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CONFIDENTIAL (FR)

July 12, 1978

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

By the Staff
Board of Governors
of the Federal Reserve System

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

	Latest Data			Per Cent Change from		
	Period	Release Date	Data	Preceding Period	Three Periods Earlier	Year earlier
				(At annual rate)		
Civilian labor force	June	7-7-78	100.6	3.7	4.7	3.1
Unemployment rate (%)1/	June	7-7-78	5.7	6.1	6.2	7.1
Insured unemployment rate (%)1/	June	7-7-78	3.1	3.1	3.5	3.8
Nonfarm employment, payroll (mil.)	June	7-7-78	85.7	3.9	5.6	4.3
Manufacturing	June	7-7-78	20.3	-.2	1.8	3.3
Nonmanufacturing	June	7-7-78	65.5	5.1	6.7	4.7
Private nonfarm:						
Average weekly hours (hr.)1/	June	7-7-78	36.0	36.0	36.2	36.2
Hourly earnings ($)1/	June	7-7-78	5.67	5.64	5.56	5.22
Manufacturing:						
Average weekly hours (hr.)1/	June	7-7-78	40.4	40.3	40.6	40.5
Unit labor cost (1967=100)	May	7-3-78	165.6	.0	1.5	7.6
Industrial production (1967=100)	May	6-15-78	143.7	6.7	12.9	4.9
Consumer goods	May	6-15-78	147.3	.0	9.7	2.9
Business equipment	May	6-15-78	159.9	6.8	14.8	7.4
Defense & space equipment	May	6-15-78	81.5	.0	11.6	1.9
Materials	May	6-15-78	144.6	12.6	17.3	4.9
Consumer prices (1967=100)	May	6-30-78	193.7	11.3	10.8	7.1
Food	May	6-30-78	211.2	17.9	19.0	9.7
Commodities except food	May	6-30-78	172.8	7.0	6.8	5.0
Services	May	6-30-78	208.7	12.2	11.2	8.2
Producer prices (1967=100)	June	7-7-78	209.1	8.7	9.8	7.7
Industrial commodities	June	7-7-78	208.4	8.1	8.4	7.1
Farm products & foods & feeds	June	7-7-78	209.3	11.6	14.5	9.7
Personal income ($ bil.)2/	May	6-16-78	1693.3	11.0	14.4	11.6
				(Not at annual rates)		
Mfrs. new orders dur. goods ($ bil.)	May	6-30-78	70.0	-.1	4.9	18.9
Capital goods industries	May	6-30-78	22.3	3.9	8.4	25.3
Nondefense	May	6-30-78	18.2	4.3	1.6	21.9
Defense	May	6-30-78	4.1	2.0	54.9	42.4
Inventories to sales ratio:1/						
Manufacturing and trade, total	Apr.	7-11-78	1.39	1.42	1.47	1.45
Manufacturing	May	6-30-78	1.51	1.49	1.53	1.60
Trade	Apr.	7-11-78	1.30	1.33	1.35	1.31
Ratio: Mfrs.' durable goods inventories to unfilled orders1/	May	6-30-78	.593	.600	.613	.647
Retail sales, total ($ bil.)	June	7-11-78	64.0	.1	2.0	10.6
GAF3/	June	7-11-78	14.2	.3	4.5	13.3
Auto sales, total (mil. units.)2/	June	7-11-78	11.9	-2.9	-.2	1.2
Domestic models	June	7-11-78	9.9	-1.6	.2	2.7
Foreign models	June	7-11-78	2.0	-8.7	-2.3	-5.8
Housing starts, private (thous.)2/	May	6-16-78	2,075	-4.9	32.2	4.7
Leading indicators (1967=100)	May	7-3-78	135.9	-.1	1.0	4.6

1/ Actual data used in lieu of per cent changes for earlier periods.
2/ At annual rate.
3/ Excludes mail order houses.

DOMESTIC NONFINANCIAL DEVELOPMENTS

Economic activity appears to be expanding at a moderate pace, but the rate of inflation remains exceptionally high. Employment gains were again substantial in June, although they were limited to sectors other than manufacturing. Growth in industrial production was probably quite modest last month. Consumer purchases of durable goods--primarily automobiles--remained robust in June, while nondurable spending was about unchanged. The strength in plant and equipment outlays and inventory investment appears to have been sustained in the second quarter as a whole. Prices have continued to rise rapidly, paced by large increases in the food component.

Employment and Production

Employment continued to increase briskly in June as nonfarm payrolls climbed 275,000 following an upward revised rise of 230,000 in May. While these recent gains were strong, they were considerably below the average monthly rise of nearly 450,000 during the first four months of the year. Gains in June were concentrated in service producing industries and in contract construction. Manufacturing employment was unchanged and the factory workweek edged up .1 to 40.4 hours.

The unemployment rate dropped 0.4 percentage point in June to 5.7 per cent--the lowest rate in nearly 4 years--as total employment measured by the household survey grew by 700,000. Over a third of this rise was accounted for by a sharp rise in agricultural employment. Half of the drop in unemployment reflected an improved jobless

AVERAGE MONTHLY CHANGES IN EMPLOYMENT
(Thousands of jobs; based on seasonally adjusted data)

	Dec. 76 to June 77	Dec. 77 to June 78	Dec. 77 to Apr. 78	Apr. 78 to May 78	May 78 to June 78
Nonfarm payroll employment 1/	298	383	449	231	275
Manufacturing	83	64	87	41	-4
Durable	53	48	61	36	6
Nondurable	30	17	26	5	-10
Construction	47	69	73	38	87
Trade	57	65	70	70	41
Services and finance	70	79	93	32	73
State and local government	25	55	59	32	61
Private nonfarm production workers	208	249	307	172	95
Total employment 2/	367	368	298	311	707
Nonagricultural	352	343	310	351	469

1/ Survey of establishments.
2/ Survey of households.

SELECTED UNEMPLOYMENT RATES
(Per cent; based on seasonally adjusted data)

	1973	1977		1978			
	Annual Average	QIII	QIV	QI	QII	May	June
Total, 16 years and older	4.9	6.9	6.6	6.2	5.9	6.1	5.7
Teenagers	14.5	17.6	16.7	16.9	15.9	16.5	14.2
20-24 years old	7.7	10.9	10.3	10.3	9.4	9.0	9.2
Men, 25 years and older	2.5	4.1	3.9	3.5	3.3	3.5	3.1
Women, 25 years and older	4.0	6.1	5.8	4.9	5.1	5.3	5.2
White	4.3	6.1	5.8	5.4	5.1	5.2	4.9
Black and other	8.9	13.6	13.3	12.3	12.0	12.3	11.9
Fulltime workers	4.3	6.5	6.2	5.7	5.4	5.6	5.2
White collar	2.9	4.2	4.1	3.5	3.5	3.6	3.5
Blue collar	5.3	8.1	7.6	7.1	6.5	6.6	6.5
Craft and kindred	3.7	5.4	5.3	5.1	4.3	4.3	4.2
Operatives, ex. transpor	6.1	9.9	9.2	8.0	8.0	8.4	7.9

RECENT CHANGES IN INDUSTRIAL PRODUCTION
(Per cent changes at compound annual rates; based on seasonally adjusted data)

	1977				1978		
	QI	QII	QIII	QIV	QI	April 1/	May 2/
Total index	6.2	10.5	4.3	2.6	.9	18.4	6.9
Products, total	8.2	8.0	6.3	2.9	.9	11.6	2.6
Consumer goods	7.7	6.3	4.9	.8	-3.8	11.2	0
Durable consumer goods	10.4	14.8	7.9	-.5	-10.1	37.1	-10.6
Autos, total	10.5	31.7	7.3	-14.9	-29.2	107.7	-44.9
Nondurable consumer goods	6.6	2.9	3.5	1.4	-.8	1.7	6.1
Equipment	10.4	13.7	6.7	1.9	3.9	10.7	4.7
Business equipment	12.3	15.3	7.5	5.1	3.4	12.9	7.0
Defense & space equipment	3.7	9.5	3.0	-7.2	4.6	0	0
Intermediate products	7.4	4.7	8.0	7.3	7.5	5.7	7.3
Construction supplies	2.1	7.6	10.2	13.6	5.9	3.3	5.8
Materials	3.7	14.5	1.4	2.3	1.2	30.1	13.3
Durable goods materials	2.5	19.6	2.5	5.1	.9	31.5	14.4
Nondurable goods materials	7.3	14.3	-.5	1.6	7.7	9.4	6.1
Energy materials	.0	2.2	2.4	-4.8	-8.3	67.8	20.2

1/ Preliminary.
2/ Estimated.

situation for teenagers, but unemployment rates among experienced workers such as full-time workers, adult men, and job losers declined substantially as well.

Industrial production is expected to show only a small increase in June of around one-quarter to one-half per cent--somewhat below the preliminary May estimate. Increases in output were apparently balanced among products and materials. Auto assemblies were at a 9.3 million unit seasonally adjusted annual rate in June, as compared with 9.6 million during the April-May period; this decline was offset by a small rise in truck production.

Capacity utilization in the manufacturing sector probably continued at 83.6 per cent in June, fractionally above the postwar average. There is little evidence of capacity pressures in the materials producing sector, as operating rates remain far below their 1973 highs and there is ample slack capacity abroad.

Consumer Sector Activity

Total personal income grew at an 11 per cent annual rate in May--down somewhat from the sharp advances during the rebound months of March and April, but in line with the average pace in 1977. The increase in private wage and salary disbursements slowed in May, due to the more moderate pick-up in employment and the decline in the workweek. However, farm income increased rapidly, reflecting sharply rising agricultural prices.

PERSONAL INCOME
(Per cent changes at compound annual rates;
based on seasonally adjusted data)

	1977 QI	1977 QII	1977 QIII	1977 QIV	1978 QI	Mar. 78 to Apr. 78 1/	Apr. 78 to May 78 1/
Current dollars							
Total personal income	13.1	11.4	8.9	14.5	9.2	15.4	11.0
Nonagricultural income	12.0	11.9	10.2	12.6	10.0	15.2	9.3
Agricultural income	70.6	-6.8	-37.9	146.8	-19.6	24.6	96.6
Wage and salary disbursements	12.7	13.0	7.5	12.7	12.0	19.6	7.1
Private	14.9	15.1	7.7	12.5	13.6	23.2	7.6
Manufacturing	17.9	17.5	6.3	12.4	15.8	8.2	6.5
Government	4.9	5.0	7.1	13.2	5.9	4.6	5.1
Nonwage income	14.5	8.5	10.8	16.8	7.0	8.7	16.7
Constant dollars 2/							
Total personal income	4.4	2.4	3.5	9.5	1.2	4.7	-.2
Wage and salary disbursements	4.1	3.9	2.3	7.8	3.7	8.8	-4.1

1/ Per cent change at annual rate, not compounded.
2/ Deflated by CPI, seasonally adjusted. Beginning January 1978, deflated by CPI/U, seasonally adjusted.

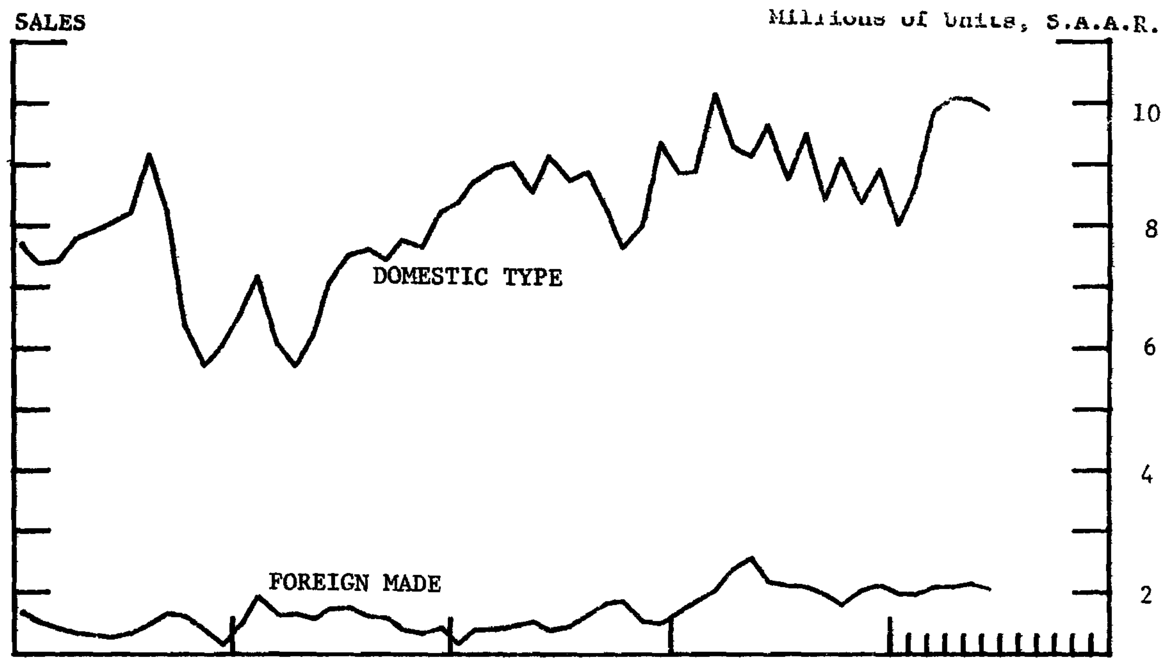
Well-maintained income growth over the past year has supported high levels of consumer goods purchases. Total auto sales in June continued at about the 12 million unit mark for the fourth consecutive month with domestic sales averaging around 10 million units during this period. Consumer surveys suggest that the sustained strength in sales has apparently been augmented by a tendency to buy cars in advance of anticipated price increases. Retail sales excluding autos and nonconsumer items were little changed in June, following average monthly increases of 1 per cent in the prior two months. In real terms, nondurable goods expenditures were virtually unchanged in the second quarter as nominal takings were boosted by large food price increases.

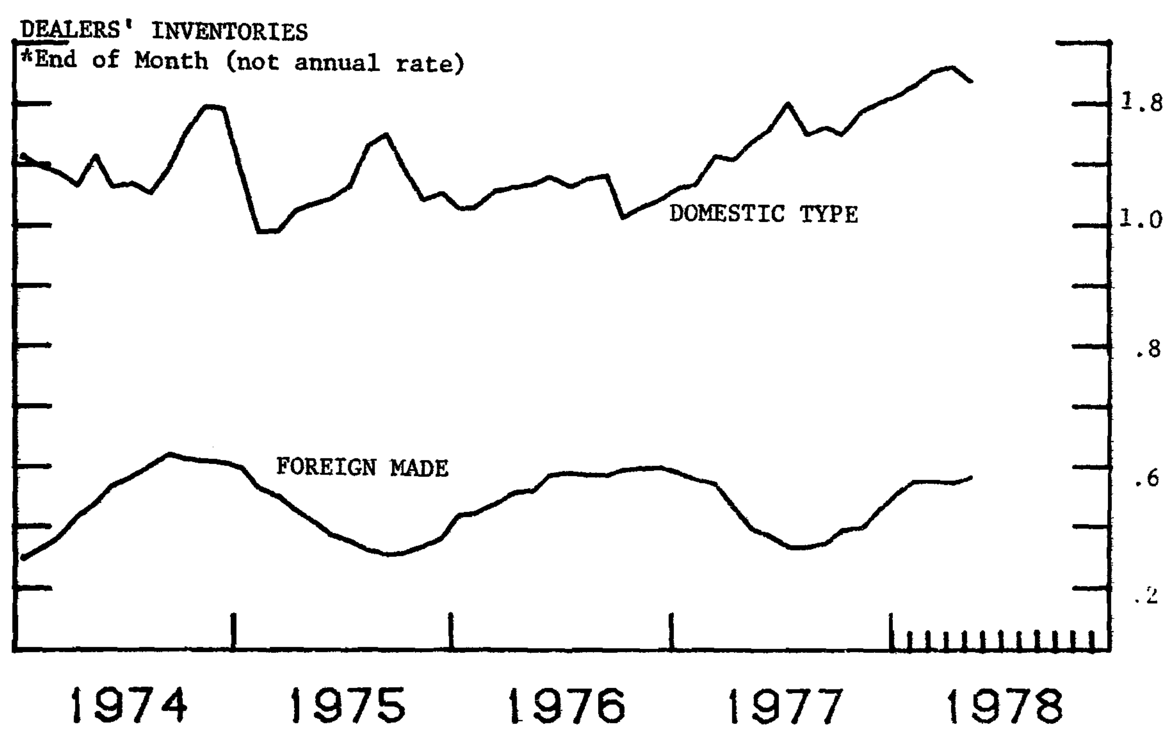
The continuing strength in durable goods sales was consistent with consumer attitudes surveyed by the Michigan Research Center in June. Households continued to report a step-up of anticipatory buying patterns for large durables. This survey--like the Conference Board survey taken at about the same time--indicates little fundamental change in consumer attitudes over the past 2-1/2 years.

Business Investment

The book value of manufacturers' inventories increased at a $21 billion annual rate in May, close to the large April rise.

AUTOS


SALES
Millions of Units, S.A.A.R.
10
8
6
4
2
DOMESTIC TYPE
FOREIGN MADE


DEALERS' INVENTORIES
*End of Month (not annual rate)
1.8
1.0
.8
.6
.2
DOMESTIC TYPE
FOREIGN MADE
1974
1975
1976
1977
1978

RETAIL SALES
(Per cent change from previous period;
based on seasonally adjusted data)

	1978				
	QI	QII	April	May	June
Total sales	-.1	4.2	2.2	-.2	.1
(Real)	-2.0	n.a.	1.3	-1.1	n.a.
Total, less auto and nonconsumption items	.3	3.6	1.2	.7	-.1
GAF	-3.7	6.3	3.3	.8	.3
Durable	-2.0	6.2	4.9	-1.6	-.5
Auto	-1.7	5.8	5.2	-3.2	.1
Furniture & appliances	-4.2	6.0	5.8	1.1	-3.9
Nondurable	.9	3.2	.9	.5	.3
Apparel	-4.5	7.1	4.3	-2.0	1.6
Food	3.1	3.3	2.3	.6	-.2
General merchandise	-3.2	6.1	2.0	1.7	1.4
Gasoline	1.9	-.1	-1.7	.3	-.4

1/ Deflated by the consumer price index for all commodities.

AUTO SALES
(Millions of units; seasonally adjusted)

	1978				
	QI	QII	Apr.	May	June
Total	10.8	12.1	12.1	12.3	11.9p
Imports	2.0	2.1	2.1	2.2	2.0p
Domestic	8.8	10.0	10.1	10.1	9.9

Durable stocks grew at an $18.2 billion rate, substantially above the advanced December to April pace. In contrast, the rate of accumulation of nondurables was much reduced from the high April rate.

Despite substantial book value increases since early this year, the ratio of inventories to sales remains low, particularly at manufacturing establishments. The only area where any buildup is noticeable is at the retail level, especially at furniture and appliance stores where the book value ratio has moved above its 1974 peak.

Indicators of business capital spending continue to suggest a more moderate rate of expansion in the second half of the year following a sharp increase in the second quarter. New orders for nondefense capital goods increased 4.3 per cent in May following small declines in the previous two months. As is often the case, the recent volatility in these bookings was due in large part to swings in orders for transportation equipment. The machinery component, which is more indicative of the underlying demand for capital equipment, has risen at a 12 per cent annual rate so far this year, considerably below the 22 per cent increase during 1977. While shipments of nondefense capital goods fell 1.7 per cent in May, the April-May average was almost 5 per cent above the first quarter level.

BUSINESS INVENTORIES
(Change at annual rate in seasonally adjusted book value; billions of dollars)

	1976	1977				1978		
	QIV	QI	QII	QIII	QIV	QI	Apr. 1/	May 2/
Manufacturing and trade	19.3	31.0	28.3	25.2	17.8	44.2	49.7	n.a.
Manufacturing	9.8	10.6	15.7	10.2	2.8	16.6	22.3	21.3
Durable	9.6	6.4	7.8	7.7	3.8	13.2	13.5	18.2
Nondurable	.3	4.2	7.9	2.4	-1.0	3.4	8.8	3.0
Trade, total	9.4	20.4	12.6	15.0	14.9	27.6	27.5	n.a.
Wholesale	3.5	12.0	2.6	4.7	7.5	19.5	17.1	n.a.
Retail	6.0	8.4	10.0	10.3	7.4	8.1	10.4	n.a.
Auto	2.7	.8	2.2	1.5	2.9	.9	1.1	n.a.

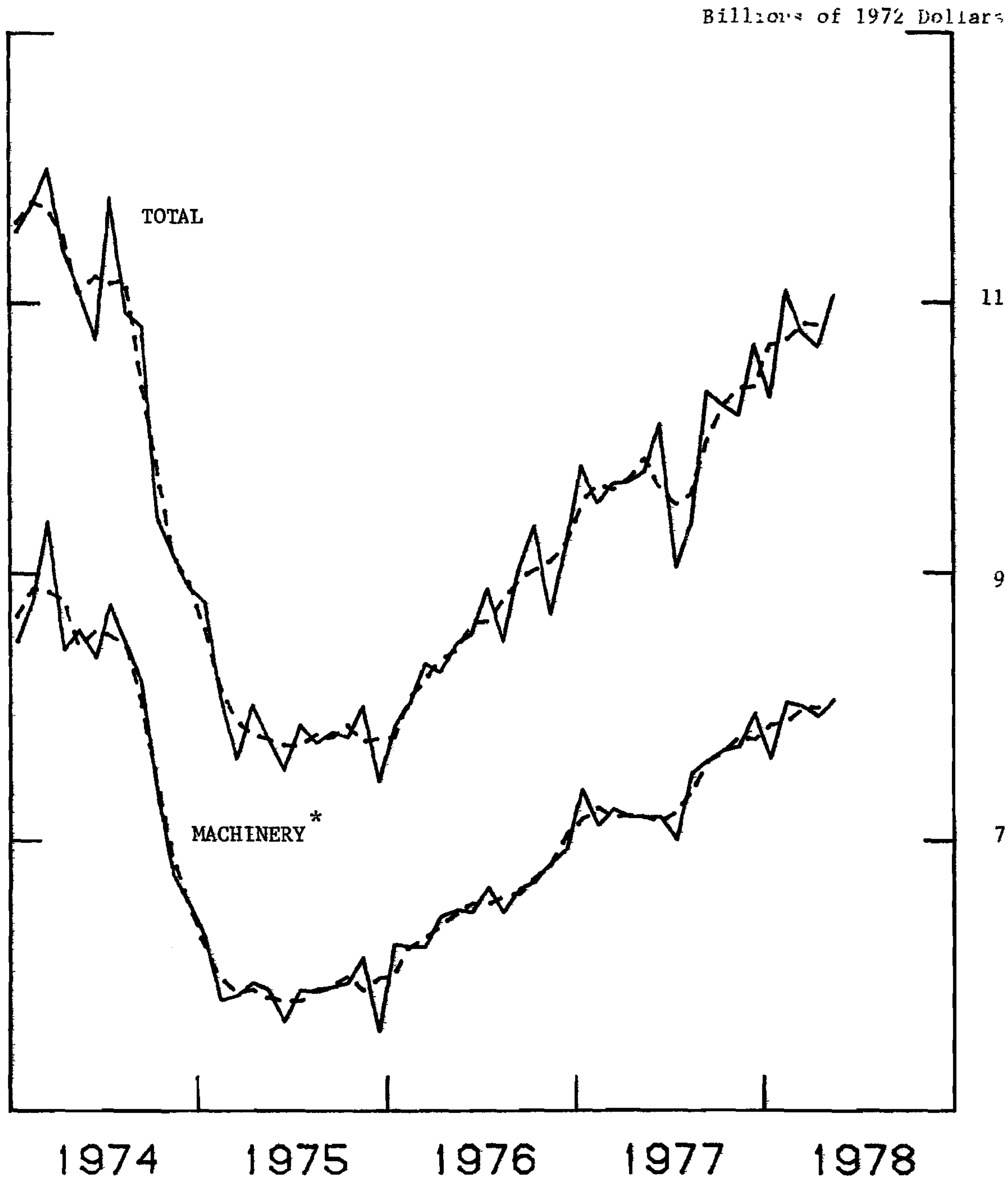
1/ Revised.
2/ Preliminary.

INVENTORY RATIOS

	1976	1977				1978		
	QIV	QI	QII	QIII	QIV	QI	Apr. 1/	May 2/
Inventory to sales:								
Manufacturing and trade	1.50	1.46	1.46	1.48	1.44	1.46	1.40	n.a.
Manufacturing	1.67	1.60	1.60	1.61	1.56	1.55	1.49	1.51
Durable	2.07	1.97	1.96	1.96	1.90	1.90	1.80	1.86
Nondurable	1.23	1.20	1.22	1.22	1.18	1.17	1.13	1.12
Trade, total	1.33	1.33	1.32	1.35	1.33	1.36	1.30	n.a.
Wholesale	1.24	1.24	1.21	1.24	1.23	1.27	1.20	n.a.
Retail	1.41	1.41	1.43	1.45	1.42	1.45	1.41	n.a.

1/ Revised.
2/ Preliminary.

NEW ORDERS FOR NONDEFENSE CAPITAL GOODS



Note: Dotted line represents 3-month moving average.
* FRB Staff estimate.

CONTRACTS AND ORDERS FOR PLANT AND EQUIPMENT[1/]
(Per cent change from preceding comparable period, seasonally adjusted)

	1977		1978			May. 77 to
	QIII	QIV	QI	Apr.	May	May 78
Current dollars						
Total	-.3	4.1	11.7	-8.1	12.9	12.7
Nondefense capital goods orders	-1.1	10.3	5.6	-.6	4.3	22.0
Construction contracts[2/]	2.9	-22.0	48.4	-47.8	98.9	-19.3
1972 dollars						
Total	-2.3	2.1	9.3	-8.1	12.6	5.9
Nondefense capital goods orders	-3.2	8.2	3.5	-.6	4.2	14.4
Construction contracts[2/]	1.8	-24.2	45.9	-48.3	100.0	-24.4

1/ The Commerce Department creates this series by adding new orders for nondefense capital goods to the seasonally adjusted sum of new contracts awarded for commercial and industrial buildings and for private nonbuilding projects (e.g., electrical utilities, pipelines, etc.).

2/ FRB staff estimate. Derived by subtracting new orders for nondefense capital goods from the published total for contracts and orders.

Construction contracts for private nonresidential structures rebounded in May after dropping sharply in April. In the first five months of the year, such contracts were almost 20 per cent above the comparable period last year. Similarly, the value of construction put-in-place in May was 18 per cent above the year earlier level, although gains in the two most recent months have been successively smaller following the weather-related rebound in March.

Residential Construction

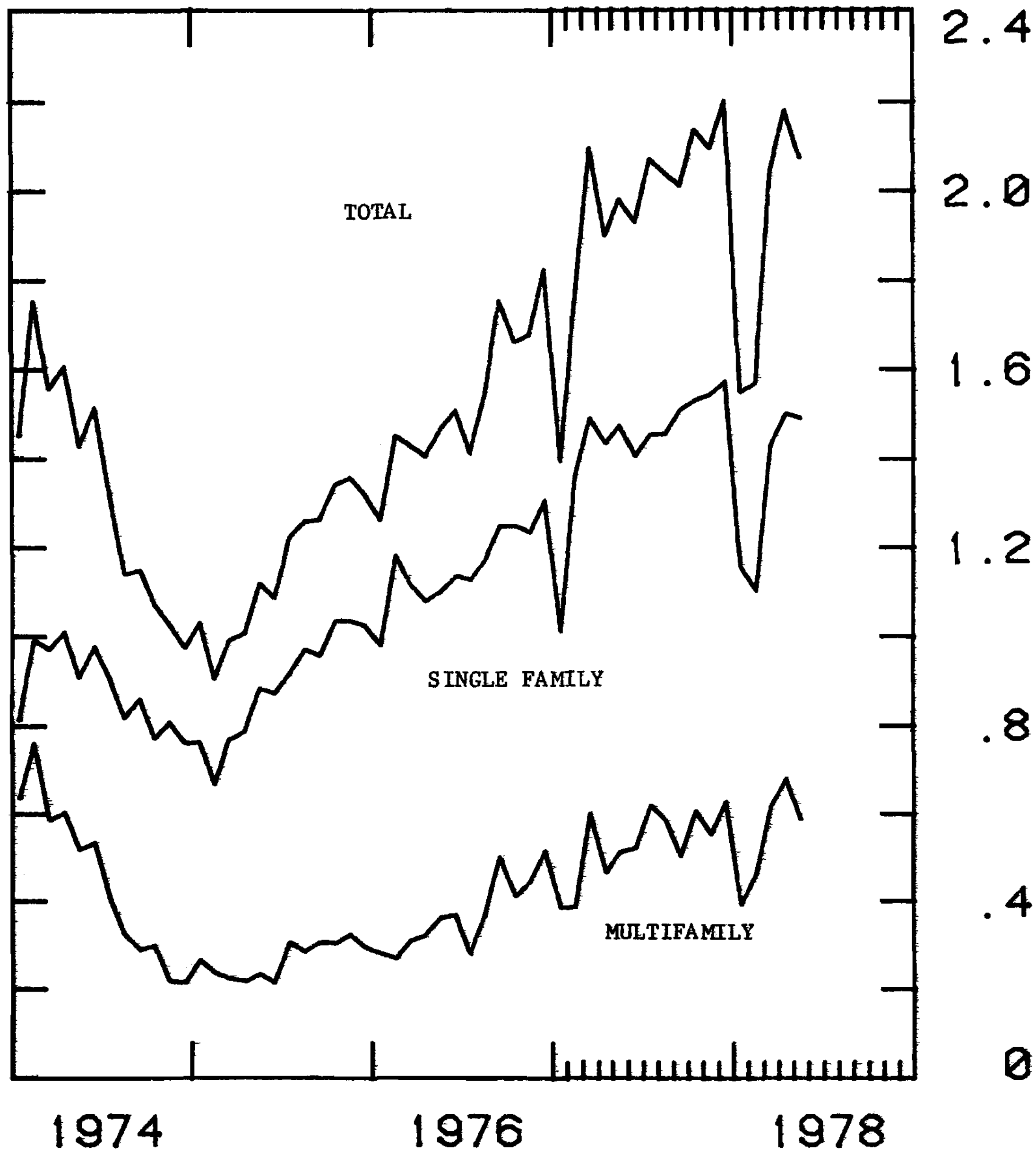
Total private housing starts declined 5 per cent in May to an annual rate of 2.08 million units, more than a fifth above the weather-depressed first quarter average but slightly below the advanced pace at the end of last year. Single-family starts edged down to just below 1.5 million units--still quite high historically. In the multi-family sector, starts declined 14 per cent from the April rate, which was the highest monthly figure in over four years.

Home sales also edged down in May. Merchant builder sales of new single-family homes were down about 1 per cent from the April pace, while existing home sales declined 3 per cent. Sales in both categories remained somewhat below their fourth quarter peaks.

Government Sector

The Administration's mid-year estimate of fiscal year 1978 outlays is about $452 billion, $2 billion below their March estimate. Downward revisions were large in energy and defense spending, agricultural price supports, and waste treatment and highways grants. The

NEW PRIVATE HOUSING STARTS
(Seasonally Adjusted Annual Rate)



Administration still estimates that revenues will total $401 billion in the current fiscal year, and that the deficit will be $51 billion, also $2 billion smaller than in the March Budget Update.

State and local spending increases were sizable in the second quarter, particularly for capital spending. Construction outlays increased 11 per cent in May--the third consecutive large rise following the curtailed level of activity during the winter--and contracts data suggest continued near-term strength. Employment growth also has been quite strong in recent months despite the fact that the public employment program (CETA) reached its funded-levels late in the spring.

Action by the California legislature to disburse the bulk of the State's surplus will probably forestall drastic cutbacks in spending this year. However, a moderation in expenditure growth will undoubtedly accompany tax relief in California and elsewhere, and the ramifications of Proposition 13 can be expected to reinforce the generally conservative State and local government spending trend that has been evident for the last two years.

Prices and Wages

Retail prices have increased at a 10-1/4 per cent annual rate in recent months. Food price increases have been very large, and prices of some nonfood items have also accelerated. Excluding food and energy items, the consumer price index has been rising at about an 8-1/2 per cent annual rate this year, up from a 6-1/2 per cent rise during 1977.

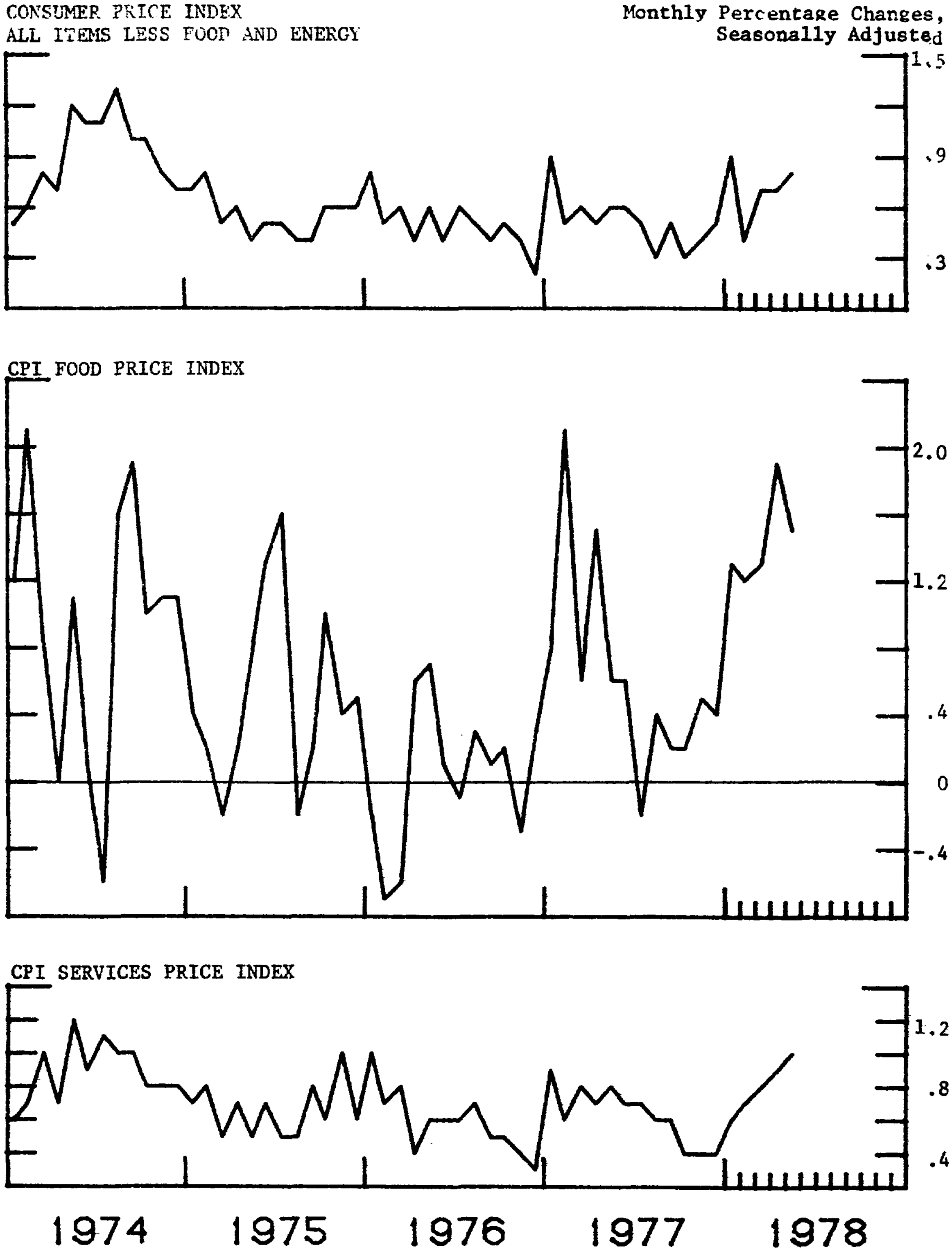
The price of food at retail rose sharply again in May. Meat, poultry, fish, and eggs prices, which had risen 4.8 per cent (monthly) in April, were up 1.7 per cent in May. Increases were large for other food products as well, including in particular a sizable jump for fruits and vegetables. June developments at the producer level suggested continued near-term pressure on retail prices; consumer finished goods rose more than 1 per cent and the index of farm prices rose by nearly 2 per cent. By mid-July, however, livestock spot prices were below their level a month earlier.

Another major factor in the acceleration of retail prices has been sharp increases in housing costs, which have climbed at a 10.7 per cent annual rate since December. In May, home financing, again rose sharply and there were further large increases in natural gas and electricity prices.

Producer prices of consumer nonfood items--often a precursor of retail price changes--rose 0.4 per cent in June, much less than in April and May. However, producer prices for capital equipment rose substantially again, as manufacturers posted higher quotations for trucks and a variety of machinery items.

Wage increases have moderated somewhat in recent months, following the very large advances in the first quarter. In June, the index of hourly earnings was up at a 5-1/2 per cent annual rate, and for the second quarter as a whole, the increase was at a 7.3 per cent

CONSUMER PRICES



RECENT CHANGES IN PRODUCER PRICES
(Per cent change at compound annual rates; based on seasonally adjusted data)1/

	Relative Importance Dec. 1977	1977 QI	1977 QII	1977 QIII	1977 QIV	1978 QI	1978 QII	1978 May	1978 June
Finished goods	41.2	10.0	6.4	2.9	7.2	9.4	11.4	8.8	8.7
Consumer foods	10.3	17.9	4.3	-2.3	7.4	21.0	14.8	5.8	13.3
Consumer nonfoods	18.7	9.0	7.8	4.0	4.7	5.1	10.7	9.3	5.3
Capital equipment	12.2	5.0	6.8	6.0	10.9	6.9	9.4	10.4	9.7
Materials	61.5	12.7	1.2	.4	8.3	14.2	8.4	6.1	7.7
Intermediate 2/	45.5	8.9	5.5	7.1	4.2	9.0	6.2	6.2	5.6
Crude nonfood	4.6	25.6	-8.1	-5.3	20.1	15.7	12.4	4.3	20.2
Crude food	6.3	24.0	-16.6	-19.6	27.6	43.6	25.2	.6	23.2
Memo: Energy 3/	11.3	22.8	15.2	7.6	2.7	4.3	9.9	9.1	11.6

1/ Changes are from final month of preceding period to final month of period indicated. Monthly changes are not compounded.
2/ Excludes intermediate materials for food manufacturing and manufactured animal feeds.
3/ Fuels and related products and power.

RECENT CHANGES IN CONSUMER PRICES
(Per cent changes at compound annual rates; based on seasonally adjusted data)1/

	Relative Importance Dec. 77 2/	1977 QI	1977 QII	1977 QIII	1977 QIV	1978 2/ QI	1978 2/ April	1978 2/ May
All items	100.0	10.0	7.8	4.5	4.9	9.3	10.7	11.3
Food	17.7	15.3	11.5	1.9	4.2	16.4	22.3	17.9
Commodities (nonfood)	41.6	7.4	4.2	2.7	5.4	6.1	6.3	7.0
Services	40.7	9.8	9.4	7.6	4.9	9.1	11.1	12.2
Memoranda:								
All items less mortgage interest costs (n.s.a.)	93.5	9.4	8.2	4.3	4.5	7.8	10.9	10.8
All items less food and energy 3/	73.7	8.5	6.9	5.1	5.3	8.0	8.5	9.7
Gas and electricity	3.4	12.5	11.9	12.0	-.9	12.2	16.5	22.1
Gasoline and fuel oil 4/	5.2	12.5	9.9	.8	2.0	.2	3.5	7.5

1/ Changes are from final month of preceding period to final month of period indicated. Monthly changes are not compounded.
2/ Based on new index for all urban consumers.
3/ Energy items excluded: gasoline and motor oil, fuel oil and coal, gas and electricity.
4/ Includes motor oil, coal, and bottled gas.

annual rate. In the first quarter, when the minimum wage was boosted, the annual rate of rise was nearly 10 per cent. The index of average hourly earnings has risen at an 8-1/4 per cent rate so far this year, with contract construction and trade showing the largest increases.

HOURLY EARNINGS INDEX[1/]
(Per cent changes, based on seasonally adjusted data)

	Dec. 75 to Dec. 76	Dec. 76 to Dec. 77	Dec. 77 to June 78[2/]	Dec. 77 to March 78[2/]	March 78 to June 78[2/]
Total private nonfarm	6.9	7.6	8.2	10.0	6.5
Manufacturing	7.5	8.0	8.2	9.2	7.1
Contract construction	5.3	4.8	9.9	10.1	9.7
Transportation and public Utilities	7.0	8.8	5.9	6.6	5.3
Total trade	7.0	7.6	9.1	12.7	5.6
Services	7.0	7.9	7.3	11.7	3.1

1/ Excludes the effect of interindustry shifts in employment and fluctuations in overtime pay in manufacturing.

2/ Computed at a compound annual rate.

SELECTED DOMESTIC FINANCIAL DATA

Indicator	Latest data		Net change from:		
	Period	Level	Month ago	Three months ago	Year ago
	$ billions		Per cent at annual rates		
Monetary and credit aggregates 1/					
Total reserves	June	37.8	17.0	12.3	8.5
Nonborrowed reserves	June	36.7	21.5	4.0	6.2
Money supply					
M1	June	350.2	5.5	10.9	8.0
M2	June	840.5	7.8	9.1	8.6
M3	June	1429.5	8.3	8.6	9.8
Time and savings deposits (less CDs)	June	490.3	9.4	7.8	9.0
CDs 2/	June	86.6	-0.5	4.6	23.3
Thrift deposits (S&Ls + MSBs + Credit Unions)	June	589.0	9.0	7.8	11.6
Bank credit (end of month)	June	926.9	6.0	13.5	11.2

Indicator		Latest data		Net change from:		
		Period	Per cent or index	Month ago	Three months ago	Year ago
Market yields and stock prices						
Federal funds	wk. endg.	7/5/78	7.72	.25	.86	2.37
easury bill (90 day)	"	7/5/78	6.99	.38	.60	1.93
rcial paper (90-119 day)	"	7/5/78	7.78	.44	1.02	2.40
utility issue Aaa	"	7/7/78	9.18	.14	.31	1.04
Municipal bonds (Bond Buyer)	1 day	7/6/78	6.31	.13	.55	.68
FNMA auction yield (FHA/VA)		7/10/78	10.02	.16	.58	1.30
Dividend price ratio (common stocks)	wk endg.	7/3/78	5.32	.25	-.23	2.02
NYSE index (12/31/65=50)	end of day	7/10/78	53.55	-2.53	2.97	-1.10

Indicator	Period	Net Change or Gross Offerings			
		Latest Data	Year ago	Year to Date 1978	Year to Date 1977
		$ billions			
Credit demands					
Business loans at commercial banks 1/	June	1.1	2.1	18.4	11.1
Consumer instalment credit outstanding 1/	May	3.9	2.7	16.8	12.6
Mortgage debt outstanding (major holders) 1/	April	8.5	7.7	31.9	26.6
Corporate bonds (public offerings)	June	1.8e	2.0	10.2e	12.1
Municipal long-term bonds (gross offerings)	June	4.1e	5.8	24.0e	24.7
Federally sponsored agcy. (net borrowing)	June	1.5	.8	10.8	3.8
U.S. Treasury (net cash borrowing)	July	3.2	1.8	26.5	18.3

1/ Seasonally adjusted.
2/ $ billions, not at annual rates.
e Estimated.

DOMESTIC FINANCIAL DEVELOPMENTS

The surge in GNP in the second quarter was associated with a pick-up in credit flows to the private nonfinancial sectors of the economy. Much of this increase was accounted for by additional strength in short- and intermediate-term business borrowing during the quarter--despite a June slowdown in growth of business loans at banks. In the household sector, mortgage financing strengthened somewhat from the reduced first quarter pace, while consumer credit continued to expand strongly. Fragmentary data for June, moreover, suggest little change in the pace of home mortgage or consumer instalment borrowing. On a seasonally adjusted basis net borrowing by the Treasury was relatively moderate compared to the first quarter level, a pattern that was continued through June. State and local long-term borrowing increased at about a seasonal pace, reflecting a burst of issues in May and more moderate offerings in April and June.

The strong advance of spending in the second quarter was also reflected in a marked acceleration of quarterly M-1 growth to a record 9-1/2 per cent annual rate. M-2 and M-3 also expanded more rapidly in the quarter as the faster M-1 growth more than offset slower growth of total interest-bearing deposits included in these broader aggregates. In June, expansion of deposits subject to regulatory ceilings was buoyed by the introduction of the new "money market" time certificate and to a lesser degree by the higher-yeilding eight-year certificate.

SELECTED FINANCIAL MARKET QUOTATIONS
(per cent)

	1977 1/ High	1977 1/ Low	1978 2/ March 31	1978 2/ FOMC June 20	1978 2/ July 3	1978 2/ July 11	Change from: Mar. 31 to July 11	Change from: June 20 to July 11
Short-term rates								
Federal funds 1/	6.65	4.47	6.82	7.53	7.72	7.72 3/	+.90	+.19
Treasury bills								
3-month	6.27	4.41	6.47	6.74	6.95	7.20	+.73	+.46
6-month	6.51	4.55	6.74	7.30	7.36	7.51	+.77	+.21
1-year	6.62	4.67	6.98	7.59	7.73	7.81	+.83	+.22
Commercial paper								
1-month	6.58	4.53	6.55	7.57	7.66	7.70	+1.15	+.13
3-month	6.66	4.63	6.75	7.68	7.79	7.83	+1.08	+.15
Large negotiable CDs 4/								
3-month	6.62	4.60	6.80	7.90	8.00	8.00	+1.20	+.10
6-month	6.84	4.65	7.25	8.30	8.50	8.60	+1.35	+.30
Bank prime rate	7.75	6.25	8.00	8.75	9.00	9.00	+1.00	+.25
Intermediate- and long-term rates								
Corporate								
New AAA 5/	8.36	7.90	8.83	9.03	9.16	9.18p	+.35	+.15
Recently offered 6/	8.48	7.95	8.75	8.96	9.18	9.19p	+.44	+.23
Municipal (Bond Buyer) 7/	5.93	5.45	5.69	6.16	6.29	6.31	+.62	+.15
U.S. Treasury (constant maturity)								
3-year	7.39	5.74	7.83	8.34	8.50	8.55	+.72	+.21
7-year	7.66	6.48	8.05	8.45	8.49	8.56	+.51	+.11
20-year	7.96	7.20	8.31	8.52	8.65	8.72	+.41	+.20

	Low 8/	High 8/	March 31	FOMC June 20	July 3	July 11	Mar. 31 to July 11	June 20 to July 11
Stock prices								
Dow-Jones Industrial	807.74	985.74	757.36	830.04	812.89	821.29	+63.93	-8.75
N.Y.S.E. Composite	50.13	56.98	49.85	54.22	53.46	53.90	+4.05	-.32
AMEX	110.37	126.86	128.94	148.22	145.54	147.48	+18.54	-.74
Keefe Bank Stock 6/	530	633	588	646	620	620	+32	-26

1/ Daily average for statement week, except where noted.
2/ One-day quotes except as noted.
3/ Average for first 6 days of statement week ending July 12.
4/ Highest quoted new issues.
5/ 1978 figures are averages for preceding week.
6/ 1978 figures are one-day quotes for preceding Friday.
7/ 1978 figures are one-day quotes for preceding Thursday.
8/ Calendar week averages.

Depository institutions in the aggregate experienced declines in liquidity and increases in borrowing ratios during the quarter. Although liquidity of other major private sectors apparently also eroded slightly further, balance sheet positions seemed reasonably comfortable, with the possible exception of households where debt burdens appear substantial by historical standards.

Since the end of March, efforts by the Federal Reserve to restrain growth in the monetary aggregates were reflected in an upward movement in the Federal funds rate of nearly one percentage point. This increase was accompanied by advances in other short-term rates of from 75 to 135 basis points. Since the June FOMC meeting, most money market interest rates have risen 15 to 25 basis points, largely in response to the quarter point increase in the funds rate to 7-3/4 per cent, though the three-month Treasury bill rate--which had increased relatively little early in the quarter--went up by 45 basis points. In addition, the prime rate increased a quarter point to 9 per cent. While rates in intermediate- and longer-term credit markets generally advanced by somewhat less than short-term rates over the quarter, during the intermeeting period they rose about as much as short-term rates.

Monetary Aggregates and Bank Credit

Following a 13-1/2 per cent average growth rate over April and May, M-1 expansion in June slowed to a moderate 5-1/2 per cent as an usually large mid-month rise in Treasury deposit balances may have

MONETARY AGGREGATES
(Seasonally adjusted) 1/

	1977 QIV	1978 QI	1978 QII p	1978 April	1978 May	1978 June p	QII-77 to QII-78 p
Major monetary aggregates							
1. M-1 (currency plus demand deposits)	7.5	5.6	9.5	19.0	8.0	5.5	7.9
2. M-2 (M-1 plus time & savings deposits at CBs other than large CDs)	8.2	6.9	8.3	11.5	7.8	7.8	8.6
3. M-3 (M-2 plus all deposits at thrift institutions)	10.7	7.7	8.0	9.8	7.5	8.3	9.9
Bank time and savings deposits							
4. Total	13.1	13.4	11.0	8.3	14.4	6.9	12.5
5. Other than large negotiable CDs at weekly reporting banks (interest bearing component of M-2)	8.6	7.9	7.4	6.2	7.7	9.4	9.1
6. Savings deposits	5.4	2.6	1.6	3.3	2.2	-1.6	4.3
7. Individuals 2/	6.6	2.4	2.1	4.7	1.7	-2.3	5.2
8. Other 3/	-7.6	2.6	-5.2	-7.8	-7.8	23.7	-6.7
9. Time deposits	11.6	12.7	12.3	8.3	12.8	18.6	13.4
10. Small time 4/	3.4	6.1	10.5	10.7	9.9	15.4	7.3
11. Large time 4/	28.3	25.5	15.5	3.9	18.3	24.4	26.7
12. Time and savings deposits subject to rate ceilings (6+10)	4.5	4.0	5.5	6.5	5.5	5.8	5.6
Deposits at nonbank thrift institutions 5/							
13. Total	14.4	8.9	7.5	7.3	7.0	9.0	11.9
14. Savings and loan associations	15.4	9.0	7.8	7.6	7.6	9.6	12.6
15. Mutual savings banks	9.9	5.8	3.6	3.6	3.6	4.4	7.4
16. Credit unions	20.0	18.2	15.8	14.7	12.1	16.8	19.9
		Average monthly changes, $ billions					
MEMORANDA:							
17. Total U.S. Govt. deposits	0.2	-1.2	1.1	0.4	-1.0	4.0	-0.1
18. Total large time deposits 6/	5.7	4.4	2.7	1.7	5.1	1.4	3.6
19. Nondeposit sources of funds 7/	1.5	1.7	0.7	1.1	0.1	0.8	1.3

p--preliminary
1/ Quarterly growth rates are computed on a quarterly average basis.
2/ Savings deposits held by individuals and nonprofit organizations.
3/ Savings deposits of business, government, and others, not seasonally adjusted.
4/ Small time deposits are time deposits in denominations less than $100,000. Large time deposits are time deposits in denominations of $100,000 and above excluding negotiable CDs at weekly reporting banks.
5/ Growth rates computed from monthly levels based on average of current and preceding end-of-month data.
6/ All large time certificates, negotiable and nonnegotiable, at all CBs.
7/ Nondeposit borrowings of commercial banks from nonbank sources include Federal funds purchased and security RPs plus other liabilities for borrowed money, including borrowings from the Federal Reserve, Eurodollar borrowings, and loans sold, less interbank loans.

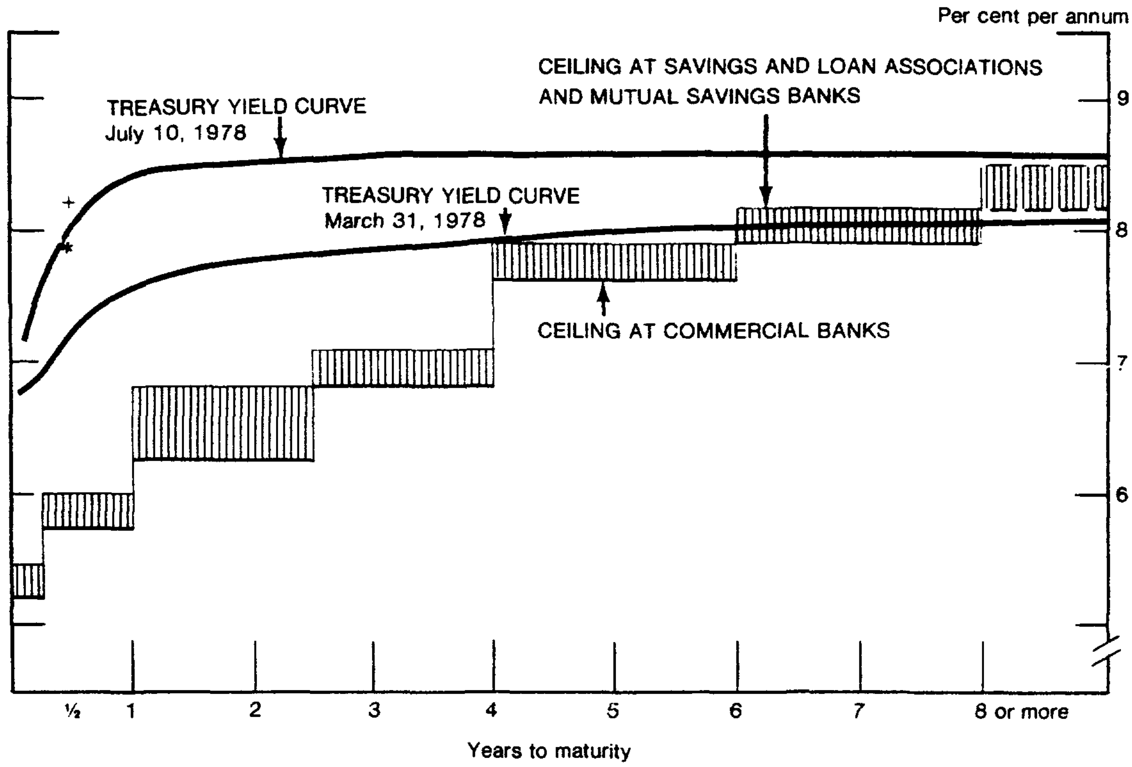
restrained growth temporarily. The rapid M-1 growth over the second quarter as a whole, however, was well below that of nominal GNP, and the estimated rate of increase of M-1 velocity of 7-3/4 per cent was the largest since early 1976. The large growth in velocity apparently reflected the usual lag before money demand adjusts fully to abrupt changes in GNP. Since the spring of last year, quarterly M-1 growth has been consistent with the historical relationship among money demand, GNP, and short-term interest rates.

Though M-2 expanded somewhat faster in the second quarter than in the first, the advance in its interest-bearing component (line 5 of the Monetary Aggregate table) moderated due to a slackening in the growth of large time deposits included in this aggregate (line 11). In contrast, growth in bank deposits subject to rate ceilings (line 12) picked up, despite the increases in market interest rates over the quarter. This pick-up may have reflected the introduction in June of the new six-month--and to a lesser extent the eight-year--accounts, both of which offer a more competitive rate of return (Chart 1). While savings deposit inflows at banks declined from the already slow pace of the preceding quarter, growth of small-denomination time deposits (line 10) in the second quarter rose by 4-1/2 percentage points to a 10-1/2 per cent annual rate. Growth of small time deposits rose to a 15-1/2 per cent rate in June.

Chart 1

Yields on U.S. Treasury Securities and Maximum Allowable Rates of Return on Commercial Bank and Thrift Deposits

March 1978 and July 1978



+ : Maximum effective yield on "money market" time deposits at thrift institutions for July 10, 1978.

* : Maximum effective yield on "money market" time deposits at commercial banks for July 10, 1978.

ESTIMATED MONEY MARKET CERTIFICATE ACTIVITY
AT BANKS AND THRIFT INSTITUTIONS

	Money Market Certificates Outstanding ($ millions)	Share of Money Market Certificates Acquired With New Funds 5/ (per cent)
Week Ending June 7		
Commercial Banks 1/	780	n.a.
S&Ls 2/	1800-2200	46
MSBs 3/	793	22
Week Ending June 21 4/		
S&Ls 2/	3200-3600	41
MSBs 3/	1350	28
Week Ending June 28		
MSBs 3/	1660	30

1/ Estimate for all commercial banks based on a survey of 522 banks.
2/ Estimates for all S&Ls based on a survey of 247 large associations representing roughly 40 per cent of industry deposits. S&L estimates are presented as ranges due to the high degree of uncertainty associated with generalizing the small sample results.
3/ Estimates for all MSBs based on a survey of MSBs represent-senting roughly 90 per cent of industry deposits.
4/ Money market certificate data are not yet available for commercial banks beyond June 7.
5/ Average of estimates of new funds by institutions responding to surveys. These estimates are necessarily very rough at this stage and include inter-institutional shifting of deposits.

n.a.--not available

Board staff estimates shown in the table on page III-7 indicate that $780 million of the newly authorized six-month certificates were issued at commercial banks during the first week of June (latest available data).[1/] Some of these funds apparently were drawn from other accounts at banks--as indicated by the net outflow from savings deposits of individuals in June for the first time since August 1973. However, banks likely retained some funds that would otherwise have been diverted to market instruments. On balance, growth of small time and savings deposits (line 12) was sustained at about the 5-1/2 per cent rate of the previous month, despite the further increases in market rates.

Other survey results indicate that the six-month certificate thus far has attracted a sizable volume of deposits at thrift institutions.[2/] Tentative estimates indicate that the outstanding volume of money market certificates was around $3.4 billion at S&Ls as of June 21 and $1.7 billion at MSBs as of June 28, representing roughly 1 to 1-1/2 per cent of total thrift deposits. Respondents at large S&Ls estimated that about 40 to 45 per cent of their sales represented new funds,

1/ About 45 per cent of banks, mainly large institutions, offered the new certificate, with the preponderance of offering banks paying the maximum allowable rate of interest. Sales of the newly-authorized eight-year certificates have reportedly been much more sluggish. Preliminary data are available only for MSBs where an estimated $275 million of the long-term certificates were issued by the end of June. MSBs surveyed estimated that somewhat less than half of these sales represented new funds.

2/ It is estimated that about 60 to 70 per cent of MSBs and roughly 90 per cent of S&Ls offered the money market certificate; nearly all institutions offering the certificate paid the ceiling rate.

while at MSBs the figure was put at 30 per cent.[1/] These inflows, together with a diminution of funds withdrawn, likely accounted for the strengthening in thrift deposit growth in June relative to May by 2 percentage points for S&Ls and three-quarters of a percentage point for MSBs. Nevertheless, in the face of upward movements in interest rates, the second-quarter growth rates at S&Ls and MSBs of 7-3/4 and 3-1/2 per cent, respectively, were weaker than the significantly reduced first quarter pace. Concomitantly, alternative short-term investment outlets for small savers, such as money market mutual fund shares and non-competitive tenders for Treasury bills, attracted sizable funds over the quarter but in somewhat smaller amounts in June.

Growth in total loans and investments at commercial banks increased to a rapid 13-1/2 per cent annual rate in the second quarter. Also representing a pick-up over the first quarter, the growth in total loans matched the 15-1/2 per cent average rate over the past 12 months, despite a marked slowdown in June. The June slowing was largely due to a sharp decrease in the pace of business lending following rapid April growth and an extraordinary surge in May. Real estate and consumer loans also added considerable strength to total loans over the

1/ These estimates may overstate the amount of new funds at the institutions collectively since inter-institutional transfers of funds are not accounted for. On the other hand, new funds may have been understated to the extent that the apparently temporary buildup of funds in passbook accounts in May, following the announcement of the new certificate, represented new funds but were not so reported when transferred to the certificate in June.

COMMERCIAL BANK CREDIT
(Per cent changes at annual rates, based on seasonally adjusted data)[1/]

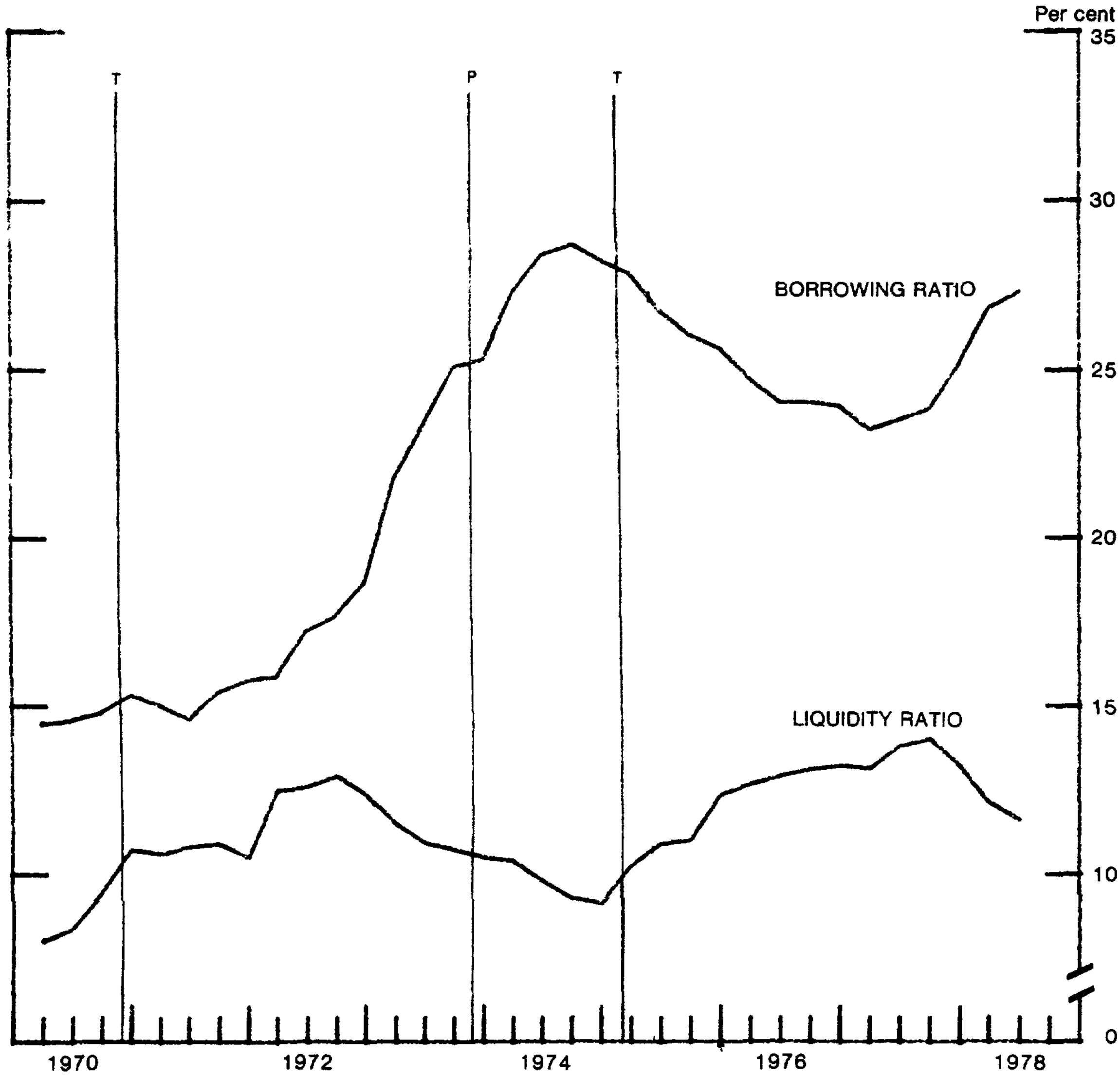
	1977 QIV	1978 QI	1978 QII	1978 April	1978 May	1978 June	12 mos ending June
Total loans & investments[2/]	9.5	9.7	13.5	18.5	15.6	6.0	11.2
Investments	-5.1	3.3	8.6	18.8	1.4	5.5	1.8
Treasury securities	-20.3	--	11.7	25.1	-6.1	16.1	-4.8
Other securities	4.6	5.3	6.7	15.0	5.9	-0.7	6.2
Total loans[2/]	15.8	12.3	15.4	18.3	21.2	6.2	15.4
Business loans	11.7	16.3	19.0	17.5	32.8	6.0	15.3
Security loans	-10.4	-29.9	62.4	215.0	-94.1	76.6	7.0
Real estate loans	17.8	16.1	17.2	15.0	19.4	16.5	18.5
Consumer loans	15.5	14.6	n.a.	18.7	20.3	n.a.	n.a.
MEMORANDA:							
1. Commercial paper issued by nonfinancial firms[3/]	15.8	-2.5	33.1	38.2	-7.4	59.3	13.3
2. Business loans at banks net of bank holdings of bankers acceptances	15.6	17.8	19.9	21.3	30.5	7.2	16.0
3. Sum of memo items 1 & 2	15.8	16.1	20.8	23.0	28.3	10.2	15.8
4. Memo item 3 plus business loans from finance companies	18.7	15.5	n.a.	21.3	24.7	n.a.	n.a.

n.a.--not available
1/ Last-Wednesday-of-month series except for June and December, which are adjusted to the last business day of the month.
2/ Loans include outstanding amounts of loans reported as sold outright by banks to their own foreign branches, nonconsolidated nonbank affiliates of the bank holding companies (if not a bank), and nonconsolidated nonbank subsidiares of holding companies.
3/ Measured from end of month.

Chart 2

Ratio of Liquid Assets to Total Liabilities and of Managed Liabilities to Total Assets

Weekly Reporting Banks, Seasonally Adjusted, Quarterly



Note: Liquidity ratio is calculated as the sum of Treasury and other securities maturing in one year or less, loans to brokers and dealers and domestic commercial banks, holding of bankers' acceptances and gross sales of Federal funds, all divided by liabilities less captial accounts, valuation reserves, and demand deposits due to banks.

Borrowing ratio is calculated as the sum of all large denomination negotiable CDs plus net Federal funds purchased and RPs plus gross liabilities to own foreign branches plus all other liabilities for borrowed funds other than borrowing from Federal Reserve Banks, all divided by total assets less Federal funds sold less cash items in the process of collection.

second quarter as they have for over a year. Bank holdings of Treasury securities increased somewhat--both at large and small banks--representing the first quarterly expansion since the second quarter of last year.

As inflows of deposits subject to rate ceilings did not keep pace with the surge in bank credit, managed liabilities increased over the second quarter, albeit at a slower rate than in the first.[1/] The ratio of managed liabilities to total assets at large banks rose further during the quarter to a level not much below the 1974 peak (Chart 2). In addition, since late 1977 these banks have reduced the share of their assets invested in liquid form, although liquidity positions generally remain comfortable relative to 1974. While the increase in the borrowing ratio and accompanying decline in the liquidity ratio do not appear at the present time to pose any serious problems for the banking system as a whole, they may portend further tightening of credit terms to borrowers.

Business Finance

Business short- and intermediate-term borrowing in the second quarter was the largest in four years. Business loans net of bankers acceptances rose at a 20 per cent annual rate--the most rapid expansion since the second quarter of 1974--with the remarkable surge in business loans in May offsetting the marked slowing in June. These monthly fluctuations were concentrated at large banks. At the very large banks--which had reported widespread strength by industry category in May--most

1/ However, in the second quarter, head offices of U.S. banks, together with agencies and branches of foreign banks, decreased their net lending to banking offices abroad--particularly to related institutions--thus freeing funds for domestic lending.

COMMERCIAL PAPER OUTSTANDING
(Monthly totals or monthly averages, seasonally adjusted, billions of dollars)1/

	Net Change in Outstanding							Outstanding June 30, 1978p
	1977	1978					12 mos. ending	
	QIV	QI	QIIp	April	May	Junep	Junep	
Total commercial paper outstanding	1.2	0.7	2.5	2.8	1.0	3.7	1.2	74.8
Bank-related	0.1	0.3	0.7	-0.1	1.5	0.6	0.3	12.0
Nonbank-related	1.1	0.5	1.9	2.9	-0.5	3.1	0.9	62.8
Financial	0.9	0.3	1.4	2.3	-0.4	2.3	0.7	45.8
Dealer	--	0.1	0.3	0.7	0.5	-0.2	0.1	7.9
Direct	0.7	0.3	1.1	1.6	-0.9	2.5	0.6	37.9
Nonfinancial	0.2	-0.1	0.5	0.6	-0.1	0.8	0.2	17.0

p - preliminary
1/ Seasonally adjusted figures are unavailable for bank-related paper. The unadjusted data for bank-related paper are combined with seasonally adjusted nonbank-related data to obtain the total for commercial paper outstanding.
NOTE: Components may not add to total due to rounding.

industries showed relative weakness in June, with loans to public utilities and commodity dealers contracting sharply.

During the second quarter of 1978, nonfinancial commercial paper showed more rapid growth than in any quarter since the third quarter of 1974.[1/] The largest monthly seasonally adjusted issuance occurred in June, although the not seasonally adjusted volume was smaller. The introduction of a new financing program for a large rural electrification cooperative accounted for over $300 million of the estimated $800 million seasonally adjusted increase in June. Business credit at finance companies expanded in April and May at about the pace of the first quarter. Retail financing of both commercial vehicles and business, industrial, and farm equipment registered large gains.

The second quarter's average monthly volume of gross public offering of corporate bonds rose to $1.8 billion (NSA), an amount larger than in the first quarter but still below last year's average monthly volume. Public offerings in June were about equal to the second quarter's average pace as an increased volume of utility issues more than offset reduced offerings by industrial corporations and financial concerns. The light volume of publicly offered corporate bonds in recent months can be attributed largely to the relatively

1/ Total commercial paper outstanding increased by a record amount during the second quarter of 1978 with nonbank-related financial firms accounting for over half of the increase. Much of this growth arose from the financing needs of the auto-related finance companies. Bank-related paper also contributed significantly to the quarterly growth.

SECURITY OFFERINGS

(Monthly totals or monthly averages, in millions of dollars)
Not seasonally adjusted

	1977	1978					
	Year	QI e/	QII e/	May e/	June e/	July f/	Aug. f/
		Gross offerings					
Corporate securities--total	4,518	3,371	3,566	3,200	4,200	3,200	3,000
Publicly offered bonds	2,016	1,583	1,833	1,700	1,800	2,000	1,600
By quality 1/							
Aaa and Aa	1,089	765	883	825	700	--	--
Less than Aa 2/	927	817	950	875	1,100	--	--
By type of borrower							
Utility	692	475	575	500	800	--	--
Industrial 3/	700	546	633	700	525	--	--
Financial	624	561	625	500	475	--	--
Privately placed bonds	1,501	1,128	933	800	1,200	800	800
Stocks	1,001	660	800	700	1,200	400	600
Foreign securities--total	621	537	630	792	501	--	--
Publicly offered	437	425	507	650	320	300	300
Privately placed	184	112	123	142	181	--	--
State and local govt. securities--total	5,771	5,172	7,060	6,305	6,100	4,700	5,000
Long-term	3,891	3,594	4,391	5,300	4,100	3,200	3,500
Short-term	1,880	1,578	2,669	1,005	2,000	1,500	1,500
		Net offerings					
U.S. Treasury	3,433	7,180	-2,417	659	3,381	600	5,200
Sponsored Federal agencies	604	1,804	2,127	3,737	1,833	1,248	2,975

1/ Bonds categorized according to Moody's bond ratings.
2/ Includes issues not rated by Moody's.
3/ Includes equipment trust certificates.
4/ Classified by original offering date.
e/ Estimated.
f/ Forecast.

small amount of nonfinancial offerings, especially large, higher-rated industrial issues. In contrast, public bond offerings by finance companies and other financial concerns have remained quite sizable.

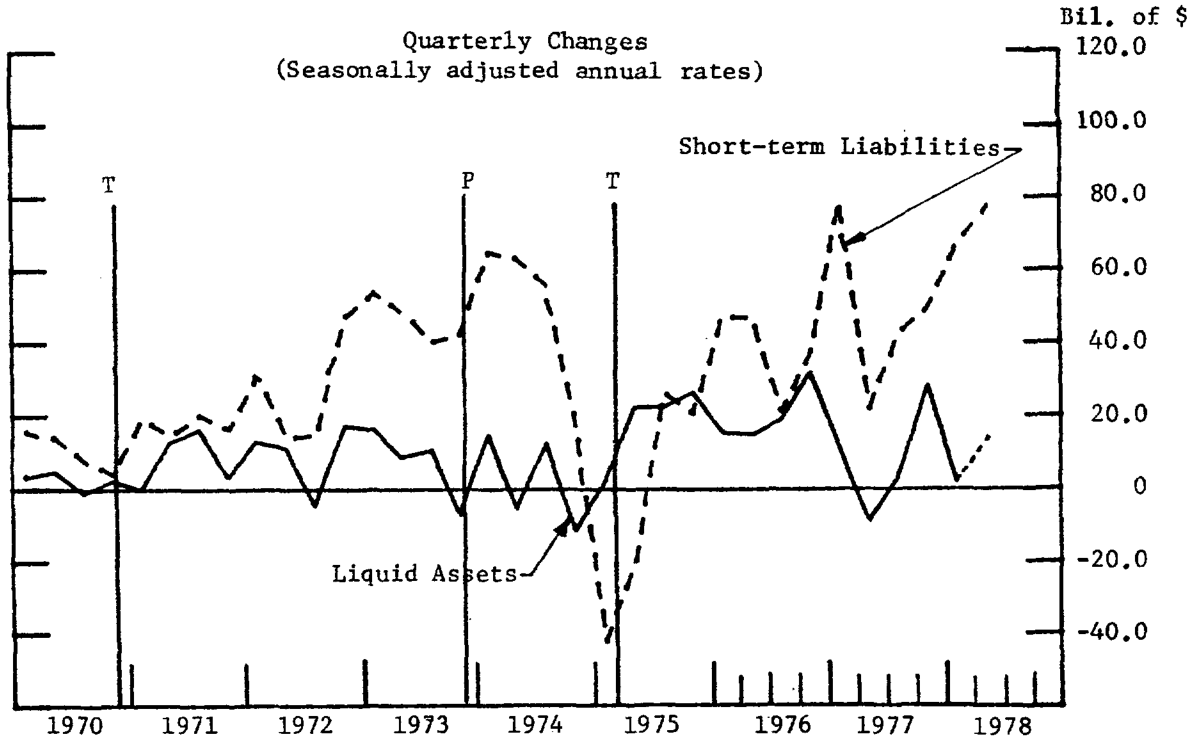
The external financing requirements of nonfinancial corporations have been very large this year and the reduction in their public bond offerings has been accompanied by heavier reliance on shorter-term credit and limited acquisitions of liquid assets. As a result, corporate liquidity (as measured by the ratio of liquid assets to short-term liabilities) has moved lower, although the current level remains well above its record 1974 low (Chart 3).

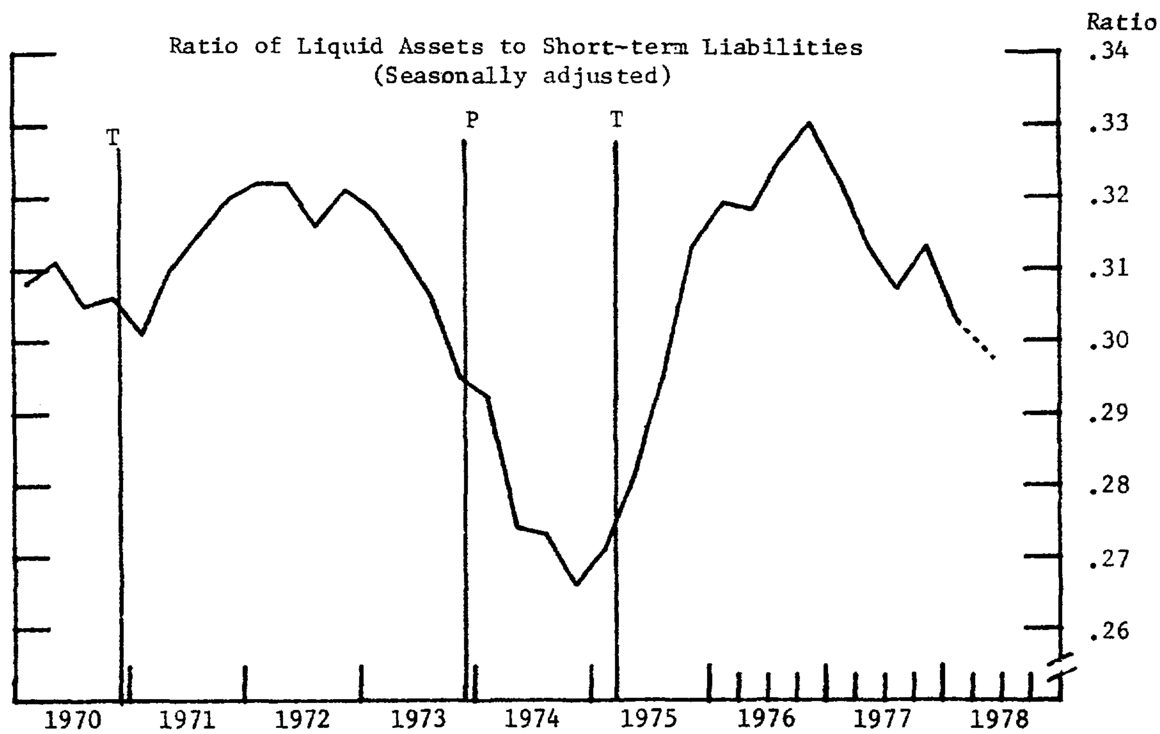
Corporate bond yields have moved higher since March, and by early July the Board's index of newly issued, Aaa-rated utility bonds had registered its highest reading since late 1975. Coincident with the 25 basis point rise in corporate bond yields in the intermeeting period, stock prices generally edged lower. Nevertheless, most major indexes, reflecting strong April-May gains, currently exceed the levels at the end of the first quarter by 8 to 14 per cent.

<u>Government Finance</u>

The 50 to 75 basis point increases in Treasury bill rates over the second quarter were moderate compared to the rise in the Federal funds rate and other short-term rates. A relative scarcity of bills apparently helped to limit the upward movements of bill rates during the quarter. Over the quarter, the Treasury paid down $5.9 billion in bills. Moreover, the System acquired $4.6 billion for its own account,

Chart 3
LIQUIDITY OF NONFINANCIAL CORPORATIONS





NOTE: Liquid assets include cash and deposits, U.S. Gov't. securities, State and local obligations, and open market paper, current liabilities consists of short-term bank loans, open market paper, finance company loans, U.S. Gov't. loans, construction loans, trade debt, and profit taxes payable.

Source: Flow of Funds; data for 1978-Q2 are preliminary.

over the April-June period, thus more than offsetting a $3.1 billion reduction of foreign official holdings which occurred despite a continued sizable deficit in the U.S. current account. After mid-June, the Treasury redeemed the $6.0 billion of cash management bills issued in early June, though it raised $500 million of new money in the one-year bill auction toward month end. In addition, Desk acquisitions of bills for System and foreign accounts over this period totaled nearly $3.9 billion.

In the Treasury coupon area, yields rose 35 to 70 basis points over the second quarter, with increases in longer term yields of around 20 basis points occurring since the last FOMC meeting. The second quarter increases in coupon rates were progressively smaller the longer the maturity of the security, and the Treasury yield curve beyond one year flattened significantly further. Unlike the rises in bill rates, the increases in coupon yields since March were generally in line with rises in yields on private securities of comparable maturities. Over the quarter, the Treasury raised $7.0 billion of new money through coupon issues and about $2.8 billion since the June FOMC meeting. Though sponsored agancies raised only $1.5 billion in June, they raised $6.2 billion during the quarter--with the FHLB System and FNMA accounting for $5.1 billion.[1/]

The substantial volume of gross tax-exempt bond offerings in the second quarter in part reflected a surge in advance refundings prior

1/ In the first half of 1978 sponsored agencies raised $10.8 billion compared to only $6.6 billion for the entire year of 1977.

to the mid-May effective date of an IRS ruling restricting certain types of issues. While representing a substantial decline from May's volume, June bond offerings remained relatively strong at $4.1 billion, due largely to the takedown of $565 million in New York City securities by city pension funds at month's end.1/

Continuing an upward movement that has developed over the past three months, yields on municipal securities have increased about 15 basis points since the last FOMC meeting. Effects of the recent passage of Proposition 13 (the Jarvis-Gann Initiative) appear to have been confined to certain obligations of California localities which finance less-essential services and are most dependent on property tax revenues and assessments. Interest rates on such obligations have adjusted upward by an estimated quarter to one percentage point as a result of the passage of the Initiative.2/

Mortgage Markets

Net mortgage lending in June appeared to hold near the pace of the first two months of the quarter. During the quarter, stepped-up net lending by commercial banks and greater support from secondary market institutions such as FNMA evidently more than offset reduced mortgage lending at S&Ls and MSBs. Thus, the second quarter total was apparently somewhat larger than the weather-depressed first quarter, but

1/ Only about $300 million of gross offerings in June were bonds sold to refund previously-issued obligations, in contrast to a record $2.2 billion of refunding issues in May and $975 million in April.

2/ Proposition 13 has not affected secondary market trading of general obligations of the State of California. A clearer test of the impact of Proposition 13 may occur on August 15 when the State has scheduled its next debt issue. Meanwhile, the Initiative faces many court challenges to its constitutionality and its applicability to various types of outstanding municipal debt.

still more than 10 per cent below the peak rate registered in the final quarter of last year.

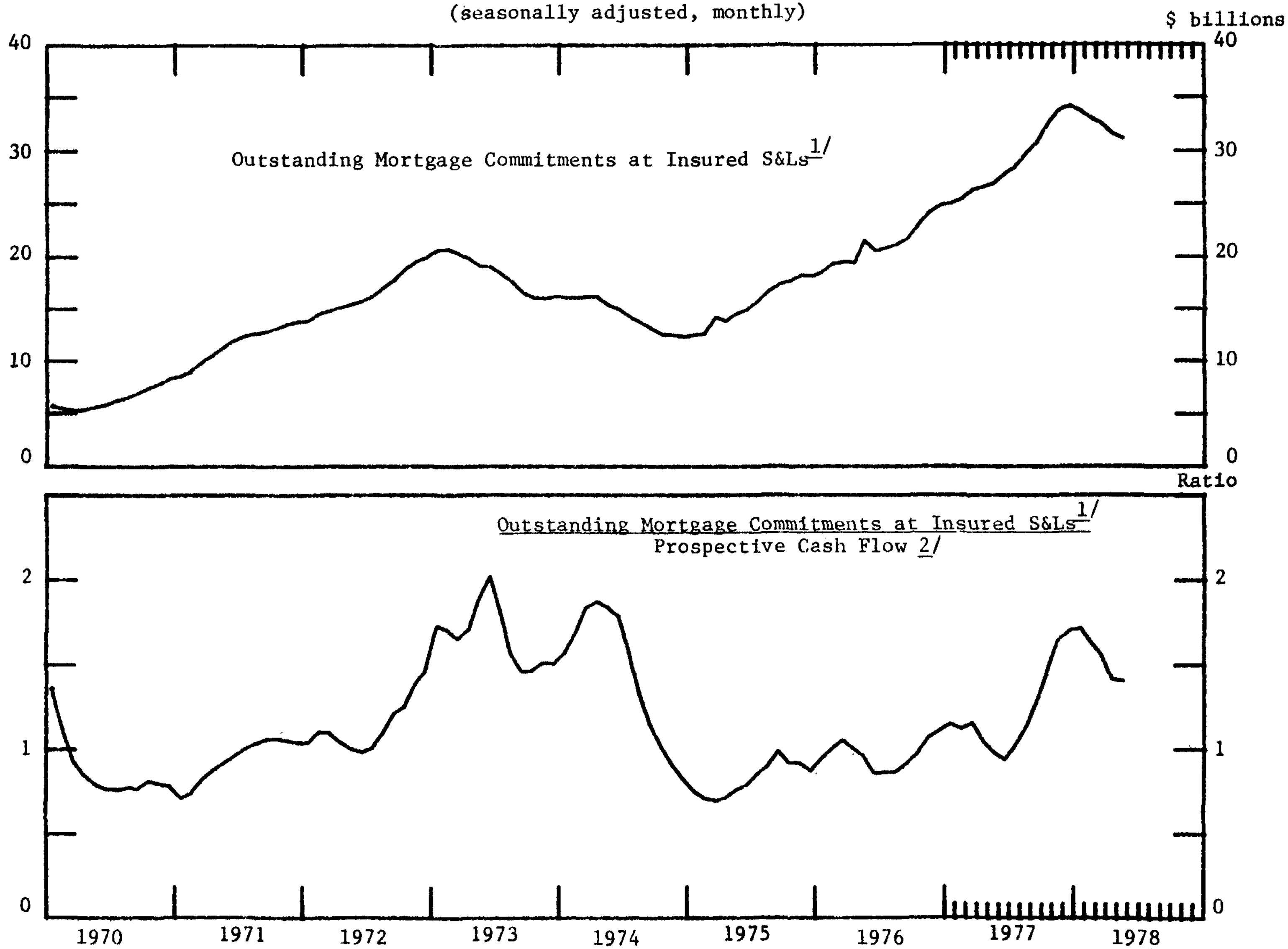
For S&Ls--still the largest single source of residential mortgage credit--mortgage commitments outstanding declined in May for the fifth consecutive month. By the end of May, S&L commitments outstanding were about 8 per cent below their peak of more than $34 billion in December 1977 (Chart 4, top panel). The ratio of these commitments at insured S&Ls relative to prospective three-month cash flow was 1.40 at the end of May--still relatively high by historical standards, but below a three-year peak of 1.72 at year-end 1977 (Chart 4, bottom panel).

In early July, mortgage funds continued to be reported in short supply at about two-thirds of a sample of S&Ls surveyed by FHLMC, sharply above the proportion at the end of the first quarter. With deposit growth remaining relatively weak in the second quarter, S&Ls continued to rely heavily upon FHLB advances and other sources of borrowing to help sustain mortgage lending; borrowing by S&Ls as a per cent of total assets is approaching 1974 highs (Chart 5). In addition, after declining for three quarters, the liquidity ratio at insured S&Ls--as measured by cash and liquid assets as a percentage of deposits plus short-term borrowings--was 8.3 per cent, seasonally adjusted, only 0.7 of a percentage point above its trough in the third quarter of 1974.[1/]

1/ The minimum required liquidity ratio, set by the FHLBB, now stands at 6.5 per cent. In recent years the aggregate liquidity ratio at S&Ls has remained at least 1.5 per cent above the requirement, and the FHLBB has typically lowered the requirement when that level has been approached. In addition, FHLBB policies have not slowed the growth of advances; thus far in July advances have risen by $500 million.

Chart 4

OUTSTANDING SAVINGS & LOAN MORTGAGE COMMITMENTS AND RATIO TO PROSPECTIVE CASH FLOW
(seasonally adjusted, monthly)



1/ Including loans in process.
2/ Deposit growth plus mortgage repayments in subsequent 3 months.

INTEREST RATES AND SUPPLY OF MORTGAGE FUNDS
AT SELECTED S&Ls

Period	Conventional home mortgages: Average rate on new commitments for 80% loans (Per cent)	Basis point change from month or week earlier	Spread[1] (basis points)	Per cent of S&Ls[2] with mortgage funds in short supply
1977--High	9.00	--	+92	22
Low	8.65	--	+37	2
1978--High	9.73	--	+70	69
Low	9.00	--	+30	19
1978--Jan	9.05	+2	--	27
Feb	9.15	+10	+44	38
Mar	9.25	+10	+42	45
Apr	9.43	+18	+51	54
May	9.68	+15	+66	67
Jun 2	9.68	0	--	66
9	9.70	+ 2	+66	66
16	9.73	+ 3	+70	65
23	9.70	- 3	+57	65
30	9.73	+ 3	+57	64
Jul 7	9.73	0	+55	67

1/ Average mortgage rate minus average yield on new issues of Aaa utility bonds.
2/ Per cent reporting supply of funds slightly or substantially below normal seasonal patterns.

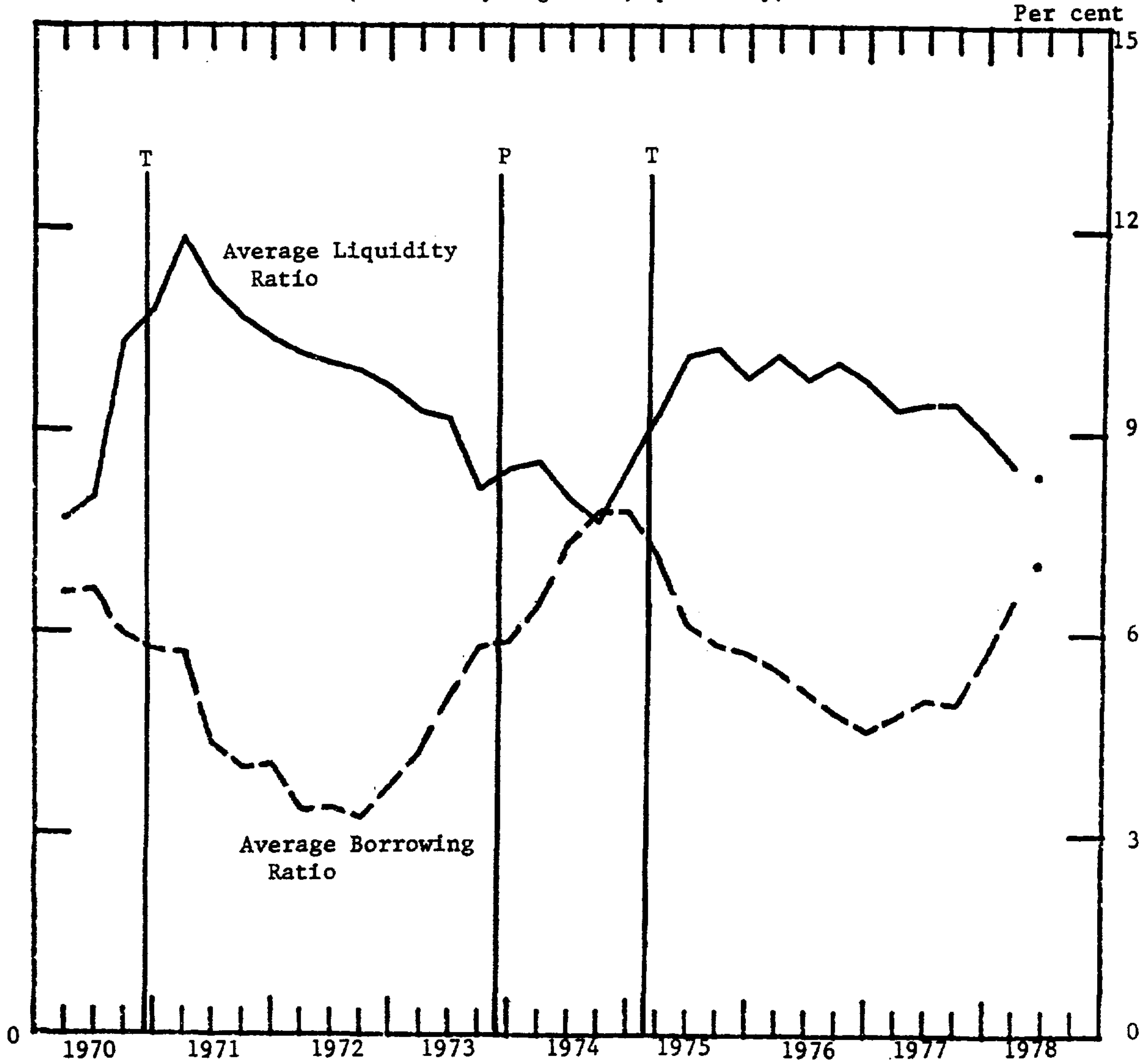
SECONDARY HOME MORTGAGE MARKET ACTIVITY

	FNMA auctions of forward purchase commitments: Conventional			Govt.-underwritten			Yields on GNMA guaranteed mortgage backed securities for immediate delivery[2]
	Amount ($ millions)		Yield to FNMA[1]	Amount ($ millions)		Yield to FNMA[1]	
	Offered	Accepted		Offered	Accepted		
1977--High	416	278	9.21	885	570	8.98	8.43
Low	123	83	8.81	50	35	8.45	7.56
1978--Jun 5							9.02
12	350	207	10.07	522	285	9.86	8.95
19							9.05
26	224	135	10.13	573	351	9.96	9.16
Jul 3							9.14
10	170	91	10.17	503	327	10.02	9.20

1/ Average gross yield before deducting fee of 38 basis points for mortgage servicing. Data, based on 4-month FNMA purchase commitments, reflect the average accepted bid yield for home mortgages, assuming a prepyment period of 12 years for 30-year loan without special adjustment for FNMA commitment fees and related stock requirements. Mortgage amounts offered by bidders relate to total eligible bids required.
2/ Average net yields to investors assuming prepayment in 12 years on pools of 30-year FHA-VA mortgages carrying the prevailing ceiling rate on such loans.

Chart 5

LIQUIDITY AND BORROWING RATIOS AT S&LS
(Seasonally adjusted, quarterly)



NOTE: The liquidity ratio is measured by cash and eligible liquid assets as a per centage of deposits plus short-term borrowing. The borrowing ratio is measured by FHLB advances plus other borrowings as a percentage of total assets.

• denotes May observation, the latest available.

Average interest rates on new commitments for 80 per cent conventional home mortgages at sampled S&Ls have remained around 9-3/4 per cent during the recent intermeeting period, nearly 50 basis points higher than at the end of March. Yields in secondary mortgage markets rose somewhat further in the week following the last FOMC meeting. To bring FHA/VA rates more closely in line with the market, the Administration again raised the ceiling rate on both mome and project mortgages, this time to 9-1/2 per cent, effective June 28.[1/] By the FNMA auction of July 10, yields had edged still higher.

Consumer Finance

The stronger expansion of consumer instalment credit outstanding which had begun in March persisted into the second quarter, with the 20 per cent annual rate of growth over April and May moderately above the first quarter's pace. The major stimulus to accelerated growth has continued to be auto credit, which has increased despite a sustained rise in average monthly payments on new-auto contracts at finance companies and commercial banks (based on information through early 1978).

Measures of household debt burdens generally increased in the second quarter. Relative to disposable personal income the stock of outstanding debt--including both consumer and home mortgage loans--rose to a new high of 66 per cent. The net flow of home mortgage and consumer credit also edged higher relative to disposable income during the

1/ The 50 basis point upward adjustment in the FHA/VA contract interest rate reduced required discounts on home mortgages by more than 3 points. In the July 10 FNMA auction, discounts on home loans bearing the higher rate averaged 3.5 points.

CONSUMER INSTALMENT CREDIT 1/

	1975	1976	1977	1977 QIV	1978 QI	1978 Apr	1978 May
Total							
Change in outstandings							
Billions of dollars	7.4	20.0	30.8	32.9	36.6	44.6	46.3
Per Cent	4.7	12.3	16.9	16.0	17.2	20.0	20.5
Bank share (per cent)	39.4	53.9	50.8	52.4	48.3	53.8	48.8
Extensions							
Billions of dollars	163.9	192.4	226.0	238.4	245.4	265.4	268.0
Bank share (per cent)	47.2	48.9	49.1	49.9	49.1	50.3	49.3
Liquidations							
Billions of dollars	156.6	172.4	195.3	205.6	208.8	220.8	221.7
Ratio to disposable income	14.4	14.5	14.9	15.0	14.9	15.4	15.3
Automobile Credit							
Change in outstandings							
Billions of dollars	3.2	10.2	13.2	13.5	15.2	20.7	21.5
Per cent	6.1	18.3	20.1	17.8	19.2	24.9	25.4
Extensions							
Billions of dollars	51.5	62.8	73.1	76.6	77.9	87.0	88.6

1/ Quarterly and monthly dollar figures and related per cent changes are seasonally adjusted annual rates.

second quarter, following an unusually sharp drop in the first quarter which has been attributed largely to weather-reduced mortgage borrowing. By contrast, the ratio of loan repayments to disposable income--an indicator of near-term debt-servicing burden--remained essentially unchanged in the second quarter, at a level slightly below the high in the last quarter of 1977. Meanwhile, the liquidity of the household sector balance sheet has eroded somewhat, since the uptrend in total assets in recent quarters has been fueled primarily by sharply expanding values of homes while growth of financial assets has lagged.

U.S. International Transactions
(in millions of dollars; receipts, or increase in liabilities, +)

	1976	1977			1978		
	Year	Year	Q3	Q4	Q1	April	May
1. Trade balance 1/	-9,353	-31,059	-7,250	-10,170	-11,201	-3,118	-2,642
2. Merchandise exports	114,694	120,585	31,013	29,457	30,664	11,469	11,635
3. Merchandise imports	124,047	151,644	38,263	39,627	41,865	14,587	14,277
4. Change in net foreign positions of banking offices in U.S. (excl. liab. to foreign official inst.)	-9,935	-3,907	336	-5,142	-6,031	5,511	-2,897
Through interbank transactions with							
5. a) Own offices in foreign countries	-6,282	-2,717	4,612	-5,545	-3,346	4,300	-3,910
6. b) Unaffiliated banking offices in foreign countries	-3,220	-2,203	-2,305	-147	-2,369	1,354	669
Through nonbank transactions							
7. a) Claims on nonbanks in foreign countries (increase,-)	-3,142	-423	-740	-487	-180	-314	-280
8. b) Liabilities to private nonbanks in foreign countries (inc. custody liab.)	2,709	1,436	-1,231	1,037	-136	171	624
9. Private securities transactions, net	-4,697	-1,859	-388	-225	900	-12	916
10. Foreign net purchases of U.S. corp. bonds	397	1,549	377	223	83	-13	22
11. Foreign net purchases of U.S. corp. stocks	853	1,385	139	580	341	618	346
12. Foreign net purchases of U.S. Treasury securities	2,783	569	1,252	-297	881	-265	600
13. U.S. net purchases (-) of foreign securities	-8,730	-5,362	-2,156	-731	-405	-352	-52
14. Change in foreign official reserve assets in U.S. (increase +)	13,091	35,406	7,893	15,152	14,899	-4,068	-1,336
By Area							
15. OPEC	6,802	5,989	1,415	757	1,399	-1,233	-737
16. All other countries	6,289	29,417	6,478	14,935	13,500	-2,835	-599
17. Change in U.S. reserve assets (increase -)	-2,532	-237	151	-2	246	287	-159
18. All other transactions and statistical discrepancy	13,426	1,656	-742	387	1,187	1,400	6,118
MEMO:							
Current account 4/	4,339	-15,221	-2,868	-6,934	-6,954	n.a.	n.a.

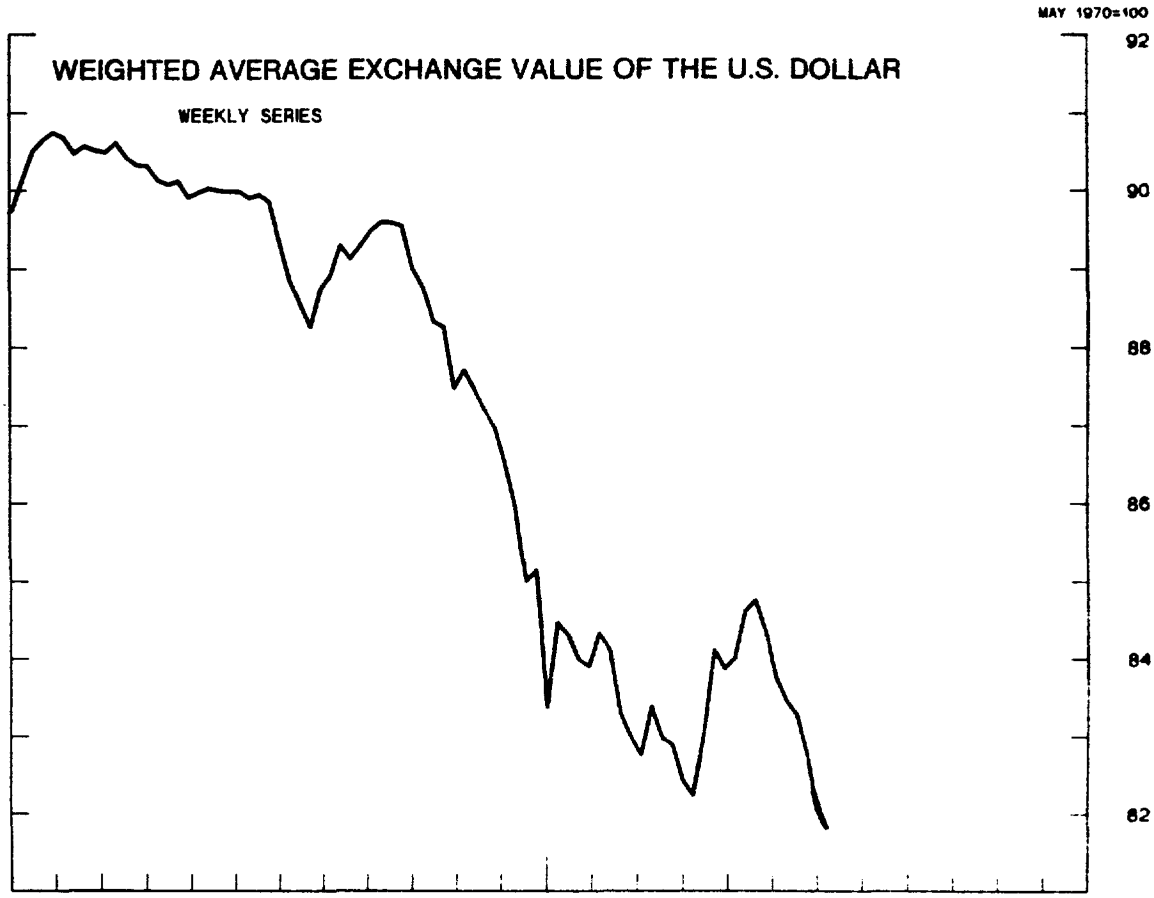
1/ International accounts basis, seasonally adjusted.
2/ Includes deposits in banks, commercial paper, bankers' acceptances, and borrowing under repurchase agreements.
3/ Amount at end of period.
4/ Seasonally adjusted.

INTERNATIONAL DEVELOPMENTS

Foreign exchange markets. The dollar remained under periodic heavy selling pressure on exchange markets over the past month. In the four weeks since the last green book the average exchange value of the dollar dropped by over 2 per cent, bringing the dollar's cumulative decline since the resumption of downward pressure in late May to over 3-1/2 per cent. The dollar has fallen to its lowest point so far this year and is nearly 9 per cent below its level of last September.

The recent strong selling pressure on the dollar apparently reflects heightened market concern over the expected high U.S. inflation rate and large U.S. payments deficits at a time when inflation abroad has declined and the large current account surpluses of Japan and Germany continue unabated. Pressure on the dollar intensified in reaction to the July 6-7 conference of Common Market heads of government in Bremen with its focus on developing closer monetary cooperation in Europe and from expectations that the July 16-17 Bonn summit conference will fail to achieve agreement on measures which might reverse the recent downtrend of dollar exchange rates.

. The Desk sold small amounts of marks from System and Treasury


MAY 1970=100
WEIGHTED AVERAGE EXCHANGE VALUE OF THE U.S. DOLLAR
WEEKLY SERIES
92
90
88
86
84
82

balances on several occasions over the past month when the dollar was depreciating sharply. The Desk also made intervention sales of $18 million equivalent of Swiss francs, financed by swap drawings by the System on the Swiss National Bank. At other times during the period, however, the Desk purchased substantial amounts of marks

and over the past four weeks the Desk made net purchases of $370 million equivalent of marks on behalf of the System and the Treasury. These purchases enabled the System to repay nearly $220 million equivalent of swap drawings on the Bundesbank, reducing outstanding System mark swap drawings to $910 million equivalent. Treasury swap repayments to the Bundesbank of $150 million equivalent during the period reduced outstanding Treasury swap obligations to $380 million equivalent.

The recent general rise of foreign currencies against the dollar has been led by the sharp appreciation of the Japanese yen. The yen rose by over 6 per cent against the dollar over the past month, and has risen by nearly 13 per cent since late May. This strong demand for yen reflects the mounting evidence that the Japanese current account surplus this year will substantially exceed last year's $11 billion surplus.

The approach of the Bremen meeting in early July generated speculation that some or all of the traditionally weaker European Community currencies -- the French franc, the British pound and the Italian lira -- might be included in an expanded European currency band, and this speculation led to an increased exchange market demand for these currencies. The French franc and pound appreciated by 3 per cent against the dollar and rose slightly relative to the existing snake currencies. The lira moved up by nearly 2 per cent against the dollar.

At the conclusion of the Bremen conference, EC leaders agreed to study and work toward implementing a new European monetary arrangement, apparently involving grouping the present joint float currencies in a narrower fluctuation band, adding new members to the band -- possibly with initially wider fluctuation limits -- and some pooling of reserves.

The German mark and other snake currencies rose by about 2 per cent against the dollar over the past month.

. The Belgian franc trailed the mark in its rise against the dollar, and the franc moved to its lower limit against the mark within the existing snake, OPEC surpluses and investment flows. New external investments by OPEC countries so far in 1978 have been at a greatly reduced rate compared with either the first half of 1977 or any period in the years 1974-76. The OPEC investible surplus has been declining rapidly since mid-1977 as OPEC imports have continued to rise while oil revenues first stabilized and then declined in reflection of a variety of factors. For 1978 as a whole the surplus may be reduced by about 50 per cent from the 1977 figure of $37 billion.

The OPEC investible surplus (current account adjusted for credit to oil companies) is estimated to have decreased from a high level of around $24-1/2 billion in the first half of 1977 to about $12-1/2 billion in the second half (see table). Oil export receipts in the second half of 1977 were approximately unchanged while imports rose 15 per cent to a level 40 per cent above a year earlier; the deficit on services also widened. In addition to these changes, OPEC grant aid was somewhat larger in the second half, and OPEC countries resumed making net credits to oil companies in the second half after effectively receiving net repayments in the first half when lags in export receipts were shortened.

For the year 1978 the investible surplus is expected to be in the range of $15-20 billion. Oil exports have actually declined in early 1978 because of weak demand, a running down of inventories in consuming countries, increased oil supplies from non-OPEC countries and the absence of a price increase by OPEC. First-quarter oil receipts were down 10 per cent from a year earlier. While a pick-up is expected

Estimated Disposition of OPEC Surpluses
(in billions of dollars)

		1976	1977			1978
		Year	Year	1st H	2nd H	Q-1
I.	Surplus on Current Account excluding Grant Aid	40.7	38.8	22.1	16.8	7.0
II.	less OPEC Grant Aid	3.8	4.7	2.1	2.7	1.0
III.	less Net Credit to Oil Companies	7.5	-3.1	-4.6	1.5	-3.3
IV.	=Investments, as shown below	29.4	37.2	24.6	12.6	9.3
V.	In United States	12.1	9.2	5.4	3.8	1.9
	A. Short-term assets 1/	.3	-.5	.6	-1.1	1.0
	B. Other deposits and securities	7.7	7.4	3.6	3.8	.3
	C. Other capital flows 2/	4.2	2.2	1.2	1.0	.6
VI.	In United Kingdom	-1.1	.7	.6	.1	.2
	A. Liquid sterling assets	-2.4	.1	.2	-.1	.2
	B. Other loans and investments	1.3	.6	.4	.2	0
VII.	In Euro-Currency Markets	12.6	11.9	8.9	3.0	2.5
	A. United Kingdom	5.6	3.4	3.4	0	1.0
	B. Other 3/	7.0	8.5	5.5	3.0	1.5
VIII.	International and Regional Institutions	1.8	.6	.5	.1	*/
IX.	Other Investments	4.0	14.8	9.2	5.6	4.7

1/ Treasury bills, bank deposits and CD's, repurchase agreements.
2/ Direct investment, import prepayments, debt repayments, real estate, miscellaneous.
3/ Including domestic-currency deposits outside the U.S. and the U.K.
*/ Less than $50 million.

in the second half, oil export receipts for 1978 as a whole are projected to be about 3 per cent, or $4-5 billion, less than in 1977. After rising 22 per cent last year the dollar value of OPEC imports is conservatively expected to increase 15 per cent ($12 billion) this year, partly in reflection of the depreciation of the dollar. The expected rise in imports reflects, _inter alia_, Saudi Arabia's willingness to absorb the entire drop in total OPEC oil sales. The services deficit should also widen further. The 1978 investible surplus projections by the staff and the estimates for 1976-77 are as follows (in billions of dollars):

	1976	1977	1978
Oil exports	123	137	132
Non-oil exports	8	10	11
Imports	-68	-83	-95
Services (net)	-22-1/2	-24-1/2	-27
Grant aid	-4	-4-1/2	-4
Credit to oil companies	-7-1/2	3	0
Investible surplus	29-1/2	37	17

In the first quarter of 1978 the current account surplus (excluding grants and credit to oil companies) may have been about $7 billion, with the investible surplus higher at $9 billion as falling oil sales caused net reductions in credit to oil companies. Known or estimated investment flows in the first quarter totaled $4.6 billion; the decrease in these flows from rates observed in the first half of 1977 was somewhat less pronounced than the drop in the investible surplus itself. First-quarter inflows to the United States and the United Kingdom were about two-thirds the average quarterly rate in the first half of last year (with longer-term investments down the most) while the inflow to the Euro-currency market was about one-half as much (although still the largest flow).

U.S. International Transactions. The U.S. merchandise trade deficit was $31.7 billion (annual rate) in May (see Chart 1) and $34.6 billion in April-May combined, down substantially from the very high $44.8 billion annual rate recorded in the first quarter. The deficit declined as exports rose strongly for the first time in more than a year and the growth in imports slowed somewhat.

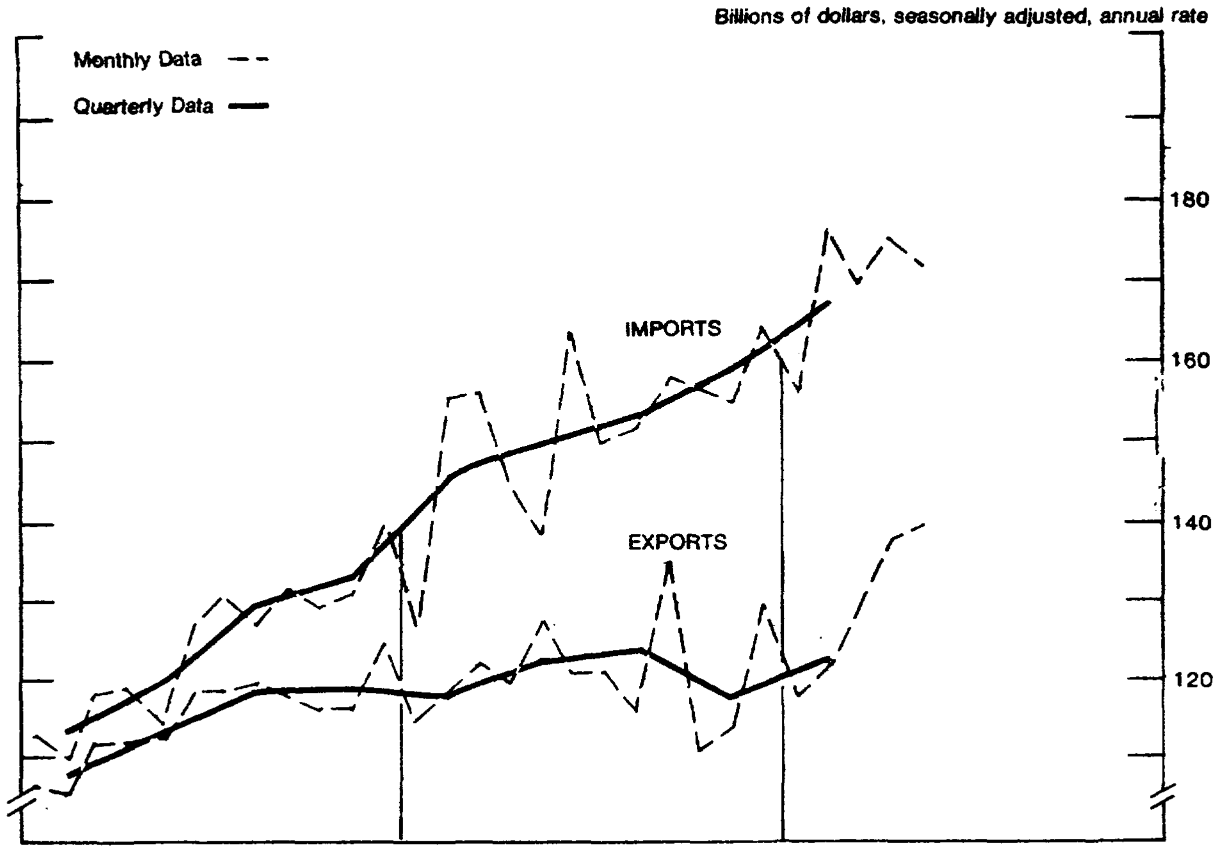
U.S. International Transactions Summary
(in billions of dollars, (-) = outflow)

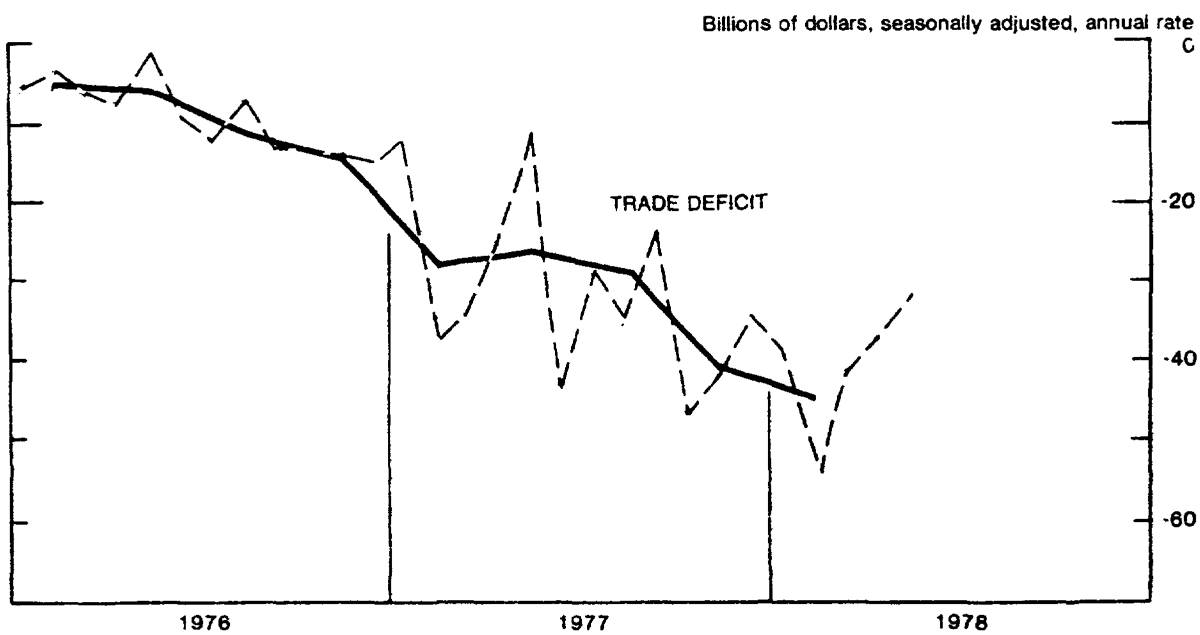
		1977		1978		
		Year	Q-4	Q-1	April	May
1.	Trade balance 1/	-31.1	-10.2	11.2	-3.1	-2.6
2.	(annual rate)	-31.4	-40.7	-44.8	-37.4	-31.7
3.	Private capital trans. adj. 2/	-6.6	-3.3	-8.0	4.5	.0
4.	Private capital as rept. net	-6.6	-5.8	-6.2	5.5	-2.0
	Reporting bias 3/	--	2.5	-1.8	-1.0	2.8
6.	OPEC net investments in U.S.	6.0	.8	1.4	-1.2	-.8
7.	Other foreign official assets	29.4	14.4	13.5	-2.8	-.6
8.	U.S. reserve assets	-.2	*	.2	.3	-.2
	All other 4/	2.5	-1.7	4.1	2.3	3.4
9.	Not seasonally adjusted	2.5	-2.8	4.0	1.9	2.9
10.	Seasonal component 5/	--	1.1	.1	.4	.5
	Memorandum:					
11.	GNP net exports of goods and services	-10.9	-4.7	-5.9	n.a.	n.a.
12	Current account balance r/	-15.2	-6.9	-7.0	n.a.	n.a.

1/ Seasonally adjusted.
2/ Includes bank-reported capital, foreign purchases of U.S. Treasury securities, and other private securities transactions.
3/ Adjustment for reporting bias in bank-reported data associated with week-end transactions. See page IV 10-11 in the June 1976 greenbook.
4/ Includes service transactions, unilateral transfers, U.S. government capital, direct investment, nonbank capital transactions, and statistical discrepancy.
5/ Equal but opposite in sign to the seasonal component of the trade balance.
*/ Less than $50 million.
e/ Estimated.
Revised (see Appendix A)

U.S. Merchandise Trade

International Accounts Basis





Holdings of foreign official assets in the United States, including those of both OPEC and non-OPEC countries declined in April-May for the first time in over a year. This shift was offset in part by an increased net inflow of private bank-reported and securities transactions.

Data were released at the end of June for the first quarter U.S current account balance. The numbers showed a deficit of $27.8 billion (annual rate) compared with $15.2 billion for 1977. These data were revised to include reinvested earnings of incorporated affiliates as investment income flows. This revision is described in detail in Appendix A.

U.S. merchandise trade. Total exports were up by 13 per cent in April-May, with nonagricultural shipments up by 10 per cent and agricultural shipments up by more than 20 per cent over first quarter rates. The growth in total exports was largely in terms of volume; the nonagricultural export unit value index was about unchanged and that for agricultural exports rose by 6 per cent. The total export increase was broadly based across geographical regions. Exports to developing countries (including oil exporters) continued their rapid pace of earlier this year, while those to industrial countries picked up after having declined since mid-1977.

U.S. Merchandise Trade, International Accounts Basis
(billions of dollars, seasonally adjusted annual rates)

	1977	1977		1978			
	Year	3Q	4Q	1Q	April & May	April	May
EXPORTS	120.6	124.1	117.8	122.7	138.6	137.6	139.6
Agric.	24.4	23.9	22.7	26.1	32.3	31.0	33.7
Nonagric.	96 2	100.2	95.2	96.6	106.3	106.7	106.0
IMPORTS	151.6	153.1	158.5	167.5	173.2	175.0	171.3
Petroleum	45.0	45.2	42.3	39.8	43.4	45.6	41.3
Nonpetrol.	106.7	107.8	116.3	127.7	129.7	129.4	130.1
BALANCE	-31.1	-29.0	-40.7	-44.8	-34.6	-37.4	-31.7

NOTE: Details may not add to totals because of rounding.

Among nonagricultural commodities, shipments of coal in April-May were more than triple their strike-depressed levels in the first quarter, though they were still below last year's average rate. Exports of aircraft and nonferrous metals were up by more than 20 per cent, while consumer goods advanced by 15 per cent and machinery and automotive vehicles by 10 per cent each.

An exceptionally rapid growth in agricultural exports during April-May was led by very large shipments of the major export crops, soybeans, corn and (to a lesser extent) wheat. Some pickup in these exports had been anticipated in the second quarter because weather and strike-related transportation difficulties in previous months had caused shipments to fall behind schedule relative to total sales for the current marketing year. The large size of the April-May increase exceeded expectations, however. Supplies in other major exporting regions have been relatively tight due to drought-reduced production in the Southern Hemisphere, while the United States has had a more than ample stock position. At the same time, increased livestock numbers, particularly in Western Europe and the Soviet Bloc, have strengthened foreign demand for grain and soybeans for feed. The recent dollar depreciation also may have stimulated some demand, although shipments to Japan (whose currency has risen the fastest against the dollar) grew only moderately.

Total imports declined in May after rising strongly in April. For April-May combined they were up by 3-1/2 per cent over the first quarter. Most of the movement in total imports reflected sharp fluctuations in petroleum imports, as nonpetroleum imports were relatively stable on average. The volume of oil imports in April-May was 10 per cent above the first quarter rate when domestic stocks were being run down from the high levels accumulated last year. Steel imports declined sharply in May when the Treasury's trigger price mechanism went into full effect. However, the decline was apparently not as great as steel industry exports had expected. Coffee imports also dropped sharply, in terms of both price and volume, for the second consecutive month. These declines were offset by moderate increases in most other categories of nonpetroleum imports.

<u>Foreign official assets</u> in the United States (excluding OPEC holdings) were about unchanged in May, rising by only $0.2 billion, after having fallen by $3.0 billion in April.

Based on preliminary data, these foreign official assets are estimated to have remained little changed in June. This would imply roughly a $2.5 billion decline in holdings for the second quarter, a significant reversal of the large scale increased over the past year.

. Official inflows resumed in early July, however, with the renewed downward pressure on the dollar.

<u>OPEC banking and security holdings</u> in the United States fell by $0.3 billion in May, following a $1.2 billion decline in April. Together with preliminary data for June, these holdings are estimated to have declined by more than $2 billion in the second quarter, following sizable increases over the past year. The recent

decline in OPEC holdings may be related, in part, to the reduced OPEC current account surplus.(see section on OPEC investment flows above).

The shift to a net outflow of officially held funds was offset by a sizable net private capital inflow. Bank-reported private capital transactions (adjusted for reporting bias) showed a small net outflow in May, but amounted to a $4.5 billion inflow for April-May combined. Most of this inflow reflected transfers from foreign affiliates of U.S. banks.

Foreign private net purchases of U.S. corporate stocks were $350 million in May, and $950 million for April-May combined, up substantially from the rate during the previous six months. U.S. purchases of foreign securities fell to $50 million in May and $400 million in April-May combined, about half the average rate over the past year. However, foreign placements in the U.S. bond market have not slowed as much as the decline in U.S. purchases. An increasing share of foreign placements in the U.S. market has been purchased by foreign residents.

Foreign Economic Developments. The continuation of extremely large current-account surpluses in Japan and Germany has been the dominant international development over the past month. The pace of economic activity and the movement of prices in the six major foreign industrial countries have proceeded as generally expected, although recent data for Germany has revealed surprising weakness. These developments are likely to be among the principal topics of discussion at the Bonn Summit later this month.

The May current-account surplus (s.a.) in Japan was somewhat higher than the April figure, bringing the cumulative current-account surplus through the first five months of this year to over $8 billion. The performance so far this year, together with further J-curve effects from continued appreciation of the yen, makes it extremely unlikely that the Japanese current-account surplus for 1978 -- in dollar terms -- can be reduced from last year's $11 billion figure. In Germany, the cumulative current-account surplus (n.s.a.) through May has already reached $2.7 billion, and is virtually certain to surpass the $3.9 billion surplus for all of last year. The external accounts of Italy and France have also shown surprising strength in recent months.

In Germany and Japan it still appears that real GNP growth is likely to fall short of official targets. In Germany, real GNP growth in the first quarter of 1978 was basically flat and was marked by a nearly 1 per cent (s.a.) decline in fixed investment. Both industrial production and new orders decreased in May, although both series tend to be quite erratic. In Japan, private consumption appears to have strengthened somewhat in recent months, and industrial production has continued to rise (although rather slowly), due in large part to increased government expenditure. There are no indications yet, however, of an incipient recovery of private investment.

The economies of the United Kingdom and Italy are continuing on an expansionary path. On the basis of provisional figures, GDP in the United Kingdom rose by about 1/2 per cent in the first quarter, led by a 2 per cent increase in private consumption expenditure. Industrial production in the United Kingdom has also continued to expand through April. The recovery in Italy is now proceeding at a pace at which real growth may exceed 2-1/2 per cent in 1978, with strength coming from a growing public-sector deficit. Real growth in Canada is continuing at a modest rate, but private investment is at an extremely low level.

Moderation of rates of increase in consumer prices has continued in most of the six major foreign industrial countries. An exception is France where the upward trend in consumer prices has accelerated sharply to double-digit rates in recent months. Although the French government is committed to restraint on wage increases, high rates of inflation are expected to continue, at least through this quarter, as the economy adjusts to increases in public-sector tariffs and to the phasing out of industrial price controls. In Italy, there is concern that the growing public-sector deficit, together with stronger activity and a more rapid growth of monetary aggregates, may intensify the still high rate of inflation. In the United Kingdom, recent large money supply increases and accelerating unit wage costs have raised fears of a new inflationary surge later in the year.

Real GNP and Industrial Production in Major Industrial Countries
(percentage change from previous period, seasonally adjusted)

					1977			1978	1978			
		1975	1976	1977	Q2	Q3	Q4	Q1	Feb.	Mar.	Apr.	May
Canada:	GNP	1.3	5.5	2.7	0.3	0.3	1.5	0.7	*	*	*	*
	IP	-4.8	5.0	3.4	0.3	0.0	0.8	0.3	1.2	0.3	-0.2	n.a.
France:	GDP	0.3	5.0	2.5	-1.2	0.2	1.4	n.a.	*	*	*	*
	IP	-9.2	10.1	1.6	-1.8	-1.3	-0.3	2.4	0.0	2.4	1.6	n.a.
Germany:	GNP	-2.5	5.7	2.4	-0.1	0.0	1.4	0.1	*	*	*	*
	IP	-5.5	7.7	3.1	-1.1	0.3	1.1	-0.9	-3.3	-0.9	2.6	-1.7
Italy:	GDP	-3.5	5.7	1.7	-2.5	-0.5	-0.1	2.0	*	*	*	*
	IP	-9.2	12.9	1.0	-7.0	-0.8	-2.7	5.3	3.2	-1.0	-2.8	n.a.
Japan:	GNP	2.5	6.2	5.2	1.7	0.4	1.1	2.4	*	*	*	*
	IP	-11.1	11.1	4.2	-0.2	-0.2	1.2	3.1	0.3	2.1	0.1	0.3
United Kingdom:	GNP	-2.1	2.4	1.0	0.5	0.3	0.3	0.5	*	*	*	*
	IP	-4.9	0.5	0.3	-1.2	0.8	-0.5	0.9	0.6	-0.3	1.6	n.a.
United States:	GNP	-1.3	6.0	4.9	1.5	1.3	0.9	0.0	*	*	*	*
	IP	-8.9	10.1	5.6	2.5	1.1	0.6	0.2	-0.3	1.2	1.4	0.6

*GNP data are not published on monthly basis.

Consumer and Wholesale Prices in Major Industrial Countries
(percentage change, from previous period or as indicated)

					1977		1978		Latest 3 Months from:		
		1975	1976	1977	Q3	Q4	Q1	Q2	Previous 3 Months (at Ann. Rate)	Year Ago	Latest Month
Canada:	CPI	10.8	7.5	8.0	2.2	2.2	1.8	2.4	10.1	8.9	June
	WPI	6.5	4.3	9.1	0.9	1.1	2.6	n.a.	11.8	7.4	Apr.
France:	CPI	11.7	9.6	9.5	2.4	1.9	1.6	n.a.	10.8	9.1	May
	WPI	-5.7	7.4	5.6	-0.9	0.0	1.2	n.a.	7.6	1.3	May
Germany:	CPI	5.9	4.6	3.9	0.2	0.2	1.3	0.9	3.6	2.7	June
	WPI	3.4	5.8	1.8	-1.8	-0.9	1.0	0.3	1.3	-1.4	June
Italy:	CPI	16.9	16.8	18.4	2.5	3.3	2.6	n.a.	13.6	12.3	May
	WPI	8.5	22.9	17.4	1.5	2.0	2.1	n.a.	9.7	8.0	May
Japan:	CPI	12.1	9.7	8.3	0.3	0.8	0.9	2.0	8.1	4.1	June
	WPI	3.0	5.0	1.9	-0.5	-0.7	-0.5	n.a.	-0.8	-2.0	May
United Kingdom:	CPI	24.2	16.6	15.8	1.6	1.5	1.7	n.a.	9.9	8.2	May
	WPI	24.1	16.4	19.2	3.3	1.6	2.5	2.0	8.1	9.7	June
United States:	CPI	9.1	5.7	6.5	1.5	1.1	1.7	n.a.	9.5	6.7	May
	WPI	9.2	4.6	6.1	0.2	1.1	2.4	n.a.	12.6	6.3	May

Trade and Current-Account Balances of Major Industrial Countries a/
(billions of U.S. dollars; seasonally adjusted)

		1975	1976	1977	1977 Q1	1977 Q2	1977 Q3	1977 Q4	1978 Q1	1978 Feb.	1978 Mar.	1978 Apr.	1978 May
Canada:	Trade	-0.6	1.2	2.7	0.8	0.3	0.6	1.0	1.2	0.2	0.7	0.1	0.3
	Current Account	-4.7	-4.2	-4.0	-0.8	-1.4	-1.1	-0.7	-0.6	*	*	*	*
France:	Trade	1.5	-4.2	-2.4	-1.1	-0.6	-0.5	-0.2	-0.2	0.0	0.3	0.2	0.0
	Current Account	0.0	-6.0	-3.3	-1.3	-0.8	-0.8	-0.3	0.2	*	*	*	*
Germany:	Trade	15.3	13.5	16.5	3.7	4.2	3.7	4.8	4.3	1.4 b/	1.8 b/	1.6 b/	1.3 e b/
	Current Account	4.1	3.9	3.9	0.8	1.1	-0.5	2.4	1.4	0.3 b/	1.4 b/	0.8 b/	0.3 b/
Italy:	Trade	-3.5	-6.7	-2.5	-1.4	-0.8	0.1	-0.4	-0.2	-0.1	-0.1	0.3	n.a.
	Current Account b/	-0.6	-2.9	n.a.	-0.9	0.2	2.4	n.a.	n.a.	*	*	*	*
Japan:	Trade	5.0	9.9	17.5	4.2	4.4	4.2	4.6	7.4	2.5	2.8	1.8	2.1
	Current Account	-0.7	3.7	11.0	2.3	2.8	2.7	3.1	5.5	1.9	2.1	1.3	1.4
United Kingdom.	Trade	-7.1	-6.3	-2.9	-1.7	-1.2	-0.1	0.1	-1.0	0.1	-0.5	0.4	-0.3
	Current Account	-3.7	-2.0	0.3	-0.8	-0.6	0.9	0.9	-0.6	0.4	-0.3	0.6	-0.1
United States:	Trade	9.0	-9.4	-31.1	-7.0	-6.6	-7.3	-10.2	-11.2	-4.5	-3.4	-3.1	-2.6
	Current Account	18.4	4.3	-15.2	-2.7	-2.7	-2.9	-6.9	-7.0	*	*	*	*

a/ The current account includes goods, services, and private and official transfers.
b/ Not seasonally adjusted.
* Comparable monthly current-account data are not published.

Notes on Individual Countries. The increase in the Japanese current-account surplus to \$1.4 billion (s.a.) in May has pushed the cumulative surplus for the first five months of 1978 over \$8 billion. It is estimated that the May surplus would have been even higher were it not for a substantial volume of accelerated oil imports induced by the June 1 imposition of a special oil tax. Preliminary trade figures for June indicate that the current-account was strongly positive in that month as well. Industrial production in Japan advanced in May for the seventh consecutive month. Since October of last year the index of industrial production has increased at an annual rate of slightly below 12 per cent but increases in April and May have been small. Household consumption appears to have strengthened somewhat in recent months, but no clear indications of a sustained recovery of private investment have yet emerged. Excess capacity is still at a high level, and no progress has been made in reducing unemployment.

Through May the German current-account surplus has already reached \$2.7 billion (n.s.a.); the deficit in the services account in particular was considerably below its level for the same five months a year ago. First-quarter German national accounts reveal that strong contributions to real growth from private and government consumption were almost completely offset by declines in fixed investment and net exports. The weak performance of GNP in the first quarter makes it likely that real growth will fall below 3 per cent in 1978. The central government budget appears to be on track, but state and local deficits (which were budgeted to grow by DM10 billion this year) were running below their 1977 levels in the first quarter. A number of proposals for stimulating domestic demand -- including public investment spending, tax cuts, and increased social welfare payments -- are being discussed within the German Cabinet, and some announcement appears likely following the July 16-17 Bonn Summit.

The recovery in activity in Italy appears to be progressing at a modest pace. However, the failure until now of the authorities to adopt measures that would reduce the enlarged-public-sector deficit to the government's announced 24-25 trillion lire target, and the strong chance that the deficit will surpass the target by a substantial margin, may produce a stronger growth of GDP in 1978 than the 2-1/2 per cent that was expected on the basis of the lower deficit. A large public-sector deficit, which would probably be financed primarily by the central bank, also would lead to a faster expansion of monetary aggregates; higher monetary growth and stronger activity probably would intensify a still high rate of inflation. Although stronger activity and higher inflation in time would reduce or eliminate the current-account surplus, at present the external situation is strong, in part because of a good tourist season.

In the United Kingdom a consumption-led expansion in economic activity is under way. Provisional figures show that real GDP rose 1/2 per cent (s.a.) in the first quarter of 1978. In the same period real consumer expenditures increased by some 2 per cent. Also, recently revised data indicate that for the first 5 months of 1978, the British current account recorded a slight deficit. Most forecasts continue to show a current-account surplus for 1978, but its expected size has been reduced considerably.

Canadian real GNP increased by 0.7 (s.a.) per cent in the first quarter of 1978 following a revised increase of 1.5 per cent in the fourth quarter of 1977. Strong contributions were made by consumption expenditure and net exports. Fixed investment continued to be the major source of weakness in the economy; real business capital formation was at its lowest level in three years in the first quarter. Further strength in consumer spending during the second quarter of this year is indicated by recent new orders data while investment spending is expected to continue to be weak due to low capacity utilization. Consumer prices rose by 1.3 per cent during May, reflecting continued large increases in the price of food. Increases in non-food consumer prices -- i.e., the prices of those items that had been subject to the wage and price control program -- continued to moderate.

In France consumer prices rose at an average annual rate of over 12 per cent during the three months to May, representing a substantial acceleration of inflation over the previous three-month period. Double-digit rates of price increases are expected to continue for at least the next few months as the economy continues to adjust to public-sector price increases and the phasing out of industrial price controls. Underlying cost pressures, however, have not shown clear signs of intensifying; the rate of increase in nominal wages in fact continued to decelerate in the first quarter. A recently announced increase of 3.8 per cent in the minimum wage, effective July 1, is not expected to compromise seriously government efforts to continue to reduce the average rate of wage increases in the economy. The trade balance remained in small surplus in May. Imports are expected to increase further in coming months, however, so that a shift back towards deficit would seem likely.

In the Netherlands another 1 billion guilder rise in the projected 1978 budget deficit has prompted a series of economy measures that will reduce the rate of growth of government expenditures over the next three years. Even after these cuts, however, the Dutch authorities project that the budget still will exert an increasingly expansionary influence on the economy and reduce somewhat the rate of unemployment. In May, Sweden experienced its fourth consecutive monthly trade surplus together with decelerating consumer price inflation, indicating some success on the two major policy fronts.

Monetary and financial developments abroad. The general decline in short-term interest rates observed abroad last year and early this year came to an end in the second quarter (see Table). Interest rates have risen (or, at least, have stopped declining) in all the major countries -- except France -- since March, although only in Britain have they risen as much as in the United States.

The reversal of the downward trend of short-term interest rates seems to reflect two factors. First, declines in inflation rates also observed last year seem to be coming to an end; indeed, especially in Italy and the United Kingdom (and in France, where interest rates have declined this year but were relatively high at the end of last year), there is concern about accelerating inflation rates. Second, growth rates of the monetary aggregates in Germany, Switzerland, and the United Kingdom so far this year (see Table) suggest that target

3-Month and Long-Term Interest Rates In Selected Industrial Countries
(per cent per annum)

	1977 June	1977 December	Change During Q1 1978	Change During Q2 1978	Latest Level
3-Month Rates [1/]					
Canada	7.16	7.20	+0.30	+0.63	8.25 (7/11)
France	9.01	9.88	-1.38	-0.44	7.63 (7/12)
Germany	4.24	3.94	-0.39	+0.10	3.75 (7/12)
Italy	14.65	11.38	+0.37	0	11.75 (7/12)
Japan	6.05	5.75	-1.25	+0.25	4.75 (7/12)
Switzerland	3.80	2.20	-1.70	+1.00	4.25 (7/12)
United Kingdom	7.81	6.76	-0.57	+3.94	9.94 (7/12)
United States	5.35	6.66	+0.08	+1.26	8.00 (7/5)
Long-Term Bond Yields [2/]					
Canada	8.70	8.77	+0.40	+0.06	9.23 (6/30)
France	10.92	10.86	-0.02	-0.46	10.38 (6/16)
Germany	6.11	5.60	-0.40	+0.44	5.64 (6/23)
Italy	14.71	14.25	-0.19	-0.60	13.46 (6/30)
Japan	7.32	6.27	-0.23	+0.03	6.07 (6/30)
Switzerland	4.38	3.75	-0.26	-0.10	3.39 (6/30)
United Kingdom	12.24	9.57	+0.63	+1.69	11.89 (6/30)
United States	7.57	7.98	+0.33	+0.36	8.72 (7/11)

1/ Averages of daily rates; all interbank rates, except: Canada-finance company paper; Japan-Private discount on paper over 2 month maturity.
2/ End-of-period quotations; mostly composite yields on government bonds.

Growth of Money Stock in Selected Industrial Countries

	1978 (percentage change from previous month, seasonally adjusted monthly rates)					Percentage change in latest 3 months from same period year earlier
	Jan.	Feb.	Mar.	Apr.	May	
Canada(M_1)	-0.9	1.1	-0.7	-0.4	3.1	9.5
France(M_2)	0.7	1.9	0.4	1.5	n.a.	13.5
Germany(CBM)1/	1.8	1.0	0.4	0.4	0.8	11.5
Japan(M_2)	0.6	0.9	1.0	2.2	n.a.	11.4
Switzerland(M_1)2/	0.2	2.0	6.6	0.3	n.a.	14.5
United Kingdom(£M_3)	2.4	2.4	0.7	2.5	0.8	15.8
United States(M_1)	0.8	-0.1	0.3	1.6	0.5	7.3
(M_2)	0.7	0.4	0.4	0.9	0.6	8.3

1/Central Bank Money, equal to currency plus non-currency components of M_3 weighted by their reserve requirements as of January 1974.

2/Not seasonally adjusted.

growth rates may be exceeded. Consequently, monetary authorities -- especially in Britain -- have acted to raise interest rates to slow money growth.

The increase in interest rates in Canada reflects different considerations. Specifically, it reflects concern on the part of Canadian authorities about the decline in the exchange value of the Canadian dollar and, correspondingly, actions to keep Canadian rates in line with U.S. rates.

The trend of long-term bond yields since March has been mixed. The most significant movements have been (1) the sharp increase in yields in Britain, which reflects again the expectation of accelerating inflation and official actions to slow money growth; and (2) the increase in yields in Germany, which is significant because it has taken place in spite of unchanged inflation rates and unexpectedly weak economic activity (and may reflect some concern about the financing of the public-sector deficit).

APPENDIX A*
INCLUSION OF REINVESTED EARNINGS IN U.S. INTERNATIONAL TRANSACTIONS STATISTICS

The presentation of the summary of U.S. international transactions has been revised back to 1960 to include reinvested earnings of incorporated affiliates. These earnings are incorporated in both the current account (in direct investment income receipts and payments) and in private capital flows (in U.S. direct investment abroad and in foreign direct investment in the United States). The effect of this addition is to increase recorded U.S. net income receipts (thus reducing the level of the current-account deficit), and to increase the amount of direct investment capital flows recorded each quarter (thus increasing net capital outflows from the United States.) For the most part, inclusion of reinvested earnings adjusts the levels but not the quarter-to-quarter changes of the accounts. Table 1 summarizes the effects of this revision. Chart 1 shows the current account balance on both the old and new bases. At present, reinvested earnings will not be included in the GNP account (net exports); they will be added during the next GNP benchmark revision (perhaps in 1979 or 1980).

The inclusion of reinvested earnings in direct investment income recognizes that a direct investor's share in the total earnings of an incorporated affiliate (net of the affiliate's income taxes and withholding taxes on dividends) is income to the direct investor, whether or not it is repatriated. The counterpart entry in the capital account of these reinvested income flows appears as changes in U.S. direct investment abroad and foreign direct investment in the United States.

Until now, reinvested earnings have been reported as memoranda items in table 5 in the quarterly U.S. International Transactions articles in the Survey of Current Business. Because reports of earnings are not as complete as for other direct-investment related items the data were published with a one quarter lag. Data for the current quarter are now published on an estimated basis.

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Inclusion of reinvested earnings in the quarterly U.S. international transactions figures follows the recommendation made in the Report of the Advisory Committee on the Presentation of the Balance of Payments Statistics (May, 1976), and also conforms with recommendations by the IMF.1/

1/ At present, in addition to the United States, three other large industrial countries (Germany, the United Kingdom, and France) report undistributed direct investment income flows in their balance-of-payments compilations. Data reported by these countries, however, appear to understate seriously such flows.

Table 1
Effect of Reinvested Earnings on
the Current Account Balance and Net Private Capital Flows.
(in billions of dollars)

	1976	1977
U.S. Current Account Balance (New Basis 1/)	4.3	-15.2
(Old Basis 2/)	(-1.7)	(-20.9)
of which:		
Net investment income from:	15.9	17.5
Direct investments, net	15.9	17.0
REINVESTED EARNINGS, NET	6.0	5.7
U.S. FIRMS ABROAD	7.7	7.3
FOREIGN FIRMS IN U.S.	-1.7	-1.6
Other direct invest. income, net	9.9	11.2
Other investment income, net.	*	.5
Private Capital Flows, Net (New Basis 1/)	-25.0	-17.0
(Old Basis 2/)	(-19.0)	(-11.3)
U.S. assets abroad, net	-43.9	-30.7
of which:		
U.S. direct investment abroad	-11.6	-12.2
REINVESTED EARNINGS	-7.7	-7.3
Other	-3.9	-4.9
Foreign assets in the U.S., net	18.9	13.7
of which:		
Foreign direct investment abroad	4.3	3.3
REINVESTED EARNINGS	1.7	1.6
Other	2.7	1.8

1/ New basis includes reinvested earnings
2/ Old basis exludes reinvested earnings
*/ Less than $50 million

Chart I

U.S. Current Account Balance

Quarterly Data