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SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

August 14, 1974

Summary and Outlook

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Economic activity has continued sluggish this summer, and prices are still rising at exceptionally rapid rates. As yet, there are no signs of an emergence from the economic slowdown of the first half, and prospects for such emergence appear to have weakened.

In July, industrial production is estimated to have shown little change for the second consecutive month. Output of consumer goods was up moderately last month, but business equipment production remained unchanged, as did output of materials; output of construction products, on the other hand, was off.

Most labor market indicators showed some weakening in July. The unemployment rate edged up to 5.3 per cent, and nonfarm payroll employment declined for the second consecutive month. Strikes accounted for some of the June-July decline, but the July drop in manufacturing employment was substantial and widespread, following little change in June. The manufacturing workweek recovered to the May level, but was still 1/2 hour below its peak of September 1973.

Retail sales rose sharply in July, according to the advance Census report, following a quarter in which the rise in dollar volume of sales about matched the advance in prices. Unit sales of autos, both domestic-type and imports, increased slightly while sales of other goods appeared generally strong. The latest Conference Board survey of consumer attitudes, taken in late May and early June, indicates continued pessimism and does not suggest any sustained upsurge in spending.

New orders for nondefense capital goods declined somewhat in June for the second consecutive month, and with prices of equipment

rising sharply, the drop in real terms was appreciable. Over the first half of the year as a whole, such orders changed little in real terms.

Revised GNP data for the period since 1970 indicate substantially more inventory accumulation over the past three years--and particularly during the past 18 months--than had been previously estimated. Estimates of real final sales, on the other hand, were revised down, so that inventory-sales ratios on a GNP basis now appear much higher than before. The new data imply a continued large buildup in stocks over the last two quarters, although less than the exceptionally high rate of accumulation reached in late 1973. Inventories of materials appear to have been rising at an unsustainably high rate in the first half, probably reflecting a replenishing of stocks depleted by shortages and anticipations of price increases.

Although the rise in wage rates was moderate in July, the rate of increase was exceptionally rapid for the May-July period. In July, the adjusted hourly earnings index was 8 per cent above the level of a year earlier, well below the rise in consumer prices. In the second quarter, unit labor costs in the private nonfarm economy rose sharply further, as the rise in compensation per manhour accelerated while productivity declined.

Inflationary pressures continue to be acute. Reflecting widespread and severe drought in the Midwest, wholesale prices of farm products and foods rose sharply in July, following four months of decline. Prices of industrial commodities continued their extraordinary rate of increase--monthly advances of 2 per cent or more for each of the last seven months. Increases were widespread, but were especially important

for metals and metal products, fuels, machinery, chemicals, and wood pulp and wood products. In June, consumer prices had advanced 1.0 per cent to a level 11 per cent above a year earlier. Increases were widespread among commodities and services.

Outlook. Staff projections through calendar year 1975 incorporate the following monetary and fiscal assumptions: (1) Growth in M_1 is still assumed to average an annual rate of about 5-1/4 per cent in the second half of 1974 and to rise to 5-3/4 per cent for 1975. Given the weaker outlook for real activity, this would imply little further rise in short term interest rates from current advanced levels. (2) A considerably expanded public employment program is now assumed, with a maximum additional outlay at an annual rate of \$4 billion in the second half of 1975, and a net increase of some 375,000 jobs in State and local government because of this program. Funds for such a program have not yet been provided. (3) In the absence of other information, other Federal expenditures are assumed to remain close to the budget for fiscal 1975. (4) An increase in social security benefits of \$4 billion, or 6 per cent, is assumed to be effective July 1, 1975, under the automatic cost of living adjustment provisions incorporated in existing legislation.

The staff has lowered its projection of real growth appreciably, while raising its projection of price increases. Real GNP is now projected to change relatively little in the third quarter, but then to begin declining again in the fourth quarter and to continue a downward trend through the first half of 1975. A modest upturn in real growth is expected in the second half of calendar year 1975.

The more sluggish economic performance now projected results in part from an expected decline in the rate of inventory investment, reflecting the appreciably higher level of stock-sales ratios revealed by recently revised data. Projections of residential construction have also been revised down, reflecting a deteriorating outlook for savings inflows to mortgage lending thrift institutions--with the development of new market instruments and the success of the recent Treasury re-funding in attracting small investors. Business fixed investment is also expected to weaken in real terms, with outlays for commercial construction off appreciably, and expenditures by public utilities also curtailed. And demands for nonagricultural exports are expected to slacken with weaker activity abroad.

In extending the projection through the second half of 1975, the staff finds a basis for believing that growth in real GNP may turn positive again late next year, paced by a resumption of expansion in real consumer purchases. Wage rate increases are expected to exceed the rate of consumer price increases, so that there would be a resumption of growth in real earnings. Also, the increase in social security benefits scheduled for mid-1975 would boost consumer purchasing power. Additionally, we anticipate the beginning of a turnaround in housing starts late in 1975, reflecting some expansion of the volume of savings inflows over the course of next year, a leveling off of mortgage interest rates, and growing backlogs of demand for housing. Business fixed investment, on the other hand, is expected to continue drifting off in real terms.

The staff has again raised appreciably its projection of prospective price increases. Given the recent pattern of price increases and wage settlements, compensation per manhour now appears likely to rise even faster than earlier assumed. Food prices appear to be increasing at an accelerated rate this quarter. Moreover, the shortfall in harvests of feed grains appears likely to affect adversely the prices of hogs, poultry, and dairy products later this year and in early 1975. The adverse effects on beef prices may well be delayed until late next year.

In view of the weaker outlook for real GNP, employment is now projected to edge down through the end of 1975. Even though labor force growth is expected to slow appreciably, in response to weak demand for labor, the unemployment rate is now projected to increase more rapidly than assumed four weeks ago, reaching 6-3/4 per cent by mid-1975 and about 7-1/4 per cent by the end of next year--even on the assumption of an expanded public service employment program.

STAFF GNP PROJECTIONS

	Per cent change, annual rate									
	Changes in nominal GNP \$ billion		Real GNP				Gross private product fixed weighted price index		Unemployment rate (per cent)	
	7/10/74	8/14/74	7/10/74	8/14/74	7/10/74	8/14/74	7/10/74	8/14/74		
1971 <u>1/</u>	78.3	77.8	3.2	3.3	4.6	4.3	5.9	5.9		
1972 <u>1/</u>	99.7	103.1	6.1	6.2	3.2	3.3	5.6	5.6		
1973 <u>1/</u>	133.9	136.9	5.9	5.9	6.1	6.3	4.9	4.9		
1974	103.2	104.4	-.8	-1.4	9.7	10.9	5.4	5.5		
1975	--	99.1	--	-.8	--	8.0	--	6.9		
1973: I <u>1/</u>	43.3	44.2	8.7	9.5	7.0	7.4	5.0	5.0		
II <u>1/</u>	29.5	29.0	2.4	2.2	7.9	8.1	4.9	4.9		
III <u>1/</u>	32.5	31.0	3.4	1.6	7.0	8.4	4.7	4.7		
IV <u>1/</u>	33.0	35.1	1.6	2.3	8.6	9.1	4.7	4.7		
1974: I <u>1/</u>	14.7	14.8	-6.3	-7.0	13.5	14.1	5.2	5.2		
II <u>1/</u>	23.1	24.7	-.8	-1.2	9.0	12.3	5.1	5.1		
III	29.2	31.0	.2	-.4	8.8	10.1	5.5	5.5		
IV	32.5	26.0	1.3	-1.2	7.8	8.5	5.8	6.0		
1975: I	26.5	20.0	.8	-1.6	6.7	7.4	6.2	6.4		
II	24.5	21.5	.8	-1.0	6.0	7.1	6.5	6.7		
III	--	25.0	--	.2	--	6.7	--	7.1		
IV	--	33.0	---	1.7	--	6.6	--	7.3		
Change: 72-IV to 73-IV	138.3	139.3	4.0	3.9	7.8	8.3	-.6	-.6		
73-IV to 74-IV	98.5	96.5	-1.5	-2.5	9.8	11.2	1.1	1.3		
74-II to 75-II	112.7	98.5	.8	-1.1	7.3	8.3	1.4	1.6		
74-IV to 75-IV	--	99.5	--	-.2	--	6.9	--	1.3		

1/ Actual.

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income
figures are billions of dollars, with quarter figures at annual rates.)

	1973	1974 Proj.	1973		1974		Projected	
			III	IV	I	IIp	III	IV
Gross National Product	1294.9	1399.3	1308.9	1344.0	1358.8	1383.5	1414.5	1440.5
Final purchases	1279.6	1385.3	1297.0	1315.1	1341.9	1368.4	1401.5	1429.5
Private	1003.2	1077.1	1020.1	1028.7	1045.6	1064.9	1089.7	1108.0
Excluding net exports	999.3	1075.3	1013.4	1019.4	1034.3	1064.7	1090.9	1111.3
Personal consumption expenditures	805.2	875.7	816.3	823.9	840.6	866.8	889.2	906.3
Durable goods	130.3	130.3	132.4	124.3	123.9	130.2	132.4	134.5
Nondurable goods	338.0	379.9	343.8	352.1	364.4	375.2	386.8	393.3
Services	336.9	365.6	340.1	347.4	352.4	361.4	370.0	378.5
Cross private domestic investment	209.4	213.6	209.0	224.5	210.5	213.0	214.7	216.0
Residential construction	57.2	47.9	58.1	53.6	48.4	48.7	47.9	46.6
Business fixed investment	136.8	151.7	139.0	141.9	145.2	149.2	153.8	158.4
Change in business inventories	15.4	14.0	11.8	28.9	16.9	15.1	13.0	11.0
Nonfarm	11.4	11.8	7.4	24.0	13.1	11.9	11.5	10.5
Net exports of goods and services ^{1/}	3.9	1.8	6.7	9.3	11.3	.2	-1.2	-3.3
Exports	100.4	139.2	103.7	113.6	131.2	138.6	142.2	144.7
Imports	96.4	137.4	96.9	104.3	119.9	138.4	143.4	148.0
Gov't. purchases of goods and services	276.4	308.3	276.9	286.4	296.3	303.5	311.8	321.5
Federal	106.6	115.5	105.3	108.4	111.5	113.9	116.1	120.6
Defense	74.4	77.9	73.3	75.3	75.8	76.1	78.0	81.6
Other	32.2	37.7	32.0	33.1	35.7	37.8	38.1	39.0
State and local	169.8	192.8	171.6	177.9	184.8	189.6	195.7	200.9
Gross national product in constant (1958) dollars	839.2	827.6	840.8	845.7	830.5	828.0	827.2	824.7
GNP implicit deflator (1958 = 100)	154.3	169.1	155.7	158.9	163.6	167.1	171.0	174.7
Personal income	1055.0	1148.1	1068.0	1099.3	1112.5	1133.8	1160.9	1185.3
Wage and salary disbursements	691.7	757.6	698.2	717.0	727.6	744.9	781.8	776.0
Disposable income	903.7	978.0	913.9	939.4	950.6	965.9	987.8	1007.5
Personal saving	74.4	76.2	73.2	89.3	84.4	73.3	72.4	74.6
Saving rate (per cent)	8.2	7.8	8.0	9.5	8.9	7.6	7.3	7.4
Corporate profits & inventory val. adj.	105.1	113.7	105.2	106.4	107.7	113.1	117.8	116.1
Corporate profits before tax	122.7	145.7	122.7	122.7	138.7	150.4	149.5	144.0
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	258.5	291.6	261.8	268.3	279.4	289.5	296.8	300.8
Expenditures	264.2	296.3	263.4	270.6	281.0	291.2	302.3	310.8
Surplus or deficit (-)	-5.6	-4.7	-1.7	-2.3	-1.5	-1.7	-5.5	-10.0
High employment surplus or deficit (-)	-6.6	-1.6	-4.8	-4.2	-3.0	-3.1	-2.9	2.8
State and local government surplus or deficit (-), (N.I.A. basis)	9.2	2.2	8.4	4.6	3.4	2.3	2.3	.8
Total labor force (millions)	91.0	93.2	91.3	92.2	92.8	92.9	93.4	93.7
Armed forces "	2.3	2.2	2.3	2.3	2.3	2.2	2.2	2.2
Civilian labor force "	88.7	91.0	89.0	89.9	90.5	90.6	91.2	91.5
Unemployment rate (per cent)	4.9	5.5	4.7	4.7	5.2	5.1	5.5	6.0
Nonfarm payroll employment (millions)	75.6	76.9	75.7	76.6	76.7	77.1	77.0	76.8
Manufacturing	19.8	19.8	19.8	20.1	19.9	19.9	19.8	19.6
Industrial production (1967 = 100)	125.6	125.2	126.7	127.0	124.9	125.4	125.4	125.0
Capacity utilization, mfg. (per cent)	83.0	79.6	83.3	82.6	80.5	80.1	79.3	78.3
Major materials (per cent)	93.0	89.0	93.5	92.3	90.2	90.0	88.7	86.9
Housing starts, private (millions, A.R.)	2.05	1.51	2.01	1.58	1.63	1.57	1.45	1.40
Sales new autos (millions, A.R.)	11.44	9.19	11.33	10.15	9.04	9.20	9.25	9.25
Domestic models	9.67	7.86	9.66	8.51	7.49	7.95	8.00	8.00
Foreign models	1.77	1.33	1.67	1.64	1.55	1.25	1.25	1.25
^{1/} Net exports of g. & s. (Bal. of Paymts.)	4.2	2.2	6.6	10.6 ^{2/}	11.6 ^{2/}	.7	-.7	-2.8
Exports	101.0	140.8	103.7	116.0 ^{2/}	131.5 ^{2/}	140.5	144.2	146.7
Imports	96.8	138.6	97.1	105.5	119.9	139.9	144.9	149.5

^{2/} includes shipments of military equipment and supplies to Israel not included in GNP figures; for 1973-IV these are \$2.4 billion and for 1974-I, \$3 billion.

GROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income figures are billions of dollars, with quarter figures at annual rates.)

	1974 Proj.	1975 Proj.	1974		1975			
			III	IV	Projected			
					I	II	III	IV
Gross National Product	1399.3	1497.4	1414.5	1440.5	1460.5	1482.0	1507.0	1540.0
Final purchases	1385.3	1490.4	1401.5	1429.5	1453.5	1475.0	1500.0	1533.0
Private	1077.1	1151.5	1089.7	1108.0	1125.8	1139.7	1158.7	1181.8
Excluding net exports	1075.3	1156.7	1090.9	1111.3	1129.8	1144.1	1164.2	1188.5
Personal consumption expenditures	875.7	948.1	889.2	906.3	922.8	938.0	955.8	975.6
Durable goods	130.3	135.5	132.4	134.5	134.5	133.0	135.0	139.5
Nondurable goods	379.9	413.2	386.8	393.3	401.3	409.5	417.3	424.6
Services	365.6	399.4	370.0	378.5	387.0	395.5	403.5	411.5
Gross private domestic investment	213.6	215.6	214.7	216.0	214.0	213.1	215.4	219.9
Residential construction	47.9	43.1	47.9	46.6	45.1	41.6	41.9	43.8
Business fixed investment	151.7	165.5	153.8	158.4	161.9	164.5	166.5	169.1
Change in business inventories	14.0	7.0	13.0	11.0	7.0	7.0	7.0	7.0
Nonfarm	11.8	7.4	11.5	10.5	8.0	7.5	7.0	7.0
Net exports of goods and services ^{1/}	1.8	-5.2	-1.2	-3.3	-4.0	-4.4	-5.5	-6.7
Exports	139.2	151.8	142.2	144.7	147.5	149.8	153.2	156.7
Imports	137.4	157.0	143.4	148.0	151.5	154.2	158.7	163.4
Gov't. purchases of goods and services	308.3	338.9	311.8	321.5	327.7	335.3	341.3	351.2
Federal	115.5	125.1	116.1	120.6	122.0	123.8	124.9	129.5
Defense	77.9	84.7	78.0	81.6	82.5	83.8	84.4	88.0
Other	37.7	40.4	38.1	39.0	39.5	40.0	40.5	41.5
State & local	192.8	213.8	195.7	200.9	205.7	211.5	216.4	221.7
Gross national product in constant (1958) dollars	827.6	820.9	827.2	824.7	821.3	819.3	819.7	823.1
GNP implicit deflator (1958 = 100)	169.1	182.3	171.0	174.7	177.8	180.9	183.9	187.1
Personal income	1148.1	1236.6	1160.9	1185.3	1208.3	1203.1	1255.2	1279.7
Wage and salary disbursements	757.6	815.1	761.8	776.0	791.6	807.1	821.8	839.8
Disposable income	978.0	1055.4	987.8	1007.5	1026.4	1044.3	1065.5	1085.4
Personal saving	76.2	79.6	72.4	74.6	76.6	78.8	81.7	81.3
Saving rate (per cent)	7.8	7.5	7.3	7.4	7.5	7.5	7.7	7.5
Corporate profits & inventory val. adj.	113.7	109.9	117.8	116.1	110.4	108.2	108.4	112.4
Corporate profits before tax	145.7	129.4	149.5	144.0	133.5	128.5	126.5	129.0
Federal government receipts and expenditures, (N.I.A. basis)								
Receipts	291.6	310.9	296.8	300.8	305.3	308.2	312.0	318.2
Expenditures	296.3	329.4	302.3	310.8	317.9	325.9	334.0	339.9
Surplus or deficit (-)	-4.7	-18.5	-5.5	-10.0	-12.6	-17.7	-22.0	-21.7
High employment surplus or deficit (-)	-1.6	15.9	-2.9	2.8	9.3	14.8	17.2	22.4
State and local government surplus or deficit (-), (N.I.A. basis)	2.2	-2.7	2.3	.8	-1.2	-1.9	-2.6	-5.0
Total labor force (millions)	93.2	94.2	93.4	93.7	93.9	94.1	94.3	94.4
Armed forces "	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Civilian labor force "	91.0	92.0	91.2	91.5	91.7	91.9	92.1	92.2
Unemployment rate (per cent)	5.5	6.9	5.5	6.0	6.4	6.7	7.1	7.2
Nonfarm payroll employment (millions)	76.9	76.5	77.0	76.8	76.7	76.6	76.5	76.4
Manufacturing	19.8	19.2	19.8	19.6	19.5	19.3	19.0	18.6
Industrial production (1967 = 100)	125.2	124.3	125.4	125.0	124.5	123.9	124.1	124.1
Capacity utilization, mfg. (per cent)	79.6	76.1	79.3	78.3	77.3	76.3	75.6	75.1
Major materials (per cent)	89.0	83.5	88.7	86.9	84.9	83.8	82.9	82.1
Housing starts, private (millions, A.R.)	1.51	1.26	1.45	1.40	1.25	1.20	1.25	1.3
Sales new autos (millions, A.R.)	9.19	8.87	9.25	9.25	9.00	8.75	8.75	9.0
Domestic models	7.86	7.76	8.00	8.00	7.85	7.65	7.65	7.9
Foreign models	1.33	1.11	1.25	1.25	1.15	1.10	1.10	1.1
^{1/} Net exports of g. & s. (Bal. of Paymts.)	2.2	-4.7	-.7	-2.8	-3.5	-3.9	-5.0	-6.
Exports	140.8	153.8	144.2	146.7	149.5	151.8	155.2	158.
Imports	138.6	158.5	144.9	149.5	153.0	155.7	160.2	164.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1973	1974 Proj.	1973		1974		Projected	
			III	IV	I	IIp	III	IV
-----Billions of Dollars-----								
Gross National Product	136.9	104.4	31.0	35.1	14.8	24.7	31.0	26.0
Inventory change	6.9	- 1.4	1.1	17.1	-12.0	- 1.8	- 2.1	- 2.0
Final purchases	130.0	105.7	29.8	18.1	26.8	26.5	33.1	28.0
Private	109.3	73.9	26.2	8.6	16.9	19.3	24.8	18.3
Net exports	9.9	- 2.1	6.2	2.6	2.0	-11.1	- 1.4	- 2.1
Excluding net exports	99.4	76.0	20.0	6.0	14.9	30.4	26.2	20.4
Personal consumption expenditures	76.2	70.5	17.3	7.6	16.7	26.2	22.4	17.1
Durable goods	11.9	.0	.3	- 8.1	- .4	6.3	2.2	2.1
Nondurable goods	38.0	41.9	11.1	8.3	12.3	10.8	11.6	6.5
Services	26.0	28.7	5.9	7.3	5.0	9.0	8.6	8.5
Residential fixed investment	3.2	- 9.3	- .6	- 4.5	- 5.2	.3	- .8	- 1.3
Business fixed investment	20.0	14.9	3.4	2.9	3.3	4.0	4.6	4.6
Government	20.7	31.9	3.6	9.5	9.9	7.2	8.3	9.7
Federal	1.7	8.9	- .9	3.1	3.1	2.4	2.2	4.5
State and local	19.0	5.5	4.5	6.3	6.9	4.8	6.1	5.2
GNP in constant (1958) dollars	46.7	-11.6	3.4	4.9	-15.2	- 2.5	- .8	- 2.5
Final purchases	43.0	- 9.4	3.1	- 7.0	- 5.8	- 1.0	- .2	- 1.2
Private	45.2	-10.6	3.3	- 9.0	- 6.1	- .3	- .1	- 1.0
-----Per Cent Per Year ^{1/} -----								
Gross National Product	11.8	8.1	10.1	11.2	4.5	7.5	9.3	7.6
Final purchases	11.3	8.3	9.7	5.7	8.4	8.1	10.0	8.2
Private	12.2	7.4	11.0	3.4	6.7	7.6	9.6	6.9
Personal consumption expenditures	10.5	8.8	8.9	3.8	8.4	13.1	10.7	7.9
Durable goods	10.1	.0	.9	-22.3	- 1.3	21.9	6.9	6.5
Nondurable goods	12.8	12.4	14.0	10.0	14.7	12.4	13.0	6.9
Services	8.4	8.5	7.3	8.9	5.9	10.6	9.9	9.5
Gross private domestic investment	16.8	2.0	7.8	33.1	-22.7	4.8	3.2	2.4
Residential structures	5.9	-16.3	- 4.0	-27.6	-33.5	2.5	- 6.4	-10.4
Business fixed investment	17.1	10.9	10.4	8.6	9.6	11.5	12.9	12.5
Gov't. purchases of goods & services	8.1	11.5	5.4	14.4	14.6	10.1	11.4	13.0
Federal	1.6	8.3	- 3.3	12.3	11.9	8.9	8.0	16.4
Defense	.5	4.7	- 3.7	11.4	2.7	1.6	10.4	19.8
Other	7.0	17.1	- 2.5	14.5	35.3	25.7	3.2	9.8
State and local	12.6	13.5	11.2	15.5	16.4	10.8	13.5	11.1
GNP in constant (1958) dollars	5.9	- 1.4	1.6	2.3	- 7.0	- 1.2	- .4	- 1.2
Final purchases	5.5	- 1.1	1.5	- 3.3	- 2.8	- .5	- .1	- .6
Private	6.5	- 1.5	1.9	- 5.1 ^{2/}	- 3.5 ^{2/}	- .2	- .0	- .6 ^{2/}
GNP implicit deflator	5.6	9.6	8.3	8.6 ^{2/}	12.3 ^{2/}	8.8	9.7	8.8 ^{2/}
Private GNP fixed weighted index ^{3/}	6.3	10.9	8.4	9.1	14.1	12.3	10.1	8.5
Personal income	11.7	8.8	11.6	12.2	4.9	7.9	9.9	8.7
Wage and salary disbursements	10.3	9.5	8.7	11.2	6.0	9.9	21.3	- 2.9
Disposable income	12.6	8.2	10.1	11.6	4.9	6.6	9.4	8.2
Corporate profits before tax	23.7	18.7	- 6.9	.0	63.3	38.3	- 2.4	-13.9
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	13.8	12.8	11.1	10.3	17.6	15.3	10.5	5.5
Expenditures	8.0	12.1	1.5	11.4	16.3	15.3	16.1	11.7
Nonfarm payroll employment	3.9	1.7	2.2	4.4	.8	1.8	- .5	- 1.0
Manufacturing	4.7	.0	1.2	4.5	- 2.9	.4	- 2.0	- 4.0
Industrial production	9.0	- .3	6.2	1.0	- 6.5	1.6	.0	- 1.4
Housing starts, private	-13.2	-26.2	-32.0	-61.4	11.6	-14.2	-27.2	-13.1
Sales new autos	4.7	-19.7	-21.3	-35.5	-37.1	7.2	2.2	.0
Domestic models	3.7	-18.7	-18.6	-39.8	-40.0	27.1	2.5	.0
Foreign models	9.8	-24.9	-35.0	- 5.9	-20.0	-38.2	.0	.0

^{1/} Percentage rates are annual rates compounded quarterly.^{2/} Excluding Federal pay increases rates of change are: 1973-IV, 8.0 per cent; 1974-I, 12.2 per cent; and 1974-IV, 8.3 per cent.^{3/} Using expenditures in 1967 as weights.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1974 Proj.	1975 Proj.	1974		1975			
					Projected			
			III	IV	I	II	III	IV
-----Billions of Dollars-----								
Gross National Product	104.4	98.1	31.0	26.0	20.0	21.5	25.0	33.0
Inventory change	- 1.4	- 7.0	- 2.1	- 2.0	- 4.0	.0	.0	.0
Final purchases	105.7	105.1	33.1	28.0	24.0	21.5	25.0	33.0
Private	73.9	74.4	24.8	18.3	17.8	13.9	19.0	23.1
Net exports	- 2.1	- 7.0	- 1.4	- 2.1	- .7	- .4	- 1.1	- 1.2
Excluding net exports	76.0	81.4	26.2	20.4	18.5	14.3	20.1	24.3
Personal consumption expenditures	70.5	72.4	22.4	17.1	16.5	15.2	17.8	19.8
Durable goods	.0	5.2	2.2	2.1	.0	- 1.5	2.0	4.5
Nondurable goods	41.9	33.3	11.6	6.5	8.0	8.2	7.8	7.3
Services	28.7	33.8	8.6	8.5	8.5	8.5	8.0	8.0
Residential fixed investment	- 9.3	- 4.8	- .8	- 1.3	- 1.5	- 3.5	.3	1.9
Business fixed investment	14.9	13.8	4.6	4.6	3.5	2.6	2.0	2.6
Government	31.9	30.6	8.3	9.7	6.2	7.6	6.0	9.9
Federal	8.9	9.6	2.2	4.5	1.4	1.8	1.1	4.6
State and local	5.5	21.0	6.1	5.2	4.8	5.8	4.9	5.3
GNP in constant (1958) dollars	-11.6	- 6.7	- .8	- 2.5	- 3.4	- 2.0	.4	3.4
Final purchases	- 9.4	- 3.2	.2	- 1.2	- 1.7	- 2.9	- .6	3.4
Private	-10.6	- 3.9	- .1	- 1.0	- .7	- 3.4	- .9	2.6
-----Per Cent Per Year ^{1/} -----								
Gross National Product	8.1	7.0	9.3	7.6	5.7	6.0	6.9	9.1
Final purchases	8.3	7.6	10.0	8.2	6.9	6.0	7.0	9.1
Private	7.4	6.9	9.6	6.9	6.6	5.0	6.8	8.2
Personal consumption expenditures	8.8	8.3	10.7	7.9	7.5	6.8	7.8	8.5
Durable goods	.0	4.0	6.9	6.5	.0	- 4.4	6.2	14.0
Nondurable goods	12.4	8.8	13.0	6.9	8.4	8.4	7.8	7.2
Services	8.5	9.2	9.9	9.5	9.3	9.1	8.3	8.2
Gross private domestic investment	2.0	.9	3.2	2.4	- 3.7	- 1.7	4.4	8.6
Residential structures	-16.3	-10.0	- 6.4	-10.4	-12.3	-27.6	2.9	19.4
Business fixed investment	10.9	9.1	12.9	12.5	9.1	6.6	5.0	6.4
Gov't. purchases of goods & services	11.5	9.9	11.4	13.0	7.9	9.6	7.4	12.1
Federal	8.3	8.3	8.0	16.4	4.7	6.0	3.6	15.6
Defense	4.7	8.7	10.4	19.8	4.5	6.5	2.9	18.2
Other	17.1	7.2	3.2	9.8	5.2	5.2	5.1	10.2
State and local	13.5	10.9	13.5	11.1	9.9	11.8	9.6	10.2
GNP in constant (1958) dollars	- 1.4	- .8	- .4	- 1.2	- 1.6	- 1.0	.2	1.7
Final purchases	- 1.1	- .4	.1	- .6	- .8	- 1.4	- .3	1.7
Private	- 1.5	- .6	- .0	- .6	- .4	- 2.0	- .5	1.6 ^{2/}
GNP implicit deflator	9.6	7.8	9.7	8.8 ^{2/}	7.4 ^{2/}	7.1	6.7	7.2 ^{2/}
Private GNP fixed weighted index ^{3/}	10.9	8.0	10.1	8.5	7.4	7.1	6.7	6.6
Personal income	8.8	7.7	9.9	8.7	8.0	- 1.7	18.5	8.0
Wage and salary disbursements	9.5	7.6	21.3	- 2.9	8.3	8.1	7.5	9.1
Disposable income	8.2	7.9	9.4	8.2	7.7	7.2	8.4	7.7
Corporate profits before tax	18.7	-11.2	- 2.4	-13.9	-26.1	-14.2	- 6.1	8.1
Federal government receipts and expenditures (N.I.A. basis)								
Receipts	12.8	6.6	10.5	5.5	6.1	3.9	5.0	8.2
Expenditures	12.1	11.2	16.1	11.7	9.5	10.5	10.3	7.3
Nonfarm payroll employment	1.7	- .5	- .5	- 1.0	- .5	- .5	- .5	- .5
Manufacturing	.0	- 3.0	- 2.0	- 4.0	- 2.0	- 4.0	- 6.1	- 2.1
Industrial production	- .3	- .7	.0	- 1.4	- 1.6	- 1.6	.5	2.1
Housing starts, private	-26.2	-16.6	-27.2	-13.1	-36.4	-15.1	17.7	36.0
Sales new autos	-19.7	- 3.5	2.2	.0	-10.4	-10.7	.0	11.9
Domestic models	-18.7	- 1.3	2.5	.0	- 7.3	- 9.8	.0	13.7
Foreign models	-24.9	-16.5	.0	.0	-28.4	-16.3	.0	.0

^{1/} Percentage rates are annual rates compounded quarterly.

^{2/} Excluding Federal pay increases rates of change are: 1974-IV, 8.3 per cent; 1975-I, 7.3 per cent; and 1975-IV, 6.6 per cent.

^{3/} Using expenditures in 1967 as weights.

DOMESTIC FINANCIAL SITUATION

Tensions in financial markets, though still marked, have moderated appreciably since the early July period of peak uncertainty. A key element in this change has, of course, been the 1-1/2 percentage point drop in the average Federal funds rate from its early July high of more than 13-1/2 per cent. This change has tempered market expectations regarding the degree of money market tautness being sought by the Open Market Committee. And recent evidence of slower growth in the monetary aggregates has tended to reinforce this judgment.

As pressures on money and credit markets have moderated, commercial banks have been generally successful in coping with the continuing squeeze on their liquidity. Although some regional banks have apparently continued to experience difficulties selling large CD's, particularly in national markets, aggregate CD growth at all banks outside New York and Chicago has remained strong.

At the same time, bank needs for funds to finance business loans appear to have slackened a little. Some of this change undoubtedly reflects the impact of tighter bank lending policies inaugurated in recent months. But reports of less robust business demands for funds have also surfaced recently. A waning of business desires to accumulate inventories--in light of the large holdings already in place--reportedly has been a key factor contributing to this change. In addition, important instances of stretch-outs in capital spending plans have developed. And pressures on banks have been relieved recently because prime corporations are again finding it more favorable to finance in the commercial paper market.

In contrast to the modest net declines of most private security market rates since early July, yields on U. S. Treasury and Federal agency securities have shown significant net advances. Major shifts in the immediate market supply account for the bulk of this change. A series of Treasury financings in the latter part of July and early August corrected a marked earlier supply shortage--particularly in the bill area. At the same time, demands for Treasury debt from the investment of Arab oil profits proved to be substantially smaller than the market had anticipated. Dealers' net positions--which previously had been close to zero--thus, suddenly became quite substantial. To cover the resulting high costs of position financing, market rates had to be raised.

Net savings growth at thrift institutions was barely positive in July--even after adjustment for usual seasonal outflows. Enthusiastic public participation in the Treasury's early August auction of 8-1/2 and 9 per cent coupon issues has no doubt contributed to continuing pressures on these institutions. Non-competitive tenders amounted to a record 50 per cent of the total offered to the public, into full payment on these issues due at mid-month. In addition, attractive rates available on other recent offerings of new Treasury bills and Federal agency securities, and the new variable rate debt instruments being sold by bank holding and industrial companies have probably cut further into thrift account flows.

With the thrift institutions generally anticipating heavy deposit drains over the summer period, commitments on new mortgage lending were cut sharply in June and July, and average mortgage loan rates have continued to rise where usury ceilings permit. In the FNMA's August 12 auction, the secondary market rate rose to more than 10 per cent for the first time. Following the auction, maximum rates allowed an FHA and VA mortgage were raised to 9-1/2 per cent.

Outlook. The combination of rapid continuing inflation and the generally depleted liquidity status of both financial institutions and business corporation is likely to maintain relatively heavy pressure on financial markets for some time ahead. With capital spending continuing to rise in dollar terms and profits running low in many sectors, sizable short-falls in business funds available from internal sources are likely to create continuing needs for external financing.

The still sensitive state of the commercial paper and corporate securities markets, and the continuing squeeze on non-bank financial institutions can be expected to maintain pressure on commercial banks, particularly the large institutions that operate as lenders of next-to-last resort. While these latter institutions have a preferred status in the CD, commercial paper, and Euro-dollar markets, the magnitude of their needs for funds should tend to inhibit short-term rate declines.

As already noted, the U.S. Treasury expects to borrow additional funds in early September. While no further Treasury need is

projected for October, financing requirements of Federal agencies will tend to sustain a high volume of overall Federal borrowing, as loans recently committed under the new Federal housing support programs are taken down. The market impact of these financing requirements will depend in part on the ultimate plans of oil producing states regarding the investment of their oil royalties, about which little is known at this point.

In light of the recent evidence of minimal growth in the monetary aggregates and the current tendency for forecasts of real growth in the economy to be revised downward, market expectations of declining interest rates could develop. Without further declines in the Federal funds rate, however, over-all interest rate declines are unlikely to proceed very far. If the staff projection of an 8 to 9 per cent growth rate in nominal GNP over the last half of the year holds, reserve provision to achieve a 5-1/4 per cent money growth rate leaves little leeway for sustained rate declines. Moreover, securities markets are still quite sensitive to any shocks to confidence that might arise from business failures, including those coming from abroad.

INTERNATIONAL DEVELOPMENTS

Summary and outlook. Since the July Committee meeting, the dollar has continued the gradual appreciation in exchange markets that began in mid-May. Political events in the United States have probably contributed to a somewhat stronger appreciation recently, while some other currencies, notably the yen and the lira, have been under downward pressure.

As usual, it is difficult to find data on specific kinds of transactions to which recent developments in the exchange markets can be related. It can only be inferred that flows of private capital, plus inflows of official funds accruing to the oil-exporting countries, have been sufficient to match a continuing deficit on goods and services. There are signs, however, that the trade deficit is moderating. Imports of fuels have leveled off since April in both quantity and price, and agricultural exports are expected to remain high because of the upturn in prices. Moreover, the performance of other sectors of the trade accounts was generally good through June, with exports showing gains in both volume and price while imports were rising only because of rising prices, with volumes of non-fuel imports changing only slightly.

Information on capital flows in recent months shows U.S. banks still very active in lending abroad, while borrowing somewhat smaller amounts from private foreigners. In June, banks' claims on foreigners again rose sharply -- by \$2.7 billion -- of which about

one-third went to Japan. Banks' liabilities to private foreigners -- including their own affiliates abroad -- rose by about \$1.0 billion in the month. Banking claims on foreigners reportedly rose substantially further in July, but borrowing from abroad also appears to have increased considerably.

Inflows of oil producers' funds have an increasingly important role in the U.S. balance of payments. According to the best data we have at present, these countries' liquid funds held in the United States increased about \$1.0 billion in the first quarter and \$2.4 billion in the second quarter, including \$1.3 billion in June alone. In July, the increase again probably exceeded \$1 billion. These increases are now the major component of the over-all increase in U.S. liabilities to foreign official accounts.

The outlook for the U.S. trade balance in the period ahead in dollar terms is somewhat improved -- mainly reflecting, unfortunately, the prospect of food shortages and higher prices for agricultural exports. It may well be that some of this increase will require U.S. Government financing. The prolonged recession in the United States now projected, together with growth rates abroad generally well below normal, could have serious consequences for world trade and payments. In such an environment, trade volumes would contract, and efforts by other countries to score export gains would probably intensify, perhaps limiting further improvement in the U.S. non-oil, non-agricultural trade balance.