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Part 1

September 14, 1977

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Summary and Outlook

Prepared for the Federal Open Market Committee

By the staff of the Board of Governors of the Federal Reserve System

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. The latest economic data show a mixed picture. In August, industrial production apparently declined and employment growth slowed. New orders for durable goods are indicated to have fallen sharply in July. However, retail sales recorded strong gains in July and August, residential construction activity has been strong, and the latest survey of business spending plans indicates further growth in plant and equipment outlays. Additionally, increases in prices overall have moderated relative to the large rises earlier in the year.

Industrial production is tentatively estimated to have declined about 1/2 per cent in August; about two-fifths of the reduction was attributable to increased strike activity. Manufacturing employment declined by 64,000 in August, and the factory workweek fell for the second consecutive month. Job gains in service-producing industries, however, more than offset the decline in manufacturing, and total employment rose moderately. The unemployment rate also rose--0.2 percentage point to 7.1 per cent in August--as the labor force increased sharply.

Retail sales are estimated to have risen 1.7 per cent in August, following an upward revised 0.9 per cent increase in July. These increases more than offset the decline recorded between March and June. Excluding autos and mainly nonconsumer items, retail sales in August were up 1.7 per cent from the second quarter average--about the same as the average quarterly gain during the first half.

Residential construction activity remained strong in July. Total private housing starts were at a 2.1 million annual rate, 8 per cent above the June pace. Increases were recorded in both single-family and multifamily units, with gains in the latter primarily supported by Federal subsidy programs.

Recent adjustments in industrial production appear to have resulted mainly from continuing attempts to prevent an excessive build-up of inventories after some run-up during the spring. The book value of manufacturers' stocks rose at an \$11-1/2 billion annual rate in July--less than the rate in both June and the second quarter as a whole. The accumulation by durable-goods producers was only about half the June rate, while soft-goods manufacturers' inventories rose slightly after some liquidation in June.

Indicators of business spending on plant and equipment have been mixed recently. After rising nearly 5 per cent in June, new orders for nondefense capital goods fell about 10 per cent in July. The swing was concentrated largely in orders for aircraft; foreign orders for aircraft and parts, which had risen sharply in June, declined sharply in July. Orders for machinery, which comprise about four-fifths of capital goods bookings, declined 1-3/4 per cent in July after rising almost 2-1/2 per cent in June. At the same time, the latest Commerce survey of anticipated plant and equipment expenditures--taken in late July and August--shows that business is planning a 13.3 per cent increase for 1977, the third successive upward revision in spending

plans since the initial survey for the year was taken last December. In addition, manufacturers' newly approved capital appropriations, which typically lead spending by about a year, rose 13 per cent in the second quarter if the volatile petroleum industry is excluded. For the first half of 1977, these appropriations were almost 16 per cent above the 1976 average.

Wholesale prices of industrial commodities less fuels and power rose .5 per cent in August--about in line with the average rate of increase in this series over the past year and a half. Reflecting falling prices of farm products and foods, however, the total Wholesale Price Index rose only 0.1 per cent in August after declining in June and July. Falling farm product prices have also been helping to constrain price increases at retail. The all-items CPI was up .4 per cent in July; exclusive of food and energy items the rise was .6 per cent--the same as in the previous three months.

Outlook. In light of incoming data, we have scaled back our estimate of third quarter real GNP growth about three-fourths of a percentage point to about 4-1/2 per cent (annual rate). The recent slowing has been somewhat more pronounced than expected earlier, but support to aggregate activity through the end of 1978 is still expected from substantial growth in business fixed investment outlays, and continued increases in State and local government spending and from consumption expenditures. Beyond the current quarter, consequently, real growth is projected to be only slightly less than anticipated a month ago.

Fiscal policy assumptions are little changed from those incorporated into last month's outlook. Despite recent indications of stepped up wheat support activity by the Commodity Credit Corporation, incoming data on Federal sector spending remain consistent with the staff's earlier projection of total outlays at about \$402 billion for FY 1977. Recent tax revenues have fallen slightly below expectations, however, and the FY 1977 deficit estimate has been increased by \$2 billion to \$45 billion; this is still expected to increase to \$58 billion in FY 1978. We continue to assume that growth in M_1 will average 5-1/4 per cent at an annual rate from the 1977-II base level. However, the recent more rapid rise of M_1 implies higher short-term interest rates over the projection period than we had assumed last month.

The renewed strength of retail sales and the decline in industrial output in August suggest that inventory accumulation will be considerably more moderate during the current quarter than was anticipated last month. This is the principal factor in the downward revision of the GNP growth rate for the current quarter. In addition, consumption expenditures and business fixed investment have been reduced somewhat as a result of earlier data revisions. The rise in the implicit price deflator for the third quarter also has been reduced, principally reflecting lower prices for agricultural products and food.

Over the subsequent five quarters of the projection period real GNP gains are expected to average about 4-3/4 per cent. The staff projection incorporates an increase of 14 per cent for business fixed investment in 1977--consistent with the August Commerce survey--and about the same rise for 1978. With income growth supported importantly by gains in investment and State and local spending, consumption growth is projected to pick up after the current quarter and in real terms to average 4-1/4 per cent (annual rate) in the remaining five quarters of the projection period. Given this growth path of consumption and income, the saving rate is expected to average about 6-1/4 per cent after rebounding from the sharp drop earlier this year.

Payroll employment is projected to rise at a 3 per cent rate through the end of 1978. This is sufficient to reduce the unemployment rate by about half a percentage point over the projection period to 6-1/2 per cent at the end of 1978. Projections of productivity and compensation gains are unchanged this month and still yield an average rise in unit labor costs of 6-1/2 per cent during 1978. These cost pressures are expected to be reflected in prices and the fixed-weighted gross private business product fixed-weighted price index is also expected to increase at nearly a 6-1/2 per cent rate next year.

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)	
	8/10/77	9/14/77	8/10/77	9/14/77	8/10/77	9/14/77	8/10/77	9/14/77
1974 ^{1/}	8.1	8.1	-1.4	-1.4	10.4	10.4	5.6	5.6
1975 ^{1/}	8.2	8.2	-1.3	-1.3	9.5	9.5	8.5	8.5
1976 ^{1/}	11.6	11.6	6.0	6.0	5.4	5.4	7.7	7.7
1977	11.1	10.9	5.1	4.9	5.9	6.0	7.0	7.1
1978	11.7	11.4	5.3	4.9	6.2	6.3	6.4	6.7
1977-I ^{1/}	13.2	13.2	7.5	7.5	6.8	6.8	7.4	7.4
1977-II	13.5	13.7	6.4	6.1	7.0	7.5	7.0	7.0
1977-III	12.0	10.3	5.3	4.4	5.9	5.5	6.8	7.1
1977-IV	12.4	12.0	5.6	5.1	5.9	5.9	6.7	7.0
1978-I	11.7	11.6	5.4	5.0	6.4	6.6	6.6	6.8
1978-II	10.7	10.9	5.0	4.8	6.2	6.3	6.5	6.7
1978-III	11.0	10.6	4.7	4.5	6.2	6.2	6.4	6.6
1978-IV	11.6	11.5	4.5	4.5	6.4	6.3	6.3	6.6
Change:								
76-II to 77-II	10.5	10.5	4.7	4.6	6.0	6.1	-.4	-.4
76-IV to 77-IV	12.8	12.3	6.2	5.8	6.4	6.4	-1.2	-.9
77-II to 78-II	11.7	11.2	5.3	4.8	6.1	6.1	-.5	-.3
77-IV to 78-IV	11.3	11.1	4.9	4.7	6.3	6.3	-.4	-.4

^{1/} Actual

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II FOMCGROSS 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	I	II	III	IV
Gross National Product	1810.8	1869.7	1916.1	1971.3	2026.0	2079.0	2132.0	2190.9
Final purchases	1797.0	1848.0	1899.1	1948.5	2007.7	2054.0	2105.8	2162.7
Private	1422.1	1457.4	1493.6	1530.7	1579.3	1615.2	1655.6	1699.5
Excluding net exports	1430.3	1467.2	1501.9	1541.2	1585.3	1627.8	1671.3	1716.2
Personal consumption expenditures	1172.4	1194.0	1217.5	1245.5	1278.3	1311.2	1345.4	1381.3
Goods	643.6	653.0	664.0	678.0	696.8	715.7	735.4	756.1
Services	528.8	541.1	553.5	567.5	581.5	595.5	610.0	625.2
Gross private domestic investment	271.8	294.9	301.4	318.5	325.3	341.6	352.1	363.1
Residential construction	81.0	90.8	97.3	102.8	107.8	110.8	113.3	115.3
Business fixed investment	177.0	182.4	187.1	192.9	199.2	205.8	212.6	219.6
Change in business inventories	13.8	21.7	17.0	22.8	18.3	25.0	26.2	28.2
Nonfarm	14.1	22.4	17.5	22.5	18.3	25.0	26.2	28.2
Net exports of goods and services ^{1/}	-8.2	-9.8	-8.3	-10.5	-6.0	-12.6	-15.7	-16.7
Exports	170.4	178.0	179.8	185.4	192.6	198.3	203.0	209.0
Imports	178.6	187.8	188.1	195.9	198.6	210.9	218.7	225.7
Gov't. purchases of goods and services	374.9	390.6	405.5	417.8	428.4	438.8	450.2	463.2
Federal ^{2/}	136.3	143.6	150.9	155.5	158.3	161.0	164.8	170.4
State and local	238.5	247.0	254.6	262.3	270.1	277.8	285.4	292.8
Gross national product in constant (1972) dollars	1311.0	1330.6	1345.1	1362.1	1378.7	1395.1	1410.5	1425.9
National income	1476.8	1517.2	1549.2	1594.6	1636.3	1678.6	1725.2	1774.5
Wage and salary disbursements	951.3	980.9	999.0	1027.3	1056.3	1082.3	1108.8	1139.2
Disposable income	1252.4	1292.5	1323.2	1360.5	1401.8	1435.6	1467.9	1506.8
Saving rate (per cent)	4.1	5.3	5.7	6.1	6.5	6.3	6.0	6.0
Corporate profits with I.V.A. and C.C. Adj.	125.4	139.7	153.2	159.9	155.4	161.0	164.3	169.6
Corporate profits before tax	161.7	173.4	185.4	191.9	187.7	193.5	196.8	202.1
Federal government surplus or deficit (-) (N.I.A. basis)	-38.8	-40.6	-52.4	-54.2	-53.2	-48.1	-41.9	-38.4
High employment surplus or deficit (-)	9.4	-0.5	-12.0	-16.2	-13.2	-9.5	-4.1	-2.1
State and local government surplus or deficit (-) (N.I.A. basis)	27.3	25.4	26.6	27.6	27.5	26.7	25.6	24.1
Excluding social insurance funds	11.9	9.9	10.1	10.5	10.0	8.7	7.1	5.1
Civilian labor force (millions)	96.1	97.2	97.6	98.2	98.7	99.3	99.9	100.4
Unemployment rate (per cent)	7.4	7.0	7.1	7.0	6.8	6.7	6.6	6.6
Nonfarm payroll employment (millions)	80.9	81.9	82.5	83.1	83.8	84.4	85.0	85.6
Manufacturing	19.3	19.6	19.6	19.8	20.0	20.3	20.5	20.7
Industrial production (1967=100)	133.5	137.3	138.8	141.4	143.9	146.5	149.0	151.6
Capacity utilization: all manufacturing (per cent)	81.0	82.9	82.8	83.8	84.6	85.5	86.3	87.2
Materials (per cent)	80.3	82.6	82.4	83.4	84.3	85.2	85.8	86.6
Housing starts, private (millions, A.R.)	1.76	1.91	2.00	2.05	2.05	2.00	1.95	1.90
Sales new autos, (millions, A.R.)	11.12	11.70	11.40	11.70	11.65	11.75	11.75	11.75
Domestic models	9.28	9.34	9.30	9.70	9.75	9.85	9.85	9.85
Foreign models	1.84	2.36	2.10	2.00	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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CLASS II FOMC

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1977				1978			
	I	II	III	IV	Projected			
	I	II	III	IV	I	II	III	IV
	----- Billions of dollars -----							
Gross National Product	55.4	58.9	46.4	55.2	54.7	53.0	53.0	58.9
Inventory change	14.7	7.9	-4.7	5.8	-4.5	6.7	1.2	2.0
Final purchases	40.7	51.0	51.1	49.4	59.2	46.3	51.8	56.9
Private	35.8	35.3	36.2	37.1	48.6	35.9	40.4	43.9
Net exports	-11.2	-1.6	1.5	-2.2	4.5	-6.6	-3.1	-1.0
Excluding net exports	47.0	36.9	34.7	39.3	44.1	42.5	43.5	44.9
Personal consumption expenditures	33.4	21.6	23.5	28.0	32.8	32.9	34.2	35.9
Goods	18.5	9.4	11.0	14.0	18.8	18.9	19.7	20.7
Services	14.9	12.3	12.4	14.0	14.0	14.0	14.5	15.2
Residential fixed investment	4.3	9.8	6.5	5.5	5.0	3.0	2.5	2.0
Business fixed investment	9.4	5.4	4.7	5.8	6.3	6.6	6.8	7.0
Government	4.9	15.7	14.9	12.3	10.6	10.4	11.4	13.0
Federal	2.1	7.3	7.3	4.6	2.8	2.7	3.8	5.6
State and local	2.7	8.5	7.6	7.7	7.8	7.7	7.6	7.4
GNP in constant (1972) dollars	23.6	19.6	14.5	17.0	16.6	16.4	15.4	15.5
Final purchases	12.0	16.2	17.5	13.3	17.7	12.5	15.0	14.2
Private	13.3	9.5	10.8	11.2	14.9	9.6	11.8	12.4
	----- In Per Cent per Year ^{1/} -----							
Gross National Product	13.2	13.7	10.3	12.0	11.6	10.9	10.6	11.5
Final purchases	9.6	11.8	11.5	10.8	12.7	9.5	10.5	11.3
Private	10.7	10.3	10.3	10.3	13.3	9.4	10.4	11.0
Personal consumption expenditures	12.2	7.6	8.1	9.5	11.0	10.7	10.8	11.1
Goods	12.4	6.0	6.9	8.7	11.6	11.3	11.5	11.7
Services	12.0	9.6	9.5	10.5	10.2	10.0	10.1	10.3
Gross private domestic investment	55.5	38.6	9.1	24.7	8.8	21.6	12.9	13.1
Residential structures	24.2	57.9	31.9	24.6	20.9	11.6	9.3	7.2
Business fixed investment	24.5	12.8	10.7	13.0	13.7	13.9	13.9	13.8
Gov't. purchases of goods and services	5.4	17.9	16.2	12.7	10.5	10.1	10.3	12.1
Federal	6.6	23.3	21.9	12.8	7.4	7.0	9.8	14.3
State and local	4.7	14.9	12.9	12.7	12.4	11.9	11.4	10.8
GNP in constant (1972) dollars	7.5	6.1	4.4	5.1	5.0	4.8	4.5	4.5
Final purchases	3.8	5.1	5.4	4.1	5.4	3.7	4.4	4.1
Private	5.3	3.7	4.3	4.3	5.7	3.6	4.4	4.6
GNP implicit deflator ^{2/}	5.3	7.1	5.6	6.5	6.3	5.8	5.8	6.8
Gross business product fixed-weighted price index ^{3/}	6.8	7.5	5.5	5.9	6.6	6.3	6.2	6.3
Personal income	13.1	11.4	8.7	12.2	10.9	10.8	11.6	11.9
Wage and salary disbursements	12.7	13.0	7.6	11.8	11.8	10.2	10.2	11.4
Disposable income	10.1	13.4	9.9	11.8	12.7	10.0	9.3	11.0
Corporate profits before tax	19.1	32.2	30.7	14.7	-8.5	12.9	7.0	11.4
Nonfarm payroll employment	4.3	4.9	2.9	3.2	3.1	2.9	2.9	2.9
Manufacturing	5.3	6.4	1.0	4.8	4.4	4.7	4.0	4.2
Nonfarm business sector								
Output per hour	5.0	.4	3.7	2.0	2.2	2.2	2.0	2.0
Compensation per hour	11.7	7.4	6.8	7.7	11.2	7.8	7.9	7.9
Unit labor costs	6.3	6.9	3.1	5.7	9.0	5.6	5.9	5.9
Industrial production	5.6	11.9	4.4	7.7	7.3	7.4	7.0	7.2
Housing starts, private	-2.6	38.9	20.5	10.4	.0	-9.4	-9.6	-9.9
Sales new autos	53.4	22.5	-10.0	10.9	-1.7	3.5	.0	.0
Domestic models	55.1	2.6	-1.8	18.3	2.1	4.2	.0	.0
Foreign models	45.2	170.5	-37.4	-17.7	-18.5	.0	.0	.0

^{1/} Percentage rates are annual rates compounded quarterly.

^{2/} Including Federal pay increases rates of change are: 1977-I, 5.3 per cent; 1977-IV, 5.8 per cent; 1978-I, 6.2 per cent; 1978-IV, 6.1 per cent.

^{3/} Using expenditures in 1972 as weights.

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I FOMCGROSS 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	1892.0	2107.0
Final purchases	1057.1	1161.7	1288.6	1404.0	1540.3	1693.1	1873.2	2082.5
Private	823.4	908.6	1019.1	1101.3	1201.4	1331.7	1476.0	1637.4
Excluding net exports	821.8	911.9	1012.0	1095.3	1181.0	1323.9	1485.2	1650.1
Personal consumption expenditures	668.2	733.0	809.9	889.6	980.4	1093.9	1207.4	1329.0
Goods	374.8	410.5	457.5	498.3	542.2	601.6	659.6	726.0
Services	293.4	322.4	352.3	391.3	438.2	492.3	547.7	603.0
Gross private domestic investment	160.0	188.3	220.0	214.6	189.1	243.3	296.7	345.5
Residential construction	49.6	62.0	66.1	55.1	51.5	68.0	93.0	111.8
Business fixed investment	104.1	116.8	136.0	150.6	149.1	161.9	184.9	209.3
Change in business inventories	6.4	9.4	17.9	8.9	-11.5	13.3	18.8	24.4
Nonfarm	5.1	8.8	14.7	10.8	-15.1	14.9	19.1	24.4
Net exports of goods and services	1.6	-3.3	7.1	6.0	20.4	7.8	-9.2	-12.7
Exports	65.6	72.7	101.6	137.9	147.3	162.9	178.4	200.7
Imports	64.0	75.9	94.4	131.9	126.9	155.1	187.6	213.5
Gov't. purchases of goods and services	233.7	253.1	269.5	302.7	338.9	361.4	397.2	445.1
Federal	96.2	102.1	102.2	111.1	123.3	130.1	146.6	163.6
State and local	137.5	151.0	167.3	191.5	215.6	231.2	250.6	281.5
Gross national product in constant (1972) dollars	1107.5	1171.1	1235.0	1217.8	1202.1	1274.7	1337.2	1402.5
Personal income	859.1	942.5	1052.4	1154.9	1253.4	1382.7	1534.5	1703.6
and salary disbursements	579.4	633.8	701.3	764.6	805.7	891.8	989.6	1096.6
Disposable income	742.8	801.3	901.7	984.6	1084.4	1185.8	1307.2	1453.0
Saving rate (per cent)	7.7	6.2	7.8	7.3	7.4	5.6	5.3	6.2
Corporate profits with I.V.A. and C.C. Adj.	77.2	92.1	99.1	83.6	99.3	128.1	144.6	162.6
Corporate profits before tax	82.0	96.2	115.8	126.9	123.5	156.9	178.1	195.0
Federal government surplus or deficit (-) (N.I.A. basis)	-22.0	-17.3	-6.7	-10.7	-70.2	-54.0	-46.5	-45.4
High employment surplus or deficit (-)	-5.3	-5.9	-7	17.1	-20.3	-10.4	-4.8	-7.2
State and local government surplus or deficit (-) (N.I.A. basis)	3.7	13.7	13.0	7.5	5.9	18.4	26.7	26.0
Excluding social insurance funds	-3.8	5.6	4.1	-2.9	-6.2	3.9	10.6	7.7
Civilian labor force (millions)	84.1	86.5	88.7	91.0	92.6	94.8	97.3	99.6
Unemployment rate (per cent)	6.0	5.6	4.9	5.6	8.5	7.7	7.1	6.7
Nonfarm payroll employment (millions)	71.2	73.7	76.9	78.4	77.1	79.4	82.1	84.7
Manufacturing	18.6	19.1	20.1	20.0	18.3	19.0	19.6	20.4
Industrial production (1967=100)	109.6	119.7	129.8	129.3	117.8	129.8	137.8	147.8
Capacity utilization: all manufacturing (per cent)	78.0	83.1	87.5	84.2	73.6	80.1	82.6	85.9
Materials (per cent)	83.1	88.0	92.4	87.7	73.6	80.3	82.2	85.5
Housing starts, private (millions, A.R.)	2.05	2.36	2.05	1.34	1.16	1.54	1.93	1.97
Sales new autos (millions, A.R.)	10.24	10.93	11.42	8.91	8.66	10.12	11.48	11.72
Domestic models	8.68	9.32	9.65	7.49	7.08	8.63	9.41	9.82
Foreign models	1.56	1.61	1.77	1.42	1.58	1.50	2.08	1.90

September 14, 1977

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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	185.5	214.9
Inventory change	2.6	3.0	8.5	-9.0	-20.4	24.8	5.5	5.6
Final purchases	78.5	104.6	126.9	115.4	136.3	152.8	180.1	209.3
Private	63.7	85.2	110.5	82.2	100.1	130.3	144.3	161.4
Net exports	-2.3	-4.9	10.4	-1.1	14.4	-12.6	-17.0	-3.5
Excluding net exports	66.0	90.1	100.1	83.3	85.7	142.9	161.3	164.9
Personal consumption expenditures	49.4	64.8	76.9	79.7	90.8	113.5	113.5	121.7
Goods	25.2	35.7	47.0	40.8	43.9	59.4	58.0	66.4
Services	24.3	29.0	29.9	39.0	46.9	54.1	55.4	55.3
Residential fixed investment	13.0	12.4	4.1	-11.0	-3.6	16.5	25.0	18.8
Business fixed investment	3.6	12.7	19.2	14.6	-1.5	12.8	23.0	24.4
Government	14.8	19.4	16.4	33.2	36.2	22.5	35.8	48.0
Federal	.6	5.9	.1	8.9	12.2	6.8	16.5	17.0
State and local	14.3	13.5	16.3	24.2	24.1	15.6	19.4	30.9
GNP in constant (1972) dollars	32.2	63.6	63.9	-17.2	-15.7	72.6	62.5	65.4
Final purchases	29.9	60.8	56.8	-8.6	2.1	54.2	59.2	60.8
Private	30.7	57.1	57.4	-13.8	-3.2	52.8	51.4	47.2
-----In Per Cent Per Year-----								
Gross National Product	8.2	10.1	11.6	8.1	8.2	11.6	10.9	11.4
Final purchases	8.0	9.9	10.9	8.9	9.7	9.9	10.6	11.2
Private	8.4	10.3	12.2	8.1	9.1	10.8	10.8	10.9
Personal consumption expenditures	8.0	9.7	10.5	9.8	10.2	11.6	10.4	10.1
Goods	7.2	9.5	11.4	8.9	8.8	11.0	9.6	10.1
Services	9.0	9.9	9.3	11.1	12.0	12.4	11.3	10.1
Gross private domestic investment	13.6	17.7	16.8	-2.5	-11.9	28.7	21.9	16.5
Residential structures	35.5	25.1	6.6	-16.7	-6.5	32.2	36.8	20.2
Business fixed investment	3.6	12.3	16.4	10.8	-1.0	8.6	14.2	13.2
Gov't. purchases of goods and services	6.8	8.3	6.5	12.3	12.0	6.6	9.9	12.1
Federal	.6	6.1	.1	8.7	11.0	5.5	12.7	11.6
State and local	11.6	9.8	10.8	14.5	12.6	7.2	8.4	12.3
GNP in constant (1972) dollars	3.0	5.7	5.5	-1.4	-1.3	6.0	4.9	4.9
Final purchases	2.8	5.5	4.9	-.7	.2	4.5	4.7	4.6
Private	3.7	6.7	6.3	-1.4	-.3	5.6	5.1	4.5
GNP implicit deflator	5.1	4.1	5.8	9.7	9.6	5.3	5.7	6.2
Gross business product fixed-weighted price index ^{1/}	4.4	3.3	5.7	10.4	9.5	5.4	6.4	6.3
Personal income	7.2	9.7	11.7	9.7	8.5	10.3	11.0	11.0
Wage and salary disbursements	6.0	9.4	10.7	9.0	5.4	10.7	11.0	10.8
Disposable income	8.3	7.9	12.5	9.2	10.1	9.4	10.2	11.2
Corporate profits before tax	14.7	17.3	20.4	9.6	-2.7	27.0	13.5	9.5
Nonfarm payroll employment	.4	3.5	4.3	2.0	-1.7	3.1	3.4	3.1
Manufacturing	-4.0	2.8	5.1	-.1	-8.5	3.3	3.3	4.1
Nonfarm business sector								
Output per hour	2.9	3.0	1.7	-2.9	1.6	4.1	2.1	2.1
Compensation per hour	6.6	5.8	7.8	9.4	9.6	8.7	8.6	8.5
Unit labor costs	3.5	2.7	6.0	12.7	7.9	4.5	6.3	6.3
Industrial production	1.7	9.2	8.4	-.4	-8.9	10.2	6.2	7.3
Housing starts	43.1	14.9	-13.2	-34.6	-13.3	32.6	25.4	2.1
Sales of new autos	21.9	6.8	-4.7	-14.5	-2.8	16.9	13.4	2.1
Sedans	21.9	7.4	3.5	-22.4	-5.5	21.9	9.0	4.4
Van models	21.8	3.1	9.7	-19.9	11.4	-5.1	38.6	-8.5

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

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

	Fiscal Year	F.R.B. staff estimates													
		FY 1977 e/		FY 1978 e/			CY 1976	CY 1977 e/		Calendar quarters; unadjusted data					
		Admin.	F.R.	Admin.	F.R.	Cong.		F.R.	1977						
		1976*	est. 1/ Board	est. 1/ Board	est. 1/ Board	est. 2/ Board	*	Board	I*	II*	III	IV	1978		
Unified budget receipts	299.2	358.3	357.5	401.4	397.8	397.0	317.6	367.1	79.0	110.5	91.9	85.8	86.5	120.6	105.0
Unified budget outlays	365.7	406.4	402.3	462.9	455.5	458.3	374.2	411.1	97.6	101.8	103.8	107.9	109.3	116.3	122.0
Surplus(+)/Deficit(-), unified budget	-66.5	-48.1	-44.8	-61.5	-57.7	-61.3	-56.6	-44.0	-18.7	8.6	-11.9	-22.1	-22.8	4.3	-17.0
Surplus(+)/Deficit(-), off-budget agencies 3/	-7.3	-10.1	-9.5	-7.7	-9.5	n.a.	-5.7	-9.4	-4.3	.1	-5.7	.5	-4.2	-.1	-5.6
Means of financing combined deficits:															
Net borrowing from public	82.9	n.a.	49.7	n.a.	63.0	n.a.	69.0	49.2	17.6	-1.1	15.8	16.9	25.5	-2.7	23.3
Decrease in cash operating balance	-7.2	n.a.	2.0	n.a.	4.4	n.a.	-3.2	.7	2.6	-7.2	.9	4.4	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.	15.4	n.a.	11.0	n.a.	11.7	11.0	9.0	16.3	15.4	11.0	11.0	11.0	11.0
Memo: Sponsored agency borrowing 5/	3.4	n.a.	5.7	n.a.	n.e.	n.a.	2.9	5.9	.7	2.9	1.6	.5	2.4	n.e.	n.e.
NIA Budget									Seasonally adjusted annual rates						
Receipts	312.5	365.4	363.6 ^{6/}	415.3	411.7 ^{6/}	n.a.	332.3	376.3	364.9	370.9	378.5	390.9	404.9	418.4	436.8
Outlays	373.1	417.2	411.7	469.3	462.1	n.a.	386.3	422.8	403.7	411.5	430.9	445.1	458.1	466.5	478.7
Purchases (total)	127.0	143.6	141.3	163.5	159.3	n.a.	130.1	145.3	136.3	143.3	147.7	154.0	157.2	160.9	164.9
Defense	85.9	92.8	92.0	105.2	103.8	n.a.	86.8	95.4	89.7	94.2	96.7	100.8	103.0	104.7	106.5
Non-defense	41.2	50.8	49.3	58.3	55.5	n.a.	43.3	50.0	46.7	49.1	51.0	53.2	54.2	56.2	58.4
All other outlays	246.1	273.6	270.4 ^{6/}	305.8	302.9 ^{6/}	n.a.	256.2	277.5	267.4	268.2	283.2	291.1	300.9	305.6	313.8
Surplus(+)/Deficit(-)	-60.6	-51.8	-48.1 ^{6/}	-54.0	-50.4 ^{6/}	n.a.	-54.0	-46.5	-38.8	-40.6	-52.4	-54.2	-53.2	-48.1	-41.9
High Employment Surplus(+)/Deficit(-) (NIA basis) 7/	-15.7	n.a.	-2.6	n.a.	-10.8	n.a.	-10.4	-4.7	9.4	-.5	-12.0	-16.2	-13.2	-9.5	-4.1

*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/ Conference Report on the Second Concurrent Resolution (September 13, 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 \$1.1 billion for FY 1977 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

The staff's budget outlook has been revised only slightly from the August Greenbook. The projected deficit for FY1977 has been increased by about \$2 billion to \$45 billion, mainly because collections of corporate, withheld and social insurance taxes are running about \$1-1/2 billion below earlier expectations. Total outlays are projected to be \$402-1/2 billion, marginally higher than last month. Commodity Credit Corporation (CCC) nonrecourse loans have increased more than had been expected earlier and this is responsible for most of the upward adjustment to unified outlays and to third quarter NIA nondefense purchases. At the same time, public assistance grants have been running less than expected, offsetting part of the CCC rise.

For FY1978, receipts remain about unchanged from last month's forecast of \$397-1/2 billion, but outlays have been reduced fractionally to \$455-1/2 billion, reflecting Administration re-estimates of spending for the Strategic Petroleum Reserve program. Thus, the unified deficit continues to be forecast at \$58 billion, about \$3-1/2 billion below the \$61.3 billion target set by Congress in the second concurrent budget resolution.

In the current quarter, the Treasury has been a very active borrower, raising approximately \$12 billion in the market and another \$3-1/2 billion with nonmarketable debt. The Treasury is expected to end the current quarter with a \$15-1/2 billion cash balance, well positioned to meet a projected large \$21-1/2 billion fourth quarter

combined deficit (unified plus off budget). The staff forecasts that this deficit will be financed through the issuance of \$14-1/2 billion in marketable and \$2-1/2 billion in nonmarketable securities. The remainder is expected to be met by a rundown in the cash balance.

The full employment budget shifted sharply to a \$4-1/2 billion surplus in the first half of calendar 1977 from a \$9 billion deficit in the last half of calendar 1976. This movement mainly reflected higher estate and gift taxes resulting from the 1976 Tax Reform Act and the slow pace of Federal spending earlier this year. The full employment budget is expected to return to a deficit in both 1977 H:2 (\$14 billion) and 1978 H:1 (\$11 billion), when the pace of Federal spending picks up because of the public works and employment programs, and the higher refunds resulting from the 1977 Tax Act. With no further new fiscal initiatives and continued growth in receipts, the projected full employment deficit declines to \$3 billion in the last half of 1978.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. Growth rates for both M_1 and M_2 slowed considerably in August from their exceptionally rapid July pace. Both demand deposits and time and savings deposits other than large negotiable CD's at banks expanded much less than in July. However, net inflows of deposits to thrift institutions in August remained strong last month, perhaps reflecting in part some shift of funds in maturing wild card certificates from banks to thrift institutions.

Although slower than in July, the expansion of M_1 and M_2 in August and early September was nonetheless strong enough so that growth in the third quarter is likely to be even more rapid than in the second. In an effort to restrain monetary growth, the funds rate was pushed up a little further in recent days from the 6 per cent level attained around mid-August. Treasury bill rates--after showing little net change in the latter half of August and early September--have risen about 20 basis points in the past several days, as the market has reassessed the current direction of monetary policy. Longer-term interest rates, which had been declining since mid-August, have also backed up in recent days.

Private credit demands have been well maintained recently. Although the growth of short-term business credit (measured by the sum of business loans at commercial banks plus nonfinancial commercial paper) has moderated, offerings of corporate bonds in August were substantial. The latest data available for the household sector suggest growth in outstanding consumer instalment credit has remained

strong in recent months, though below the exceptional pace earlier in the year. Mortgage acquisitions by S&L's were strong in July, though down somewhat from the previous record levels, while outstanding mortgage commitments again reached new highs. At commercial banks, mortgage loans continued to grow at a rapid pace.

In the public sector, the Treasury has remained an active borrower, raising \$6.3 billion in cash since the last FOMC meeting. Most of the funds were obtained through regular auctions of 2- and 4-year notes, though the bill market was tapped for new money for the first time since late last year.

State and local governments have continued to offer a large volume of long-term debt, accelerating some issues and continuing to offer substantial amounts of securities for refunding purposes. Such activity has been induced by the lowest market yields in three years, as fire and casualty companies--experiencing large cash flows emanating from a recovery in profits and increases in premium income--reportedly have been heavy purchasers of tax-exempt securities.

Outlook. Total credit demands are likely to show little net change over the balance of the year. Although the Treasury budget deficit is expected to increase in the fourth quarter, this higher deficit is expected to be met in part by a sizable run-down in the cash balance; market borrowing is likely to increase from \$12 billion in the current quarter to \$14.5 billion in the fourth quarter.

Borrowings by the State and local sector may be maintained for a time, as a number of large units--principally in Massachusetts and New York--move ahead with plans for advance refundings. But once these refundings are completed, long-term tax-exempt issues should abate somewhat, as offerings begin to return to a more normal level relative to State and local expenditures.

In the business sector, the financing gap--i.e. the difference between capital outlays and internally generated funds--is not expected to widen appreciably over the near term. As a result, total business credit demands are not likely to strengthen further.

With consumption spending, including spending on durables, projected to pick up in coming quarters, extensions of consumer instalment credit will probably continue to rise at a brisk pace. Liquidations of debt, though, will increase more rapidly in lagged response to the recent high rates of growth in extensions. Some slackening in the rate of expansion of instalment debt outstanding, consequently, is in prospect. Demands for residential mortgages, however, should be maintained at close to present levels, given current projections of construction expenditures and the outlook for a continued active market for new and existing homes.

These credit demands in the aggregate can probably be financed with little, if any, upward pressure on long-term rates. However, short-term rates may rise somewhat further by year-end, reflecting efforts to restrain money growth to within acceptable

ranges, given the apparent strengthening of money demand. Under these circumstances, deposit inflows to banks and thrift institutions are likely to be slower, on balance, during the fall than in the summer. Commercial banks may have to rely somewhat more heavily, therefore, on managed liabilities--such as large denomination CD's, Federal funds, and RP's--while thrift institutions may borrow more actively from the Home Loan Bank System.

The ample cash flows of long-term investors should limit upward pressures on long-term rates. Life insurance companies and pension funds probably will make further large corporate bond acquisitions. Fire and casualty companies are likely to continue investing heavily in the municipal securities market, given persistence of their favorable financial positions. In the mortgage market, diversified lenders probably will continue to show increasing interest in mortgage investments, in response to relatively wide spreads between primary mortgage rates and bond yields. Should the residential mortgage market tend to tighten, mortgage originators could rely on a large cushion of FNMA mortgage purchase commitments as a supplementary source of financing.

INTERNATIONAL DEVELOPMENTS

Summary. In the past five weeks there have been several features of the international economic scene of consequence for the United States. The large U.S. trade deficit persisted, while U.S. interest rates tended to rise against foreign rates. A number of foreign countries have been moving toward more stimulative economic policies. In the exchange markets,

, the Swedish krona was devalued and dropped out of the EC joint float, and smaller devaluations occurred for the Norwegian and Danish kroner. During the period the trade-weighted average value of the dollar rose about .7 per cent, regaining the level of late June.

The reported U.S. merchandise trade deficit declined to a \$26.2 billion annual rate in July, substantially below the second quarter rate of \$31.7 billion, but much of the decline in July represented temporary factors and the underlying rate of deficit was probably unchanged. Non-agricultural exports did not change much, and agricultural exports declined somewhat as prices weakened. On the import side, petroleum imports were down from the record June rate, and imports of coffee were also reduced. However, imports of cars and capital goods remained high.

Capital transactions in July for which monthly data are available registered a \$6.0 billion net inflow (not annual rate), but about \$2.0 billion of this is attributable to the timing of banks'

reporting. Nevertheless, the reported inflow was well above average, and apparently more than was required to cover the current account deficit in that month. Reflecting the relative rise in U.S. interest rates, banks reduced their net claims on foreign banks by about \$3.0 billion (after adjustment for the timing of reports) in July. Foreign official assets in the United States rose \$3.8 billion,

, as well as an unusually large \$1.4 billion increase in OPEC assets in the United States.

While the U.S. trade deficit has been increasing rapidly this year most other major industrial countries have shown reduced deficits or larger surpluses. For the six largest foreign industrial countries the combined trade balance rose \$15 billion -- from a surplus of \$10 billion (annual rate) in the second quarter of 1976 to \$25 billion in the second quarter of 1977. In the same period the U.S. deficit rose by nearly \$26 billion. The German and Japanese trade surpluses have each recently exceeded \$17 billion at an annual rate. In the case of Japan this rate of surplus has resulted from major increases in export volume for some years while the volume of imports has not risen above the 1974 level; for Germany the present level has come from a combination

of strong terms of trade and sustained volumes of both exports and imports, which have further inflated a large initial surplus position.

A major factor in the weakness of the U.S. trade balance has been the extended slowdown in the rate of economic growth in the major foreign economies. U.S. export volume in the second quarter of this year was scarcely higher than it was a year ago. Moreover, recent data confirm the hesitation in growth abroad, with industrial production in the second quarter declining in France, Germany, the Netherlands and the United Kingdom, and rising only .3 per cent in Canada and .9 per cent in Japan. In July, industrial production fell 1.2 per cent from the June level in Japan and was flat in Germany. Data for real GNP show a similar trend, though Japan's GNP indicated somewhat more strength.

Stirred by the lack of economic vitality, especially in the investment sector, and with inflation rates somewhat improved, a number of countries have announced, or are considering, measures intended to stimulate their economies. Among the major economies, Japan reduced its discount rate again on September 5 and announced a \$7-1/2 billion (1 per cent of GNP) package involving mainly expenditures on public works and housing; Germany is preparing a package of fiscal measures amounting to \$3 billion (.5 per cent of GNP) aimed at raising consumption and investment; and French authorities announced a set of measures at the end of August to deal with some particular sectoral problems and

reduced the discount rate. Last week a French budget was announced that broke precedent by showing a planned deficit.

Outlook. Even allowing for the potential effects of recent stimulative moves abroad, and discounting the data showing a slowdown in the summer months, the rate of growth of real GNP in foreign industrial countries is likely to lag behind the rate now projected for the United States. In terms of the U.S. trade balance this implies some further deterioration, with the trade deficit rising from \$31 billion this year to \$38 billion next year. However, of that \$7 billion change, rising petroleum imports and declining agricultural exports each account for about \$2 billion. The expected decline in agricultural prices produced the largest change from last month's outlook.

The U.S. lead in recovery of economic activity should tend to induce large net capital flows to the United States, serving to finance the current account deficit with little change in the average value of the dollar. However, the magnitude of the trade deficit is unprecedented, and on the assumptions used in these projections it will persist at a high level through next year. While financing on that scale may be available, pressures from groups directly affected by imports, and the chance of some pressure on the dollar in the market, are likely to mount.

	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	-10.7	-14.8	7.8	2.9	-8.2	-11.8	-10.3	-12.5	-8.0	-14.6	-17.7	-18.7
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(7.8)	(-9.2)	(-12.7)	(7.9)	(3.0)	(-8.2)	(-9.8)*	(-8.3)	(-10.5)	(-6.0)	(-12.6)	(-15.7)	(-16.7)
3. a) Merchandise Trade Balance	-9.2	-31.1	-38.2	-11.1	-14.3	-27.9	-31.7*	-31.2	-33.6	-30.4	-37.8	-41.6	-43.0
4. Exports (excl. military)	114.7	121.6	135.7	118.4	118.8	117.9	121.6*	121.6	125.2	129.5	133.6	137.2	142.4
5. Agricultural	23.4	24.6	22.6	25.0	23.6	24.5	26.6*	24.0	23.2	23.0	22.6	22.0	22.6
6. Nonagricultural	91.3	97.0	113.1	93.5	95.3	93.4	94.9*	97.6	102.0	106.5	111.0	115.2	119.8
7. Imports	123.9	152.7	173.9	129.5	133.2	145.8	153.3*	152.8	158.8	159.9	171.4	178.8	185.4
8. Petroleum and petrol. products	34.6	44.2	46.3	37.6	37.4	44.3	47.7*	41.4	43.4	40.1	46.1	48.6	50.4
9. Nonpetroleum	89.3	108.5	127.6	91.9	95.8	101.5	105.5*	111.4	115.4	119.8	125.3	130.2	135.0
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	-20.4	-26.9	-1.5	-5.9	-17.1	-21.1	-20.1	-23.0	-19.6	-26.7	-29.8	-31.1
14. a) GNP net exports (line 1.)	7.8	-10.7	-14.8	7.8	2.9	-8.2	-11.8	-10.3	-12.5	-8.0	-14.6	-17.7	-18.7
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	67.3	71.4	68.4	67.3	66.2	67.2	67.3	68.5	69.6	70.8	72.0	73.2
17. (% change, annual rates)	(3.4)	(0.9)	(6.1)	(13.0)	(-6.6)	(+6.6)	(6.1)	(0.4)	(7.4)	(6.6)	(7.0)	(7.0)	(7.0)
18. Merchandise imports	62.8	71.2	76.6	64.9	66.1	70.0	71.9	70.5	72.4	72.0	76.1	78.2	80.1
19. (% change, annual rates)	(22.5)	(13.4)	(7.6)	(29.1)	(7.4)	(25.8)	(11.2)	(+7.8)	(11.2)	(-2.4)	(24.8)	(11.7)	(10.0)
<u>Foreign Outlook - Major Industrial Countries <u>6/</u></u>													
20. Real GNP, % change, annual rates	5.1	3.1	4.6	1.6	3.2	5.3	0.0	3.7	4.9	4.9	5.3	5.3	4.5
21. Wholesale Prices, % change, annual rates <u>7/</u>	9.5	8.9	6.0	11.7	8.7	10.4	7.4	4.1	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.