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# **Part 1**

## **CURRENT ECONOMIC AND FINANCIAL CONDITIONS**

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### **Summary and Outlook**

Prepared for the Federal Open Market Committee

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

CONFIDENTIAL (FR)

December 14, 1977

SUMMARY AND OUTLOOK

By the Staff  
Board of Governors  
of the Federal Reserve System

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## **SUMMARY AND OUTLOOK**

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**DOMESTIC NONFINANCIAL DEVELOPMENTS**

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Summary. The tempo of economic activity has apparently picked up in the past few months. Purchases of consumer goods other than autos have risen sharply, and employment and industrial production recorded stronger gains in November than in other recent months. Indicators of current trends in residential construction activity and business investment spending continued generally favorable. However, the November Commerce Department survey suggested slower growth of plant and equipment expenditures through the first half of 1978. Retail price increases were moderate again in October, but in November some components of wholesale prices--notably farm and food products--rose sharply.

Industrial production in November is estimated to have increased one half per cent--following a rise of 0.3 per cent in the preceding month, with gains widespread. In the auto industry, however, assemblies were cut sharply, partly in response to weakened sales. Gains in nonfarm payroll employment were strong last month, particularly in the service-producing industries; they accounted for about two-thirds of the overall rise of 312,000 jobs. Factory employment advanced moderately, and hours edged up. Employment continued to advance in durable goods industries, and it turned up in nondurable goods firms after having drifted lower between June and October.

Total employment was indicated by the household survey to have risen very sharply in November, but the reported increase of 950,000

probably was overstated due to technical factors. Labor force growth about equaled the rise in total employment, and the unemployment rate declined 0.1 percentage point to 6.9 per cent.

Advance retail sales data indicate further sizable gains in nonautomotive sales in November and a larger increase for October than had been previously estimated. Gains have been especially large recently at apparel and food stores. Unit sales of domestic autos, however, weakened substantially in November while sales of imported autos increased.

Indicators of business fixed investment activity suggest continued strength in the near term, although the evidence is not unambiguous. New orders for nondefense capital goods rose 1.1 per cent in October to a level 8-1/2 per cent above the third quarter average. Construction contracts for commercial and industrial buildings declined further in October from the exceptionally high level recorded in August but the dollar value figure was still 18 per cent above its year-earlier level. Additionally, newly approved manufacturers' capital appropriations rose substantially in the third quarter.

In contrast, the Commerce Department survey of anticipated plant and equipment expenditures taken in November suggests that growth of capital outlays between 1977:QIII and 1978:QII will average 9 per cent (annual rate)--down from the 16-1/2 per cent rate of growth over the preceding three quarters. However, the quarterly pattern of spending indicated by earlier samplings in this survey has differed considerably

from actual spending, and thus the results of the latest survey should be interpreted with caution.

Residential construction activity continues to show considerable strength. Single-family housing starts edged up further in October to a record level for the series of 1.56 million units. Multifamily housing starts rose sharply reflecting, in part, a large surge in the number of Federally assisted (Section 8) units processed in September. Continued strength in residential building activity is suggested by the record levels of total home sales and of mortgage commitments at insured savings and loan associations.

Business inventory policies apparently have remained conservative. Manufacturers' book value of inventories rose at an \$8 billion rate in October, somewhat less than in September. Inventory-sales ratio for both durable and nondurable goods producers were little changed at relatively low levels.

Price rises have been comparatively moderate since June, following the large increases in the first half of 1977. Consumer prices rose at about a 3-1/3 per cent annual rate in October--slightly less than the average rise since June. These prices had risen at a 9.0 per cent annual rate over the first half. Wholesale prices of finished goods have generally shown a similar slowing--up at a 5.2 per cent annual rate in November and at about a 4 per cent annual rate since June. Much of the improved performance was a result of the sharply reduced rate of price rises for food. The large increases in wholesale prices of farm

and food products may presage a faster rate of consumer food price increases early next year.

Outlook. Real GNP in the fourth quarter is projected to increase at about a 5 per cent annual rate--slightly more than the upward revised figure now shown for the third quarter. Growth in consumer demand appears likely to be considerably stronger than in the two preceding quarters. In addition, the advanced level of single-family housing starts in the past several months is expected to substantially boost fourth quarter expenditures for residential structures and a rebound in business investment spending appears to be in train this quarter after a very small rise in the third quarter. However, the staff anticipates some slowing of inventory investment and some weakening in the U.S. net export position.

Policy assumptions conditioning the current projection are little changed from a month ago. The Federal budget deficit for fiscal year 1978 is now estimated to be about 61.0 billion. The details of the energy tax package assumed are unchanged from last month. However, their effective date has been shifted from January 1 to February 15, 1978. Apart from energy, we are assuming no tax changes beyond those already legislated. The growth path assumption for  $M_1$  continues to average 5-1/4 per cent from the 1977:QIII base period through 1978:QIII with interest rates, particularly in short-term markets, expected to move upward over the projection period.

The staff outlook for 1978 is little changed from last month. Growth of real GNP is projected to average 4.3 per cent over the four quarters of the year, but with gains slowing in the second half. Early in the year, residential construction should continue to provide support, but the primary impetus is projected to come from business fixed investment. Although the Commerce Department survey indicates slower growth in planned capital spending through mid-1978, the staff views the favorable near-term commitments data for contracts and orders and the substantial gain in capital appropriations over the past year as indicating a stronger underlying trend of growth in business investment than suggested by the Commerce survey.

Although income gains are projected to slow from the 1977 pace, purchasing power is expected to be sufficient to support moderate growth in consumption spending--about 3-1/2 per cent in real terms over the four quarters of 1978. The saving rate is expected to remain unchanged at about 6 per cent over the projection period,

The projected rate of real GNP growth is anticipated to generate a rise in total employment of nearly 2-1/2 million over the four quarters of 1978. But because this gain is likely to be accompanied by a continued substantial rise in the labor force, the unemployment rate is projected to show only a small further decline. Productivity advances are still anticipated to average about 2 per cent next year, providing only modest offset to a projected hourly compensation rise of about 8-1/2 per cent.

Consequently, unit labor cost increases are expected to average 6-1/2 per cent--about the same as the projected rise in prices. As a result, the profits share is anticipated to remain about unchanged over the 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)	
	11/9/77	12/14/77	11/9/77	12/14/77	11/9/77	12/14/77	11/9/77	12/14/77
1974 <sup>1/</sup>	8.1	8.1	-1.4	-1.4	10.4	10.4	5.6	5.6
1975 <sup>1/</sup>	8.2	8.2	-1.3	-1.3	9.5	9.5	8.5	8.5
1976 <sup>1/</sup>	11.6	11.6	6.0	6.0	5.4	5.4	7.7	7.7
1977	10.7	10.9	4.8	5.0	6.0	6.1	7.1	7.1
1978	11.2	11.3	4.6	4.7	6.3	6.4	6.6	6.6
1977-I <sup>1/</sup>	13.2	13.2	7.5	7.5	6.8	6.8	7.4	7.4
1977-II <sup>1/</sup>	13.7	13.7	6.2	6.2	7.5	7.5	7.0	7.0
1977-III <sup>1/</sup>	9.2	10.0	3.8	4.7	5.2	5.1	7.0	7.0
1977-IV	12.1	12.4	5.0	5.1	6.0	6.2	6.9	6.9
1978-I	11.4	11.2	4.7	4.6	6.8	6.7	6.7	6.7
1978-II	10.9	11.0	4.5	4.4	6.5	6.7	6.7	6.7
1978-III	10.5	10.4	4.2	4.1	6.2	6.2	6.6	6.6
1978-IV	11.3	11.3	4.1	4.1	6.3	6.3	6.6	6.6
Change:								
76-II to 77-II <sup>1/</sup>	10.5	10.5	4.7	4.7	6.1	6.1	-.4	-.4
76-IV to 77-IV	12.0	12.3	5.6	5.9	6.4	6.4	-1.0	-1.0
77-II to 78-II	10.9	11.1	4.5	4.7	6.1	6.2	-.3	-.3
77-IV to 78-IV	11.0	11.0	4.4	4.3	6.4	6.4	-.3	-.3

<sup>1/</sup> Actual.

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

	1977				1978			
	I	II	III	IV	Projected I	II	III	IV
Gross National Product	1810.8	1869.9	1914.9	1971.6	2024.7	2078.2	2130.1	2188.0
Final purchases	1797.0	1848.2	1891.7	1952.0	2006.8	2056.9	2106.6	2162.3
Private	1422.1	1457.6	1488.4	1535.3	1579.7	1619.0	1658.0	1699.7
Excluding net exports	1430.3	1467.3	1496.0	1544.4	1587.8	1629.0	1669.9	1711.6
Personal consumption expenditures	1172.4	1194.0	1216.9	1253.7	1285.9	1317.2	1348.5	1380.8
Goods	643.6	653.0	656.6	677.4	694.8	711.9	728.6	746.3
Services	528.8	541.1	560.3	576.3	591.1	605.3	619.9	634.5
Gross private domestic investment	271.8	294.9	302.3	310.3	319.8	333.1	344.9	356.5
Residential construction	81.0	90.8	92.5	98.5	103.5	107.0	110.0	112.5
Business fixed investment	177.0	182.4	186.7	192.2	198.4	204.8	211.4	218.3
Change in business inventories	13.8	21.7	23.1	19.6	17.9	21.3	23.5	25.7
Nonfarm	14.1	22.4	22.6	19.3	17.9	21.3	23.5	25.7
Net exports of goods and services <sup>1/</sup>	-8.2	-9.7	-7.6	-9.1	-8.1	-10.0	-11.9	-11.9
Exports	170.4	178.1	180.4	180.5	190.8	197.7	203.9	210.0
Imports	178.6	187.7	188.1	189.7	199.0	207.8	215.9	222.0
Gov't. purchases of goods and services	374.9	390.6	403.3	416.7	427.1	437.9	448.6	462.6
Federal <sup>2/</sup>	136.3	143.6	149.3	154.9	157.6	160.9	164.1	170.8
State and local	238.5	247.0	254.0	261.8	269.5	277.0	284.5	291.8
Gross national product in constant (1972) dollars	1311.0	1330.7	1346.1	1363.1	1378.5	1393.3	1407.4	1421.5
Personal income	1476.8	1517.2	1549.3	1601.4	1642.0	1681.6	1731.3	1778.6
Wage and salary disbursements	951.3	980.9	998.4	1029.3	1058.3	1081.8	1108.3	1136.7
Disposable income	1252.4	1292.5	1321.7	1366.1	1404.9	1438.2	1473.2	1510.6
Saving rate (per cent)	4.1	5.3	5.6	5.9	6.1	6.1	6.1	6.2
Corporate profits with I.V.A. and C.C. Adj.	125.4	140.2	147.8	155.2	152.1	155.7	159.4	166.3
Corporate profits before tax	161.7	174.0	171.6	187.2	184.4	188.2	191.9	198.8
Federal government surplus or deficit (-) (N.I.A. basis)	-38.8	-40.3	-59.4	-57.1	-53.7	-47.1	-42.6	-43.8
High employment surplus or deficit (-)	7.5	-1.1	-19.9	-19.5	-14.3	-6.9	-3.3	-5.2
State and local government surplus or deficit (-) (N.I.A. basis)	27.3	25.4	30.5	29.2	27.4	26.4	24.3	22.6
Excluding social insurance funds	11.9	10.0	14.9	12.1	9.9	8.4	5.8	3.6
Civilian labor force (millions)	96.1	97.2	97.6	98.6	99.1	99.7	100.3	100.8
Unemployment rate (per cent)	7.4	7.0	7.0	6.9	6.7	6.7	6.6	6.6
Nonfarm payroll employment (millions)	80.9	81.9	82.5	83.2	83.8	84.4	85.0	85.5
Manufacturing	19.3	19.6	19.6	19.7	19.9	20.1	20.3	20.4
Industrial production (1967=100)	133.6	137.0	138.5	140.0	142.4	145.7	146.9	149.0
Capacity utilization: all manufacturing (per cent)	81.2	82.7	83.0	83.0	83.6	84.2	84.6	85.0
Materials (per cent)	80.4	82.6	82.5	82.8	83.6	84.3	84.7	85.3
Housing starts, private (millions, A.R.)	1.76	1.91	2.06	2.10	2.15	2.10	2.05	2.00
Sales new autos, (millions, A.R.)	11.12	11.70	10.92	10.80	11.15	11.15	11.15	11.15
Domestic models	9.28	9.34	8.88	8.90	9.25	9.25	9.25	9.25
Foreign models	1.84	2.36	2.04	1.90	1.90	1.90	1.90	1.90

<sup>1/</sup> Balance of payments data and projection underlying these estimates are shown in the International Developments section of this part of the Greenbook.

<sup>2/</sup> 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			
	----- Billions of dollars -----							
Gross National Product	55.4	59.1	45.0	56.7	53.1	53.5	51.9	57.9
Inventory change	14.7	7.9	1.4	-3.5	-1.7	3.4	2.2	2.2
Final purchases	40.7	51.2	43.5	60.3	54.8	50.1	49.7	55.7
Private	35.8	35.5	30.8	46.9	44.4	39.3	39.0	41.7
Net exports	-11.2	-1.5	2.1	-1.5	1.0	-1.9	-1.9	.0
Excluding net exports	47.0	37.0	28.7	48.4	43.4	41.2	40.9	41.7
Personal consumption expenditures	33.4	21.6	22.9	36.8	32.2	31.3	31.3	32.3
Goods	18.5	9.4	3.6	20.8	17.4	17.1	16.7	17.7
Services	14.9	12.3	19.2	16.0	14.8	14.2	14.6	14.6
Residential fixed investment	4.3	9.8	1.7	6.0	5.0	3.5	3.0	2.5
Business fixed investment	9.4	5.4	4.3	5.5	6.2	6.4	6.6	6.9
Government	4.9	15.7	12.7	13.4	10.4	10.8	10.7	14.0
Federal	2.1	7.3	5.7	5.6	2.7	3.3	3.2	6.7
State and local	2.7	8.5	7.0	7.8	7.7	7.5	7.5	7.3
GNP in constant (1972) dollars	23.6	19.7	15.4	17.0	15.4	14.8	14.1	14.1
Final purchases	12.0	16.3	13.3	19.2	16.0	12.6	12.9	12.6
Private	13.3	9.6	7.7	16.5	13.2	9.7	10.0	10.6
	----- In Per Cent Per Year <sup>1/</sup> -----							
Gross National Product	13.2	13.7	10.0	12.4	11.2	11.0	10.4	11.3
Final purchases	9.6	11.9	9.8	13.4	11.7	10.4	10.0	11.0
Private	10.7	10.4	8.7	13.2	12.1	10.3	10.0	10.4
Personal consumption expenditures	12.2	7.6	7.9	12.7	10.7	10.1	9.8	9.9
Goods	12.4	6.0	2.2	13.3	10.7	10.2	9.7	10.1
Services	12.0	9.6	15.0	11.9	10.7	10.0	10.0	9.8
Gross private domestic investment	55.5	38.6	10.5	11.0	12.8	17.7	14.9	14.1
Residential structures	24.2	57.9	7.7	28.6	21.9	14.2	11.7	9.4
Business fixed investment	24.5	12.8	9.7	12.3	13.5	13.5	13.5	13.7
Gov't. purchases of goods and services	5.4	17.9	13.7	14.0	10.4	10.5	10.1	13.1
Federal	6.6	23.3	16.7	15.9	7.2	8.6	8.2	17.4
State and local	4.7	14.9	12.0	12.9	12.3	11.6	11.3	10.7
GNP in constant (1972) dollars	7.5	6.2	4.7	5.1	4.6	4.4	4.1	4.1
Final purchases	3.8	5.1	4.1	5.9	4.8	3.7	3.8	3.7
Private	5.3	3.8	3.0	6.4	5.0	3.6	3.7	3.9
GNP implicit deflator <sup>2/</sup>	5.3	7.1	5.0	6.9	6.3	6.4	6.0	7.0
Gross business product fixed-weighted price index <sup>3/</sup>	6.8	7.5	5.1	6.2	6.7	6.7	6.2	6.3
Personal income	13.1	11.4	8.7	14.2	10.5	10.0	12.4	11.4
Wage and salary disbursements	12.7	13.0	7.3	13.0	11.8	9.2	10.2	10.7
Disposable income	10.1	13.4	9.3	14.1	11.9	9.8	10.1	10.5
Corporate profits before tax	19.1	34.1	-5.4	41.7	-5.9	8.6	8.1	15.1
Nonfarm payroll employment	4.1	4.8	3.3	3.2	3.1	2.8	2.9	2.5
Manufacturing	5.4	5.4	1.3	2.1	3.9	4.0	3.1	3.5
Nonfarm business sector								
Output per hour	4.8	.7	2.9	2.2	2.2	2.2	2.0	2.0
Compensation per hour	11.4	7.5	7.6	7.9	11.5	7.8	8.0	8.0
Unit labor costs	6.3	6.8	4.5	5.7	9.3	5.6	6.0	6.0
Industrial production	6.2	10.6	4.5	4.4	7.0	9.8	3.1	6.0
Housing starts, private	-2.6	37.7	36.4	8.4	9.9	-9.0	-9.2	-9.4
Sales new autos	53.4	22.5	-24.1	-4.5	13.6	.0	.0	.0
Domestic models	55.1	2.6	-18.4	.9	16.7	.0	.0	.0
Foreign models	45.2	170.5	-43.9	-25.2	.0	.0	.0	.0

<sup>1/</sup> Percentage rates are annual rates compounded quarterly.

<sup>2/</sup> Excluding Federal pay increases rates of change are: 1977-I, 5.3 per cent; 1977-IV, 6.1 per cent; 1978-I, 6.3 per cent; 1978-IV, 6.3 per cent.

<sup>3/</sup> 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	Projected	
							1977	1978
Gross National Product	1063.4	1171.1	1306.6	1412.9	1528.8	1706.5	1891.8	2105.2
Final purchases	1057.1	1161.7	1288.6	1404.0	1540.3	1693.1	1872.2	2083.1
Private	823.4	908.6	1019.1	1101.3	1201.4	1331.7	1475.9	1639.1
Excluding net exports	821.8	911.9	1012.0	1095.3	1181.0	1323.9	1484.5	1649.6
Personal consumption expenditures	668.2	733.0	809.9	889.6	980.4	1093.9	1209.2	1333.1
Goods	374.8	410.5	457.5	498.3	542.2	601.6	657.7	720.4
Services	293.4	322.4	352.3	391.3	438.2	492.3	551.6	612.7
Gross private domestic investment	160.0	188.3	220.0	214.6	189.1	243.3	294.8	338.6
Residential construction	49.6	62.0	66.1	55.1	51.5	68.0	90.7	108.2
Business fixed investment	104.1	116.8	136.0	150.6	149.1	161.9	184.6	208.2
Change in business inventories	6.4	9.4	17.9	8.9	-11.5	13.3	19.5	22.1
Nonfarm	5.1	8.8	14.7	10.8	-15.1	14.9	19.6	22.1
Net exports of goods and services	1.6	-3.3	7.1	6.0	20.4	7.8	-8.7	-10.5
Exports	65.6	72.7	101.6	137.9	147.3	162.9	177.3	200.6
Imports	64.0	75.9	94.4	131.9	126.9	155.1	186.0	211.1
Gov't. purchases of goods and services	233.7	253.1	269.5	302.7	338.9	361.4	396.4	444.0
Federal	96.2	102.1	102.2	111.1	123.3	130.1	146.0	163.3
State and local	137.5	151.0	167.3	191.5	215.6	231.2	250.3	280.7
Gross national product in constant (1972) dollars	1107.5	1171.1	1235.0	1217.8	1202.1	1274.7	1337.7	1400.1
Personal income	859.1	942.5	1052.4	1154.9	1253.4	1382.7	1536.2	1708.4
Wage and salary disbursements	579.4	633.8	701.3	764.6	805.7	891.8	990.0	1096.3
Disposable income	742.8	801.3	901.7	984.6	1084.4	1185.8	1308.2	1456.7
Saving rate (per cent)	7.7	6.2	7.8	7.3	7.4	5.6	5.2	6.1
Corporate profits with I.V.A. and C.C. Adj.	77.2	92.1	99.1	83.6	99.3	128.1	142.2	158.4
Corporate profits before tax	82.0	96.2	115.8	126.9	123.5	156.9	173.6	190.8
Federal government surplus or deficit (-) (N.I.A. basis)	-22.0	-17.3	-6.7	-10.7	-70.2	-54.0	-48.9	-46.8
High employment surplus or deficit (-)	-5.3	-5.9	-.7	17.1	-20.3	-10.4	-8.0	-7.4
State and local government surplus or deficit (-) (N.I.A. basis)	3.7	13.7	13.0	7.5	5.9	18.4	28.1	25.2
Excluding social insurance funds	-3.8	5.6	4.1	-2.9	-6.2	3.9	12.2	6.9
Civilian labor force (millions)	84.1	86.5	88.7	91.0	92.6	94.8	97.4	100.0
Unemployment rate (per cent)	6.0	5.6	4.9	5.6	8.5	7.7	7.1	6.6
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	20.2
Industrial production (1967=100)	109.6	119.7	129.8	129.3	117.8	129.8	137.3	146.0
Capacity utilization: all manufacturing (per cent)	78.0	83.1	87.5	84.2	73.6	80.2	82.5	84.3
Materials (per cent)	83.1	88.0	92.4	87.7	73.6	80.4	82.1	84.5
Housing starts, private (millions, A.R.)	2.05	2.36	2.05	1.34	1.16	1.54	1.96	2.07
Sales new autos (millions, A.R.)	10.24	10.93	11.42	8.91	8.66	10.12	11.14	11.15
Domestic models	8.68	9.32	9.65	7.49	7.08	8.63	9.10	9.25
Foreign models	1.56	1.61	1.77	1.42	1.58	1.50	2.04	1.90

CONFIDENTIAL - FR  
CLASS II FOMC

CHANGES IN GROSS NATIONAL PRODUCT  
AND RELATED ITEMS

	1971	1972	1973	1974	1975	1976	Projected	
							1977	1978
-----Billions of Dollars-----								
Gross National Product	81.0	107.7	135.5	106.3	115.9	177.7	185.3	213.4
Inventory change	2.6	3.0	8.5	-9.0	-20.4	24.8	6.2	2.6
Final purchases	78.5	104.6	126.9	115.4	136.3	152.8	179.1	210.9
Private	63.7	85.2	110.5	82.2	100.1	130.3	144.2	163.2
Net exports	-2.3	-4.9	10.4	-1.1	14.4	-12.6	-16.5	-1.9
Excluding net exports	66.0	90.1	100.1	83.3	85.7	142.9	160.6	165.1
Personal consumption expenditures	49.4	64.8	76.9	79.7	90.8	113.5	115.3	123.9
Goods	25.2	35.7	47.0	40.8	43.9	59.4	56.1	62.7
Services	24.3	29.0	29.9	39.0	46.9	54.1	59.3	61.1
Residential fixed investment	13.0	12.4	4.1	-11.0	-3.6	16.5	22.7	17.5
Business fixed investment	3.6	12.7	19.2	14.6	-1.5	12.8	22.7	23.6
Government	14.8	19.4	16.4	33.2	36.2	22.5	35.0	47.6
Federal	.6	5.9	.1	8.9	12.2	6.8	15.9	17.3
State and local	14.3	13.5	16.3	24.2	24.1	15.6	19.1	30.4
GNP in constant (1972) dollars	32.2	63.6	63.9	-17.2	-15.7	72.6	63.0	62.4
Final purchases	29.9	60.8	56.8	-8.6	2.1	54.2	58.7	60.2
Private	30.7	57.1	57.4	-13.8	-3.2	52.8	51.3	46.8
-----In Per Cent Per Year-----								
Gross National Product	8.2	10.1	11.6	8.1	8.2	11.6	10.9	11.3
Final purchases	8.0	9.9	10.9	8.9	9.7	9.9	10.6	11.3
Private	8.4	10.3	12.2	8.1	9.1	10.8	10.8	11.1
Personal consumption expenditures	8.0	9.7	10.5	9.8	10.2	11.6	10.5	10.2
Goods	7.2	9.5	11.4	8.9	8.8	11.0	9.3	9.5
Services	9.0	9.9	9.3	11.1	12.0	12.4	12.0	11.1
Gross private domestic investment	13.6	17.7	16.8	-2.5	-11.9	28.7	21.2	14.8
Residential structures	35.5	25.1	6.6	-16.7	-6.5	32.2	33.4	19.3
Business fixed investment	3.6	12.3	16.4	10.8	-1.0	8.6	14.0	12.8
Gov't. purchases of goods and services	6.8	8.3	6.5	12.3	12.0	6.6	9.7	12.0
Federal	.6	6.1	.1	8.7	11.0	5.5	12.2	11.9
State and local	11.6	9.8	10.8	14.5	12.6	7.2	8.3	12.1
GNP in constant (1972) dollars	3.0	5.7	5.5	-1.4	-1.3	6.0	5.0	4.7
Final purchases	2.8	5.5	4.9	-.7	.2	4.5	4.6	4.5
Private	3.7	6.7	6.3	-1.4	-.3	5.6	5.1	4.4
GNP implicit deflator	5.1	4.1	5.8	9.7	9.6	5.3	5.6	6.3
Gross business product fixed-weighted price index <sup>1/</sup>	4.4	3.3	5.7	10.4	9.5	5.4	6.1	6.4
Personal income	7.2	9.7	11.7	9.7	8.5	10.3	11.1	11.2
Wage and salary disbursements	6.0	9.4	10.7	9.0	5.4	10.7	11.0	10.7
Disposable income	8.3	7.9	12.5	9.2	10.1	9.4	10.3	11.4
Corporate profits before tax	14.7	17.3	20.4	9.6	-2.7	27.0	10.6	9.9
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	3.2	3.2
Nonfarm business sector								
Output per hour	2.9	3.0	1.7	-2.9	1.6	4.1	2.2	2.2
Compensation per hour	6.6	5.8	7.8	9.4	9.6	8.7	8.7	8.7
Unit labor costs	3.5	2.7	6.0	12.7	7.9	4.5	6.5	6.6
Industrial production	1.7	9.2	8.4	-.4	-8.9	10.2	5.8	6.4
Housing starts	43.1	14.9	-13.2	-34.6	-13.3	32.6	27.1	5.9
Sales new autos	21.9	6.8	-4.7	-14.5	-2.8	16.9	10.0	.1
Domestic models	21.9	7.4	3.5	-22.4	-5.5	21.9	5.5	1.6
Foreign models	21.8	3.1	9.7	-19.9	11.4	-5.1	35.9	-6.7

<sup>1/</sup> Using expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS  
(billions of dollars)

December 14, 1977

	Fiscal Year 1977*	FY 1978 e/			CY 1976 *	CY '77 e/ F.R. Board	F.R.B. staff estimates Calendar quarters; unadjusted data						
		Admin. est. 1/	F.R. Board	Cong. est. 2/			1977				1978		
							I*	II*	III*	IV	I	II	III
Unified budget receipts	356.9	401.4	395.3	397.0	317.6	365.9	79.0	110.5	91.3	85.2	85.8	119.6	104.7
Unified budget outlays	401.9	459.8	456.6	458.3	374.2	414.9	97.6	101.8	103.4	112.1	110.6	116.0	118.0
Surplus(+)/Deficit(-), unified budget	-45.0	-58.5	-61.3	-61.3	-56.6	-49.2	-18.7	8.6	-12.2	-26.9	-24.8	3.6	-13.3
Surplus(+)/Deficit(-), off-budget agencies 3/	-8.7	n.a.	-10.6	n.a.	-5.7	-10.8	-4.3	.1	-4.9	-1.7	-3.1	-0.8	-5.1
Means of financing combined deficits:													
Net borrowing from public	53.5	n.a.	63.5	n.a.	69.0	55.7	17.6	-1.1	19.6 <sup>8/</sup>	19.6 <sup>8/</sup>	26.1	-1.3	19.1
Decrease in cash operating balance	-1.7	n.a.	7.1	n.a.	-3.2	0.4	2.6	-7.2	-2.8 <sup>8/</sup>	7.8 <sup>8/</sup>	-0.7	0	0
Other 4/	1.9	n.a.	1.5	n.a.	-3.5	3.9	2.7	-4	0.4	1.2	2.5	-1.5	-0.7
Cash operating balance, end of period	19.1	n.a.	12.0	n.a.	11.7	11.3	9.0	16.3	19.1 <sup>8/</sup>	11.3	12.0	12.0	12.0
Memo: Sponsored agency borrowing 5/	6.1	n.a.	n.e.	n.a.	2.9	7.5	.7	3.0	2.0	1.8	3.6	2.8	n.e.
<b>NIA Budget</b>							<b>Seasonally adjusted annual rates</b>						
Receipts	361.7 <sup>6/</sup>	n.a.	410.4 <sup>6/</sup>	n.a.	332.3	375.1	364.9	371.2	373.3	390.8	405.2	417.1	435.8
Outlays	412.1	465.6	462.3	n.a.	386.3	424.0	403.7	411.5	432.8	447.9	458.9	464.2	478.4
Purchases (total)	140.9	160.1	159.4	n.a.	130.1	146.0	136.3	143.6	149.3	154.9	157.6	160.9	164.1
Defense	91.9	102.4	102.5	n.a.	86.8	94.8	89.7	93.4	96.0	100.0	101.7	103.4	105.0
Non-defense	49.0	57.7	56.8	n.a.	43.3	51.3	46.7	50.2	53.3	54.9	55.9	57.5	59.1
All other outlays	271.2	305.5	302.9	n.a.	256.2	277.9	267.4	267.9	283.5	293.0	301.3	303.3	314.3
Surplus(+)/Deficit(-)	-50.4 <sup>6/</sup>	n.a.	-51.9 <sup>6/</sup>	n.a.	-54.0	-49.0	-38.8	-40.3	-59.4	-57.1	-53.7	-47.1	-42.6
High Employment Surplus(+)/Deficit(-) (NIA basis) 7/	-5.0	n.a.	-11.0	n.a.	-10.4	-8.0	7.5	-0.1	-19.9	-19.5	-14.3	-6.9	-3.3
	*--actual	e--estimated	r--revised	n.e.--not estimated	n.a.--not available	p--preliminary							

1/ OMB Revised 1978 Budget Outlay Estimates, (November 11, 1977).

2/ Congress' Second Concurrent Resolution on the Budget (September 15, 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 (until October 1977), 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 \$1.8 billion for FY 1977 and FY 1978 due to spreading of wage base effect over calendar year.

7/ Estimated by F.R.B. staff.

8/ Includes \$2.5 billion of borrowing from the Federal Reserve on September 30 which was repaid October 4.

Comments on the Federal Sector Outlook

Treasury Department data and a recent Administration budget update now suggest that Federal spending in the current fiscal year will be somewhat higher than was anticipated last month. In particular, Small Business Administration loans to farmers and farm price support payments now appear likely to exceed earlier estimates. In addition, estimates of outlays to settle the claims of various States regarding social service programs have been raised. Given these changes, the staff has revised upward unified outlays by \$1 billion to \$456-1/2 billion. This is about \$3 billion below the Administration's most recent estimate (\$459.8 billion). The staff's projection of receipts in fiscal year 1978 has been reduced by about \$1-1/2 billion to \$395-1/2 billion, mainly because of a reestimation of 1978 tax refunds and delayed passage of the Energy Bill. The above estimates suggest a unified budget deficit in fiscal year 1978 of around \$61 billion and a total deficit to be financed (unified plus off-budget) of almost \$72 billion.

In the current quarter, the Treasury is projected to run a total deficit (unified plus off-budget) of about \$28-1/2 billion. It is expected that this deficit will be financed by running down the high end-of-September cash balance (\$8 billion), and by issuing marketable (\$19 billion) and nonmarketable securities (\$1.0 billion). The total unified and off-budget agency deficit is expected to remain

around the \$28 billion level in the first quarter. With a lower starting cash balance, however, the Treasury's borrowing needs in the first quarter of 1978 are projected to be up about \$6-1/2 billion from the current quarter.<sup>1/</sup>

Incoming expenditure data for October and November have been stronger than projected last month, partly reflecting an advance in the timing of payments made for farm price supports and for veterans' benefits. As a result, our estimate of unified outlays in 1977:4 has been raised to \$112 billion, about \$3 billion higher than last month. Spending in the first quarter also has been revised upward from last month's projection. Spending for the fiscal year as a whole has been raised by only \$1 billion, however, with the redistribution within the year arising from the special timing factors mentioned above and changing seasonals associated with the new fiscal year.

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<sup>1/</sup> Note: the borrowing numbers in this paragraph are being quoted on a payments basis to make them consistent with deficit figures. Data provided in the section's financial draft for the Greenbook are presented on an offering basis to make them coincide with data on bond issuance by corporations and municipalities. On a payments basis, borrowing appears much larger in the first quarter than in the fourth; on an offering basis it appears about the same level in both quarters.

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**DOMESTIC FINANCIAL DEVELOPMENTS**

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Summary. Following several months of rapid growth,  $M_1$  declined slightly in November. This decline and the accompanying stability of the Federal funds rate contributed to an easing in pressures on short-term interest rates. Yields on most private short-term debt instruments were about unchanged over the intermeeting period. However, the spread between interest rates on bank CDs and Treasury bills widened somewhat as bank sales of large-denomination time deposits increased sharply while foreign official institutions made unusually large purchases of Treasury securities.

Reflecting sales of a large volume of new coupon issues and market expectations of substantial Treasury financing in early 1978, intermediate-term Treasury rates rose somewhat after the November FOMC meeting to reach their highest levels of the year. These rates are now within 25 to 70 basis points, respectively, of the effective yield on commercial bank and thrift deposits offered at ceiling rates in the popular over-four-year area.

Commercial banks, whose shorter term liabilities subject to ceilings generally yield considerably less than market securities of comparable maturity, have experienced difficulty in attracting small-denomination deposits in the last few months. Time and savings deposits subject to interest rate ceilings apparently have contracted slightly at these institutions in October and November combined. Faced with strong demands for bank credit, particularly from real estate and business borrowers, commercial banks issued a record volume of large

time deposits in November. These deposits, which are not subject to rate ceilings, also had risen sharply in the previous month.

Inflows of deposits to thrift institutions have slowed markedly from the relatively rapid pace of earlier months. Deposits at savings and loan associations and mutual savings banks (combined) expanded at an 8-3/4 per cent annual rate on an end-of-month basis in November, and partial data for MSBs in early December indicate continued weakness in the growth of deposits at these institutions.

Mortgage indebtedness apparently increased substantially further in November. Also, thrift institutions, which have supplied about one-half of the record growth in mortgage credit in the last year, increased their outstanding commitments sharply. S&L commitments as a percentage of their projected cash flow now stand at their highest level since mid-1974. In order to accommodate takedowns of these growing commitments in the face of declining deposit inflows, S&Ls have increased their borrowing from the Federal Home Loan Banks and, on balance, have reduced their liquidity positions somewhat from the comfortable levels that prevailed earlier in the year. Mortgage interest rates edged upward a few basis points in November.

The general upward movement in interest rates this year has been associated with a substantial flattening of the yield curve as short- and intermediate-term rates rose appreciably, rates on private long-term debt instruments increased modestly, and yields on long-term tax-exempt securities declined. Despite these interest rate developments, growth in

short-term business borrowing has accelerated in the current quarter from the already advanced pace established earlier in the year. Business borrowing from banks in particular has remained strong despite a growing movement by banks to tighten non-price terms of lending. With sales of long-term debt obligations by nonfinancial corporations remaining moderately below the pace set earlier in the recovery, the ratio of short- to long-term debt of such corporations--a rough inverse index of balance sheet strength--has risen somewhat over the year.

Outlook. Even with the slowing in November, the monetary aggregates have expanded at rapid rates over the first 11 months of the year:  $M_1$  at a 7-1/4 per cent annual rate; and  $M_2$  and  $M_3$  at 9-1/4 and 11-1/4 per cent annual rates, respectively. Growing demands for transactions balances associated with further economic expansion should continue to stimulate growth in  $M_1$ , and System efforts to restrain this growth are likely to contribute to additional increases in short-term interest rates after the first of the year. Enlarged Treasury financing needs in the first quarter and continued commercial bank issuance of CDs to accommodate expected strong demands for bank credit should tend to reinforce upward pressure on interest rates. Rising market rates can be expected further to restrain inflows of time and savings deposits subject to rate ceilings at banks and thrift institutions.

As inflows to thrifts and commercial banks slow, mortgage market conditions are likely to firm somewhat. However, in the weeks immediately ahead, any tendencies toward tightening are likely to be

ameliorated by the ability of thrifts to sustain their current lending pace by increasing further their borrowing from the FHLB and by drawing upon their still adequate liquidity. Moreover, FNMA, GNMA, and FHLMC support of the mortgage market should help to moderate upward pressures on mortgage rates.

Intermediate- and longer-term interest rates may rise further in the first few months of next year as credit demands continue generally strong. Nonfinancial corporate financing needs as measured by the financing gap--the difference between investment expenditures and internally generated funds--are expected to rise somewhat further over the course of the year. Should businesses seek to restore short- to long-term debt ratios to the lower levels reached last year, a substantial part of the increased financing needs could be concentrated in bond markets.

Despite these growing credit demands, longer-term interest rates will likely rise only modestly in the first few months of 1978. The updrift in intermediate- and long-term rates in the last few weeks indicates that the market has already adjusted to expectations of stronger credit demands early in the year. Moreover, continued sizable supplies of funds from institutional investors should tend to moderate upward pressures on long-term rates next year. Purchases of long-term securities by pension funds and life insurance companies in particular are expected to remain near the higher levels reached in 1977.

INTERNATIONAL DEVELOPMENTS

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Summary. Pressure on the dollar in foreign exchange markets continued during the past five weeks. The weighted average exchange rate for the dollar depreciated a further 3 per cent, raising to about 5 per cent the total depreciation since the emergence of the pressure on the dollar in late September.

. The System sold somewhat less than \$400 million equivalent of marks during the period.

Since last month's green book, all major currencies have appreciated against the dollar, with the most pronounced rises recorded by the German and Swiss currencies. The relatively steep appreciation of the mark has led to renewed pressure within the EC snake,

. The Canadian dollar has appreciated by about 1 per cent since the end of November, halting a steady decline of that currency over the past year.

The persistent pressure on the dollar reflects continuing market uncertainty about U.S. economic policies and prospects and a growing realization that U.S. trade and current-account deficits may continue large for some time. A stream of public statements by European, Japanese and U.S. officials about the present pattern of exchange rates and exchange-rate policies has contributed to increased variability of exchange-rate movements in recent weeks.

The United States recorded a \$40 billion trade deficit (annual rate) in October, compared with a third-quarter deficit rate of \$30 billion. About \$10 billion of the enlarged deficit can be attributed to the two-month dock strike that terminated at the end of November, in which recorded exports were more severely affected than recorded imports. The effects of the strike will continue to be felt in the next few months, and render assessment of underlying U.S. trade developments more difficult.

Foreign official assets in the United States (excluding OPEC holdings) increased by \$5.5 billion in October,

After adjusting for the timing of banks' reporting, private capital flows for which monthly data are available shifted to an outflow of \$2 billion in October.

Total outstanding claims on non-U.S. residents held by domestic and foreign offices of U.S.-owned banks rose by nearly 8 per cent during the first nine months of this year compared with a rate in excess of 12 per cent for the corresponding period in 1976. Claims on most country groups have increased more slowly this year than last, and, in some cases, actually have declined.

Outlook. Latest data indicate that the pace of economic expansion abroad continues to be sluggish. The September/October levels of industrial production in the six major foreign industrial countries were at or below levels achieved in the early months of the year. Unemployment rates, already high, are continuing to rise. For the six

major foreign countries combined, real GNP is projected to advance this year by less than 3 per cent compared with a 5 per cent year-to-year rise in 1976. For 1978, the staff projects an acceleration in the rate of expansion for this group of countries to a year-over-year rate of 4 per cent, and a fourth-quarter-to-fourth-quarter rate of 4.5 per cent. Considerable uncertainty surrounds these projections and, even if these growth rates materialize, they will do little to absorb prevailing high levels of underutilized resources.

Current projections for the U.S. trade and current accounts next year indicate slightly smaller deficits than those presented in last month's green book. Projected trade and current-account deficits on the order of \$35 billion and \$22.5 billion, respectively, next year (both about \$5 billion larger than estimated for 1977) continue to reflect differences in the cyclical position of the United States and its main trading partners, and the huge U.S. oil import bill.

Taking into account the substantial depreciation of the dollar already experienced in recent months, the staff expects that the average value of the dollar will show no significant change over the year ahead. At the same time, we anticipate a substantial realignment among currencies, with the mark and the yen rising moderately further relative to the dollar in the year ahead, and the Italian lira and French franc depreciating against the dollar. The staff's outlook for the average value of the dollar reflects the balancing of two alternative views. One view is that the dollar could well depreciate further over the next year as a consequence of the continuation and widening of the large

U.S. trade and current-account deficits. An alternative view is that the dollar will appreciate as market participants shift their focus on factors more favorable to the dollar, such as the relatively better U.S. economic performance, the relative attractiveness of investments in dollar-demoninated assets, and the U.S. record of political stability.

	1976	1977 <sup>P</sup>	1978 <sup>P</sup>	1976		1977				1978 <sup>P</sup>			
				III	IV	I	II	III <sup>P</sup>	IV <sup>P</sup>	I	II	III	IV
1. <u>GNP NET EXPORTS</u> - Intl Acct. data	7.7	-8.1	-10.1	7.8	2.9	-7.4	-8.7	-7.2	-8.8	-7.8	-9.8	-11.6	-11.6
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(7.8)	(-8.7)	(-10.5)	(7.9)	(3.0)	(-8.2)	(-9.7)	(-7.6)	(-9.1)	(-8.1)	(-10.0)	(-11.9)	(-11.9)
3. a) Merchandise Trade Balance	-9.3	-30.3	-34.9	-11.2	-14.4	-28.4	-31.4	-29.9*	-31.3	-31.4	-34.1	-37.0	-37.3
4. Exports (excl. military)	114.7	121.4	137.3	118.4	118.8	117.8	122.0	123.4*	122.3	129.6	134.9	139.7	144.9
5. Agricultural	23.4	24.3	23.4	25.0	23.5	24.5	26.8	23.9*	22.1	22.6	23.2	23.6	24.2
6. Nonagricultural	91.3	97.1	113.9	93.5	95.3	93.4	95.2	99.5*	100.2	107.0	111.7	116.1	120.7
7. Imports	124.0	151.7	172.2	129.6	133.2	146.2	153.4	153.4*	153.6	161.0	169.0	176.7	182.2
8. Petroleum and petrol. products	34.6	45.8	48.5	37.6	37.4	44.1	47.7	45.8*	45.7	45.2	48.0	50.5	50.4
9. Nonpetroleum	89.4	105.8	123.7	92.0	95.9	102.1	105.7	107.5*	107.9	115.8	121.0	126.2	131.8
10. b) Military transactions, net <u>2/</u>	--	1.6	1.6	.6	.5	1.7	1.5	1.6	1.5	1.6	1.6	1.6	1.6
11. c) Investment income, net <u>3/</u>	14.3	18.8	21.2	15.3	14.4	17.9	18.7	19.3	19.3	20.2	20.9	21.8	21.9
12. d) Other services, net <u>4/</u>	2.7	1.8	2.0	3.1	2.4	1.4	2.5	1.8	1.7	1.8	1.8	2.0	2.2
13. <u>U.S. CURRENT ACCOUNT BALANCE</u> <u>2/</u>	-1.0	-17.7	-22.6	-1.6	-6.0	-16.5	-17.8	-16.9	-19.2	-19.8	-22.2	-24.2	-24.2
14. a) GNP net exports (line 1.)	7.7	-8.1	-10.1	7.8	2.9	-7.4	-8.7	-7.2	-8.8	-7.8	-9.8	-11.6	-11.6
15. b) U.S. Govt & private transfers <u>5/</u>	-8.7	-9.6	-12.5	-9.3	-8.9	-9.0	-9.1	-9.7	-10.4	-12.0	-12.4	-12.6	-12.6
<u>Constant (1972) dollars</u>													
16. Merchandise exports (excl. military)	66.7	67.5	72.9	68.4	67.3	66.1	67.4	68.6	68.0	71.0	72.3	73.4	74.7
17. (% change, annual rates)	(3.4)	(1.2)	(8.0)	(13.0)	(-6.6)	(-7.4)	(8.2)	(7.4)	(-3.8)	(18.8)	(7.4)	(6.1)	(7.4)
18. Merchandise imports	62.8	71.0	75.8	64.9	66.1	70.2	72.0	71.0	70.7	72.7	74.7	77.1	78.3
19. (% change, annual rates)	(22.5)	(13.1)	(6.8)	(29.1)	(7.4)	(27.2)	(10.4)	(-5.7)	(-1.6)	(11.7)	(11.7)	(13.4)	(7.0)
<u>Foreign Outlook - Major Industrial Countries</u> <u>6/</u>													
20. Real GNP, % change, annual rates	5.2	3.0	4.1	1.6	2.9	5.3	.9	1.6	4.9	5.1	4.6	4.2	4.0
21. Wholesale Prices, % change, A.R. <u>7/</u>	9.5	8.9	5.9	11.7	8.7	10.6	7.4	3.4	5.7	6.1	6.3	6.4	6.3

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.