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CONFIDENTIAL (FR)

July 13, 1977

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Gains in economic activity appear to have moderated somewhat from their very rapid recent pace. Growth of employment and production slowed in June and retail sales were little changed over the past two months. At the same time, wholesale and retail price increases have moderated from their rapid rates earlier this year.

Industrial production is estimated to have risen about three-fourths per cent in June; while still comparatively strong, this rise was well below the average pace of the previous three months. Auto assemblies rose 5-1/2 per cent, following small declines in April and May, and output of business equipment apparently rose strongly again. The June rise in materials production was apparently more moderate than earlier in the year; steel production, which had been boosted in earlier months by strong inventory demand in anticipation of price increases, was little changed in June.

The unemployment rate edged up 0.2 to 7.1 per cent in June, as growth in the labor force outpaced the rise in employment. The increase in unemployment was among persons seeking part-time jobs, mainly women and teenagers; the jobless rate for adult men declined. Nonfarm payroll employment rose only 135,000 in June, less than half the average pace of the prior six months. Jobs in nondurable manufacturing declined slightly, following several strong monthly increases, but employment in the durables group edged up.

According to advance Census figures, total retail sales were unchanged in June after declining marginally in May. Sales of nondurable goods were essentially unchanged in May and June, following very large increases over earlier months. But unit sales of new autos continued at a near record pace in June, edging up to an 11.8 million unit annual rate. Sales of domestic models rose moderately, while imports fell back after two record-breaking months.

Inventory accumulation has accelerated considerably in recent months. The book value of manufacturers inventories rose at a \$25 billion annual rate in May--the largest monthly rise in 2-1/2 years. A large part of the May increase was in finished goods inventories. With shipments declining slightly, the ratio of inventories to sales rose a bit but remained low by historical standards. For manufacturing and trade combined, inventory investment now appears likely to be considerably larger in the second quarter than in the first, especially in nondurables.

Residential construction has continued to be a source of strength. At a 1.93 million unit annual rate in May, total private housing starts were slightly above the advanced April level and 9 per cent above the rate of the fourth and first quarters. Single-family starts continued to be the primary source of strength; multifamily starts have not yet evidenced a sustained expansion, even though rental market conditions have improved.

It now appears that business fixed investment in the second quarter was not as strong as indicated earlier. In May, new orders for nondefense capital goods were unchanged and the dollar value of commercial and industrial building contracts fell for a second consecutive month.

Spending by State and local governments, which began to strengthen early this year, has continued to rise at a brisk pace. The value of construction put-in-place increased more than \$2 billion in May to a level that was \$4 billion above the first quarter average. Employment growth has also strengthened in this sector.

Price increases have moderated in recent months. The May rise in the Consumer Price Index was 0.6 per cent--below the rate of increase earlier in the year but still higher than in 1976. Wholesale prices in June fell 0.6 per cent, reflecting declines of 6.3 per cent for farm products and 1.7 per cent for processed foods. Industrial commodities prices rose 0.3 per cent in June, well below the average rate of increase recorded since last summer.

Outlook. Growth in real GNP during the second quarter is still estimated to have been at about a 6-3/4 per cent annual rate--close to the strong gain reported for the first quarter. Upward revisions in our estimates of residential construction outlays and inventory accumulation were about offset by reductions in goods consumption and nonresidential construction. Our estimate of the GNP

deflator for the second quarter was raised, largely because of faster-than-expected increases in costs of residential construction.

Fiscal policy assumptions made by the staff for this projection are essentially the same as those incorporated last month. The energy assumptions remain consistent with the bill recently reported by the House Ways and Means Committee. The staff assumes that growth in the narrowly defined money stock, M_1 , will be at a 5-1/2 per cent annual rate from 1977-II to 1978-IV. Short-term interest rates are still projected to rise, but the anticipated increase is smaller than previously projected.

This month the projection period has been extended through the end of 1978. Real GNP is projected to grow at an annual rate of 5-1/2 per cent during the second half of this year, and to ease to annual rates of just over 5 and 4-1/2 per cent, respectively, in the first and second halves of 1978. The pattern of slowing basically reflects an assumption of only moderate gains in business fixed investment and inventory accumulation next year and expectations of a decline in real housing outlays as starts slow in response to a tightening of mortgage market conditions. In this environment, income growth is expected to moderate and consumption is projected to show only modest gains. The savings rate is projected to rise from the current unusually low level to a rate a little above 6 per cent in 1978.

Nevertheless, growth in activity should be sufficient to continue to reduce unemployment gradually to 6-1/4 per cent by the end of 1978. Productivity gains are projected to average 2-1/4 per cent in 1978--a little under the postwar average--and with compensation rising faster--in part because of minimum wage increases and social security and unemployment insurance tax increases--labor cost increases are projected to average more than 6 per cent during 1978.

Price increases are still projected to slow from the accelerated pace in the second quarter of 1977, with the reductions concentrated in the food component. However, over the six quarters ending in 1978-IV, increases in the fixed-weighted price index for gross business product are still expected to average 6-1/4 per cent, considerably above the 4-1/2 per cent rate in 1976. Although it is anticipated that price rises will be especially rapid in the construction sector, the pressures of increasing unit labor costs leave little room for moderation of price increases elsewhere.

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

STAFF GNP PROJECTIONS

Per cent changes, annual rate								
	Nominal GNP		Real		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	6/15/77	7/13/77	6/15/77	7/13/77	6/15/77	7/13/77	6/15/77	7/13/77
1974 ^{1/}	8.2	8.2	-1.7	-1.7	10.2	10.2	5.6	5.6
1975 ^{1/}	7.3	7.3	-1.8	-1.8	9.3	9.3	8.5	8.5
1976 ^{1/}	11.6	11.6	6.1	6.1	5.2	5.2	7.7	7.7
1977	11.3	11.6	5.1	5.3	6.3	6.5	6.9	7.0
1978	--	11.8	--	5.3	--	6.2	--	6.4
1977-I ^{1/}	12.2	13.0	6.4	6.9	6.5	6.5	7.4	7.4
1977-II	14.2	14.6	6.6	6.7	7.1	7.6	6.9	7.0
1977-III	12.3	12.3	5.6	5.5	5.8	5.9	6.8	6.9
1977-IV	12.3	12.7	5.5	5.6	5.8	5.9	6.7	6.7
1978-I	11.9	11.8	5.5	5.4	6.2	6.3	6.6	6.6
1978-II	11.3	10.9	5.4	5.0	6.0	6.0	6.5	6.5
1978-III	--	10.7	--	4.5	--	6.2	--	6.4
1978-IV	--	11.4	--	4.5	--	6.3	--	6.3
Change:								
76-II to 77-II	10.8	11.1	4.9	5.0	5.7	5.9	-.5	-.4
76-IV to 77-IV	12.8	13.2	6.0	6.2	6.3	6.5	-1.2	-1.2
77-II to 78-II	12.0	11.9	5.5	5.4	6.0	6.0	-.4	-.5
77-IV to 78-IV	--	11.2	--	4.9	--	6.1	--	-.4

^{1/} Actual

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

	1977				1978			
	I	II	III	IV	Projected I	II	III	IV
Gross National Product	1799.3	1861.8	1916.5	1974.7	2030.4	2083.6	2137.1	2195.8
Final purchases	1785.5	1841.6	1894.3	1950.0	2002.2	2051.9	2104.4	2162.1
Private	1407.0	1452.4	1493.0	1534.7	1575.9	1613.8	1654.7	1700.5
Excluding net exports	1413.2	1457.0	1495.2	1533.7	1577.2	1618.8	1661.2	1706.9
Personal consumption expenditures	1159.1	1189.5	1215.2	1243.0	1276.1	1309.4	1343.6	1380.3
Goods	638.7	656.5	670.1	685.4	704.5	723.8	743.6	765.2
Services	520.4	533.0	545.1	557.6	571.6	585.6	600.0	615.1
Gross private domestic investment	267.9	287.7	302.2	315.4	329.3	341.1	350.3	360.3
Residential construction	80.2	88.9	95.9	100.9	105.2	107.2	108.7	110.2
Business fixed investment	173.9	178.6	184.1	189.8	195.9	202.2	208.9	216.4
Change in business inventories	13.8	20.2	22.2	24.7	28.2	31.7	32.7	33.7
Nonfarm	13.0	19.7	22.2	24.7	28.2	31.7	32.7	33.7
Net exports of goods and services ^{1/}	-6.2	-4.6	-2.2	1.0	-1.3	-5.0	-6.5	-6.4
Exports	171.4	176.2	180.2	185.8	193.0	199.5	205.9	211.1
Imports	177.6	180.8	182.4	184.8	194.3	204.5	212.4	217.5
Gov't. purchases of goods and services	378.5	389.2	401.3	415.3	426.3	438.1	449.7	461.6
Federal ^{2/}	138.2	140.5	145.2	151.8	155.0	159.0	163.1	167.6
State and local	240.3	248.7	256.1	263.5	271.3	279.1	286.6	294.0
Gross national product in constant (1972) dollars	1302.0	1323.1	1341.1	1359.4	1377.4	1394.4	1410.0	1425.5
Personal income	1464.0	1508.8	1546.2	1590.4	1628.1	1668.0	1712.9	1759.0
Wage and salary disbursements	947.1	979.5	1003.5	1033.9	1059.9	1085.9	1112.6	1142.8
Disposable income	1245.8	1289.8	1325.2	1362.1	1401.2	1433.6	1465.3	1502.1
Saving rate (per cent)	4.8	5.6	6.2	6.6	6.8	6.6	6.2	6.1
Corporate profits with I.V.A. and C.C. Adj.	117.9	128.1	137.7	145.4	146.3	153.6	158.9	165.5
Corporate profits before tax	160.0	169.9	175.2	179.9	178.3	184.6	188.9	195.5
Federal government surplus or deficit (-) (N.I.A. basis)	-41.2	-40.1	-49.4	-52.4	-53.8	-49.7	-43.3	-36.6
High employment surplus or deficit (-)	8.8	2.9	-7.3	-12.3	-11.4	-8.5	-2.4	2.8
State and local government surplus or deficit (-) (N.I.A. basis)	20.2	18.8	23.1	24.0	23.8	22.4	20.3	18.2
Excluding social insurance funds	6.3	4.4	8.1	8.4	7.8	5.9	3.3	.7
Civilian labor force (millions)	96.1	97.2	97.8	98.3	98.9	99.5	100.0	100.6
Unemployment rate (per cent)	7.4	7.0	6.9	6.7	6.6	6.5	6.4	6.3
Nonfarm payroll employment (millions)	80.9	81.9	82.4	83.1	83.8	84.4	85.0	85.6
Manufacturing	19.3	19.6	19.7	19.9	20.2	20.5	20.7	20.9
Industrial production (1967=100)	133.5	137.7	139.7	142.1	145.1	148.2	150.9	153.4
Capacity utilization: all manufacturing (per cent)	81.0	83.0	83.5	84.3	85.5	86.7	87.5	88.3
Materials (per cent)	80.2	82.6	83.1	84.0	85.1	86.3	87.0	87.7
Housing starts, private (millions, A.R.)	1.76	1.94	1.98	2.00	2.00	2.00	1.95	1.90
Sales new autos, (millions, A.R.)	11.12	11.70	11.70	11.65	11.70	11.80	11.80	11.80
Domestic models	9.28	9.34	9.70	9.75	9.80	9.90	9.90	9.90
Foreign models	1.84	2.36	2.00	1.90	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	54.2	62.5	54.7	58.2	55.7	53.2	53.5	58.7
Inventory change	12.1	6.5	2.0	2.5	3.5	3.5	1.0	1.0
Final purchases	42.1	56.1	52.7	55.7	52.2	49.7	52.5	57.7
Private	39.8	45.4	40.6	41.7	41.2	37.9	40.9	45.8
Net exports	-10.4	1.6	2.4	3.2	-2.3	-3.7	-1.5	.1
Excluding net exports	50.2	43.8	38.2	38.5	43.5	41.6	42.4	45.7
Personal consumption expenditures	37.1	30.4	25.7	27.8	33.1	33.3	34.2	36.7
Goods	20.7	17.8	13.6	15.3	19.1	19.3	19.8	21.6
Services	16.4	12.6	12.1	12.5	14.0	14.0	14.4	15.1
Residential consumption expenditures	4.7	8.7	7.0	5.0	4.3	2.0	1.5	1.5
Business fixed investment	8.3	4.7	5.5	5.7	6.1	6.3	6.7	7.5
Government	2.3	10.7	12.1	14.0	11.0	11.8	11.6	11.9
Federal	-.7	2.3	4.7	6.6	3.2	4.0	4.1	4.5
State and local	2.9	8.4	7.4	7.4	7.8	7.8	7.5	7.4
GNP in constant (1972) dollars	21.6	21.1	17.9	18.4	17.9	17.0	15.5	15.6
Final purchases	13.4	17.3	17.2	16.4	15.7	14.6	14.9	14.8
Private	16.3	13.7	12.8	13.0	12.7	11.0	11.7	13.6
	----- In Per Cent Per Year ^{1/} -----							
Gross National Product	13.0	14.6	12.3	12.7	11.8	10.9	10.7	11.4
Final purchases	10.0	13.2	11.9	12.3	11.1	10.3	10.6	11.4
Private	12.2	13.5	11.7	11.6	11.2	10.0	10.5	11.5
Personal consumption expenditures	13.9	10.9	8.9	9.5	11.1	10.9	10.9	11.4
Goods	14.1	11.6	8.5	9.5	11.6	11.4	11.4	12.1
Services	13.7	10.1	9.4	9.5	10.4	10.2	10.2	10.5
Gross private domestic investment	48.2	33.1	21.7	18.7	18.8	15.1	11.2	11.9
Residential construction	27.5	51.0	35.4	22.5	18.2	7.8	5.7	5.6
Business fixed investment	21.7	11.2	12.9	13.0	13.5	13.5	13.9	15.2
Gov't. purchases of goods and services	2.5	11.8	13.0	14.7	11.0	11.5	11.0	11.0
Federal	-1.9	6.9	14.1	19.5	8.7	10.7	10.7	11.5
State and local	5.1	14.7	12.4	12.1	12.4	12.0	11.2	10.7
GNP in constant (1972) dollars	6.9	6.7	5.5	5.6	5.4	5.0	4.5	4.5
Final purchases	4.3	5.5	5.3	5.0	4.8	4.4	4.4	4.3
Private	6.6	5.4	5.0	5.0	4.8	4.1	4.3	5.0
GNP implicit deflator ^{2/}	5.7	7.5	6.4	6.7	6.1	5.6	5.9	6.7
Gross business product fixed-weighted price index ^{3/}	6.5	7.6	5.9	5.9	6.3	6.0	6.2	6.3
Personal income	12.4	12.8	10.3	11.9	9.8	10.2	11.2	11.2
Wage and salary disbursements	11.8	14.4	10.2	12.7	10.4	10.2	10.2	11.3
Disposable income	10.0	14.9	11.4	11.6	12.0	9.6	9.1	10.4
Corporate profits before tax	15.9	27.1	13.0	11.1	-3.5	14.9	9.7	14.6
Nonfarm payroll employment	4.2	4.8	2.5	3.4	3.3	2.9	3.0	2.9
Manufacturing	5.3	6.0	3.4	4.3	4.9	5.7	4.7	4.0
Nonfarm business sector								
Output per hour	4.1	2.3	2.7	2.6	2.5	2.1	2.1	2.0
Compensation per hour	10.3	8.6	7.9	7.9	10.6	8.1	8.1	8.2
Unit labor costs	6.0	6.3	5.2	5.3	8.1	6.0	6.0	6.2
Industrial production	5.3	12.3	5.9	7.1	8.8	8.9	7.3	6.8
Housing starts, private	-2.2	47.6	8.5	4.1	.0	.0	-9.6	-9.9
Sales new autos	52.9	22.6	.0	-1.7	1.7	3.5	.0	.0
Domestic models	54.8	2.6	16.3	2.1	2.1	4.1	.0	.0
Foreign models	43.9	170.6	-48.4	-18.5	.0	.0	.0	.0

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

^{2/} Excluding Federal pay increases rates of change are: 1977-I, 5.6 per cent; 1977-IV, 6.1 per cent; 1978-I, 6.0 per cent; 1978-IV, 6.7 per cent.

^{3/} Using expenditures in 1972 as weights.

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

	1971	1972	1973	1974	1975	1976	Projected	
							1977	1978
Gross National Product	1063.4	1171.1	1306.6	1413.2	1516.3	1691.6	1888.1	2111.7
Final purchases	1057.1	1161.7	1288.6	1402.5	1531.0	1679.7	1867.9	2080.1
Private	823.4	908.6	1019.1	1099.2	1192.0	1314.1	1471.8	1636.2
Excluding net exports	821.8	911.9	1012.0	1091.7	1171.5	1307.5	1474.8	1641.0
Personal consumption expenditures	668.2	733.0	809.9	887.5	973.2	1079.7	1201.7	1327.3
Goods	374.8	410.5	457.5	497.8	540.8	596.9	662.7	734.3
Services	293.4	322.4	352.3	389.6	432.4	482.8	539.0	593.1
Gross private domestic investment	160.0	188.3	220.0	215.0	183.7	239.6	293.3	345.2
Residential construction	49.6	62.0	66.1	55.1	51.2	67.7	91.5	107.8
Business fixed investment	104.1	116.8	136.0	149.2	147.1	160.0	181.6	205.8
Change in business inventories	6.4	9.4	17.9	10.7	-14.6	11.9	20.2	31.6
Nonfarm	5.1	8.8	14.7	12.2	-17.6	11.9	19.9	31.6
Net exports of goods and services	1.6	-3.3	7.1	7.5	20.5	6.6	-3.0	-4.8
Exports	65.6	72.7	101.6	144.4	148.1	162.7	178.4	202.4
Imports	64.0	75.9	94.4	136.9	127.6	156.0	181.4	207.2
Gov't. purchases of goods and services	233.7	253.1	269.5	303.3	339.0	365.6	396.1	443.9
Federal	96.2	102.1	102.2	111.6	124.4	133.4	143.9	161.2
State and local	137.5	151.0	167.3	191.6	214.5	232.2	252.1	282.7
Gross national product in constant (1972) dollars	1107.5	1171.1	1235.0	1214.0	1191.7	1264.7	1331.4	1401.8
Personal income	859.1	942.5	1052.4	1153.3	1249.7	1375.3	1527.4	1692.0
Wage and salary disbursements	579.4	633.8	701.3	765.0	806.7	890.4	991.0	1100.3
Disposable income	742.8	801.3	901.7	982.9	1080.9	1181.7	1305.7	1450.6
Saving rate (per cent)	7.7	6.2	7.8	7.3	7.8	6.5	5.8	6.4
Corporate profits with I.V.A. and C.C. Adj.	77.2	92.1	99.1	84.8	91.6	117.8	132.3	156.1
Corporate profits before tax	82.0	96.2	115.8	127.6	114.5	147.9	171.3	186.8
Federal government surplus or deficit (-) (N.I.A. basis)	-22.0	-17.3	-6.7	-11.5	-71.2	-58.6	-45.8	-45.9
High employment surplus or deficit (-)	-5.3	-5.9	-7	16.8	-17.2	-11.2	-2.0	-4.9
State and local government surplus or deficit (-) (N.I.A. basis)	3.7	13.7	13.0	7.3	6.9	14.0	21.5	21.2
Excluding social insurance funds	-3.8	5.6	4.1	-2.8	-5.1	.9	6.8	4.4
Civilian labor force (million)	84.1	86.5	88.7	91.0	92.6	94.8	97.3	99.7
Unemployment rate (per cent)	6.0	5.6	4.9	5.6	8.5	7.7	7.0	6.4
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	20.6
Industrial production (1967=100)	109.6	119.7	129.8	129.3	117.8	129.8	138.2	149.4
Capacity utilization: all manufacturing (per cent)	78.0	83.1	87.5	84.2	73.6	80.1	82.9	87.0
Materials (per cent)	83.1	88.0	92.4	87.7	73.6	80.3	82.5	86.5
Housing starts, private (millions, A.R.)	2.05	2.36	2.05	1.33	1.16	1.54	1.92	1.96
Sales new autos (millions, A.R.)	10.24	10.93	11.42	8.91	8.66	10.12	11.54	11.77
Domestic models	8.68	9.32	9.65	7.49	7.08	8.63	9.52	9.87
Foreign models	1.56	1.61	1.77	1.42	1.58	1.50	2.03	1.90

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CLASS II FOMCCHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1971	1972	1973	1974	1975	1976	Projected	
							1977	1978
-----Billions of Dollars-----								
Gross National Product	81.0	107.7	135.5	106.6	103.1	175.3	196.5	223.6
Inventory change	2.6	3.0	8.5	-7.2	-25.3	26.5	8.3	11.4
Final purchases	78.5	104.6	126.9	113.9	128.5	148.7	188.2	212.3
Private	63.7	85.2	110.5	80.1	92.8	122.1	157.7	164.4
Net exports	-2.3	-4.9	10.4	.4	13.0	-13.9	-9.6	-1.8
Excluding net exports	66.0	90.1	100.1	79.7	79.8	136.0	167.3	166.2
Personal consumption expenditures	49.4	64.8	76.9	77.6	85.7	106.5	122.0	125.7
Goods	25.2	35.7	47.0	40.3	43.0	56.1	65.8	71.6
Services	24.3	29.0	29.9	37.3	42.8	50.4	56.2	54.1
Residential fixed investment	13.0	12.4	4.1	-11.0	-3.9	16.5	23.8	16.4
Business fixed investment	3.6	12.7	19.2	13.2	-2.1	12.9	21.6	24.2
Government	14.8	19.4	16.4	33.8	35.7	26.6	30.5	47.9
Federal	.6	5.9	.1	9.4	12.8	9.0	10.5	17.3
State and local	14.3	13.5	16.3	24.3	22.9	17.7	19.9	30.6
GNP in constant (1972) dollars	32.2	63.6	63.9	-21.0	-22.3	73.0	66.7	70.4
Final purchases	29.9	60.8	56.8	-13.0	-1.8	52.9	61.9	63.0
Private	30.7	57.1	57.4	-16.9	-6.4	49.8	57.9	49.8
-----In Per Cent Per Year-----								
Gross National Product	8.2	10.1	11.6	8.2	7.3	11.6	11.6	11.8
Final purchases	8.0	9.9	10.9	8.8	9.2	9.7	11.2	11.4
Private	8.4	10.3	12.2	7.9	8.4	10.2	12.0	11.2
Personal consumption expenditures	8.0	9.7	10.5	9.6	9.7	10.9	11.3	10.5
Goods	7.2	9.5	11.4	8.8	8.6	10.4	11.0	10.8
Services	9.0	9.9	9.3	10.6	11.0	11.7	11.6	10.0
Gross private domestic investment	13.6	17.7	16.8	-2.3	-14.6	30.5	22.4	17.7
Residential structures	35.5	25.1	6.6	-16.7	-7.1	32.4	35.2	17.9
Business fixed investment	3.6	12.3	16.4	9.7	-1.4	8.7	13.5	13.4
Jov't. purchases of goods & services	6.8	8.3	6.5	12.5	11.8	7.9	8.3	12.1
Federal	.6	6.1	.1	9.2	11.5	7.2	7.9	12.0
State and local	11.6	9.8	10.8	14.5	11.9	8.2	8.6	12.1
GNP in constant (1972) dollars	3.0	5.7	5.5	-1.7	-1.8	6.1	5.3	5.3
Final purchases	2.8	5.5	4.9	-1.1	-.1	4.4	4.9	4.8
Private	3.7	6.7	6.3	-1.7	-.7	5.3	5.8	4.7
GNP implicit deflator	5.1	4.1	5.8	10.0	9.3	5.1	6.0	6.2
Gross business product fixed-weighted price index ^{1/}	4.4	3.3	5.7	10.2	9.3	5.2	6.5	6.2
Personal income	7.2	9.7	11.7	9.6	8.4	10.1	11.1	10.8
Wage and salary disbursements	6.0	9.4	10.7	9.1	5.5	10.4	11.3	11.0
Disposable income	8.3	7.9	12.5	9.0	10.0	9.3	10.5	11.1
Corporate profits before tax	14.7	17.3	20.4	10.2	-10.3	29.2	15.8	9.1
Nonfarm payroll employment	.4	3.5	4.3	2.0	-1.7	3.0	3.4	3.2
Manufacturing	-3.6	2.7	5.2	-.5	-8.5	3.8	3.2	5.1
Nonfarm business sector								
Output per hour	2.9	3.0	1.7	-3.5	1.6	3.7	2.4	2.4
Compensation per hour	6.6	5.8	7.8	9.4	9.5	7.4	8.3	8.7
Unit labor costs	3.5	2.7	6.0	13.4	7.7	3.6	5.9	6.3
Industrial production	1.7	9.2	8.4	-.4	-8.9	10.2	6.5	8.1
Housing starts	43.4	15.1	-13.1	-35.1	-12.2	32.8	24.7	2.2
Sales new autos	21.9	6.7	4.5	-22.0	-2.8	16.9	14.0	2.0
Domestic models	21.9	7.4	3.5	-22.4	-5.5	21.9	10.3	3.7
Foreign models	21.9	3.2	9.9	-19.8	11.3	-5.1	35.3	-6.4

^{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			1978		
								I*	II	III	IV	I	II	III			
Unified budget receipts <u>3/</u>	299.2	358.3	358.3	401.4	397.0	396.3	317.6	367.9	79.0	109.8	93.3	85.8	86.5	119.7	105.0		
Unified budget outlays <u>3/</u>	365.7	406.4	403.7	462.9	456.8	461.0	374.2	413.7	97.6	102.8	104.3	109.0	109.5	116.3	122.0		
Surplus(+)/Deficit(-), unified budget	-66.5	-48.1	-45.4	-61.5	-59.8	-64.7	-56.6	-45.8	-18.7	7.0	-11.0	-23.2	-23.0	3.4	-17.0		
Surplus(+)/Deficit(-), off-budget agencies <u>4/</u>	-7.3	-10.1	-10.1	-7.7	-6.8	n.a.	-5.7	-10.3	-4.3	.3	-6.6	.3	-3.0	.3	-4.4		
Means of financing combined deficits:																	
Net borrowing from public	82.9	n.a.	46.4	n.a.	66.0	n.a.	69.0	50.6	17.6	-1.1	12.5	21.6	24.5	-2.2	22.1		
Decrease in cash operating balance	-7.2	n.a.	5.3	n.a.	1.1	n.a.	-3.2	.7	2.6	-7.3	4.2	1.1	0	0	0		
Other <u>5/</u>	-1.9	n.a.	4.0	n.a.	-5	n.a.	-3.5	5.0	2.7	1.1	1.0	.2	1.5	-1.5	-.7		
Cash operating balance, end of period	14.8	n.a.	12.1	n.a.	11.0	n.a.	11.7	11.0	9.0	16.3	12.1	11.0	11.0	11.0	11.0		
Memo: Sponsored agency borrowing <u>6/</u>	3.4	n.a.	5.4	n.a.	n.e.	n.a.	2.9	6.6	.7	2.5	1.8	1.6	n.e.	n.e.	n.e.		
NIA Budget									Seasonally adjusted, annual rates								
Receipts	313.6	n.a.	366.3 ^{2/}	n.a.	413.8	n.a.	330.3	378.8	366.4	374.4	381.2	393.0	406.0	419.1	437.1		
Outlays	373.0	n.a.	414.6	n.a.	463.6	n.a.	388.9	424.5	407.6	414.5	430.6	445.4	459.8	468.8	480.4		
Purchases (total)	127.2	n.a.	140.7	n.a.	157.2	n.a.	133.4	143.9	138.2	140.5	145.2	151.8	155.0	159.0	163.1		
Defense	85.8	n.a.	92.5	n.a.	102.1	n.a.	88.2	94.4	91.5	92.5	94.7	99.0	101.2	103.2	105.0		
Non-defense	41.4	n.a.	48.2	n.a.	55.1	n.a.	45.2	49.5	46.7	48.0	50.5	52.8	53.8	55.8	58.1		
All other outlays	245.8	n.a.	273.9 ^{2/}	n.a.	306.4	n.a.	255.5	280.6	269.4	274.0	285.4	293.6	304.8	309.8	317.3		
Surplus(+)/Deficit(-)	-59.4	n.a.	-48.3 ^{2/}	n.a.	-49.8	n.a.	-58.6	-45.8	-41.2	-40.1	-49.4	-52.4	-53.8	-49.7	-43.3		
High Employment Surplus(+)/Deficit(-) (NIA basis) <u>8/</u>	-14.7	n.a.	-1.0	n.a.	-8.7	n.a.	-11.2	-2.0	8.8	2.9	-7.3	-12.3	-11.4	-8.5	-2.4		

- *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' First Concurrent Resolution on the Budget (May 17, 1977).
3/ Earned income credit payments in excess of an individual's tax liability, formerly treated as outlays, are now classified as income tax refunds.
4/ 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.
5/ Checks issued less checks paid, accrued items and other transactions.
6/ Includes Federal Home Loan Banks, FNMA, Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.
7/ Quarterly average exceeds fiscal year total by \$.8 billion for FY 1977 due to spreading of wage base effect over calendar year.
8/ 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 GNP projection continues to assume passage of an energy package similar to the bill recently reported by the House Ways and Means Committee. Our budget projections now foresee a unified deficit of \$45-1/2 billion for fiscal year 1977, about \$1-1/2 billion lower than last month. Receipts remain unchanged from the June forecast but fiscal 1977 outlays have been lowered from \$405-1/2 billion to \$404 billion because of an unexpectedly large (mid-June) sale of offshore oil leases and some further weakness in Federal spending during the months of May and June.

The combined deficit (unified plus off-budget) is projected to be \$18 billion during the current quarter. The Treasury is expected to meet its cash needs by running down its \$16.3 billion end-of-June cash balance to \$12 billion, by issuing \$10 billion in marketable and \$2 billion in nonmarketable securities, and by relying on other miscellaneous sources of financing.

For fiscal 1978, the unified deficit is now forecast at \$60 billion, down \$2-1/2 billion from last month. Projected receipts have been revised upward by \$2 billion mainly in response to higher estimates of corporate profits. Estimates of fiscal year 1978 outlays are essentially unchanged at \$457 billion, \$6 billion below the Administration's most recent forecast. (See Appendix A.) Our outlay projection anticipates a spending shortfall of approximately \$8

billion, about in line with the shortfalls experienced in the two previous fiscal years. However, higher interest outlays are expected to offset about \$2 billion of the spending shortfall.

The full employment budget, after registering a \$9 billion deficit in the last half of fiscal 1976, shifted sharply to a \$6 billion surplus in the first half of 1977. Higher estate and gift taxes resulting from the 1976 Tax Reform Act and the slow pace of Federal spending were mainly responsible for this movement. The full employment budget is expected to return to a \$10 billion deficit in both 1977 H:2 and 1978 H:1, when the pace of Federal spending picks up from the public works and employment programs and when the higher refunds resulting from the 1977 Tax Act are mailed to taxpayers. With no new fiscal initiatives and continued growth in receipts, the full employment budget is projected to return to balance in the last half of 1978.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. Despite a pick-up in total credit demands in June, most interest rates have changed little since the last FOMC meeting, reflecting stability in the Federal funds rate and the expectations engendered by moderate growth in the monetary aggregates. Primary mortgage rates, however, have continued to move upward in response to strong demands in that market.

Business loans plus nonfinancial commercial paper in June grew at an annual rate of nearly 18 per cent, part of which may have been to finance record corporate tax payments. Industrial corporations continued to substitute short-term for long-term credit. Nonetheless, there was an appreciable increase in public bond volume, largely accounted for by new offerings of domestic financial concerns and public utilities, and foreign issuers.

In the household sector, borrowing apparently has continued near the recent strong pace. The latest data available on consumer instalment loans indicate only a slight slackening of extensions in May from the previous advanced rate. Mortgage commitments outstanding at S&Ls have remained at the peak level reached earlier, while mortgage holdings of these institutions rose by a record amount. Mortgage acquisitions by commercial banks have been increasing vigorously as well.

The Treasury continued net pay-downs of marketable debt in June, though by smaller amounts than in May. The emphasis has remained on debt lengthening, as indicated by the \$1.5 billion sale in late June of 15-year bonds, all for new money. Over the second quarter, the Treasury reduced outstanding bills by \$9.1 billion, while increasing outstanding marketable notes and bonds by \$4.1 billion.

In the State and local securities market, a record \$5.7 billion of bond offerings in June and increased issues of short-term debt were absorbed by investors at little change in interest rates. State and local units persisted in substantial advance refundings, channelling the proceeds into special nonmarketable Treasury issues.

In June, deposit flows into thrift institutions remained at about the average pace for the two preceding months. At commercial banks, however, there was a net outflow of savings deposits; yields on some open market instruments recently have been above rate ceilings on those accounts. Growth in large denomination time deposits meanwhile accelerated, more than replacing outflows from savings accounts.

Outlook. Credit demands of the private sector and of State and local governments in the second half of the year are not likely to be significantly stronger than in the first half of 1977. However, the Treasury budget position is expected to deteriorate more than seasonally--moving from a combined surplus of \$7.6 billion in the

second quarter, to a deficit of around \$17.6 billion and \$27.6 billion in the third and fourth quarters, respectively.

In the State and local sector, bond issuance may edge downward from the recent record rate, given the advance refundings completed by some major units and the other anticipatory borrowing that apparently was undertaken in expectation of rising interest rates. Nevertheless, debt issuance by State and local governments in the summer and fall is likely to remain quite large by historical standards.

The corporate financing gap--i.e., the difference between capital outlays and internally generated funds--which had widened in the first half of 1977, is not expected to increase further over the balance of the year. Thus, aggregate business credit demands are not likely to strengthen further.

With the growth in consumer spending projected to moderate in coming months, instalment credit will probably expand somewhat less rapidly than in the first half of the year. Household demands for mortgages, however, are likely to remain quite large.

Although private and State and local credit demands are not likely to strengthen appreciably, the staff expects market rates to rise somewhat further as the year progresses, largely as a result of increased Treasury credit market demands and greater demands of the public

for transactions balances as the economic expansion continues. Increases probably would be concentrated in short-term rates, since the availability of funds for long-term investments is likely to remain ample, given large projected cash flows for life and casualty companies and pension funds.

At depository institutions, inflows of short-term, small denomination time and savings deposits may slow in line with the rise in short-term rates. Nevertheless, such institutions should have little difficulty in retaining the bulk of the \$27 billion in "wild card" certificates that mature in summer and early fall--given the large differential between rate ceilings on long-term deposits and open market rates of interest. Some funds from maturing "wild card" accounts, though, may shift on balance from commercial banks to thrifts, because of the higher rates offered by the latter institutions. As a result, commercial banks, which have already faced some erosion in the growth of small denomination time and savings deposits, may have to rely more heavily on large denomination deposits and non-deposit sources of funds.

INTERNATIONAL DEVELOPMENTS

Summary. Following more than a year of general stability, the average value of the dollar against major foreign currencies has depreciated one per cent since the end of June. By mid-July, the value of the dollar had receded to the level prevailing in March 1976.

The dollar weakened against all major currencies (except the Canadian dollar), with depreciations exceeding 3 per cent against the Japanese, German and Swiss currencies. Since the beginning of last December, the yen has appreciated against the dollar by about 13 per cent, and it is currently at its highest rate against the dollar in 4 years.

Recent exchange-market developments to some extent are a continuation of earlier trends (especially vis-à-vis the yen)

More fundamentally, the pressure on the dollar probably reflects some upward revisions in expectations of the likely size of the U.S. current-account deficit in the near term, at a time when Japan, Germany, Switzerland, and the Netherlands are continuing to record sizable trade and current-account surpluses. The intensification of pressure against the dollar in recent weeks was triggered by public

statements by officials supporting the view that appreciations of currencies by countries with strong current-account positions would be appropriate.

The Spanish exchange markets were closed on July 11 prior to that day's announcement of a 20 per cent devaluation of the peseta, as part of an economic stabilization program. The package, announced by the newly-elected government, seeks to deal with Spain's serious domestic and external economic problems. The Swedish krona continued to be subject to downward pressure in the EC snake.

The U.S. trade deficit in May declined to a \$21 billion annual rate from the high \$34 billion rate recorded in April. The average April-May rate of deficit was nearly \$28 billion, similar to the rate in the first quarter. The reduction in the May trade deficit was primarily attributable to a sharp rise in agricultural exports (in large part due to a rise in unit values) and a fall-off in petroleum imports. Non-agricultural exports were unchanged; these have been flat since the third quarter of last year, reflecting the moderate pace of economic expansion abroad, and particularly sluggish investment. Non-fuel imports advanced slightly, with industrial supplies, non-durable consumer goods, and automotive imports recording the largest increases.

Foreign official reserve assets in the United States increased by \$1.6 billion, while private capital flows for which data are currently available recorded a small net inflow in May. Total net private capital inflow through May amounted to nearly \$2 billion at an annual rate

compared with a net outflow of \$14.6 million for the full year 1976. The major components of this shift include a change in bank-reported private transactions from a net-lender position last year to a net-borrower position this year; a decline in new issues of foreign securities (mainly by Canada); and an increase in net sales of U.S. securities. Some of these shifts in private capital flows are associated with the continued easing of short-term foreign interest rates relative to U.S. rates through May, as well as credit demands associated with the relatively more favorable outlook for U.S. than foreign economic activity.

Outlook. Recent production data indicate that the pace of economic expansion abroad has slowed from the rates recorded in recent quarters. The staff expects the pace of expansion to resume in the second half of this year and to continue into 1978. For the major foreign countries combined, we currently project real GNP to grow by 4-1/2 per cent from the fourth quarter of 1976 to the fourth quarter of 1977 and by 5 per cent over the subsequent four quarters. There is considerable uncertainty regarding these projections, and even if these rates of growth are achieved, they will do little to reduce prevailing high levels of unemployment and excess capacity.

The moderate pace of foreign activity projected through 1978 is expected to result in a correspondingly moderate advance of U.S. exports for the projection period. The volume of non-agricultural exports is expected to reattain its previous 1974 peak by the end of 1977 and is projected to advance at a 7 per cent rate next year. Imports of petroleum and products are projected to decline in value in the second half of

1977, reflecting the expected initial shipments from Alaska and the working-down of stocks built-up in anticipation of the mid-year OPEC price increase. Subsequently, imports of petroleum and products are projected to resume their past growth path, as a result of rising consumption and increased imports for the Government strategic stockpile program.

Given present policies and projections for activity and prices here and abroad, the staff now expects a trade deficit of about \$25 billion for the full year 1977, that would increase further next year to almost \$30 billion. The associated current-account deficits are expected to reach about \$15 and \$19 billion respectively. It is the staff's judgment that, in view of continued capital inflows, deficits of these orders of magnitude will be associated with little or no further change in the weighted average value of the dollar through the projection period. One-year forward rates for the dollar continue to indicate market expectations of a small appreciation of the average value of the dollar. We expect the dollar, on average, to appreciate slightly from current levels, although we also anticipate that the yen and the mark will rise moderately further relative to the dollar in the year ahead.

CONFIDENTIAL (FR)
CLASS II FOMCU.S. Net Exports and Related Items
(seasonally adjusted annual rates)

	1976	1977p	1978p	1976		1977				1978p			
				III	IV	I	IIp	IIIp	IVp	I	II	III	IV
Billions of dollars													
Net Exports of Goods and Services (GNP basis of net exports) ^{1/}	3.7 (6.6)	-9.9 (-3.0)	-13.7 (-4.8)	3.6 (4.7)	-1.3 (4.2)	-12.7 (-6.2)	-11.2 (-4.6)	-9.2 (-2.2)	-6.6 (1.0)	-9.9 (-1.3)	-14.0 (-5.0)	-15.5 (-6.5)	-15.5 (-6.4)
Merchandise trade balance (excl. military)	-9.2	-24.9	-29.7	-11.1	-14.3	-27.9	-26.2	-24.3	-21.5	-25.1	-29.6	-32.0	-32.2
Exports (excl. military)	114.7	122.8	139.2	118.4	118.9	117.9	121.4	123.9	127.7	131.9	136.8	141.9	146.2
Agricultural	23.4	25.0	24.7	25.0	23.6	24.5	26.4	24.8	24.2	24.0	24.4	25.2	25.2
Nonagricultural	91.3	97.8	114.5	93.5	95.3	93.4	95.3	99.1	103.5	107.9	112.4	116.7	121.0
Imports	123.9	147.7	168.9	129.5	133.2	145.8	147.6	148.2	149.2	157.0	166.4	173.9	178.4
Petroleum and Products	34.6	41.0	44.7	37.6	37.4	44.3	43.3	39.7	36.8	40.1	44.0	46.8	47.8
Nonpetroleum	89.3	106.7	124.2	91.9	95.8	101.5	104.3	108.5	112.4	116.9	122.4	127.1	130.6
Military and Service Transactions, net	12.9	15.1	16.0	14.7	13.0	15.3	15.0	15.1	14.9	15.2	15.6	16.5	16.7
Military transactions, net	.4	.8	1.4	.9	.9	.3	.9	1.0	1.1	1.2	1.3	1.4	1.5
Investment income, net	9.8	12.4	13.1	10.7	9.7	12.7	12.2	12.4	12.3	12.4	12.8	13.5	13.7
Other services, net	2.7	1.9	1.5	3.1	2.4	2.3	1.9	1.7	1.5	1.6	1.5	1.6	1.5
U.S. Current Account Balance ^{2/} (excl. special transactions with Israel) ^{3/}	-1.3 (-.9)	-14.6 (-14.6)	-18.9 (-18.9)	-4.1 (-1.5)	-5.4 (-5.9)	-17.3 (-17.1)	-15.9 (-15.9)	-14.1 (-14.1)	-11.4 (-11.4)	-15.0 (-15.0)	-19.1 (-19.1)	-20.8 (-20.8)	-20.8 (-20.8)
Constant (1972) dollars													
Merchandise exports (excl. military) (% change, annual rates)	66.7 (3.4)	66.9 (0.3)	71.0 (6.1)	68.4 (13.0)	67.3 (-6.6)	66.2 (-7.0)	66.5 (2.0)	66.8 (1.6)	67.9 (6.6)	69.1 (7.8)	70.5 (8.2)	71.7 (7.4)	72.9 (6.6)
Merchandise imports (% change, annual rates)	62.8 (22.5)	69.2 (10.3)	74.7 (7.8)	64.9 (29.1)	66.1 (7.4)	70.0 (26.2)	69.8 (-1.2)	69.0 (-5.5)	68.4 (-4.0)	70.9 (15.6)	74.1 (18.8)	76.3 (12.6)	77.1 (4.1)
Foreign Outlook - Major Industrial Countries ^{4/}													
Real GNP, % change, annual rates	5.1	4.0	4.9	1.2	4.5	4.9	3.7	4.5	4.9	5.3	5.7	4.5	4.5
Wholesale Prices, % change, A.R. ^{5/}	9.5	9.8	6.9	11.7	8.7	10.8	8.7	7.4	7.0	6.6	7.0	6.6	5.7

^{1/} 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.

^{2/} Includes goods and services plus private and official remittances and pensions and U.S. Government grants.

^{3/} Excludes grants to Israel under military assistance acts and exports financed by those grants.

^{4/} 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.

^{5/} Data are largely manufactured goods prices.

^{p/} Projected.

^{e/} Estimated.

^{*} Published data.