

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,¹ and then making the scanned versions text-searchable.² 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.

¹ 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).

² 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)

May 16, 1979

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary of Recent Developments. Recent data on economic activity have been distorted to some extent by the effects of strike and weather patterns, but it is the staff's judgment that economic activity is growing at a rather moderate pace. Inflation remains at double digit rates, with price increases widespread and especially large rises for energy items.

In April, the trucking disruption depressed employment as well as the average workweek. However, the unemployment rate, at 5.8 per cent, was little changed from the previous month. Nonfarm payroll employment showed a small gain of 130,000 (strike adjusted), concentrated in service producing industries; manufacturing employment was down slightly. Industrial production is estimated to have declined 1 per cent in April. Declines were widespread, although a major portion of the over-all drop was accounted for by a cut-back in the production of motor vehicles and parts as a result of both the trucking dispute and inventory back-ups.

Retail sales rose 0.5 per cent in April. Large gains were posted for food and gasoline where price increases have been especially rapid. In real terms, total retail sales appear to have continued the decline that has characterized the year to date. Spending for discretionary items has been particularly weak, with current dollars sales at the GAF grouping of stores (general merchandise, apparel and furniture and appliances) down 0.4 per cent during April and virtually unchanged since the end of 1978.

Unit auto sales were at an 11.4 million annual rate in April after the near-record 12.3 million selling pace in March. Fuel-efficient imports and American subcompacts continued to sell extremely well.

In the first quarter, real personal income remained about unchanged, but real disposable income increased somewhat due to the Federal income tax cut. Consumer confidence as measured by the University of Michigan and Conference Board surveys deteriorated further in April, with heightened concerns over current and prospective economic and financial conditions.

Business investment spending increased substantially in March as shipments of nondefense capital goods and construction activity rebounded from earlier weather-depressed levels. In the first quarter, new orders for total nondefense capital goods rose substantially less than in late 1978, but the pace of growth remained close to the brisk pace of last year as a whole. Construction contracts data, however, suggest a somewhat slower growth of nonresidential construction activity than last year.

The book value of manufacturers' inventories rose at an annual rate of about \$26 billion in March; this was the third month of large increases in nominal values which partly reflected the recent acceleration of inflation. Unlike the two earlier months in the quarter, the March inventory rise was concentrated in materials and supplies; however, the distribution among industries suggested some strike hedging. Because of the exceptionally large weather-related increase in manufacturers' shipments in March, the inventory-to-sales ratio fell to the lowest level

in nearly 30 years. Trade inventories rose at a hefty \$32 billion annual rate in March. This increase was concentrated in nondurable commodities, partly because general merchandise and apparel stocks were being replenished by retailers following three months of liquidation.

Housing starts picked up substantially in March from the weather-depressed rates in January and February. The bounceback occurred in both single and multi-family units. Nonetheless, housing starts as well as permits and total home sales were off substantially from fourth quarter rates with the weakness fairly widespread among regions.

Recent price data show a continuation of the stepped-up inflation rate that began at the turn of the year. Consumer prices rose in March at a 12 per cent annual rate and in April producer finished goods prices increased at an 11 per cent rate. Recent inflationary pressures have been especially intense for energy products, reflecting the higher prices of imported oil, a relaxation of gasoline pricing regulations and, apparently, increased demand as well as somewhat reduced stocks of gasoline. For food prices, there may be some moderation in the months ahead, since price increases at the farm level have slowed considerably. However, even excluding food and energy items, prices have continued to rise rapidly so far this year.

Wage rates, as measured by the average hourly earnings index, increased at an 8.3 per cent annual rate over the first four months of this year, about the same pace as during 1978 and less than the rate of inflation. The light collective bargaining calendar in the first quarter was a factor

damping the increase of wage gains somewhat. Productivity during the first quarter of 1979 declined sharply, and contributed to an unusually large increase in unit labor costs.

Outlook. The staff now projects a 2-1/4 per cent annual rate of real GNP growth in the second quarter of 1979, and an annual rate of increase of 1-1/2 per cent for the first and second quarters combined. These estimates are slightly less than in the previous Greenbook. As before, we expect economic activity to be strengthened temporarily in the second quarter by some rebound in private and public construction from weather-related disruptions, which resulted in sizable increases in business fixed investment and State and local purchases. Consumer outlays are projected to grow at about the same moderate pace during the spring as in the earlier quarter. Inventory investment is not expected to contribute significantly to over-all growth in GNP. In addition, with housing starts in March having risen less than expected and inflows at thrift institutions reduced, residential construction expenditures are now projected to weaken somewhat more than was previously assumed. The price situation--especially for energy items--continues to look bleak, and the gross business product fixed-weight price index is now projected to increase at an annual rate of 10-1/4 per cent in the current quarter, one-half point above last month's indication.

The assumptions underlying the staff projection over the remainder of 1979 and in 1980 are little changed from a month ago. If gasoline

shortages were to persist and grow worse, they could have a damping impact on economic activity and affect the pattern of outlays. But the outlook for supplies remains quite unclear at this point, and thus we have not revised our projections to incorporate new assumptions in regard to fuel shortages. As regards monetary policy, M_1 growth still is assumed to be about 6 per cent in both 1979 and 1980, after adjustment for the downward effect of ATS. Short-term interest rates are expected to remain around their current levels over the remainder of this year and then to recede gradually in 1980. The recent reduction in thrift deposits flows has led to lower the projection of these flows and hence mortgage credit conditions are expected to tighten somewhat further in the next several months. While Federal fiscal policy assumptions remain essentially unchanged, the projected Federal deficits have been reduced somewhat due to the higher-than-expected personal income tax yields observed in April. The unified deficit is expected to be around \$30 billion in FY 1979 and around \$27 billion in FY 1980.

The pattern of economic activity projected from mid-1979 to the end of 1980 remains similar to that shown last month. The rate of real GNP growth is expected to slow to about 1 per cent annual rate by the last half of 1979 and remain in this area during 1980.

We now anticipate that housing starts will drop to a 1.55 million unit annual rate at the end of this year--about 50,000 below last month's indication. The projection continues to assume a slowing in the pace of real business fixed investment outlays--based on the February Commerce survey

of business spending, our expectations of weakening aggregate demands and other factors. The more optimistic results of a recent private survey were discounted in part because of a long history of large upward bias. Given these investment spending patterns and a projected modest growth of government outlays, household real income and consumption are expected to rise quite slowly over the next year and a half. At the same time, however, the personal saving rate is anticipated to remain in an historically low range of around 5 per cent.

Reflecting the expected pattern of output growth, increases in employment are projected to be smaller and the unemployment rate is expected to rise to around 7 per cent by the end of 1980. Despite this easing in labor demand, hourly compensation increases over the next two years still are expected to be influenced by past inflation and to average 9-1/4 per cent, down only moderately from 1978. Moreover, with the projected slow growth in productivity, unit labor costs will rise rapidly, putting continued upward pressure on prices. In the second half of this year the over-all rate of price rise--measured by the gross business product fixed-weight price index--is projected at an annual rate of 8-1/4 per cent, about 1-3/4 percentage points below that of the first half; much of the relief stems from an easing of food prices that is currently evident at the wholesale level. Over the four quarters of 1980, the business product price index is projected to rise about 8 per cent.

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)	
	4/11/79	5/16/79	4/11/79	5/16/79	4/11/79	5/16/79	4/11/79	5/16/79
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 1/	11.7	11.7	4.0	4.0	7.7	7.7	6.0	6.0
1979	11.8	11.6	3.1	2.9	9.2	9.2	6.0	6.0
1980	9.4	9.5	1.2	1.2	8.3	8.3	6.8	6.8
1978-III 1/	9.6	9.6	2.6	2.6	8.0	8.0	6.0	6.0
1978-IV 1/	15.7	15.6	6.9	6.9	8.0	8.0	5.8	5.8
1979-I 1/	10.8	9.5	1.3	.7	10.4	9.8	5.7	5.7
1979-II	11.3	12.0	2.4	2.2	9.7	10.3	5.9	5.9
1979-III	8.6	8.4	1.0	.8	8.3	8.3	6.1	6.1
1979-IV	9.8	9.8	1.1	1.0	8.3	8.3	6.3	6.3
1980-I	9.2	9.3	1.1	1.1	8.4	8.5	6.5	6.5
1980-II	9.4	9.4	1.2	1.2	8.2	8.2	6.7	6.7
1980-III	9.2	9.2	1.4	1.4	7.7	7.7	6.9	6.9
1980-IV	9.7	9.6	1.4	1.4	7.7	7.7	7.1	7.1
Change:								
77-IV to								
78-IV 1/	13.1	13.1	4.4	4.4	8.7	8.7	-.8	-.8
78-IV to								
79-IV	10.1	9.9	1.4	1.2	9.2	9.2	.5	.5
79-IV to								
80-IV	9.4	9.4	1.3	1.3	8.0	8.0	.8	.8
Memo:								
Growth Over Annual Policy Period:								
78-IV to								
79 IV	10.1	9.9	1.4	1.2	9.2	9.2	.5	.5
1/ Actual.								

CONFIDENTIAL - FR
 ASS 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.)

	1979				1980			
	Projected							
	I	II	III	IV	I	II	III	IV
Gross national product	2265.6	2330.9	2378.5	2434.5	2489.2	2545.7	2602.3	2662.9
Final purchases	2247.4	2312.3	2360.9	2417.4	2472.1	2529.6	2587.2	2648.8
Private	1788.0	1842.1	1879.8	1924.0	1969.1	2017.0	2065.0	2113.3
Excluding net exports	1798.3	1849.5	1889.3	1929.5	1972.4	2017.0	2061.2	2106.4
Personal consumption expenditures	1444.7	1487.5	1522.1	1556.1	1591.1	1626.9	1662.6	1699.6
Goods	783.1	806.9	822.4	837.8	853.3	869.7	886.2	903.2
Services	661.6	680.6	699.7	718.3	737.8	757.2	776.4	796.4
Gross private domestic investment	371.6	380.6	384.8	390.5	398.4	406.2	413.7	420.9
Residential construction	110.9	109.4	107.9	107.9	109.6	112.4	115.2	118.2
Business fixed investment	242.6	252.6	259.3	265.5	271.7	277.7	283.4	288.6
Change in business inventories	18.1	18.6	17.6	17.1	17.1	16.1	15.1	14.1
Nonfarm	19.6	18.6	17.6	17.1	17.1	16.1	15.1	14.1
Net exports of goods and services ^{1/}	-10.3	-7.4	-9.5	-5.5	-3.3	.0	3.8	6.9
Exports	229.0	239.6	250.2	260.2	267.8	277.1	286.2	294.6
Imports	239.2	246.9	259.6	265.6	271.0	277.0	282.3	287.6
Gov't. purchases of goods and services	459.4	470.2	481.1	493.4	503.0	512.6	522.2	535.5
Federal ^{2/}	164.7	164.7	169.1	174.9	177.7	180.2	182.6	188.6
State and local	294.8	305.5	312.0	318.5	325.3	332.4	339.6	346.9
Gross national product in constant (1972) dollars	1417.3	1425.0	1427.7	1431.3	1435.3	1439.7	1444.7	1449.7
Personal income	1834.1	1883.1	1938.1	1987.2	2028.5	2073.2	2128.5	2177.1
Wage and salary disbursements	1184.7	1210.7	1234.9	1262.9	1290.6	1316.5	1343.3	1373.8
Disposable personal income	1563.5	1603.6	1648.0	1687.2	1721.4	1757.9	1803.8	1842.3
Saving rate (per cent)	5.2	4.8	5.2	5.3	5.0	4.9	5.2	5.1
Corporate profits with I.V.A. and C.C. Adj.	165.2	178.5	176.8	179.7	180.9	186.1	190.0	194.7
Corporate profits before tax	226.2	236.8	228.8	231.9	234.5	240.0	242.2	248.1
Federal government surplus or deficit (-) (N.I.A. basis)	-19.9	-13.6	-27.0	-28.1	-22.7	-18.8	-23.4	-20.5
High employment surplus or deficit (-)	6.0	13.5	5.9	8.6	19.6	28.2	28.2	35.0
State and local government surplus or deficit (-) (N.I.A. basis)	26.2	22.8	23.3	24.2	23.9	22.8	22.2	22.1
Excluding social insurance funds	2.4	-1.6	-1.8	-1.4	-2.3	-4.0	-5.1	-5.8
Civilian labor force (millions)	102.5	102.7	103.6	104.1	104.7	105.2	105.7	106.2
Unemployment rate (per cent)	5.7	5.9	6.1	6.3	6.5	6.7	6.9	7.1
Nonfarm payroll employment (millions)	87.9	88.5	88.8	89.1	89.4	89.6	89.9	90.1
Manufacturing	20.9	21.0	21.0	21.0	20.9	20.9	20.9	20.9
Industrial production (1967=100)	151.3	152.2	152.8	153.3	153.6	154.0	154.4	154.8
Capacity utilization: all mfg. (per cent)	86.1	85.8	85.3	84.7	84.1	83.6	83.0	82.4
Materials (per cent)	87.5	87.3	86.9	86.6	86.1	85.7	85.3	84.9
Housing starts, private (million units, A.R.)	1.62	1.80	1.60	1.55	1.60	1.65	1.70	1.75
New autos sales, (millions, A.R.)	11.55	11.20	10.95	10.70	10.60	10.55	10.50	10.50
Domestic models	9.13	8.90	8.85	8.80	8.75	8.75	8.75	8.80
Foreign models	2.42	2.30	2.10	1.90	1.85	1.80	1.75	1.70

^{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.

May 16, 1979

CONFIDENTIAL - FR
ASS II FOMC

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

	1979				1980			
	I	II	III	Projected IV	I	II	III	IV
<u>Constant (1972) dollars</u>								
Gross national product	.7	2.2	.8	1.0	1.1	1.2	1.4	1.4
Final purchases	-1.3	2.2	.9	1.2	1.1	1.4	1.6	1.5
Private	.5	2.2	.5	1.2	1.1	1.4	1.7	1.6
Excluding net exports	1.0	1.7	.6	.6	.7	1.0	1.2	1.2
Personal consumption expenditures	1.8	2.0	1.3	1.1	.8	1.0	1.3	1.5
Goods	-1.1	.3	-.5	-.3	-.6	-.1	.5	.6
Services	5.3	4.0	3.3	2.7	2.5	2.2	2.3	2.4
Gross private domestic investment	4.5	.8	-3.7	-2.6	.1	-.1	-.6	-.7
Residential structures	-13.8	-15.1	-15.1	-10.3	-3.2	1.5	1.7	2.1
Business fixed investment	2.6	7.2	2.3	1.6	1.3	.9	.5	-.4
Gov't. purchases of goods and services	-3.4	2.1	3.0	1.2	1.4	1.4	1.4	1.4
Federal	-1.8	-4.5	5.9	1.6	1.4	.9	.9	1.0
State and local	-4.4	6.2	1.3	1.0	1.4	1.7	1.7	1.7
Disposable personal income	3.2	.4	3.1	1.6	-.1	.5	3.0	1.1
<u>Current dollars</u>								
Gross national product	9.5	12.0	8.4	9.8	9.3	9.4	9.2	9.6
Final purchases	8.6	12.1	8.7	9.9	9.4	9.6	9.4	9.9
Private	9.8	12.7	8.4	9.7	9.7	10.1	9.9	9.7
Excluding net exports	8.2	11.9	8.9	8.8	9.2	9.4	9.1	9.1
Personal consumption expenditures	12.1	12.4	9.6	9.2	9.3	9.3	9.1	9.2
Goods	11.3	12.7	7.9	7.7	7.6	7.9	7.8	7.9
Services	13.3	12.0	11.7	11.1	11.3	10.9	10.5	10.7
Gross private domestic investment	8.6	10.0	4.5	6.1	8.3	8.1	7.6	7.1
Residential structures	-8.4	-5.3	-5.4	.0	6.5	10.6	10.3	10.8
Business fixed investment	9.6	17.5	11.0	9.9	9.7	9.1	8.5	7.5
Gov't. purchases of goods and services	4.4	9.7	9.6	10.6	8.0	7.9	7.7	10.6
Federal	5.4	.1	11.1	14.4	6.6	5.7	5.4	13.8
State and local	3.8	15.4	8.8	8.6	8.8	9.0	8.9	8.9
Disposable personal income	13.7	10.7	11.5	9.9	8.4	8.7	10.9	8.8
Personal income	10.5	11.1	12.2	10.5	8.6	9.1	11.1	9.5
Wage and salary disbursements	12.9	9.1	8.2	9.4	9.1	8.3	8.4	9.4
Corporate profits with IVA & C.C. Adj.	-23.4	36.3	-3.8	6.7	2.7	12.0	8.6	10.3
Corporate profits before tax	2.3	20.1	-12.9	5.6	4.5	9.8	3.8	10.1
Nonfarm payroll employment	4.2	2.9	1.2	1.3	1.4	1.2	1.0	1.0
Manufacturing	6.0	1.7	.6	-.5	-1.2	-.6	-.4	-.2
Nonfarm business sector								
Output per hour	-4.2	1.2	.5	.7	.7	.9	1.1	1.0
Compensation per hour	10.2	8.7	8.9	9.0	10.3	9.0	8.9	8.8
Unit labor costs	15.0	7.5	8.4	8.3	9.6	8.0	7.7	7.7
GNP implicit deflator <u>1/</u>	8.7	9.6	7.6	8.7	8.1	8.1	7.7	8.2
Gross business product fixed-weighted price index <u>2/</u>	9.8	10.3	8.3	8.3	8.5	8.2	7.7	7.7
Industrial production	4.3	2.4	1.6	1.3	.7	1.0	1.1	1.1

1/ Excluding Federal pay increase rates of change are: 1979 QI, 8.7 per cent; 1979 QIV, 8.1 per cent; 1980 QI, 8.1 per cent; 1980 QIV, 7.7 per cent.
Using expenditures in 1972 as weights.

May 16, 1979

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.)

	1977				1978			
	I	II	III	IV	I	II	III	IV
Gross national product	1806.8	1867.0	1916.8	1958.1	1992.0	2087.5	2136.1	2214.8
Final purchases	1796.5	1850.0	1894.9	1945.0	1975.3	2067.4	2122.5	2201.3
Private	1421.5	1461.2	1495.4	1532.5	1558.6	1642.7	1682.7	1746.8
Excluding net exports	1430.0	1467.1	1502.4	1555.7	1582.7	1648.2	1693.4	1754.4
Personal consumption expenditures	1167.7	1188.6	1214.5	1255.2	1276.7	1322.9	1356.9	1403.9
Goods	639.1	649.2	657.1	684.1	684.9	717.1	731.2	762.5
Services	528.6	539.4	557.5	571.1	591.8	605.8	625.8	641.4
Gross private domestic investment	272.5	295.6	309.7	313.5	322.7	345.4	350.1	364.0
Residential construction	81.6	91.4	94.3	100.2	100.3	105.3	109.0	113.4
Business fixed investment	180.6	187.2	193.5	200.3	205.6	220.1	227.5	237.1
Change in business inventories	10.3	17.0	21.9	13.1	16.7	20.1	13.6	13.5
Nonfarm	11.1	16.5	22.0	10.4	16.9	22.1	14.6	13.4
Net exports of goods and services ^{1/}	-8.5	-5.9	-7.0	-23.2	-24.1	-5.5	-10.7	-7.6
Exports	170.9	178.1	180.8	172.1	181.7	205.4	210.1	221.9
Imports	179.4	184.0	187.8	195.2	205.8	210.9	220.8	229.5
Gov't. purchases of goods and services	375.0	388.8	399.5	412.5	416.7	424.7	439.8	454.5
Federal ^{2/}	138.3	142.9	146.8	152.2	151.5	147.2	154.0	162.5
State and local	236.7	245.9	252.7	260.3	265.2	277.6	285.8	292.0
Gross national product in constant (1972) dollar	1306.7	1325.5	1343.9	1354.5	1354.2	1382.6	1391.4	1414.7
Personal income	1470.7	1508.6	1543.7	1593.0	1628.9	1682.4	1731.7	1789.0
Wage and salary disbursements	946.4	973.4	993.6	1021.2	1050.8	1090.2	1113.2	1149.4
Disposable personal income	1248.0	1285.3	1319.1	1359.6	1391.6	1433.3	1468.4	1513.9
Saving rate (per cent)	4.2	5.3	5.6	5.4	5.9	5.3	5.2	4.8
Corporate profits with I.V.A. and C.C. Adj.	129.9	143.7	154.8	148.2	132.6	163.4	165.2	176.6
Corporate profits before tax	164.8	175.1	177.5	178.3	172.1	205.5	205.4	224.9
Federal government surplus or deficit (-) (N.I.A. basis)	-37.3	-40.3	-56.4	-58.6	-52.6	-23.6	-22.8	-20.8
High employment surplus or deficit (-)	-2.9	-10.8	-29.9	-31.6	-19.5	-5	1.8	-1.0
State and local government surplus or deficit (-) (N.I.A. basis)	29.5	28.5	31.2	29.0	31.5	29.8	23.4	28.8
Excluding social insurance funds	12.5	10.8	12.8	9.9	11.5	9.3	1.8	5.9
Civilian labor force (millions)	96.2	97.1	97.6	98.5	99.3	100.1	100.8	101.5
Unemployment rate (per cent)	7.4	7.2	6.9	6.6	6.2	6.0	6.0	5.8
Nonfarm payroll employment (millions)	80.8	82.0	82.7	83.5	84.3	85.7	86.1	87.0
Manufacturing	19.4	19.6	19.7	19.9	20.1	20.3	20.3	20.6
Industrial production (1967=100)	133.6	137.0	138.4	139.3	139.6	144.0	147.0	149.7
Capacity utilization: all mfg. (per cent)	81.2	82.7	83.0	82.9	82.1	84.0	85.0	85.9
Materials (per cent)	80.4	82.6	82.3	82.2	81.7	84.5	86.0	87.6
Housing starts, private (million units, A.R.)	1.81	1.93	2.02	2.09	1.80	2.10	2.04	2.08
New autos sales, (millions, A.R.)	11.12	11.70	10.92	10.75	10.80	12.12	11.16	11.07
Domestic models	9.28	9.34	8.88	8.77	8.80	10.01	9.19	9.06
Foreign models	1.84	2.36	2.04	1.98	2.00	2.11	1.98	2.00

^{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.

May 16, 1979

CONFIDENTIAL - FR
CLASS II FOMC

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

	1977				1978			
	I	II	III	IV	I	II	III	IV
<u>Constant (1972) dollars</u>								
Gross national product	7.3	5.9	5.7	3.2	-1	8.7	2.6	6.9
Final purchases	5.3	4.6	5.0	4.7	-1.6	8.6	3.7	7.2
Private	6.1	3.7	4.8	4.8	-1.1	11.0	2.8	8.0
Excluding net exports	6.9	3.8	4.3	8.7	-1.0	7.7	3.7	7.7
Personal consumption expenditures	5.1	1.4	4.1	9.0	-1.4	6.0	4.1	7.6
Goods	5.2	1.2	2.4	13.5	-8.1	9.7	2.6	11.5
Services	4.9	1.5	6.1	3.9	7.0	1.9	5.9	3.1
Gross private domestic investment	32.8	25.7	9.7	-2.9	11.3	15.2	-5.1	5.8
Residential structures	10.2	37.8	5.2	11.1	-5.2	2.7	-1.6	4.0
Business fixed investment	19.0	7.5	5.3	5.3	4.2	21.3	3.5	9.5
Gov't. purchases of goods and services	2.4	8.0	5.8	4.2	-3.5	-2	7.2	4.0
Federal	5.1	10.7	6.4	2.9	-8.9	-15.3	14.3	8.8
State and local	.7	6.3	5.4	5.1	-1	9.6	3.4	1.3
Disposable personal income	1.7	6.2	5.9	7.8	1.1	3.5	3.6	6.1
<u>Current dollars</u>								
Gross national product	13.7	14.0	11.1	8.9	7.1	20.6	9.6	15.6
Final purchases	11.0	12.5	10.1	11.0	6.4	20.0	11.1	15.7
Private	11.3	11.6	9.7	10.3	7.0	23.4	10.1	16.1
Excluding net exports	14.9	10.8	10.0	15.0	7.1	17.6	11.4	15.2
Personal consumption expenditures	12.5	7.3	9.0	14.1	7.0	15.3	10.7	14.6
Goods	12.1	6.5	5.0	17.5	.5	20.2	8.1	30.7
Services	13.1	8.4	14.1	10.1	15.3	9.8	13.9	10.3
Gross private domestic investment	48.0	38.5	20.5	5.1	12.2	31.3	5.5	16.9
Residential structures	25.1	57.8	13.5	27.3	.5	21.0	14.9	17.3
Business fixed investment	25.9	15.3	14.1	14.8	11.1	31.2	14.3	18.0
Gov't. purchases of goods and services	9.9	15.5	11.5	13.7	4.1	7.9	15.0	14.1
Federal	11.5	14.0	11.3	15.7	-2.0	-10.9	20.0	23.9
State and local	9.0	16.4	11.6	12.5	7.8	19.9	12.4	9.0
Disposable personal income	9.0	12.5	10.9	12.9	9.8	12.5	10.2	13.0
Personal income	11.7	10.7	9.6	13.4	9.3	13.8	12.2	13.9
Wage and salary disbursements	12.0	11.9	8.6	11.6	12.1	15.9	8.7	13.7
Corporate profits with IVA & C.C. Adj.	26.4	49.8	34.7	-16.0	-35.9	130.6	4.5	30.6
Corporate profits before tax	29.1	27.5	5.6	1.8	-13.2	103.3	-2	43.7
Nonfarm payroll employment	3.9	5.6	3.6	4.0	3.8	6.9	2.1	4.0
Manufacturing	5.2	5.7	1.5	3.2	5.7	3.1	-2	6.0
Nonfarm business sector								
Output per hour	2.4	-1.4	3.7	.5	-3.1	1.7	2.3	1.9
Compensation per hour	8.3	6.5	8.1	7.6	12.2	8.2	9.6	9.1
Unit labor costs	5.8	8.0	4.2	7.1	15.7	6.4	7.1	7.0
GNP implicit deflator 1/	6.0	7.7	5.1	5.5	7.2	11.0	6.9	8.2
Gross business product fixed-weighted price index 2/	6.7	7.9	4.7	6.3	6.7	12.1	8.0	8.0
Industrial production	6.2	10.6	4.2	2.6	.9	13.2	8.6	7.6

1/ Excluding Federal pay increase rates of change are: 1977:QI, 5.9 per cent; 1977:QIV, 4.8 per cent; 1978:QI, 7.2 per cent; 1978:QIV, 7.6 per cent.
Using expenditures in 1972 as weights.

May 16, 1979

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

	1973	1974	1975	1976	1977	1978	Projected	
							1979	1980
Gross national product	1306.6	1412.9	1528.8	1700.1	1887.2	2107.6	2352.4	2575.1
Final purchases	1288.6	1404.0	1539.6	1689.9	1871.6	2091.6	2334.5	2559.5
Private	1019.1	1101.3	1201.2	1330.4	1477.6	1657.7	1858.5	2041.1
Excluding net exports	1012.0	1095.3	1180.8	1323.0	1488.7	1669.7	1866.7	2039.2
Personal consumption expenditures	809.9	889.6	979.1	1090.2	1206.5	1340.1	1502.6	1645.0
Goods	457.5	498.3	541.5	599.2	657.4	724.0	812.6	878.1
Services	352.3	391.3	437.5	491.0	549.2	616.2	690.0	766.9
Gross private domestic investment	220.0	214.6	190.9	243.0	297.8	345.6	381.9	409.8
Residential construction	66.1	55.1	51.5	68.2	91.9	107.0	109.0	113.8
Business fixed investment	136.0	150.6	150.2	164.6	190.4	222.6	255.0	280.3
Change in business inventories	17.9	8.9	-10.7	10.2	15.6	16.0	17.8	15.6
Nonfarm	14.7	10.8	-14.3	12.2	15.0	16.7	18.2	15.6
Net exports of goods and services ^{1/}	7.1	6.0	20.4	7.4	-11.1	-12.0	-8.1	1.9
Exports	101.6	137.9	147.3	163.2	175.5	204.8	244.7	281.4
Imports	94.4	131.9	126.9	155.7	186.6	216.8	252.8	279.5
Gov't. purchases of goods and services	269.5	302.7	338.4	359.5	394.0	433.9	476.0	518.3
Federal ^{2/}	102.2	111.1	123.1	129.9	145.1	153.8	168.3	182.3
State and local	167.3	191.5	215.4	229.6	248.9	280.2	307.7	336.0
Gross national product in constant (1972) dollars	1235.0	1217.8	1202.3	1271.0	1332.7	1385.7	1425.4	1442.3
Personal income	1052.4	1154.9	1255.5	1380.9	1529.0	1708.0	1910.6	2101.8
Wage and salary disbursements	701.3	764.6	805.9	890.1	983.6	1100.9	1223.3	1331.0
Disposable personal income	901.7	984.6	1086.7	1184.4	1303.0	1451.8	1625.6	1781.3
Saving rate (per cent)	7.8	7.3	7.7	5.7	5.1	5.3	5.1	5.1
Corporate profits with I.V.A. and C.C. Adj.	99.1	83.6	95.9	127.0	144.2	159.5	175.0	187.9
Corporate profits before tax	115.8	126.9	120.4	155.9	173.9	202.0	230.9	241.2
Federal government surplus or deficit (N.I.A. basis)	-6.7	-10.7	-70.6	-53.8	-48.1	29.9	-22.2	-21.4
High employment surplus or deficit (-)	-1.3	14.9	-26.9	-19.5	-18.8	-4.8	8.5	27.8
State and local government surplus or deficit (-) (N.I.A. basis)	13.0	7.6	6.2	20.7	29.6	28.3	24.1	22.7
Excluding social insurance funds	4.1	-2.9	-6.2	5.5	11.5	7.1	-6	-4.3
Civilian labor force (millions)	88.7	91.0	92.6	94.8	97.4	100.4	103.2	105.5
Unemployment rate (per cent)	4.9	5.6	8.5	7.7	7.0	6.0	6.0	6.8
Nonfarm payroll employment (millions)	76.8	78.3	76.9	79.4	82.3	85.8	88.5	89.7
Manufacturing	20.2	20.1	18.3	19.0	19.6	20.3	21.0	20.9
Industrial production (1967=100)	129.8	129.3	117.8	129.8	137.1	145.2	152.4	154.2
Capacity utilization: all manufacturing (per cent)	87.5	84.2	73.6	80.2	82.5	84.3	85.5	83.3
Materials (per cent)	92.4	87.7	73.6	80.4	81.9	85.0	87.1	85.5
Housing starts, private (million units, A.R.)	2.05	1.34	1.16	1.54	1.99	2.02	1.64	1.67
New auto sales, (millions, A.R.)	11.42	8.91	8.66	10.12	11.13	11.29	11.10	10.54
Domestic models	9.65	7.49	7.08	8.63	9.07	9.27	8.92	8.76
Foreign models	1.77	1.42	1.58	1.50	2.06	2.02	2.18	1.77

- ^{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.

May 16, 1979

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

	1973	1974	1975	1976	1977	1978	Projected	
							1979	1980
<u>Constant (1972) dollars</u>								
Gross national product	5.5	-1.4	-1.3	5.7	4.9	4.0	2.9	1.2
Final purchases	4.9	-.7	.2	4.3	4.7	3.9	2.8	1.3
Private	6.3	-1.4	-.3	5.5	5.3	4.3	3.1	1.2
Excluding net exports	5.1	-2.3	-1.0	6.4	6.0	4.5	3.0	.9
Personal consumption expenditures	4.7	-.9	1.8	5.8	4.7	4.0	3.3	1.1
Goods	5.0	-3.4	.7	6.4	5.0	3.4	2.7	-.2
Services	4.4	2.3	3.2	5.0	4.4	4.6	4.1	2.7
Gross private domestic investment	10.0	-11.4	-22.3	21.6	13.2	7.3	1.9	-1.0
Residential structures	-3.7	-24.6	-13.9	23.4	20.5	3.8	-8.4	-5.3
Business fixed investment	12.2	-.3	-13.0	4.7	9.1	8.1	5.8	1.6
Gov't. purchases of goods and services	-.2	2.1	1.9	.1	2.4	2.2	1.6	1.6
Federal	-5.4	-.8	.7	.1	5.2	-1.3	1.8	1.4
State and local	3.2	3.8	2.6	.1	.8	4.2	1.5	1.7
Disposable personal income	6.7	-1.5	2.1	3.5	4.1	4.3	3.1	1.2
<u>Current dollars</u>								
Gross national product	11.6	8.1	8.2	11.2	11.0	11.7	11.6	9.5
Final purchases	10.9	8.9	9.7	9.8	10.8	11.8	11.6	9.6
Private	12.2	8.1	9.1	10.8	11.1	12.2	12.1	9.8
Excluding net exports	11.0	8.2	7.8	12.0	12.5	12.2	11.8	9.2
Personal consumption expenditures	10.5	9.8	10.1	11.4	10.7	11.1	12.1	9.5
Goods	11.4	8.9	8.7	10.7	9.7	10.1	12.2	8.1
Services	9.3	11.1	11.8	12.2	11.8	12.2	12.0	11.1
Gross private domestic investment	16.8	-2.5	-11.0	27.3	22.6	16.0	10.5	7.3
Residential structures	6.6	-16.7	-6.5	32.5	34.8	16.4	1.9	4.4
Business fixed investment	16.4	10.8	-.3	9.6	15.7	16.9	14.6	9.9
Gov't. purchases of goods and services	6.5	12.3	11.8	6.2	9.6	10.1	9.7	8.9
Federal	.1	8.7	10.7	5.5	11.7	6.0	9.4	8.3
State and local	10.8	14.5	12.5	6.6	8.4	12.6	9.8	9.2
Disposable personal income	12.5	9.2	10.4	9.0	10.0	11.4	12.0	9.6
Personal income	11.7	9.7	8.7	10.0	10.7	11.7	11.9	10.0
Wage and salary disbursements	10.6	9.0	5.4	10.4	10.5	11.9	11.1	8.8
Corporate profits with IVA & C.C. Adj.	7.6	-15.6	14.7	32.4	13.5	10.6	9.7	7.4
Corporate profits before tax	20.4	9.6	-5.1	29.5	11.5	16.2	14.3	4.5
Nonfarm payroll employment	4.3	1.9	-1.7	3.2	3.6	4.3	3.3	1.4
Manufacturing	5.2	-.4	-8.7	3.7	3.4	3.5	3.1	-.4
Nonfarm business sector								
Output per hour	1.7	-2.9	1.9	3.5	1.3	.5	.0	.8
Compensation per hour	7.8	9.4	9.9	8.4	8.1	9.3	9.3	9.3
Unit labor costs	6.0	12.7	7.8	4.7	6.7	8.8	9.3	8.4
GNP implicit deflator	5.9	9.7	9.6	5.2	5.9	7.4	8.5	8.2
Gross business product fixed-weighted price index ^{1/}	5.7	10.4	9.4	5.4	6.2	7.7	9.2	8.3
Industrial production	8.4	-.4	-8.9	10.2	5.6	5.9	5.0	1.2

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

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

May 16, 1979

	Fiscal Year 1978*	FY 1979 e/ Admin. F.R. 1/ Board		FY 1980 e/ Admin. F.R. 1/ Board		CY 1978*	CY79e/ F.R. Board	FRB Staff Estimates Calendar quarters; unadjusted data								
								1978			1979			1980		
								IV*	I*	II	III	IV	I	II	III	
Unified budget receipts	402.0	461.8	464.3	503.9	512.2	416.9	475.3	99.5	102.1	142.9	119.8	110.4	112.0	154.1	135.6	
Unified budget outlays	450.8	495.0	494.3	532.3	539.2	460.6	504.5	123.2	122.6	123.3	125.3	133.3	133.1	135.2	137.6	
Surplus(+)/Deficit(-), unified budget	-48.8	-33.2	-30.0	-28.4	-27.0	-43.7	-29.2	-23.7	-20.5	19.6	-5.5	-22.9	-21.1	18.9	-2.0	
Surplus(+)/Deficit(-), off-budget agencies 2/	-10.3	-12.0	-13.4	-12.0	-11.5	-9.1	-14.3	-0.1	-3.0	-6.0	-4.3	-1.0	-3.0	-4.0	-3.5	
Combined deficit to be financed	-59.1	-45.2	-43.4	-40.4	-38.5	-52.8	-43.5	-23.8	-23.5	13.6	-9.8	-23.9	-24.1	14.9	-5.5	
Means of financing combined deficits:																
Net borrowing from public	59.1	35.8	31.1	38.4	37.2	53.6	34.8	15.2	10.6	-4.9	10.2	18.9	17.5	-4.9	5.7	
Decrease in cash operating balance	-3.3	7.4	7.4	0.0	0.0	-4.0	4.3	6.1	8.6	-6.3	-1.0	3.0	4.0	-8.0	1.0	
Other 3/	3.2	2.0	4.9	2.0	1.4	3.2	4.3	2.6	4.2	-2.4	0.5	2.0	2.6	-2.0	-1.2	
Cash operating balance, end of period	22.4	15.0	15.0	15.0	15.0	16.3	12.0	16.3	7.7	14.0	15.0	12.0	8.0	16.0	15.0	
Memo: Sponsored agency borrowing 4/	19.1	n.a.	23.1	n.a.	14.7	22.0	21.9	4.9	5.9	7.3	5.0	3.7	3.0	4.0	4.0	
NIA Budget								Seasonally adjusted annual rates								
Receipts 5/	413.8	470.1	472.6	515.9	523.6	431.5	485.8	463.1	467.2	482.7	490.5	502.8	516.0	528.7	541.3	I - 14
Expenditures 5/	450.6	496.3	496.2	540.8	545.4	461.4	508.0	483.8	487.2	496.3	517.5	530.9	538.7	547.5	564.7	
Purchases (total)	151.1	166.2	165.3	178.8	178.8	153.8	168.4	162.5	164.7	164.7	169.1	174.9	177.7	180.2	182.6	
Defense	98.1	105.3	105.1	116.0	114.9	99.5	107.5	102.1	103.9	106.1	108.2	111.9	113.8	115.9	118.0	
Non-defense	53.0	60.9	60.2	62.8	63.9	54.3	60.8	60.4	60.8	58.6	60.9	63.0	63.9	64.3	64.6	
All other expenditures	299.5	330.1	330.9	362.0	366.6	307.6	339.6	321.3	322.5	331.6	348.4	356.0	361.0	367.3	382.1	
Surplus(+)/Deficit(-) 5/	-36.8	-26.2	-23.6	-24.9	-21.8	-29.9	-22.2	-20.8	-19.9	-13.6	-27.0	-28.1	-22.7	-18.8	-23.4	
High Employment Surplus(+)/Deficit(-) (NIA basis) 6/	-12.4	n.a.	6.1	n.a.	21.1	-4.8	8.5	-1.0	6.0	13.5	5.9	8.6	19.6	28.2	28.2	
	*--actual	e--estimated		r--revised		n.a.--not available										

- 1/ The Budget of the United States Government: Fiscal Year 1980, January 1979, and Current Budget Estimates. March 1979, Office of Management and Budget.
- 2/ Includes Federal Financing Bank, Postal Service Fund, Rural Electrification and Telephone Revolving Fund, Rural Telephone Bank, and Pension Benefit Guaranty Corporation.
- 3/ Checks issued less checks paid, accrued items and other transactions.
- 4/ Includes Federal Home Loan Banks, FNMA, Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.
- 5/ The fiscal year totals as published by the BEA "Fiscal Year 1980 Budget Translation," January 1979, 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 BEA and staff estimates comparable.
- 6/ FRB staff estimates are consistent with the Council's new potential GNP series as reported in the Economic Report of the President, January 1979.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. The major monetary aggregates expanded sharply in April. M-1 grew at a 17 per cent annual rate, following six months of little net change. About half of this increase apparently was attributed to delays in the processing of income tax payments and a bunching of refunds. The interest-bearing component of M-2 also grew more rapidly in April, as outflows of savings deposits at banks slowed, while inflows of small-denomination time deposits picked up substantially. The latter component was bolstered by larger net sales of money market certificates (MMCs) and a reduction of outflows from fixed-rate-ceiling time accounts. The rise in MMC sales at banks reflected, in part, the elimination on March 15 of the 1/4 percentage point ceiling rate differential between banks and thrifts. In April, the bank share of net MMC sales rose nearly 15 percentage points from its average in the first quarter. The relative weakness in MMC issuance at thrifts contributed to a sharp drop-off in combined deposit growth at S&Ls and MSBs in April to a 2-1/2 per cent annual rate on a month-end basis.

With the marked acceleration in monetary aggregate growth, the Federal funds rate was increased slightly in late April to around 10-1/4 per cent. This action led to a reversal of the decline in short-term rates that had occurred around the time of the April FOMC meeting when many market participants concluded that a tightening of money market conditions was not imminent. Following their recent increases, Treasury bill rates now are a few basis points above their levels at the time of the meeting, while many private short-term rates remain somewhat lower. Taxable bond yields generally moved up by 15 to 25 basis points over the intermeeting period, primarily in response to the persistent strength of inflation, and stock prices fell around

3 per cent. The prices of stocks and bonds issued by many utilities were affected adversely by investor response to the Three Mile Island mishap.

Home mortgage rates in both primary and secondary markets have risen since mid-April, as a number of developments suggested that the decline in mortgage credit availability would continue. Despite some rebound in demand from the effects of severe weather earlier this year, mortgage lending by S&Ls last month likely remained around the reduced first quarter pace. The level of loan commitments outstanding had again fallen in March, and S&Ls probably adopted an even more cautious approach to mortgage market activity as a result of weak deposit growth in April, about three-fourths of S&Ls reported mortgage money in short supply in early May, up from just over one-half in late March. Sponsored agencies apparently increased their support of mortgage markets in April, as would be expected when other sources of funds decline. the rise in FHLB advances was the largest since the introduction of the MMC, and FNMA purchases are estimated to have remained sizable. Total net home mortgage lending had fallen more than 10 per cent from the fourth to first quarters, and in April probably remained close to the first quarter pace.

Mortgage-revenue bond sales by State and local governments declined slightly in April, contributing to a decrease in total bond offerings by these issuers. Tax-exempt bond sales have fallen even further in early May, following the introduction of a bill that would prohibit, beginning April 25, most State and local borrowing whose proceeds were slated for mortgage lending on owner-occupied dwellings. In contrast, Treasury borrowing picked up substantially in early April, reflecting in part auctions postponed from March due to debt ceiling constraints. Since the April FOMC meeting seasonal

tax inflows have been used to make large paydowns of regular and cash management bills. However, borrowing in the coupon market has remained sizable, including \$2-1/2 billion obtained in the mid-May refunding, as the Treasury has sought to build up its cash balance while meeting redemptions of nonmarketable debt by foreign official institutions.

Strength in credit demands of nonfinancial business has persisted, apparently reflecting a continued sizable financing gap. Bond offerings by nonfinancial firms have remained quite low, and much of the credit needs of this sector continue to be met at banks and in the commercial paper market.

Led by the pick-up in business loan growth, bank credit expansion accelerated sharply in April. With inflows to deposits included in the monetary aggregates strengthening markedly, banks allowed over \$6 billion of large CDs to run off in April, and borrowing from nondeposit sources slowed slightly. Bank holding companies tapped the securities markets for a large volume of longer-term funds in April through the issuance of more than \$1 billion of floating-rate notes; the proceeds of these issues were passed through to affiliate banks as injections of capital as well as used to refund maturing holding company debt.

Outlook. The staff expects that no further significant changes in the general level of short-term interest rates will be necessary to achieve monetary growth within the FOMC's longer-run ranges over coming months. Changes in the structure of short-term rates, of course, could well occur in reaction to such factors as shifts in the composition of international capital flows, which have produced a substantial narrowing of the spread between yields on private short-term instruments and Treasury

bills this year. With short-term rates essentially unchanged and inflation not expected to accelerate further, bond yields generally should remain close to current levels.

An important exception to the general stability of interest rates is likely to occur in the home mortgage market, where a reduction in the supply of funds through specialized lenders is expected to put some additional upward pressures on mortgage rates. Deposit growth at nonbank thrift institutions is projected to recover from its extraordinarily low rate in April, but the elimination of the differential between offering rates on MMCs at banks and thrifts will, apparently, adversely affect deposit inflows at S&Ls to a greater extent than previously projected. Although these institutions can be expected to meet mortgage commitments by curtailing liquid asset accumulation and stepping up their borrowing from Home Loan Banks and elsewhere, they also are likely to reduce their activity in mortgage markets even further. In addition, it seems probable that some limits will be placed on mortgage funds advanced through State and local borrowing. And FNMA has shown some reluctance to make commitments for mortgage purchases, as the marginal cost of its funds has risen above the return on newly acquired mortgages.

No significant interest rate pressures would appear to be associated with the expected pattern of credit flows in other markets. State and local bond issuance should remain quite moderate. The Treasury is scheduled to pay down additional cash management bills in June and raise only a small amount of money through intermediate-term coupon offerings. Although total Treasury borrowing is projected to pick up more than seasonally in the third quarter, it is expected to be below the pace set last year. The external financing needs of nonfinancial

the pace set last year. The external financing needs of nonfinancial businesses are likely to remain around recent high levels, with firms continuing to place a substantial share of their demands for credit on banks and in the commercial paper market.

INTERNATIONAL DEVELOPMENTS

Summary. The dollar has continued to be in strong demand on exchange markets over the five week period since the last Greenbook. Announcements of a reduced U.S. trade deficit in March and continued sharp price increases abroad contributed to the dollar's strength.

U.S. intervention has resulted in sales of about \$3/4 billion. The average exchange value of the dollar has risen about 1 per cent over the past 5 weeks.

The Japanese yen has fluctuated over a wide range in this period. The yen continued to drop sharply against the dollar in late April and the first several days of May, but statements by Japanese officials indicating their desire that the yen be stabilized at a substantially higher level triggered a sharp rise in the yen, and further support came from a relaxation of controls on inward capital flows. Between May 2 and May 14 the yen rose against the dollar by over 6 per cent, returning to about its level at the time of the last Greenbook.

The Desk purchased about \$1 billion of marks over the past 5 weeks, mostly in the last 2 weeks of April. These marks were used mainly to repay the last of the System's outstanding swap debt. Smaller-scale mark purchases so far this month have been added to Treasury balances. There were no Desk operations for U.S. account in yen or Swiss francs.

The main features of U.S. international transactions in recent months have been a moderation in the U.S. trade deficit, large net inflows of private capital, especially through shifts in banks' foreign positions, and a major liquidation of foreign official holdings of assets in the United States.

With a much reduced March deficit, the first quarter merchandise trade deficit was at an annual rate of about \$25 billion, close to the rate of the preceding quarter. Exports were up 5 per cent in value and 3 per cent in volume over the fourth quarter rate, with exports of capital goods (notably aircraft) and chemicals especially strong. Agricultural exports were down somewhat, as had been anticipated. All major categories of imports except petroleum declined in volume in the first quarter, and only capital goods imports rose in value. Imports of steel-mill products were down 30 per cent in volume, but somewhat less in value as the trigger-price formula operated to force up import prices relative to domestic prices. Imports of petroleum increased by nearly 8 per cent in value over the fourth quarter, with volume up nearly 5 per cent to 9.2 million barrels per day, and prices up about 4-1/2 per cent.

Intervention sales of dollars from January through the first week of May are estimated to have exceeded the large fourth-quarter increase in foreign official reserve holdings in the United States. These holdings declined by \$8.1 billion during the first quarter and by a further \$10 billion during the first six weeks of the second quarter. The sales by foreign official accounts have been concentrated in short-dated U.S. Treasury securities, exerting upward pressure on yields in that sector of the market.

U.S. banks reported a net private capital inflow of \$13.6 billion during the first quarter, mainly through interbank transactions, and indications are that such inflows continued into April. At the same time there was a \$6-7 billion outflow of U.S. funds for deposit in Euro-banks -- predominantly in foreign branches of U.S. banks -- financing about half of the interbank net inflow. The outflow into Eurodollar deposits was probably influenced by the two per cent increase, effective last November, in the reserve requirements on time deposits held at domestic offices of member banks.

Abroad, inflationary pressures in most major industrial countries continue to be strong. Whereas increases in consumer prices that occurred earlier in the year were partly seasonal, it appears now that the pass-through of previous increases in wholesale prices has become a more important force in consumer price inflation. Higher prices for imported oil and commodities, as well as the dollar's strength, have

continued to drive wholesale prices upward at rapid rates, and further increases are likely as recent oil price increases become reflected in the indexes. There are also signs in Germany and Japan that pressure from domestic demand has started to put pressure on prices.

In response to rising prices and some strengthening of demand, monetary conditions have recently become more restrictive in Japan, Germany, Canada and Switzerland.

Outlook. The staff's projection of this year's merchandise trade deficit has been scaled down by \$3 billion to about \$24 billion. A stronger rise in exports is now expected, with volumes still rising strongly while prices are pushed up more by rising domestic prices. The outlook for economic activity abroad is essentially unchanged from a month ago, while U.S. demand is projected somewhat slower, holding down imports, apart from oil. Petroleum imports are projected at a little over \$50 billion this year, with volumes up about 2 per cent by the fourth quarter compared to the fourth quarter of 1978, and prices up about 26 per cent.

The trade deficit is projected to diminish slowly in 1980, with the effects of the 1977-78 depreciation of the dollar on exports phasing out, while the oil import bill, even without further large price increases, rises to \$50 billion. Taking into account expected gains in the income and services components, the current-account deficit is projected at under \$10 billion this year, and close to balance by mid-1980. The staff does not expect the weighted average value of the dollar to change much from current levels over the year ahead.

OUTLOOK FOR U.S. NET EXPORTS AND RELATED ITEMS
(billions of dollars, seasonally adjusted annual rates)

May 16, 1979

	1978	1979 ^P	1980 ^P	1978		1 9 7 9 ^P				1 9 8 0 ^P			
				III	IV	I	II	III	IV	I	II	III	IV
1. <u>U.S. Current Account Balance</u>	-16.0	-6.4	4.0	-14.8	-5.3	-8.0	-5.9	-8.0	-4.2	-1.8	1.9	5.9	9.6
2. <u>GNP Net Exports of Goods & Services 1/</u>	-11.2	1.6	11.6	-10.0	-2.5	-.4	2.4	.3	4.3	6.5	9.8	13.6	16.7
3. (using GNP account data) <u>2/</u>	(-12.0)	(-8.1)	(1.9)	(-10.7)	(-7.6)	(-10.3*)	(-7.4)	(-9.5)	(-5.5)	(-3.3)	(0)	(+3.8)	(+6.9)
4. a) Merchandise Trade Balance	-34.1	-23.8	-19.5	-32.0	-25.5	-24.9*	-22.0	-25.5	-23.0	-22.2	-20.8	-18.7	-16.5
5. Exports (excl. military)	141.8	176.5	202.2	145.9	157.3	164.6*	172.9	180.6	187.8	193.0	199.0	205.3	211.6
6. Agricultural	29.9	31.6	33.8	31.7	31.3	30.4*	31.7	32.2	32.2	33.0	33.4	34.2	34.7
7. Nonagricultural	111.9	144.9	168.4	114.2	126.0	134.3*	141.3	148.5	155.6	160.0	165.6	171.2	176.9
8. Imports	176.0	200.3	221.8	177.9	182.7	189.5*	194.9	206.1	210.8	215.1	219.8	224.0	228.2
9. Petroleum and petrol. products	42.3	51.2	57.6	43.5	43.2	46.6*	48.0	54.4	55.6	56.5	57.3	58.0	58.7
10. Nonpetroleum	133.7	149.2	164.1	134.4	139.5	143.0*	146.9	151.7	155.2	158.7	162.5	166.0	169.4
11. b) Other Transactions, net	22.9	25.4	31.1	22.0	23.0	24.4	24.4	25.8	27.3	28.5	30.6	32.3	33.2
12. Selected Invest. Income, net <u>3/</u>	20.0	25.8	31.6	22.4	23.3	24.7	24.8	26.3	27.6	29.0	31.0	32.6	33.7
13. Other, net <u>4/</u>	2.9	-.4	-.5	-.4	-.3	-.3	-.4	-.5	-.3	-.5	-.4	-.3	-.5
<u>Merchandise Trade in 1972 \$</u>													
14. Merchandise exports (excl. military)	71.9	79.8	84.3	73.1	75.4	77.5*	78.9	80.5	82.1	82.9	83.8	84.7	85.7
15. (% change, annual rates)	(7.4)	(10.9)	(5.6)	(-.8)	(13.0)	(12.1)*	(7.0)	(8.7)	(8.2)	(3.6)	(4.5)	(4.5)	(4.5)
16. Merchandise imports	75.8	78.5	81.5	76.3	76.7	77.1*	77.2	79.5	80.3	80.5	81.3	81.9	82.4
17. (% change, annual rates)	(7.0)	(3.6)	(3.8)	(10.0)	(2.4)	(1.6*)	(.4)	(12.6)	(4.1)	(.8)	(3.6)	(2.8)	(2.8)
<u>Foreign Outlook - Ten Industrial Countries 5/</u>													
18. Real GNP, % change, annual rates	3.6	3.9	3.8	2.5	4.7	3.3	4.2	3.9	3.8	3.7	3.7	3.6	3.7
19. Consumer Prices, <u>6/</u> % change, A.R.	4.4	5.9	5.9	2.8	3.3	8.7	7.0	6.2	5.8	5.8	5.9	5.6	5.7

1/ Using data from the international accounts.

2/ Lines 2 and 3 are defined identically but, data in line 3 differ from Int'l. Acct. data (line 2) in that they usually lag the Int'l Acct. data in publication of revisions and new information.

3/ Excluding U.S. Govt. interest payments to foreigners, and reinvested earnings of incorporated affiliates.

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

5/ 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.

6/ Wholesale prices for Japan.

p/ Projected.

e/ Estimated.

*/ Published data.

NOTE: A revised methodology for seasonally adjusting merchandise exports and imports was introduced with the January data. Data for 1978 have been revised accordingly. The new seasonal pattern results in a smaller 1978-IV trade deficit and a larger 1978-I deficit; there is no change in the annual figures. These changes will be incorporated in the published GNP data in July 1979.