

## **Prefatory Note**

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

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

---

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

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

July 2, 1980

## **RECENT DEVELOPMENTS**

---

Prepared for the Federal Open Market Committee

By the staff of the Board of Governors of the Federal Reserve System

## DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Recent data indicate a substantially sharper economic contraction during the second quarter than had been projected previously, with real gross national product apparently registering its second largest decline in the postwar era. All major components of domestic final demand have exhibited considerable weakness in recent months, resulting in sizable cutbacks in employment and production. There are some indications, however, that the pace of contraction may be moderating. Price increases have eased somewhat, and this is associated importantly with developments in the energy sector.

Industrial production fell two percent in both April and May, following smaller declines earlier in the year. Output reductions in May were broadly based, with the most sizable declines occurring for motor vehicle products, home goods, construction supplies, and durable goods materials. Capacity utilization rates for both manufacturing and materials producers fell substantially further in May and are now 8 percentage points below their 1979 highs.

Labor demand continued to deteriorate in May. The unemployment rate rose to 7.8 percent as higher jobless rates were reported for nearly all demographic and occupational groups. Much of the retrenchment in May was again in durable goods manufacturing, with particularly large layoffs in automotive and construction-related industries. The factory workweek was off another 0.2 hour; since January, factory work schedules have been shortened by nearly one hour.

Consumer outlays for goods also continued to decline in May, reflecting sluggish income receipts, depressed levels of confidence, and, to some extent, the credit restraint program. Total retail sales in current dollars fell 1.5 percent--the fourth consecutive large monthly decline. Reductions in auto sales and outlays for building materials led the contraction in May. Domestic car sales have remained in the 5 to 5-1/2 million unit range (at an annual rate) since mid-April, the lowest selling rate for a comparable period in nearly two decades. Sales of foreign models have also declined recently; however, they held up relatively better than domestic units, and their share of the market has increased to a record 28.4 percent. In May, spending at the furniture, appliances, and general merchandise grouping of stores was up after three months of decline, but sales in this sector remained well below the first-quarter average. In real terms, retail sales fell about 2 percent in May and stood more than 10 percent below their recent January peak--a sharper decline than in the 1974-75 recession.

The housing market weakened further in May. Home sales fell for the seventh month in a row, while private housing starts dipped 11 percent to a seasonally adjusted annual rate of 920,000 units. Most of the drop in starts was in the multifamily sector, which had held up relatively well through the winter. Single-family starts remained at a depressed 600,000 unit pace for the third consecutive month. Since their cyclical peak in mid-1978, starts have fallen 55 percent, nearly matching the decline during the 1974-75 recession. Fragmentary data for June suggest some improvement in both buyer interest and building permits.

Business fixed investment outlays have fallen markedly since the first quarter. Although shipments of nondefense capital goods rose 1-3/4 percent in May, this increase followed a sharp decline in April and the two-month average was about 2 percent below the first quarter pace. Sales of heavyweight trucks dropped further in May to a level lower than in the previous recession. In addition, nonresidential construction activity fell again in May. Indicators of capital spending plans generally suggest further weakness in investment spending over the coming months.

The book value of manufacturers' inventories increased at only a \$7 billion annual rate in May. This small rise followed an exceptional increase of \$70 billion in total manufacturing and trade stocks during April. The accumulation of stocks so far during the second quarter has been accompanied by declines in sales and shipments. On a constant dollar basis, the stock-sales ratios have risen to levels only slightly below their peaks in early 1975. May data for automobile dealers show a further increase in days' supply for almost all car models.

The pace of inflation has slowed somewhat in recent months. Consumer prices increased 0.9 percent in both April and May, after rising 1.4 percent during each month of the first quarter; a marked deceleration in energy prices contributed substantially to a slowing in the CPI. At the producer level an easing of price pressures for finished goods was widely distributed, particularly in May. Since the beginning of the year the behavior of food prices has exerted a moderating influence on overall price indexes.

Outlook. The staff now expects that real GNP fell in the second quarter at about an 8-3/4 percent annual rate--compared with the projected 6 percent drop shown in the last Greenbook. All major components of private final demand are weaker than previously anticipated. The consequent involuntary accumulation of stocks and the continuing declines in final demand are expected to result in further production cutbacks in coming months. But, given the extent of production and employment adjustments to date, we now expect the recession to bottom out by the end of 1980, a bit earlier than projected last month.

The fiscal policy assumptions underlying the staff GNP projections have changed in two important respects since the last Greenbook. First, it is now assumed that effective January 1, 1981, corporate and personal income taxes will be cut by \$28 billion. The reduction in tax liabilities in 1981 is distributed as follows: \$20 billion in personal income taxes, \$5 billion in corporate income taxes, and \$3 billion as the first-year impact of liberalized depreciation allowances. Second, the President's proposed oil import fee, which would have added \$10 billion a year to federal revenues, has been deleted from the projection. Given the staff's economic projections and tax assumptions, the unified federal deficit is anticipated to be somewhat over \$50 billion for both the 1980 and 1981 fiscal years.

Our monetary policy assumptions involve M-1A growth of 4-1/2 percent in 1980 and 1981. In light of recent shortfalls in this aggregate, a faster monetary growth rate is implied in the near-term. Some adjustment of the growth path may be necessary to take account of shifts

from demand deposits into interest-bearing checking accounts in 1981. Interest rates are expected to increase somewhat over the balance of the year and then to rise more rapidly in 1981 as economic activity expands.

The cumulative peak-to-trough decline in real GNP is now projected to total 4.3 percent. The fundamental forces operating on the economy--particularly the corrosive effects of inflation and the impact of restrictive monetary and fiscal policy assumptions--are expected to depress activity further and limit the pace of the recovery. Real personal consumption expenditures and business capital spending are projected to continue falling throughout 1980, and a smaller than average cyclical rebound is expected for housing activity.

The recovery beginning in 1981 is expected to be moderate in comparison to previous cyclical expansions. Output is now projected to advance 2-1/2 percent over the four quarters of 1981; excluding the assumed tax cut, the rise would likely be around 1 percent. Personal consumption expenditures are projected to grow about 1-1/4 percent as the effects of the reduction in personal income taxes take hold, but the increase is tempered by sluggish growth in real income. With substantial excess capacity remaining, real outlays for business fixed investment are not expected to turn up during 1981. The increase in output anticipated in 1981 should exert some downward pressure on the unemployment rate as the year progresses. The staff currently expects the jobless rate to rise to about 9 percent in the beginning of 1981 and thereafter to edge down to about 8-3/4 percent by year-end.

Recent price performance has been somewhat better than anticipated. Overall, it appears that gross business product prices rose at a 9-3/4 percent rate in the second quarter, compared with an 11-1/4 percent rate in the first quarter. However, over the entire projection horizon the inflation outlook is only slightly improved from the last Greenbook. Price pressures are likely to remain relatively strong over the next year and a half as a result of recent and expected price increases by foreign oil producers, decontrol of domestic oil prices, some reacceleration of food prices, and large increases in unit labor costs. During the last half of this year, inflation is projected at a 9-3/4 percent rate, slowing to about an 8-1/2 percent rate in late 1981.

Detailed data for these projections are shown in the following tables.

## STAFF GNP PROJECTIONS

Percent changes, annual rate										
Nominal GNP		Real GNP		Gross domestic business product fixed-weighted price index				Unemployment rate (percent)		
				Total		Excluding food and energy				
5/14/80	7/2/80	5/14/80	7/2/80	5/14/80	7/2/80	5/14/80	7/2/80	5/14/80	7/2/80	
<b>Annual changes:</b>										
1978 <u>1/</u>	12.0	12.0	4.4	4.4	7.6	7.6	7.2	7.2	6.0	6.0
1979 <u>1/</u>	11.3	11.3	2.3	2.3	9.5	9.5	8.1	8.1	5.8	5.8
1980	8.3	7.1	-1.1	-1.7	10.6	9.9	8.2	7.9	7.4	7.8
1981	7.7	9.1	-1.8	-2	9.7	9.4	8.3	7.8	8.9	8.8
<b>Quarterly changes:</b>										
1979-Q1 <u>1/</u>	10.6	10.6	1.1	1.1	10.0	10.0	7.7	7.7	5.7	5.7
1979-Q2 <u>1/</u>	6.7	6.7	-2.3	-2.3	10.1	10.1	7.9	7.9	5.8	5.8
1979-Q3 <u>1/</u>	11.9	11.9	3.1	3.1	10.4	10.4	7.6	7.6	5.8	5.8
1979-Q4 <u>1/</u>	10.5	10.5	2.0	2.0	8.4	8.4	6.6	6.6	5.9	5.9
1980-Q1 <u>1/</u>	10.7	10.8	1.1	1.2	11.8	11.2	8.8	8.8	6.1	6.1
1980-Q2	4.4	-4	-5.9	-8.8	11.7	9.5	9.5	8.6	7.3	7.6
1980-Q3	4.6	2.1	-4.7	-6.1	10.6	9.5	8.4	7.8	7.9	8.6
1980-Q4	6.3	8.2	-3.7	-2.1	9.8	9.8	8.3	7.7	8.3	8.9
1981-Q1	8.4	12.0	-1.5	1.9	10.0	9.7	8.7	8.0	8.7	9.0
1981-Q2	9.3	12.6	.4	3.6	9.2	9.3	8.1	7.7	8.9	8.9
1981-Q3	9.2	10.3	.9	2.2	8.5	8.4	7.5	7.2	9.0	8.8
1981-Q4	10.2	10.9	1.2	2.2	8.5	8.4	7.4	7.2	9.1	8.7
<b>Two-quarter changes:</b> <sup>2/</sup>										
1979-Q4 <u>1/</u>	11.2	11.2	2.5	2.5	9.3	9.3	7.1	7.1	.1	.1
1980-Q2	7.5	5.1	-2.5	-3.9	11.7	10.4	9.2	8.6	1.4	1.7
1980-Q4	5.5	5.1	-4.2	-4.1	10.2	9.6	8.3	7.7	1.0	1.3
1981-Q2	8.8	12.3	-.6	2.8	9.7	9.5	8.4	7.9	.6	.0
1981-Q4	9.7	10.6	1.1	2.2	8.5	8.4	7.4	7.3	.2	-.2
<b>Four-quarter changes:</b> <sup>3/</sup>										
1978-Q4 <u>1/</u>	13.4	13.4	4.8	4.8	8.6	8.6	8.1	8.1	-.7	-.7
1979-Q4 <u>1/</u>	9.9	9.9	1.0	1.0	9.7	9.7	7.5	7.5	.1	.1
1980-Q4	6.5	5.1	-3.3	-4.0	11.0	10.0	8.7	8.1	2.4	3.0
1981-Q4	9.3	11.4	.2	2.5	9.0	8.9	7.9	7.6	.8	-.2

NOTE: Without the assumed 1981 tax cut, projected real GNP growth from 1980-Q4 to 1981-Q4 would be 1.0 percent and the unemployment rate would average 9.2 percent in 1981-Q4.

1/ Actual.

2/ Percent change from two quarters earlier.

3/ Percent change from four quarters earlier.

July 2, 1980

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.)

	1980				Projection	1981			
	Q1	Q2	Q3	Q4		Q1	Q2	Q3	Q4
Gross national product	2520.8	2518.5	2531.3	2581.4	2655.6	2735.4	2803.4	2876.7	
Final purchases	2516.1	2501.0	2538.8	2601.2	2670.6	2730.9	2791.3	2857.7	
Private	1998.9	1974.5	2002.0	2050.2	2109.1	2159.0	2207.8	2258.1	
Excluding net exports	2012.5	1978.8	2004.0	2044.7	2097.8	2151.9	2203.4	2257.0	
Personal consumption expenditures	1629.5	1625.2	1652.5	1687.7	1733.7	1778.2	1820.6	1863.3	
Goods	872.2	848.1	856.1	871.5	893.7	914.2	935.8	957.4	
Services	757.3	777.1	796.4	816.2	840.0	864.0	884.8	905.9	
Gross private domestic investment	387.7	371.1	344.0	337.2	349.1	378.2	394.9	412.7	
Residential construction	110.4	91.0	86.0	89.8	95.7	103.0	109.5	115.8	
Business fixed investment	272.6	262.6	265.5	267.2	268.4	270.7	273.3	277.9	
Change in business inventories	4.7	17.5	-7.5	-19.8	-15.0	4.5	12.1	19.0	
Nonfarm	4.4	17.5	-7.5	-19.8	-15.0	4.5	12.1	19.0	
Net exports of goods and services <sup>1/</sup>	-13.6	-4.3	-2.0	5.5	11.3	7.1	4.4	1.1	
Exports	308.1	307.8	310.6	313.1	323.2	333.4	343.9	354.6	
Imports	321.7	312.1	312.6	307.5	311.9	326.3	339.5	353.4	
Gov't. purchases of goods and services	517.2	526.5	536.8	551.0	561.5	571.9	583.5	599.6	
Federal <sup>2/</sup>	186.2	191.1	194.8	202.7	207.0	210.9	214.5	222.6	
State and local	331.0	335.4	342.0	348.3	354.5	361.0	369.0	377.0	
Gross national product in constant (1972) dollars	1444.7	1411.9	1390.0	1382.7	1389.2	1401.6	1409.3	1416.9	
Personal income	2057.4	2074.2	2123.1	2169.4	2207.3	2259.1	2319.4	2377.1	
Wage and salary disbursements	1303.7	1306.0	1316.0	1340.0	1365.9	1395.0	1423.7	1458.4	
Disposable personal income	1737.4	1752.7	1794.6	1832.2	1880.5	1921.3	1972.9	2017.9	
Saving rate (percent)	3.7	4.7	5.3	5.2	5.2	4.8	5.0	5.0	
Corporate profits with I.V.A. and C.C. Adj.	175.0	154.3	131.2	125.5	133.9	147.9	155.5	160.1	
Corporate profits before tax	260.4	212.2	193.7	190.7	201.3	214.1	220.5	226.6	
Federal government surplus or deficit (-) (N.I.A. basis)	-22.9	-44.7	-72.3	-75.1	-77.9	-66.2	-73.2	-70.6	
High employment surplus or deficit (-)	4.0	21.7	19.0	29.4	30.5	42.0	37.9	44.7	
State and local government surplus or deficit (-) (N.I.A. basis)	24.6	15.6	16.1	15.9	17.8	19.5	19.2	19.9	
Excluding social insurance funds	-4.2	-13.8	-13.8	-14.6	-13.3	-12.2	-13.1	-13.0	
Civilian labor force (millions)	104.2	104.9	105.2	105.4	105.7	106.0	106.3	106.7	
Unemployment rate (percent)	6.1	7.6	8.6	8.9	9.0	8.9	8.8	8.7	
Nonfarm payroll employment (millions)	90.8	90.3	89.3	89.1	89.1	89.4	89.7	90.1	
Manufacturing	20.9	20.4	19.9	19.6	19.5	19.7	19.8	19.9	
Industrial production (1967=100)	152.2	145.6	142.1	140.1	140.0	141.8	142.2	143.1	
Capacity utilization: all mfg. (percent)	83.7	78.9	76.3	74.6	74.1	74.4	74.1	74.1	
Materials (percent)	85.4	80.3	76.8	74.6	73.9	74.4	74.4	74.5	
Housing starts, private (million units, A.R.)	1.26	.95	1.00	1.15	1.20	1.35	1.35	1.40	
New autos sales, (millions, A.R.)	10.65	7.67	8.35	8.60	8.90	9.10	9.25	9.60	
Domestic models	7.87	5.57	6.00	6.25	6.50	6.65	6.75	7.10	
Foreign models	2.77	2.10	2.35	2.35	2.40	2.45	2.50	2.50	

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

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

July 2, 1980

CONFIDENTIAL - FR  
CLASS II FOMCPERCENT CHANGES IN GROSS NATIONAL PRODUCT  
AND RELATED ITEMS  
(Annual rates compounded quarterly)

	1980				1981			
	Q1	Q2	Q3	Q4	Projection Q1	Q2	Q3	Q4
<u>Constant (1972) dollars</u>								
Gross national product	1.2	-8.8	-6.1	-2.1	1.9	3.6	2.2	2.2
Final purchases	1.5	-11.1	-2.4	-3	1.1	.8	1.1	1.2
Private	.9	-13.5	-3.0	-4	1.4	.9	1.2	1.2
Excluding net exports	-.8	-15.7	-4.1	-1.6	.9	1.2	1.3	1.5
Personal consumption expenditures	.5	-11.3	-2.9	-1.3	1.3	1.2	1.4	1.2
Goods	-1.8	-19.9	-6.0	-3.3	.1	-2	1.2	.9
Services	3.2	-.8	.6	.8	2.5	2.6	1.6	1.6
Gross private domestic investment	-8.3	-19.2	-32.5	-15.8	5.3	27.2	9.6	10.2
Residential structures	-26.2	-58.0	-26.8	9.1	18.9	23.7	17.2	14.7
Business fixed investment	1.7	-23.2	-4.0	-5.7	-6.0	-4.3	-3.7	-1.0
Gov't. purchases of goods and services	4.2	-.9	.2	.0	-.1	.1	1.1	1.3
Federal	13.1	3.3	1.2	1.2	1.2	1.2	.9	1.5
State and local	-.7	-3.3	-.5	-.7	-.8	-.5	1.2	1.3
Disposable personal income	.9	-7.2	-.2	-1.5	1.0	-.4	2.6	1.0
<u>Current dollars</u>								
Gross national product	10.8	-.4	2.1	8.2	12.0	12.6	10.3	10.9
Final purchases	11.0	-2.4	6.2	10.2	11.1	9.3	9.1	9.9
Private	10.4	-4.8	5.7	10.0	12.0	9.8	9.4	9.4
Excluding net exports	10.7	-6.5	5.2	8.4	10.8	10.7	9.9	10.1
Personal consumption expenditures	13.0	-1.1	6.9	8.8	11.4	10.7	9.9	9.7
Goods	12.5	-10.6	3.8	7.4	10.6	9.5	9.8	9.6
Services	13.6	10.9	10.3	10.3	12.2	11.9	10.0	9.9
Gross private domestic investment	.5	-16.1	-26.2	-7.7	14.9	37.7	18.9	19.3
Residential structures	-19.3	-53.8	-20.2	18.9	29.0	34.2	27.7	25.1
Business fixed investment	11.6	-13.9	4.5	2.6	1.8	3.5	3.9	6.9
Gov't. purchases of goods and services	13.4	7.4	8.1	11.0	7.8	7.6	8.4	11.5
Federal	18.7	10.9	8.0	17.2	8.8	7.8	7.0	16.0
State and local	10.5	5.4	8.1	7.6	7.3	7.5	9.2	9.0
Disposable personal income	13.5	3.6	9.9	8.6	11.0	9.0	11.2	9.5
Personal income	10.9	3.3	9.8	9.0	7.2	9.7	11.1	10.3
Wage and salary disbursements	10.9	.7	3.1	7.5	8.0	8.8	8.5	10.1
Corporate profits with IVA & C.C. Adj.	-3.1	-39.6	-47.7	-16.3	29.6	48.9	22.2	12.4
Corporate profits before tax	31.9	-56.0	-30.5	-6.1	24.1	28.0	12.6	11.5
Nonfarm payroll employment	3.0	-2.1	-4.2	-1.1	.2	1.3	1.3	1.6
Manufacturing	.3	-9.9	-8.3	-6.5	-2.5	4.2	1.8	2.5
Nonfarm business sector								
Output per hour	-1.4	-3.1	-2.4	-.8	2.0	2.7	1.1	.8
Compensation per hour	10.2	8.7	9.1	9.0	11.6	8.2	8.1	8.3
Unit labor costs	11.8	12.2	11.8	9.9	9.4	5.4	6.9	7.4
GNP implicit deflator <sup>1/</sup>	9.5	9.2	8.6	10.4	9.9	8.6	7.9	8.5
Gross domestic business product								
fixed-weighted price index <sup>2/</sup>	11.2	9.5	9.5	9.8	9.7	9.3	8.4	8.4
Excluding food and energy	8.8	8.6	7.8	7.7	8.0	7.7	7.2	7.2
Consumer price index (all urban)	17.2	13.8	8.9	7.8	9.9	10.2	9.5	9.5
Industrial production	.0	-16.2	-9.3	-5.7	-.2	5.2	1.4	2.4

<sup>1/</sup> Excluding Federal pay increases, the rates of change are: 1980-Q1, 9.4 percent; 1980-Q4, 9.8 percent; 1981-Q1, 9.9 percent; 1981-Q4, 7.9 percent.

<sup>2/</sup> Uses expenditures in 1972 as weights.

July 2, 1980

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			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Gross national product	2011.3	2104.2	2159.6	2235.2	2292.1	2329.8	2396.5	2456.9
Final purchases	1988.5	2078.4	2139.5	2214.5	2272.9	2296.4	2381.9	2451.4
Private	1569.1	1650.1	1698.6	1760.7	1812.8	1829.8	1904.1	1950.2
Excluding net exports	1591.3	1657.7	1705.4	1765.2	1808.8	1837.9	1906.4	1962.1
Personal consumption expenditures	1287.2	1331.2	1369.3	1415.4	1454.2	1475.9	1528.6	1580.4
Goods	691.2	722.1	740.2	770.2	784.9	789.9	818.1	846.9
Services	596.0	609.1	629.1	645.1	669.3	686.0	710.6	733.5
Gross private domestic investment	327.0	352.3	356.2	370.5	373.8	395.4	392.3	387.2
Residential construction	100.5	107.7	110.2	113.7	111.2	112.9	116.0	116.4
Business fixed investment	203.7	218.8	225.9	236.1	243.4	249.1	261.8	265.2
Change in business inventories	22.8	25.8	20.0	20.6	19.1	33.4	14.5	5.6
Nonfarm	22.0	25.3	18.5	19.3	18.8	32.6	12.6	2.1
Net exports of goods and services <sup>1/</sup>	-22.2	-7.6	-6.8	-4.5	4.0	-8.1	-2.3	-11.9
Exports	184.4	205.7	213.8	224.9	238.5	243.7	267.3	280.4
Imports	206.6	213.3	220.6	229.4	234.4	251.9	269.5	292.4
Gov't. purchases of goods and services	419.4	428.3	440.9	453.8	460.1	466.6	477.8	501.2
Federal <sup>2/</sup>	150.9	148.2	152.3	159.0	163.6	161.7	162.9	178.4
State and local	268.5	280.1	288.6	294.8	296.5	304.9	314.9	322.8
Gross national product in constant (1972) dollar	1367.8	1395.2	1407.3	1426.6	1430.6	1422.3	1433.3	1440.3
Personal income	1634.8	1689.3	1742.5	1803.1	1852.6	1892.5	1946.6	2005.0
Wage and salary disbursements	1052.0	1090.0	1116.8	1154.3	1189.3	1212.4	1238.1	1270.5
Disposable personal income	1395.0	1437.3	1476.5	1524.8	1572.2	1601.7	1640.0	1683.1
Saving rate (percent)	5.3	5.0	4.8	4.7	5.0	5.4	4.3	3.5
Corporate profits with I.V.A. and C.C. Adj.	141.2	169.4	175.2	184.8	178.9	176.6	180.8	176.4
Corporate profits before tax	177.5	207.2	212.0	227.4	233.3	227.9	242.3	243.0
Federal government surplus or deficit (-) (N.I.A. basis)	-49.4	-24.6	-20.4	-16.3	-11.7	-7.0	-11.3	-15.7
High employment surplus or deficit (-)	-24.9	-8.0	-6.8	-6.6	-9	13.8	10.8	7.2
State and local government surplus or deficit (-) (N.I.A. basis)	30.2	29.6	22.7	27.1	27.6	19.7	25.3	25.8
Excluding social insurance funds	7.9	6.5	-9	3.3	2.6	-6.3	-1.8	-2.2
Civilian labor force (millions)	99.1	100.2	100.8	101.5	102.3	102.4	103.2	103.7
Unemployment rate (percent)	6.2	6.0	6.0	5.8	5.7	5.8	5.8	5.9
Nonfarm payroll employment (millions)	84.8	86.3	86.9	87.8	88.7	89.4	89.8	90.1
Manufacturing	20.2	20.4	20.5	20.8	21.0	21.1	21.0	20.9
Industrial production (1967=100)	140.8	145.1	147.9	150.7	152.2	151.9	152.3	152.2
Capacity utilization: all mfg. (percent)	82.0	83.9	85.2	86.4	86.7	85.9	85.4	84.6
Materials (percent)	82.6	85.0	86.4	88.2	88.0	87.3	87.2	86.3
Housing starts, private (million units, A.R.)	1.86	2.10	2.03	2.06	1.67	1.82	1.81	1.59
New autos sales, (millions, A.R.)	10.80	12.09	11.16	11.06	11.56	10.65	10.79	9.80
Domestic models	8.80	10.01	9.21	9.14	9.30	8.16	8.63	7.43
Foreign models	2.00	2.09	1.96	1.92	2.25	2.49	2.16	2.37

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

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

July 2, 1980

CONFIDENTIAL - FR  
CLASS II FOMCPERCENT CHANGES IN GROSS NATIONAL PRODUCT  
AND RELATED ITEMS  
(Annual rates compounded quarterly)

	1978				1979			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
<u>Constant (1972) dollars</u>								
Gross national product	1.9	8.3	3.5	5.6	1.1	-2.3	3.1	2.0
Final purchases	.4	8.7	4.6	5.7	1.1	-3.9	6.4	3.6
Private	.8	10.7	4.4	6.7	1.8	-4.1	7.8	3.1
Excluding net exports	1.0	7.9	4.1	6.9	.4	-2.9	5.3	3.1
Personal consumption expenditures	.8	5.6	4.8	6.8	.6	-2.9	4.9	4.1
Goods	-4.7	9.2	4.2	9.9	-4.4	-7.3	6.0	4.7
Services	7.9	1.4	5.5	3.2	7.1	2.5	3.6	3.5
Gross private domestic investment	12.3	15.7	-5.0	6.6	-.5	8.5	-12.8	-11.6
Residential structures	-4.7	11.0	-4.9	-1.1	-14.3	-7.2	-1.5	-4.5
Business fixed investment	4.6	23.2	3.9	11.3	4.8	-.8	10.7	-.3
Gov't. purchases of goods and services	-1.2	.9	5.0	1.8	-1.8	-3.3	1.0	6.0
Federal	-7.4	-12.3	8.2	3.2	7.2	-11.3	-2.6	16.0
State and local	2.7	9.3	3.3	1.0	-6.6	1.6	3.1	.8
Disposable personal income	2.0	4.0	4.2	6.4	2.1	-1.4	.2	1.1
<u>Current dollars</u>								
Gross national product	8.4	19.8	10.9	14.8	10.6	6.7	11.9	10.5
Final purchases	7.5	19.3	12.3	14.8	11.0	4.2	15.8	12.2
Private	7.7	22.3	12.3	15.4	12.4	3.8	17.3	10.0
Excluding net exports	8.8	17.8	12.0	14.8	10.3	6.6	15.8	12.2
Personal consumption expenditures	9.0	14.4	11.9	14.2	11.4	6.1	15.0	14.3
Goods	3.3	19.1	10.4	17.2	7.9	2.6	15.1	14.8
Services	16.1	9.1	13.8	10.6	15.8	10.4	15.1	13.5
Gross private domestic investment	13.3	34.8	4.5	17.1	3.6	25.2	-3.0	-5.1
Residential structures	2.4	32.0	9.5	13.5	-8.5	6.1	11.7	1.4
Business fixed investment	10.6	33.3	13.7	19.3	12.9	9.6	22.0	5.4
Gov't. purchases of goods and services	6.5	8.8	12.3	12.2	5.6	5.8	10.0	21.1
Federal	-.9	-7.0	11.7	18.7	12.1	-4.6	3.1	43.8
State and local	11.1	18.5	12.6	8.9	2.3	11.9	13.8	10.4
Disposable personal income	10.3	12.7	11.4	13.8	13.0	7.7	9.9	10.9
Personal income	10.0	14.0	13.2	14.7	11.4	8.9	11.9	12.6
Wage and salary disbursements	11.7	15.3	10.2	14.1	12.7	8.0	8.8	10.9
Corporate profits with IVA & C.C. Adj.	-27.5	107.2	14.4	23.8	-12.2	-5.0	9.9	-9.4
Corporate profits before tax	-11.5	85.7	9.6	32.4	10.8	-8.9	27.8	1.2
Nonfarm payroll employment	4.6	7.1	2.8	4.4	4.3	2.9	1.8	1.6
Manufacturing	5.8	3.8	1.3	5.5	5.0	.8	-1.3	-2.3
Nonfarm business sector								
Output per hour	-.9	1.9	2.7	.8	-3.2	-4.1	-1.4	.7
Compensation per hour	11.4	7.5	8.8	8.8	10.4	7.9	8.5	9.4
Unit labor costs	12.4	5.4	6.0	8.0	14.0	12.5	10.1	8.6
GNP implicit deflator <sup>1/</sup>	6.3	10.6	7.2	8.7	9.3	9.3	8.5	8.4
Gross domestic business product								
fixed-weighted price index <sup>2/</sup>	6.6	10.5	8.8	8.7	10.0	10.1	10.4	8.4
Excluding food and energy	5.5	9.4	8.9	8.7	7.7	7.9	7.6	7.7
Consumer price index (all urban)	7.8	10.2	8.8	9.1	11.1	13.6	12.9	13.2
Industrial production	1.4	12.8	7.9	7.8	4.0	-.8	1.1	-.3

<sup>1/</sup> Excluding Federal pay increases, rates of change were: 1978-Q1, 6.3 percent; 1978-Q4, 8.1 percent; 1979-Q1, 9.3 percent; 1979-Q4, 8.0 percent.

<sup>2/</sup> Uses expenditures in 1972 as weights.

CONFIDENTIAL - FR  
CLASS II FOMC

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

	1974	1975	1976	1977	1978	1979	Projected	
							1980	1981
Gross national product	1412.9	1528.8	1702.2	1899.5	2127.6	2368.8	2538.0	2767.8
Final purchases	1404.0	1539.6	1692.1	1877.6	2105.2	2350.6	2539.3	2762.6
Private	1101.3	1201.2	1330.8	1481.4	1669.6	1874.2	2006.4	2183.5
Excluding net exports	1095.3	1180.8	1322.8	1491.3	1679.9	1878.8	2010.0	2177.5
Personal consumption expenditures	889.6	979.1	1089.9	1210.0	1350.8	1509.8	1648.7	1798.9
Goods	498.3	541.5	601.3	660.1	730.9	809.9	862.0	925.3
Services	391.3	437.5	488.5	549.8	619.8	699.8	786.7	873.7
Gross private domestic investment	214.6	190.9	243.0	303.3	351.5	387.2	360.0	383.7
Residential construction	55.1	51.5	68.1	91.9	108.0	114.1	94.3	106.0
Business fixed investment	150.6	150.2	164.9	189.4	221.1	254.9	267.0	272.6
Change in business inventories	8.9	-10.7	10.0	21.9	22.3	18.2	-1.3	5.1
Nonfarm	10.8	-14.3	12.1	20.7	21.3	16.5	-1.4	5.1
Net exports of goods and services <u>1/</u>	6.0	20.4	8.0	-9.9	-10.3	-4.6	-3.6	6.0
Exports	137.9	147.3	163.3	175.9	207.2	257.5	309.9	338.8
Imports	131.9	126.9	155.4	185.8	217.5	262.1	313.5	332.8
Gov't. purchases of goods and services	302.7	338.4	361.3	396.2	435.6	476.4	532.9	579.1
Federal <u>2/</u>	111.1	123.1	129.7	144.4	152.6	166.6	193.7	213.7
State and local	191.5	215.4	231.6	251.8	283.0	309.8	339.2	365.4
Gross national product in constant (1972) dollars	1217.8	1202.3	1273.0	1340.5	1399.2	1431.6	1407.3	1404.3
Personal income	1154.9	1255.5	1381.6	1531.6	1717.4	1924.2	2106.0	2290.7
Wage and salary disbursements	764.6	805.9	890.0	984.0	1103.3	1227.6	1316.4	1410.7
Disposable personal income	984.6	1086.7	1184.5	1305.1	1458.4	1624.3	1779.2	1948.2
Saving rate (percent)	7.3	7.7	5.8	5.0	4.9	4.5	4.8	5.0
Corporate profits with I.V.A. and C.C. Adj.	83.6	95.9	126.8	150.0	167.7	178.2	146.5	149.4
Corporate profits before tax	126.9	120.4	156.0	177.1	206.0	236.6	214.3	215.6
Federal government surplus or deficit (N.I.A. basis)	-10.7	-70.6	-53.6	-46.3	-27.7	-11.4	-53.8	-72.0
High employment surplus or deficit (-)	9.0	-19.2	-14.3	-19.3	-11.5	7.7	18.6	38.8
State and local government surplus or deficit (-) (N.I.A. basis)	7.6	6.2	17.9	26.8	27.4	24.6	18.1	19.1
Excluding social insurance funds	-2.9	-6.2	2.3	7.3	4.2	-1.9	-11.6	-12.9
Civilian labor force (millions)	91.0	92.6	94.8	97.4	100.4	102.9	104.9	106.2
Unemployment rate (percent)	5.6	8.5	7.7	7.0	6.0	5.8	7.8	8.8
Nonfarm payroll employment (millions)	78.3	77.0	79.4	82.4	86.4	89.5	89.9	89.6
Manufacturing	20.1	18.3	19.0	19.7	20.5	21.0	20.2	19.7
Industrial production (1967=100)	129.3	117.8	130.5	138.2	146.1	152.2	145.0	141.8
Capacity utilization: all manufacturing (percent)	83.8	72.9	79.5	81.9	84.4	85.7	78.4	74.2
Materials (percent)	87.1	73.4	81.1	82.7	85.6	87.2	79.3	74.3
Housing starts, private (million units, A.R.)	1.34	1.16	1.54	1.99	2.02	1.75	1.09	1.32
New auto sales, (millions, A.R.)	8.91	8.66	10.12	11.13	11.28	10.70	8.82	9.21
Domestic models	7.49	7.08	8.63	9.07	9.29	8.38	6.42	6.75
Foreign models	1.42	1.58	1.50	2.06	1.99	2.32	2.39	2.46

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.

July 2, 1980

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

	1974	1975	1976	1977	1978	1979	Projected	
							1980	1981
<u>Constant (1972) dollars</u>								
Gross national product	-1.4	-1.3	5.9	5.3	4.4	2.3	-1.7	-2
Final purchases	-.7	.2	4.5	4.8	4.4	2.7	-.9	-.5
Private	-1.4	-.3	5.6	5.6	5.0	3.2	-1.6	-.6
Excluding net exports	-2.3	-1.0	6.5	6.2	5.0	2.6	-2.9	-1.2
Personal consumption expenditures	-.9	1.8	5.9	5.0	4.5	2.6	-1.4	-.6
Goods	-3.4	.7	6.9	5.1	4.1	1.3	-4.3	-2.6
Services	2.3	3.2	4.8	4.9	5.1	4.3	2.0	1.6
Gross private domestic investment	-11.4	-22.3	21.6	15.4	7.1	.4	-14.3	-2.1
Residential structures	-24.6	-13.9	23.3	20.7	4.2	-5.7	-24.5	2.9
Business fixed investment	-.3	-13.0	4.8	8.6	8.4	6.2	-4.1	-6.0
Gov't. purchases of goods and services	2.1	1.9	.2	2.0	1.8	.4	1.9	.2
Federal	-.8	.7	-.2	4.4	-2.0	.9	5.8	1.3
State and local	3.8	2.6	.5	.6	4.0	.2	-.3	-.5
Disposable personal income	-1.5	2.1	3.7	4.2	4.6	2.3	-1.1	-.2
<u>Current dollars</u>								
Gross national product	8.1	8.2	11.3	11.6	12.0	11.3	7.1	9.1
Final purchases	8.9	9.7	9.9	11.0	12.1	11.7	8.0	8.8
Private	8.1	9.1	10.8	11.3	12.7	12.3	7.1	8.8
Excluding net exports	8.2	7.8	12.0	12.7	12.6	11.8	7.0	8.3
Personal consumption expenditures	9.8	10.1	11.3	11.0	11.6	11.8	9.2	9.1
Goods	8.9	8.7	11.0	9.8	10.7	10.8	6.4	7.3
Services	11.1	11.8	11.7	12.5	12.7	12.9	12.4	11.0
Gross private domestic investment	-2.5	-11.0	27.3	24.8	15.9	10.2	-7.0	6.6
Residential structures	-16.7	-6.5	32.3	35.0	17.5	5.7	-17.4	12.4
Business fixed investment	10.8	-.3	9.8	14.9	16.7	15.2	4.7	2.1
Gov't. purchases of goods and services	12.3	11.8	6.8	9.7	9.9	9.4	11.9	8.7
Federal	8.7	10.7	5.4	11.3	5.7	9.2	16.3	10.4
State and local	14.5	12.5	7.5	8.7	12.4	9.5	9.5	7.7
Disposable personal income	9.2	10.4	9.0	10.2	11.7	11.4	9.5	9.5
Personal income	9.7	8.7	10.0	10.9	12.1	12.0	9.4	8.8
Wage and salary disbursements	9.0	5.4	10.4	10.6	12.1	11.3	7.2	7.2
Corporate profits with IVA & C.C. Adj.	-15.6	14.7	32.2	18.3	11.8	6.3	-17.8	2.0
Corporate profits before tax	9.6	-5.1	29.6	13.5	16.3	14.9	-9.4	.6
Nonfarm payroll employment	2.0	-1.7	3.1	3.8	4.9	3.5	.4	-.3
Manufacturing	-.4	-8.7	3.7	3.6	4.0	2.5	-3.8	-2.5
Nonfarm business sector								
Output per hour	-3.1	1.9	3.5	1.6	.5	-1.1	-1.6	.5
Compensation per hour	9.1	9.9	8.3	8.0	8.6	8.9	9.2	9.3
Unit labor costs	12.7	7.9	4.7	6.3	8.0	10.2	11.0	8.7
GNP implicit deflator	9.7	9.6	5.2	6.0	7.3	8.8	9.0	9.2
Gross domestic business product								
fixed-weighted price index <sup>1/</sup>	10.4	9.4	5.3	6.2	7.6	9.5	9.9	9.4
Excluding food and energy	8.1	9.5	5.8	6.3	7.2	8.1	7.9	7.8
Consumer price index (all urban)	11.0	9.1	5.8	6.5	7.7	11.3	13.4	9.6
Industrial production	-.4	-8.9	10.8	5.9	5.7	4.2	-4.7	-2.2

<sup>1/</sup> Uses expenditures in 1972 weights.

FEDERAL SECTOR ACCOUNTS  
(Billions of dollars)

July 2, 1980

	Fiscal Year 1979*	FY 1980 e/		FY 1981 e/2/		CY 1979*	CY80e/ F.R. Board	FRB Staff Estimates								
		Admin. 1/	F.R. Board	Admin. 1/	F.R. Board			Calendar quarters; unadjusted data								
								1979 IV*	I*	II	III	IV	1981			
Unified budget receipts	465.9	532.4	522.9	628.0	572.5	480.5	532.8	114.0	114.6	156.4	137.8	123.9	126.9	172.8	148.8	
Unified budget outlays	493.7	568.9	574.7	611.5	625.8	508.7	588.1	138.6	141.8	146.5	147.8	152.0	152.5	157.9	163.4	
Surplus(+)/deficit(-), unified budget	-27.7	-36.5	-51.8	16.5	-53.3	-28.2	-55.3	-24.6	-27.2	9.9	-10.0	-28.1	-25.6	14.9	-14.6	
Surplus(+)/deficit(-), off-budget agencies 3/	-12.4	-15.0	-16.0	-18.7	-20.0	-13.2	-16.3	-1.0	-3.8	-6.5	-4.7	-1.3	-6.9	-6.6	-5.2	
Combined deficit to be financed	-40.2	-51.5	-67.8	-2.2	-73.3	-41.4	-71.6	-25.6	-31.0	3.4	-14.7	-29.4	-32.5	8.3	-19.8	
Means of financing combined deficits:																
Net borrowing from public	33.7	39.3	56.2	1.4	68.9	37.3	65.7	18.9	19.1	4.6	13.6	28.4	29.5	-6.3	17.3	
Decrease in cash operating balance	-1.8	9.2	9.2	0	3.0	0.4	3.9	8.3	7.7	-5.9	-0.9	3.0	0	0	0	
Other 4/	8.3	3.0	2.4	0.8	1.5	3.5	2.1	-1.7	4.1	-2.0	2.0	-2.0	3.0	-2.0	2.5	
Cash operating balance, end of period	24.2	15.0	15.0	15.0	12.0	15.9	12.0	15.9	8.2	14.1	15.0	12.0	12.0	12.0	12.0	
Memo: Sponsored agency borrowing 5/	19.1	16.2	26.9	16.7	14.3	25.5	22.7	7.5	7.7	6.0	5.7	3.3	3.0	4.0	4.0	
<b>NIA Budget</b>								<b>Seasonally adjusted annual rates</b>								
Receipts 6/	483.7	543.2	527.7	636.1	561.6	497.6	536.1	524.7	538.4	531.0	531.5	543.4	550.9	570.5	585.6	
Expenditures 6/	493.6	568.1	570.9	621.4	635.7	509.0	589.8	540.4	561.3	575.7	603.8	618.5	628.8	636.7	658.8	
Purchases (total)	162.4	188.1	187.6	204.4	208.8	166.6	193.7	178.4	186.2	191.1	194.8	202.7	207.0	210.9	214.5	
Defense	105.9	122.4	121.2	136.8	139.0	108.3	126.1	114.6	119.6	123.2	127.5	133.9	137.5	140.8	143.9	
Nondefense	56.5	65.7	66.4	67.6	69.8	58.4	67.6	63.8	66.6	67.9	67.3	68.8	69.5	70.1	70.6	
All other expenditures	331.2	380.0	383.3	417.0	426.9	342.4	396.1	362.0	375.1	384.6	409.0	415.8	421.8	425.8	444.3	
Surplus(+)/deficit(-) 6/	-9.9	-24.9	-43.2	14.7	-74.1	-11.4	-53.7	-15.7	-22.9	-44.7	-72.3	-75.1	-77.9	-66.2	-73.2	
High employment surplus(+)/deficit(-) (NIA basis)	4.3	n.a.	13.0	n.a.	35.0	7.7	18.6	7.2	4.0	21.7	19.0	29.4	30.5	42.0	37.9	

\*--actual                      e--estimated                      n.a.--not available

1. OMB Fiscal Year 1981 Budget Revisions, March 1980 and BEA NIA translations, March 1980.
2. In the First Concurrent Resolution on the Budget, Fiscal Year 1981, June 1980, the Congress called for receipts of \$613.8 billion and outlays of \$613.6 billion.
3. Includes Federal Financing Bank Postal Service Fund, Rural Electrification and Telephone Revolving Fund, Rural Telephone Bank, and Pension Benefit Guaranty Corporation.
4. Checks issued less checks paid, accrued items and other transactions.
5. FRB staff estimates include Federal Home Loan Banks, FNMA, Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives marketable debt on an offerings basis.
6. BEA NIA translations, March 1980. The fiscal year totals 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 the staff estimates comparable.

## Comments on the Federal Sector Outlook

The fiscal policy assumptions have been revised to include a tax cut beginning January 1981 and to remove the administration's proposed oil import fee. The staff has assumed a tax package that reduces personal and corporate tax liabilities by \$28 billion in calendar year 1981. About \$20 billion of the tax cut would accrue to individuals in the form of a reduction in personal income tax rates; the remainder would be in the form of a cut in the corporate tax rate from 46 percent to 44 percent, and a 25 percent reduction in depreciation-tax lives. The first-year revenue loss that results from the acceleration in depreciation allowances is estimated to be around \$3 billion. However, the stimulus associated with this change is expected to be larger than implied by the first-year revenue loss, since additional depreciation allowances are built in for subsequent years. We estimate that this acceleration in depreciation is equivalent to a \$10 billion investment tax credit. As shown in the table, overall tax burdens are still expected to increase on balance next year, because of the scheduled increases in social security and windfall profits taxes, and the automatic increase in the personal tax bite during periods of inflation.

MAJOR 1981 TAX CHANGES: NIA BASIS  
(Changes from calendar year 1980 to 1981, in billions of dollars)

Tax Paying Unit	Tax increases	Assumed tax cuts	Total tax change
<u>Households</u>			<u>-\$1-1/2</u>
Personal income tax			
Increase due to inflation	\$9-1/2		
Assumed tax cut		\$20	
Employee contributions, payroll taxes <sup>1</sup>	\$ 9		
<u>Businesses</u>			<u>\$14</u>
Corporate income tax		\$ 5	
Accelerated depreciation <sup>2</sup>		\$ 3	
Windfall tax on oil sales	\$13		
Employer contributions, payroll taxes <sup>1</sup>	\$ 9		
GRAND TOTALS	\$40-1/2	\$28	\$12-1/2

1. Includes revenues arising from increase in tax rate and wage base.
2. Reflects first year tax reduction; revenue loss rises substantially in subsequent years.

Taking these tax assumptions and our new economic projections into account, federal receipts, on a unified budget basis, are now estimated to be around \$573 billion, down by \$30 billion from last month. Expenditures, on the other hand, have been revised upward from \$623 billion to \$626 billion due to higher spending for defense and extended unemployment benefits.

The staff thus estimates a fiscal year 1981 budget deficit of around \$53 billion, as compared to the last Greenbook's \$20 billion projection. For the current fiscal year, the staff expects the deficit to be about \$52 billion, with receipts and outlays projected at \$523 billion and \$575 billion, respectively. Finally, the high employment

budget, which measures discretionary changes in fiscal policy by excluding the effect of cyclical changes in the budget, now shows a \$22 billion swing toward surplus from fiscal year 1980 to 1981. This movement toward restraint in 1981 is substantially lower than the estimate in the previous Greenbook, reflecting the assumed cut in federal taxes and the removal of the import fee.

## DOMESTIC FINANCIAL DEVELOPMENTS

---

Summary. Credit market conditions generally have continued to ease since the May FOMC meeting, responding to a further drop in the federal funds rate, the continued contraction in economic activity and credit demands, and a 2 percentage point reduction in the discount rate to 11 percent. Although market rates have backed up in the past couple of weeks as monetary aggregates have strengthened and the federal funds rate has stabilized around 9 percent, short-term interest rates are down on balance by another 1/4 to 1-1/4 percentage points over the intermeeting period. Bank prime rates have dropped more sharply--by 4-1/2 percentage points--but remain relatively high compared with other short-term rates. In long-term bond markets, yields on high grade corporate and Treasury bonds have dropped about 1/2 percentage point but yields on municipal securities have edged up. Average rates on new mortgage commitments have moved down another 1-3/4 percentage points to 12-3/8 percent.

Borrowing by the household sector appears to have weakened further over May and June, the consequence of both the deteriorating economic situation and continued taut supply conditions. Consumer installment credit, after declining in April for the first time since the spring of 1975, apparently fell further in May. Data are not yet available for June, but further weakness is indicated by reports on retail sales and large bank reports for the month. In addition, a recent special survey of consumer lenders--conducted by the Federal Reserve Banks--indicated that credit demands generally continued to

drop off over the period from early May to mid-June and that the availability of such credit remained under considerable constraint.

Mortgage credit flows also have remained quite weak in recent months. Mortgage holdings at S&Ls declined in May after posting only a slight increase in April. Moreover, little if any growth appears likely to have been recorded in June. Despite the recent pickup of deposit flows, most associations reported recently that their loanable funds were in short supply, a condition reflected by a further drop in May in the volume of new commitments extended and in the level of outstanding commitments. Supplies of funds from other private financial institutions are reported to remain relatively light, and the flow of funds from sponsored agencies has dropped off recently. Fund availability has been supplemented, however, by state and local government agencies through issuance of revenue bonds to finance single-family units.

Although business borrowing is estimated to have dropped off in the second quarter, a pickup occurred in May and June following April's weak expansion, apparently reflecting the need to finance growing inventories at a time of eroding profits. Corporate offerings of long-term bonds to the public were at a record pace over the May-June period. A marked step-up in offerings by industrial firms accounted for a major part of the increase in volume. While business loans at banks dropped sharply in May, after also declining in April, these reductions were essentially offset by a substantial volume of commercial paper issuance, as firms shifted to the open market to obtain lower cost funds. Only

partial data are available for June, but this pattern appears to have continued.

In the government sector, bond issuance by municipalities has continued heavy, although the average volume of issues sold in May and June did not match April's strong level. The U.S. Treasury raised a total of \$2.8 billion of new money since the May FOMC meeting. The Congress finally increased the Treasury's temporary debt ceiling to \$925 billion--to be effective through February 1981--after having twice extended the old temporary debt ceiling for short time periods.

In addition to the sharp drop in business loans in May, banks also recorded declines in security loans and consumer loans, while growth in real estate loans continued at about the weak pace set in April. Together these developments resulted in a drop in total loans at a 14 percent annual rate. However, reflecting substantial security acquisitions, total loans and investments contracted at only a 6 percent annual rate. Preliminary bank data suggest that similar developments are occurring at large banks in June, except that the weak real estate loan growth has turned negative.

Both M-1A and M-1B recorded slight gains in May, following sharp declines in April, and then expanded at 14-1/2 and 17-1/2 percent annual rates, respectively, in June. The strengthening reflects a pick-up in growth of both currency and demand deposits. M-2 growth accelerated markedly in May and rose further to a 16-1/4 percent annual rate in June. Outflows from savings deposits slowed substantially in May and then shifted to a comparatively strong inflow in June. Exceptionally strong growth of money market mutual funds also was recorded

in these months. At the same time, expansion of small time deposits slowed markedly in June--as growth in the 2-1/2 year small certificates was offset by a drop in money market certificates--and large CDs declined.

Outlook. The staff is expecting both short- and long-term interest rates to increase in coming months, as continued rapid inflation will likely generate an increase in credit demands and needs for transactions balances. However, administered rates will likely be under continuing downward pressures over the near term.

Business credit demands appear likely to remain comparatively strong over the summer, as internal cash flows diminish. Efforts to lengthen the maturity structure of liabilities will probably continue, and firms will likely meet a major portion of their borrowing needs through the issuance of bonds. With the current wide differential between bank prime rates and commercial paper rates, firms that have the option will probably continue to shift their borrowing into the paper market. Thus, business loans at banks should remain relatively weak over the near term.

Borrowing by the household sector will probably remain quite depressed through the summer. The availability of funds in the mortgage market may increase if, as expected, deposit flows continue at June's somewhat stronger pace and improving liquidity conditions permit other lenders to channel a greater volume of funds into the mortgage market. Nonetheless, with real household incomes falling and the economic outlook uncertain, demands for mortgage funds to finance house purchases are expected to recover slowly. Although consumer credit

supplies may become less taut in coming months, consumer borrowing is likely to remain depressed in the face of the continued drop off in real incomes.

As is typical of recessionary times, government demands for funds are likely to accelerate in tandem with a net drop in private fund demands. Bond offerings by state and local governments may drop back a bit from the exceptionally rapid second quarter but should remain relatively strong, in part because of continued heavy issuance of housing revenue bonds to finance home mortgages with below market rates. The combined unified and off budget deficit of the federal government is expected to widen to around \$15 billion in the current quarter reflecting both seasonal and cyclical factors. Market borrowing should about match this deficit as a further expected runoff of savings bonds may about offset a decline in the Treasury's operating balance.

Summary. The dollar continued to decline against major foreign currencies in late May and early June in response to declining dollar interest rates. The exchange value of the dollar has been stable since the second week of June, as dollar interest rates have levelled off and interest rates on a number of foreign currencies have declined somewhat. The weighted-average value of the dollar against major foreign currencies is now about 2-1/4 percent lower than at the time of the May Greenbook.

The United States has made net purchases of \$1.3 billion against foreign currencies in intervention operations since the last Greenbook. Almost all of these purchases occurred before mid-June.

Economic growth in major foreign industrial countries is slowing. In the first quarter, real GNP grew strongly in Japan, Germany, and Italy but declined in Canada and the United Kingdom. However, more recent industrial production data and other indicators suggest little or no overall expansion occurred in the second quarter. The most recent monthly price increases for a number of foreign countries indicate that the peak rates of price increase have passed, but consumer prices are continuing to rise at annual rates above 10

percent, except in Germany and Switzerland.

The U.S. merchandise trade deficit in April and May averaged \$28 billion at an annual rate, \$14 billion less than the first quarter deficit. Both oil and non-oil imports fell sharply, while exports declined by a small amount. These trade developments are consistent with the sharp decline in U.S. economic activity that has occurred and a slowing of growth abroad. But, in part, the reduction in trade activity in April-May represents an adjustment from levels of exports and imports in the first quarter that were unusually strong, given underlying developments.

U.S. banking offices reduced their net borrowings from related foreign institutions and unrelated foreign banks by \$11 billion from March to May. Preliminary data indicate a further large capital outflow through intrabank transactions in June. The outflows during the Spring occurred at a time when domestic bank credit demand was weak. During part of this period, banks were able to raise funds by issuing CDs in the United States at lower cost, adjusted for reserve requirements, than by issuing Eurodollar CDs, and in larger volume than was needed to satisfy U.S. bank credit demands.

Outlook. The staff projects the U.S. merchandise trade deficit to shrink to about \$22 billion at an annual rate in the first quarter next year. Thereafter, the deficit is projected to widen again. A surplus on current account is expected to emerge by the end of this year, but to evaporate by the end of next year. Projected aggregate demand developments in the United States and abroad dominate this picture. Unlike the United States, most of the major foreign economies

are not expected to experience actual recessions. Average foreign growth is likely to be very slow through the rest of this year, however. Projected U.S. growth during the recovery in 1981 is expected to exceed average growth abroad.

The staff expects the weighted-average exchange value of the dollar to strengthen somewhat over the next year. The decline in dollar interest rates and its adverse impact on the dollar appear to have run their course, and interest rate movements later this year and into 1981 should be more favorable. The U.S. trade and current account improvement should also provide support for the dollar over much of the projection period. Countering these positive developments for the dollar will be the U.S. inflation rate, which is projected to slow but remain above the average rate for major foreign economies.

CONFIDENTIAL (FR)  
CLASS II FOMC

OUTLOOK FOR U.S. NET EXPORTS AND RELATED ITEMS  
(BILLIONS OF DOLLARS, SEASONALLY ADJUSTED ANNUAL RATES)

	1979 ANN.	1980 ANN.	1981 ANN.	1980 Q I	1980 Q II	1980 Q III	1980 Q IV	1981 Q I	1981 Q II	1981 Q III	1981 Q IV
<b>1. GNP NET EXPORTS</b>											
CURRENT \$, NET	-4.6	-3.4	6.0	-13.6	-4.1	-1.2	5.5	11.3	7.1	4.4	1.1
EXPORTS OF G&S	257.5	309.9	338.8	308.1	307.8	310.6	313.2	323.2	333.4	343.9	354.6
IMPORTS OF G&S	262.1	313.3	332.8	321.7	312.0	311.8	307.6	311.9	326.4	339.5	353.4
CONSTANT 72 \$, NET	17.6	31.8	37.4	25.0	31.1	34.0	36.9	38.3	37.6	37.2	36.4
EXPORTS OF G&S	119.9	128.8	129.1	131.7	128.9	127.9	126.7	127.3	128.4	129.8	131.0
IMPORTS OF G&S	102.3	97.1	91.8	106.7	97.8	93.9	89.8	89.0	90.8	92.7	94.6
TERMS OF TRADE (1972=100) 1/	83.8	74.5	72.3	77.6	74.9	73.1	72.2	72.4	72.3	72.3	72.4
<b>2. U.S. MERCHANDISE TRADE BALANCE 2/</b>											
EXPORTS (EXCL. MILITARY)	182.1	220.1	238.9	218.8	217.3	220.6	223.5	229.8	235.6	241.8	248.4
AGRICULTURAL	35.4	39.0	41.2	41.5	38.9	38.0	37.6	39.6	40.7	41.6	42.9
NONAGRICULTURAL	146.6	181.1	197.7	177.3	178.4	182.6	185.9	190.2	194.9	200.2	205.6
IMPORTS	211.5	254.8	268.2	262.3	252.5	254.4	250.2	251.7	263.0	273.5	284.5
PETROLEUM AND PRODUCTS	60.0	88.3	102.2	86.4	85.1	90.0	91.8	94.3	100.7	104.5	109.3
NONPETROLEUM	151.5	166.5	166.0	175.9	167.4	164.5	158.4	157.4	162.3	169.0	175.2
<b>3. U.S. CURRENT ACCOUNT BALANCE</b>											
OF WHICH: NET INVESTMENT INCOME	32.5	38.5	39.2	40.5	36.5	38.6	38.5	38.4	39.0	39.5	39.8
<b>4. FOREIGN OUTLOOK - TEN INDUSTRIAL COUNTRIES 3/</b>											
REAL GNP, % CHANGE, ANNUAL RATES	3.8	2.3	1.2	2.7	0.8	0.1	0.4	1.1	1.6	2.4	2.6
CONSUMER PRICES, 4/, % CHANGE, ANNUAL RATES	7.8	11.7	8.6	14.5	12.7	9.5	9.0	8.3	7.9	7.2	7.3

1/ GNP EXPORT IMPLICIT DEFLATOR DIVIDED BY GNP IMPORT IMPLICIT DEFLATOR.

2/ INTERNATIONAL ACCOUNTS BASIS.

3/ GEOMETRIC WEIGHTS USED TO AGGREGATE FOREIGN REAL GNP AND CONSUMER PRICES -- PER CENT SHARE IN TEN-COUNTRY TOTAL MULTILATERAL TRADE. CANADA (9.1%), JAPAN (13.6%), UNITED KINGDOM (11.9%), GERMANY (20.8%), FRANCE (13.1%), ITALY (9.0%), BELGIUM (6.4%), THE NETHERLANDS (8.3%), SWITZERLAND (3.6%), SWEDEN (4.2%).

4/ WHOLESALE PRICES FOR JAPAN.

P/ PROJECTED.

I-26