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CONFIDENTIAL (FR)

October 11, 1978

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Indicators of economic activity suggest a moderate rate of expansion in recent months. Industrial production increased further in September, but employment leveled off following the unusually rapid gains earlier this year. Consumer demand for goods apparently remained sluggish while business spending appears to have been increasing at a moderate pace. Nonfood prices continued rising at about the same rapid pace as earlier this year, but renewed inflationary pressures surfaced in the food sector in September following two months of easing.

Nonfarm payroll employment was little changed in September, following small increases in recent months. Manufacturing employment and the factory workweek were unchanged, with employment still below its May level. Industrial production is tentatively estimated to have risen somewhat further in September, but probably less than in the earlier months of the quarter.

Total retail sales in current dollars have apparently remained on a plateau since last spring. Unit auto sales declined substantially in September, as domestic sales fell to an 3.7 million unit annual rate, following unusually high sales rates in the spring and summer months. Sales of foreign cars also declined in September to 1.9 million units, annual rate. Judging from weekly data, retail sales of nondurable goods appear to have increased in September following little change over the preceding three months.

Business capital spending has continued to rise, although at a slower pace than in the first half. Shipments of equipment moved up considerably in August, and the July-August average in current dollars was a little more than 3 per cent above that of the second quarter. The value of non-residential construction put in place in August was off a bit from the preceding month, but was still at a high level following large gains in earlier months.

Recent trends in orders and contracts suggest that moderate increases will continue in business capital spending. New orders for capital goods, which had declined in July, were boosted in August by sharp increases in the volatile transportation equipment category. However, the important machinery component of capital equipment orders has remained on a plateau since February. In the construction area, the value of contracts rose further in August, indicating continued strength in this sector.

Residential construction activity edged lower in August, but remained at a high level. Private housing starts were at a 2.03 million unit annual rate in August, only slightly lower than the upward revised July rate. Housing demand as measured by sales of homes increased further in August, but recent strength has been concentrated in sales of existing homes.

Inventory accumulation at manufacturers, as measured in book value terms, continued brisk in August, but at a pace somewhat below the second quarter. With a sharp increase in factory shipments the inventory-to-sales ratio in August dropped back and was at a low level.

Total government purchases in real terms increased in the third quarter, after declines in the two preceding quarters. The large increase in Federal purchases mainly reflected net additions to CCC inventories. State and local outlays, however, rose by smaller amounts than in the spring quarter, as employment receded somewhat.

A sharp, but temporary, decline in some food prices helped hold down the increase in total consumer prices in August for the second month in a row. But renewed food price pressures were reported in September, as producer prices of crude agricultural goods and finished foodstuffs both increased by nearly 2 per cent. Consumer prices of all nonfood items rose 0.7 per cent in August, close to the average rate so far this year.

Outlook. The staff estimates that real GNP increased at about a 3 per cent annual rate in the third quarter, little changed from the previous month. Incoming data for residential structures are indicating somewhat more strength than anticipated earlier, while net exports appear a bit weaker than expected. Larger than previously expected price increases--mainly in construction--have resulted in a somewhat higher estimate of inflation for the third quarter; the gross business product fixed-weighted price index is now estimated to have risen at a 7.0 per cent annual rate.

The policy assumptions underlying the staff forecasts are little changed from a month ago. For monetary policy, M-1 growth through the end of 1979 is assumed to be near the upper end of the Committee's long-run target range of 4 to 6-1/2 per cent. Short-term interest rates are expected to rise a bit further, as indicated by the lower end of the Federal funds rate range shown in the Bluebook. For fiscal policy, there is still a good deal of uncertainty regarding the size and composition of the eventual tax reduction. We have assumed a tax cut of around \$20 billion, effective January 1979, in addition to the extension of the \$9 billion of previous tax cuts scheduled to expire at the end of this year. In response to the adoption of the Congressional Budget resolution, Federal outlays are projected to total \$491 billion in FY 1979, down \$3 billion from the previous estimate; the staff's estimate of the budget deficit is about \$41 billion. The staff has deleted the assumption of a crude oil equalization tax.

The contour of the projection is little changed from last month. Growth of real GNP is projected to average about 3-1/3 per cent, annual rate, over the five quarters through the end of 1979. We anticipate that growth in economic activity will pick up somewhat in early 1979 as a result of the assumed tax cut, but then drift gradually lower over the balance of the year. During 1979, growth of real business fixed investment-- although moderating over the course of the year--still represents the principal sector showing an above average rise. Residential construction

is expected to weaken gradually as financial market conditions constrain activity. A moderate rate of increase is projected for consumption, and the personal saving rate is anticipated to hold at about 5-3/4 per cent, close to recent levels.

Growth in total employment, after averaging 4-1/4 per cent over the year just completed, is shown to slow to about a 2-1/2 per cent annual rate during the projection period. The unemployment rate is expected to hold just under 6 per cent until mid-1979 and then to edge up slightly.

The staff continues to anticipate a high rate of inflation next year. The fixed-weighted price index for gross business product is projected to rise at a 7-1/2 per cent annual rate through the end of 1979. Food prices are projected to rise 8 per cent next year, considerably less than the 14 per cent increase so far this year. Mainly as a result of this, the over-all rate of price advance in 1979 is about 1/2 percentage point less than in 1978. The rate of price increase is still expected to show a bulge early in 1979, reflecting in part increases in payroll taxes and minimum wages which go into effect at the beginning of the year.

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STAFF GNP PROJECTIONS

	Per cent changes, annual rate							
	Nominal GNP		Real GNP		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	9/13/78	10/11/78	9/13/78	10/11/78	9/13/78	10/11/78	9/13/78	10/11/78
1975 ^{1/}	8.2	8.2	-1.3	-1.3	9.5	9.5	8.5	8.5
1976 ^{1/}	11.2	11.2	5.7	5.7	5.4	5.4	7.7	7.7
1977 ^{1/}	11.0	11.0	4.9	4.9	6.2	6.2	7.0	7.0
1978	11.2	11.5	3.7	3.8	7.4	7.5	6.0	6.0
1979	11.4	11.5	3.8	3.7	7.5	7.7	5.9	5.9
1978-I ^{1/}	7.1	7.1	-.1	-.1	6.7	6.7	6.2	6.2
1978-II ^{1/}	19.6	20.6	8.0	8.7	12.0	12.1	5.9	5.9
1978-III	10.1	10.6	2.9	3.1	6.3	7.0	6.0	6.0
1978-IV	10.8	10.9	3.3	3.3	6.7	6.9	5.9	5.9
1979-I	12.2	11.8	4.2	4.1	7.9	7.9	5.8	5.8
1979-II	10.5	10.4	3.5	3.3	7.7	7.9	5.8	5.8
1979-III	10.1	10.3	3.2	3.3	6.9	7.2	5.9	5.9
1979-IV	10.2	10.5	2.7	2.7	7.0	7.4	6.0	6.0
Change:								
77-II to 78-II ^{1/}	11.6	11.8	4.1	4.3	7.5	7.5	-1.2	-1.2
77-IV to 78-IV	11.8	12.2	3.5	3.7	8.0	8.2	-.7	-.7
78-II to 79-II	10.9	10.9	3.5	3.4	7.1	7.4	-.1	-.1
78-IV to 79-IV	10.7	10.8	3.4	3.3	7.4	7.6	.1	.1
Memo:								
Growth Over Annual Policy Period:								
78-III to 79-III	10.9	10.9	3.6	3.5	7.4	7.5	-.1	-.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	2087.5	2140.6	2196.9	2259.1	2315.6	2373.3	2433.2
Final purchases	1975.3	2067.4	2119.0	2174.3	2235.5	2291.0	2348.2	2407.6
Private	1558.6	1642.7	1678.8	1720.0	1772.1	1818.0	1863.5	1909.9
Excluding net exports	1582.7	1648.2	1686.1	1726.7	1777.1	1823.5	1866.7	1910.5
Personal consumption expenditures	1276.7	1322.9	1351.4	1384.3	1426.6	1465.5	1501.5	1536.9
Goods	684.9	717.1	728.1	744.9	768.0	787.9	805.5	822.8
Services	591.8	605.8	623.3	639.4	658.6	677.6	696.0	714.1
Gross private domestic investment	322.7	345.4	356.3	365.0	374.1	382.6	390.3	399.2
Residential construction	100.3	105.3	108.5	109.7	110.6	110.6	110.6	111.6
Business fixed investment	205.6	220.1	226.2	232.7	239.9	247.4	254.6	262.0
Change in business inventories	16.7	20.1	21.6	22.6	23.6	24.6	25.1	25.6
Nonfarm	16.9	22.1	21.6	22.6	23.6	24.6	25.1	25.6
Net exports of goods and services ^{1/}	-24.1	-5.5	-7.3	-6.7	-5.0	-5.5	-3.2	-6
Exports	181.7	205.4	209.1	217.3	225.6	234.6	242.5	251.3
Imports	205.8	210.9	216.4	224.0	230.6	240.1	245.7	251.9
Gov't. purchases of goods and services	416.7	424.7	440.2	454.3	463.4	473.0	484.7	497.7
Federal ^{2/}	151.5	147.2	154.6	161.8	164.0	166.6	171.2	177.2
State and local	265.2	277.6	285.6	292.5	299.4	306.4	313.5	320.5
Gross national product in constant (1972) dollars	1354.2	1382.6	1393.0	1404.2	1418.3	1429.8	1441.5	1451.2
Personal income	1628.9	1682.4	1730.5	1775.3	1820.0	1866.4	1917.5	1965.0
Wage and salary disbursements	1050.8	1090.2	1114.0	1140.8	1174.5	1202.9	1231.3	1262.6
Disposable personal income	1391.6	1433.3	1469.6	1505.2	1554.0	1591.6	1633.6	1671.8
Saving rate (per cent)	5.9	5.3	5.7	5.6	5.8	5.5	5.7	5.7
Corporate profits with I.V.A. and C.C. Adj.	132.6	163.4	173.6	179.5	178.9	182.9	189.0	193.8
Corporate profits before tax	172.1	205.5	211.5	216.8	216.0	220.3	226.7	231.8
Federal government surplus or deficit (-) (N.I.A. basis)	-52.6	-23.6	-27.7	-30.3	-33.5	-30.2	-32.8	-33.0
High employment surplus or deficit (-)	-2.9	17.4	13.8	12.9	11.9	18.0	17.3	19.8
State and local government surplus or deficit (-) (N.I.A. basis)	31.5	29.8	22.9	23.2	22.0	20.9	20.0	21.8
Excluding social insurance funds	11.5	9.3	1.8	1.5	-3	-2.0	-3.5	-2.3
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)	84.3	85.7	86.1	86.4	87.0	87.4	87.9	88.4
Manufacturing	20.1	20.3	20.3	20.4	20.6	20.7	20.8	20.9
Industrial production (1967=100)	139.6	144.0	146.4	148.2	150.7	152.5	154.1	155.6
Capacity utilization: all mfg. (per cent)	82.1	83.9	84.5	84.8	85.3	85.6	85.7	85.7
Materials (per cent)	81.7	84.5	85.3	85.8	86.5	87.0	87.3	87.5
Housing starts, private (million units, A.R.)	1.72	2.11	2.04	1.90	1.90	1.85	1.80	1.75
New autos sales, (millions, A.R.)	10.80	12.12	11.16	10.90	10.90	10.75	10.65	10.55
Domestic models	8.80	10.01	9.19	9.00	8.95	8.90	8.85	8.80
Foreign models	2.00	2.11	1.98	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.

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

October 11, 1978

	1978				1979			
	I	II	III	IV	Projected			
	I	II	III	IV	I	II	III	IV
<u>Constant (1972) dollars</u>								
Gross national product	-1	8.7	3.1	3.3	4.1	3.3	3.3	2.7
Final purchases	-1.6	8.6	2.9	3.0	3.9	3.0	3.2	2.7
Private	-1.1	11.0	1.6	2.7	4.5	3.1	3.1	2.8
Excluding net exports	-1.0	7.7	1.7	2.5	4.2	3.2	2.7	2.4
Personal consumption expenditures	-1.4	6.0	1.7	3.0	4.7	3.7	3.2	2.6
Goods	-8.1	9.7	.0	3.1	5.1	3.5	2.7	2.0
Services	7.0	1.9	3.9	2.8	4.1	4.0	3.7	3.3
Gross private domestic investment	11.3	15.2	2.6	2.4	2.8	3.0	1.1	2.0
Residential structures	-5.2	2.7	-1.0	-6.7	-6.1	-8.3	-8.3	-4.9
Business fixed investment	4.2	21.3	2.5	3.7	5.0	5.0	4.1	4.0
Gov't. purchases of goods and services	-3.5	-2	8.2	4.1	1.5	2.5	3.7	2.3
Federal	-8.9	-15.3	15.8	6.6	-1	2.6	5.9	2.3
State and local	-1	9.6	4.2	2.7	2.5	2.5	2.5	2.3
Disposable personal income	1.1	3.5	3.2	2.9	5.5	2.5	3.9	2.5
<u>Current dollars</u>								
Gross national product	7.1	20.6	10.6	10.9	11.8	10.4	10.3	10.5
Final purchases	6.4	20.0	10.4	10.9	11.7	10.3	10.4	10.5
Private	7.0	23.4	9.1	10.2	12.7	10.8	10.4	10.3
Excluding net exports	7.1	17.6	9.5	10.0	12.2	10.9	9.8	9.7
Personal consumption expenditures	7.0	15.3	8.9	10.1	12.8	11.4	10.2	9.8
Goods	.5	20.2	6.3	9.6	13.0	10.8	9.2	8.9
Services	15.3	9.8	12.1	10.7	12.6	12.0	11.3	10.8
Gross private domestic investment	12.2	31.3	13.2	10.1	10.4	9.4	8.3	9.4
Residential structures	.5	21.0	12.9	4.5	3.3	.0	.0	3.7
Business fixed investment	11.1	31.2	11.6	12.0	13.0	13.1	12.2	12.1
Gov't. purchases of goods and services	4.1	7.9	15.4	13.4	8.3	8.5	10.3	11.2
Federal	-2.0	-10.9	21.7	20.0	5.6	6.5	11.5	14.8
State and local	7.8	19.9	12.1	10.0	9.8	9.7	9.6	9.2
Disposable personal income	9.8	12.5	10.5	10.0	13.6	10.0	11.0	9.7
Personal income	9.3	13.8	12.0	10.7	10.5	10.6	11.4	10.3
Wage and salary disbursements	12.1	15.9	9.0	10.0	12.3	10.0	9.8	10.6
Corporate profits with IVA & C.C. Adj.	-35.9	130.6	27.4	14.3	-1.3	9.2	14.0	10.6
Corporate profits before tax	-13.2	103.3	11.9	10.5	-1.5	8.3	12.1	9.3
Nonfarm payroll employment	3.8	6.9	2.0	1.3	2.5	2.3	2.4	2.1
Manufacturing	5.7	3.1	-3	1.6	4.3	2.8	2.0	1.7
Nonfarm business sector								
Output per hour	-3.3	1.2	2.6	2.3	2.1	1.7	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	5.0	6.0	10.2	7.0	7.1	7.3
GNP implicit deflator ^{1/}	7.2	11.0	7.3	7.4	7.4	6.9	6.8	7.5
Gross business product fixed-weighted price index ^{2/}	6.7	12.1	7.0	6.9	7.9	7.9	7.2	7.4
Industrial production	.9	13.2	7.1	5.1	6.7	5.0	4.4	3.8

^{1/} Excluding Federal pay increase rates of change are: 1978 QI, 7.2 per cent; 1978 QIV, 6.9 per cent; 1979 QI, 7.4 per cent; 1979 QIV, 7.0 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	2104.3	2345.3
Final purchases	1161.7	1288.6	1404.0	1539.6	1689.9	1871.6	2084.0	2320.6
Private	908.6	1019.1	1101.3	1201.2	1330.4	1477.6	1650.0	1840.9
Excluding net exports	911.9	1012.0	1095.3	1180.8	1323.0	1488.7	1660.9	1844.4
Personal consumption expenditures	733.0	809.9	889.6	979.1	1090.2	1206.5	1333.8	1482.6
Goods	410.5	457.5	498.3	541.5	599.2	657.4	718.7	796.0
Services	322.4	352.3	391.3	437.5	491.0	549.2	615.1	686.6
Gross private domestic investment	188.3	220.0	214.6	190.9	243.0	297.8	347.4	386.5
Residential construction	62.0	66.1	55.1	51.5	68.2	91.9	105.9	110.8
Business fixed investment	116.8	136.0	150.6	150.2	164.6	190.4	221.2	251.0
Change in business inventories	9.4	17.9	8.9	-10.7	10.2	15.6	20.2	24.7
Nonfarm	8.8	14.7	10.8	-14.3	12.2	15.0	20.8	24.7
Net exports of goods and services <u>1/</u>	-3.3	7.1	6.0	20.4	7.4	-11.1	-10.9	-3.6
Exports	72.7	101.6	137.9	147.3	163.2	175.5	203.4	238.5
Imports	75.9	94.4	131.9	126.9	155.7	186.6	214.3	242.1
Gov't. purchases of goods and services	253.1	269.5	302.7	338.4	359.5	394.0	434.0	479.7
Federal <u>2/</u>	102.1	102.2	111.1	123.1	129.9	145.1	153.8	169.7
State and local	151.0	167.3	191.5	215.4	229.6	248.9	280.2	309.9
Gross national product in constant (1972) dollars	1171.1	1235.0	1217.8	1202.3	1271.0	1332.7	1383.5	1435.2
Personal income	942.5	1052.4	1154.9	1255.5	1380.9	1529.0	1704.3	1892.2
Wage and salary disbursements	633.8	701.3	764.6	805.9	890.1	983.6	1098.9	1217.8
Disposable personal income	801.3	901.7	984.6	1086.7	1184.4	1303.0	1449.9	1612.8
Saving rate (per cent)	6.2	7.8	7.3	7.7	5.7	5.1	5.6	5.7
Corporate profits with I.V.A. and C.C. Adj.	92.1	99.1	83.6	95.9	127.0	144.2	162.3	186.2
Corporate profits before tax	96.2	115.8	126.9	120.4	155.9	173.9	201.5	223.7
Federal government surplus or deficit (N.I.A. basis)	-17.3	-6.7	-10.7	-70.6	-53.8	-48.1	-33.5	-32.4
High employment surplus or deficit (-)	-5.9	-7	17.1	-19.4	-9.3	-4.6	10.3	16.8
State and local government surplus or deficit (-) (N.I.A. basis)	13.7	13.0	7.6	6.2	20.7	29.6	26.9	21.2
Excluding social insurance funds	5.6	4.1	-2.9	-6.2	5.5	11.5	6.1	-2.0
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	76.8	78.3	76.9	79.4	82.2	85.6	87.7
Manufacturing	19.2	20.2	20.1	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	153.2
Capacity utilization: all manufacturing (per cent)	83.1	87.5	84.2	73.6	80.2	82.4	83.8	85.6
Materials (per cent)	88.0	92.4	87.7	73.6	80.4	81.9	84.3	87.1
Housing starts, private (million units, A.R.)	2.36	2.05	1.34	1.16	1.54	1.99	1.94	1.82
New auto sales, (millions, A.R.)	10.93	11.42	8.91	8.66	10.12	11.13	11.25	10.71
Domestic models	9.32	9.65	7.49	7.08	8.63	9.07	9.25	8.87
Foreign models	1.61	1.77	1.42	1.58	1.50	2.06	2.00	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.

	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	3.8	3.7
Final purchases	5.5	4.9	-.7	.2	4.3	4.7	3.5	3.6
Private	6.7	6.3	-1.4	-.3	5.5	5.3	3.8	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	2.6	3.5
Services	5.3	4.4	2.3	3.2	5.0	4.4	4.3	3.6
Gross private domestic investment	12.9	10.0	-11.4	-22.3	21.6	13.2	8.1	3.2
Residential structures	18.8	-3.7	-24.6	-13.9	23.4	20.5	3.1	-5.6
Business fixed investment	8.1	12.2	-.3	-13.0	4.7	9.1	7.6	5.2
Gov't. purchases of goods and services	1.5	-.2	2.1	1.9	.1	2.4	2.3	3.2
Federal	-1.7	-5.4	-.8	.7	.1	5.2	-1.2	3.3
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	3.6
<u>Current dollars</u>								
Gross national product	10.1	11.6	8.1	8.2	11.2	11.0	11.5	11.5
Final purchases	9.9	10.9	8.9	9.7	9.8	10.8	11.3	11.4
Private	10.3	12.2	8.1	9.1	10.8	11.1	11.7	11.6
Excluding net exports	11.0	11.0	8.2	7.8	12.0	12.5	11.6	11.1
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	9.3	10.8
Services	9.9	9.3	11.1	11.8	12.2	11.8	12.0	11.6
Gross private domestic investment	17.7	16.8	-2.5	-11.0	27.3	22.6	16.7	11.3
Residential structures	25.0	6.6	-16.7	-6.5	32.5	34.8	15.2	4.6
Business fixed investment	12.2	16.4	10.8	-.3	9.6	15.7	16.2	13.5
Gov't. purchases of goods and services	8.3	6.5	12.3	11.8	6.2	9.6	10.2	10.5
Federal	6.1	.1	8.7	10.7	5.5	11.7	6.0	10.4
State and local	9.8	10.8	14.5	12.5	6.6	8.4	12.6	10.6
Disposable personal income	7.9	12.5	9.2	10.4	9.0	10.0	11.3	11.2
Personal income	9.7	11.7	9.7	8.7	10.0	10.7	11.5	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	12.6	14.7
Corporate profits before tax	17.3	20.4	9.6	-5.1	29.5	11.5	15.9	11.0
Nonfarm payroll employment	3.4	4.3	1.9	-1.7	3.2	3.6	4.1	2.4
Manufacturing	3.1	5.2	-.4	-8.7	3.7	3.4	3.2	2.4
Nonfarm business sector								
Output per hour	3.0	1.7	-2.9	1.9	3.6	1.5	.5	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	8.4	7.6
GNP implicit deflator	4.1	5.9	9.7	9.6	5.2	5.9	7.4	7.5
Gross business product fixed-weighted price index ^{1/}	3.3	5.7	10.4	9.4	5.4	6.2	7.5	7.7
Industrial production	9.2	8.4	-.4	-8.9	10.2	5.6	5.5	6.0

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

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

October 11, 1978

	Fiscal Year 1977*	FY 1978 ^{e/}		FY 1979 ^{e/}			CY 1977*	CY 78 ^{e/} F.R. Board	F.R. Staff Estimate Calendar quarters; unadjusted data								
		Admin. 1/	F.R. Board	Admin. 1/	F.R. Board	Cong. 2/			1977			1978			1979		
									IV*	I*	II*	III	IV	I	II	III	
Unified budget receipts ^{3/}	357.8	401.2	402.1	448.2	450.0	448.7	366.1	416.2	84.5	85.4	125.3	106.9	98.3	98.3	137.2	116.2	
Unified budget outlays ^{3/}	402.8	452.3	450.2	496.6	491.3	487.5	417.0	459.4	113.3	111.2	111.3	114.4	122.5	121.5	122.5	124.8	
Surplus(+)/Deficit(-), unified budget	-45.0	-51.1	-48.1	-48.5	-41.3	-38.8	-50.9	-43.2	-28.8	-25.8	14.0	-7.5	-24.2	-23.2	14.7	-8.6	
Surplus(+)/Deficit(-), off-budget agencies ^{4/}	-8.7	-11.0	-10.5	-12.9	-12.8	n.a.	-10.4	-10.5	-1.3	-3.6	-2.3	-3.3	-1.3	-3.4	-3.9	-4.3	
Means of financing combined deficits:																	
Net borrowing from public	53.5	54.9	59.1	62.0	45.7	n.a.	56.8	53.9	20.7 ^{9/}	20.8	2.5	15.1	15.5	19.8	-6.3	16.8	
Decrease in cash operating balance	-1.7	4.0	-3.3	0	10.4	n.a.	-0.6	0.3	6.8 ^{9/}	5.9	-11.1	-4.9	10.4	3.0	-3.0	0	
Other ^{5/}	1.9	3.2	2.7	-0.6	-2.0	n.a.	5.3	-0.2	2.6	2.8	-3.2	0.5	-0.3	3.7	-1.5	-3.9	
Cash operating balance, end of period	19.1	15.1	22.4	15.1	12.0	n.a.	12.3	12.0	12.3	6.4	17.5	22.4	12.0	9.0	12.0	12.0	
Memo: Sponsored agency borrowing ^{6/}	5.2	n.a.	19.1	n.a.	15.1	n.a.	6.8	19.9	2.0	4.5	6.5	6.1	2.8	2.1	4.6	5.6	
NIA Budget ^{7/}									Seasonally adjusted annual rates								
Receipts	362.7 ^{10/}	411.4 ^{11/}	411.0 ^{10/}	457.7 ^{11/}	461.7 ^{10/}	n.a.	374.5	427.6	385.5	396.2	424.8	438.5	450.9	454.9	467.2	481.2	
Expenditures	411.9	454.7	451.9	499.7	495.3	n.a.	422.6	461.2	444.1	448.8	448.4	466.2	481.2	488.4	497.4	514.0	
Purchases (total)	140.7	153.5	151.4	169.0	165.9	n.a.	145.1	153.8	152.2	151.5	147.2	154.6	161.8	164.0	166.6	171.7	
Defense	92.3	98.5	98.3	105.5	105.0	n.a.	94.3	99.8	97.1	97.9	98.6	99.8	102.7	103.7	105.8	107.9	
Nondefense	48.4	55.0	53.0	63.5	60.9	n.a.	50.8	54.0	55.1	53.6	48.6	54.8	59.1	60.3	60.8	63.3	
All other expenditures	271.2 ^{10/}	301.2	300.5 ^{10/}	330.7	329.4 ^{10/}	n.a.	277.5	307.4	291.9	297.3	301.2	311.6	319.4	324.4	330.8	342.8	
Surplus(+)/Deficit(-)	-49.2 ^{10/}	-43.3	-40.9 ^{10/}	-42.0	-33.6 ^{10/}	n.a.	-48.1	-33.6	-58.6	-52.6	-23.6	-27.7	-30.3	-33.5	-30.2	-32.8	
High Employment Surplus(+)/Deficit(-) (NIA basis) ^{8/}	-3.0	n.a.	3.0	n.a.	15.0	n.a.	-4.6	10.3	-16.2	-2.9	17.4	13.8	12.9	11.9	18.0	17.3	

*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/} Second Concurrent Budget Resolution (September 20, 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 Fund, Rural Electrification and Telephone Revolving Fund, Rural Telephone Bank, 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 10, 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. Short-term market interest rates generally have risen 25 to 50 basis points further since the September FOMC meetings. Long-term yields, which had been comparatively stable despite the large increases in short-term rates from mid-August to mid-September, have risen 5 to 30 basis points since then, but still remain below their July peaks. The average rate charged by S&Ls on mortgages has also edged up in recent weeks.

A key impetus to the general advance in market yields was provided by intermeeting increases in the System's Federal funds rate objective--cumulating to 3/8 percentage point in response to evidence of strengthened growth in the monetary aggregates. M-1 advanced at a 14-3/4 per cent annual rate in September, well above the already rapid August pace. In addition to continued strong transactions demand for money, M-1 growth was bolstered temporarily by the early disbursement of social security checks and delays in processing quarterly Federal tax payments by individuals due to an unusually large volume. M-2 expansion also picked up in September, as a result of faster growth in M-1.

Inflows into time and savings deposits subject to regulatory ceilings at both commercial banks and thrift institutions were surprisingly large in September. Continued sizable inflows of funds to the six-month money market certificate--which now pays the highest rate of all maturities of small time deposits--accounted for a large part of the strength in small time deposits.

Bank credit growth accelerated to a 10 per cent annual rate in September following weakness in August, which was attributable to declines in investments and security loans. In September these components expanded while real estate and business lending advanced at just below their average rates for the third quarter as a whole.

Although credit flows to the private nonfinancial sectors of the economy in the third quarter were considerably below the first half, primarily due to reduced business borrowing, they apparently picked up slightly in September. While public bond offerings by corporations again were relatively light, short- and intermediate-term business borrowing was somewhat larger than in August. In the household sector, growth of consumer credit probably changed little in September, but expansion of mortgage lending is likely to have increased for the second consecutive month. Public sector borrowing, on the other hand, which had been bolstered in August by a surge in advance refundings of tax-exempt issues prior to the September 1 implementation of new Treasury regulations, fell substantially in September.

Outlook. Sectoral credit flows through the remainder of the year are likely to remain about the same as in the third quarter. With increased cash flow available to nonfinancial corporate businesses to finance incremental investment expenditures, their net borrowing in the fourth quarter is likely to stay about flat. Little change in the composition of short- versus long-term borrowing appears in prospect.

The U.S. Treasury's financing needs will rise seasonally in the remainder of the current quarter, with the Treasury expected to issue

about \$11 billion of securities, concentrated in the coupon area. Municipal security issues to finance new projects will likely maintain recent levels, while sponsored agency issues should taper off somewhat. A slight moderation in net flows of consumer instalment credit appears probable, as growth of credit liquidations continues to reflect recent rapid additions to the stock of debt, while new credit extensions are restrained by the moderate rates of growth projected for consumer expenditures.

In light of continued success of the six-month money market certificates in attracting funds, staff projections of deposit flows at thrift institutions have been raised. As a result, S&L net mortgage acquisitions are expected to rise in the current quarter, despite some rebuilding of liquid assets and reduced borrowing from the FHLB banks. While mortgage investment by the diversified lenders may slacken a bit, on balance the net change in total mortgage debt is expected to pick up somewhat over the remainder of the year, and little further pressure on primary mortgage rates is anticipated.

With bank credit expansion about the same as the third quarter pace, banks are likely to add further to managed liabilities. With liquidity positions and credit availability already relatively tight at non-money center banks, their terms of lending may become still more stringent. Commercial banks are expected actively to promote savings accounts subject to automatic transfers which will be permitted beginning November 1. This is likely to induce shifts from demand deposits to savings deposits and have only slight effects on deposit flows at thrifts.

Since underlying credit conditions may exert little pressure on market interest rates, market expectations concerning inflation and real economic activity together with monetary policy actions would appear to be the major determinants of any interest rate movements over the coming months. Demand for money--whether in the form of demand deposits or savings with automatic transfer features--may remain strong, considering projected growth in nominal GNP. Further System tightening moves may be needed to keep growth of the monetary aggregates within their long-run ranges.

INTERNATIONAL DEVELOPMENTS

Summary. The dollar has been under considerable downward pressure during the past four weeks. This occurred despite the announcement of a sharp reduction in the U.S. trade deficit in August, the upward movement of U.S. interest rates and other policy developments -- for example, improved prospects for energy legislation -- that might have been expected to increase confidence in the dollar. The decline in the average value of the dollar since September 12 has been 3 per cent. Upward pressure through most of the period was concentrated on the Swiss franc. The franc moved up sharply against all currencies until Swiss authorities announced a new strategy of energetic intervention and less reliance on capital controls in order to contain the rise of their currency, particularly against the German mark. The franc was forced down from its peak rate against the mark, and it now stands $4\frac{1}{2}$ per cent below its high against the dollar. The German mark also was under increasing upward pressure over the past four weeks,

In August the U.S. trade deficit fell sharply, reversing the jump recorded in July. The deficit for July and August combined was \$33 billion at an annual rate -- only a little larger than in the second quarter. Nonagricultural exports for the two-month period were up 3 per cent from the second quarter but non-oil imports were up 5 per cent.

Recently released data for U.S. international transactions in the second quarter reveal a sharp increase in U.S. direct investment income and a shift towards a smaller deficit from travel and tourism. These developments reinforced the sharp reduction in the trade deficit in the second quarter to bring the current-account deficit down to \$13 billion at an annual rate -- less than half the rate in the preceeding quarter.

Private capital transactions through banks resulted in a sizable net capital inflow in the second quarter. Adjusting for special factors, this inflow appears to have continued, but at a slower rate in July and August. Foreign official reserves in the United States increased \$5.6 billion in July and August despite a \$1 billion decline in OPEC holdings. Indicators of official holdings showed little net change in September but increased sharply again in early October

The expansion of real output abroad continues to appear stronger than it had been earlier in the year, although growth rates remain well below historical averages in all industrial countries. Inflation rates moved up over the first half of the year in several countries including Canada and the United Kingdom, but some slowing has occurred in recent months. In France the deregulation of prices has led to a sharply higher rate of price increase which authorities hope will abate soon. Germany and Switzerland continue to enjoy virtual price stability -- consumer price increases over the latest

twelve months have been 2.4 per cent in Germany and even less in Switzerland. Japan and several small European countries have also recorded good price performances with consumer price increases of about 4 per cent over the latest twelve months.

Outlook. Over the past several months the staff has become increasingly confident that moderate real growth will continue through 1979 in major foreign economies. Uncertainties persist, however, especially with respect to inflation rates in several countries -- notably the United Kingdom, France, Italy and Canada. These uncertainties cloud the growth outlook towards the end of 1979. Moreover, growth rates are unlikely to be sufficient to reduce unemployment in many countries.

The staff projection for U.S. trade remains essentially unchanged -- a deficit of \$33 billion at an annual rate is expected in the current quarter, and this rate is expected to continue through most of 1979 with a slow shrinkage of the deficit occurring late next year.

A U.S. trade deficit of this size appears to be in line with market expectations and is not expected to contribute either to a stronger dollar or to a weaker dollar. Better inflation performances in some countries compared to the United States could well lead to further small appreciations of their currencies against the dollar, although scope for a rebound of the dollar exists -- particularly against the Swiss franc and Japanese yen. The major tensions in exchange markets in coming months are likely to be within the EC snake

and among the currencies of prospective members of a new European Monetary System or expanded snake. Thus, exchange markets for European currencies are likely to remain unsettled and the dollar could well continue to be buffeted by these cross currents, at least in the near term. Over the next year the staff foresees little change in the average value of the dollar from its average level in August-September.

	1977	1978 ^P	1979 ^P	1978				1979 ^P			
				I	II	III ^P	IV ^P	I	II	III	IV
1. <u>GNP NET EXPORTS</u> - Intl Acct. data	-11.1	-10.7	-3.3	-23.8	-5.3	-7.0	-6.4	-4.7	-5.2	-2.9	-3
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(-10.9)	(-10.9)	(-3.6)	(-24.1)	(-5.5)	(-7.3)	(-6.7)	(-5.0)	(-5.5)	(-3.2)	(-6)
3. a) Merchandise Trade Balance	-31.1	-35.5	-32.2	-44.8	-31.2	-32.2	-33.5	-32.0	-33.6	-32.5	-30.4
4. Exports (excl. military)	120.6	138.6	164.5	122.7	140.3	143.6	148.1	154.5	161.1	167.5	174.9
5. Agricultural	24.4	29.3	28.9	26.0	32.0	30.6	28.7	28.8	28.6	28.7	29.6
6. Nonagricultural	96.2	109.3	135.6	96.6	108.3	113.0	119.4	125.7	132.5	138.8	145.3
7. Imports	151.6	174.1	196.7	167.5	171.5	175.8	181.6	186.5	194.7	200.0	205.3
8. Petroleum and petrol. products	45.0	43.1	48.3	39.8	43.2	43.0	46.3	44.9	48.5	49.4	50.3
9. Nonpetroleum	106.7	131.0	148.4	127.7	128.2	132.8	135.3	141.6	146.2	150.6	155.0
10. b) Military transactions, net <u>2/</u>	.9	1.6	3.0	.4	1.9	2.0	2.2	2.4	2.8	3.2	3.6
11. c) Investment income, net <u>3/</u>	17.3	20.5	22.2	18.4	21.3	20.4	21.8	21.5	22.0	22.6	22.6
12. d) Other services, net <u>4/</u>	1.7	2.7	3.7	2.2	2.8	2.8	3.1	3.4	3.6	3.8	3.9
13. <u>U.S. CURRENT ACCOUNT BALANCE</u>	-15.2	-17.5	-13.1	-27.4	-13.0	-14.4	-14.9	-14.3	-15.2	-12.6	-10.0
14. a) GNP net exports (line 1.)	-11.1	-10.7	-3.3	-24.1	-5.3	-7.0	-6.4	-4.7	-5.2	-2.9	-3
15. b) U.S. Govt & private transfers <u>5/</u>	-4.1	-6.8	-9.8	-3.3	-7.7	-7.4	-8.5	-9.6	-10.0	-9.7	-9.7
<u>Constant (1972) dollars</u>											
16. Merchandise exports (excl. military)	67.0	71.5	78.2	65.7	72.8	73.2	74.1	75.8	77.4	78.8	80.6
17. (% change, annual rates)	(0.3)	(6.7)	(9.4)	(4.5)	(51.3)	(2.0)	(4.9)	(9.5)	(8.7)	(7.4)	(9.5)
18. Merchandise imports	71.0	75.0	78.8	74.5	75.1	74.8	75.7	76.8	78.4	79.3	80.4
19. (% change, annual rates)	(13.0)	(5.6)	(5.1)	(7.0)	(3.2)	(-1.6)	(4.9)	(5.7)	(8.2)	(4.5)	(5.7)
<u>Foreign Outlook - Ten Industrial Countries <u>6/</u></u>											
20. Real GNP, % change, annual rates	2.9	3.6	4.1	5.6	3.6	3.6	3.9	4.6	4.1	4.1	4.2
21. Consumer Prices, % change, A.R.	7.9	5.5	6.2	4.9	6.8	4.8	5.5	6.6	6.2	6.9	7.0

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, United Kingdom, Netherlands, Sweden, Belgium, and Switzerland in the sum of the real GNP of the ten countries in dollar terms.

p/ Projected.

e/ Estimated.

* Published data.

NOTE: Foreign outlook data have been revised to include 10 countries.