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# Part 1

May 11, 1977

## CURRENT ECONOMIC AND FINANCIAL CONDITIONS

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### **Summary and Outlook**

Prepared for the Federal Open Market Committee

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

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## **SUMMARY AND OUTLOOK**

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DOMESTIC NONFINANCIAL DEVELOPMENTS

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Summary. Vigorous expansion continues to be indicated by most measures of economic activity: employment, income, general merchandise sales, industrial production and housing starts. In addition, investment anticipation surveys report a further scaling up of planned business spending on fixed capital, and low inventory-sales ratios suggest the likelihood of greater inventory accumulation in the months ahead. At the same time, wholesale prices rose sharply again in April, in large part as a result of higher prices for food and fuels.

Industrial production is tentatively estimated to have increased around 3/4 per cent in April. Gains were widespread among materials, consumer goods and other final products; auto assemblies, however, declined somewhat from the advanced March level, in part because of local strikes. Total employment rose by over half a million in April, and the unemployment rate fell .3 percentage point to 7.0 per cent--its lowest level since late 1974. Nonfarm payroll employment also continued a strong upward trend, rising over a quarter million last month, and manufacturing employment rose substantially further with gains concentrated in nondurable industries.

Total retail sales in April were unchanged from the advanced March level. Excluding autos and nonconsumer items, however, sales rose 1 per cent. Unit auto sales were at an 11.6 million unit rate in April, somewhat below the exceptionally strong March pace. Sales of domestic models matched the advanced first quarter rate while sales of foreign models jumped to a 2.4 million unit annual rate, a recordbreaking performance.

Private housing starts rose by 17 per cent from February to a 2.1 million unit annual rate in March--the highest in nearly four years. Some of the March starts probably had been deferred during bad weather earlier in the year. Starts of multi-family units showed an exceptionally strong increase from February. Conditions appear favorable in the housing sector: mortgage credit remains ample, home sales were still vigorous in March, and rental vacancies have continued to decline.

Business fixed capital spending, to date the principal lagging sector in the recovery, appears to be poised for marked expansion. The McGraw-Hill spring survey--conducted in late March and early April--shows business planning to increase capital spending by 18 per cent this year, up 3 percentage points from the special February check-up survey and 5 percentage points from the fall survey. New orders for nondefense capital goods rose over 6 per cent in the first quarter, and the volatile series on construction contracts for commercial and industrial buildings measured in floor space--which had fluctuated at a comparatively low level for about a year--rose very sharply in March.

Although still quite moderate, inventory accumulation also appears to be edging higher. Book Value of manufacturers' inventories is estimated to have risen at an \$8-1/2 billion annual rate in March and a \$10-1/3 billion rate in the first quarter. These compare with a \$6-1/2 billion rate in the fourth quarter. Stocks of finished goods at factories fell in March in connection with a substantial rise in shipments. Overall inventory-sales ratios in manufacturing dropped sharply in March; for producers of durable goods, this ratio was at its lowest level in 11 years.

Wholesale prices continued to rise rapidly, increasing 1.1 per cent in April, the same as in March. Prices of farm products and foods increased 2.9 per cent last months to a level 10 per cent higher than six months earlier. Industrial commodity prices were up 0.6 per cent in April; increases were widespread by industry grouping but were especially large for fuels and power. Excluding energy items, industrial commodity prices rose 0.5 per cent--about the same as the average monthly increase over the past year.

Outlook. Incoming data now suggest a second quarter gain in real GNP of about 7 per cent (annual rate), a significant increase from last month's projection. Much of the upward revision was accounted for by strengthened consumer outlays, net exports, and nonresidential construction. The outlook for prices has deteriorated somewhat further, however.

The current projection incorporates the near-term effects of the Administration's recent energy proposals which we assume will be enacted and will take effect at the beginning of 1978. It is anticipated that a crude oil equalization tax--the so-called wellhead tax--will boost the rate of rise of the gross business product fixed-weighted price index by about half a per cent (annual rate) in the first quarter and will raise about \$5 billion in Federal revenues (to be redistributed to consumers) in calendar year 1978. Penalty excise taxes on new fuel inefficient cars and rebates for fuel efficient cars are assumed to begin in January. Since the Administration's rebate proposal is retroactive to May 1st, we assume an estimated half billion dollars in

rebates will be paid out in the first quarter of 1978; thereafter, the penalty taxes and rebates are assumed to offset each other.<sup>1/</sup>

Aside from the new energy assumptions, the projections incorporate the fiscal policy measures recently passed by the Congress (see Appendix to Part II for a brief description). These measures are largely the same as those assumed in last month's Greenbook. However, because of the strengthened near-term income outlook, tax receipts are expected to be larger, and given the earlier shortfall of Federal spending, the deficit for FY 1977 is now projected to total about \$49 billion--some \$4-1/2 billion below last month's forecast. Staff monetary policy assumptions are still consistent with a 5-1/2 per cent growth of  $M_1$  from 1977-QI to 1978-QI; due to the unanticipated current quarter surge in the money stock, growth rates in the following quarters are projected to be below the annual average.

Real GNP is projected to rise at about a 6 per cent annual rate over the five quarter period ending in 1978-QII --somewhat above

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<sup>1/</sup> Retroactive tax credits are assumed for residential, commercial and industrial weatherization expenditures, conversion of industrial plants and electric utilities to coal, and purchases of solar energy equipment; these would have negligible revenue effects over the forecast period. Proposed changes in the regulatory coverage and pricing structure for natural gas are not tax changes and will have no direct revenue effects. The proposed pricing changes will take considerable time, mostly beyond the projection period, before they are reflected in prices and expenditures.

last month's projections. We have raised our projection of business fixed investment slightly. This represents some scaling up of spending plans, as indicated by recent private capital spending surveys, tempered by added uncertainty about the resolution of proposed energy legislation. In the housing sector, we continue to project a leveling off of total starts at about a 2 million unit annual rate in late 1977 as deposit flows to lending institutions are projected to slow. Our projection of inventory investment still calls for a significant step-up in the rate of accumulation through mid-1978; but with real final demands expected to grow at over a 5 per cent annual rate for the next five quarters, total stocks would remain quite lean relative to sales.

The income growth associated with the projected level of activity would support average annual real consumption gains of about 4-1/4 per cent over the projection period and still allow for some recovery in the rate of personal savings. The savings rate is projected to rise about 1 percentage point to the 6 per cent range from its relatively low current level.

Reflecting in part the recent reduction in unemployment, the labor market outlook now calls for a 6-1/2 per cent unemployment rate by 1978-QII--somewhat below last month's indication. Productivity gains are still expected to average about 3 per cent through mid-1978--a pace strong enough to hold the rise in unit labor costs to about 5-1/2 per cent on average.



The projected inflation rate has been raised slightly from last month. On a fixed-weighted basis, price increases for gross business product are expected to average about 5-3/4 per cent over the five quarters ending in 1978-QII. Some allowance has been incorporated for higher food prices and for a climb in energy prices at the end of the projection period when tax increases on oil presumably become effective.

## STAFF GNP PROJECTIONS

	Per cent changes, annual rate							
	Nominal GNP		Real GNP		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	4/15/77	5/11/77	4/15/77	5/11/77	4/15/77	5/11/77	4/15/77	5/11/77
1973 <sup>1/</sup>	11.6	11.6	5.5	5.5	5.7	5.7	4.9	4.9
1974 <sup>1/</sup>	8.2	8.2	-1.7	-1.7	10.2	10.2	5.6	5.6
1975 <sup>1/</sup>	7.3	7.3	-1.8	-1.8	9.3	9.3	8.5	8.5
1976 <sup>1/</sup>	11.6	11.6	6.1	6.1	5.2	5.2	7.7	7.7
1977	10.7	11.0	4.6	5.0	5.8	6.0	7.2	6.9
1976-III <sup>1/</sup>	8.5	8.5	3.9	3.9	4.3	4.3	7.8	7.8
1976-IV <sup>1/</sup>	8.5	8.5	2.6	2.6	4.9	4.9	7.9	7.9
1977-I <sup>1/</sup>	11.4	11.3	4.8	5.2	6.4	6.8	7.4	7.4
1977-II	12.4	14.0	6.0	7.0	5.8	6.1	7.2	6.9
1977-III	11.2	11.9	5.3 <sup>1</sup>	5.6	5.5	5.5	7.1	6.8
1977-IV	12.9	12.7	6.1	6.1	5.5	5.6	7.0	6.7
1978-I	12.0	12.5	6.0	6.1	5.5	6.0	6.8	6.5
1978-II	11.6	11.7	5.8	5.8	5.6	5.8	6.7	6.4
Change:								
75-IV to 76-IV <sup>1/</sup>	9.9	9.9	5.0	5.0	4.5	4.5	-0.5	-0.5
76-II to 77-II	10.2	10.6	4.3	4.7	5.3	5.6	-0.2	-0.5
76-IV to 77-IV	12.0	12.5	5.6	6.0	5.8	6.0	-0.9	-1.2
77-II to 78-II	11.9	12.2	5.8	5.9	5.5	5.7	-0.5	-0.5

<sup>1/</sup> 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.)

	1976		1977				1978	
	III	IV	I	II	Projected III	Projected IV	I	II
Gross National Product	1709.8	1745.1	1792.5	1852.2	1904.9	1962.9	2021.4	2077.9
Final purchases	1694.7	1743.4	1785.0	1842.2	1891.3	1943.8	1997.3	2047.2
Private	1325.1	1367.2	1404.6	1451.4	1488.0	1527.1	1571.5	1611.5
Excluding net exports	1320.4	1363.0	1409.5	1451.5	1487.3	1526.8	1570.7	1613.9
Personal consumption expenditures	1088.5	1122.0	1156.8	1186.2	1210.7	1238.7	1271.5	1305.7
Goods	599.4	618.0	637.1	654.9	667.9	683.4	702.4	722.2
Services	489.1	504.0	519.6	531.3	542.8	555.3	569.1	583.5
Gross private domestic investment	247.0	242.8	260.2	275.3	290.2	307.2	323.3	338.9
Residential construction	68.9	75.5	79.7	84.9	90.0	95.0	99.3	101.3
Business fixed investment	163.0	165.6	173.1	180.4	186.6	193.1	199.9	206.9
Change in business inventories	15.1	1.7	7.5	10.0	13.6	19.1	24.1	30.7
Nonfarm	15.6	2.2	7.5	9.5	13.6	19.1	24.1	30.7
Net exports of goods and services <sup>1/</sup>	4.7	4.2	-4.9	-.1	.7	.3	.8	-2.4
Exports	167.7	168.5	170.5	177.4	183.6	188.6	193.8	199.2
Imports	163.0	164.3	175.4	177.5	182.9	188.3	193.0	201.6
Gov't. purchases of goods and services	369.6	376.2	380.4	390.8	403.3	416.7	425.8	435.7
Federal <sup>2/</sup>	134.5	138.9	139.5	142.7	147.9	153.9	156.7	160.3
State and local	235.0	237.4	240.9	248.1	255.4	262.8	269.1	275.4
Gross national product in constant (1972) dollars	1272.2	1280.4	1296.8	1319.0	1337.2	1357.0	1377.1	1396.6
Personal income	1386.0	1421.7	1462.8	1504.8	1544.8	1586.7	1624.3	1665.7
Wage and salary disbursements	897.8	921.0	946.2	977.4	1003.4	1031.8	1058.2	1085.7
Disposable income	1190.2	1216.5	1245.5	1282.3	1316.9	1351.7	1388.4	1422.2
Saving rate (per cent)	6.4	5.6	5.0	5.3	5.9	6.2	6.3	6.1
Corporate profits with I.V.A. and C.C. Adj.	122.0	117.8	115.6	122.1	129.1	138.7	142.6	148.4
Corporate profits before tax	150.2	154.2	155.8	158.4	161.9	169.0	169.9	174.7
Federal government surplus or deficit (-) (N.I.A. basis)	-57.4	-59.3	-46.5	-42.7	-50.7	-52.8	-50.0	-43.9
High employment surplus or deficit (-)	-9.9	-8.3	5.0	-1.1	-11.3	-15.7	-12.0	-7.4
State and local government surplus or deficit (-) (N.I.A. basis)	12.7	21.9	21.2	21.0	24.0	24.5	25.2	25.1
Excluding social insurance funds	-.6	8.4	7.4	6.6	9.0	8.9	9.2	8.6
Civilian labor force (millions)	95.3	95.7	96.1	97.0	97.5	98.0	98.6	99.1
Unemployment rate (per cent)	7.8	7.9	7.4	6.9	6.8	6.7	6.5	6.4
Nonfarm payroll employment (millions)	79.7	80.1	80.9	81.8	82.4	83.1	83.7	84.4
Manufacturing	19.0	19.0	19.3	19.6	19.8	20.1	20.4	20.7
Industrial production (1967=100)	130.9	131.8	133.5	136.6	139.2	142.1	145.2	148.8
Capacity utilization: all manufacturing (per cent)	80.8	80.6	80.9	82.0	82.9	84.1	85.3	86.8
Materials (per cent)	81.3	80.2	80.0	81.2	82.2	83.4	84.7	86.3
Housing starts, private (millions, A.R.)	1.57	1.77	1.78	1.93	1.97	2.00	2.00	2.00
Sales new autos, (millions, A.R.)	10.16	10.00	11.12	11.60	11.70	11.35	11.40	11.50
Domestic models	8.61	8.32	9.28	9.60	9.90	9.75	9.80	9.90
Foreign models	1.55	1.68	1.84	2.00	1.80	1.60	1.60	1.60

<sup>1/</sup> Balance of payments data and projection 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.

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CHANGES IN GROSS NATIONAL PRODUCT  
AND RELATED ITEMS

	1976		1977				1978	
	III	IV	I	II	Projected III	Projected IV	I	II
	----- Billions of dollars -----							
Gross National Product	34.6	35.3	47.4	59.7	52.7	58.0	58.5	56.5
Inventory change	-.9	-13.4	5.8	2.5	3.6	5.5	5.0	6.6
Final purchases	35.5	48.7	41.6	57.2	49.1	52.5	53.5	49.9
Private	27.9	42.1	37.4	46.8	36.6	39.1	44.4	40.0
Net exports	-4.6	-.5	-9.1	4.8	.8	-.4	.5	-3.2
Excluding net exports	32.5	42.6	46.5	42.0	35.8	39.5	43.9	43.2
Personal consumption expenditures	23.8	33.5	34.8	29.4	24.5	28.0	32.8	34.2
Goods	9.6	18.6	19.1	17.8	13.0	15.5	19.0	19.8
Services	14.2	14.9	15.6	11.7	11.5	12.5	13.8	14.4
Residential fixed investment	3.6	6.6	4.2	5.2	5.1	5.0	4.3	2.0
Business fixed investment	5.1	2.6	7.5	7.3	6.2	6.5	6.8	7.0
Government	7.6	6.6	4.2	10.4	12.5	13.4	9.1	9.9
Federal	3.3	4.4	.6	3.2	5.2	6.0	2.8	3.6
State and local	4.1	2.4	3.5	7.2	7.3	7.4	6.3	6.3
GNP in constant (1972) dollars	12.2	8.2	16.4	22.2	18.2	19.8	20.1	19.5
Final purchases	13.2	17.5	12.4	20.8	16.3	16.0	17.0	15.3
Private	11.3	17.7	13.9	17.3	11.7	12.8	15.3	13.0
	----- In Per Cent Per Year <sup>1/</sup> -----							
Gross National Product	8.5	8.5	11.3	14.0	11.9	12.7	12.5	11.7
Final purchases	8.8	12.0	9.9	13.5	11.1	11.6	11.5	10.4
Private	8.9	13.3	11.4	14.0	10.5	10.9	12.1	10.6
Personal consumption expenditures	9.2	12.9	13.0	10.6	8.5	9.6	11.0	11.2
ces	6.7	13.0	12.9	11.7	8.2	9.6	11.6	11.8
ces	12.5	12.8	13.0	9.3	8.9	9.5	10.3	10.5
Gross private domestic investment	13.8	-6.7	32.0	25.3	23.5	25.6	22.7	20.7
Residential structures	24.3	43.7	24.2	29.0	26.3	24.1	19.4	8.3
Business fixed investment	13.5	6.5	19.3	18.1	14.5	14.7	14.8	14.8
Gov't. purchases of goods & services	8.6	7.4	4.5	11.4	13.4	14.0	9.0	9.6
Federal	10.7	13.6	1.7	9.5	15.4	17.2	7.5	9.5
State and local	7.4	4.0	6.1	12.5	12.3	12.1	9.9	9.7
GNP in constant (1972) dollars	3.9	2.6	5.2	7.0	5.6	6.1	6.1	5.8
Final purchases	4.3	5.7	3.9	6.6	5.0	4.9	5.1	4.6
Private	4.7	7.3	5.6	6.9	4.5	4.9	5.8	4.9
GNP implicit deflator <sup>2/</sup>	4.4	5.8	5.8	6.5	5.9	6.3	6.0	5.6
Gross business product fixed-weighted price index <sup>3/</sup>	4.3	4.9	6.8	6.1	5.5	5.6	6.0	5.8
Personal income	7.2	10.7	12.1	12.0	11.1	11.3	9.8	10.6
Wage and salary disbursements	7.8	10.7	11.4	13.9	11.1	11.8	10.6	10.8
Disposable income	6.2	9.1	9.9	12.3	11.2	11.0	11.3	10.1
Corporate profits before tax	11.4	11.1	4.0	7.1	9.1	18.6	2.1	11.9
Nonfarm payroll employment	2.0	2.0	4.1	4.5	3.2	3.2	3.1	3.2
Manufacturing	.0	.0	6.5	6.2	5.6	6.0	5.9	6.2
Nonfarm business sector								
Output per hour	2.6	-1.2	2.6	2.2	2.7	3.3	3.0	2.7
Compensation per hour	7.1	7.0	10.2	8.1	8.6	7.8	8.9	8.1
Unit labor costs	4.3	8.3	7.3	5.9	5.9	4.5	5.9	5.4
Industrial production	4.7	2.8	5.3	9.6	7.8	8.8	9.0	10.1
Housing starts, private	41.3	61.5	2.3	38.2	8.6	6.2	.0	.0
Sales new autos	-6.8	-6.2	52.9	18.4	3.5	-11.4	1.8	3.6
domestic models	-12.4	-12.8	54.8	14.5	13.1	-5.9	2.1	4.1
ign models	34.2	38.0	43.9	39.6	-34.4	-37.6	.0	.0

<sup>1/</sup> Percentage rates are annual rates compounded quarterly.

<sup>2/</sup> Excluding Federal pay increases rates of change are: 1976-IV, 5.3 per cent; 1977-I, 5.7 per cent; 1977-IV, 5.7 per cent; 1978-I, 6.0 per cent.

<sup>3/</sup> Using expenditures in 1972 as weights.

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

	1970	1971	1972	1973	1974	1975	1976	Projected 1977
Gross National Product	982.4	1063.4	1171.1	1306.6	1413.2	1516.3	1691.6	1878.1
Final purchases	978.6	1057.1	1161.7	1288.6	1402.5	1531.0	1679.7	1865.6
Private	759.7	823.4	908.6	1019.1	1099.2	1192.0	1314.1	1467.8
Excluding net exports	755.8	821.8	911.9	1012.0	1091.7	1171.5	1307.5	1468.8
Personal consumption expenditures	618.8	668.2	733.0	809.9	887.5	973.2	1079.7	1198.1
Goods	349.6	374.8	410.5	457.5	497.8	540.8	596.9	660.8
Services	269.1	293.4	322.4	352.3	389.6	432.4	482.8	537.2
Gross private domestic investment	140.8	160.0	188.3	220.0	215.0	183.7	239.6	283.2
Residential construction	36.6	49.6	62.0	66.1	55.1	51.2	67.7	87.4
Business fixed investment	100.5	104.1	116.8	136.0	149.2	147.1	160.0	183.3
Change in business inventories	3.8	6.4	9.4	17.9	10.7	-14.6	11.9	12.5
Nonfarm	3.7	5.1	8.8	14.7	12.2	-17.6	11.9	12.4
Net exports of goods and services	3.9	1.6	-3.3	7.1	7.5	20.5	6.6	-1.0
Exports	62.5	65.6	72.7	101.6	144.4	148.1	162.7	180.0
Imports	58.5	64.0	75.9	94.4	136.9	127.6	156.0	181.0
Gov't. purchases of goods and services	218.9	233.7	253.1	269.5	303.3	339.0	365.6	397.8
Federal	95.6	96.2	102.1	102.2	111.6	124.4	133.4	146.0
State and local	123.2	137.5	151.0	167.3	191.6	214.5	232.2	251.8
Gross national product in constant (1972) dollars	1075.3	1107.5	1171.1	1235.0	1214.0	1191.7	1264.7	1327.5
Personal income	801.3	859.1	942.5	1052.4	1153.3	1249.7	1375.3	1524.8
Wage and salary disbursements	546.5	579.4	633.8	701.3	765.0	806.7	890.4	989.7
Disposable income	685.9	742.8	801.3	901.7	982.9	1080.9	1181.7	1299.1
Saving rate (per cent)	7.4	7.7	6.2	7.8	7.3	7.8	6.5	5.6
Corporate profits with I.V.A. and C.C. Adj.	67.9	77.2	92.1	99.1	84.8	91.6	117.8	126.4
Corporate profits before tax	71.5	82.0	96.2	115.8	127.6	114.5	147.9	161.3
Federal government surplus or deficit (-) (N.I.A. basis)	-12.1	-22.0	-17.3	-6.7	-11.5	-71.2	-58.6	-48.2
High employment surplus or deficit (-)	3.0	-5.3	-5.9	-.7	16.8	-17.2	-11.2	-5.8
State and local government surplus or deficit (-) (N.I.A. basis)	2.8	3.7	13.7	13.0	7.3	6.9	14.0	22.7
Excluding social insurance funds	-4.0	-3.8	5.6	4.1	-2.8	-5.1	.9	8.0
Civilian labor force (millions)	82.8	84.1	86.5	88.7	91.0	92.6	94.8	97.1
Unemployment rate (per cent)	5.0	6.0	5.6	4.9	5.6	8.5	7.7	6.9
Nonfarm payroll employment (millions)	70.9	71.2	73.7	76.9	78.4	77.1	79.4	82.1
Manufacturing	19.3	18.6	19.1	20.1	20.0	18.3	19.0	19.7
Industrial production (1967=100)	107.8	109.6	119.7	129.8	129.3	117.8	129.8	137.9
Capacity utilization: all manufacturing (per cent)	79.2	78.0	83.1	87.5	84.2	73.6	80.1	82.5
Materials (per cent)	84.3	83.1	88.0	92.4	87.7	73.6	80.3	81.7
Housing starts, private (millions, A.R.)	1.43	2.05	2.36	2.05	1.33	1.16	1.54	1.92
Sales new autos (millions, A.R.)	8.40	10.24	10.93	11.42	8.91	8.66	10.12	11.44
Domestic models	7.12	8.68	9.32	9.65	7.49	7.08	8.63	9.63
Foreign models	1.28	1.56	1.61	1.77	1.42	1.58	1.50	1.81

May 11, 1977

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

	1970	1971	1972	1973	1974	1975	1976	Projected 1977
	-----Billions of Dollars-----							
Gross National Product	46.9	81.0	107.7	135.5	106.6	103.1	175.3	186.5
Inventory change	-5.6	2.6	3.0	8.5	-7.2	-25.3	26.5	.6
Final purchases	52.4	78.5	104.6	126.9	113.9	128.5	148.7	185.9
Private	41.4	63.7	85.2	110.5	80.1	92.8	122.1	153.7
Net exports	2.1	-2.3	-4.9	10.4	.4	13.0	-13.9	-7.6
Excluding net exports	39.3	66.0	90.1	100.1	79.7	79.8	136.0	161.3
Personal consumption expenditures	39.1	49.4	64.8	76.9	77.6	85.7	106.5	118.4
Goods	17.1	25.2	35.7	47.0	40.3	43.0	56.1	63.9
Services	21.9	24.3	29.0	29.9	37.3	42.8	50.4	54.4
Residential fixed investment	-1.3	13.0	12.4	4.1	-11.0	-3.9	16.5	19.7
Business fixed investment	1.6	3.6	12.7	19.2	13.2	-2.1	12.9	23.3
Government	11.0	14.8	19.4	16.4	33.8	35.7	26.6	32.2
Federal	-1.9	.6	5.9	.1	9.4	12.8	9.0	12.6
State and local	12.8	14.3	13.5	16.3	24.3	22.9	17.7	19.6
GNP in constant (1972) dollars	-3.5	32.2	63.6	63.9	-21.0	-22.3	73.0	62.8
Final purchases	2.8	29.9	60.8	56.8	-13.0	-1.8	52.9	63.1
Private	9.3	30.7	57.1	57.4	-16.9	-6.4	49.8	57.6
	-----In Per Cent Per Year-----							
Gross National Product	5.0	8.2	10.1	11.6	8.2	7.3	11.6	11.0
Final purchases	5.7	8.0	9.9	10.9	8.8	9.2	9.7	11.1
Private	5.8	8.4	10.3	12.2	7.9	8.4	10.2	11.7
Personal consumption expenditures	6.7	8.0	9.7	10.5	9.6	9.7	10.9	11.0
Goods	5.1	7.2	9.5	11.4	8.8	8.6	10.4	10.7
Services	8.9	9.0	9.9	9.3	10.6	11.0	11.7	11.3
Residential fixed investment	-3.7	13.6	17.7	16.8	-2.3	-14.6	30.5	18.2
Business fixed investment	1.6	3.6	12.3	16.4	9.7	-1.4	8.7	14.6
Gov't. purchases of goods & services	5.3	6.8	8.3	6.5	12.5	11.8	7.9	8.8
Federal	-1.9	.6	6.1	.1	9.2	11.5	7.2	9.4
State and local	11.6	11.6	9.8	10.8	14.5	11.9	8.2	8.4
GNP in constant (1972) dollars	-.3	3.0	5.7	5.5	-1.7	-1.8	6.1	5.0
Final purchases	.3	2.8	5.5	4.9	-1.1	-.1	4.4	5.0
Private	1.1	3.7	6.7	6.3	-1.7	-.7	5.3	5.8
GNP implicit deflator	5.4	5.1	4.1	5.8	10.0	9.3	5.1	5.8
Gross business product fixed-weighted price index <sup>1/</sup>	4.4	4.4	3.3	5.7	10.2	9.3	5.2	6.0
Personal income	7.4	7.2	9.7	11.7	9.6	8.4	10.1	10.9
Wage and salary disbursements	6.2	6.0	9.4	10.7	9.1	5.5	10.4	11.2
Disposable income	8.8	8.3	7.9	12.5	9.0	10.0	9.3	9.9
Corporate profits before tax	-14.3	14.7	17.3	20.4	10.2	-10.3	29.2	9.1
Nonfarm payroll employment	.7	.4	3.5	4.3	2.0	-1.7	3.0	3.4
Manufacturing	-4.5	-3.6	2.7	5.2	-.5	-8.5	3.8	3.7
Nonfarm business sector								
Output per hour	.2	2.9	3.0	1.7	-3.5	1.6	3.7	2.0
Compensation per hour	6.7	6.6	5.8	7.8	9.4	9.5	7.4	8.3
Unit labor costs	6.5	3.5	2.7	6.0	13.4	7.7	3.6	6.2
Industrial production	-3.0	1.7	9.2	8.4	-.4	-8.9	10.2	6.2
Housing starts	-2.7	43.4	15.1	-13.1	-35.1	-12.2	32.8	24.7
Sales new autos	-12.2	21.9	6.7	4.5	-22.0	-2.8	16.9	13.0
Domestic models	-15.8	21.9	7.4	3.5	-22.4	-5.5	21.9	11.6
Foreign models	15.3	21.9	3.2	9.9	-19.8	11.3	-5.1	20.7

<sup>1/</sup> Using expenditures in 1972 as weights.

FEDERAL SECTOR ACCOUNTS  
(Billions of dollars)

	Fiscal Year 1976*	FY 1977 e/ 1/		FY 1978		CY 1976 *	CY 1977 F.R. Board	F.R.B. staff estimates						
		Admin. est. 2/	F.R. Board	Admin. est. 2/	F.R. Board			Calendar quarters; unadjusted data						
								1977	1978					
								I*	II	III	IV	I	II	III
Unified budget receipts	300.0	359.5	357.7	404.7	396.0	318.5	366.6	79.5	109.1	93.0	85.1	86.7	119.2	105.0
Unified budget outlays	366.5	408.2	407.0	462.6	459.0	375.1	419.5	98.2	103.4	106.5	111.4	110.1	115.8	121.7
Surplus(+)/Deficit(-), unified budget	-66.5	-48.7	-49.3	-57.9	-63.0	-56.6	-52.8	-18.7	5.7	-13.5	-26.3	-23.4	3.4	-16.7
Surplus(+)/Deficit(-), off-budget entities 3/	-7.3	-10.8	-10.9	-8.5	-6.8	-5.7	-7.8	-4.3	-.9	-6.2	3.6	-6.3	.3	-4.4
Means of financing combined deficits:														
Net borrowing from public	82.9	n.a.	50.7	n.a.	70.6	69.0	56.2	17.6	1.7	13.9	23.0	27.2	.9	19.5
Decrease in cash operating balance	-7.2	n.a.	7.2	n.a.	-.3	-3.2	1.6	2.6	-6.1	4.9	.2	1.0	-3.1	1.6
Other 4/	-1.9	n.a.	2.3	n.a.	-.5	-3.5	2.7	2.7	-.4	.9	-.5	1.5	-1.5	0.0
Cash operating balance, end of period	14.8	n.a.	10.2	n.a.	10.5	11.7	10.0	9.0	15.1	10.2	10.0	9.0	12.1	10.5
Memo: Sponsored agency borrowing 5/	3.4	n.a.	4.6	n.a.	n.e.	2.9	5.6	.7e	1.8	1.7	1.4	n.e.	n.e.	n.e.
<b>NIA Budget</b>								<b>Seasonally adjusted, annual rates</b>						
Receipts	313.6	368.3	366.5 <sup>6/</sup>	421.2	n.e.	330.3	379.7	365.0e	374.5	383.9	395.4	410.8	425.4	n.e.
Outlays	373.0	419.1	417.2	468.4	464.4	388.9	427.9	411.4p	417.2	434.6	448.2	460.8	469.3	479.4
Purchases (total)	127.2	144.2	142.3	162.4	158.5	133.4	146.0	139.5p	142.7	147.9	153.9	156.7	160.3	163.2
Defense	85.8	92.8	93.0	105.0	102.9	88.2	95.1	91.5p	93.2	95.9	99.9	102.2	103.8	105.5
Non-defense	41.4	51.4	49.3	57.4	55.7	45.2	50.9	48.0p	49.5	52.0	54.0	54.5	56.5	57.7
All other outlays	245.8	274.9	275.0 <sup>6/</sup>	306.0	305.9	255.5	281.9	271.9p	274.5	286.7	294.3	304.1	309.0	316.2
Surplus(+)/Deficit(-)	-59.4	-51.0	-50.7 <sup>6/</sup>	-47.2	n.e.	-58.6	-48.2	-46.4e	-42.7	-50.7	-52.8	-50.0	-43.9	n.e.
High Employment Surplus(+)/Deficit(-) (NIA basis) 7/	-14.7	n.a.	-3.9	n.a.	n.e.	-11.2	-5.8	5.0	-1.1	-11.3	-15.7	-12.0	-7.4	n.e.

- \*actual      e--estimated      r--revised      n.e.--not estimated      n.a.--not available      p--preliminary
- 1/ Congress' Third Concurrent Resolution on the Budget (March 3, 1977) set receipts at \$347.7, outlays at \$417.5 and unified deficit at \$69.8.
- 2/ OMB Current Budget Estimates, April 1977 and Department of Commerce.
- 3/ Includes Federal Financing Bank, Postal Service, U.S. Railway Association, Rural Electrification and Telephone Revolving fund, Housing for the Elderly or Handicapped Fund, and Pension Benefit Guaranty Corporation.
- 4/ Checks issued less checks paid, accrued items and other transactions.
- 5/ Includes Federal Home Loan Banks, FNMA, Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.
- 6/ Quarterly average exceeds fiscal year total by \$.9 billion for FY 1977 due to spreading of wage base effect over calendar year.
- 7/ Estimated by F.R.B. staff. The high employment budget forecast incorporates the Council of Economic Advisors revised estimates of potential GNP and also fully incorporates taxes on inventory profits beginning 1973.

Comments on the Federal Sector Outlook

The staff's fiscal outlook now incorporates energy-tax assumptions discussed in the previous section. As before, our projection includes the increase in the standard deduction for personal taxes and outlay increases for public service employment, local public works, and countercyclical revenue sharing, all of which have been recently enacted or funded by Congress. This month's forecast also incorporates the business tax cut--a 50 per cent employment tax credit--that was included in the "Tax Reduction and Simplification Act of 1977."

The staff estimates that the fiscal year 1977 deficit will total about \$49 billion, some \$4-1/2 billion below last month's projection. Projected receipts have been revised upward from \$354 to \$358 billion, due mainly to higher estimates of personal income. Projected outlays have been reduced by around \$1/2 billion--to \$407 billion--reflecting the likelihood that spending on the recently enacted public jobs programs will be somewhat slower than the Administration expects. The staff's deficit forecast is very close to the OMB's \$48.7 billion April re-estimate.

The above estimates suggest that the combined deficit (unified and off-budget) for this fiscal year will be around \$60 billion. Approximately \$7 billion of this deficit will be financed by a run down of the Treasury's cash balance, with the remaining \$53 billion to be raised through security sales. During the first 6 months



of this fiscal year, the Treasury had borrowed \$35 billion. In early April, an additional \$2.7 billion was raised through marketable security sales. Given the seasonally high tax receipts in the April to June quarter, however, the Treasury's need for new cash during this period is expected to be minimal, allowing a paydown approximately \$1 billion net over the quarter. Even with these paydowns the Treasury's cash balance at the end of the current quarter is still expected to be a high \$15 billion. During the third quarter, the Treasury is expected to raise \$14 billion.

For fiscal year 1978, the staff expects a unified deficit of \$63 billion, up slightly from last month. Outlays in fiscal year 1978 have been increased--from \$456.5 billion to \$459 billion--reflecting some carryover of this years outlay shortfall into fiscal year 1978. Receipts also have been revised upward from \$394 billion to \$396 billion due to the assumed imposition of the wellhead oil tax (\$5 billion at an annual rate). Approximately \$3 billion of these oil revenues are to be returned to households during FY 1978 in the form of a \$15 per capita payment. The remaining \$2 billion are likely to be used to reimburse those households that use oil heat and are assumed to be paid in fiscal 1979.

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DOMESTIC FINANCIAL DEVELOPMENTS

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Summary. Interest rates have come under upward pressure since the last Committee meeting, largely reflecting the firming in money market conditions. In addition, interest rates have been affected by the expectational impact on market participants of the sharp growth in  $M_1$ , and the further evidence of strengthening real economic activity and continued inflation. Upward rate adjustments, however, have been moderated by recent and expected pay-downs of Treasury debt and the low inventory positions of U.S. Government securities dealers. Although the funds rate has increased by more than one-half percentage point since mid-April, the 90-day Treasury bill rate has risen only 40 basis points, and other short- and intermediate-term yields generally by 25 to 45 basis points. Long-term yields have risen only 5 to 20 basis points.

There was a marked rise in non-Federal, short-term borrowing in April. Business loans continued to expand at the rapid pace that began last fall, and total commercial paper issuance by financial and nonfinancial firms increased by the largest amount in over three years. Moreover, short-term borrowing by State and local governments rose sharply as New York State issued \$3.6 billion of three- to eleven-month paper to meet its seasonal cash needs.

In addition to the substantial rise in short-term borrowing, State and local bond offerings in April were at a record pace for that month, with advance refundings and anticipatory borrowing continuing to add to the high volume. Despite this large supply of new securities and

general upward rate pressures, however, tax-exempt yields are essentially unchanged from their mid-April levels as bank acquisitions have recently supplemented the continued sizable purchases by bond funds and fire and casualty insurance companies.

In long-term corporate securities markets, bond and stock offerings declined in April as business firms continued to shift to short-term markets for an increasing share of their external funds. Most of the decline in business capital market financing occurred in public offerings, while private placements, mainly by life insurance companies, are estimated to have remained near record levels.

The most recent indicators of household borrowing suggest a continued advance in both consumer instalment and mortgage credit outstanding. Household acquisitions of interest-bearing deposits at banks and thrift institutions have maintained the slower pace established in the first quarter. While some of this slowdown reflects previous deposit rate cutting and reduced advertising, the continued rapid gain in consumer spending and large personal income tax payments also probably played a significant role.

Reflecting slower deposit inflows and the increase in market rates, the average interest rate on new commitments for conventional home mortgages at S&L's has risen about 15 basis points from its low in early March of 8.65 per cent. Most recently, offerings for forward mortgage commitments to FNMA have risen sharply, and the average yield on accepted bids has approached previous 1977 highs.

Outlook. Between now and mid-year, the Treasury is likely to make additional net reductions of outstanding bills. This will tend to moderate upward market interest rate pressures that may be generated by strong private credit demands associated with the improvement in economic activity. However, in the second half of 1977 the Treasury is expected to re-enter the market to acquire about \$35 to \$40 billion of new money.

Consumers are expected to maintain at least their already high rate of borrowing to finance housing, durable goods, and other outlays. In addition, the staff expects that while capital market borrowings of businesses will remain below the 1975-76 pace, their short-term credit demands will continue at the recent higher pace, and may even increase somewhat further. There is increasing evidence that large business firms have substantially completed their balance sheet restructuring; moreover, their short-term financing needs are likely to expand along with rising inventory and other working capital requirements, as well as large June tax payments. Indications are that State and local long-term borrowing will remain at record levels this spring, but may slacken thereafter.

The projection of aggregate credit demands implies that banks and thrift institutions will moderate their acquisition of liquid assets in the months ahead, and that depository institutions might start to draw down such assets later in the year to fulfill lending commitments. Short-term interest rates are likely to be under significant additional upward rate pressures, especially after the Treasury re-enters the market after mid-year. Rising short-term rates can be expected to slow inflows

to banks and thrift institutions further and, consequently, contribute to higher home mortgage rates. In bond markets, upward rate adjustments are likely to be more limited as public corporate bond offerings remain relatively modest, as long-term tax-exempt offerings moderate from recent record levels, and as life, fire, and casualty insurance companies seek to invest their relatively large cash flows in corporate and tax-exempt bonds.

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INTERNATIONAL DEVELOPMENTS

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Summary. In the four weeks since the last green book, the dollar exchange rate has remained virtually unchanged on a trade-weighted basis. The dollar rose nearly 2 per cent against the yen, declined slightly against the snake currencies, and exhibited little movement against other currencies. The decline in the yen rate reflected the recent rather sharp fall in Japanese short-term interest rates, as well as the initial market reaction to the U.S. Customs Court decision to impose countervailing duties on Japanese consumer electronic products. Despite its recent easing, the yen has appreciated nearly 7 per cent against the dollar since last December.

March trade data showed a widening of the already large U.S. trade deficits of recent months, to an annual rate of \$33.5 billion. The record deficit in the first quarter, at an annual rate of nearly \$28 billion, was about double the rate recorded in the fourth quarter of last year. The enlarged trade deficit in the first quarter can be traced to a 10 per cent rise in imports; exports remained nearly flat. The increase in imports was about equally divided between non-fuel and fuel imports. Food (mainly coffee), automobiles from Canada, and non-automotive consumer durables were the most important components of

the rise in non-fuel imports. The sharp rise in fuel imports in recent months has been due to the severe winter weather, a further decline in domestic petroleum production, and the rebuilding of petroleum inventories.

The value of agricultural exports increased slightly in the first quarter, as higher prices about offset lower volumes. The value of non-agricultural exports has been essentially unchanged for three consecutive quarters. The sluggishness of non-agricultural exports reflects last year's pause in economic activity abroad and the moderate character of the subsequent upswing. In particular, foreign demand for U.S. capital goods is being limited by weak private investment spending abroad.

For the first quarter, the net outflow of \$1.9 billion of bank-reported capital transactions was well below the \$4.2 billion recorded in the final quarter of 1976. Foreign non-official net purchases of U.S. Treasury securities provided an inflow of \$1 billion in this period largely reflecting portfolio restructuring by the World Bank. The \$1.3 billion of foreign securities newly issued in the United States in the first quarter was about \$1 billion less than the total of such issues in the previous quarter. The reduction was primarily accounted for by the absence in the market of the World Bank, which sold more than \$800 million of securities in the United States in the final quarter of last year.

Total OPEC investments (official and private) in bank deposits and securities in the United States in the first quarter are estimated at \$2.6 billion, an amount that represents about a fourth of the estimated

total OPEC investible surplus for that period. In January and February, OPEC countries ceased drawing down their sterling balances. Net placements by OPEC countries in the Euro-currency markets in January-February were estimated at \$3.3 billion, continuing the high rate of such placements of the second half of last year.

Outlook. Expansion of economic activity abroad is expected to remain relatively sluggish during the second quarter, but is projected to accelerate in subsequent quarters. Latest data on production and orders and recent survey results, however, suggest that there remains considerable uncertainty about the strength of the recovery abroad. In view of continuing high rates of inflation in most countries, most governments have been cautious in introducing measures aimed at stimulating internal demand. At the recently-concluded London Summit the leaders of the seven major industrial countries committed themselves to achieve stated growth targets, while continuing to reduce inflation.

The U.S. trade deficit is expected to diminish in coming quarters from the exceptionally high rate recorded in the first quarter, as the unusually high level of fuel imports of the first quarter is reduced. Largely because of the results for the first quarter, the merchandise trade deficit is projected to be about \$23 billion in 1977, about \$2 billion larger than in last month's (April 15 revised) projection. The corresponding current-account deficit is projected to be about \$11 billion. Thus far, the dollar has not been under pressure in foreign exchange markets despite the increased likelihood of continuing substantial trade- and current-account deficits. In view of an expected firming



of U.S. interest rates relative to those abroad, the staff does not foresee difficulties in financing the large projected current-account deficit. One-year forward rates for the dollar continue to indicate market expectations of a small appreciation of the average value of the dollar. In recent months the staff has revised downwards its expectations for a moderate appreciation of the average value of the dollar over the year ahead, and it again has done so this month. At present, we expect the dollar, on average, to appreciate only slightly.

	1975	1976	1977 <sup>P</sup>	1976				1977 <sup>P</sup>				1978 <sup>P</sup>	
				I	II	III	IV	I	II	III	IV	I	II
<b>Billions of dollars</b>													
Net Exports of Goods and Services (GNP basis of net exports) <sup>1/</sup>	16.3 (20.5)	4.4 (6.6)	-6.5 (-1.0)	5.7 (8.4)	6.2 (9.3)	4.8 (4.7)	.9 (4.2)	-11.5 (-4.9)*	-4.8 (-.1)	-4.4 (.7)	-5.1 (.3)	-4.7 (.8)	-8.0 (-2.4)
Merchandise trade balance (excl. military)	9.0	-9.2	-23.1	-5.3	-6.1	-11.1	-14.3	-27.7*	-21.3	-21.2	-22.1	-21.9	-25.4
Exports (excl. military)	107.1	114.7	124.2	108.0	113.5	118.4	118.9	118.7*	122.0	126.4	129.9	134.1	138.5
Agricultural	22.2	23.4	24.4	21.5	23.1	25.3	23.7	24.4*	24.0	24.8	24.5	25.0	25.4
Nonagricultural	84.8	91.3	99.8	86.5	90.5	93.1	95.2	94.2*	98.0	101.6	105.4	109.1	113.1
Imports	98.1	123.9	147.3	113.3	119.7	129.5	133.2	146.3*	143.3	147.6	152.0	156.0	163.9
Fuels	28.5	37.1	42.7	32.5	35.3	40.1	40.7	46.6*	40.9	41.3	41.8	41.8	45.4
Nonfuels	69.5	86.8	104.6	80.8	84.4	89.5	92.5	99.7*	102.4	106.3	110.2	114.2	118.5
Military and Service Transactions, net	7.3	13.6	16.6	11.0	12.4	15.9	15.2	16.1	16.6	16.8	17.0	17.2	17.4
Military transactions, net	-9	.4	1.9	-.1	-.6	1.4	.9	1.6	1.8	2.0	2.0	2.0	2.0
Investment income, net	6.0	10.5	12.0	9.1	9.9	11.1	12.0	11.9	12.0	11.9	12.0	12.2	12.3
Other services, net	2.2	2.7	2.7	1.9	3.1	3.4	2.3	2.6	2.8	2.9	3.0	3.0	3.1
U.S. Current Account Balance <sup>2/</sup> (excl. special transactions with Israel) <sup>3/</sup>	11.7 (12.0)	-.6 (--)	-11.3 (-11.3)	1.2 (1.3)	2.6 (2.3)	-2.9 (-.2)	-3.3 (-3.5)	-16.3 (-16.3)	-9.5 (-9.5)	-9.4 (-9.4)	-10.1 (-10.1)	-9.7 (-9.7)	-13.0 (-13.0)
<b>Constant (1972) dollars</b>													
Merchandise exports (excl. military) (% change, annual rates)	64.6 (-2.4)	66.5 (+2.9)	67.4 (+1.3)	63.8 (-16.1)	66.5 (+17.4)	68.4 (+12.6)	67.3 (-6.6)	66.6 (-4.1)	66.8 (+1.2)	67.7 (+5.7)	68.6 (+5.3)	70.1 (+9.1)	71.3 (+7.0)
Merchandise imports (% change, annual rates)	51.3 (-12.5)	62.6 (+22.0)	68.9 (+10.1)	58.7 (+41.7)	60.9 (+15.6)	64.9 (+29.1)	66.1 (+7.4)	69.8 (+24.4)	67.5 (-13.9)	68.5 (+6.1)	69.5 (+6.1)	70.5 (+5.7)	73.2 (+16.1)
<b>Foreign Outlook - Major Industrial Countries <sup>4/</sup></b>													
Real GNP, % change, annual rates	-.8	5.0	3.4	9.5	3.2	1.6	3.2	3.2	3.9	4.5	5.3	5.3	5.3
Wholesale Prices, % change, A.R. <sup>5/</sup>	5.8	9.5	9.8	11.3	17.0	11.7	8.7	10.8	8.7	7.4	7.4	6.1	6.1

<sup>1/</sup> The GNP account excludes from service imports, U.S. Government interest payments to foreigners (\$4.5 billion in 1976), and excludes from exports, military shipments to Israel under cash grant programs (\$300 million in 1976). It also lags the international accounts data significantly in taking account of data revisions.

<sup>2/</sup> Includes goods and services plus private and official remittances and pensions and U.S. Government grants.

<sup>3/</sup> Excludes grants to Israel under military assistance acts and exports financed by those grants.

<sup>4/</sup> Weighted by the shares of Canada, France, Germany, Italy, Japan and the United Kingdom in the sum of the real GNP of the six countries in dollar terms.

<sup>5/</sup> Data are largely manufactured goods prices.

<sup>P</sup> Projected.

<sup>e</sup> Estimated.

<sup>\*</sup> Published data.