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January 14, 1976

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. The pace of economic activity appears to have picked up appreciably in recent weeks, following a two-month pause. Retail sales surged in the pre-Christmas period, and industrial production and employment showed strong gains in December, supporting continued growth in real personal income. However, indications of a strong recovery in capital spending are still lacking, and the most recent Commerce survey suggests less strength in this sector during 1976 than most earlier surveys. While wholesale prices of farm products and foods declined last month and the wage index was unchanged, industrial commodity prices continued to rise at a substantial rate, and underlying inflationary pressures do not appear to have eased.

Industrial production is estimated to have risen by about 1 per cent in December--about twice the upward revised gain in November. The December increase was about equal to the rate of rise during the first five months of recovery. Strength was broadly based in December in both durable and nondurable goods sectors; output of both materials and final products rose strongly. Output increases were widespread among consumer goods industries, with auto assemblies edging up to a 7.8 million unit annual rate. A good gain in new car sales in December suggests that scheduled increases of production in the first quarter may be realized. Business equipment production rose strongly in December after having slowed in the previous two months.

Nonfarm payroll employment rose by 240,000 in December, almost as much as the average increase during the summer months. Gains in December occurred in 66 per cent of the 172 reporting industries. Manufacturing employment increased by 80,000, with most of the rise in durable goods, and there were also moderate job gains in the trade and service industries. The factory workweek jumped 0.4 hours in December to a level 1-1/2 hours above its February low; part of the reported rise in December, however, may reflect seasonal adjustment problems. The unemployment rate remained unchanged last month as the rise in total employment was about matched by an increase in the labor force, following several months of little net change.

Retail sales in December rose strongly--by 3-1/2 per cent, spurred by strong auto sales and vigorous Christmas buying. Excluding autos and outlets selling mainly nonconsumption items, retail purchases were up 2.2 per cent. Gains were widespread, but were particularly strong at general merchandise stores and at furniture and appliance outlets. Fragmentary data suggest that strength in sales may be carrying over into early January.

Unit sales of domestic model new cars in December increased strongly, to an 8.2 million annual rate, about 8 per cent above November and over 40 per cent above their April low. Sales of foreign cars, which recently have been curtailed by shortages and increased

price competition from small domestics, also rose somewhat, to a 1.4 million rate. Total unit auto sales reached a 9.6 million annual rate in December, the highest since late 1974.

It now appears that inventory liquidation is nearing an end in manufacturing. The book value of factory stocks rose at a \$2.4 billion annual rate in November, and revised estimates for October now show a small rise. Durable goods stocks are still being reduced, but the decline has become progressively smaller and has been partly offset by accumulation of nondurables. The acceleration of industrial activity in December suggests a further strengthening of inventory investment in manufacturing. Trade inventories had already turned up in the third quarter, and these stocks rose rapidly, at a \$20 billion annual rate, in October. Retail stocks may have been drawn down temporarily in December by the surge in retail sales.

In contrast to the improved outlook in other sectors, the latest reports on business spending have been disappointing. New orders received by durable goods manufacturers fell by 2.6 per cent in November, to a level slightly under that of last July, and orders for nondefense capital goods dropped by 1.3 per cent, to a level only a little above last Spring. In addition, there was a sharp drop in November in contracts for commercial and industrial building which offset the increases of the two previous months.

The most recent Commerce Department survey of anticipated plant and equipment spending for 1976 indicates a year-over-year

increase of 5-1/2 per cent in nominal terms, and a 9-1/2 per cent expected price rise. During the short period of its existence (since 1971), this December survey has been quite accurate. These new data suggest a weaker outlook for capital spending than the earlier Commerce survey (covering plans for the first two quarters of the year) or the McGraw-Hill survey, which reported a 9 per cent increase for 1976 as a whole.

Residential construction activity has continued to improve. Housing starts in November were at a seasonally adjusted annual rate of 1.38 million, down only slightly from the strong October pace. In the fourth quarter, they probably averaged somewhat over 1.4 million units, about 13 per cent above the third quarter and some 40 per cent above the cyclical low in the first quarter. The continued rise in mortgage commitments outstanding, and the increase of residential building permits in November, suggest further gains in activity in coming months.

The hourly earnings index was unchanged in December, after two months of sharp increases. This is an erratic series, and a longer perspective suggests little moderation in wages. For the fourth quarter as a whole, the index rose at about a 7-3/4 per cent rate; in December the index was 7.6 per cent above a year earlier.

Wholesale prices declined 0.4 per cent in December on a seasonally adjusted basis, as prices of farm and food products declined sharply for the second month in a row and more than offset a

further rise in industrial commodity prices. The December price index for farm and food products was unchanged from a year earlier, after increasing by 11 per cent during 1974. Industrial commodity prices rose 0.6 per cent in December, the same as in November, and were 6 per cent above a year ago. Over the past half year, however, they have moved up at close to a 9 per cent annual rate.

Outlook. It now appears that activity in the fourth quarter of 1975 was somewhat stronger than indicated earlier, the result of a more rapid swing to inventory accumulation and increased government purchases of goods and services. We now estimate a fourth quarter increase of real GNP at around a 6 per cent annual rate.

Our fiscal policy assumptions remain largely unchanged. Although Federal spending is now estimated to be \$2 billion larger, at \$372 billion for FY 1976, this is largely the result of the smaller than expected sales of oil leases--a transaction in property rights rather than in income or product. While fiscal policy for FY 1977 is subject to active debate, the course of policy in that fiscal year, which starts October 1, will have little effect on activity during 1976. For now, we have assumed a further six-month extension of current tax rates, beginning in July, and a continuation during the latter half of 1976 of growth in Federal spending along the patterns of recent experience.

With respect to monetary policy, we assume M_1 growth for the year beginning in the third quarter of 1975 to average 6-1/4

per cent--the mid-point of a 5 to 7-1/2 per cent range adopted by the FOMC. This pattern of monetary expansion, in conjunction with our GNP projection, is still expected to result in a cyclical rise in short-term interest rates. But the projected increase in 1976 has again been reduced, in part, because the recent shortfall of money growth is assumed to be made up. Given present interest rate expectations, we have dropped our previous assumption of an increase during 1976 of Regulation Q ceiling rates on time certificates of deposit.

In reevaluating the GNP outlook in light of the unfolding economic news since early December, three events have stood out: (1) the renewed momentum of consumer buying, (2) indications of a smaller 1976 recovery in business fixed investment than had been previously projected, and (3) the likelihood that the increase in short-term interest rates will be more moderate. Projected consumption expenditures have been strengthened only a little, because the recent resumption of more aggressive buying had largely been anticipated. Upward revisions were also made in projections for net exports, mainly reflecting larger sales of military goods, and in residential construction, reflecting the change in interest rate expectations. Projections of business fixed investment have been revised downward. The projected year-over-year increase in plant and equipment outlays now amounts to 7 per cent in nominal terms--slightly more than the recent Commerce survey indicates, allowing for some expansion in business plans during the year.

Taken together, these changes have resulted in a slightly weaker outlook for 1976. The annual growth rate of real GNP this year is now projected to average about 4-1/4 per cent for the four quarters. In terms of year-to-year growth, this is equivalent to a 5-1/2 per cent increase. The unemployment rate is still projected to edge down only slightly during 1976, to the neighborhood of 8 per cent in the second half.

In our price projections, we have incorporated slightly higher wage (and unit labor cost) assumptions and somewhat lower energy prices--the latter as a consequence of the recently enacted Energy Policy and Conservation Act. Compensation per man hour is now projected to rise about 8-3/4 per cent during 1976, close to half a per cent more than during 1975. The Energy Act implies a near-term reduction in the average price of all domestically-produced crude oil from its recent level of around \$8.60 per barrel to \$7.66. A sizable part of this rollback will be achieved automatically due to competitive pressures that arise from the recent termination of the \$2.00 oil import fee. However, there may be other upward pressures on import prices. In addition, the rollback in domestic crude oil prices is not expected to be passed through on a one-for-one basis, due to a number of factors operating to push up prices of refined product. We have assumed a quite moderate decline in prices of refined oil products through mid-year, and small price increases thereafter as the Act's provisions for gradual decontrol start taking hold. By year-end, prices of fuels are expected to be about the same as a year earlier.

In consequence of these various factors, the fixed-weighted price index for gross private product, which increased at a 6-1/2 per cent annual rate in the last half of 1975, is projected to rise at around a 5-1/2 per cent annual rate during the four quarters of 1976.

Details on these projections are presented in the tables that follow.

STAFF GNP PROJECTIONS

	Per cent change, annual rate							
	Changes in nominal GNP (\$ billions)		Real GNP		Gross private product fixed-weighted price index		Unemployment rate (per cent)	
	12/10/75	1/14/76 ^{1/}	12/10/75	1/14/76 ^{1/}	12/10/75	1/14/76 ^{1/}	12/10/75	1/14/76
1972 ^{2/}	103.1	103.1	6.2	6.2	3.3	3.3	5.6	5.6
1973 ^{2/}	136.9	136.9	5.9	5.9	6.3	6.3	4.9	4.9
1974 ^{2/}	102.5	102.5	-2.1	-2.1	11.4	11.4	5.6	5.6
1975	80.2	n.a.	-2.9	n.a.	9.2	n.a.	8.5	8.5
1976	168.9	n.a.	5.6	n.a.	6.0	n.a.	8.0	8.0
1974-I ^{2/}	14.8	14.8	-7.0	-7.0	14.1	14.1	5.2	5.2
II ^{2/}	25.0	25.0	-1.6	-1.6	12.3	12.3	5.1	5.1
III ^{2/}	32.5	32.5	-1.9	-1.9	13.8	13.8	5.5	5.5
IV ^{2/}	14.6	14.6	-9.0	-9.0	12.6	12.6	6.6	6.6
1975-I ^{2/}	-14.3	-14.3	-11.4	-11.4	7.7	7.7	8.3	8.3
II ^{2/}	24.3	24.3	1.9	1.9	5.5	5.5	8.9	8.9
III ^{2/}	62.6	62.6	13.2	13.2	7.3	7.3	8.4	8.4
IV	45.6	47.9	5.0	6.1	6.5	5.9	8.4	8.4
1976-I	37.7	37.0	4.8	4.5	5.9	5.6	8.2	8.2
II	39.4	40.3	4.8	4.5	5.6	5.6	8.1	8.1
III	39.5	41.0	4.6	4.3	5.3	5.6	7.9	7.9
IV	41.2	42.5	4.3	4.0	5.0	5.5	7.9	7.9
Change:								
74-II to								
75-II ^{2/}	57.1	n.a.	-5.3	n.a.	9.8	n.a.	3.8	3.8
74-IV to								
75-IV	118.3	n.a.	1.8	n.a.	6.7	n.a.	1.8	1.8
75-II to								
76-II	185.4	193.1	6.9	8.7	6.3	n.a.	- .8	- .8
75-IV to								
76-IV	157.8	160.8	4.7	4.3	5.4	5.6	- .5	- .5

^{1/} Projected figures are based on indications of effects of new revisions in income and product data and may not be strictly comparable to previous projections.

^{2/} Actual.

REVISED NATIONAL INCOME AND PRODUCT ACCOUNTS

The GNP and related income and product data shown in the following tables for the period 1974-I through 1975-III are the Commerce Department unrevised previously-published estimates. The staff projection of GNP and related items for the period 1975-IV through 1976-IV are based on STRICTLY CONFIDENTIAL indications of the effects of the revisions on major income and product accounts components to be released on January 16 by the Department of Commerce. The new revisions of the accounts include, in addition to the usual statistical revisions, twenty definitional and classificational revisions--some of which are relatively large and affect relationships among various components of the accounts significantly. Because detail on both the nature of these revisions and their magnitude are not available, the projections of some of the N.I.P.A. components may be more tenuous than usual.

The revised estimates of the national income and product accounts (N.I.P.A) to be released on Friday will be for those N.I.P.A. tables which will be carried regularly in the Survey of Current Business and will in general cover the period 1947-I through 1975-III. A brief description of the highlights of the revision is scheduled for release about the middle of next week. Preliminary estimates for the final quarter of last year are scheduled to be released on January 20.

The revised N.I.P.A. data for the period 1970-I through 1975-III and for 1968-1975 will be included in the Supplement to this Greenbook, along with a brief discussion of some of the more important effects of the revisions on major income and product account components.

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.)

	1975		1976			1975	1976
	IV	I	II	III	IV		
	-----Revised N.I.P.A.* Basis-----						
Gross National Product	1576.4	1613.4	1653.7	1694.7	1737.2	1499.8	1674.8
Final purchases	1567.4	1600.4	1639.2	1679.7	1721.2	1511.7	1660.1
Private	1223.4	1252.1	1283.8	1316.5	1347.1	1180.7	1299.9
Excluding net exports	1202.9	1236.4	1269.8	1302.9	1333.5	1159.6	1285.7
Personal consumption expenditures	998.3	1024.2	1048.9	1072.7	1096.1	963.1	1060.5
Durable goods	133.8	137.3	141.0	145.0	150.1	127.1	143.4
Nondurable goods	424.6	435.3	445.5	454.7	463.4	410.0	449.7
Services	439.9	451.6	462.4	473.0	482.6	426.0	467.4
Gross private domestic investment	213.6	225.2	235.4	245.2	253.4	184.7	239.8
Residential construction	54.3	58.0	62.8	67.0	68.9	48.5	64.2
Business fixed investment	150.3	154.2	158.1	163.2	168.5	148.1	161.0
Change in business inventories	9.0	13.0	14.5	15.0	16.0	-11.9	14.6
Nonfarm	7.0	12.0	14.5	15.0	16.0	-12.9	14.4
Net exports of goods and services ^{1/}	20.5	15.7	14.0	13.6	13.6	21.0	14.2
Exports	151.5	154.7	158.5	163.1	167.5	147.2	161.0
Imports	131.0	139.0	144.5	149.5	153.9	126.2	146.7
Gov't. purchases of goods and services	344.0	348.3	355.4	363.2	374.1	331.0	360.3
Federal	130.0	131.8	133.8	135.8	141.0	123.2	135.6
Defense	88.8	89.6	91.1	92.2	95.9	84.3	92.2
Other	41.2	42.2	42.7	43.6	45.1	38.9	43.4
State and local	214.0	216.5	221.6	227.4	233.1	207.8	224.7
Gross national product in constant (1972) dollars	1219.3	1232.8	1246.6	1259.9	1272.2	1186.9	1252.8
GNP implicit deflator (1972=100)	129.3	130.9	132.7	134.5	136.6	126.3	133.7
Personal income	1294.5	1326.7	1354.7	1387.0	1418.4	1245.9	1371.7
Wage and salary disbursements	830.2	850.4	870.9	890.7	913.4	801.5	881.4
Disposable income	1113.6	1143.8	1168.8	1194.6	1220.7	1076.6	1187.0
Personal saving	91.3	95.5	95.6	97.5	100.1	89.6	97.2
Saving rate (per cent)	8.2	8.3	8.2	8.2	8.2	8.3	8.2
Corporate profits with I.V.A. and C.C.Adj.	117.6	120.4	128.3	136.5	142.8	101.6	132.0
Corporate profits with I.V.A., without C.C.Adj.	123.6	126.4	134.3	142.0	148.3	107.1	137.8
Corporate profits before tax	134.6	136.4	143.3	150.0	155.3	117.4	146.3
Federal government receipts and expenditures, (N.I.A. basis)							
Receipts ^{2/}	302.9	309.0	317.9	329.6	339.3	282.5	324.0
Expenditures	374.8	384.9	391.1	401.5	412.8	357.1	397.6
Surplus or deficit (-) ^{2/}	-71.9	-75.9	-73.2	-71.9	-73.5	-74.6	-73.5
High employment surplus or deficit (-)	-5.4	-11.7	-7.3	-8.6	-5.3	-8.9	-8.2
State and local government surplus or deficit (-) (N.I.A. basis)	13.6	15.0	14.7	13.7	13.8	10.3	14.3
	-----Published Basis-----						
Total labor force (millions)	95.4	95.8	96.3	96.7	97.1	94.9	96.5
Armed forces "	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Civilian labor force "	93.2	93.6	94.1	94.5	94.9	92.7	94.3
Unemployment rate (per cent)	8.4	8.2	8.1	7.9	7.9	8.5	8.0
Nonfarm payroll employment (millions)	77.6	78.0	78.5	79.0	79.3	77.0	78.7
Manufacturing	18.5	18.6	18.8	18.9	19.0	18.4	18.8
Industrial production (1967=100)	117.5	119.5	121.5	123.3	125.1	113.4	122.4
Capacity utilization, mfg. (per cent)	70.6	71.3	71.9	72.4	72.8	68.7	72.1
Major materials (per cent)	80.6	81.2	81.9	82.3	82.7	74.9	82.0
Housing starts, private (millions, A.R.)	1.43	1.55	1.65	1.70	1.73	1.19	1.66
Sales new autos (millions, A.R.)	9.20	9.60	9.75	10.00	10.20	8.66	9.89
Domestic models	7.90	8.10	8.25	8.50	8.70	7.09	8.39
Foreign models	1.30	1.50	1.50	1.50	1.50	1.57	1.50

*N.I.P.A.: National Income and Product

Accounts

Exports of g. & s. (Bal. of paymts)	16.6	11.2	9.1	8.7	8.7	16.9	9.4
Imports	152.0	154.9	158.7	163.3	167.7	147.5	161.2
Imports	135.4	143.7	149.6	154.6	159.0	130.7	151.7

^{2/} Federal government N.I.A. receipts in 1975-II reflect the \$8.1 billion rebate of 1974 individual income taxes and in 1975-III and following quarters the \$9.3 billion reduction in 1975 individual income taxes; the withholding rates associated with the latter reduction are assumed to be continued in 1976.

^{3/} Includes \$.3 billion, annual rate of shipments of military equipment and supplies to Israel which are not included in GNP exports.

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1975		1976			1975	1976
	IV	I	II	III	IV		
Gross National Product	47.9	37.0	40.3	41.0	42.5	92.9	175.0
Inventory change	11.3	4.0	1.5	.5	1.0	-21.6	26.5
Final purchases	36.6	33.0	38.8	40.5	41.5	114.5	148.4
Private	26.7	28.7	31.7	32.7	30.6	84.6	119.2
Net exports	-1.6	-4.8	-1.7	-.4	.0	13.3	-6.8
Excluding net exports	28.3	33.5	33.4	33.1	30.6	71.2	126.1
Personal consumption expenditures	20.9	25.9	24.7	23.8	23.4	77.2	97.4
Durable goods	2.8	3.5	3.7	4.0	5.1	5.2	16.3
Nondurable goods	8.2	10.7	10.2	9.2	8.7	34.3	39.7
Services	10.7	11.7	10.8	10.6	9.6	37.7	41.4
Residential fixed investment	3.9	3.7	4.8	4.2	1.9	-6.1	15.7
Business fixed investment	3.5	3.9	3.9	5.1	5.3	13.1	12.9
Government	9.9	4.3	7.1	7.8	10.9	29.9	29.3
Federal	5.8	1.8	2.0	2.0	5.2	11.5	12.4
State and local	4.1	2.5	5.0	5.8	5.7	18.4	6.9
GNP in constant (1972) dollars	18.0	13.5	13.8	13.3	12.3	-23.8	75.9
Final purchases	10.3	9.8	13.0	13.7	11.4	-7.7	46.6
Private	7.9	10.1	10.9	11.1	9.2	-10.9	28.6
	-----In Per Cent Per Year ^{1/} -----						
Gross national product	13.1	9.7	10.4	10.3	10.4	6.6	11.7
Final purchases	9.9	8.7	10.1	10.3	10.3	8.2	9.8
Private	9.2	9.7	10.5	10.6	9.6	7.7	10.1
Personal consumption expenditures	8.8	10.8	10.0	9.4	9.0	8.7	10.1
Durable goods	6.2	10.9	11.2	11.8	14.8	4.3	12.8
Nondurable goods	8.1	10.5	9.7	8.5	7.9	.3	9.7
Services	10.4	11.1	9.9	9.5	8.4	9.7	9.7
Gross private domestic investment	44.3	23.6	19.4	17.7	14.1	-13.0	29.8
Residential structures	34.7	30.2	37.4	29.6	11.8	-11.2	32.4
Business fixed investment	9.9	10.8	10.5	13.5	13.6	.1	8.7
Gov't purchases of goods & services	12.4	5.1	8.4	9.1	12.6	9.9	8.9
Federal	20.0	5.7	6.2	6.1	16.2	10.3	10.1
Defense	19.7	3.7	6.9	4.9	17.0	8.9	9.4
Other	20.8	10.1	4.8	8.7	14.5	13.4	11.6
State and local	8.0	4.8	9.8	10.9	10.4	9.7	8.1
GNP in constant (1972) dollars	6.2	4.5	4.5	4.3	4.0	-2.0	5.6
Final purchases	3.5	3.3	4.3	4.5	3.7	-.6	3.9
Private	3.4	4.3	4.6	4.6	3.8	-1.1	4.8
GNP implicit deflator ^{2/}	6.6	5.0	5.6	5.7	6.2	8.7	5.9
Private GNP fixed weighted index ^{3/}	5.9	5.6	5.6	5.6	5.5	8.9	5.9
Personal income	11.0	10.3	8.7	9.9	9.4	7.9	10.1
Wage and salary disbursements	11.8	10.1	10.0	9.4	10.6	5.0	10.0
Disposable income	10.3	11.3	9.0	9.1	9.0	9.5	9.8
Corporate profits before tax	16.7	5.5	21.8	20.1	14.9	-11.1	14.6
Federal Government receipts and expenditures (N.I.A. basis)							
Receipts	13.7	8.3	12.0	15.6	12.3	-2.0	14.7
Expenditures	12.7	11.2	6.6	11.1	11.7	19.0	11.3
Nonfarm payroll employment	3.2	2.1	2.6	2.6	1.5	-1.8	2.2
Manufacturing	4.4	2.2	4.4	2.1	2.1	-8.2	2.2
Industrial production	12.1	7.0	6.9	6.1	6.0	-9.1	7.9
Housing starts, private	65.9	38.0	28.4	12.7	7.2	-11.0	39.5
Sales new autos	-.4	18.6	6.4	10.7	8.2	-2.4	14.2
Domestic models	21.8	10.5	7.6	12.7	9.7	-4.8	18.3
Foreign models	-65.0	77.3	.0	.0	.0	10.6	-4.5

1/ Percentage rates are annual rates compounded quarterly.

2/ Excluding Federal pay increases rates of change are: 1975-IV, 5.9 per cent; 1976-I, 4.9 per cent; and 1976-IV, 5.5 per cent.

3/ Using expenditures in 1967 as weights.

CLASS II FOMC

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				1975		
	I	II	III	IV	I	II	III
	-----Published Basis-----						
Gross National Product	1358.8	1383.8	1416.3	1430.9	1416.6	1330.9	1504.4
Final purchases	1341.9	1370.3	1407.6	1413.1	1435.8	1471.9	1509.8
Private	1045.6	1065.9	1095.3	1089.3	1104.2	1133.8	1166.3
Excluding net exports	1034.3	1067.4	1098.4	1087.4	1095.4	1117.6	1153.3
Personal consumption expenditures	840.6	869.1	901.3	895.8	913.2	938.6	968.8
Durable goods	123.9	129.5	136.1	120.7	124.9	130.6	138.6
Nondurable goods	364.4	375.8	389.0	391.7	398.8	410.1	322.7
Services	352.4	363.8	376.2	383.5	389.5	397.9	407.5
Gross private domestic investment	210.5	211.8	205.8	209.4	163.1	148.1	179.1
Residential construction	48.4	48.8	46.2	40.4	35.3	36.4	41.0
Business fixed investment	145.2	149.4	150.9	151.2	146.9	142.7	143.6
Change in business inventories	16.9	13.5	8.7	17.8	-19.2	-31.0	-5.5
Nonfarm	13.1	10.4	6.6	17.5	-17.8	-30.6	-7.2
Net exports of goods and services ^{1/}	11.3	-1.5	-3.1	1.9	8.8	16.2	13.0
Exports	131.2	138.5	143.6	147.5	142.2	136.0	142.7
Imports	119.9	140.0	146.7	145.7	133.4	119.8	129.8
Gov't. purchases of goods and services	296.3	304.4	312.3	323.8	331.6	338.1	343.5
Federal	111.5	114.3	117.2	124.5	126.5	128.4	130.5
Defense	75.8	76.6	78.4	84.0	84.7	84.8	86.1
Other	35.7	37.7	38.8	40.6	41.8	43.6	44.4
State & local	184.8	190.1	195.1	199.3	205.1	209.7	213.0
Gross national product in constant (1958) dollars	830.5	827.1	823.1	804.0	780.0	783.6	808.6
GNP implicit deflator (1958 = 100)	163.6	167.3	172.1	178.0	181.6	183.9	186.1
Personal income	1112.5	1134.6	1168.2	1186.9	1193.4	1220.5	1255.2
Wage and salary disbursements	727.6	745.2	763.0	769.2	765.1	773.0	791.4
posable income	950.6	966.5	993.1	1008.8	1015.5	1078.5	1079.6
Personal saving	84.4	71.5	65.5	86.5	75.9	113.8	84.6
Saving rate (per cent)	8.9	7.4	6.6	8.6	7.5	10.6	7.8
Corporate profits & inventory val. adj.	107.7	105.6	105.8	103.4	94.3	104.9	123.0
Corporate profits before tax	135.4	139.0	157.0	131.5	101.2	113.3	134.6
Federal government receipts and expenditures, (N.I.A. basis)							
Receipts	278.1	288.6	302.8	294.7	284.1	251.8	295.8
Expenditures	281.0	291.6	304.7	319.3	338.5	355.0	362.7
Surplus or deficit (-)	-2.8	-3.0	-1.9	-24.5	-54.4	-103.3	-67.0
High employment surplus or deficit (-)	14.5	10.5	26.1	21.0	11.0	-35.8	-5.0
State and local government surplus or deficit (-), (N.I.A. basis)	3.2	2.0	2.1	-1	-1.6	-9	4.1
Total labor force (millions)	92.7	92.9	93.6	94.0	94.0	94.7	95.4
Armed forces "	2.2	2.3	2.2	2.2	2.2	2.2	2.2
Civilian labor force "	90.5	90.6	91.4	91.8	91.8	92.5	93.2
Unemployment rate (per cent)	5.2	5.1	5.5	6.6	8.4	8.9	
Nonfarm payroll employment (millions)	78.2	78.5	78.7	78.3	76.9	76.4	77.0
Manufacturing	20.2	19.8	20.1	19.6	18.5	18.1	18.3
Industrial production (1967 = 100)	124.9	125.5	125.4	121.3	111.6	110.4	114.2
Capacity utilization, mfg. (per cent)	80.5	80.1	79.4	75.7	68.2	67.0	69.0
Major materials (per cent)	90.2	90.2	88.5	79.1	70.0	70.9	78.0
Housing starts, private (millions, A.R.)	1.61	1.53	1.21	1.00	1.00	1.07	1.26
Sales new autos (millions, A.R.)	9.04	9.17	10.07	7.38	3.31	7.90	9.21
Domestic models	7.49	7.92	8.52	6.05	6.60	6.33	7.52
Foreign models	1.55	1.25	1.55	1.33	1.71	1.57	1.69
1/ Net exports of g. & s. (Bal. of paymts)	12.0	.3	-9	4.0	12.7	20.1	18.2
Exports	133.3	142.0	148.7	153.7	148.4	140.8	149.0
Imports	121.4	141.7	149.7	149.7	135.7	120.7	130.8

^{2/} Federal government N.I.A. receipts in 1975-II reflects the \$8.1 billion rebate of 1974 individual income taxes and in 1975-III and following quarters the \$9.3 billion reduction in 1975 individual income taxes; the withholding rates associated with the latter reduction are assumed to be continued in 1976.

^{3/} Includes \$.3 billion, annual rate of shipments of military equipment and supplies to Israel which are not included in GNP exports.

Class II FOMC

CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1974				1975		
	I	II	III	IV	I	II	III
	-----Published Basis-----						
Gross National Product	14.8	25.0	32.5	14.6	-14.3	24.3	63.5
Inventory change	-12.0	-3.4	-4.8	9.1	-37.0	-11.8	25.5
Final purchases	26.8	28.4	37.3	5.5	22.7	36.1	37.9
Private	16.9	20.3	29.4	-6.0	14.9	29.6	32.5
Net exports	2.0	-12.8	-1.6	5.0	6.9	7.4	-3.2
Excluding net exports	14.9	33.1	31.0	-11.0	8.0	22.2	35.7
Personal consumption expenditures	16.7	28.5	32.2	-5.5	17.4	25.4	30.2
Durable goods	-4	5.6	6.6	-15.4	4.2	5.7	8.0
Nondurable goods	12.3	11.4	13.2	2.7	7.1	11.3	12.6
Services	5.0	11.4	12.4	7.3	6.0	8.4	9.6
Residential fixed investment	-5.2	.4	-2.6	-5.8	-5.1	1.1	4.6
Business fixed investment	3.3	4.2	1.5	.3	-4.3	-4.2	.9
Government	9.9	8.1	7.9	11.5	7.8	6.5	5.4
Federal	3.1	2.8	2.9	7.3	2.0	1.9	2.1
State and local	6.9	5.3	5.0	4.2	5.8	4.6	3.3
GNP in constant (1958) dollars	-15.2	-3.4	-4.0	-19.1	-24.0	3.6	25.0
Final purchases	-5.8	-1.0	-.8	-25.0	-1.3	8.9	10.2
Private	-6.1	-.8	-.9	-25.4	-2.7	7.4	9.3
	-----In Per Cent Per Year ^{1/} -----						
Gross National Product	4.5	7.6	9.7	4.2	-3.9	7.0	18.8
Final purchases	8.4	8.7	11.3	1.6	6.6	10.4	10.7
Private	6.7	8.0	11.5	-2.2	5.6	11.2	12.0
Personal consumption expenditures	8.4	14.3	15.7	-2.4	8.0	11.6	13.5
Durable goods	-1.3	19.3	22.0	-38.1	14.7	19.5	26.8
Nondurable goods	14.7	13.1	14.8	2.8	7.4	11.8	12.9
Services	5.9	13.6	14.3	8.0	6.4	8.9	10.0
Gross private domestic investment	-22.7	2.5	-10.9	7.2	-63.2	-32.0	113.9
Residential structures	-33.5	3.3	-19.7	-41.5	-41.7	13.1	61.0
Business fixed investment	9.6	12.1	4.1	.8	-10.9	-11.0	2.5
Gov't purchases of goods & services	14.6	11.4	10.8	15.6	10.0	8.1	6.5
Federal	11.9	10.4	10.5	27.3	6.6	6.1	6.7
Defense	2.7	4.3	9.7	31.8	3.4	.5	6.3
Other	35.3	24.4	12.2	19.9	12.4	18.4	7.5
State and local	16.4	12.0	10.9	8.9	12.2	9.3	6.4
GNP in constant (1958) dollars	-7.0	-1.6	-1.9	-9.0	-11.4	1.9	13.4
Final purchases	-2.8	-.5	-.4	-11.7	-.7	4.6	5.2
Private	-3.5	-.5	-.5	-14.3	-1.7	4.7	5.8
GNP implicit deflator ^{2/}	12.3	9.4	11.9	14.4	8.4	5.1	4.8
Private GNP fixed weighted index ^{3/}	12.7	11.1	12.7	12.5	7.5	5.5	7.0
Personal income	4.9	8.2	12.4	6.6	2.2	9.4	11.9
Wage and salary disbursements	6.0	10.0	9.9	3.3	-2.1	4.2	9.9
Disposable income	4.9	6.9	11.5	6.5	2.7	27.2	.4
Corporate profits before tax	48.3	11.1	62.8	-50.8	-64.9	57.1	99.2
Federal Government receipts and expenditures (N.I.A. basis)							
Receipts	15.4	16.0	21.2	-10.3	-13.6	-38.3	90.4
Expenditures	16.3	16.0	19.2	20.6	26.3	21.0	9.0
Nonfarm payroll employment	1.5	1.5	1.0	-2.0	-7.0	-2.6	3.2
Manufacturing	-2.0	-7.7	6.2	-9.6	-20.6	-8.4	4.5
Industrial production	-6.5	1.9	-.3	-12.5	-28.4	-4.2	14.5
Housing starts, private	-2.4	-18.4	-60.9	-53.3	.0	31.1	92.3
Sales new autos	-37.1	5.9	45.4	-71.2	60.8	-18.3	84.7
Domestic models	-40.0	25.0	33.9	-74.6	41.6	-15.4	99.2
Foreign models	-20.2	-57.7	136.4	-45.8	173.3	-28.9	34.3

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

Excluding Federal pay increases rates of change are: 1975-I, 8.3 per cent.

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

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. In the weeks since the last Committee meeting, financial market participants have become increasingly convinced that credit demands and monetary policy are unlikely to lead to significant increases in interest rates in the months ahead. These views gained support from the continued weakness in the monetary and credit statistics and the more accommodative System policy stance. At the same time, such expectations were reinforced by the developing 'standard' forecast for 1976 of only moderate real economic growth accompanied by continued slowing of inflation.

Reflecting the more ebullient market attitude in the inter-meeting period, interest rates on short-term securities declined 5/8 to 1 percentage point and on long-term securities by about one-fourth to over one-half of a percentage point. Most of these declines have occurred since the beginning of the new year and--except in the tax-exempt market--investors seem to be more willing to acquire lower quality assets. In equity markets, which absorbed almost \$11 billion of new issues in 1975, prices have risen 7 to 9 per cent since the last FOMC meeting, as investors focussed on rising corporate profits in an environment of only moderate upward interest rate pressures.

All of the major depository aggregates were weak in December, as M_1 declined and growth in other time deposits--excluding the estimated amount of corporate savings accounts--slowed perceptibly. Bank credit

(end-of-month series) contracted in December and the fourth quarter rate of growth was below that of the preceding three quarters.

Virtually all categories of loans were weak in December. Business loans declined sharply, perhaps reflecting a continuation of conservative inventory policies, the rapid pace of retail sales last month, and rising corporate profits.

With their relatively strong deposit inflows and unusually comfortable liquidity positions, thrift institutions--particularly S&L's--apparently continued a high rate of residential mortgage commitments, but in primary home mortgage markets, where credit demands have remained strong, interest rates have been relatively sticky. By mid-January the conventional mortgage rate had declined only 5 basis points from the level of early December and was only 13 basis points below its October high. In secondary markets, however, yields declined more in line with general market developments, falling between 20 to 30 basis points in the inter-meeting period.

Outlook. Over the near term, business borrowing at banks and in the commercial paper market is expected to remain quite modest in light of still expanding corporate cash flows, continued above average reliance on capital markets, and reduced capital spending plans. During the first quarter, however, markets will have to absorb a record \$27 billion of Treasury securities (only \$4 billion of which has been issued). Much of this borrowing is expected to be short-term. Banks, while still large takers of Treasury issues, have slowed their acquisitions of such securities in recent months--apparently reflecting their improved liquidity positions. With their portfolio liquidity improved and with an expected

modest pick-up in business short-term credit demands to finance general working capital needs, banks are unlikely to be particularly aggressive buyers of Treasury bills and other shorter-term securities. Similarly, thrift institutions facing large takedowns of existing mortgage commitments, are also expected to be a less significant factor in the Treasury securities market.

The cumulative pressure of continued Treasury borrowing and the expected increase in private credit demands is likely to lead to some increases in short-term interest rates as the year progresses. However, the staff now expects a smaller increase in short-term rates than thought previously, accompanied by long-term rates somewhat lower than current levels. Institutional investors--particularly savings banks, insurance companies, and pension funds--are expected to remain relatively aggressive bond investors in light of their large cash ~~in~~flows and the financial market outlook. Moreover, commercial banks with their liquidity improved in 1975, are likely to place more emphasis on higher yielding intermediate-term Treasury issues, rather than bills, in an effort to improve earnings.

Even with a reduction in projected capital outlays, the staff expects a much larger volume of new bond offerings than most forecasters, since there appears to be considerable balance sheet restructuring yet to be done. This expectation, along with the likelihood of continued large foreign borrowing in U.S. capital markets in 1976, suggests that

further declines in long-term rates are likely to be modest. However, if inflationary expectations continue to abate, larger declines could occur in long-term rates, even with increasing short-term rates.

The outlook for declining interest rates in the tax-exempt market is more uncertain because of the New York situation. In addition, it is difficult to evaluate bank reactions to proposed SEC regulations regarding bank publication of their specific tax-exempt bond holdings, whenever holdings of a particular issuer exceed specified minimum ratios.

INTERNATIONAL DEVELOPMENTS

Summary. Exchange markets in the last half of December were relatively inactive, and the weighted average exchange rate for the dollar held steady. After the turn of the year, however, the dollar came under some downward pressure in the market, mainly as a consequence of declining U.S. interest rates.

A major factor in the strong position of the dollar in the last half of 1975 was the unexpectedly large surplus in the goods and services balance. The merchandise trade balance registered another large surplus in November, \$8.6 billion at an annual rate, and it appears that the fourth quarter surplus was about equal to the \$8 billion rate of the third quarter. Exports held up well during the period of slack demand in foreign markets, and rose somewhat in October-November in response to reviving economic activity abroad. Meanwhile U.S. imports, which had dropped sharply during the first half, have risen somewhat faster than exports since mid-1975, with fuel accounting for much of the increase.

The surplus balance on military and service transactions rose sharply in the third quarter -- to an annual rate of \$10 billion -- with investment income receipts and military sales both increasing. Goods

and service transactions together registered an \$18 billion surplus rate in the third quarter, only moderately less than the record \$20 billion rate of the second quarter.

Capital account transactions through banks, together with transactions in securities with foreigners, resulted in a net capital inflow of about \$2 billion in November -- a sharp contrast with a net outflow of \$4 billion in October for these types of capital transactions. The shift between months occurred mainly in flows between foreign banks and their U.S. agencies and branches; there is no evident divergence in interest rate patterns that might account for such a shift. Weekly data on banks' foreign liabilities in December show a further large increase in borrowings from foreign banks, but much of this was reversed in early January as U.S. money market rates eased. The increase in U.S. bank claims on foreigners declined to about \$1/2 billion in November, bringing the 11-month total to about \$11-1/2 billion, compared with \$19-1/2 billion for the year 1974.

U.S. purchases of new foreign bond issues exceeded \$2.3 billion in the fourth quarter, including a large IBRD issue, raising the total for the year to about \$7.0 billion (\$2.4 billion in 1974). At the same time foreign purchases of U.S. corporate stocks were well sustained and probably reached \$3-1/2 billion for the year (\$.5 billion in 1974).

Foreign official holdings of U.S. assets, apart from OPEC funds, declined slightly in November, and probably also in December,

but some increases have occurred since late last year as official purchases of the dollar in exchange markets came into play. The growth of OPEC assets in the United States has slowed markedly, with funds held at banks down about \$350 million in November and perhaps rising by a comparable amount in December. OPEC countries' recorded purchases of U.S. corporate stocks continued at about \$125 million per month through November, about the average for the year.

Outlook. As incoming data indicate stronger than expected trade results, and other elements of the current account also show strength, projections of the outcome for goods and services have been gradually raised for the year ahead. Nevertheless, a considerable drop off in the trade balance is still anticipated as demand is expected to rise more rapidly here than in most other industrial countries. Moreover, absolute increases in exports to OPEC countries will probably be smaller, and other developing countries are likely to have difficulties in financing increases in their imports until their export markets and prices strengthen again.

Whether recent downward pressure on the dollar continues will depend mainly on trends in money market interest rates. In most other industrial countries authorities seem likely to continue a fairly accommodative policy, at least until an upward movement of private demand is more clearly established. However, in a few countries concern about the balance of payments limits the scope for easing, and in others there is

still a good deal of caution about the possible inflationary consequences of any further easing.

The recent meeting of the IMF Interim Committee in Jamaica succeeded in reaching agreement on the most prominent outstanding issues on the agenda for international monetary reform: the exchange rate regime, the disposition of gold, and expansion of the scope of the IMF's credit-granting capabilities. While much depends on the way in which these agreements are implemented, the reaching of accords on these issues will give more assurance of support for developing countries facing large deficits, and may tend to produce more coordination in economic policy and activities directly affecting exchange markets.

[Note: because of a change in accounting procedures in the GNP accounts the balance on goods and services as recorded in the balance of payments accounts will be less than the foreign balance in the GNP accounts by the amount of interest paid to foreigners by the U.S. Government. Such payments will be counted as transfer payments in the Government sector of the GNP accounts rather than as part of the external goods and services sector. In the third quarter such interest payments were at an annual rate of \$4.5 billion.]