

## **Prefatory Note**

The attached document represents the most complete and accurate version available based on original copies culled from the files of the FOMC Secretariat at the Board of Governors of the Federal Reserve System. This electronic document was created through a comprehensive digitization process which included identifying the best-preserved paper copies, scanning those copies,<sup>1</sup> and then making the scanned versions text-searchable.<sup>2</sup> Though a stringent quality assurance process was employed, some imperfections may remain.

Please note that this document may contain occasional gaps in the text. These gaps are the result of a redaction process that removed information obtained on a confidential basis. All redacted passages are exempt from disclosure under applicable provisions of the Freedom of Information Act.

---

<sup>1</sup> In some cases, original copies needed to be photocopied before being scanned into electronic format. All scanned images were deskewed (to remove the effects of printer- and scanner-introduced tilting) and lightly cleaned (to remove dark spots caused by staple holes, hole punches, and other blemishes caused after initial printing).

<sup>2</sup> A two-step process was used. An advanced optimal character recognition computer program (OCR) first created electronic text from the document image. Where the OCR results were inconclusive, staff checked and corrected the text as necessary. Please note that the numbers and text in charts and tables were not reliably recognized by the OCR process and were not checked or corrected by staff.

CONFIDENTIAL (FR)

September 13, 1978

SUMMARY AND OUTLOOK

By the Staff  
Board of Governors  
of the Federal Reserve System

DOMESTIC NONFINANCIAL DEVELOPMENTS

---

Summary. Incoming information suggests moderate economic growth in the current quarter. Employment increases have been at a reduced rate in recent months and total retail sales have changed little since April. Indicators of current and prospective business fixed investment point to slower growth in the near term. On the other hand, housing starts continued at a brisk pace in July. Additionally, there has been some easing of inflation, mainly because of declines in farm products and food prices.

Total employment, as measured by the household survey, showed a moderate gain in August, and the unemployment rate moved back down to 5.9 per cent, the same as the second quarter average. Nonfarm payroll employment advanced 115,000 in August--a gain well below those registered earlier this year. Employment growth remained strong in the trade and service sectors, but jobs declined in construction and at nondurable manufacturing establishments. Based on employment reports and other data, industrial production is tentatively estimated to have risen about 1/2 per cent in August.

Consumer spending has been on a plateau in recent months, following rapid gains earlier in the year. Excluding autos and nonconsumption items, spending edged up 0.3 per cent in August. On average, sales of durable goods have continued at relatively high levels in recent months, apparently supported in part by buying ahead of anticipated price increases. In particular, auto sales rose in August to an

annual rate of 11.9 million units, close to the advanced second quarter pace. Sales of nondurables continued to be weak, as is consistent with high levels of spending on durables in a period of rapid inflation.

Activity in housing markets continued strong in July. Total private housing starts remained near a 2.1 million unit annual rate. Starts of single-family units have drifted lower over recent months, while multifamily starts have persisted at levels well above their 1977 pace. Total home sales increased in July, and since then mortgage market conditions have eased somewhat.

More moderate growth of investment outlays appears to be in prospect for the remainder of 1978. The Commerce Department survey of business plant and equipment spending plans, which was taken in July and August, indicates a 12.3 per cent rise in spending in 1978, an increase of 1 percentage point from the spring survey. But the pace of spending growth still is indicated to be slower over the second half of the year than over the first half. Supporting this was a sharp decline in manufacturers' new capital appropriations in the second quarter. New orders for nondefense capital goods declined in July to their lowest level since January, reflecting a sharp drop in the volatile transportation equipment group. Machinery orders, which are a better indicator of additions to industrial capacity, have been little changed since early this year. By contrast, construction contracts for nonresidential buildings bounced back in July and, so far this year, have shown strong gains in commercial and manufacturing areas. Thus,

growth of spending on structures appears likely to be at a faster rate than for equipment.

Increases in book value inventories moderated in July, with manufacturers' inventories rising about one-fourth less than during the second quarter and wholesalers' inventories showing an outright decline. With shipments down, the ratio of book value inventories to sales at manufacturers edged up, but was still low by historical standards.

Sharp declines in prices of some agricultural products in July and August have helped moderate the over-all rise in prices. Prices for consumer finished foods at the producer level, which edged down in July, dropped sharply further in August. Crude food prices posted a sizable decline for the second consecutive month. These declines are likely to have a damping effect in coming months on retail food prices, which were unchanged in July after rising at an 18-1/2 per cent rate in the first half. Exclusive of foods and energy, retail prices continued to rise at a rapid rate in July, although less than in May and June.

Outlook. Growth of real GNP is now estimated at around 3 per cent, annual rate, in the current quarter, somewhat lower than indicated last month. Thus far in the current quarter, construction activity has been stronger than expected earlier but consumer spending has been significantly weaker. The fixed-weighted price index for gross business product now appears likely to rise at a 6-1/4 per cent rate in the current quarter, in part reflecting less upward pressure in the foods group.

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 are projected to total just below \$450 billion in FY 1978 and around \$494 billion in FY 1979; the accompanying budget deficits are projected at about \$48 billion and \$45 billion, respectively. With respect to monetary policy, short-term interest rates are assumed to rise further this fall and early winter, 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 longer-run 4 to 6-1/2 per cent range.

The outlook for real GNP growth through the end of 1979 is essentially unchanged from last month's reading; growth is projected at nearly a 3-1/2 per cent annual rate over the next five quarters and the salient features of the outlook remain the same. Real business fixed investment growth is projected to average about 4-1/2 per cent, annual rate, over this period, still supportive of over-all activity. The housing sector is still expected to be a significant drag on activity, although the projected decline in starts arising from tighter mortgage markets is expected to be relatively mild compared with that of prior housing cycles. The assumed tax cut should provide some impetus to output growth in early 1979, but real GNP gains are still expected to recede to about 3 per cent in the latter half of next year.

Given the moderate rate of expansion of aggregate activity, growth in employment over the projection period is projected to slow to an annual rate of around 2-1/2 per cent from the unusually high 4.4 per cent increase over the past year. The unemployment rate is projected to remain near 5.9 per cent over the year ahead, and to edge up slightly toward the end of 1979.

Despite the recent slowing of food prices, inflation is generally expected to continue at a rapid pace; the fixed-weighted price index for gross business product is projected to average nearly 7-1/4 per cent at an annual rate from the current quarter until the fourth quarter of 1979. Cost pressures on prices appear likely to remain strong. Hourly compensation increases of more than 9 per cent, annual rate, are expected over the projection period and, with productivity increases likely to be moderate, unit labor costs are projected to rise at close to a 7-1/2 per cent rate on average through the end of 1979.

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

## STAFF GNP PROJECTIONS

	Per cent changes, annual rate							
	Nominal GNP		Real GNP		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	8/9/78	9/13/78	8/9/78	9/13/78	8/9/78	9/13/78	8/9/78	9/13/78
1975 <sup>1/</sup>	8.2	8.2	-1.3	-1.3	9.4	9.4	8.5	8.5
1976 <sup>1/</sup>	11.2	11.2	5.7	5.7	5.4	5.4	7.7	7.7
1977 <sup>1/</sup>	11.0	11.0	4.9	4.9	6.2	6.2	7.0	7.0
1978	11.1	11.2	3.6	3.7	7.4	7.4	6.0	6.0
1979	11.5	11.4	3.8	3.8	7.6	7.5	5.9	5.9
1978-I <sup>1/</sup>	7.1	7.1	-1	-1	6.7	6.7	6.2	6.2
1978-II <sup>1/</sup>	18.2	19.6	7.4	8.0	11.2	12.0	5.9	5.9
1978-III	11.0	10.1	3.3	2.9	7.5	6.3	6.0	6.0
1978-IV	11.0	10.8	3.4	3.3	6.8	6.7	5.9	5.9
1979-I	12.1	12.2	4.2	4.2	7.9	7.9	5.8	5.8
1979-II	11.0	10.5	3.7	3.5	7.5	7.7	5.8	5.8
1979-III	10.3	10.1	3.2	3.2	6.8	6.9	5.9	5.9
1979-IV	10.2	10.2	2.7	2.7	6.9	7.0	6.0	6.0
Change:								
77-II to 78-II <sup>1/</sup>	11.2	11.6	4.0	4.1	7.3	7.5	-1.2	-1.2
77-IV to 78-IV	11.7	11.8	3.5	3.5	8.1	8.0	-.7	-.7
78-II to 79-II	11.3	10.9	3.6	3.5	7.4	7.1	-.1	-.1
78-IV to 79-IV	10.9	10.7	3.5	3.4	7.2	7.4	.1	.1
Memo:								
Growth Over Annual Policy Period:								
78-II to 79-II	11.3	10.9	3.6	3.5	7.4	7.1	-.1	-.1

<sup>1/</sup> Actual.

CONFIDENTIAL - FR  
CLASS II FOMC

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	2083.2	2133.7	2189.1	2253.2	2310.3	2366.4	2424.4
Final purchases	1975.3	2064.3	2113.3	2167.5	2230.6	2286.7	2342.3	2399.8
Private	1558.6	1639.8	1674.2	1713.6	1768.0	1814.2	1857.9	1902.5
Excluding net exports	1582.7	1650.0	1684.8	1723.8	1775.1	1821.9	1863.8	1905.9
Personal consumption expenditures	1276.7	1324.9	1351.4	1383.6	1427.5	1466.9	1501.7	1536.2
Goods	684.9	717.8	726.8	742.9	767.6	788.2	804.8	821.3
Services	591.8	607.1	624.6	640.7	659.9	678.7	696.9	714.9
Gross private domestic investment	322.7	344.0	353.8	361.8	370.2	378.6	386.2	394.3
Residential construction	100.3	105.3	107.3	107.8	108.3	108.3	108.3	108.8
Business fixed investment	205.6	219.8	226.1	232.4	239.3	246.7	253.8	260.9
Change in business inventories	16.7	18.9	20.4	21.6	22.6	23.6	24.1	24.6
Nonfarm	16.9	20.9	20.4	21.6	22.6	23.6	24.1	24.6
Net exports of goods and services <sup>1/</sup>	-24.1	-10.2	-10.6	-10.2	-7.1	-7.7	-5.9	-3.4
Exports	181.7	200.9	206.2	214.6	224.6	233.3	241.3	249.8
Imports	205.8	211.1	216.8	224.8	231.7	241.0	247.2	253.2
Gov't. purchases of goods and services	416.7	424.5	439.1	453.9	462.6	472.5	484.4	497.3
Federal <sup>2/</sup>	151.5	147.2	153.8	161.7	163.5	166.4	171.2	177.1
State and local	265.2	277.3	285.3	292.2	299.1	306.1	313.2	320.2
Gross national product in constant (1972) dollars	1354.2	1380.5	1390.2	1401.6	1416.3	1428.4	1439.8	1449.4
Personal income	1628.9	1682.2	1730.5	1774.5	1819.6	1866.8	1917.8	1964.9
Wage and salary disbursements	1050.8	1089.9	1113.0	1139.8	1173.5	1201.9	1230.3	1261.6
Disposable personal income	1391.6	1433.3	1469.6	1504.6	1556.1	1594.6	1636.7	1674.4
Saving rate (per cent)	5.9	5.2	5.7	5.7	5.9	5.6	5.9	5.9
Corporate profits with I.V.A. and C.C. Adj.	132.6	159.5	166.7	171.9	170.3	174.8	178.6	184.1
Corporate profits before tax	172.1	201.6	201.2	208.7	207.4	212.2	216.3	222.1
Federal government surplus or deficit (-) (N.I.A. basis)	-52.6	-25.2	-31.8	-34.7	-38.2	-35.7	-39.2	-40.5
High employment surplus or deficit (-)	-2.9	14.1	10.8	10.4	9.8	14.8	14.1	15.0
State and local government surplus or deficit (-) (N.I.A. basis)	31.5	29.8	22.5	23.4	23.3	22.2	21.2	22.4
Excluding social insurance funds	11.5	9.3	1.4	1.7	1.0	-7	-2.3	-1.7
Civilian labor force (millions)	99.2	100.2	100.7	101.2	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	20.6	20.8	20.9	20.9
Industrial production (1967=100)	139.6	143.9	146.4	148.4	150.9	152.9	154.5	155.9
Capacity utilization: all mfg. (per cent)	82.1	83.8	84.5	84.8	85.5	85.8	85.9	85.9
Materials (per cent)	81.7	84.5	85.3	85.8	86.7	87.2	87.5	87.7
Housing starts, private (million units, A.R.)	1.72	2.11	2.00	1.90	1.85	1.80	1.75	1.75
New autos sales, (millions, A.R.)	10.80	12.12	11.25	10.90	10.95	10.75	10.65	10.55
Domestic models	8.80	10.01	9.25	9.00	9.00	8.90	8.85	8.80
Foreign models	2.00	2.11	2.00	1.90	1.95	1.85	1.80	1.75

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

<sup>2/</sup> Components of purchases and total receipts and total expenditures are shown in the Federal Sector Accounts table which follows.

September 13, 1978

CONFIDENTIAL - FR  
CLASS II FOMCPER 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	8.0	2.9	3.3	4.2	3.5	3.2	2.7
Final purchases	-1.6	8.2	2.6	3.1	4.1	3.3	3.2	2.6
Private	-1.1	10.4	1.4	2.7	4.8	3.5	3.0	2.8
Excluding net exports	-1.0	8.1	1.3	2.6	4.4	3.4	2.7	2.4
Personal consumption expenditures	-1.4	6.5	1.2	3.0	5.0	3.9	3.1	2.7
Goods	-8.1	10.0	-1.0	3.1	5.7	3.8	2.7	2.1
Services	7.0	2.5	3.8	2.8	4.2	4.0	3.7	3.3
Gross private domestic investment	11.3	13.9	3.6	2.0	2.7	2.4	1.3	1.6
Residential structures	-5.2	3.8	-2.0	-7.4	-6.1	-7.8	-7.8	-6.1
Business fixed investment	4.2	21.1	3.3	4.1	5.0	5.0	4.2	4.0
Gov't. purchases of goods and services	-3.5	-3	7.4	4.9	1.3	2.6	4.0	2.0
Federal	-8.9	-15.2	13.4	8.8	-8	2.9	6.6	1.5
State and local	-1	9.4	4.1	2.7	2.5	2.5	2.5	2.3
Disposable personal income	1.1	3.3	3.3	3.0	6.0	2.7	4.2	2.7
<u>Current dollars</u>								
Gross national product	7.1	19.6	10.1	10.8	12.2	10.5	10.1	10.2
Final purchases	6.4	19.3	9.8	10.7	12.2	10.4	10.1	10.2
Private	7.0	22.5	8.7	9.8	13.3	10.9	10.0	10.0
Excluding net exports	7.1	18.1	8.7	9.6	12.5	11.0	9.5	9.4
Personal consumption expenditures	7.0	16.0	8.2	9.9	13.3	11.5	9.8	9.5
Goods	.5	20.6	5.1	9.2	14.0	11.2	8.7	8.5
Services	15.3	10.8	12.0	10.7	12.5	11.9	11.2	10.7
Gross private domestic investment	12.2	29.2	11.9	9.4	9.7	9.3	8.2	8.8
Residential structures	.5	21.2	7.8	1.9	1.9	.0	.0	1.9
Business fixed investment	11.1	30.6	12.0	11.6	12.5	12.8	12.0	11.8
Gov't. purchases of goods and services	4.1	7.7	14.5	14.2	7.9	8.8	10.5	11.1
Federal	-2.0	-10.9	19.2	22.2	4.5	7.3	12.0	14.5
State and local	7.8	19.5	12.0	10.0	9.8	9.7	9.6	9.2
Disposable personal income	9.8	12.5	10.5	9.9	14.4	10.3	11.0	9.6
Personal income	9.3	13.7	12.0	10.6	10.5	10.8	11.4	10.2
Wage and salary disbursements	12.1	15.7	8.8	10.0	12.4	10.0	9.8	10.6
Corporate profits with IVA & C.C. Adj.	-35.9	109.3	19.3	13.1	-3.7	11.0	9.0	12.9
Corporate profits before tax	-13.2	88.3	-8	15.9	-2.4	9.4	8.1	11.0
Nonfarm payroll employment	4.5	6.8	2.8	1.5	2.6	2.3	2.3	2.3
Manufacturing	6.6	3.7	.7	2.3	4.3	3.1	1.6	1.3
Nonfarm business sector								
Output per hour	-3.3	1.2	1.1	2.5	2.2	1.8	1.7	1.5
Compensation per hour	12.0	8.1	7.7	8.4	12.5	8.8	8.9	8.9
Unit labor costs	15.8	6.9	6.5	5.7	10.1	6.8	7.1	7.3
GNP implicit deflator <u>1/</u>	7.2	10.7	7.0	7.2	7.7	6.8	6.6	7.3
Gross business product fixed-weighted price index <u>2/</u>	6.7	12.0	6.3	6.7	7.9	7.7	6.9	7.0
Industrial production	.9	12.9	7.1	5.5	6.9	5.4	4.3	3.7

1/ Excluding Federal pay increase rates of change are: 1978 QI, 7.2 per cent; 1978 QIV, 6.7 per cent; 1979 QI, 7.6 per cent; 1979 QIV, 6.8 per cent.

2/ Using expenditures in 1972 as weights.

September 13, 1978

CONFIDENTIAL - FR  
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	2099.5	2338.6
Final purchases	1161.7	1288.6	1404.0	1539.6	1689.9	1871.6	2080.1	2314.9
Private	908.6	1019.1	1101.3	1201.2	1330.4	1477.6	1646.5	1835.7
Excluding net exports	911.9	1012.0	1095.3	1180.8	1323.0	1488.7	1660.3	1841.7
Personal consumption expenditures	733.0	809.9	889.6	979.1	1090.2	1206.5	1334.1	1483.1
Goods	410.5	457.5	498.3	541.5	599.2	657.4	718.1	795.5
Services	322.4	352.3	391.3	437.5	491.0	549.2	616.0	687.6
Gross private domestic investment	188.3	220.0	214.6	190.9	243.0	297.8	345.6	382.3
Residential construction	62.0	66.1	55.1	51.5	68.2	91.9	105.2	108.4
Business fixed investment	116.8	136.0	150.6	150.2	164.6	190.4	221.0	250.2
Change in business inventories	9.4	17.9	8.9	-10.7	10.2	15.6	19.4	23.7
Nonfarm	8.8	14.7	10.8	-14.3	12.2	15.0	19.9	23.7
Net exports of goods and services <sup>1/</sup>	-3.3	7.1	6.0	20.4	7.4	-11.1	-13.8	-6.0
Exports	72.7	101.6	137.9	147.3	163.2	175.5	200.8	237.2
Imports	75.9	94.4	131.9	126.9	155.7	186.6	214.6	243.3
Gov't. purchases of goods and services	253.1	269.5	302.7	338.4	359.5	394.0	433.5	479.2
Federal <sup>2/</sup>	102.1	102.2	111.1	123.1	129.9	145.1	153.5	169.5
State and local	151.0	167.3	191.5	215.4	229.6	248.9	280.0	309.6
Gross national product in constant (1972) dollars	1171.1	1235.0	1217.8	1202.3	1271.0	1332.7	1381.6	1433.5
Personal income	942.5	1052.4	1154.9	1255.5	1380.9	1529.0	1704.0	1892.3
Wage and salary disbursements	633.8	701.3	764.6	805.9	890.1	983.6	1098.4	1216.8
Disposable personal income	801.3	901.7	984.6	1086.7	1184.4	1303.0	1449.7	1615.4
Saving rate (per cent)	6.2	7.8	7.3	7.7	5.7	5.1	5.6	5.8
Corporate profits with I.V.A. and C.C. Adj.	92.1	99.1	83.6	95.9	127.0	144.2	157.7	176.9
Corporate profits before tax	96.2	115.8	126.9	120.4	155.9	173.9	195.9	214.5
Federal government surplus or deficit (N.I.A. basis)	-17.3	-6.7	-10.7	-70.6	-53.8	-48.1	-36.1	38.4
High employment surplus or deficit (-)	-5.9	-7	17.1	-19.4	-9.3	-4.6	8.1	13.4
State and local government surplus or deficit (-) (N.I.A. basis)	13.7	13.0	7.6	6.2	20.7	29.6	26.8	22.3
Excluding social insurance funds	5.6	4.1	-2.9	-6.2	5.5	11.5	6.0	-9
Civilian labor force (millions)	86.5	88.7	91.0	92.6	94.8	97.4	100.3	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	87.8
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	144.6	153.5
Capacity utilization: all manufacturing (per cent)	83.1	87.5	84.2	73.6	80.2	82.4	83.8	85.7
Materials (per cent)	88.0	92.4	87.7	73.6	80.4	81.9	84.3	87.2
Housing starts, private (million units, A.R.)	2.36	2.05	1.34	1.16	1.54	1.99	1.93	1.79
New auto sales, (millions, A.R.)	10.93	11.42	8.91	8.66	10.12	11.13	11.27	10.72
Domestic models	9.32	9.65	7.49	7.08	8.63	9.07	9.27	8.89
Foreign models	1.61	1.77	1.42	1.58	1.50	2.06	2.00	1.84

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

<sup>2/</sup> Components of purchases and total receipts and total expenditures are shown in the Federal Sector Accounts table which follows.

September 13, 1978

CONFIDENTIAL - FR  
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	3.7	3.8
Final purchases	5.5	4.9	-.7	.2	4.3	4.7	3.4	3.6
Private	6.7	6.3	-1.4	-.3	5.5	5.3	3.7	3.7
Excluding net exports	7.0	5.1	-2.3	-1.0	6.4	6.0	3.9	3.3
Personal consumption expenditures	5.9	4.7	-.9	1.8	5.8	4.7	3.4	3.6
Goods	6.5	5.0	-3.4	.7	6.4	5.0	2.5	3.6
Services	5.3	4.4	2.3	3.2	5.0	4.4	4.4	3.6
Gross private domestic investment	12.9	10.0	-11.4	-22.3	21.6	13.2	8.0	3.0
Residential structures	18.8	-3.7	-24.6	-13.9	23.4	20.5	3.1	-5.8
Business fixed investment	8.1	12.2	-.3	-13.0	4.7	9.1	7.6	5.3
Gov't. purchases of goods and services	1.5	-.2	2.1	1.9	.1	2.4	2.2	3.2
Federal	-1.7	-5.4	-.8	.7	.1	5.2	-1.3	3.4
State and local	3.8	3.2	3.8	2.6	.1	.8	4.4	3.2
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	11.2	11.4
Final purchases	9.9	10.9	8.9	9.7	9.8	10.8	11.1	11.3
Private	10.3	12.2	8.1	9.1	10.8	11.1	11.4	11.5
Excluding net exports	11.0	11.0	8.2	7.8	12.0	12.5	11.5	10.9
Personal consumption expenditures	9.7	10.5	9.8	10.1	11.4	10.7	10.6	11.2
Goods	9.5	11.4	8.9	8.7	10.7	9.7	9.2	10.8
Services	9.9	9.3	11.1	11.8	12.2	11.8	12.2	11.6
Gross private domestic investment	17.7	16.8	-2.5	-11.0	27.3	22.6	16.1	10.6
Residential structures	25.0	6.6	-16.7	-6.5	32.5	34.8	14.5	3.1
Business fixed investment	12.2	16.4	10.8	-.3	9.6	15.7	16.1	13.2
Gov't. purchases of goods and services	8.3	6.5	12.3	11.8	6.2	9.6	10.0	10.5
Federal	6.1	.1	8.7	10.7	5.5	11.7	5.8	10.4
State and local	9.8	10.8	14.5	12.5	6.6	8.4	12.5	10.6
Disposable personal income	7.9	12.5	9.2	10.4	9.0	10.0	11.3	11.4
Personal income	9.7	11.7	9.7	8.7	10.0	10.7	11.4	11.0
Wage and salary disbursements	9.4	10.6	9.0	5.4	10.4	10.5	11.7	10.8
Corporate profits with IVA & C.C. Adj.	19.3	7.6	-15.6	14.7	32.4	13.5	9.4	12.2
Corporate profits before tax	17.3	20.4	9.6	-5.1	29.5	11.5	12.7	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	3.6	2.7
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	9.0	9.5
Unit labor costs	2.7	6.0	12.7	7.9	4.7	6.7	8.6	7.5
GNP implicit deflator	4.1	5.9	9.7	9.6	5.2	5.9	7.3	7.4
Gross business product fixed-weighted price index <sup>1/</sup>	3.3	5.7	10.4	9.4	5.4	6.2	7.4	7.5
Industrial production	9.2	8.4	-.4	-8.9	10.2	5.6	5.5	6.2

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

FEDERAL SECTOR ACCOUNTS  
(billions of dollars)

September 13, 1978

	Fiscal Year 1977*	FY 1978 e/		FY 1979 e/			CY 1977*	CY78e/ F.R. Board	Calendar quarters; unadjusted data								
		Admin. 1/	F.R. Board	Admin. 1/	F.R. Board	Cong. 2/			1977			1978					
									IV*	I*	II*	III	IV	I	II	III	
Unified budget receipts <sup>3/</sup>	357.8	401.2	401.3	448.2	449.1	447.2	366.1	414.1	84.5	85.4	125.3	106.1	97.4	98.6	136.9	116.2	
Unified budget outlays <sup>3/</sup>	402.8	452.3	449.5	496.6	494.3	489.5	417.0	459.2	113.3	111.2	111.3	113.7	123.0	121.5	123.5	126.3	
Surplus(+)/Deficit(-), unified budget	-45.0	-51.1	-48.2	-48.5	-45.2	-42.3	-50.9	-45.1	-28.8	-25.8	14.0	-7.6	-25.6	-22.9	13.4	-10.1	
Surplus(+)/Deficit(-), off-budget agencies <sup>4/</sup>	-8.7	-11.0	-10.1	-12.9	-12.8	n.a.	-10.4	-10.0	-1.3	-3.6	-2.3	-2.9	-1.3	-3.6	-4.5	-3.5	
Means of financing combined deficits:																	
Net borrowing from public	53.5	54.9	59.0	62.0	51.6	n.a.	56.8	56.5	20.7 <sup>9/</sup>	20.8	2.5	15.0	18.2	22.8	-7.4	18.0	
Decrease in cash operating balance	-1.7	4.0	-1.3	0	8.4	n.a.	-0.6	0.3	6.8 <sup>9/</sup>	5.9	-11.1	-2.9	8.4	0	0	0	
Other <sup>5/</sup>	1.9	3.2	0.4	-0.6	-2.0	n.a.	5.3	-1.9	2.6	2.8	-3.2	-1.8	0.3	3.7	-1.5	-4.5	
Cash operating balance, end of period	19.1	15.1	20.4	15.1	12.0	n.a.	12.3	12.0	12.3	6.4	17.5	20.4	12.0	12.0	12.0	12.0	
Memo: Sponsored agency borrowing <sup>6/</sup>	5.2	n.a.	18.9	n.a.	15.4	n.a.	6.8	20.5	2.0	4.5	6.5	5.9	3.6	2.6	4.2	5.0	
<b>NIA Budget <sup>7/</sup></b>									<b>Seasonally adjusted annual rates</b>								
Receipts	362.7 <sup>10/</sup>	411.4 <sup>11/</sup>	409.6 <sup>10/</sup>	457.7 <sup>11/</sup>	458.6 <sup>10/</sup>	n.a.	374.5	425.4	385.5	396.2	423.4	434.6	447.5	452.3	464.7	477.5	
Expenditures	411.9	454.7	452.0	499.7	497.4	n.a.	422.6	461.5	444.1	448.8	448.6	466.4	482.2	490.5	500.4	516.7	
Purchases (total)	140.7	153.5	151.2	169.0	165.7	n.a.	145.1	153.6	152.2	151.5	147.2	153.8	161.7	163.5	166.4	171.2	
Defense	92.3	98.5	98.3	105.5	105.0	n.a.	94.3	99.7	97.1	97.9	98.6	99.7	102.7	103.7	105.8	107.9	
Nondefense	48.4	55.0	52.8	63.5	60.7	n.a.	50.8	53.8	55.1	53.6	48.6	54.1	59.0	59.8	60.6	63.3	
All other expenditures	271.2 <sup>10/</sup>	301.2	300.8 <sup>10/</sup>	330.7	331.7 <sup>10/</sup>	n.a.	277.5	307.9	291.9	297.3	301.4	312.6	320.5	327.0	334.0	345.5	
Surplus(+)/Deficit(-)	-49.2 <sup>10/</sup>	-43.3	-42.4 <sup>10/</sup>	-42.0	-38.8 <sup>10/</sup>	n.a.	-48.1	-36.1	-58.6	-52.6	-25.2	-31.8	-34.7	-38.2	-35.7	-39.2	
High Employment Surplus(+)/ Deficit(-) (NIA basis) <sup>8/</sup>	-3.0	n.a.	1.4	n.a.	12.3	n.a.	-4.6	8.1	-16.2	-2.9	14.1	10.8	10.4	9.8	14.8	14.1	
		*actual		e--estimated		r--revised		n.a.--not available							p--preliminary		

- 1/ OMB Mid-Session Review of the 1979 Budget, (July 6, 1978) and the Department of Commerce, Survey of Current Business, July 1978.
- 2/ Senate Budget Resolution (September 6, 1978). The House estimates of receipts and outlays are \$450.0 and \$489.8 billion, respectively.
- 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 Fund, 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/ All NIA data incorporate the Department of Commerce's July 1978 GNP revisions.
- 8/ FRB staff estimates.
- 9/ Includes \$2.5 billion of borrowing from the Federal Reserve on September 30, 1977 which was repaid October 4, 1977.
- 10/ Quarterly average exceeds fiscal year total by \$1.0 billion for fiscal year 1977, by \$1.0 billion for fiscal year 1978, and by \$3.5 billion for fiscal year 1979, due to spreading of wage base effect over calendar year.
- 11/ The fiscal year totals as published in the July 1978 Survey of Current Business are based on unadjusted data and do not conform to the average of four seasonally adjusted quarters. The FRB staff estimates, therefore, have been adjusted in order to make the Commerce Department and the staff's estimates comparable.

DOMESTIC FINANCIAL DEVELOPMENTS

---

Summary. In response to further System tightening actions, most short-term interest rates have risen between 50 and 75 basis points since the August FOMC meeting, continuing the advance begun in early August. The Federal funds rate rose by about 50 basis points, and the discount rate was increased by a similar amount effective August 21. In contrast, yields on long-term Treasury and corporate securities have continued to edge down, apparently reflecting the growing sentiment that interest rates are near their cyclical peak, given the moderating pace of economic activity.

M-1 expanded at a 7-1/2 per cent annual rate in August--above the 5-3/4 per cent average that prevailed during June and July but still considerably below the 9-1/2 per cent second quarter average pace. The slowdown during June and July probably in part reflected the transitory effects of unusual increases in Treasury balances and contraseasonal declines in foreign official and commercial bank demand deposits; such foreign deposits are included in M-1. In August the effects of these movements dissipated. In conjunction with the faster rate of M-1 growth, another sizable advance in time deposits included in M-2 contributed to an acceleration of growth of this aggregate in August to 10-1/2 per cent. Savings deposits rose surprisingly rapidly, following two months of declines, while small time deposit growth abated--perhaps signaling a

tapering off of the major stock adjustment to the new money market certificate by depositors at commercial banks. At S&Ls the new certificate still attracted a sizable volume of deposits during August-- though less than in the previous two months--contributing to continued rapid growth of total deposits at thrift institutions.

The recent monthly pattern of growth in commercial bank credit, which surged in July and dropped in August, was significantly distorted by a similar pattern in System-matched sale-purchase agreements which gave rise to volatile movements in security loans. Abstracting from movements in security loans, the August deceleration in bank loans was considerably less. Real estate loans showed particular strength. Investments declined, due wholly to the runoff in Treasury securities.

Borrowing by nonfinancial businesses in short- and intermediate-term credit markets generally has moderated in the summer months, as improvements in cash flow coupled with reduced investment expenditures have apparently lowered their external financing requirements. Business loan growth at commercial banks has remained below the average rate in the first half of the year. Nonfinancial commercial paper outstanding declined slightly in August, and business loans at finance companies in July advanced at the slowest monthly pace since last fall. Offerings of bonds and equities by nonfinancial businesses have remained relatively light.

In the household sector, consumer instalment credit expansion, while slowing from the unusually rapid second quarter pace, remained

large in July and probably picked up a bit in August. Mortgage debt formation is also likely to have edged up last month.

Bond issuance by State and local governments was at a record volume in August, augmented by large refundings prior to the September 1 effective date of IRS and Treasury rulings reducing the attractiveness of such operations. The proceeds of the refundings were invested in Treasury non-marketable securities, and foreign central bank purchases also bolstered issuance of these as well as marketable securities. A substantial volume of Treasury marketable long-term debt was issued over the month, following two months of relatively light borrowing, and the Treasury's cash position reached a new high. Sponsored agency borrowing also picked up over the month.

Outlook. Overall credit demands over the remainder of the year are expected to strengthen somewhat from the summer pace. Some increase will be associated with the rising Federal deficit. The Treasury will be able to finance a larger part of this deficit than earlier expected by running down cash balances held at the Federal Reserve, but even so the market will have to absorb sizable System sales of securities needed to offset the associated reserve impact.

Borrowing by State and local units to finance new projects is expected to remain about the same over the balance of the year, although advance refundings will decline. Business borrowing in the fall is likely to rise somewhat, as investment in inventories and capital goods advances slightly faster than the pace of internally

generated funds, while consumer instalment borrowing is likely to remain flat.

On the supply side, inflows of savings and consumer-type time deposits to banks and thrift institutions are likely to moderate from the strong August pace. In particular, thrift institution flows may be affected by completion of the stock adjustment to the new time certificate. As banks and other institutions come to rely more heavily on other sources of funds, their liquidity positions will be adversely affected and lending terms may tighten further. Nevertheless, even with some slower expansion of mortgage credit supplied by private institutions, increased support from sponsored government agencies may maintain the recent pace of residential mortgage lending.

Market interest rates are likely to come under moderate upward pressure over the remainder of the year associated with rising credit demands in the face of moderating supplies. Short-term rates in particular may adjust upwards as the System holds back on provision of reserves in the face of strong demands for money that would be associated with projected expansion in nominal GNP. Longer-term market rates are likely to rise by less, and the present large spread of primary mortgage rates over bond rates is likely to narrow.

---

INTERNATIONAL DEVELOPMENTS

---

Summary. The dollar came under heavy selling pressure in early August, and by mid-August it stood about 9 per cent below the May high. Following President Carter's statement of concern over the dollar on August 16, and steps by the Federal Reserve to raise interest rates, an announcement by the Treasury that it would increase its sales of gold and that further measures would be taken, the dollar staged a considerable recovery. However, announcement of the high trade deficit for July, following two months of reduced deficits, triggered some negative reaction. So far in September fluctuations in dollar exchange rates have shown little trend and the dollar's average exchange value is at the end of July level.

In July the U.S. trade deficit was \$41 billion at an annual rate, considerably above the second-quarter rate. A reduction in agricultural exports reflected mainly an expected decline in the volume and price of soybean exports. The major change, however, was a sharp rise in the volume of non-oil imports, including higher imports of steel and cars from Europe and of capital goods.

Private capital transactions through banks registered a moderate net inflow in July as banks drew on their foreign branches for funds with U.S. short-term interest rates rising relative to rates abroad. Transactions in securities resulted in a small net outflow; U.S. net purchases of foreign securities continued at a fairly slow pace, while foreigners were net sellers (on a small scale) of U.S. corporate stocks for the first time since November 1976.

Foreign official assets in the United States, excluding OPEC, increased by \$3 billion in July,

. OPEC assets in U.S. banks and securities rose slightly in July after declining sharply during the second quarter, but appear to have declined again in August.

Economic activity in other industrial countries on the whole was rather flat through mid year, but there was scattered evidence of modest strength, including a rise in industrial production in Germany in June-July, and in addition both Germany and Japan have announced stimulatory fiscal actions.

Outlook. Recent monthly trade data have been somewhat erratic, but they do not seem to call for any major change in the projected trade balance through 1979. The staff continues to expect economic growth rates abroad to be somewhat stronger than in the United States over the period. A U.S. trade deficit of about \$36 billion is projected for 1978. For 1979 the deficit is projected at about \$32 billion, reflecting the effects on the trade balance of changes in relative growth rates and the depreciation of the dollar since last September.

The staff does not expect a further significant net change in trade-weighted value of the dollar over the year ahead. In the light of evidence that the market seems to be reacting strongly to news reports of all kinds, however, there may be sizable fluctuations during the period.

	1977 <sup>r</sup>	1978 <sup>P</sup>	1979 <sup>P</sup>	1978				1979 <sup>P</sup>			
				I	II <sup>P</sup>	III <sup>P</sup>	IV <sup>P</sup>	I	II	III	IV
1. <u>GNP NET EXPORTS</u> - Intl Acct. data	-11.1	-13.8	-6.0	-24.1	-10.2	-10.6	-10.2	-7.1	-7.7	-5.9	-3.4
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(-10.9)	(-13.8)	(-6.0)	(-24.1)	(-10.2*)	(-10.6)	(-10.2)	(-7.1)	(-7.7)	(-5.9)	(-3.4)
3. a) Merchandise Trade Balance	-31.1	-35.9	-32.5	-44.8	-31.3*	-33.5	-33.9	-32.4	-33.9	-32.8	-30.9
4. Exports (excl. military)	120.6	138.2	163.9	122.7	140.6*	142.0	147.4	153.8	160.6	167.0	174.2
5. Agricultural	24.4	28.8	28.3	26.0	32.0*	29.0	28.0	28.1	28.1	28.2	28.9
6. Nonagricultural	96.2	109.4	135.6	96.6	108.7*	113.0	119.4	125.7	132.5	138.8	145.3
7. Imports	151.6	174.1	196.4	167.5	172.0*	175.5	181.3	186.3	194.5	199.8	205.1
8. Petroleum and petrol. products	45.0	42.9	48.1	39.8	43.2*	42.7	46.0	44.6	48.3	49.2	50.1
9. Nonpetroleum	106.7	131.2	148.4	127.7	128.8*	132.8	135.3	141.6	146.2	150.6	155.0
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	2.7
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	-20.2	-15.9	-27.8	-16.5	-17.7	-18.7	-16.8	-17.6	-15.8	-13.2
14. a) GNP net exports (line 1.)	-11.1	-13.8	-6.0	-24.1	-10.2	-10.6	-10.2	-7.1	-7.7	-5.9	-3.4
15. b) U.S. Govt & private transfers <u>5/</u>	-4.1	-6.4	-9.9	-3.7	-6.3	-7.1	-8.5	-9.7	-9.9	-9.9	-9.8
<u>Constant (1972) dollars</u>											
16. Merchandise exports (excl. military)	67.0	71.5	78.2	65.7	72.9	73.1	74.2	75.9	77.6	78.9	80.8
17. (% change, annual rates)	(0.3)	(6.5)	(9.3)	(4.5)	(51.3)	(1.2)	(6.6)	(9.1)	(9.1)	(7.4)	(9.5)
18. Merchandise imports	71.0	74.9	78.6	74.0	74.9	74.8	76.1	76.7	78.3	79.1	80.2
19. (% change, annual rates)	(13.0)	(5.5)	(4.8)	(6.6)	(4.9)	(-3.2)	(7.0)	(3.2)	(8.7)	(4.5)	(5.7)
<u>Foreign Outlook - Major Industrial Countries <u>6/</u></u>											
20. Real GNP, % change, annual rates	2.9	3.5	4.2	5.7	2.8	4.1	4.1	4.5	4.5	4.1	4.5
21. Wholesale Prices, % change, A.R. <u>7/</u>	8.7	4.9	6.2	5.3	6.1	5.7	5.7	5.7	6.1	7.0	7.4

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.

\* Published data.

r

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