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CONFIDENTIAL (FR)

November 15, 1978

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Growth in economic activity appears to have been well maintained so far this quarter. The increase in employment was surprisingly strong in October, following a sluggish pace of hiring in the preceding few months, and industrial production continued upward. However, total retail sales edged down. While housing starts remained strong in September, sales of new homes continued at the reduced August rate. Business spending has been expanding, with shipments of capital goods continuing to rise briskly, but according to surveys these gains are expected to moderate sharply in 1979. Incoming data indicate further upward pressure on food prices as well as many nonfood prices.

In October, the unemployment rate declined 0.2 to 5.8 per cent, but remained within the range of the previous six months. Hiring increased substantially in durable-goods manufacturing, contract construction and in services. The gains in employment, coupled with a sizable increase in hourly earnings, suggest a substantial rise in personal income in October after two months of slow growth. Industrial production is estimated to have increased by 1/2 per cent in October; part of the gain reflected a recovery of auto assemblies and coal mining from the effects of railroad strikes. Gains in most other sectors were generally more moderate than in preceding months.

Unit purchases of autos picked up in October, after a slow start early in the new model year. Domestic car sales rose from a 8.7 million unit annual rate in September to 9.2 million in October--but this was still half a million annual rate below the average of the previous six months. Sales of foreign cars continued in the 2 million unit range. Retail sales other than autos reportedly edged off in October to a level not much higher than the third quarter average.

Business capital spending accelerated in August and September, according to data on equipment shipments and construction put-in-place. Moreover, advance spending commitments suggest that activity in this sector will be well maintained during the next few months. New orders for nondefense capital goods rose 3-1/2 per cent in September. The machinery component of these goods, which had remained on a plateau since February, increased sharply in September. Despite these favorable near-term indicators, private surveys of investment plans for 1979 indicate a marked deceleration in the growth of capital spending next year.

Inventory outlays by manufacturers were moderate in September, with a book value rise of \$14 billion, annual rate, suggesting a continuation of cautious business attitudes. Wholesalers increased their stocks at a \$13 billion rate, but this followed several months of relatively modest increases.

Housing starts continued strong in September, at an annual rate of 2.1 million units. Single-family starts have edged down somewhat from their highs in late 1977, but the rate of multifamily starts has increased slightly. Financial constraints may be affecting housing demand; in recent months, sales of new homes have declined and inventories of unsold new single-family homes have moved somewhat higher. The drop in sales has been concentrated in new units, but transactions in existing homes remained at advanced levels.

Spending by State and local governments had moderated in recent months. Employment this fall has been below the level reached last spring, with the decline concentrated in education.

Consumer price increases accelerated to a 9 per cent annual rate in September, as food prices jumped higher following two months of little change. Further large increases in homeownership costs and gasoline prices also contributed to the rapid climb in retail prices in September. Producer prices of finished goods rose at an annual rate of 10 per cent in October. Increases occurred at all stages of processing and were especially large in the agricultural sector, suggesting further upward pressures on retail food prices in coming months. Nonfood finished goods prices rose at an annual rate of 7-1/2 per cent in October, similar to the rates of increase earlier this year. Prices of nonfood crude and intermediate materials also were up in October, with particularly large increases for construction materials and nonferrous metals.

Outlook. Real GNP in the current quarter is expected to advance at about a 3-1/4 per cent annual rate, close to the third quarter pace but about 1 percentage point less than over the first half of the year. Business spending is expected to be the principal support for growth. More moderate gains are projected for personal consumption expenditures and Government purchases, while residential construction activity is likely to contract somewhat further. Projected fourth-quarter price increases have been revised upward since a month ago, reflecting widespread price rises that occurred in September and October. The gross business product fixed-weighted price index is now projected to rise at a 7-1/4 per cent annual rate.

The monetary policy assumptions underlying the present staff forecast include M-1 growth through the end of 1979 in the area of 3-1/4 per cent (annual rate) which is estimated to be equivalent to a 6-1/4 per cent rate of growth when the impact of automatic transfers is removed. M-2 and M-3 are assumed to grow, respectively, at around the mid-points of 6-1/2 to 9 and 7-1/2 to 10 per cent ranges for these aggregates adopted by the Committee. Short-term interest rates are projected to remain in the general vicinity of their recent advanced levels, about 3/4 per cent more than assumed a month earlier. Such projections are believed to be consistent with the mid-points of the Federal funds rate as shown for Alternative A in the Bluebook. Fiscal policy assumptions are basically unchanged through the end of

the current fiscal year. The staff estimate of Federal outlays in FY 1979 remains at \$491 billion, and total tax revenues are projected at \$452 billion.

Over the four quarters of 1979, projected growth of real GNP has been trimmed back to just over 2 per cent, annual rate, about 1-1/4 percentage points below the estimate in the last Greenbook. Real growth is expected to average about 2-3/4 per cent annual rate in the first half of 1979, but then to slow to an 1-1/2 per cent pace in the second half.

A substantial slowing of the growth of capital outlays by the latter half of next year is suggested by the disappointing surveys of capital spending plans, together with more stringent credit conditions. Moreover, these factors are likely to produce a deceleration of income gains which would tend to dampen economic growth in other sectors. We now anticipate that real business fixed investment will rise about 2-1/4 per cent during 1979, about 2 percentage points less than a month ago. Projected inventory investment has also been cut back somewhat, in part because of the scaling down of capital spending.

Housing starts in 1979 are now projected at around 1.7 million units, 100,000 less than a month ago. In the environment of higher market rates of interest, this housing projection reflects the influence of usury ceilings, increased interest payment burdens for home buyers, and cautious attitudes by mortgage lenders.

With income flows damped, projected consumption growth has also been reduced somewhat. The personal saving rate in the third quarter was 5.1 per cent, well below historical averages; more cautious spending attitudes by consumers are expected during 1979 and the saving rate is projected to edge up by about 1/2 percentage point.

In line with the projection of a moderation of economic expansion, employment growth is now estimated to slow to 1-1/2 per cent during 1979, following a sharp increase of about 3-1/2 per cent over this year. As a result, the unemployment rate is now expected to rise to about 6-1/2 per cent by year end.

The staff's estimate of inflation during 1979 is, on balance, little changed from last month. The fixed-weighted price index for gross business product is projected to rise about 7-1/2 per cent over the year, slightly less than in the previous projection. The Administration's anti-inflation guidelines are assumed to exert some moderating influence on prices and wages. However, this impact as well as the effect of reduced aggregate demand is expected to be largely offset by smaller projected growth of productivity, by a larger assumed OPEC oil price increase next year, and by the continued effects of the recent acceleration of price increases that has been evident on a broad range of products.

Price increases are expected to be larger in the early part of next year than in the second half. The recent widespread

price hikes at early stages of processing--both food and nonfood-- are expected to affect finished goods prices during the winter; the OPEC price increase is now assumed to amount to 7-1/2 per cent, effective January 1, compared to 5 per cent assumed previously; and minimum wage and payroll tax increases may also contribute to a bunching of price increases in the first part of 1979.

Detailed data for these 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)	
	10/11/78	11/15/78	10/11/78	11/15/78	10/11/78	11/15/78	10/11/78	11/15/78
1975 ^{1/}	8.2	8.2	-1.3	-1.3	9.4	9.4	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	11.5	11.5	3.8	3.9	7.5	7.5	6.0	6.0
1979	11.5	10.8	3.7	3.1	7.7	7.8	5.9	6.1
1978-I ^{1/}	7.1	7.1	-1	-1	6.7	6.7	6.2	6.2
1978-II ^{1/}	20.6	20.6	8.7	8.7	12.1	12.1	5.9	5.9
1978-III ^{1/}	10.6	10.7	3.1	3.4	7.0	7.5	6.0	6.0
1978-IV	10.9	11.2	3.3	3.3	6.9	7.3	5.9	5.9
1979-I	11.8	11.3	4.1	3.4	7.9	7.9	5.8	5.9
1979-II	10.4	9.5	3.3	2.3	7.9	7.9	5.8	6.0
1979-III	10.3	8.4	3.3	1.6	7.2	7.0	5.9	6.2
1979-IV	10.5	8.9	2.7	1.4	7.4	7.1	6.0	6.4
Change:								
77-II to 78-II ^{1/}	11.8	11.8	4.3	4.3	7.5	7.5	-1.2	-1.2
77-IV to 78-IV	12.2	12.3	3.7	3.8	8.2	8.4	-.7	-.7
78-II to 79-II	10.9	10.6	3.4	3.1	7.4	7.6	-.1	.1
78-IV to 79-IV	10.8	9.5	3.3	2.1	7.6	7.4	.1	.5
Memo:								
Growth Over Annual Policy Period:								
78-III to 79-III	10.9	10.1	3.5	2.6	7.5	7.5	-.1	.2

^{1/} Actual.

November 15, 1978

I - 9

CONFIDENTIAL - FR
CLASS II FOMCGROSS 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	2141.1	2198.4	2257.8	2309.4	2356.7	2407.3
Final purchases	1975.3	2067.4	2123.4	2178.8	2238.2	2289.8	2338.1	2389.7
Private	1558.6	1642.7	1682.1	1724.3	1774.3	1816.8	1855.3	1894.0
Excluding net exports	1582.7	1648.2	1688.6	1730.6	1778.1	1819.7	1854.1	1890.0
Personal consumption expenditures	1276.7	1322.9	1354.5	1388.0	1427.7	1465.1	1496.5	1527.2
Goods	684.9	717.1	728.7	745.1	766.1	784.9	799.5	813.7
Services	591.8	605.8	625.8	642.9	661.6	680.2	697.0	713.5
Gross private domestic investment	322.7	345.4	351.7	362.2	370.0	374.2	376.2	380.4
Residential construction	100.3	105.3	108.8	110.8	112.3	110.3	107.8	107.6
Business fixed investment	205.6	220.1	225.4	231.8	238.1	244.3	249.8	255.2
Change in business inventories	16.7	20.1	17.6	19.6	19.6	19.6	18.6	17.6
Nonfarm	16.9	22.1	18.6	19.6	19.6	19.6	18.6	17.6
Net exports of goods and services ^{1/}	-24.1	-5.5	-6.5	-6.3	-3.8	-2.9	1.2	4.0
Exports	181.7	205.4	210.9	217.7	226.5	236.6	245.1	253.5
Imports	205.8	210.9	217.3	223.9	230.2	239.4	243.8	249.4
Gov't. purchases of goods and services	416.7	424.7	441.3	454.5	463.9	473.0	482.8	495.7
Federal ^{2/}	151.5	147.2	156.1	162.8	165.3	167.6	170.7	176.9
State and local	265.2	277.6	285.2	291.7	298.6	305.4	312.1	318.8
Gross national product in constant (1972) dollars	1354.2	1382.6	1394.3	1405.6	1417.3	1425.4	1431.0	1435.8
Personal income	1628.9	1682.4	1727.2	1776.1	1819.5	1863.0	1910.7	1953.4
Wage and salary disbursements	1050.8	1090.2	1110.9	1140.6	1171.7	1197.3	1222.9	1251.5
Disposable personal income	1391.6	1433.3	1464.7	1504.4	1550.7	1586.5	1625.7	1660.3
Saving rate (per cent)	5.9	5.3	5.1	5.3	5.5	5.2	5.5	5.6
Corporate profits with I.V.A. and C.C. Adj.	132.6	163.4	174.5	178.9	176.7	180.9	183.2	186.9
Corporate profits before tax	172.1	205.5	214.7	219.5	218.1	222.6	224.7	228.2
Federal government surplus or deficit (-) (N.I.A. basis)	-52.6	-23.6	-24.4	-27.9	-31.3	-29.4	-34.1	-37.3
High employment surplus or deficit (-)	-3.0	17.3	14.3	10.4	10.8	16.8	16.9	18.2
State and local government surplus or deficit (-) (N.I.A. basis)	31.5	29.8	23.5	23.9	23.8	23.0	21.6	22.6
Excluding social insurance funds	11.5	9.3	2.2	2.0	1.3	-1.1	-2.1	-1.7
Civilian labor force (millions)	99.2	100.2	100.7	101.3	101.9	102.5	103.0	103.5
Unemployment rate (per cent)	6.2	5.9	6.0	5.9	5.9	6.0	6.2	6.4
Nonfarm payroll employment (millions)	84.3	85.7	86.1	86.7	87.1	87.4	87.7	87.9
Manufacturing	20.1	20.3	20.3	20.5	20.6	20.7	20.8	20.8
Industrial production (1967=100)	139.6	144.0	146.9	148.6	150.2	151.8	152.6	153.3
Capacity utilization: all mfg. (per cent)	82.1	84.0	84.9	85.1	85.2	85.3	84.9	84.5
Materials (per cent)	81.7	84.5	85.7	86.0	86.3	86.5	86.3	86.0
Housing starts, private (million units, A.R.)	1.72	2.11	2.08	1.95	1.85	1.75	1.65	1.60
New autos sales, (millions, A.R.)	10.80	12.12	11.16	11.05	10.80	10.65	10.45	10.30
Domestic models	8.80	10.01	9.19	9.15	9.00	8.90	8.80	8.75
Foreign models	2.00	2.11	1.98	1.90	1.80	1.75	1.65	1.55

^{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.

I - 10
 PER CENT CHANGES IN GROSS NATIONAL PRODUCT
 AND RELATED ITEMS
 (Annual rates compounded quarterly)

November 15, 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	3.4	3.3	3.4	2.3	1.6	1.4
Final purchases	-1.6	8.6	4.0	2.9	3.4	2.3	1.8	1.5
Private	-1.1	11.0	2.8	2.8	3.8	2.4	1.6	1.3
Excluding net exports	-1.0	7.7	2.6	2.6	3.3	2.1	1.0	1.0
Personal consumption expenditures	-1.4	6.0	3.4	2.8	3.8	3.2	2.0	1.5
Goods	-8.1	9.7	1.4	2.3	3.8	2.6	1.2	.6
Services	7.0	1.9	5.7	3.4	3.7	3.7	3.0	2.6
Gross private domestic investment	11.3	15.2	-4.2	4.0	1.1	-2.3	-4.6	-2.4
Residential structures	-5.2	2.7	-1.5	-3.9	-4.1	-14.6	-16.3	-8.9
Business fixed investment	4.2	21.3	-2	3.9	3.4	2.9	1.7	1.3
Gov't. purchases of goods and services	-3.5	-.2	9.0	3.2	1.9	1.9	2.4	2.1
Federal	-8.9	-15.3	21.1	5.1	1.0	1.3	3.2	2.4
State and local	-.1	9.6	2.6	2.1	2.4	2.3	2.0	1.9
Disposable personal income	1.1	3.5	2.6	3.8	4.6	1.9	3.4	1.8
<u>Current dollars</u>								
Gross national product	7.1	20.6	10.7	11.2	11.3	9.5	8.4	8.9
Final purchases	6.4	20.0	11.3	10.9	11.4	9.5	8.7	9.1
Private	7.0	23.4	9.9	10.4	12.1	9.9	8.7	8.6
Excluding net exports	7.1	17.6	10.2	10.3	11.4	9.7	7.8	8.0
Personal consumption expenditures	7.0	15.3	9.9	10.3	11.9	10.9	8.9	8.5
Goods	.5	20.2	6.6	9.3	11.8	10.2	7.7	7.3
Services	15.3	9.8	13.9	11.4	12.2	11.7	10.3	9.8
Gross private domestic investment	12.2	31.3	7.5	12.4	8.9	4.6	2.2	4.5
Residential structures	.5	21.0	14.0	7.7	5.5	-6.9	-8.8	-.7
Business fixed investment	11.1	31.2	10.0	12.0	11.3	10.8	9.3	8.9
Gov't. purchases of goods and services	4.1	7.9	16.6	12.5	8.5	8.1	8.5	11.1
Federal	-2.0	-10.9	26.7	18.3	6.3	5.7	7.6	15.3
State and local	7.8	19.9	11.4	9.4	9.8	9.4	9.1	8.9
Disposable personal income	9.8	12.5	9.1	11.3	12.9	9.5	10.3	8.8
Personal income	9.3	13.8	11.1	11.8	10.1	9.9	10.7	9.2
Wage and salary disbursements	12.1	15.9	7.8	11.1	11.4	9.0	8.8	9.7
Corporate profits with IVA & C.C. Adj.	-35.9	130.6	30.1	10.5	-4.8	9.9	5.2	8.3
Corporate profits before tax	-13.2	103.3	18.8	9.4	-2.6	8.5	3.9	6.2
Nonfarm payroll employment	3.8	6.9	2.1	2.6	1.8	1.6	1.3	1.2
Manufacturing	5.7	3.1	-.2	3.8	2.7	2.5	1.0	.9
Nonfarm business sector								
Output per hour	-3.1	1.7	3.7	.8	1.7	1.1	.7	.6
Compensation per hour	12.2	8.2	8.9	8.2	12.3	8.5	8.6	8.5
Unit labor costs	15.7	6.4	5.0	7.3	10.4	7.3	7.8	7.9
GNP implicit deflator <u>1/</u>	7.2	11.0	7.0	7.6	7.6	7.0	6.8	7.4
Gross business product fixed-weighted price index <u>2/</u>	6.7	12.1	7.5	7.3	7.9	7.9	7.0	7.1
Industrial production	.9	13.2	8.3	4.7	4.5	4.1	2.3	1.8

1/ Excluding Federal pay increase rates of change are: 1978 QI, 7.2 per cent; 1978 QIV, 7.1 per cent; 1979 QI, 7.6 per cent; 1979 QIV, 6.9 per cent.
2/ Using expenditures in 1972 as weights.

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GROSS 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	2104.8	2332.8
Final purchases	1161.7	1288.6	1404.0	1539.6	1689.9	1871.6	2086.2	2314.0
Private	908.6	1019.1	1101.3	1201.2	1330.4	1477.6	1651.9	1835.1
Excluding net exports	911.9	1012.0	1095.3	1180.8	1323.0	1488.7	1662.5	1835.5
Personal consumption expenditures	733.0	809.9	889.6	979.1	1090.2	1206.5	1335.5	1479.1
Goods	410.5	457.5	498.3	541.5	599.2	657.4	718.9	791.0
Services	322.4	352.3	391.3	437.5	491.0	549.2	616.6	688.1
Gross private domestic investment	188.3	220.0	214.6	190.9	243.0	297.8	345.5	375.2
Residential construction	62.0	66.1	55.1	51.5	68.2	91.9	106.3	109.5
Business fixed investment	116.8	136.0	150.6	150.2	164.6	190.4	220.7	246.8
Change in business inventories	9.4	17.9	8.9	-10.7	10.2	15.6	18.5	18.8
Nonfarm	8.8	14.7	10.8	-14.3	12.2	15.0	19.3	18.8
Net exports of goods and services ^{1/}	-3.3	7.1	6.0	20.4	7.4	-11.1	-10.6	-3.3
Exports	72.7	101.6	137.9	147.3	163.2	175.5	203.9	240.4
Imports	75.9	94.4	131.9	126.9	155.7	186.6	214.5	240.7
Gov't. purchases of goods and services	253.1	269.5	302.7	338.4	359.5	394.0	434.3	478.8
Federal ^{2/}	102.1	102.2	111.1	123.1	129.9	145.1	154.4	170.1
State and local	151.0	167.3	191.5	215.4	229.6	248.9	279.9	308.7
Gross national product in constant (1972) dollars	1171.1	1235.0	1217.8	1202.3	1271.0	1332.7	1384.1	1427.4
Personal income	942.5	1052.4	1154.9	1255.5	1380.9	1529.0	1703.6	1886.7
Wage and salary disbursements	633.8	701.3	764.6	805.9	890.1	983.6	1098.1	1210.8
Disposable personal income	801.3	901.7	984.6	1086.7	1184.4	1303.0	1448.5	1605.8
Saving rate (per cent)	6.2	7.8	7.3	7.7	5.7	5.1	5.4	5.5
Corporate profits with I.V.A. and C.C. Adj.	92.1	99.1	83.6	95.9	127.0	144.2	162.4	181.9
Corporate profits before tax	96.2	115.8	126.9	120.4	155.9	173.9	203.0	223.4
Federal government surplus or deficit (N.I.A. basis)	-17.3	-6.7	-10.7	-70.6	-53.8	-48.1	-32.1	-33.0
High employment surplus or deficit (-)	-5.9	-7	17.1	-19.4	-9.3	-4.6	9.8	15.7
State and local government surplus or deficit (-) (N.I.A. basis)	13.7	13.0	7.6	6.2	20.7	29.6	27.2	22.7
Excluding social insurance funds	5.6	4.1	-2.9	-6.2	5.5	11.5	6.3	-7
Civilian labor force (millions)	86.5	88.7	91.0	92.6	94.8	97.4	100.3	102.7
Unemployment rate (per cent)	5.6	4.9	5.6	8.5	7.7	7.0	6.0	6.1
Nonfarm payroll employment (millions)	73.7	76.8	78.3	76.9	79.4	82.3	85.7	87.5
Manufacturing	19.2	20.2	20.1	18.3	19.0	19.6	20.3	20.7
Industrial production (1967=100)	119.7	129.8	129.3	117.8	129.8	137.1	144.8	152.0
Capacity utilization: all manufacturing (per cent)	83.1	87.5	84.2	73.6	80.2	82.4	84.0	85.0
Materials (per cent)	88.0	92.4	87.7	73.6	80.4	81.9	84.5	86.3
Housing starts, private (million units, A.R.)	2.36	2.05	1.34	1.16	1.54	1.99	1.96	1.71
New auto sales, (millions, A.R.)	10.93	11.42	8.91	8.66	10.12	11.13	11.28	10.55
Domestic models	9.32	9.65	7.49	7.08	8.63	9.07	9.29	8.86
Foreign models	1.61	1.77	1.42	1.58	1.50	2.06	2.00	1.69

^{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	3.9	3.1
Final purchases	5.5	4.9	-.7	.2	4.3	4.7	3.7	3.2
Private	6.7	6.3	-1.4	-.3	5.5	5.3	4.0	3.2
Excluding net exports	7.0	5.1	-2.3	-1.0	6.4	6.0	4.0	2.7
Personal consumption expenditures	5.9	4.7	-.9	1.8	5.8	4.7	3.6	3.2
Goods	6.5	5.0	-3.4	.7	6.4	5.0	2.7	2.8
Services	5.3	4.4	2.3	3.2	5.0	4.4	4.6	3.6
Gross private domestic investment	12.9	10.0	-11.4	-22.3	21.6	13.2	7.3	.2
Residential structures	18.8	-3.7	-24.6	-13.9	23.4	20.5	3.3	-7.2
Business fixed investment	8.1	12.2	-.3	-13.0	4.7	9.1	7.2	3.6
Gov't. purchases of goods and services	1.5	-.2	2.1	1.9	.1	2.4	2.3	2.9
Federal	-1.7	-5.4	-.8	.7	.1	5.2	-.8	3.4
State and local	3.8	3.2	3.8	2.6	.1	.8	4.2	2.7
Disposable personal income	4.2	6.7	-1.5	2.1	3.5	4.1	4.0	3.3
<u>Current dollars</u>								
Gross national product	10.1	11.6	8.1	8.2	11.2	11.0	11.5	10.8
Final purchases	9.9	10.9	8.9	9.7	9.8	10.8	11.5	10.9
Private	10.3	12.2	8.1	9.1	10.8	11.1	11.8	11.1
Excluding net exports	11.0	11.0	8.2	7.8	12.0	12.5	11.7	10.4
Personal consumption expenditures	9.7	10.5	9.8	10.1	11.4	10.7	10.7	10.8
Goods	9.5	11.4	8.9	8.7	10.7	9.7	9.4	10.0
Services	9.9	9.3	11.1	11.8	12.2	11.8	12.3	11.6
Gross private domestic investment	17.7	16.8	-2.5	-11.0	27.3	22.6	16.0	8.6
Residential structures	25.0	6.6	-16.7	-6.5	32.5	34.8	15.7	3.0
Business fixed investment	12.2	16.4	10.8	-.3	9.6	15.7	15.9	11.8
Gov't. purchases of goods and services	8.3	6.5	12.3	11.8	6.2	9.6	10.2	10.3
Federal	6.1	.1	8.7	10.7	5.5	11.7	6.4	10.2
State and local	9.8	10.8	14.5	12.5	6.6	8.4	12.5	10.3
Disposable personal income	7.9	12.5	9.2	10.4	9.0	10.0	11.2	10.9
Personal income	9.7	11.7	9.7	8.7	10.0	10.7	11.4	10.7
Wage and salary disbursements	9.4	10.6	9.0	5.4	10.4	10.5	11.6	10.3
Corporate profits with IVA & C.C. Adj.	19.3	7.6	-15.6	14.7	32.4	13.5	12.6	12.0
Corporate profits before tax	17.3	20.4	9.6	-5.1	29.5	11.5	16.7	10.0
Nonfarm payroll employment	3.5	4.3	1.9	-1.7	3.2	3.6	4.2	2.2
Manufacturing	3.1	5.2	-.4	-8.7	3.7	3.4	3.3	2.2
Nonfarm business sector								
Output per hour	3.0	1.7	-2.9	1.9	3.6	1.3	.5	1.5
Compensation per hour	5.8	7.8	9.4	9.9	8.5	8.1	9.1	9.4
Unit labor costs	2.7	6.0	12.7	7.9	4.7	6.7	8.5	7.8
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	7.8
Industrial production	9.2	8.4	-.4	-8.9	10.2	5.6	5.6	5.0

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

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

November 15, 1978

	Fiscal Year 1978*	FY 1979 ^{e/}			CY 1977*	CY 78 ^{e/} F.R. Board	Calendar quarters; unadjusted data							
		Admin. 1/	F.R. Board	Cong. 2/			1978				F.R. staff estimates			
							I*	II*	III*	IV	I	II	III	1979
Unified budget receipts ^{3/}	402.0	452.7	451.8	448.7	366.1	415.6	85.4	125.3	106.8	98.2	99.3	138.0	116.3	
Unified budget outlays ^{3/}	450.7	491.6	490.5	487.5	417.0	459.9	111.2	111.3	114.9	122.5	121.2	122.5	124.2	
Surplus(+)/Deficit(-), unified budget	-48.7	-38.9	-38.7	-38.8	-50.9	-44.3	-25.8	14.0	-8.1	-24.3	-21.9	15.5	-7.9	
Surplus(+)/Deficit(-), off-budget agencies ^{4/}	-10.3	-12.9	-11.1	n.a.	-10.4	-10.6	-3.6	-2.3	-3.1	-1.6	-3.2	-3.7	-2.7	
Means of financing combined deficits:														
Net borrowing from public	59.1	n.a.	41.4	n.a.	56.8	55.4	20.8	2.5	15.1	17.0	16.9	-6.3	13.8	
Decrease in cash operating balance	-3.3	n.a.	10.4	n.a.	-0.6	-0.2	5.9	-11.1	-4.9	9.9	4.5	-4.0	0	
Other ^{5/}	3.2	n.a.	-2.0	n.a.	5.3	-0.4	2.8	-3.2	1.0	-1.0	3.7	-1.5	-3.2	
Cash operating balance, end of period	22.4	n.a.	12.0	n.a.	12.3	12.5	6.4	17.5	22.4	12.5	8.0	12.0	12.0	
Memo: Sponsored agency borrowing ^{6/}	19.1	n.a.	19.2	n.a.	6.8	21.4	4.5	6.5	6.1	4.3	3.6	5.6	5.7	
NIA Budget							Seasonally adjusted annual data							
Receipts	411.8 ^{8/}	n.a.	463.3 ^{8/}	n.a.	374.5	429.1	396.2	424.8	442.0	453.4	457.9	469.0	480.4	
Expenditures	451.8	495.6	495.9	n.a.	422.6	461.1	448.8	448.3	466.1	481.3	489.2	498.4	514.5	
Purchases (total)	151.8	166.8	166.6	n.a.	145.1	154.4	151.5	147.2	156.1	162.8	165.3	167.6	170.7	
Defense	98.4	104.7	105.2	n.a.	94.3	100.0	97.9	98.6	100.2	103.1	104.2	106.0	107.6	
Non-defense	53.3	62.1	61.4	n.a.	50.8	54.4	53.6	48.6	55.9	59.7	61.1	61.6	63.1	
All other outlays	300.0 ^{8/}	328.8	329.3 ^{8/}	n.a.	277.5	306.7	297.3	301.1	310.0	318.5	323.9	330.8	343.8	
Surplus(+)/Deficit(-)	-40.0 ^{8/}	n.a.	-32.6 ^{8/}	n.a.	-48.1	-32.0	-52.6	-23.6	-24.1	-27.9	-31.3	-29.4	-34.1	
High Employment Surplus(+)/Deficit(-) (NIA basis) ^{7/}	3.1	n.a.	13.7	n.a.	-4.6	9.8	-3.0	17.3	14.3	10.4	10.8	16.8	16.9	

* actual e--estimated r--revised n.a.--not available

1/ OMB October Budget Update (October 27, 1978), Mid-Session Review of the 1979 Budget (July 6, 1978) and the Department of Commerce.

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, 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/ FRB staff estimates.

8/ Quarterly average exceeds fiscal year total 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. 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 estimates comparable.

Comments on the Fiscal Policy Outlook

The fiscal policy assumptions underlying this month's projection reflect recent budgetary actions taken by the Congress and the Administration. The staff's Federal revenue forecast now includes the \$18-1/2 billion in tax cuts (NIA basis) that are mandated by the Revenue Act of 1978.^{1/} In broad terms, the projection includes:

- (1) A reduction in personal taxes--including capital gains--that lowers revenues by \$12-1/2 billion in calendar year 1979;
- (2) A cut in business taxes that lowers the top corporate rate from 48 to 46 per cent on income over \$100,000 (estimated decline in corporate tax accruals, \$5 billion in calendar year 1979);
- (3) A liberalization of the investment tax credit that allows firms to use the credits to offset 90 per cent of their tax liabilities by 1982 (60% in 1979), instead of the current 50 per cent. (Estimated first year (1979) revenue loss, \$.3 billion);
- (4) Miscellaneous business tax revisions that reduce revenues by about \$.6 billion in calendar year 1979.

The forecast also contains around \$1 billion in tax credits for home insulation and energy saving equipment, as provided by the new Energy Act.

The reduction in FY 1979 receipts resulting from both the tax cut and the energy package is estimated to be about \$2-1/2

^{1/} The major provisions of the 1978 Revenue Act are described in Part 2, Appendix A.

billion smaller than earlier staff assumptions. This change, however, is partially offset by the effects on projected revenues of reduced income assumptions. Total receipts in the current fiscal year are now expected to be around \$452 billion.

Federal spending continues to be forecast at about \$491 billion, as higher interest outlays are expected to be offset by spending reductions resulting from the President's decision to cut Federal employment by 20,000 (\$.2 billion saving) and to support the dollar by doubling gold sales (\$1.2 billion negative outlay). Recent Administration announcements indicate that further spending restraint can be expected in fiscal year 1980.

The deficit for FY 1979 is now projected at \$39 billion and the total amount that needs to be financed (unified plus off-budget) is estimated at \$50 billion. In the current quarter, the Treasury's financing requirements are expected to be around \$26 billion, up sharply from the third quarter's \$10 billion (not seasonally adjusted). The Treasury is expected to meet these needs by drawing down its large end of September cash balance by \$10 billion and by issuing \$17 billion in marketable and nonmarketable securities.

Finally, the high employment budget projections continue to show a substantial \$10 billion shift toward surplus between fiscal years 1978 and 1979.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. Since the last FOMC meeting, credit markets have adjusted to a substantial further tightening in monetary policy. In the latter part of October the Federal funds rate rose by about 1/2 of a percentage point, following a similar discount rate increase at mid-month. Then on November 1, the discount rate was raised 1 percentage point further, the reserve requirement on large time deposits was increased by 2 percentage points and an additional rise in the Federal funds rate of around 1/2 of a percentage point was initiated. These moves were part of a joint program undertaken with the Treasury to buttress the value of the dollar on foreign exchange markets and thereby counter inflationary pressures.

Largely in response to these actions, short-term market interest rates increased substantially over the intermeeting period. Commercial paper and CD rates rose as much as 150 basis points, while rates on Treasury bills, which were in heavy demand from foreign governments, moved 30 to 75 basis points higher. Bond yields have increased only about 5 to 25 basis points since mid-October. These rates had risen somewhat further in late October in response to heightened concern about the outlook for inflation and to the sharp decline in the foreign exchange value of the dollar, as well as to the rise in short-term rates, but have fallen in the wake of the November 1 policy moves. Stock prices, which had declined substantially

in late October, have shown little net change in November, remaining from 9 to 15 per cent below their levels at the time of the FOMC meeting.

The publication in early November of data suggesting substantially slower growth in the monetary aggregates also may have contributed to the recent firmer tone in capital markets. M-1 expanded at only a 3-3/4 per cent annual rate in October, following September's rapid increase, and growth of the interest-earning deposits in M-2 also moderated, due to a decline in savings deposits and the small size of the increase in the average level of its large time component.^{1/} Sales of money market certificates reached record monthly totals in October at both banks and thrift institutions. However, much of this strength apparently represented a shifting from other time deposits--an unusually large quantity of which matured early in the month--and growth slowed in both total time and savings deposits subject to ceilings at banks and total deposits at thrifts.

Bank lending picked up a little in October, financed by a substantial run-off of U.S. Treasury securities and increased use of nondeposit sources of funds, as well as the surge in small time deposits. Total large time deposits grew only slightly on average

^{1/} The impact of Automatic Transfers on the behavior of the monetary aggregates in the first week of November will be discussed in the Greenbook Supplement.

for the month, but CD's increased substantially in the last few weeks of the month, contributing to upward yield pressures in this sector.

Bank lending to businesses accelerated somewhat, as did issuance of commercial paper by nonfinancial corporations, but offerings of bonds by these firms increased less than seasonally. Bond issuance by industrial and lower-rated corporations was especially weak. The back-up in bond rates in late October was accompanied by a widening of yield spreads, which continued into November.

Consumer instalment borrowing in October is estimated to have remained at the September pace, but flows of mortgage credit may have grown somewhat, given the increase in real estate lending at banks, the further rise in mortgage commitments outstanding at S&Ls in September, and an increase in issuance of GNMA pass-throughs. Average rates on conventional mortgages at S&Ls rose substantially over the intermeeting period, and offerings at FNMA auctions swelled in early November, reflecting concerns that market rates might rise still further and that thrifts might draw back from the aggressive issuance of money market certificates, as a few reportedly have done already.

Outlook. The general level of interest rates is expected to change little over the next few months. Both the marked rise in these rates experienced in recent months and the slower growth of GNP now projected will help maintain monetary aggregate growth within

the Committee's ranges. Moreover, aggregate credit demands are unlikely to strengthen significantly further. Interest rates on mortgages, however, may move higher as deposit inflows at intermediaries diminish.

Mortgage lending at thrift institutions is expected to be well maintained over coming months, given the recent rise in their loan commitments. Deposit growth, though, is expected to slow, as the higher level of interest rates damps inflows to accounts subject to fixed rate ceilings and discourages thrifts from offering money market certificates aggressively. Under such circumstances, these institutions are expected to reduce the rate at which they accumulate liquid assets, and may have to increase once again their reliance on Home Loan Bank advances; a pick-up in this borrowing already began in October. Given continued strong demand for mortgage credit, a tightening in thrift liquidity positions can be expected to be reflected in continued pressures on mortgage rates. Such developments are likely to induce increased mortgage lending by diversified investors and greater support of the market by sponsored Federal agencies.

At businesses, external financing requirements are projected to rise slightly over coming months as profit growth, which may be held down by the slowing in economic expansion, is outpaced by the rise in capital expenditures. If the substantial increases in short-term debt ratios that have taken place induce businesses to direct a larger

proportion of this borrowing into bond markets, this would put additional upward pressures on long-term yields. However, there have not yet been any indications of a near-term pick-up in corporate bond offerings.

In the public sector, State and local borrowing should remain close to the slower pace established this fall. The Federal government's financing requirements will be substantial, but the credit market impact of Treasury borrowing will be damped to the extent that there are continued sales of U.S. Government obligations to foreigners.

INTERNATIONAL DEVELOPMENTS

Summary. Although the weighted average foreign exchange value of the dollar is at about the same level as it was five weeks ago, in the interim it shifted widely in both directions and intervention activity became intense. The dollar's foreign exchange value weakened in mid-October and dropped 4 per cent in the four days following the President's October 24 announcement of a program to contain inflation. The program that was announced evidently did little to change market participants' expectations about the near-term U.S. inflation rate. A recovery from the low point began on October 31 as the market sensed that strong support measures were soon to be announced; the dollar's average value rose sharply further when the measures were announced on November 1, and by November 3 it was nearly 8 per cent above its October low. However, the gains achieved in early November required the support of heavy central-bank intervention.

The measures announced November 1 included a package of steps to add to the resources available for intervention - \$7.6 billion added to FR swap lines with Germany, Switzerland and Japan; Treasury sales of \$2 billion equivalent of SDRs to those countries; Treasury drawings of \$3 billion of usable currencies from the U.S. reserve position in the IMF; and sales of up to \$10 billion equivalent of foreign-currency denominated securities. Intervention by the United States increased sharply in the week following the October 24 statement and amounted

to \$1 billion equivalent. A further \$2.9 billion of foreign currencies, largely DM, was sold by the United States in the November 1-14 period.

In the U.S. international accounts for the third quarter, the merchandise trade deficit was at an annual rate of \$31 billion, about the same as in the second quarter. Non-agricultural exports were up about 8 per cent in value over the second quarter level, of which about 3 per cent was higher volume. Non-oil imports were up about 7 per cent, mainly in volume. Petroleum imports were unchanged in quantity or price, holding to a \$43 billion rate. Foreign investors were net sellers of U.S. corporate stock on a small scale in the third quarter, but may have sold more heavily during the October decline in the market. U.S. net purchases of foreign securities were under \$1/2 billion in the third quarter, well below the first-half rate. Bank-reported private capital transactions recorded a moderate net outflow in the third quarter, reversing a sizable net inflow in the second quarter.

Foreign official assets in the United States, apart from OPEC's, rose about \$6 billion in the third quarter

On the other hand, OPEC assets in the United States continued the decline that began in the second quarter, bringing the total drop for the year to about \$2-1/2 billion, compared to an increase of about \$5 billion in the first nine months of 1977. The change reflects both a sharp reduction in the OPEC surpluses and some diversification out of traditional dollar-denominated assets.

More complete third-quarter data covering foreign economic developments confirm the staff view that average growth of the ten leading foreign economies is holding at about a 3-1/2 per cent annual rate. Japan and Canada had been growing at above average rates but seem to have slowed slightly; growth in Germany has been hesitant but may now be rising. Consumer prices are rising at an annual average of about 7 per cent in these ten countries, but was much lower than that average in Germany, Switzerland and Japan. With growth rates still below potential the employment picture abroad weakened in the third quarter compared to the second. The combined trade surplus of six major foreign countries remained at about \$13 billion in the third quarter (not an annual rate), mainly reflecting German and Japanese surpluses.

Outlook. It remains the staff view that GNP growth in foreign industrial countries will rise gradually from the 3-1/2 per cent rate of the second half to somewhat over 4 per cent in 1979. Growth in Japan

is expected to fall short of the 7 per cent targeted rate, though it will probably be considerably stronger than in recent quarters, and growth in Germany should be picking up soon. In France and the United Kingdom, however, growth rates are expected to taper off in the course of next year. These growth rates should not put any significant pressure on capacity abroad. The rate of increase of consumer prices abroad is expected to change little in the period ahead.

Given the projected slowdown of the U.S. economy in the year ahead, and some pickup in growth abroad, a somewhat larger reduction in the U.S. trade deficit is now projected than a month ago - from the \$31 billion rate of the third quarter to about \$26 billion by the end of 1979. The fourth quarter rate this year may be somewhat above the third quarter rate as agricultural exports decline a little and oil imports rise in anticipation of a price increase. Next year's projected oil import bill now incorporates an assumed 7-1/2 per cent price increase at the beginning of the year, but the estimated volume of oil imports has been reduced. The staff view continues to be that the average value of the dollar a year from now will be at about its average level in August-September, which would be slightly above its present level.

	1977	1978 ^P	1979 ^P	1978				1979 ^P			
				I	II	III ^P	IV ^P	I	II	III	IV
1. GNP NET EXPORTS - Intl Acct. data	-11.1	-10.2	.2	-23.8	-5.3	-6.0	-5.8	-3.3	-2.4	1.7	4.5
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(-10.9)	(-10.6)	(-.3)	(-24.1)	(-5.5)	(-6.5)*	(-6.3)	(-3.8)	(-2.9)	(1.2)	(4.0)
3. a) Merchandise Trade Balance	-31.1	-35.0	-28.7	-44.8	-31.2	-31.2*	-32.9	-30.6	-30.8	-27.9	-25.6
4. Exports (excl. military)	120.6	140.9	169.7	122.7	140.3	148.7*	151.8	158.7	166.4	173.4	180.4
5. Agricultural	24.4	29.8	30.0	26.0	32.0	31.6*	29.6	30.1	29.9	30.0	30.2
6. Nonagricultural	96.2	111.1	139.7	96.6	108.3	117.2*	122.2	128.6	136.5	143.4	150.2
7. Imports	151.6	175.9	198.4	167.5	171.5	179.9*	184.7	189.3	197.2	201.3	206.0
8. Petroleum and petrol. products	45.0	42.8	48.0	39.8	43.2	43.2*	44.8	44.6	48.4	49.0	50.1
9. Nonpetroleum	106.7	133.1	150.4	127.7	128.2	136.7*	139.9	144.7	148.8	152.3	155.9
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.S. CURRENT ACCOUNT BALANCE	-15.2	-17.0	-9.6	-27.4	-13.0	-13.4	-14.3	-12.9	-12.4	-8.0	-5.2
14. a) GNP net exports (line 1.)	-11.1	-10.2	.2	-24.1	-5.3	-6.0	-5.8	-3.3	-2.4	1.7	4.5
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	-10.4	-9.7	-9.7
16. Constant (1972) dollars	67.0	72.2	79.9	65.7	72.9	74.5*	75.5	77.1	79.2	80.8	82.4
17. Merchandise exports (excl. military)	(0.3)	(7.8)	(10.7)	(4.5)	(51.3)	(9.1)*	(5.7)	(8.7)	(10.8)	(8.2)	(8.7)
18. Merchandise imports	71.0	75.6	78.8	74.4	74.0	77.1*	76.8	76.8	78.6	79.3	80.4
19. (% change, annual rates)	(13.0)	(6.5)	(4.2)	(6.6)	(-2.0)	(17.9)*	(-1.6)	(0)	(9.5)	(4.1)	(5.3)
20. Foreign Outlook - Ten Industrial Countries <u>6/</u>											
Real GNP, % change, annual rates	3.0	3.7	4.1	5.5	4.1	3.4	3.6	4.5	4.3	4.4	4.4
21. Consumer Prices, <u>7/</u> % change, A.R.	7.9	5.4	6.1	4.9	6.8	4.1	5.6	6.3	6.4	7.3	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, United Kingdom, Netherlands, Sweden, Belgium, and Switzerland in the sum of the real GNP of the ten countries in dollar terms.

7/ Wholesale prices for Japan.

p/ Projected.

e/ Estimated.

*/ Published data.

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