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CONFIDENTIAL (FR)

October 12, 1977

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Activity apparently picked up somewhat in September. Industrial production last month appears to have about recovered the August decline, and employment rose substantially. However, weekly data suggest that retail sales edged down after two months of significant gains, and the available indicators of business fixed investment remain mixed. Price increases at retail continued to moderate in August, while industrial commodity prices rose in September more rapidly than in other recent months.

Industrial production is tentatively estimated to have increased about a half a per cent in September, about equal to the August decline. More than a third of the September rise was the result of the ending of strikes in coal and copper mining. Factory employment rose 40,000 in September, following a decline in August, but the average workweek in manufacturing fell for the third consecutive month. Jobs in the service-producing industries continued on their strong upward trend, and total payroll employment rose nearly 300,000.

Employment as measured by the household survey also increased strongly in September. The labor force rose only moderately as a sharp rise in participation by adult females was partially offset by declines in participation by both adult men and teenagers. The unemployment rate is estimated to have been 6.9 per cent last month, down 0.2 percentage point from August; September was the sixth consecutive month in which the rate of joblessness has remained close to 7 per cent.

Retail sales are tentatively estimated to have edged down in September, after rebounding in July and August from the second quarter weakness. Declines in purchases of general merchandise and furniture and appliances appear to have more than offset gains in food, gasoline and apparel. Unit auto sales were also weaker last month, falling to the lowest level since last fall. However, sales of domestic units may have been hampered by the delayed availability of 1978 models due to the unusually long model changeover; purchases of foreign autos apparently continue to be dampened by depleted inventories of some popular models.

Manufacturers continue to pursue conservative inventory policies. Reflecting reduced production and a rebound in shipments, the book value of manufacturers' stocks rose at a modest \$4.4 billion annual rate in August, well below the \$9 billion rate of accumulation in July. The August increase was about evenly divided between producers of durable and nondurable goods; in July most of the increase had been in durable goods industries.

With respect to business fixed investment, new orders for nondefense capital goods rose 2-1/3 per cent in August. While this gain recouped only part of the sharp July decline, the machinery component of these orders--generally a better indicator of future trends in business fixed investment--rose sharply in August; the July-August average was 4-1/2 per cent above the second quarter.

Moreover, the value of construction contracts for commercial and industrial buildings has risen sharply in recent months.

At the same time, a preliminary tabulation of a private capital spending survey indicates an increase of only about 8 per cent in 1978--virtually no rise in real terms. This survey, however, has had relatively large errors in the past and its results must be interpreted with care.

Residential building activity continues at a robust pace. Total private housing starts were at a 2.02 million unit annual rate in August--down a bit from July but still 6 per cent above the second quarter average. Continued strength in demand is evidenced by the sharp rise in new home sales in August.

The growth in State and local government spending slowed further in August, as a consequence of a decline--for the second consecutive month--in the value of construction put-in-place. However, State and local government spending may have accelerated in September; a 50,000 increase in employment was recorded, perhaps reflecting greater hiring under the expanded public service employment program. Federal government purchases continued to rise at a rapid pace in the third quarter.

The price performance in recent months has been substantially better than during the first half of the year. The consumer price index rose only 0.3 per cent in August--the smallest increase since

last December--in general reflecting previous declines in wholesale food prices.

Wholesale prices in September rose 0.4 per cent--after having declined slightly over the three preceding months. Prices of farm products and processed feeds were about unchanged, following three months of very sharp decline. Industrial commodity prices rose 0.8 per cent, but excluding fuels they increased 0.6 per cent--roughly in line with the rise recorded over the past year and a half.

Outlook. In the third quarter as a whole, the pace of economic activity slowed substantially from the rate in the first half of the year, and real GNP is now estimated to have increased at a 3-3/4 per cent annual rate--down half a percentage point from last month's projection. The pronounced weakness in third quarter real output reflects, in part, smaller than expected exports of both agricultural and nonagricultural goods and larger than expected imports of oil. In addition, we have scaled down somewhat the estimates of consumer expenditures for goods and of outlays for private residential and State and local government construction. Incoming data also suggest a larger than expected adjustment of inventories during the quarter. On the other hand, recent data indicate a larger third quarter rise in business investment spending.

Policy assumptions contained in the current projection are little changed from a month ago. The estimated Federal budget

deficit for fiscal year 1978 has been raised to \$59-1/2 billion, reflecting lower projected income--and therefore tax receipts. Assumptions on the energy program continue to conform to the House bill which includes a crude oil equalization tax taking effect in early 1978, to be fully returned through personal tax rebates. We are still assuming an M_1 growth path of 5-1/4 per cent (annual rate), but consistent with past practice at the time of FOMC reconsideration of its longer-run monetary growth ranges, we have shifted the base forward one quarter to 1977-QIII. Given the expected strength in demands for money, the staff continues to anticipate that such a monetary growth rate would be associated with further increases in short-term interest rates over the forecast period.

In the fourth quarter, output growth is projected to rebound to a 5-1/4 per cent rate, reflecting some pickup from the current relatively low levels of inventory investment and a rebound in the volume of exports. Over the four quarters of 1978, growth of real GNP is expected to average 4-1/2 per cent (annual rate)-- a bit less than that indicated last month. Although we anticipate only moderate growth in consumer outlays, we continue to expect support from business investment and--through mid-year--from residential construction.

The projected pace of real GNP growth should still be sufficient to reduce the unemployment rate a little over the next

year, to about a 6-1/2 per cent rate in the last half of 1978. But the reduced pace of output growth in 1978 is projected to be accompanied by a somewhat slower rate of productivity advance than in 1977 and result in a slightly accelerated rise in unit labor costs--averaging about 6-1/2 per cent over the four quarters of 1978. We are projecting prices to rise at about the same rate.

Details of the staff projection are shown in the tables that follow.

STAFF GNP PROJECTIONS

Per cent changes, annual rate								
	Nominal GNP		Real GNP		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	9/14/77	10/12/77	9/14/77	10/12/77	9/14/77	10/12/77	9/14/77	10/12/77
1974 ^{1/}	8.1	8.1	-1.4	-1.4	10.4	10.4	5.6	5.6
1975 ^{1/}	8.2	8.2	-1.3	-1.3	9.5	9.5	8.5	8.5
1976 ^{1/}	11.6	11.6	6.0	6.0	5.4	5.4	7.7	7.7
1977	10.9	10.8	4.9	4.8	6.0	6.0	7.1	7.1
1978	11.4	11.3	4.9	4.7	6.3	6.4	6.7	6.6
1977-I ^{1/}	13.2	13.2	7.5	7.5	6.8	6.8	7.4	7.4
1977-II ^{1/}	13.7	13.7	6.1	6.2	7.5	7.5	7.0	7.0
1977-III	10.3	9.2	4.4	3.8	5.5	5.3	7.1	7.0
1977-IV	12.0	12.4	5.1	5.2	5.9	6.0	7.0	6.9
1978-I	11.6	11.4	5.0	4.8	6.6	6.8	6.8	6.7
1978-II	10.9	11.2	4.8	4.7	6.3	6.5	6.7	6.7
1978-III	10.6	10.6	4.5	4.3	6.2	6.2	6.6	6.6
1978-IV	11.5	11.3	4.5	4.3	6.3	6.3	6.6	6.6
Change:								
76-II to 77-II ^{1/}	10.5	10.5	4.6	4.7	6.1	6.1	-.4	-.4
76-IV to 77-IV	12.3	12.1	5.8	5.7	6.4	6.4	-.9	-1.0
77-II to 78-II	11.2	11.0	4.8	4.6	6.1	6.1	-.3	-.3
77-IV to 78-IV	11.1	11.1	4.7	4.5	6.3	6.4	-.4	-.3

^{1/} Actual.

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

	1977				1978			
	I	II	III	IV	Projected			
					I	II	III	IV
Gross National Product	1810.8	1869.9	1911.3	1967.9	2021.9	2076.3	2129.3	2187.2
Final purchases	1797.0	1848.2	1895.3	1947.1	2003.6	2052.3	2103.8	2159.2
Private	1422.1	1457.6	1491.6	1529.5	1575.6	1614.1	1654.9	1697.2
Excluding net exports	1430.3	1467.3	1504.8	1543.3	1587.8	1629.6	1670.9	1713.8
Personal consumption expenditures	1172.4	1194.0	1221.5	1248.0	1280.6	1312.3	1343.8	1377.2
Goods	643.6	653.0	663.0	675.5	693.3	709.8	726.8	745.0
Services	528.8	541.1	558.5	572.5	587.3	602.5	617.0	632.2
Gross private domestic investment	271.8	294.9	299.3	316.1	325.5	341.3	352.6	364.6
Residential construction	81.0	90.8	95.3	101.3	106.8	110.3	113.3	115.8
Business fixed investment	177.0	182.4	188.0	194.0	200.4	207.0	213.8	220.8
Change in business inventories	13.8	21.7	16.0	20.8	18.3	24.0	25.5	28.0
Nonfarm	14.1	22.4	14.0	20.5	18.3	24.0	25.5	28.0
Net exports of goods and services ^{1/}	-8.2	-9.7	-13.2	-13.8	-12.2	-15.5	-16.0	-16.6
Exports	170.4	178.1	175.3	180.6	188.4	195.0	201.9	208.0
Imports	178.6	187.7	188.4	194.3	200.5	210.4	217.8	224.5
Gov't. purchases of goods and services	374.9	390.6	403.7	417.6	428.0	438.2	448.9	462.0
Federal ^{2/}	136.3	143.6	150.3	156.4	159.0	161.8	165.3	171.4
State and local	238.5	247.0	253.4	261.2	269.0	276.4	283.6	290.6
Gross national product in constant (1972) dollars	1311.0	1330.7	1343.2	1360.4	1376.4	1392.3	1407.1	1421.8
Personal income	1476.8	1517.2	1549.5	1598.0	1637.6	1678.4	1726.3	1773.6
Wage and salary disbursements	951.3	980.9	997.0	1025.3	1053.3	1078.3	1104.8	1134.2
Disposable income	1252.4	1292.5	1323.6	1363.5	1403.0	1435.5	1468.9	1506.3
Saving rate (per cent)	4.1	5.3	5.4	6.1	6.4	6.2	6.2	6.2
Corporate profits with I.V.A. and C.C. Adj.	125.4	140.2	148.0	155.0	151.3	158.5	162.3	168.2
Corporate profits before tax	161.7	174.0	180.2	187.0	183.6	191.0	194.8	200.7
Federal government surplus or deficit (-) (N.I.A. basis)	-38.8	-40.3	-53.4	-57.9	-55.4	-48.6	-42.1	-39.0
High employment surplus or deficit (-)	9.4	-.5	-12.5	-18.8	-14.4	-8.6	-2.8	-.7
State and local government surplus or deficit (-) (N.I.A. basis)	27.3	25.4	28.2	28.2	27.4	26.8	25.7	23.9
Excluding social insurance funds	11.9	9.9	11.7	11.1	9.9	8.8	7.2	4.9
Civilian labor force (millions)	96.1	97.2	97.6	98.2	98.7	99.3	99.9	100.4
Unemployment rate (per cent)	7.4	7.0	7.0	6.9	6.7	6.7	6.6	6.6
Nonfarm payroll employment (millions)	80.9	81.9	82.5	83.2	83.8	84.4	85.0	85.5
Manufacturing	19.3	19.6	19.6	19.8	20.1	20.3	20.5	20.7
Industrial production (1967=100)	133.6	137.0	138.8	141.4	144.0	146.7	149.1	151.5
Capacity utilization: all manufacturing (per cent)	81.2	82.6	82.9	83.8	84.5	85.2	85.7	86.2
Materials (per cent)	80.4	82.6	82.4	83.4	84.3	85.4	86.0	86.7
Housing starts, private (millions, A.R.)	1.76	1.91	2.05	2.15	2.25	2.15	2.10	2.05
Sales new autos, (millions, A.R.)	11.12	11.70	10.92	11.20	11.35	11.40	11.40	11.40
Domestic models	9.28	9.34	8.88	9.20	9.45	9.50	9.50	9.50
Foreign models	1.84	2.36	2.04	2.00	1.90	1.90	1.90	1.90

^{1/} Balance of payments data and projection 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.

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1977				1978			
	I	II	III	IV	Projected		III	IV
	-----Billions of dollars-----							
Gross National Product	55.4	59.1	41.4	56.6	54.0	54.4	53.0	57.9
Inventory change	14.7	7.9	-5.7	4.8	-2.5	5.7	1.5	2.5
Final purchases	40.7	51.2	47.1	51.8	56.5	48.7	51.5	55.4
Private	35.8	35.5	34.0	37.9	46.1	38.5	40.8	42.3
Net exports	-11.2	-1.5	-3.5	-6	1.6	-3.3	-5	-6
Excluding net exports	47.0	37.0	37.5	38.5	44.5	41.8	41.3	42.9
Personal consumption expenditures	33.4	21.6	27.5	26.5	32.6	31.7	31.5	33.4
Goods	18.5	9.4	10.0	12.5	17.8	16.5	17.0	18.2
Services	14.9	12.3	17.4	14.0	14.8	15.2	14.5	15.2
Residential fixed investment	4.3	9.8	4.5	6.0	5.5	3.5	3.0	2.5
Business fixed investment	9.4	5.4	5.6	6.0	6.4	6.6	6.8	7.0
Government	4.9	15.7	13.1	13.9	10.4	10.2	10.7	13.1
Federal	2.1	7.3	6.7	6.1	2.6	2.8	3.5	6.1
State and local	2.7	8.5	6.4	7.8	7.8	7.4	7.2	7.0
GNP in constant (1972) dollars	23.6	19.7	12.4	17.2	16.0	15.8	14.8	14.8
Final purchases	12.0	16.3	15.9	14.3	15.9	12.6	14.1	13.1
Private	13.3	9.6	10.1	11.1	13.2	10.0	11.2	11.4
	----- In Per Cent Per Year ^{1/} -----							
Gross National Product	13.2	13.7	9.2	12.4	11.4	11.2	10.6	11.3
Final purchases	9.6	9.9	10.6	11.4	12.1	10.1	10.4	11.0
Private	10.7	10.4	9.7	10.6	12.6	10.1	10.5	10.6
Personal consumption expenditures	12.2	7.6	9.5	9.0	10.9	10.3	10.0	10.3
Goods	12.4	6.0	6.3	7.8	11.0	9.9	9.9	10.4
Services	12.0	9.6	13.5	10.4	10.7	10.8	10.0	10.2
Gross private domestic investment	55.5	38.6	6.1	24.4	12.4	20.9	13.9	14.3
Residential structures	24.2	57.9	21.3	27.7	23.6	13.8	11.3	9.1
Business fixed investment	24.5	12.8	12.9	13.4	13.9	13.8	13.8	13.8
Gov't. purchases of goods and services	5.4	17.9	14.1	14.5	10.3	9.9	10.1	12.2
Federal	6.6	23.3	20.0	17.2	6.8	7.2	8.9	15.6
State and local	4.7	14.9	10.8	12.9	12.5	11.5	10.8	10.2
GNP in constant (1972) dollars	7.5	6.2	3.8	5.2	4.8	4.7	4.3	4.3
Final purchases	3.8	5.1	4.9	4.4	4.8	3.7	4.2	3.8
Private	5.3	3.8	3.9	4.3	5.0	3.7	4.2	4.2
GNP implicit deflator ^{2/}	5.3	7.1	5.2	6.8	6.3	6.2	6.0	6.8
Gross business product fixed-weighted price index ^{3/}	6.8	7.5	5.3	6.0	6.8	6.5	6.2	6.3
Personal income	13.1	11.4	8.8	13.1	10.3	10.3	11.9	11.4
Wage and salary disbursements	12.7	13.0	6.7	11.8	11.4	9.8	10.2	11.1
Disposable income	10.1	13.4	10.0	12.6	12.1	9.6	9.6	10.6
Corporate profits before tax	19.1	34.1	15.0	15.9	-7.1	17.2	8.1	12.7
Nonfarm payroll employment	4.3	4.9	3.0	3.2	3.2	2.8	2.7	2.8
Manufacturing	5.3	6.4	.7	4.7	4.4	4.5	3.9	3.5
Nonfarm business sector								
Output per hour	5.0	.4	2.6	2.2	2.2	2.2	2.0	2.0
Compensation per hour	11.7	7.4	7.0	7.7	11.2	7.8	7.9	7.9
Unit labor costs	6.3	6.9	4.4	5.5	9.0	5.6	5.9	5.9
Industrial production	6.2	10.6	5.4	7.7	7.6	7.6	6.6	6.6
Housing starts, private	-2.6	37.7	34.1	21.0	19.9	-16.6	-9.0	-9.2
Sales new autos	53.4	22.5	-24.2	10.5	5.5	1.8	.0	.0
Domestic models	55.1	2.6	-18.4	15.2	11.3	2.1	.0	.0
Foreign models	45.2	170.5	-43.9	-8.2	-18.5	.0	.0	.0

^{1/} Percentage rates are annual rates compounded quarterly.^{2/} Excluding Federal pay increases rates of change are: 1977-I, 5.3 per cent; 1977-IV, 6.1 per cent; 1978-I, 6.3 per cent; 1978-IV, 6.1 per cent.^{3/} Using expenditures in 1972 as weights.

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

	1971	1972	1973	1974	1975	1976	1977	1978
Gross National Product	1063.4	1171.1	1306.6	1412.9	1528.8	1706.5	1890.0	2103.7
Final purchases	1057.1	1161.7	1288.6	1404.0	1540.3	1693.1	1871.9	2079.7
Private	823.4	908.6	1019.1	1101.3	1201.4	1331.7	1475.2	1635.5
Excluding net exports	821.8	911.9	1012.0	1095.3	1181.0	1323.9	1486.4	1650.5
Personal consumption expenditures	668.2	733.0	809.9	889.6	980.4	1093.9	1209.0	1328.5
Goods	374.8	410.5	457.5	498.3	542.2	601.6	658.8	718.7
Services	293.4	322.4	352.3	391.3	438.2	492.3	550.2	609.7
Gross private domestic investment	160.0	188.3	220.0	214.6	189.1	243.3	295.5	346.0
Residential construction	49.6	62.0	66.1	55.1	51.5	68.0	92.1	111.5
Business fixed investment	104.1	116.8	136.0	150.6	149.1	161.9	185.4	210.5
Change in business inventories	6.4	9.4	17.9	8.9	-11.5	13.3	18.1	23.9
Nonfarm	5.1	8.8	14.7	10.8	-15.1	14.9	17.7	23.9
Net exports of goods and services	1.6	-3.3	7.1	6.0	20.4	7.8	-11.2	-15.1
Exports	65.6	72.7	101.6	137.9	147.3	162.9	176.1	198.3
Imports	64.0	75.9	94.4	131.9	126.9	155.1	187.3	213.3
Gov't. purchases of goods and services	233.7	253.1	269.5	302.7	338.9	361.4	396.7	444.3
Federal	96.2	102.1	102.2	111.1	123.3	130.1	146.6	164.4
State and local	137.5	151.0	167.3	191.5	215.6	231.2	250.0	279.9
Gross national product in constant (1972) dollars	1107.5	1171.1	1235.0	1217.8	1202.1	1274.7	1336.3	1399.4
Personal income	859.1	942.5	1052.4	1154.9	1253.4	1382.7	1535.4	1704.0
Wage and salary disbursements	579.4	633.8	701.3	764.6	805.7	891.8	988.6	1092.6
Disposable income	742.8	801.3	901.7	984.6	1084.4	1185.8	1308.0	1453.4
Saving rate (per cent)	7.7	6.2	7.8	7.3	7.4	5.6	5.3	6.2
Corporate profits with I.V.A. and C.C. Adj.	77.2	92.1	99.1	83.6	99.3	128.1	142.2	160.1
Corporate profits before tax	82.0	56.2	115.8	126.9	123.5	156.9	175.7	192.5
Federal government surplus or deficit (-) (N.I.A. basis)	-22.0	-17.3	-6.7	-10.7	-70.2	-54.0	-47.6	-46.3
High employment surplus or deficit (-)	-5.3	-5.9	-7	17.1	-20.3	-10.4	-5.6	-6.6
State and local government surplus or deficit (-) (N.I.A. basis)	3.7	13.7	13.0	7.5	5.9	18.4	27.3	26.0
Excluding social insurance funds	-3.8	5.6	4.1	-2.9	-6.2	3.9	11.2	7.7
Civilian labor force (millions)	84.1	86.5	88.7	91.0	92.6	94.8	97.3	99.6
Unemployment rate (per cent)	6.0	5.6	4.9	5.6	8.5	7.7	7.1	6.6
Nonfarm payroll employment (millions)	71.2	73.7	76.9	78.4	77.1	79.4	82.1	84.7
Manufacturing	18.6	19.1	20.1	20.0	18.3	19.0	19.6	20.4
Industrial production (1967=100)	109.6	119.7	129.8	129.3	117.8	129.8	137.7	147.8
Capacity utilization: all manufacturing (per cent)	78.0	83.1	87.5	84.2	73.6	80.2	82.6	85.4
Materials (per cent)	83.1	88.0	92.4	87.7	73.6	80.4	82.2	85.6
Housing starts, private (millions, A.R.)	2.05	2.36	2.05	1.34	1.16	1.54	1.97	2.14
Sales new autos (millions, A.R.)	10.24	10.93	11.42	8.91	8.66	10.12	11.24	11.39
Domestic models	8.68	9.32	9.65	7.49	7.08	8.63	9.15	9.49
Foreign models	1.56	1.61	1.77	1.42	1.58	1.50	2.06	1.90

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CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1971	1972	1973	1974	1975	1976	1977	1978
-----Billions of Dollars-----								
Gross National Product	81.0	107.7	135.5	106.3	115.9	177.7	183.5	213.7
Inventory change	2.6	3.0	8.5	-9.0	-20.4	24.8	4.8	5.9
Final purchases	78.5	104.6	126.9	115.4	136.3	152.8	178.8	207.8
Private	63.7	85.2	110.5	82.2	100.1	130.3	143.5	160.2
Net exports	-2.3	-4.9	10.4	-1.1	14.4	-12.6	-19.0	-3.8
Excluding net exports	66.0	90.1	100.1	83.3	85.7	142.9	162.5	164.0
Personal consumption expenditures	49.4	64.8	76.9	79.7	90.8	113.5	115.1	119.5
Goods	25.2	35.7	47.0	40.8	43.9	59.4	57.2	60.0
Services	24.3	29.0	29.9	39.0	46.9	54.1	57.9	59.5
Residential fixed investment	13.0	12.4	4.1	-11.0	-3.6	16.5	24.1	19.5
Business fixed investment	3.6	12.7	19.2	14.6	-1.5	12.8	23.5	25.1
Government	14.8	19.4	16.4	33.2	36.2	22.5	35.3	47.6
Federal	.6	5.9	.1	8.9	12.2	6.8	16.5	17.7
State and local	14.3	13.5	16.3	24.2	24.1	15.6	18.8	29.9
GNP in constant (1972) dollars	32.2	63.6	63.9	-17.2	-15.7	72.6	61.6	63.1
Final purchases	29.9	60.8	56.8	-8.6	2.1	54.2	58.8	58.4
Private	30.7	57.1	57.4	-13.8	-3.2	52.8	51.2	44.9
-----In Per Cent Per Year-----								
Gross National Product	8.2	10.1	11.6	8.1	8.2	11.6	10.8	11.3
Final purchases	8.0	9.9	10.9	8.9	9.7	9.9	10.6	11.1
Private	8.4	10.3	12.2	8.1	9.1	10.8	10.8	10.9
Personal consumption expenditures	8.0	9.7	10.5	9.8	10.2	11.6	10.5	9.9
Goods	7.2	9.5	11.4	8.9	8.8	11.0	9.5	9.1
Services	9.0	9.9	9.3	11.1	12.0	12.4	11.8	10.8
Gross private domestic investment	13.6	17.7	16.8	-2.5	-11.9	28.7	21.5	17.1
Residential structures	35.5	25.1	6.6	-16.7	-6.5	32.2	35.4	21.1
Business fixed investment	3.6	12.3	16.4	10.8	-1.0	8.6	14.5	13.6
Gov't. purchases of goods and services	6.8	8.3	6.5	12.3	12.0	6.6	9.8	12.0
Federal	.6	6.1	.1	8.7	11.0	5.5	12.7	12.1
State and local	11.6	9.8	10.8	14.5	12.6	7.2	8.1	11.9
GNP in constant (1972) dollars	3.0	5.7	5.5	-1.4	-1.3	6.0	4.8	4.7
Final purchases	2.8	5.5	4.9	-7	.2	4.5	4.6	4.4
Private	3.7	6.7	6.3	-1.4	-3	5.6	5.1	4.3
GNP implicit deflator	5.1	4.1	5.8	9.7	9.6	5.3	5.6	6.3
Gross business product fixed-weighted price index ^{1/}	4.4	3.3	5.7	10.4	9.5	5.4	6.4	6.4
Personal income	7.2	9.7	11.7	9.7	8.5	10.3	11.0	11.0
Wage and salary disbursements	6.0	9.4	10.7	9.0	5.4	10.7	10.9	10.5
Disposable income	8.3	7.9	12.5	9.2	10.1	9.4	10.3	11.1
Corporate profits before tax	14.7	17.3	20.4	9.6	-2.7	27.0	12.0	9.6
Nonfarm payroll employment	.4	3.5	4.3	2.0	-1.7	3.1	3.4	3.1
Manufacturing	-4.0	2.8	5.1	-1	-8.5	3.3	3.3	4.0
Nonfarm business sector								
Output per hour	2.9	3.0	1.7	-2.9	1.6	4.1	2.1	2.1
Compensation per hour	6.6	5.8	7.8	9.4	9.6	8.7	8.7	8.5
Unit labor costs	3.5	2.7	6.0	12.7	7.9	4.5	6.5	6.4
Industrial production	1.7	9.2	8.4	-.4	-8.9	10.2	6.1	7.3
Housing starts	43.1	14.9	-13.2	-34.6	-13.3	32.6	27.9	8.9
Sales new autos	21.9	6.8	-4.7	-14.5	-2.8	16.9	11.0	1.4
Domestic models	21.9	7.4	3.5	-22.4	-5.5	21.9	6.4	3.4
Foreign models	21.8	3.1	9.7	-19.9	11.4	-5.1	37.6	-7.8

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

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

	Fiscal Year 1976*	FY 1977 e/		FY 1978 e/			CY 1976 *	CY 1977 e/ F.R. Board	F.R.B. staff estimates								
		Admin. est. 1/	F.R. Board	Admin. est. 1/	F.R. Board	Cong. est. 2/			Calendar quarters; unadjusted data								
									1977			1978					
									I*	II*	III	IV	I	II	III		
Unified budget receipts	299.2	358.3	357.1	401.4	395.9	397.0	317.6	366.5	79.0	110.5	91.5	85.6	84.9	120.4	104.9		
Unified budget outlays	365.7	406.4	401.5	462.9	455.5	458.3	374.2	410.4	97.6	101.8	103.1	107.9	109.3	115.3	123.0		
Surplus(+)/Deficit(-), unified budget	-66.5	-48.1	-44.4	-61.5	-59.6	-61.3	-56.6	-43.9	-18.7	8.6	-11.5	-22.3	-24.4	5.1	-18.1		
Surplus(+)/Deficit(-), off-budget agencies 3/	-7.3	-10.1	-9.0	-7.7	-9.5	n.a.	-5.7	-9.0	-4.3	.1	-5.3	0.5	-4.2	-0.1	-5.6		
Means of financing combined deficits:																	
Net borrowing from public	82.9	n.a.	53.4	n.a.	63.6	n.a.	69.0	50.6	17.6	-1.1	19.5 ^{8/}	14.6 ^{8/}	28.1	-3.5	24.4		
Decrease in cash operating balance	-7.2	n.a.	0.8	n.a.	7.1	n.a.	-3.2	0.7	2.6	-7.2	-2.8 ^{8/}	8.1 ^{8/}	-1.0	0	0		
Other 4/	-1.9	n.a.	2.5	n.a.	-1.5	n.a.	-3.5	2.5	2.7	-.4	.1	-0.8	1.5	-1.5	-0.7		
Cash operating balance, end of period	14.8	n.a.	19.1	n.a.	12.0	n.a.	11.7	11.0	9.0	16.3	19.1 ^{8/}	11.0 ^{8/}	12.0	12.0	12.0		
Memo: Sponsored agency borrowing 5/	3.4	n.a.	6.3	n.a.	n.e.	n.a.	2.9	6.5	.7	2.9	2.3	0.6	1.9	n.e.	n.e.		
NIA Budget									Seasonally adjusted annual rates								
Receipts	312.5	365.4	363.4 ^{6/}	415.3	410.4 ^{6/}	n.a.	332.3	375.8	364.9	371.2	377.4	389.6	403.5	417.2	435.8		
Outlays	373.1	417.2	411.6	469.3	462.5	n.a.	386.3	423.4	403.7	411.5	430.8	447.5	458.9	465.8	477.9		
Purchases (total)	127.0	143.6	141.1	163.5	160.6	n.a.	130.1	146.7	136.3	143.6	150.3	156.4	159.0	161.8	165.3		
Defense	85.9	92.8	92.0	105.2	103.1	n.a.	86.8	95.0	89.7	93.4	96.6	100.4	102.3	104.0	105.8		
Non-defense	41.2	50.8	49.1	58.3	57.5	n.a.	43.3	51.7	46.7	50.2	53.7	56.0	56.7	57.8	59.5		
All other outlays	246.1	273.6	270.5 ^{6/}	305.8	301.9 ^{6/}	n.a.	256.2	276.7	267.4	267.9	280.5	291.1	299.9	304.0	312.6		
Surplus(+)/Deficit(-)	-60.6	-51.8	-48.2 ^{6/}	-54.0	-52.1 ^{6/}	n.a.	-54.0	-47.6	-38.8	-40.3	-53.4	-57.9	-55.4	-48.6	-42.1		
High Employment Surplus(+)/Deficit(-) (NIA basis) 7/	-15.7	n.a.	-2.8	n.a.	-11.1	n.a.	-10.4	-5.6	9.5	-0.5	-12.5	-18.8	-14.4	-8.6	-2.8		
	*actual	e--estimated	r--revised		n.e.--not estimated			n.a.--not available					p--preliminary				

1/ OMB Mid Session Review of the 1978 Budget, (July 1, 1977).

2/ Congress' Second Concurrent Resolution on the Budget (September 15, 1977).

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 \$1.1 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 Department of Commerce's July, 1977 GNP revisions.

8/ Includes \$2.5 billion of borrowing from the Federal Reserve on September 30 which was repaid October 4.

Comments on the Federal Sector Outlook

The fiscal policy outlook underlying the October forecast is little changed from last month. Projected receipts for fiscal 1978 have been reduced by \$2 billion to \$396 billion as a result of the staff's lower income forecast. Total outlays continue to be projected at \$455-1/2 billion, almost \$7-1/2 billion below the President's "July Budget Update." The staff estimates that FY 1978 spending once again may be less than Federal agencies planned in July and that this shortfall will be about in line with those experienced in the past two years.

The unified budget deficit for the current fiscal year (1978) is now projected by the staff to be \$59-1/2 billion, and the total amount that needs to be financed (unified plus off-budget) is estimated at \$69 billion. In the fourth quarter, the Treasury's financing needs are expected to be around \$21.9 billion, up from \$16.7 billion recorded in the third quarter. Despite this increase, however, borrowing from the public is expected to total \$17 billion, 1/ since the Treasury is expected to run down its very high end-of-September cash balance to meet some of its financing needs. Sales of nonmarketable issues are projected to be \$3-1/2 billion, with \$2-1/2 billion going to States and localities. The remaining \$13-1/2 billion--\$2-1/2 billion in bills and \$11 billion in coupons--is expected to be raised in the market.

1/ Excludes repayment of \$2.5 billion of special borrowing from Federal Reserve.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. Growth of the major monetary aggregates accelerated in September-- M_1 to an 8 per cent annual rate. The quarterly average increase in this aggregate, at a 9.3 per cent rate, was the largest in six years. At commercial banks, time and savings deposits other than large CDs rose a bit more rapidly in September than in August; however, growth was still quite moderate, especially compared to inflows at thrift institutions, which continued exceptionally large.

In view of the behavior of the monetary aggregates, System reserve provision has become less accommodative, and the Federal funds rate has risen from the 6-1/8 per cent level prevailing at the time of the September FOMC meeting to around 6-1/2 per cent. Most other short-term market yields have risen by similar amounts, while long-term bond rates have increased about 10 basis points. Primary mortgage market rates also have edged a bit higher.

Aggregate credit demands do not appear to have changed significantly in September. Within the business sector, however, total indebtedness of nonfinancial firms at banks and in the commercial paper market declined on balance, following two months of moderate growth. Although business credit at finance companies showed record gains in July and August, it appears that overall short- and intermediate-term business borrowing moderated in the third quarter. This development may have been a consequence, in part, of reduced inventory accumulation, but it also seems to have reflected efforts to fund

short-term debt. Led by utility issues, the calendar of corporate bond offerings in September was sizable, and the third quarter total of such financings was the largest on a seasonally adjusted basis since mid-1975.

In the household sector, mortgage credit growth probably remained strong in September. Loan commitments outstanding at S&L's reached a new record at the end of August; during September, a sizable volume of GNMA pass-throughs was issued, and commercial banks added substantially to their mortgage portfolios. Growth of consumer instalment credit picked up somewhat in August, but remained below the second quarter pace and may have slowed in September, given weaker sales of autos and other durables.

The Federal government has continued to raise substantial amounts of new cash. During the intermeeting period, sales of regular 2- and 5-year notes provided \$3.3 billion of new funds. \$800 million of these securities were taken by foreign official institutions, reflecting in part the heavy exchange market intervention that has characterized recent months.

Total tax-exempt bond offerings remained large, as States and municipalities took advantage of the lowest borrowing costs in three years. Advance refundings accounted for more than one-fifth of bonds sold. Demand from fire and casualty insurers and investment companies still was reported heavy, and commercial banks continued to show a preference for tax-exempt securities over Treasury issues.

Outlook. The staff's economic projection suggests that credit flows over the remainder of this year are likely to be very similar to those of the third quarter. In the business sector, the financing gap of nonfinancial corporations--that is, the difference between their capital outlays and internally-generated funds--should widen only slightly, and these firms probably will continue to concentrate their credit demands in long-term markets so as to preserve balance sheet liquidity. Underwriter reports point to a continued sizable amount of bond offerings by financial corporations and by foreign borrowers as well.

The State and local government sector also can be expected to maintain a high level of long-term borrowing activity. Indeed, massive refundings planned by Massachusetts and New York entities indicate that gross tax-exempt bond offerings this fall could challenge the record pace of the second quarter.

At the Federal level, the Treasury's sale of marketable debt to the public in the fourth quarter should total \$13 to \$14 billion--about \$1 billion more than in the July-September period. Prospective developments with respect to international trade and payments suggest that foreign official institutions may continue, at least over the near term, to be significant purchasers of Treasury securities.

In the household sector, growth of consumer credit may slow a bit further in the months ahead, given the projection for disposable income and consumption expenditures. The outlook for housing, however, indicates that residential mortgage credit flows should continue at their recent high level.

Although aggregate credit demands should not change appreciably over the remainder of this year, efforts to bring monetary growth trends within acceptable ranges--in the face of apparent underlying strength in the public's demand for liquidity--are likely to exert some pressure on interest rates. Consequently, interest rates can be expected to continue moving upward, most noticeably in the shorter end of the maturity spectrum. The rise in market yields should reduce deposit growth at banks and thrift institutions from third quarter rates--especially with respect to savings and shorter-term consumer-type time deposits, which already are at a yield disadvantage relative to market instruments. Commercial banks may be prompted to make somewhat greater use of CDs and other managed liabilities, and S&L's may tap the Home Loan Banks and other lenders for a greater volume of funds.

Upward adjustments in short-term rates are likely to be communicated more to long-term rates than in the past several months. Demand for mortgage credit is strong, and thrift institutions may raise mortgage rates as deposit flows diminish and costs of other

funds rise further. Given the current wide spread of mortgage rates over corporate bond yields, an increase in mortgage rates would tend to pull bond yields up too. Still, upward pressures on long-term rates should be moderated by the ample liquidity of thrift institutions, the sizable stock of FNMA standby commitments held by mortgage bankers, and the large cash flows of such long-term investors as life insurance companies, pension funds, and fire and casualty insurers. Upward pressures on long rates would also be limited to the extent that corporate and municipal financings were postponed, as they might be if the tightening of credit conditions is perceived as temporary.

INTERNATIONAL DEVELOPMENTS

Summary. Pressure on the dollar in foreign-exchange markets emerged at the end of September, following two months during which the dollar recovered from the depreciation earlier this summer.

Increases in U.S. interest rates relative to foreign interest rates also helped support the exchange value of the dollar.

Since the end of September the trade-weighted value of the dollar against major foreign currencies has depreciated by about 1 per cent. The dollar weakened against all major currencies, except the Canadian dollar. The sharpest declines in the value of the dollar since the end of September have been against the yen and the Swiss franc (about 3-3/4 and 2 per cent respectively), with lesser depreciations against other European currencies. Sterling was allowed to appreciate about 1 per cent against the dollar;

. A depreciation of the Canadian dollar against the U.S. dollar by about 1-3/4 per cent reflected continued uncertainties about political and economic prospects in Canada as well as a decline in the interest-rate differential in favor of Canada.

The major factor contributing to this latest weakness of the U.S. dollar was the market's reaction to public statements by U.S. Government officials during the end-of-September Annual Meetings of

the IMF/IBRD relating to the large U.S. trade and current-account deficits projected for 1977 and 1978. At the same time, the market was reacting to intensified international pressure on countries in current-account surplus -- particularly Japan -- to adopt measures to reduce their continuing surpluses.

The U.S. trade deficit in August increased to a \$37.5 billion annual rate from the \$28.6 billion rate recorded in July. Monthly trade deficits are fairly erratic, but the average July-August rate of deficit of \$33 billion indicates a continuing widening of the deficit. Both exports and imports in July-August declined from second-quarter rates. The value of agricultural exports fell largely due to a decline in prices. Imports of petroleum and products declined from the high second-quarter level, but non-petroleum imports increased somewhat.

Total foreign official reserves held in the United States increased by a relatively small amount, about \$0.5 billion, in August. OPEC holdings of reserve assets in the United States declined, while other official holders increased their dollar holdings by \$1 billion. Preliminary indications for September suggest a larger increase in non-OPEC foreign official reserve holdings in the United States,

Net private capital transactions in August for which data currently are available shifted to a small outflow.

Interest rates abroad have continued to decline, as economic activity and the associated demand for funds have proved to be unexpectedly

weak. The most pronounced declines in short-term interest rates have occurred in the United Kingdom and Italy. With the exception of Japan, monetary policy abroad, as measured by actual and/or target rates of growth of monetary aggregates, has generally not been eased. Foreign authorities in a number of countries, however, have announced or are reportedly considering selective fiscal measures designed to spur demand.

Outlook. Staff projections of economic activity abroad and of the U.S. trade and current-account deficits through next year are little changed from last month. The recent policy moves designed to stimulate demand -- which were incorporated in last month's projection -- are not expected to speed significantly the moderate pace of the recovery abroad. As a consequence, only a moderate rise of U.S. exports is expected throughout the projection period. On the import side, whereas about one-third of this year's projected rapid rise in imports is accounted for by rising imports of petroleum and petroleum products, almost all of the rise in total imports projected for next year is expected to be accounted for by non-oil imports, primarily industrial supplies and capital goods that are associated with the continued expansion in U.S. economic activity.

The staff expects current-account deficits to be \$20 billion and \$26.5 billion in 1977 and 1978 respectively. However, the general attractiveness of dollar-denominated financial instruments, as well as expectations of a continued increase in U.S. short-term interest rates, should continue to generate substantial capital flows to the

United States. It seems reasonable to expect, therefore, that private and official capital inflows will match the large and continuing current-account deficit without requiring a significant change in the weighted-average value of the dollar.

	1976	1977 ^P	1978 ^P	1976		1977				1978 ^P			
				III	IV	I	II	III ^P	IV ^P	I	II	III	IV
<u>Billions of dollars</u>													
1. GNP NET EXPORTS - Intl Acct. data	7.7	-10.3	-14.0	7.8	2.9	-7.4	-8.7	-12.2	-12.8	-11.2	-14.6	-15.0	-15.6
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(7.8)	(-11.2)	(-15.1)	(7.9)	(3.0)	(-8.2)	(-9.7)	(-13.2)	(-13.8)	(-12.2)	(-15.5)	(-16.0)	(-16.6)
3. a) Merchandise Trade Balance	-9.3	-32.2	-38.8	-11.2	-14.4	-28.4	-31.4	-34.1	-34.7	-34.8	-38.9	-40.4	-41.3
4. Exports (excl. military)	114.7	120.5	135.1	118.4	118.8	117.8	122.0	119.2	123.1	127.3	132.3	137.8	143.0
5. Agricultural	23.4	24.1	22.6	25.0	23.5	24.5	26.8	22.9	22.4	21.9	22.2	22.9	23.5
6. Nonagricultural	91.3	96.4	112.5	93.5	95.3	93.4	95.2	96.3	100.7	105.4	110.1	114.9	119.5
7. Imports	124.0	152.7	173.9	129.6	133.2	146.2	153.4	153.3	157.8	162.1	171.2	178.2	184.3
8. Petroleum and petrol. products	34.6	45.6	47.3	37.6	37.4	44.1	47.7	44.8	45.6	43.8	47.4	48.8	49.3
9. Nonpetroleum	89.4	107.1	126.6	92.0	95.9	102.1	105.7	108.5	112.2	118.3	123.8	129.4	135.0
10. b) Military transactions, net <u>2/</u>	--	1.6	1.6	.6	.5	1.7	1.5	1.6	1.5	1.6	1.6	1.6	1.6
11. c) Investment income, net <u>3/</u>	14.3	18.5	21.2	15.3	14.4	17.9	18.7	18.5	18.7	20.2	20.9	21.8	21.9
12. d) Other services, net <u>4/</u>	2.7	1.8	2.0	3.1	2.4	1.4	2.5	1.8	1.7	1.8	1.8	2.0	2.2
13. U.S. CURRENT ACCOUNT BALANCE <u>2/</u>	-1.0	-19.9	-26.5	-1.6	-6.0	-16.5	-17.8	-21.9	-23.2	-23.2	-27.0	-27.6	-28.2
14. a) GNP net exports (line 1.)	7.7	-10.3	-14.0	7.8	2.9	-7.4	-8.7	-12.2	-12.8	-11.2	-14.6	-15.0	-15.6
15. b) U.S. Govt & private transfers <u>5/</u>	-8.7	-9.6	-12.5	-9.3	-8.9	-9.0	-9.1	-9.7	-10.4	-12.0	-12.4	-12.6	-12.6
<u>Constant (1972) dollars</u>													
16. Merchandise exports (excl. military)	66.7	67.2	71.9	68.4	67.3	66.1	67.4	66.6	68.5	69.7	71.1	72.6	73.9
17. (% change, annual rates)	(3.4)	(0.7)	(7.0)	(13.0)	(-6.6)	(-7.4)	(8.2)	(-4.5)	(11.7)	(7.4)	(7.8)	(8.7)	(7.0)
18. Merchandise imports	62.8	71.5	77.3	64.9	66.1	70.2	72.0	71.1	72.6	73.8	76.7	78.6	80.0
19. (% change, annual rates)	(22.5)	(13.8)	(8.1)	(29.1)	(7.4)	(27.2)	(10.4)	(-5.3)	(8.7)	(6.6)	(16.5)	(10.0)	(7.0)
<u>Foreign Outlook - Major Industrial Countries <u>6/</u></u>													
20. Real GNP, % change, annual rates	5.2	3.1	4.7	1.6	2.9	4.9	1.2	2.9	4.9	5.3	5.3	5.7	4.9
21. Wholesale Prices, % change, annual rates <u>7/</u>	7.5	8.9	6.0	11.7	8.7	10.4	7.4	4.1	6.1	6.1	6.1	6.6	7.0

1/ Lags Intl. Acct. data (line 1) in the inclusion of revisions and new data.

2/ Excludes grants to Israel under military assistance acts and exports financed by those grants.

3/ Excludes U.S. Govt. interest payments to foreigners, which are included in line 15.

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

5/ Includes U.S. Govt grants, U.S. Govt interest payments to foreigners, and remittances and pensions.

6/ 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.

7/ Data are largely manufactured goods prices.

P/ Projected.

e/ Estimated.

* Published data.