Research Department
Federal Reserve
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Winter of Discontent

The two basic economic documents —the Federal budget and the President's Economic Report—make pretty gloomy reading these long midwinter nights. They present a picture of a nation which is making only slow and grudging progress against the triple-barreled threat of recession, inflation and energy crisis. (For 1975, they forecast a 3.3-percent drop in real GNP, an 8.1-percent unemployment rate, and a 10.8-percent rise in the general price level, and for 1976, they forecast only a moderate improvement.) But this analysis seems logical, in view of the protracted character of our problems and the sometimes contradictory nature of the cures suggested for them. In this situation, it's worthwhile to examine some of the numbers in the headlines, to see whether they are likely to remain at their current unprecedented levels.

With its forthright approach, the Administration broke the first rule of budgetmaking: always forecast a surplus in the coming fiscal year. In each of the last several recession years (1958, 1961 and 1970), the Administration budgeted a small $1-billion surplus for the upcoming year, notwithstanding the likelihood that the figures in those budget periods would be unbalanced by recession. As it turned out, record or near-record peacetime deficits then developed—$13 billion in fiscal 1959, $7 billion in fiscal 1962, and $23 billion in fiscal 1971. But fiscal 1976 will now claim the record with its projected $52-billion deficit, as receipts lag because of the recession and expenditures soar because of built-in spending increases.

The $52-billion deficit figure will probably be off the mark, as most such estimates are, but no one can say in which direction. Some analysts claim that that figure will be on the low side, but we shouldn't overlook the possibility that the deficit will be reduced significantly if a strong enough business recovery gets under way later this year.

Energy problems

Much depends on what legislation emerges from the political arena and how it impacts on consumers and businessmen. A major point at issue is the Administration's proposed energy package. The imposition of import fees, the passage of excise taxes on crude oil and natural gas, and the decontrol of the domestic crude-oil industry, together will add $30 billion (Administration estimate) or $50 billion (Congressional estimate) to the nation's oil and gas bill. Critics claim that if the Administration's proposal is enacted—a big if at this stage—it could have severe recessionary consequences, especially if its impact is in the $50-billion range and offsetting tax reductions are only in the $30-billion range.

Critics have also attacked the energy package because of its probable impact on prices, which would amount to a 1.3-percent increase in consumer prices by midyear,

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according to the Economic Report. The Administration approach puts it in the unenviable position of defending a rise in the price of world oil, when it had recently been pressing for a sharp price reduction by the oil-exporting countries. But the Administration contends that its proposal fits in with the need to lower imports and thereby to reduce the nation's vulnerability to interruptions in supply.

The program aims at discouraging petroleum consumption and encouraging domestic production by raising the relative price of energy. Some observers argue that it would be uneconomic to rely so heavily on domestic production—and unreasonable to seek complete independence in this increasingly interdependent world. Still, there is general agreement on the wisdom of the President's proposal to build up strategic oil reserves to the level of 1.3 billion barrels equal to about 6 months' supply of imported oil.

Consumer problems

Less controversy has been caused by the Administration's anti-recession package, which now has been paralleled—in fact, expanded—by the tax proposal of the House Ways and Means Committee. The House Committee's bill involves $20.2 billion in tax cuts—an $8.0-billion rebate on last year's individual taxes, an $8.4-billion permanent reduction in income taxes, and a $3.8-billion cut in business taxes, primarily from an increase to 10 percent in the investment-tax credit. The Committee bill is larger than the Administration's $16.0-billion rebate proposal. Moreover, the bill includes permanent reductions, and it is weighted more heavily than the Administration proposal in favor of low- and middle-income taxpayers.

If consumers resume spending because of these tax cuts, a significant turnaround in the economy could occur in the second half of 1975. Last year, real disposable per capita income—the key determinant of consumer spending behavior—declined 3.4 percent. (This was by far the steepest drop of the past quarter-century.) This situation developed as workers' real earnings were pushed down by the recession and as taxpayers were pushed up into higher tax brackets by the inflation. A further loss in earned income is expected this year, but it should be cushioned by a rise in unemployment benefits—up from $7 billion in 1974 to $18 billion in 1975—and by a midyear rise in social-security benefits.

In the Council's view, the tax-cut-induced rise in disposable income and the slowdown in the price trend should lead to a strong improvement in real income in the second half of this year. They expect this shift to create an overall rise in consumer expenditures, on the heels of an improvement in durable-goods spending this spring occasioned by the income-tax rebate. The Council admits that much of the rebate will initially be saved, and some critics are even less optimistic, in view of the general tendency of consumers to save most windfall gains. It might take a great deal to shake consumers out of their lethargy; indeed, the saving rate was roughly 8 percent of disposable income in four of the last five years, despite the frequent charge that consumers were contributing to inflation with their reckless spending. By way of comparison, the saving rate averaged 5½ percent in the first half of the 1960's and 6½ percent in the last half of that decade.

Job problems

Consumer caution was evident long before the recession worsened, but it is likely to be compounded by the recent upsurge in the jobless rate, from 4.7 percent in the final quarter of 1973 to 8.2 percent in the opening month of 1975. In this recession situation, we could see a further rise in the incidence of unemployment (the percentage of the workforce with some unemployment during the year) and a rise in the average duration of unemployment experienced by the jobless.

A hopeful sign in the labor market last year was a decline in the average duration of unemployment, from 10.0 weeks in 1973 to 9.7 weeks in 1974, but the measure then jumped to 10.7 weeks this January. That figure doesn't compare with the peak of the early 1960's, especially with the 15.6-week average of 1961, but the sharpness of the recent rise still appears worrisome.

Consumer confidence is not likely to be helped by the Council's budget assumption that unemployment will stay in the 7-to-8-percent range throughout the 1975-78 period. But this estimate undoubtedly reflects the Council's view that the labor market will remain under pressure as the products of the post-World War II baby boom continue to reach maturity. The key 25-34-year age bracket is growing by 9.1 million this decade after a 2.6-million increase in the 1960's—a 52-percent as against a 17-percent gain. The massive business expansion of the early 1970's helped absorb much of this large group of young workers, but the present combination of recession and a fast-rising labor force creates somber implications for the next several years.

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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 1/29/75	Change from 1/22/75	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	84,605	− 580	+5,740	+ 7.28
Loans (gross, adjusted)—total	66,207	− 189	+6,337	+ 10.58
Security loans	1,090	+ 67	+ 45	+ 4.31
Commercial and industrial	23,882	− 217	+2,838	+ 13.49
Real estate	19,996	− 15	+1,483	+ 8.01
Consumer instalment	9,884	− 4	+ 729	+ 7.96
U.S. Treasury securities	5,615	− 212	− 453	− 7.47
Other securities	12,783	− 179	− 144	− 1.11
Deposits (less cash items)—total*	82,778	− 564	+7,461	+ 9.91
Demand deposits (adjusted)	22,394	+ 72	+ 898	+ 4.18
U.S. Government deposits	410	− 96	− 766	− 65.14
Time deposits—total*	58,672	− 499	+7,151	+ 13.88
States and political subdivisions	7,161	− 267	− 256	− 3.45
Savings deposits	18,319	+ 17	+ 648	+ 3.67
Other time deposits‡	29,973	− 14	+6,198	+ 26.07
Large negotiable CD's	16,528	− 213	+5,259	+ 46.67

Weekly Averages of Daily Figures	Week ended 1/22/75	Week ended 1/29/75	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves	− 84	− 24	22
Borrowings	3	39	331
Net free (+) / Net borrowed (−)	− 87	− 63	− 309
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions Net purchases (+) / Net sales (−)	+1,532	+1,840	+1,137
Transactions of U.S. security dealers Net loans (+) / Net borrowings (−)	+ 401	+ 466	+ 134

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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