	980.4	1093.9	1208.3	1332.8
Goods	374.8	410.5	457.5	498.3	542.2	601.6	662.4	733.0
Services	293.4	322.4	352.3	391.3	438.2	492.3	545.9	599.7
Gross private domestic investment	160.0	188.3	220.0	214.6	189.1	243.3	298.7	349.9
Residential construction	49.6	62.0	66.1	55.1	51.5	68.0	91.7	108.2
Business fixed investment	104.1	116.8	136.0	150.6	149.1	161.9	186.1	211.5
Change in business inventories	6.4	9.4	17.9	8.9	-11.5	13.3	20.9	30.1
Nonfarm	5.1	8.8	14.7	10.8	-15.1	14.9	21.1	30.1
Net exports of goods and services	1.6	-3.3	7.1	6.0	20.4	7.8	-7.4	-9.8
Exports	65.6	72.7	101.6	137.9	147.3	162.9	177.2	200.4
Imports	64.0	75.9	94.4	131.9	126.9	155.1	184.6	210.2
Gov't. purchases of goods and services	233.7	253.1	269.5	302.7	338.9	361.4	395.9	444.4
Federal	96.2	102.1	102.2	111.1	123.3	130.1	145.3	163.2
State and local	137.5	151.0	167.3	191.5	215.6	231.2	250.5	281.2
Gross national product in constant (1972) dollars	1107.5	1171.1	1235.0	1217.8	1202.1	1274.7	1339.6	1410.0
Personal income	859.1	942.5	1052.4	1154.9	1253.4	1382.7	1540.3	1712.6
Wage and salary disbursements	579.4	633.8	701.3	764.6	805.7	891.8	992.3	1102.9
Tangible income	742.8	801.3	901.7	984.6	1084.4	1185.8	1312.0	1460.2
Inflation rate (per cent)	7.7	6.2	7.8	7.3	7.4	5.6	5.6	6.4
Corporate profits with I.V.A. and C.C. Adj.	77.2	92.1	99.1	83.6	99.3	128.1	138.2	156.8
Corporate profits before tax	82.0	96.2	115.8	126.9	123.5	156.9	171.8	189.2
Federal government surplus or deficit (-) (N.I.A. basis)	-22.0	-17.3	-6.7	-10.7	-70.2	-54.0	-47.8	-45.2
High employment surplus or deficit (-)	-5.3	-5.9	-7	17.1	-20.3	-10.4	-4.1	-7.7
State and local government surplus or deficit (-) (N.I.A. basis)	3.7	13.7	13.0	7.5	5.9	18.4	27.4	27.0
Excluding social insurance funds	-3.8	5.6	4.1	-2.9	-6.2	3.9	11.2	8.8
Civilian labor force (millions)	84.1	86.5	88.7	91.0	92.6	94.8	97.3	99.7
Unemployment rate (per cent)	6.0	5.6	4.9	5.6	8.5	7.7	7.0	6.4
Nonfarm payroll employment (millions)	71.2	73.7	76.9	78.4	77.1	79.4	82.2	84.9
Manufacturing	18.6	19.1	20.1	20.0	18.3	19.0	19.7	20.6
Industrial production (1967=100)	109.6	119.7	129.8	129.3	117.8	129.8	138.7	150.6
Capacity utilization: all manufacturing (per cent)	78.0	83.1	87.5	84.2	73.6	80.1	83.1	87.2
Materials (per cent)	83.1	88.0	92.4	87.7	73.6	80.3	82.6	86.8
Housing starts, private (millions, A.R.)	2.05	2.36	2.05	1.34	1.16	1.54	1.89	1.96
Sales new autos (millions, A.R.)	10.24	10.93	11.42	8.91	8.66	10.12	11.41	11.76
Domestic models	8.68	9.32	9.65	7.49	7.08	8.63	9.38	9.86
Foreign models	1.56	1.61	1.77	1.42	1.58	1.50	2.03	1.90

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1971	1972	1973	1974	1975	1976	1977	1978
----- Billions of Dollars -----								
Gross National Product	81.0	107.7	135.5	106.3	115.9	177.7	189.0	221.8
Inventory change	2.6	3.0	8.5	-9.0	-20.4	24.8	7.6	9.3
Final purchases	78.5	104.6	126.9	115.4	136.3	152.8	181.5	212.5
Private	63.7	85.2	110.5	82.2	100.1	130.3	147.0	164.1
Net exports	-2.3	-4.9	10.4	-1.1	14.4	-12.6	-15.2	-2.4
Excluding net exports	66.0	90.1	100.1	83.3	85.7	142.9	162.2	166.5
Personal consumption expenditures	49.4	64.8	76.9	79.7	90.8	113.5	114.4	124.5
Goods	25.2	35.7	47.0	40.8	43.9	59.4	60.8	70.7
Services	24.3	29.0	29.9	39.0	46.9	54.1	53.6	53.8
Residential fixed investment	13.0	12.4	4.1	-11.0	-3.6	16.5	23.7	16.5
Business fixed investment	3.6	12.7	19.2	14.6	-1.5	12.8	24.2	25.4
Government	14.8	19.4	16.4	33.2	36.2	22.5	34.5	48.6
Federal	.6	5.9	.1	8.9	12.2	6.8	15.2	17.8
State and local	14.3	13.5	16.3	24.2	24.1	15.6	19.3	30.7
GNP in constant (1972) dollars	32.2	63.6	63.9	-17.2	-15.7	72.6	64.9	70.4
Final purchases	29.9	60.8	56.8	-8.6	2.1	54.2	60.1	63.4
Private	30.7	57.1	57.4	-13.8	-3.2	52.8	53.1	49.3
----- In Per Cent Per Year -----								
Gross National Product	8.2	10.1	11.6	8.1	8.2	11.6	11.1	11.7
Final purchases	8.0	9.9	10.9	8.9	9.7	9.9	10.7	11.3
Private	8.4	10.3	12.2	8.1	9.1	10.8	11.0	11.1
Personal consumption expenditures	8.0	9.7	10.5	9.8	10.2	11.6	10.5	10.3
Goods	7.2	9.5	11.4	8.9	8.8	11.0	10.1	10.7
Services	9.0	9.9	9.3	11.1	12.0	12.4	10.9	9.9
private domestic investment	13.6	17.7	16.8	-2.5	-11.9	28.7	22.8	17.1
Residential structures	35.5	25.1	6.6	-16.7	-6.5	32.2	34.9	18.0
Business fixed investment	3.6	12.3	16.4	10.8	-1.0	8.6	14.9	13.7
Gov't. purchases of goods and services	6.8	8.3	6.5	12.3	12.0	6.6	9.5	12.3
Federal	.6	6.1	.1	8.7	11.0	5.5	11.7	12.3
State and local	11.6	9.8	10.8	14.5	12.6	7.2	8.3	12.3
GNP in constant (1972) dollars	3.0	5.7	5.5	-1.4	-1.3	6.0	5.1	5.3
Final purchases	2.8	5.5	4.9	-.7	.2	4.5	4.7	4.8
Private	3.7	6.7	6.3	-1.4	-.3	5.6	5.3	4.7
GNP implicit deflator	5.1	4.1	5.8	9.7	9.6	5.3	5.7	6.1
Gross business product fixed-weighted price index ^{1/}	4.4	3.3	5.7	10.4	9.5	5.4	5.9	6.2
Personal income	7.2	9.7	11.7	9.7	8.5	10.3	11.4	11.2
Wage and salary disbursements	6.0	9.4	10.7	9.0	5.4	10.7	11.3	11.1
Disposable income	8.3	7.9	12.5	9.2	10.1	9.4	10.6	11.3
Corporate profits before tax	14.7	17.3	20.4	9.6	-2.7	27.0	9.5	10.1
Nonfarm payroll employment	.4	3.5	4.3	2.0	-1.7	3.1	3.5	3.3
Manufacturing	-4.0	2.8	5.1	-.1	-8.5	3.3	3.7	4.9
Nonfarm business sector								
Output per hour	2.9	3.0	1.7	-2.8	1.6	4.1	2.0	2.3
Compensation per hour	6.6	5.8	7.8	9.4	9.6	8.7	8.8	8.6
Unit labor costs	3.5	2.7	6.0	12.6	7.9	4.4	6.7	6.3
Industrial production	1.7	9.2	8.4	-.4	-8.9	10.2	6.9	8.5
Housing starts	43.1	14.9	-13.2	-34.6	-13.3	32.6	23.0	3.8
Sales new autos	21.9	6.8	-4.7	-14.5	-2.8	16.9	12.7	3.1
Domestic models	21.9	7.4	3.5	-22.4	-5.5	21.9	8.8	5.1
Foreign models	21.6	1.1	9.7	-19.9	11.4	-5.1	25.2	-6.2

^{1/} Using expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

	Fiscal Year 1976*	FY 1977 e/		FY 1978 e/			CY 1976 *	CY 1977 e/		F.R.B. staff estimates Calendar quarters; unadjusted data :						
		Admin.	F.R.	Admin.	F.R.	Cong.		F.R.	1977			1978				
		est. 1/ Board	est. 1/ Board	est. 1/ Board	est. 1/ Board	est. 2/ Board		est. 1/ Board	I*	II*	III	IV	I	II	III	
Unified budget receipts	299.2	358.3	358.9	401.4	397.3	396.5	317.6	368.5	79.0	110.5	93.4	85.6	86.6	120.2	105.1	
Unified budget outlays	365.7	406.4	401.9	462.9	455.8	461.0	374.2	411.1	97.6	101.8	103.5	108.2	109.3	116.3	122.0	
Surplus(+)/Deficit(-), unified budget	-66.5	-48.1	-43.0	-61.5	-58.3	-64.7	-56.6	-42.8	-18.7	8.6	-10.1	-22.6	-22.7	3.9	-16.9	
Surplus(+)/Deficit(-), off-budget agencies 3/	-7.3	-10.1	-10.4	-7.7	-9.5	n.a.	-5.7	-10.3	-4.3	.1	-6.6	.5	-4.2	-.1	-5.6	
Means of financing combined deficits:																
Net borrowing from public	82.9	n.a.	45.3	n.a.	67.2	n.a.	69.0	48.8	17.6	-1.1	11.4	20.9	25.4	-2.3	23.2	
Decrease in cash operating balance	-7.2	n.a.	5.4	n.a.	1.0	n.a.	-3.2	.7	2.6	-7.2	4.3	1.0	0	0	0	
Other 4/	-1.9	n.a.	2.5	n.a.	-.5	n.a.	-3.5	3.5	2.7	-.4	1.0	.2	1.5	-1.5	-.7	
Cash operating balance, end of period	14.8	n.a.	12.0	n.a.	11.0	n.a.	11.7	11.0	9.0	16.3	12.0	11.0	11.0	11.0	11.0	
Memo: Sponsored agency borrowing 5/	3.4	n.a.	5.5	n.a.	n.e.	n.a.	2.9	5.9	.7	2.8 ^{e/}	1.5	.9	2.4	n.e.	n.e.	
NIA Budget									Seasonally adjusted, annual rates							
Receipts	312.5	365.4	362.7 ^{6/}	415.3	411.6 ^{6/}	n.a.	332.3	374.8	364.9	367.7 ^{e/}	376.8	389.9	404.6	417.8	437.1	
Outlays	373.1	417.2	411.6	469.3	461.9	n.a.	386.3	422.6	403.7	413.2 ^{2/}	429.2	444.3	457.5	466.8	478.8	
Purchases (total)	127.0	143.6	140.4	163.5	159.3	n.a.	130.1	145.3	136.3	143.3 ^{2/}	147.7	154.0	157.2	160.9	164.9	
Defense	85.9	92.8	92.3	105.2	103.8	n.a.	86.8	95.4	89.7	94.2 ^{2/}	96.7	100.8	103.0	104.7	106.5	
Non-defense	41.2	50.8	48.2	58.3	55.5	n.a.	43.3	50.0	46.7	49.1 ^{2/}	51.0	53.2	54.2	56.2	58.4	
All other outlays	246.1	273.6	271.3	305.8	302.6	n.a.	256.2	277.3	267.4	269.9 ^{2/}	281.5	290.3	300.3	305.9	313.9	
Surplus(+)/Deficit(-)	-60.6	-51.8	-48.9 ^{6/}	-54.0	-50.3 ^{6/}	n.a.	-54.0	-47.8	-38.8	-45.4 ^{e/}	-52.4	-54.4	-52.9	-49.0	-41.7	
High Employment Surplus(+)/Deficit(-) (NIA basis) 7/	-15.7	n.a.	-2.0	n.a.	-11.1	n.a.	-10.4	-4.1	9.5	.8	-11.0	-15.7	-13.2	-10.6	-4.9	
	*actual	e--estimated	r--revised	n.e.--not estimated	n.a.--not available									p--preliminary		

1/ OMB Mid-Session Review of the 1978 Budget, (July 1, 1977).

2/ Congress' First Concurrent Resolution on the Budget (May 17, 1977).

3/ Includes Federal Financing Bank, Postal Service, U.S. Railway Association, Rural Electrification and Telephone Revolving fund, Housing for the Elderly or Handicapped Fund, and Pension Benefit Guaranty Corporation.

4/ Checks issued less checks paid, accrued items and other transactions.

5/ Includes Federal Home Loan Banks, FNMA, Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.

6/ Quarterly average exceeds fiscal year total by \$.8 billion for FY 1977 and FY 1978 due to spreading of wage base effect over calendar year.

7/ Estimated by F.R.B. staff. The high employment budget forecast incorporates the Department of Commerce's July, 1977 GNP revisions.

Comments on the Federal Sector Outlook

Federal spending, on a unified budget basis has continued to run below Administration and staff expectations. Final data for June indicate that payments by foreign governments into the military assistance trust fund (an outlay offset) were \$0.7 billion larger than expected.^{1/} Preliminary data also suggest that the spending shortfall increased further during July. As a result of these developments, the staff has revised its estimates of fiscal year 1977 outlays downward by approximately \$2 billion to \$402 billion. Receipts are expected to total \$359 billion and the resulting deficit now is projected at \$43 billion.

To meet its financing needs for the final quarter of this fiscal year (1977:3), the Treasury is expected to borrow \$8 to \$10 billion in the market. The Treasury will have raised about \$6 billion of this total when it completes its mid-August refunding operation. The remaining cash needs will be met through regular auctions of 2- and 4-year notes.

For fiscal year 1978, the outlays estimate has been revised down by about \$1 billion to \$456 billion, and expected receipts have been increased fractionally to \$397-1/2 billion as a result of

^{1/} Despite the recent outlay shortfalls, Federal unified spending on an unadjusted basis, increased by \$4 billion to \$102 billion during the second quarter of 1977.

slightly higher income projections. Thus, the unified deficit is now forecast to be \$58 billion, down about \$1-1/2 billion from last month.

Given the expected increase in the fiscal 1978 deficit, the Treasury's borrowing activity will likely pick up in the fourth quarter. About \$18 to \$20 billion of new cash is expected to be raised in the market--a total which probably will necessitate renewed use of the bill market.

Given incoming spending data, we continue to project a \$4-1/2 billion increase, annual rate, in Federal purchases during the current quarter, with most of the rise occurring in defense spending and CCC outlays.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. In recent weeks, growth in the monetary aggregates accelerated sharply. M_1 expanded at an annual rate of about 18 per cent in July, an increase traceable only to a limited extent to the influence of transitory special factors. In addition, growth in time and savings deposits, other than negotiable CDs, picked up significantly at both commercial banks and thrift institutions.

As the aggregates strengthened, demand pressures on reserves were accompanied by a rise in the Federal funds rate from 5-3/8 to around 5-3/4 per cent. Reflecting this tightening in the money market, most short- and intermediate-term market rates have risen about 20 to 35 basis points since the last FOMC meeting. Yields on long-term Treasury issues have risen around 5 to 10 basis points, while other long-term rates are little changed. Most major stock price indexes, in addition, have declined around three to four per cent.

Treasury borrowing has picked up somewhat recently, but credit flows to State and local governments and businesses have slackened on balance. The Treasury raised about \$3.0 billion in new money through coupon issues sold in connection with the mid-August refunding, and another \$1.5 billion in cash was obtained through an earlier sale of 2-year notes. Meanwhile, gross issues of long-term, tax-exempt securities in July fell more than seasonally, following a bulge in offerings in June. In the business sector, credit flows in July seemed to have slackened on balance despite some rise in

corporate bond offerings, as short-term borrowing at banks and in the commercial paper market moderated.

Funds raised by households in July are likely to have remained close to the same vigorous pace seen for some months. At thrift institutions, large outstanding mortgage commitments suggest that net mortgage lending rose somewhat further. Consumer instalment credit outstanding probably expanded at around the recent rapid pace, given relatively strong new car sales and firmness in other consumer durable goods purchases.

Outlook. Treasury borrowing is likely to increase substantially in coming months, as the Treasury budget deficit is projected to widen more than seasonally from \$16.7 billion in this quarter to \$22.1 billion in the fourth quarter of the year. In the tax-exempt market, on the other hand, debt issuance may taper off somewhat through the end of the year. Signs of some slowing in heavy advance refundings are already evident, and these and other anticipatory borrowings probably will abate in coming months.

The gap between business capital outlays and internally generated funds is projected to change little over the balance of the year. While external financing demands are therefore unlikely to strengthen, somewhat more borrowing may be concentrated within the banking system--with banks expected to persist in campaigns, now underway, to offer more attractive terms of lending to small and intermediate-sized businesses.

Given the staff GNP projections, households are likely to continue to accumulate instalment debt at about the rapid pace of recent months. Household demands for mortgages, in addition, should remain quite substantial.

Under these circumstances, aggregate credit demands are not likely to pick up significantly further, although money demands should continue to grow in response to continued expansion of economic activity. In this environment, the staff expects any additional upward interest rate pressures over the balance of the year to be relatively moderate and confined mainly to the shorter end of the maturity spectrum. Limited upward movements in longer-term rates would reflect, in part, a continued abundance of funds available for long-term investments by institutions such as life insurance companies and pension funds.

Given only modest upward pressure on longer-term rates and the wide spreads still existing between the regulatory ceilings on 4- and 6-year accounts, it seems probable that depository institutions will be able to continue to compete successfully for funds in longer-maturity accounts. Inflows into shorter-term accounts, though, will likely deteriorate as returns on these deposits compare more unfavorably with market yields. In partial response to this slowing, commercial banks can be expected to seek more aggressively market sources of funds, such as negotiable CD's or nondeposit

sources of funds like RP's, while thrift institutions rely more heavily on borrowings, principally FHL Bank advances.

The supply of mortgage funds, though, should remain ample for quite some time. Total sources of funds to thrift institutions are likely to remain strong, at least for a time, and diversified lenders should continue to be attracted to the market as long as the spreads between mortgage rates and long-term market yields, like the corporate bond rate, are relatively wide. Should the market begin to tighten, mortgage originators--primarily mortgage companies--could begin to tap on accumulated \$6 billion in FIMA purchase commitments, the largest amount in two years.

INTERNATIONAL DEVELOPMENTS

Summary. The weighted average exchange rate for the dollar against major foreign currencies recovered about 1 per cent from the low point reached on July 25 and now stands about 1 per cent below the level of late June.

The recent strengthening of the dollar reflects market reaction both to the statements of U.S. officials indicating that the United States attaches great importance to maintaining the strength of the dollar, and to the rise in dollar interest rates. The dollar appreciated most sharply against the DM and the Yen. It depreciated against sterling because of a decision of the U.K. authorities in late July to discontinue their policy of maintaining a target ceiling rate for sterling exclusively in terms of the U.S. dollar.

Recent data on consumer and wholesale prices show that U.S. performance continues to be better than that for most major industrial countries. In Japan and most other G-10 countries, consumer prices have been rising at rates of close to 10 per cent annually or greater, except in a few countries for short periods when particularly favorable trends in food prices have held down the rate of inflation. However, consumer prices have been rising in Switzerland at an annual rate of less than 2 per cent, and in Germany at a rate of about 5 per cent. Wholesale prices in Japan have been virtually stable this year and have risen only slightly in Germany, but those of most other industrial countries have increased at annual rates ranging from 10 to more than 20 per cent.

The U.S. trade deficit rose sharply in June, as imports rebounded from the May level and exports declined. For the second quarter, the trade deficit was \$31 billion at an annual rate. Imports picked up strongly in the second quarter, with substantial increases in purchases of industrial supplies, especially steel and nonferrous metals. Second-quarter imports were also swelled by a 5 per cent rise in the volume of oil imports, primarily a result of stock building in anticipation of the July 1 OPEC price increase. At the end of June, U.S. stocks of crude petroleum and products were unusually high; the estimated second-quarter increase in these stocks added about \$4-1/2 billion at an annual rate to the import bill for the quarter.

Exports in the second quarter rose about 4 per cent from the first quarter; there were notable increases in agricultural exports (primarily soybeans reflecting both higher volumes and prices), in shipments of industrial supplies (especially coal which goes largely to Japan), and in exports of civilian aircraft.

Matching the current account deficit, estimated at about \$20 billion (annual rate) in the second quarter were very large capital inflows from foreign official institutions;

, with relatively small investments by OPEC. Net private capital flows were very small. Foreign countries have continued to arrange large amounts of medium-term credits in Euro-currency and Euro-bond markets, although LDC borrowing is down from late 1976 levels. Additional official financing resources will become available in 1978 as a result of the recently negotiated

IMF Supplementary Credit (Witteveen) Facility. Under this facility of close to \$10 billion, IMF members whose financing needs cannot be met by their normal four tranches would have access to supplementary funds for periods of 3 to 7 years, subject to IMF conditions and performance targets.

Outlook. Recent information on activity abroad -- notably the weakness of industrial production during the second quarter -- continues to suggest that growth in output for the remainder of this year will be at an annual rate of 4-5 per cent. As a consequence the outlook is for moderate growth in U.S. exports over the balance of this year. By the fourth quarter of this year, U.S. exports are projected to pick up, and to grow at roughly the same rate as U.S. imports through the end of 1978. The U.S. trade deficit is now expected to be about \$30 billion for 1977 and about \$36 billion for 1978, and the respective current account deficits to be about \$20 billion and \$25 billion.

The trade deficit now projected for this year is larger than earlier expected by the staff because of the stronger outlook for both oil and non-oil imports. The \$4-1/2 billion (annual rate) rise in oil stocks in the second quarter reflected purchases mainly in anticipation of the mid-year rise in prices. Oil companies are expected to import oil in the second half at a rate that will enable them to take full advantage of the subsidy to imported oil (the so-called entitlement¹⁾) before this subsidy is reduced as a result of the well-head tax of \$3.50 per barrel, scheduled to go into effect in January 1978. Thus, although oil companies may reduce imports and stocks somewhat in the

third quarter, they are expected to rebuild stocks in the fourth. The higher levels of year-end oil stocks now expected together with lower expected shipments of Alaskan oil, imply larger oil imports for the year than earlier anticipated.

The volume of non-oil imports is expected to rise about 12 per cent this year, and 10 per cent next year, and import prices are projected to increase at roughly 7-8 per cent per annum. Imports of industrial supplies and capital goods, which have been strong so far this year, are expected to rise further in line with the expansion in U.S. economic activity. On the other hand, some temporary slowing may occur in imports of foods (which rose sharply earlier this year) and of consumer goods (which have been large but relatively stable).

The staff expects that, on balance, the projected larger trade deficits for this year and next will be matched by capital inflows at roughly the present average rate for the dollar. And, in fact, the staff continues to look for a slight appreciation in the average exchange rate over the year ahead -- reflecting the relatively favorable price performance of the U.S. economy compared to most other industrial countries.

	1976	1977 ^P	1978 ^P	1976		1977				1978 ^P			
				III	IV	I	II ^P	III ^P	IV ^P	I	II	III	IV
<u>Billions of dollars</u>													
1. GNP NET EXPORTS - Intl Acct. data	7.8	-9.8	-13.1	7.8	2.9	-8.2	-11.3	-8.6	-11.0	-6.3	-15.0	-15.6	-15.1
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(7.8)	(-7.4)	(-9.8)	(7.9)	(3.0)	(-8.2)	(-8.1)*	(-5.4)	(-7.8)	(-3.1)	(-11.8)	(-12.4)	(-11.9)
3. a) Merchandise Trade Balance	-9.2	-30.2	-36.5	-11.1	-14.3	-27.9	-31.2*	-29.5	-32.1	-28.7	-38.2	-39.5	-39.4
4. Exports (excl. military)	114.7	122.7	138.4	118.4	118.9	117.9	122.1*	123.5	127.3	131.4	136.1	141.0	145.2
5. Agricultural	23.4	24.9	24.7	25.0	23.6	24.5	26.7*	24.4	24.0	24.0	24.4	25.2	25.2
6. Nonagricultural	91.3	97.8	113.7	93.5	95.3	93.4	95.4*	99.1	103.3	107.4	111.7	115.8	120.0
7. Imports	123.9	152.9	174.9	129.5	133.2	145.8	153.3*	150.3	159.4	160.1	174.3	180.5	184.6
8. Petroleum and petrol. products	34.6	44.4	47.5	37.6	37.4	44.3	47.7*	41.6	44.0	40.3	49.0	50.2	50.4
9. Nonpetroleum	89.3	108.5	127.4	91.9	95.8	101.5	105.5*	111.4	115.4	119.8	125.3	130.3	134.2
10. b) Military transactions, net <u>2/</u>	--	.8	1.4	.5	.4	-.1	.7	1.3	1.2	1.4	1.4	1.4	1.4
11. c) Investment income, net <u>3/</u>	14.3	17.8	20.5	15.3	14.4	17.6	17.3	17.9	18.3	19.4	20.3	21.0	21.4
12. d) Other services, net <u>4/</u>	2.7	1.8	1.5	3.1	2.4	2.2	1.9	1.7	1.6	1.6	1.5	1.5	1.5
13. U.S. CURRENT ACCOUNT BALANCE <u>2/</u>	-9	-19.5	-25.1	-1.5	-5.9	-17.1	-20.6	-18.4	-21.5	-17.9	-27.1	-27.7	-27.5
14. a) GNP net exports (line 1.)	7.8	-9.8	-13.1	7.8	2.9	-8.2	-11.3	-8.6	-11.0	-6.3	-15.0	-15.6	-15.1
15. b) U.S. Govt & private transfers <u>5/</u>	-8.7	-9.7	-12.1	-9.3	-8.8	-8.9	-9.3	-9.8	-10.5	-11.6	-12.1	-12.1	-12.4
<u>Constant (1972) dollars</u>													
16. Merchandise exports (excl. military)	66.7	67.5	71.5	68.4	67.3	66.2	67.5	67.5	68.6	69.7	70.9	72.1	73.1
17. (% change, annual rates)	(3.4)	(1.2)	(6.0)	(13.0)	(-6.6)	(-7.0)	(8.2)	(0)	(6.6)	(6.6)	(7.0)	(7.0)	(5.3)
18. Merchandise imports	62.8	71.3	76.6	64.9	66.1	70.0	71.9	70.5	72.5	71.7	76.9	78.5	79.1
19. (% change, annual rates)	(22.5)	(13.5)	(7.4)	(29.1)	(7.4)	(26.2)	(11.2)	(-7.8)	(11.7)	(-4.5)	(32.6)	(8.7)	(3.3)
<u>Foreign Outlook - Major Industrial Countries: <u>6/</u></u>													
20. Real GNP, % change, annual rates	5.1	3.7	4.8	1.2	4.5	4.9	2.0	4.1	4.5	4.9	5.3	5.3	4.9
21. Wholesale Prices, % change, annual rates <u>7/</u>	9.5	9.5	6.5	11.7	8.7	10.8	8.2	6.6	6.1	6.1	6.1	6.6	7.0

1/ Lags Intl. Acct. data (line 1) in the inclusion of revisions and new data.

2/ Excludes grants to Israel under military assistance acts and exports financed by those grants.

3/ Excludes U.S. Govt. interest payments to foreigners, which are included in line 15.

4/ Includes travel, transportation, fees and royalties, and miscellaneous other service transactions.

5/ Includes U.S. Govt grants, U.S. Govt interest payments to foreigners, and remittances and pensions.

6/ Weighted by the shares of Canada, France, Germany, Italy, Japan and the United Kingdom in the sum of the real GNP of the six countries in dollar terms.

7/ Data are largely manufactured goods prices.

p/ Projected.

e/ Estimated.

*/ Published data.