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CONFIDENTIAL (FR)

August 9, 1978

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Recent data suggest a continuation of economic growth at a moderate pace. Payroll employment and industrial production rose further in July, and retail sales other than autos resumed an upward path. However, unit auto sales fell back from the extremely strong pace of the preceding four months. In the business sector, new orders and shipments of nondefense capital goods were little changed from April to June, but expenditures for private nonresidential structures moved higher at the end of the quarter. At the same time, over-all price increases continued very large through June.

The total unemployment rate, after having dropped 0.4 per cent in June, jumped half a point to 6.2 per cent in July. The swing in unemployment was concentrated among youths and women; the jobless rate for adult men declined slightly over the May to July period. Total employment, according to the household survey, showed a large drop in July, after an exceptionally large rise in June. In contrast, nonfarm payroll employment rose in July at close to the May and June rate, but slower than during the first four months of the year. As in the previous two months, advances in payroll employment in July were concentrated in private service-producing industries and contract construction. Manufacturing employment advanced only modestly, while the factory workweek held steady. Based on these and other data, industrial production appears likely to have risen around one-half per cent in July.

Reflecting gains in employment and wage rates as well as increased farm income, personal income rose 0.9 per cent in June, and probably increased further in July. After a pause in June, consumer spending on nonautomotive goods appears from weekly data to have advanced more than one per cent in July. Total auto sales declined in July to a 10.9 million unit annual rate, considerably below the 12 million unit rate over the four prior months. Unit sales were lower for both foreign and domestic models, although the decline for the latter was most pronounced.

Business fixed investment recorded a strong second-quarter rise, but developments were mixed in June. New orders for nondefense capital goods declined, while shipments were no higher than in April. The drop in these new orders was concentrated in machinery, which returned to about the same current dollar level as late last year. At the same time, expenditures for private nonresidential structures rose sharply, suggesting considerable strength in an area where the recovery of activity had been moderate until last year. The book value of manufacturers' inventories rose at a \$16.7 billion annual rate in June, down about one-fourth from the April and May average.

The most recent reading on housing developments indicates that the level of building activity has held up well in the face of tighter mortgage market conditions. Total private housing starts were at a 2.1 million unit annual rate in June--about the same as in

the March-May period and in the fourth quarter of 1977. Single-family starts have drifted lower this year, while starts of multi-family units have been well maintained.

State and local government spending apparently slowed late in the second quarter, after sharp increases in March and April. The value of construction put-in-place edged down in June (reversing the strong uptrend of earlier months), and employment data show small gains over the last two months.

Price increases have continued very large; the consumer price index rose 0.9 per cent in June and at a 10-1/2 per cent annual rate over the first half of the year. Food prices increased 1.3 per cent in June, considerably less than in April and May, reflecting a smaller rise in meat prices and declines in prices of fresh vegetables, eggs, and coffee. Home financing costs and natural gas and electricity prices rose sharply again in June. (Data on producer prices should be available for the Greenbook supplement).

Outlook. Available data for June and July suggest a slowing of real GNP growth in the current quarter to about a 3-1/4 per cent annual rate--somewhat below the reported 3.6 per cent average in the first half of the year. Consumer outlays are projected to grow at a moderate rate in the third quarter, reflecting among other factors slower growth of employment and real income, and high debt burdens. In the business sector, recent information on orders and shipments suggest only a moderate rise in fixed investment. The increase projected for the

fixed-weighted price index for gross business product was raised to 7.5 per cent, annual rate, for the current quarter, reflecting indications of still-strong upward pressures on consumer food prices and in construction costs.

The fiscal and monetary policy assumptions underlying the staff projection are essentially unchanged this month. The staff continues to assume that a \$19 billion tax cut will take effect on January 1, 1979. Federal outlays still are projected to total about \$450 billion in FY 1978 and \$495 billion in FY 1979; the accompanying budget deficits are assumed to be about \$49 billion and \$47 billion, respectively, little changed from last month. With respect to monetary policy, interest rates are assumed to rise in the months ahead consistent with the lower end of the federal funds rate ranges shown in the Bluebook. M-1 is still assumed to grow at an average annual rate of 6-1/4 per cent throughout the projection period, close to the high end of the Committee's long-run 4 to 6-1/2 per cent range.

In this general environment, real GNP growth is expected to average about 3-1/2 per cent at an annual rate through the end of 1979. Reduced activity in the housing sector in response to tight mortgage market conditions is expected to be the major drag on growth. The assumed tax cut should provide an uplift to the rate of expansion of over-all activity in the first half of next year, but by the second half growth is projected to slip back to a 3 per cent pace.

Given the relatively slow rate of expansion of aggregate activity, growth in employment over the projection period is projected to slow to a rate of around 2-1/2 per cent annually from the unusually high 4.4 per cent increase over the past year. The unemployment rate is likely to remain near 6 per cent over the year ahead, and to edge up slightly toward the end of 1979.

Inflation is expected to continue rapid; increases in the fixed-weighted price index for gross business product are still projected to average nearly 7-1/4 per cent, annual rate, from the current quarter until the fourth quarter of 1979. Some near-term slowing of food price increases is expected, but inflationary pressures appear likely to remain intense elsewhere. Hourly compensation seems likely to rise at an average rate of more than 9 per cent over the projection period. Productivity increases are expected to average less than 2 per cent (annual rate), so that unit labor costs will continue to put substantial upward pressure on prices.

STAFF GNP PROJECTIONS

Per cent changes, annual rate								
	Nominal GNP		Real GNP		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	7/11/78	8/9/78	7/11/78	8/9/78	7/11/78	8/9/78	7/11/78	8/9/78
1975 ^{1/}	8.2	8.2	-1.3	-1.3	9.5	9.4	8.5	8.5
1976 ^{1/}	11.6	11.2	6.0	5.7	5.4	5.4	7.7	7.7
1977 ^{1/}	10.7	11.0	4.9	4.9	6.0	6.2	7.0	7.0
1978	11.2	11.1	4.0	3.6	6.6	7.4	5.9	6.0
1979	11.4	11.5	3.9	3.8	7.4	7.6	5.8	5.9
1978-I ^{1/}	7.0	7.1	.0	-.1	6.2	6.7	6.2	6.2
1978-II ^{1/}	18.8	18.2	8.8	7.4	9.7	11.2	5.9	5.9
1978-III	10.5	11.0	3.5	3.3	7.1	7.5	5.8	6.0
1978-IV	10.8	11.0	3.4	3.4	6.7	6.8	5.8	5.9
1979-I	11.7	12.1	4.2	4.2	7.9	7.9	5.7	5.8
1979-II	10.9	11.0	3.7	3.7	7.5	7.5	5.7	5.8
1979-III	10.2	10.3	3.2	3.2	6.8	6.8	5.8	5.9
1979-IV	10.1	10.2	2.7	2.7	6.9	6.9	5.9	6.0
Change:								
77-II to 78-II ^{1/}	11.4	11.2	4.4	4.0	6.4	7.3	-1.2	-1.2
77-IV to 78-IV	11.7	11.7	3.9	3.5	7.3	8.1	-.8	-.7
78-II to 79-II	11.0	11.3	3.7	3.6	7.3	7.4	-.2	-.1
78-IV to 79-IV	10.7	10.9	3.5	3.5	7.2	7.2	.1	.1
Memo:								
Growth Over Annual Policy Period:								
78-II to 79-II	11.0	11.3	3.7	3.6	7.3	7.4	-.2	-.1

^{1/} Actual.

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

	1978				1979			
	I	II	III	IV	Projected			
					I	II	III	IV
Gross national product	1992.0	2076.9	2131.7	2188.1	2251.4	2310.7	2368.2	2426.4
Final purchases	1975.3	2056.2	2109.2	2164.6	2226.1	2284.6	2341.6	2399.3
Private	1558.6	1631.6	1672.3	1713.6	1764.5	1812.7	1858.2	1903.0
Excluding net exports	1582.7	1645.5	1685.2	1724.3	1775.4	1822.0	1864.3	1906.9
Personal consumption expenditures	1276.7	1324.0	1356.5	1388.7	1432.9	1472.3	1507.1	1541.6
Goods	684.9	715.9	731.4	748.5	773.5	794.1	810.7	827.2
Services	591.8	608.1	625.1	640.2	659.4	678.2	696.4	714.4
Gross private domestic investment	322.7	342.2	351.2	359.1	367.8	375.8	383.8	392.4
Residential construction	100.3	104.8	105.8	106.3	106.3	106.3	106.8	107.8
Business fixed investment	205.6	216.7	222.9	229.3	236.2	243.4	250.4	257.5
Change in business inventories	16.7	20.7	22.5	23.5	25.3	26.1	26.6	27.1
Nonfarm	16.9	22.7	22.5	23.5	25.3	26.1	26.6	27.1
Net exports of goods and services ^{1/}	-24.1	-13.9	-12.9	-10.7	-10.9	-9.3	-6.1	-3.9
Exports	181.7	199.4	204.7	215.4	224.9	234.1	242.5	250.8
Imports	205.8	213.3	217.6	226.1	235.8	243.4	248.6	254.7
Gov't. purchases of goods and services	416.7	424.6	436.9	451.0	461.6	471.9	483.4	496.3
Federal ^{2/}	151.5	147.4	152.4	159.6	163.3	166.6	171.1	177.0
State and local	265.2	277.2	284.5	291.4	298.3	305.3	312.3	319.3
Gross national product in constant (1972) dollars	1354.2	1378.6	1389.8	1401.4	1415.9	1428.7	1440.1	1449.8
Personal income	1628.9	1682.5	1732.5	1778.1	1823.2	1870.5	1922.2	1969.4
Wage and salary disbursements	1050.8	1088.6	1112.7	1140.0	1173.7	1202.1	1230.5	1261.8
Disposable personal income	1391.6	1433.7	1471.0	1507.6	1558.6	1597.1	1640.0	1677.8
Saving rate (per cent)	5.9	5.3	5.4	5.5	5.7	5.4	5.7	5.7
Corporate profits with I.V.A. and C.C. Adj.	132.6	154.3	160.9	167.7	165.4	170.8	173.8	177.5
Corporate profits before tax	172.1	195.8	199.1	205.8	204.2	210.2	213.8	218.1
Federal government surplus or deficit (-) (N.I.A. basis)	-52.6	-32.7	-33.7	-34.6	-37.0	-33.1	-35.2	-34.4
High employment surplus or deficit (-)	-3.0	11.8	10.3	13.2	10.8	15.8	16.0	21.6
State and local government surplus or deficit (-) (N.I.A. basis)	31.5	27.8	25.9	23.2	22.9	21.7	19.8	18.9
Excluding social insurance funds	11.5	7.3	4.9	1.7	.9	-.8	-3.2	-4.6
Civilian labor force (millions)	99.2	100.2	100.8	101.3	101.9	102.5	103.1	103.6
Unemployment rate (per cent)	6.2	5.9	6.0	5.9	5.8	5.8	5.9	6.0
Nonfarm payroll employment (millions)	84.1	85.5	86.1	86.4	87.0	87.5	88.0	88.5
Manufacturing	20.1	20.3	20.3	20.4	20.7	20.8	20.9	21.0
Industrial production (1967=100)	139.6	143.7	145.5	147.7	150.1	152.1	153.6	154.9
Capacity utilization: all mfg. (per cent)	82.1	83.8	84.2	84.7	85.3	85.6	85.6	85.6
Materials (per cent)	81.7	84.1	84.6	85.3	86.1	86.6	86.8	87.0
Housing starts, private (million units, A.R.)	1.72	2.12	1.90	1.80	1.75	1.70	1.70	1.70
New autos sales, (millions, A.R.)	10.80	12.12	11.15	10.80	10.95	10.75	10.65	10.55
Domestic models	8.80	10.01	9.25	8.90	9.00	8.90	8.85	8.80
Foreign models	2.00	2.11	1.90	1.90	1.95	1.85	1.80	1.75

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

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

August 9, 1978

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PER CENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS
(Annual rates compounded quarterly)

	1978				1979			
	I	II	III	IV	Projected			
	I	II	III	IV	I	II	III	IV
<u>Constant (1972) dollars</u>								
Gross national product	-1	7.4	3.3	3.4	4.2	3.7	3.2	2.7
Final purchases	-1.6	7.2	2.9	3.3	4.1	3.6	3.3	2.7
Private	-1.1	9.0	2.1	3.0	4.4	3.7	3.2	2.8
Excluding net exports	-1.0	7.1	2.1	2.5	4.3	3.4	2.7	2.5
Personal consumption expenditures	-1.4	6.1	2.5	2.9	5.0	3.9	3.1	2.6
Goods	-8.1	8.5	1.8	3.5	5.6	3.8	2.4	2.1
Services	7.0	3.4	3.4	2.2	4.2	4.0	3.7	3.3
Gross private domestic investment	11.3	12.4	3.4	1.7	2.2	2.0	.7	2.1
Residential structures	-5.2	3.6	-5.6	-7.4	-7.8	-7.8	-6.1	-4.3
Business fixed investment	4.2	15.1	3.2	4.6	5.0	4.9	4.2	4.0
Gov't. purchases of goods and services	-3.5	.6	5.9	4.3	2.9	2.9	3.7	2.0
Federal	-8.9	-14.5	10.2	7.1	3.5	3.9	5.9	1.5
State and local	-1	10.4	3.6	2.8	2.5	2.4	2.4	2.3
Disposable personal income	1.1	3.4	3.0	3.3	5.8	2.7	4.4	2.7
<u>Current dollars</u>								
Gross national product	7.1	18.2	11.0	11.0	12.1	11.0	10.3	10.2
Final purchases	6.4	17.4	10.7	10.9	11.9	10.9	10.4	10.2
Private	7.0	20.1	10.4	10.3	12.4	11.4	10.4	10.0
Excluding net exports	7.1	16.8	10.0	9.6	12.4	10.9	9.6	9.5
Personal consumption expenditures	7.0	15.6	10.2	9.8	13.4	11.5	9.8	9.5
Goods	.5	19.4	8.9	9.7	14.0	11.1	8.6	8.4
Services	15.3	11.5	11.7	10.0	12.5	11.9	11.2	10.7
Gross private domestic investment	12.2	26.4	10.9	9.3	10.0	9.0	8.8	9.3
Residential structures	.5	19.1	3.9	1.9	.0	.0	1.9	3.8
Business fixed investment	11.1	23.4	11.9	12.0	12.6	12.8	12.0	11.8
Gov't. purchases of goods and services	4.1	7.8	12.1	13.5	9.7	9.2	10.1	11.1
Federal	-2.0	-10.3	14.3	20.3	9.6	8.3	11.2	14.5
State and local	7.8	19.4	11.0	10.1	9.8	9.7	9.5	9.3
Disposable personal income	9.8	12.7	10.8	10.3	14.2	10.2	11.2	9.6
Personal income	9.3	13.8	12.3	11.0	10.5	10.8	11.5	10.2
Wage and salary disbursements	12.1	15.2	9.2	10.2	12.4	10.0	9.8	10.6
Corporate profits with IVA & C.C. Adj.	-35.9	83.4	18.2	18.0	-5.4	13.7	7.2	8.8
Corporate profits before tax	-13.2	67.5	6.7	14.1	-3.1	12.5	7.0	8.2
Nonfarm payroll employment	4.5	6.7	3.0	1.5	2.6	2.3	2.4	2.3
Manufacturing	6.6	3.7	1.5	2.3	4.3	3.1	1.6	1.3
Nonfarm business sector								
Output per hour	-3.2	.6	1.6	2.5	2.2	1.9	1.7	1.5
Compensation per hour	12.0	8.1	8.2	8.4	12.5	8.8	8.9	8.9
Unit labor costs	15.8	7.4	6.5	5.7	10.1	6.8	7.1	7.3
GNP implicit deflator ^{1/}	7.2	10.0	7.4	7.4	7.6	7.0	6.9	7.3
Gross business product fixed-weighted price index ^{2/}	6.7	11.2	7.5	6.8	7.9	7.5	6.8	6.9
Industrial production	.9	12.3	5.1	6.2	6.7	5.4	4.0	3.4

^{1/} Excluding Federal pay increase rates of change are: 1978 QI, 7.2 per cent; 1978 QIV, 6.8 per cent; 1979 QI, 7.5 per cent; 1979 QIV, 6.8 per cent.

^{2/} Using expenditures in 1972 as weights.

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CLASS II FOMCGROSS NATIONAL PRODUCT AND RELATED ITEMS
(Expenditures and income figures are billions of current dollars.)

	1972	1973	1974	1975	1976	1977	Projected	
							1978	1979
Gross national product	1171.1	1306.6	1412.9	1528.8	1700.1	1887.2	2097.2	2339.2
Final purchases	1161.7	1288.6	1404.0	1539.6	1689.9	1871.6	2076.3	2312.9
Private	908.6	1019.1	1101.3	1201.2	1330.4	1477.6	1644.0	1834.6
Excluding net exports	911.9	1012.0	1095.3	1180.8	1323.0	1488.7	1659.4	1842.1
Personal consumption expenditures	733.0	809.9	889.6	979.1	1090.2	1206.5	1336.5	1488.5
Goods	410.5	457.5	498.3	541.5	599.2	657.4	720.2	801.4
Services	322.4	352.3	391.3	437.5	491.0	549.2	616.3	687.1
Gross private domestic investment	188.3	220.0	214.6	190.9	243.0	297.8	343.8	379.9
Residential construction	62.0	66.1	55.1	51.5	68.2	91.9	104.3	106.8
Business fixed investment	116.8	136.0	150.6	150.2	164.6	190.4	218.6	246.9
Change in business inventories	9.4	17.9	8.9	-10.7	10.2	15.6	20.8	26.3
Nonfarm	8.8	14.7	10.8	-14.3	12.2	15.0	21.4	26.3
Net exports of goods and services ^{1/}	-3.3	7.1	6.0	20.4	7.4	-11.1	-15.4	-7.5
Exports	72.7	101.6	137.9	147.3	163.2	175.5	200.3	238.1
Imports	75.9	94.4	131.9	126.9	155.7	186.6	215.7	245.6
Gov't. purchases of goods and services	253.1	269.5	302.7	338.4	359.5	394.0	432.3	478.3
Federal ^{2/}	102.1	102.2	111.1	123.1	129.9	145.1	152.7	169.5
State and local	151.0	167.3	191.5	215.4	229.6	248.9	279.6	308.8
Gross national product in constant (1972) dollars	1171.1	1235.0	1217.8	1202.3	1271.0	1332.7	1381.0	1433.6
Personal income	942.5	1052.4	1154.9	1255.5	1380.9	1529.0	1705.8	1896.3
Wage and salary disbursements	633.8	701.3	764.6	805.9	890.1	983.6	1098.0	1217.0
Disposable personal income	801.3	901.7	984.6	1086.7	1184.4	1303.0	1451.2	1618.4
Saving rate (per cent)	6.2	7.8	7.3	7.7	5.7	5.1	5.5	5.6
Corporate profits with I.V.A. and C.C. Adj.	92.1	99.1	83.6	95.9	127.0	144.2	153.9	171.9
Corporate profits before tax	96.2	115.8	126.9	120.4	155.9	173.9	193.2	211.6
Federal government surplus or deficit (N.I.A. basis)	-17.3	-6.7	-10.7	-70.6	-53.8	-48.1	-38.4	-34.9
High employment surplus or deficit (-)	-5.9	-7	17.1	-19.4	-9.3	-4.6	8.1	16.1
State and local government surplus or deficit (-) (N.I.A. basis)	13.7	13.0	7.6	6.2	20.7	29.6	27.1	20.9
Excluding social insurance funds	5.6	4.1	-2.9	-6.2	5.5	11.5	6.4	-1.9
Civilian labor force (millions)	86.5	88.7	91.0	92.6	94.8	97.4	100.4	102.8
Unemployment rate (per cent)	5.6	4.9	5.6	8.5	7.7	7.0	6.0	5.9
Nonfarm payroll employment (millions)	73.7	76.9	78.4	77.1	79.4	82.1	85.5	87.7
Manufacturing	19.1	20.1	20.0	18.3	19.0	19.6	20.3	20.8
Industrial production (1967=100)	119.7	129.8	129.3	117.8	129.8	137.1	144.1	152.7
Capacity utilization: all manufacturing (per cent)	83.1	87.5	84.2	73.6	80.2	82.4	83.7	85.5
Materials (per cent)	88.0	92.4	87.7	73.6	80.4	81.9	83.9	86.6
Housing starts, private (million units, A.R.)	2.36	2.05	1.34	1.16	1.54	1.99	1.88	1.71
New auto sales, (millions, A.R.)	10.93	11.42	8.91	8.66	10.12	11.13	11.22	10.72
Domestic models	9.32	9.65	7.49	7.08	8.63	9.07	9.24	8.89
Foreign models	1.61	1.77	1.42	1.58	1.50	2.06	1.98	1.84

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

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

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CLASS II FOMCPER CENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1972	1973	1974	1975	1976	1977	Projected	
							1978	1979
<u>Constant (1972) dollars</u>								
Gross national product	5.7	5.5	-1.4	-1.3	5.7	4.9	3.6	3.8
Final purchases	5.5	4.9	-.7	.2	4.3	4.7	3.3	3.7
Private	6.7	6.3	-1.4	-.3	5.5	5.3	3.6	3.8
Excluding net exports	7.0	5.1	-2.3	-1.0	6.4	6.0	3.8	3.4
Personal consumption expenditures	5.9	4.7	-.9	1.8	5.8	4.7	3.5	3.7
Goods	6.5	5.0	-3.4	.7	6.4	5.0	2.6	3.9
Services	5.3	4.4	2.3	3.2	5.0	4.4	4.5	3.5
Gross private domestic investment	12.9	10.0	-11.4	-22.3	21.6	13.2	7.7	2.6
Residential structures	18.8	-3.7	-24.6	-13.9	23.4	20.5	2.7	-6.3
Business fixed investment	8.1	12.2	-.3	-13.0	4.7	9.1	6.6	5.1
Gov't. purchases of goods and services	1.5	-.2	2.1	1.9	.1	2.4	2.2	3.4
Federal	-1.7	-5.4	-.8	.7	.1	5.2	-1.7	4.0
State and local	3.8	3.2	3.8	2.6	.1	.8	4.5	3.1
Disposable personal income	4.2	6.7	-1.5	2.1	3.5	4.1	4.0	3.9
<u>Current dollars</u>								
Gross national product	10.1	11.6	8.1	8.2	11.2	11.0	11.1	11.5
Final purchases	9.9	10.9	8.9	9.7	9.8	10.8	10.9	11.4
Private	10.3	12.2	8.1	9.1	10.8	11.1	11.3	11.6
Excluding net exports	11.0	11.0	8.2	7.8	12.0	12.5	11.5	11.0
Personal consumption expenditures	9.7	10.5	9.8	10.1	11.4	10.7	10.8	11.4
Goods	9.5	11.4	8.9	8.7	10.7	9.7	9.6	11.3
Services	9.9	9.3	11.1	11.8	12.2	11.8	12.2	11.5
Gross private domestic investment	17.7	16.8	-2.5	-11.0	27.3	22.6	15.4	10.5
Residential structures	25.0	6.6	-16.7	-6.5	32.5	34.8	13.5	2.4
Business fixed investment	12.2	16.4	10.8	-.3	9.6	15.7	14.8	12.9
Gov't. purchases of goods and services	8.3	6.5	12.3	11.8	6.2	9.6	9.7	10.6
Federal	6.1	.1	8.7	10.7	5.5	11.7	5.3	11.0
State and local	9.8	10.8	14.5	12.5	6.6	8.4	12.3	10.5
Disposable personal income	7.9	12.5	9.2	10.4	9.0	10.0	11.4	11.5
Personal income	9.7	11.7	9.7	8.7	10.0	10.7	11.6	11.2
Wage and salary disbursements	9.4	10.6	9.0	5.4	10.4	10.5	11.6	10.8
Corporate profits with IVA & C.C. Adj.	19.3	7.6	-15.6	14.7	32.4	13.5	6.7	11.7
Corporate profits before tax	17.3	20.4	9.6	-5.1	29.5	11.5	11.1	9.5
Nonfarm payroll employment	3.5	4.3	2.0	-1.7	3.1	3.4	4.1	2.6
Manufacturing	2.8	5.1	-.1	-8.5	3.3	3.2	3.8	2.8
Nonfarm business sector								
Output per hour	3.0	1.7	-2.9	1.9	3.6	1.5	.3	1.9
Compensation per hour	5.8	7.8	9.4	9.9	8.5	8.3	9.1	9.5
Unit labor costs	2.7	6.0	12.7	7.9	4.7	6.7	8.7	7.5
GNP implicit deflator	4.1	5.9	9.7	9.6	5.2	5.9	7.2	7.5
Gross business product fixed-weighted price index ^{1/}	3.3	5.7	10.4	9.4	5.4	6.2	7.4	7.6
Industrial production	9.2	8.4	-.4	-8.9	10.2	5.6	5.1	5.9

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

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

August 9, 1978

	Fiscal Year 1977*	FY 1978 ^{e/}		FY 1979 ^{e/}			CY 1977*	CY 1978 ^{e/} F.R. Board	Calendar quarters; unadjusted data								
		Admin. 1/	F.R. Board	Admin. 1/	F.R. Board	Cong. 2/			F.R. staff estimates								
									1978			1979					
								I*	II*	III	IV	I	II	III			
Unified budget receipts ^{3/}	357.8	401.2	401.2	448.2	447.7	447.9	366.1	413.9	85.4	125.3	106.0	97.3	98.0	136.3	116.0		
Unified budget outlays ^{3/}	402.8	452.3	450.2	496.6	494.7	498.8	417.0	458.9	111.2	111.3	111.4	122.0	120.5	123.7	128.5		
Surplus(+)/Deficit(-), unified budget	-45.0	-51.1	-49.0	-48.5	-47.0	-50.9	-50.9	-45.0	-25.8	14.0	-8.4	-24.7	-22.5	12.6	-12.5		
Surplus(+)/Deficit(-), off-budget agencies ^{4/}	-8.7	-11.0	-10.4	-12.9	-12.7	n.a.	-10.4	-10.1	-3.6	-2.3	-3.2	-1.0	-3.9	-3.2	-4.6		
Means of financing combined deficits:																	
Net borrowing from public	53.5	54.9	55.5	62.0	56.3	n.a.	56.8	54.8	20.8	2.5	11.5	20.0	24.8	-8.2	19.8		
Decrease in cash operating balance	-1.7	4.0	1.7	0	5.4	n.a.	-0.6	0.3	5.9	-11.1	0.1	5.4	0	0	0		
Other ^{5/}	1.9	3.2	2.1	-0.6	-2.0	n.a.	5.3	-0.2	2.8	-3.2	-0.1	0.3	1.6	-1.2	-2.7		
Cash operating balance, end of period	19.1	15.1	17.4	15.1	12.0	n.a.	12.3	12.0	6.4	17.5	17.4	12.0	12.0	12.0	12.0		
Memo: Sponsored agency borrowing ^{6/}	5.2	n.a.	18.7	n.a.	12.4	n.a.	6.8	20.1	4.5	6.5	5.7	3.4	1.0	3.5	4.5		
NIA Budget ^{8/}																	
Receipts	362.0 ^{7/}	411.4	406.2 ^{7/}	457.7	460.1 ^{7/}	n.a.	374.5	423.2	Seasonally adjusted annual rates								
Expenditures	411.9	454.7	452.4	499.7	496.8	n.a.	422.6	461.6	396.2	417.5	432.9	446.3	453.6	467.3	480.8		
Purchases (total)	140.7	153.5	150.9	169.0	165.3	n.a.	145.1	152.7	448.8	450.2	466.6	480.7	490.3	500.3	515.7		
Defense	92.3	98.5	98.5	105.5	105.3	n.a.	94.3	100.0	151.5	147.4	152.4	159.6	163.3	166.6	171.5		
Nondefense	48.4	55.0	52.4	63.5	59.9	n.a.	50.8	52.8	97.9	98.9	100.0	103.0	104.0	106.1	108.2		
All other expenditures	271.2 ^{7/}	301.2	301.5 ^{7/}	330.7	331.5 ^{7/}	n.a.	277.5	308.9	53.6	48.5	52.4	56.6	59.3	60.5	63.3		
Surplus(+)/Deficit(-)	-49.9 ^{7/}	-43.3	-46.2 ^{7/}	-42.0	-36.7 ^{7/}	n.a.	-48.1	-38.4	297.3	302.8	314.2	321.1	327.0	333.7	344.2		
High Employment Surplus(+)/Deficit(-) (NIA basis) ^{9/}	-3.0	n.a.	0.7	n.a.	14.0	n.a.	-4.6	8.1	-52.6	-32.7	-33.7	-34.4	-36.7	-33.0	-34.9		
	*actual	e--estimated	r--revised	n.a.--not available	p--preliminary												

1/ OMB Mid-Session Review of the 1979 Budget, (July 6, 1978).

2/ Congress' First Concurrent Resolution on the Budget, (May 17, 1978).

3/ Adjusted for accounting change in earned income credit payments--formerly treated as income tax refunds and now classified as outlays.

4/ Includes Federal Financing Bank, Postal Service, U.S. Railway Association, Rural Electrification and Telephone Revolving fund, Housing for the Elderly and Handicapped Fund (until October 1977), and Pension Benefit Guaranty Corporation.

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

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

7/ Quarterly average exceeds fiscal year total by \$1.7 billion for FY 1977, by \$1.8 billion for FY 1978, and by \$1.9 billion for FY 1979, due to spreading of wage base effect over calendar year.

8/ All NIA data incorporate the Department of Commerce's July 1978 GNP revisions.

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

Comments on the Fiscal Policy Outlook

This month's FY 1978 forecast of unified Federal receipts and outlays are slightly higher than last month's. Individual income tax collections ran higher than expected in June, and the staff now projects receipts for the fiscal year at \$401 billion, about \$1 billion higher than last month's forecast. June data also indicate that outlays were somewhat larger than expected, and consequently, the staff forecast for fiscal year 1978 outlays has been revised upward by about \$1/2 billion.

This month's outlay projection for FY 1979 remains unchanged at \$495 billion. Our estimate is some \$3 billion larger than the reduced budget goal recently recommended by OMB Director McIntyre; this difference largely reflects higher interest payments assumed by the staff.

On an NIA basis, Federal expenditures are projected at \$452 billion for fiscal year 1978 and \$497 billion for fiscal year 1979, revised downward from last month's totals of \$455 billion and \$498 billion, respectively, as a result of the July NIA revisions. Most of the downward revision occurs in defense and nondefense purchases.

On the tax side, the staff continues to assume a \$19 billion tax cut for calendar year 1979. However, this number bears close watching in light of the recently passed \$16 billion House Ways and Means Committee package.

The full employment budget now shows a \$13 billion shift toward surplus between fiscal year 1978 and 1979, about in line with the staff's projected \$10 billion reduction in the Federal deficit (NIA basis) over this period when unemployment is expected to show little change.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. Despite a further slight rise in the Federal funds rate, other interest rates generally have declined about 20 to 35 basis points since the July FOMC meeting. A shift in market interest rate expectations--in response to the recent deceleration of growth in the aggregates and to signs of a slowing in economic expansion--appears to have sparked the rally. Technical market conditions were also conducive to such a development, as many security dealers had short positions and oncoming supplies of new corporate bonds were relatively light. Treasury bill rates, moreover, were subject to special downward pressure from foreign central bank investment of dollars gained in currency exchange support operations. With interest rates declining and corporate profits up in the second quarter, major stock market indexes have increased 6 to 8 per cent since the last FOMC meeting in record trading activity.

M-1 expansion slowed to a 4-3/4 per cent annual rate in July, down somewhat from June and well below the second quarter's 9-1/2 per cent annual rate of advance. M-2 increased at about an 8 per cent annual rate in July, in line with its rate of growth in June and over the second quarter. Growth of the interest-bearing component of M-2 picked up in July, reflecting a sharp further rise in the large deposits included in this measure. Deposit expansion at S&Ls and mutual savings banks strengthened in July, as these institutions, given their interest rate advantage, continued aggressively to market the new money market certificates.

Commercial bank credit expanded at a 16-3/4 per cent annual rate in July, following the slowdown of growth in June. Business loans expanded by more than in June, but by far less than the rapid pace of the first five months of the year. Expansion in other loans was quite strong, however, and total investments rose substantially, as banks made considerable purchases of Treasury securities. In addition to funds obtained from growth in deposits included in the key aggregates, banks also issued negotiable CDs and increased their Euro-dollar liabilities. Loan-to-deposit ratios generally continued to rise at banks; regional and smaller banks, whose ratios are generally above the high levels of 1974, are reported to be tightening lending terms.

In the household sector, mortgage debt formation is estimated to have edged up from the June pace which, in turn, was stronger than the second quarter average. S&Ls have continued to be active lenders in the mortgage market, financing their operations with further heavy borrowing at the Home Loan Banks as well as with improved deposit flows. Primary mortgage rates have changed little since mid-June, and fewer institutions have been reporting severe shortages of fund supplies. Consumer instalment credit also appears to have risen substantially further in July, judging from weekly reporting bank data.

In capital markets, the total of publicly offered bonds and equities issued by nonfinancial corporations dropped more than seasonally in July and early August. The volume of municipal bond issues coming to market was also down somewhat in July, but has surged in recent weeks.

The Treasury has raised somewhat more than \$4 billion of new money since the July FOMC meeting, with about \$2.6 billion of the total obtained in its quarterly refunding operation. Sponsored Federal agencies have continued their heavy borrowing, issuing a bit more than \$2 billion of additional debt in July, in line with their average monthly borrowing over the second quarter.

Outlook. The staff still expects interest rates to rise over the remainder of the year, as aggregate credit demands remain generally strong and liquidity positions of major financial institutions continue to tighten. Apart from the possibility of some technical reaction over the next few weeks to the recent sharp drop in yields, upward rate pressures may be most marked in the fall when Treasury credit demands strengthen, and System action to restrain growth in the monetary aggregates may be required.

Business spending on inventories and plant and equipment is expected to continue growing at about the same pace as internally generated funds in coming months. Thus, the strength of nonfinancial business demands on financial markets will likely about match that displayed in

the first half of the year. Over the near term, firms may continue to focus their financing on short- and intermediate-term sources. The improved state of bond and equity markets, however, may encourage some shifting to these areas.

With growth in spending on durable goods expected to slacken through the remainder of the year, consumer instalment credit will likely expand at a more moderate rate than in recent months. Mortgage indebtedness is also expected to increase somewhat more slowly than in recent months. Flows of deposits into nonbank thrift institutions will probably moderate, following the initial strong public response to the new money market-type deposit instruments. At the same time, the thrifts, with their indebtedness at Home Loan Banks already quite high, may cut back on such borrowing.

The Treasury is expected to raise new money in late August in its auction of 2- and 4-year notes, and will likely issue a substantial volume of cash management bills in early September. It will then remain out of the market until late September, but borrowing over the fourth quarter will be heavy. Demands of sponsored Federal agencies will also continue quite strong, as funds are raised to support the mortgage market.

Gross borrowing by State and local governments likely will remain quite strong over the remainder of August, reflecting the surge of refunding activity prior to the early September change in Treasury regulations pertaining to such operations. Municipal bond issuance over the remainder of 1978 likely will taper off somewhat from the very strong average monthly volume recorded so far this year.

INTERNATIONAL DEVELOPMENTS

Summary. The dominant feature of foreign exchange markets in the past four weeks was the sharp appreciation of the Japanese yen. Against the dollar the yen advanced 8 per cent, while on a weighted average basis it rose by about 6-1/2 per cent.

. European currencies, especially the Swiss franc, also advanced against the dollar, influenced by continuing high rates of U.S. inflation and market expectations that U.S. interest rates might not rise further. On a weighted average basis the dollar declined 3-3/4 per cent over the four-week period, bringing the cumulative decline since May to 7 per cent, and to about double that amount since last September.

In the past two weeks exchange rate movements have become more volatile. This atmosphere of heightened uncertainty also affected the gold market, where the price exceeded \$200 per ounce for the first time, rising by 10 per cent in the four-week period.

. The United States continued to acquire marks for repaying swap drawings; net sales of dollars were over \$600 million.

The U.S. trade deficit was reduced in May-June, with exports up for both agricultural and other products while imports rose more slowly. For the second quarter the trade deficit was at an annual rate of \$32 billion (international accounts basis), a considerable change from the rates of \$40-45 billion registered in the previous half year. However, though the U.S. deficit was reduced, high and rising trade surpluses for Japan and Germany were continuing.

Information on capital transactions in the U.S. international accounts for recent months may be subject to considerable revision, partly because of a change in the reporting system. It appears that net private capital movements through banks registered a sizable inflow in the second quarter, and net foreign private and official purchases of U.S. corporate stocks rose to \$1.3 billion in the quarter.

Foreign official assets in the United States dropped by about \$6 billion in the second quarter, including a decline of \$2 billion in OPEC holdings.

Economic activity abroad appears to have slowed in the second quarter. The growth rates of domestic demand in Germany and Japan were, if anything, a little weaker than earlier in the year. The most recent available data for industrial production show weakness in most major

foreign countries. Meanwhile, rates of consumer price increase have edged up in all of the large foreign industrial countries except Germany.

Outlook. Given the stronger than expected performance of exports in May-June, the projection of the trade deficit has been somewhat scaled down for the period ahead. For 1978 the deficit is now estimated at about \$35 billion, declining to a \$31 billion rate next year. The corresponding current account deficits (including net reinvested earnings) are \$19 billion and \$14 billion.

One of the underlying assumptions in these projections is that the depreciation of the dollar has now run its course; the staff does not expect the dollar's weighted average exchange rate to change much over the year ahead. Moreover, it is still expected that growth rates abroad will be somewhat faster than in the United States for the projection period. Such an outcome would be consistent with the undertakings to take stimulatory actions announced at the Bonn summit on July 17.

	1977 ^F	1978 ^P	1979 ^P	1978				1979 ^P			
				I	II ^P	III ^P	IV ^P	I	II	III	IV
1. <u>GNP NET EXPORTS</u> - Intl Acct. data	-11.1	-12.6	-3.7	-24.1	-10.1	-9.1	-6.9	-7.1	-5.5	-2.3	-.1
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(-10.9)	(-15.4)	(-7.6)	(-24.1)	(-13.9*)	(-12.9)	(-10.7)	(-10.9)	(-9.3)	(-6.1)	(-3.9)
3. a) Merchandise Trade Balance	-31.1	-35.1	-30.9	-44.8	-31.9*	-32.7	-31.3	-33.1	-32.4	-29.9	-28.3
4. Exports (excl. military)	120.6	138.3	165.6	122.7	140.1*	141.3	149.0	154.9	162.2	169.9	176.0
5. Agricultural	24.4	29.1	30.3	26.1	32.0*	28.5	29.8	29.5	30.0	30.5	31.0
6. Nonagricultural	96.2	109.2	135.3	96.6	108.0*	112.8	119.2	125.4	132.2	138.5	145.0
7. Imports	151.6	173.4	196.5	167.5	171.9*	174.0	180.3	188.0	194.6	198.9	204.3
8. Petroleum and petrol. products	45.0	43.2	48.9	39.8	43.2*	43.2	46.6	47.9	49.3	48.8	49.5
9. Nonpetroleum	106.7	130.2	147.6	127.7	128.7*	130.8	133.7	140.1	145.3	150.1	154.8
10. b) Military transactions, net <u>2/</u>	.9	1.5	3.1	.8	1.4	1.8	2.1	2.5	2.9	3.3	3.7
11. c) Investment income, net <u>3/</u>	17.3	19.3	21.7	18.2	18.4	20.0	20.4	21.4	21.6	21.8	21.9
12. d) Other services, net <u>4/</u>	1.7	1.8	2.4	1.7	1.9	1.9	1.9	2.1	2.4	2.5	2.6
13. <u>U.S. CURRENT ACCOUNT BALANCE</u>	-15.2	-19.4	-14.3	-27.8	-17.1	-16.9	-16.1	-17.5	-16.1	-12.9	-10.6
14. a) GNP net exports (line 1.)	-11.1	-12.6	-3.7	-24.1	-10.1	-9.1	-6.9	-7.1	-5.5	-2.3	-.1
15. b) U.S. Govt & private transfers <u>5/</u>	-4.1	-6.8	-10.6	-3.7	-7.0	-7.8	-9.2	-10.4	-10.6	-10.6	-10.5
<u>Constant (1972) dollars</u>											
16. Merchandise exports (excl. military)	67.0	71.1	78.1	65.7	72.8*	71.8	74.3	75.5	77.4	78.9	80.6
17. (% change, annual rates)	(0.3)	(6.3)	(9.8)	(4.5)	(50.7*)	(-6.1)	(14.3)	(7.0)	(10.4)	(8.2)	(8.2)
18. Merchandise imports	71.0	74.9	78.7	74.5	75.3	74.3	75.5	77.1	78.4	79.1	80.2
19. (% change, annual rates)	(13.0)	(5.5)	(5.1)	(7.0)	(4.9)	(-5.3)	(7.8)	(8.2)	(6.6)	(3.2)	(6.1)
<u>Foreign Outlook - Major Industrial Countries <u>6/</u></u>											
20. Real GNP, % change, annual rates	2.9	3.6	4.2	5.7	3.6	3.8	4.0	4.6	4.3	4.2	4.5
21. Wholesale Prices, % change, A.R. <u>7/</u>	8.7	5.0	6.3	5.4	6.3	6.1	6.2	6.0	6.0	7.0	7.3

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

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

3/ Excludes U.S. Govt. interest payments to foreigners, and reinvested earnings of incorporated affiliates which are included in line 15.

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

5/ Includes U.S. Govt. grants, U.S. Govt. interest payments to foreigners, remittances and pensions, and exports to Israel financed by U.S. military assistance grants, and reinvested earnings of incorporated affiliates.

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

7/ Data are largely manufactured goods prices.

P/ Projected.

E/ Estimated.

F/ Published data.

NOTE: The current account now includes reinvested earnings of incorporated affiliates.