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CONFIDENTIAL (FR)

June 14, 1978

SUMMARY AND OUTLOOK

**By the Staff
Board of Governors
of the Federal Reserve System**

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Economic activity maintained an upward path in May although the pace was more moderate than during the preceding period of rebound from severe weather and coal strike effects. Growth of employment and of industrial production moderated in May, and unemployment edged up. However, auto demand continued particularly strong. Capital goods shipments and order backlogs continued to rise through April. At the same time, inflationary pressures have remained intense, led by continued large increases in meat prices.

Growth of nonfarm payroll employment slowed to 170,000 in May, and the manufacturing workweek dropped back to the level in the second half of last year. In contrast to early this year, only about half of the industry groups reported increases in May and the bulk of the job gains were in retail trade and services. The sizable increase in the civilian labor force exceeded total employment growth as the unemployment rate edged up to 6.1 per cent. Industrial production is estimated to have increased 0.6 per cent in May, following an upward revised 1.4 per cent gain in April. Business equipment output posted another--although smaller--gain, and output of steel and other materials also increased further. Auto assemblies, however, dropped back from April's exceptionally high level.

Residential construction activity was maintained at a brisk rate through April as new private starts edged up to 2.2 million units, annual rate, reflecting increases in both single and multi-family starts.

And sales of new and existing houses rose further from the depressed rate early in the year.

Retail sales, exclusive of autos and nonconsumption items, rose 0.8 per cent in May; total retail sales were about unchanged. Although the dollar value of sales at automotive stores is reported to have declined in May, unit sales of new cars remained exceptionally high. While sales contests probably were a factor in the strength of auto demand, it also appears that consumers may be moving ahead purchases of major durable goods in anticipation of higher prices.

In the government sector, Federal spending on average appears to have continued to run short of the Administration's projections so far this quarter. At the State and local level, construction activity rebounded in April reflecting a step-up following the severe winter; the only data available for May--employment--were little changed.

Business intentions for investment outlays appear to have changed little in the past several months. The Commerce Department's April-May survey of capital spending plans indicated an 11-1/4 per cent increase in planned capital outlays for 1978--up fractionally from the February survey results. Other indicators of capital spending on balance continue to be encouraging. Manufacturers' capital appropriations, although little changed over the past half year, remain 25 per cent above a year earlier; contracts for commercial and industrial buildings remain strong. Despite declines in March and April, new orders for non-defense capital goods continue well above the fourth quarter level.

Increases in the book value of inventories have been very large in recent months. In March, total business inventories increased at an upward revised annual rate of \$65 billion, and in April business inventories, excluding retail, rose at a rate of about \$36 billion. In both months, however, an appreciable part of the rise was accounted for by stocks of foods at sharply higher prices.

The intensification of inflation this year has been dominated by exceptionally large increases in food prices along with higher service costs--particularly for home operation and financing. The May report of producer prices--taken during the second week of the month--showed a deceleration in the price rise for food and farm products, but spot prices for many of those commodities turned up again later in the month. Producer prices for consumer finished goods other than foods rose at a 9 per cent annual rate in May, largely reflecting a further rise of auto and tire prices. Capital equipment prices, which had increased at nearly a 7 per cent annual rate during the first four months of the year, accelerated to a 10 per cent rate in May in large part due to a 2 per cent hike in truck and auto prices.

Outlook. The staff estimate of second quarter real GNP growth is little changed from last month; incoming data suggest an annual rate of increase of almost 9 per cent. However, our current quarter estimate of the rise in the fixed-weighted price index has been revised up substantially from an annual rate of 7-3/4 per cent last month to 9-1/4 per

cent this month, due to a surge in prices paced by increases in foods and gas and electricity rates.

The staff projections for the year ahead have been modified in a number of respects, in part reflecting new fiscal policy assumptions. An assumed \$19 billion (annual rate) tax cut to take effect on January 1, 1979 has replaced the previous assumption of a \$25 billion cut in October. The form of the reduction remains the same, with two-thirds going to individuals. Also, the assumed starting date of the energy program has been pushed forward one quarter to October. Staff estimates of Federal outlays are \$454 billion for FY 1978 and \$499 for FY 1979--about the same as last month. We continue to assume a 5-1/4 per cent annual growth rate of M-1 through mid-1979, and interest rates are still projected to rise substantially further beginning this summer.^{1/}

Over the year ahead, through the second quarter of 1979, the staff has reduced the projected rate of real growth by half a percentage point to 3-3/4 per cent. Because of the recent burst of inflation and the intensification of underlying cost pressures, the fixed-weighted price index for gross business product is now expected to rise at an average annual rate of nearly 7-1/4 per cent, about 1/4 percentage point above last month's projection. While the reduction in the assumed fiscal

^{1/} Projected Federal funds rate ranges are shown in Appendix Table 1 of the Bluebook. The GNP projections assume interest rates toward the lower ends of those ranges.

stimulus is the major factor contributing to the lower rate of real GNP growth, the faster rate of price advance is also expected to have some inhibiting effect on activity.

Given the moderate rate of economic expansion nonfarm payroll employment growth over the next year is expected to slow to about half the rate experienced over the past year. With continued substantial expansion in the labor force expected, the unemployment rate is projected to move only marginally lower--to about 5.9 per cent--by mid-1979.

STAFF GNP PROJECTIONS

Per cent changes, annual rate								
	Nominal GNP		Real GNP		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	5/10/78	6/14/78	5/10/78	6/14/78	5/10/78	6/14/78	5/10/78	6/14/78
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 ^{1/}	10.7	10.7	4.9	4.9	6.0	6.0	7.0	7.0
1978	11.1	11.0	4.1	3.9	6.4	6.7	5.9	6.1
1977-III ^{1/}	10.2	10.2	5.1	5.1	5.0	5.0	6.9	6.9
1977-IV ^{1/}	9.9	9.9	3.8	3.8	5.4	5.4	6.6	6.6
1978-I ^{1/}	6.5	6.6	-0.6	-0.4	6.6	6.5	6.2	6.2
1978-II	17.4	18.1	9.0	8.8	7.7	9.3	5.9	6.1
1978-III	11.6	10.8	4.4	3.7	6.9	7.0	5.9	6.0
1978-IV	12.2	10.7	4.6	3.2	6.9	7.0	5.8	6.0
1979-I	11.5	12.0	4.2	4.5	7.3	7.7	5.7	5.9
1979-II	10.5	10.8	3.8	3.9	6.9	7.3	5.7	5.9
Change:								
76-IV to 77-IV ^{1/}	11.8	11.8	5.7	5.7	6.1	6.1	-1.2	-1.2
77-II to 78-II	10.9	11.1	4.3	4.3	6.1	6.5	-1.2	-1.0
77-IV to 78-IV	11.9	11.5	4.3	3.8	7.0	7.4	-0.8	-0.6
78-II to 79-II	11.4	11.1	4.3	3.8	7.0	7.3	-0.2	-0.2
Memo:								
Growth Over Annual Policy Period:								
78-I to 79-I	13.1	12.9	5.5	5.0	7.2	7.7	-0.5	-0.3

^{1/} Actual.

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

	1977		1978				1979	
	III	IV	I	II	III	IV	I	II
Gross national product	1915.9	1961.8	1993.4	2078.2	2132.4	2187.2	2250.0	2308.5
Final purchases	1892.2	1948.2	1973.7	2053.0	2106.2	2159.5	2220.5	2277.8
Private	1491.3	1534.4	1557.1	1622.9	1665.7	1705.3	1755.6	1802.2
Excluding net exports	1498.8	1552.6	1581.7	1641.3	1679.5	1719.0	1769.4	1815.7
Personal consumption expenditures	1218.9	1259.5	1281.9	1327.2	1358.9	1392.2	1435.9	1474.7
Goods	659.4	685.9	687.1	714.9	731.3	749.1	773.6	793.5
Services	559.5	573.7	594.8	612.3	627.6	643.1	662.3	681.2
Gross private domestic investment	303.6	306.7	319.5	339.3	346.8	354.5	363.0	371.7
Residential construction	92.5	99.7	100.1	104.6	105.1	105.1	105.1	105.6
Business fixed investment	187.5	193.5	199.7	209.5	215.5	221.7	228.4	235.4
Change in business inventories	23.6	13.5	19.7	25.2	26.2	27.7	29.5	30.7
Nonfarm	23.1	9.0	18.9	24.4	26.2	27.7	29.5	30.7
Net exports of goods and services <u>1/</u>	-7.5	-18.2	-24.6	-18.4	-13.8	-13.7	-13.8	-13.5
Exports	179.9	170.6	180.3	192.5	200.5	208.5	219.1	226.7
Imports	187.4	188.8	204.8	210.8	214.2	222.1	232.8	240.1
Gov't. purchases of goods and services	400.9	413.8	416.6	430.1	440.5	454.2	464.9	475.6
Federal <u>2/</u>	148.1	153.8	152.7	154.7	158.1	164.5	168.1	171.8
State and local	252.9	260.0	263.9	275.4	282.4	289.7	296.8	303.8
Gross national product in constant (1972) dollars	1347.4	1360.2	1358.8	1387.7	1400.4	1411.3	1426.9	1440.6
Personal income	1549.8	1603.0	1638.8	1691.7	1737.3	1783.0	1830.9	1876.6
Wage and salary disbursements	998.9	1029.1	1058.4	1095.6	1119.1	1146.4	1181.0	1210.3
Disposable personal income	1323.8	1368.3	1402.1	1444.2	1477.6	1517.2	1567.6	1604.7
Saving rate (per cent)	5.5	5.6	6.1	5.7	5.6	5.8	6.0	5.7
Corporate profits with I.V.A. and C.C. Adj.	149.0	144.8	126.8	148.8	157.4	158.3	158.3	162.7
Corporate profits before tax	172.8	178.3	172.2	194.9	200.1	200.7	201.2	206.1
Federal government surplus or deficit (N.I.A. basis)	-58.9	-60.0	-55.7	-41.8	-39.7	-40.3	-41.3	-36.4
High employment surplus or deficit (-)	-20.4	-22.1	-9.7	-3.8	-1.2	.5	-.8	4.6
State and local government surplus or deficit (-) (N.I.A. basis)	32.9	31.1	33.7	30.7	27.9	25.3	22.5	20.2
Excluding social insurance funds	17.4	15.4	17.6	14.1	10.8	7.7	4.4	1.6
Civilian labor force (millions)	97.6	98.6	99.2	100.2	100.7	101.2	101.8	102.3
Unemployment rate (per cent)	6.9	6.6	6.2	6.1	6.0	6.0	5.9	5.9
Nonfarm payroll employment (millions)	82.5	83.2	84.1	85.3	85.6	86.1	86.7	87.2
Manufacturing	19.6	19.8	20.1	20.2	20.3	20.4	20.7	20.9
Industrial production (1967=100)	138.4	139.3	139.7	143.6	145.6	147.5	150.3	152.4
Capacity utilization: all mfg. (per cent)	83.0	82.9	82.1	83.5	84.0	84.3	85.0	85.5
Materials (per cent)	82.3	82.2	81.7	83.8	84.4	84.8	85.9	86.5
Housing starts, private (million units, A.R.)	2.04	2.15	1.73	2.00	1.80	1.75	1.70	1.70
New autos sales, (millions, A.R.)	10.92	10.75	10.80	11.95	11.00	10.55	10.80	10.75
Domestic models	8.88	8.77	8.80	9.90	9.00	8.60	8.90	8.90
Foreign models	2.04	1.98	2.00	2.05	2.00	1.95	1.90	1.85

1/ Balance of payments data and details 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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PER CENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS
(Annual rates compounded quarterly)

	1977		1978				1979	
	III	IV	I	II	III	IV	I	II
<u>Constant (1972) dollars</u>								
Gross national product	5.1	3.8	-4	8.8	3.7	3.2	4.5	3.9
Final purchases	4.4	6.1	-1.9	7.7	3.5	3.0	4.2	3.6
Private	4.0	6.5	-1.4	7.9	3.4	2.8	4.5	3.7
Excluding net exports	2.9	9.1	-5	6.5	2.5	2.6	4.3	3.5
Personal consumption expenditures	3.0	9.3	-1.0	5.5	2.9	3.0	5.0	3.9
Goods	.9	13.8	-7.6	7.2	3.1	3.2	5.7	3.7
Services	5.4	4.3	7.5	3.5	2.6	2.8	4.3	4.1
Gross private domestic investment	7.5	-6.4	12.8	19.0	2.2	2.2	3.4	3.8
Residential structures	-.7	17.6	-5.3	9.9	-6.1	-7.8	-7.8	-6.1
Business fixed investment	3.9	4.0	5.5	12.1	4.3	4.7	5.2	5.1
Gov't. purchases of goods and services	6.1	4.3	-3.7	6.8	4.1	3.6	2.8	3.3
Federal	8.9	3.4	-9.0	-.1	5.7	3.9	2.4	4.3
State and local	4.4	4.9	-.4	11.1	3.1	3.5	3.1	2.8
Disposable personal income	4.3	9.5	1.7	3.4	2.6	4.0	5.8	2.6
<u>Current dollars</u>								
Gross national product	10.2	9.9	6.6	18.1	10.8	10.7	12.0	10.8
Final purchases	9.9	12.4	5.3	17.1	10.8	10.5	11.8	10.7
Private	9.6	12.1	6.1	18.0	11.0	9.9	12.3	11.0
Excluding net exports	8.9	15.1	7.7	16.0	9.6	9.7	12.3	10.9
Personal consumption expenditures	8.6	14.0	7.3	14.9	9.9	10.2	13.2	11.1
Goods	4.0	17.1	.7	17.2	9.5	10.1	13.7	10.7
Services	14.3	10.5	15.6	12.3	10.4	10.3	12.5	11.9
Gross private domestic investment	12.4	4.1	17.8	27.2	9.1	9.2	9.9	9.9
Residential structures	7.7	35.0	1.7	19.2	1.9	.0	.0	1.9
Business fixed investment	11.6	13.4	13.4	21.2	12.0	12.0	12.6	12.8
Gov't. purchases of goods and services	11.0	13.5	2.8	13.6	10.0	13.0	9.8	9.5
Federal	12.9	16.3	-2.6	5.3	9.1	17.2	9.0	9.1
State and local	9.9	11.8	6.1	18.6	10.6	10.7	10.2	9.8
Disposable personal income	10.0	14.2	10.3	12.6	9.6	11.2	13.9	9.8
Personal Income	8.9	14.5	9.2	13.6	11.2	10.9	11.2	10.4
Wage and salary disbursements	7.5	12.7	11.9	14.8	8.9	10.1	12.6	10.3
Corporate profits with IVA & C.C. Adj.	27.6	-10.8	-41.2	89.6	25.2	2.3	.0	11.6
Corporate profits before tax	-2.7	13.4	-13.0	64.1	10.9	1.2	1.1	10.1
Nonfarm payroll employment	3.3	3.2	4.5	5.8	1.5	2.2	2.6	2.5
Manufacturing	1.3	2.7	6.6	3.2	1.1	2.8	5.0	3.4
Nonfarm business sector								
Output per hour	3.8	2.3	-2.7	3.0	3.3	1.8	2.1	2.0
Compensation per hour	7.5	8.2	13.6	7.7	7.9	8.0	12.4	8.7
Unit labor costs	3.5	5.8	16.8	4.7	4.6	6.0	10.1	6.6
GNP implicit deflator ^{1/}	4.8	5.9	7.1	8.6	6.9	7.3	7.2	6.7
Gross business product fixed-weighted price index ^{2/}	5.0	5.4	6.5	9.3	7.0	7.0	7.7	7.3
Industrial production	4.2	2.6	1.2	11.6	5.7	5.3	7.8	5.7

^{1/} Excluding Federal pay increase rates of change are: 1977 QIV, 5.1 per cent; 1978 QI, 7.0 per cent; 1978 QIV, 6.7 per cent; 1979 QI, 7.1 per cent.

^{2/} Using expenditures in 1972 as weights.

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

	1971	1972	1973	1974	1975	1976	1977	Projected 1978
Gross national product	1063.4	1171.1	1306.6	1412.9	1528.8	1706.5	1889.6	2097.8
Final purchases	1057.1	1161.7	1288.6	1404.0	1540.3	1693.1	1871.4	2073.1
Private	823.4	908.6	1019.1	1101.3	1201.4	1331.7	1476.4	1637.8
Excluding net exports	821.8	911.9	1012.0	1095.3	1181.0	1323.9	1487.3	1655.4
Personal consumption expenditures	668.2	733.0	809.9	889.6	980.4	1094.0	1211.2	1340.0
Goods	374.8	410.5	457.5	498.3	542.2	601.6	660.5	720.6
Services	293.4	322.4	352.3	391.3	438.2	492.3	550.7	619.4
Gross private domestic investment	160.0	188.3	220.0	214.6	189.1	243.3	294.2	340.0
Residential construction	49.6	62.0	66.1	55.1	51.5	68.0	91.0	103.7
Business fixed investment	104.1	116.8	136.0	150.6	149.1	161.9	185.1	211.6
Change in business inventories	6.4	9.4	17.9	8.9	-11.5	13.3	18.2	24.7
Nonfarm	5.1	8.8	14.7	10.8	-15.1	14.9	17.1	24.3
Net exports of goods and services ^{1/}	1.6	-3.3	7.1	6.0	20.4	7.8	-10.9	-17.6
Exports	65.6	72.7	101.6	137.9	147.3	162.9	174.7	195.4
Imports	64.0	75.9	94.4	131.9	126.9	155.1	185.6	213.0
Gov't. purchases of goods and services	233.7	253.1	269.5	302.7	338.9	361.4	395.0	435.3
Federal ^{2/}	96.2	102.1	102.2	111.1	123.3	130.1	145.4	157.5
State and local	137.5	151.0	167.3	191.5	215.6	231.2	249.6	277.8
Gross national product in constant (1972) dollars	1107.5	1171.1	1235.0	1217.8	1202.1	1274.7	1337.3	1389.5
Personal income	859.1	942.5	1052.4	1154.9	1253.4	1382.7	1536.7	1712.7
Wage and salary disbursements	579.4	633.8	701.3	764.6	805.7	891.8	990.0	1104.9
Disposable personal income	742.8	801.3	901.7	984.6	1084.4	1185.8	1309.2	1460.3
Saving rate (per cent)	7.7	6.2	7.8	7.3	7.4	5.6	5.1	5.8
Corporate profits with I.V.A. and C.C. Adj.	77.2	92.1	99.1	83.6	99.3	128.1	139.9	147.8
Corporate profits before tax	82.0	96.2	115.8	126.9	123.5	156.9	171.7	192.0
Federal government surplus or deficit (-) (N.I.A. basis)	-22.0	-17.3	-6.7	-10.7	-70.2	-54.0	-49.5	-44.4
High employment surplus or deficit (-)	-5.3	-5.9	-.7	17.1	-20.3	-10.4	-8.7	-3.5
State and local government surplus or deficit (-) (N.I.A. basis)	3.7	13.7	13.0	7.5	5.9	18.4	29.2	29.4
Excluding social insurance funds	-3.8	5.6	4.1	-2.9	-6.2	3.9	13.7	12.5
Civilian labor force (millions)	84.1	86.5	88.7	91.0	92.6	94.8	97.4	100.3
Unemployment rate (per cent)	5.9	5.6	4.9	5.6	8.5	7.7	7.0	6.1
Nonfarm payroll employment (millions)	71.2	73.7	76.9	78.4	77.1	79.4	82.1	85.3
Manufacturing	18.6	19.1	20.1	20.0	18.3	19.0	19.6	20.3
Industrial production (1967=100)	109.6	119.7	129.8	129.3	117.8	129.8	137.1	144.1
Capacity utilization: all manufacturing (per cent)	78.0	83.1	87.5	84.2	73.6	80.2	82.4	83.5
Materials (per cent)	83.1	88.0	92.4	87.7	73.6	80.4	81.9	83.7
Housing starts, private (million units, A.R.)	2.05	2.36	2.05	1.34	1.16	1.54	1.19	1.82
New auto sales, (millions, A.R.)	10.24	10.93	11.42	8.91	8.66	10.12	11.13	11.08
Domestic models	8.68	9.32	9.65	7.49	7.08	8.63	9.07	9.08
Foreign models	1.56	1.61	1.77	1.42	1.58	1.50	2.06	2.00

^{1/} Balance of payments data and details 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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CLASS II EDMOPER CENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1971	1972	1973	1974	1975	1976	1977	Projected 1978
<u>Constant (1972) dollars</u>								
Gross national product	3.0	5.7	5.5	-1.4	-1.3	6.0	4.9	3.9
Final purchases	2.8	5.5	4.9	- .7	.2	4.5	4.7	3.5
Private	3.7	6.7	6.3	-1.4	-.3	5.6	5.3	3.6
Excluding net exports	4.0	7.0	5.1	-2.3	-1.0	6.4	6.0	3.9
Personal consumption expenditures	3.4	5.9	4.7	-.9	1.9	6.0	4.9	3.5
Goods	21.4	6.5	5.0	-3.4	.9	6.9	5.1	2.5
Services	3.0	5.3	4.4	2.3	3.0	4.9	4.6	4.7
Gross private domestic investment	7.8	12.9	10.0	-11.4	-22.0	22.2	13.0	8.0
Residential structures	29.2	18.8	-3.7	-24.6	-13.8	22.9	19.3	4.4
Business fixed investment	-1.8	8.1	12.2	-.3	-13.7	3.6	8.6	6.0
Gov't. purchases of goods and services	-.3	1.5	-.2	2.1	2.1	.5	2.5	3.2
Federal	-6.1	-1.7	-5.4	-.8	.9	-.2	5.1	1.3
State and local	4.3	3.8	3.2	3.8	2.8	1.0	1.1	4.4
Disposable personal income	3.7	4.2	6.7	-1.5	1.8	3.8	4.6	4.3
<u>Current dollars</u>								
Gross national product	8.2	10.1	11.6	8.1	8.2	11.6	10.7	11.0
Final purchases	8.0	9.9	10.9	8.9	9.7	9.9	10.5	10.8
Private	8.4	10.3	12.2	8.0	9.1	10.8	10.9	10.9
Excluding net exports	8.7	11.0	11.0	8.2	7.8	12.1	12.3	11.3
Personal consumption expenditures	8.0	9.7	10.5	9.8	10.2	11.6	10.7	10.6
Goods	7.2	9.5	11.4	8.9	8.8	11.0	9.8	9.7
Services	9.0	9.9	9.3	11.1	12.0	12.3	11.9	12.1
Gross private domestic investment	13.6	17.7	16.8	-2.5	-11.9	28.7	20.9	15.6
Residential structures	35.5	25.0	6.6	-16.6	-6.5	32.0	33.8	14.0
Business fixed investment	3.6	12.2	16.4	10.7	-1.0	8.6	14.3	14.3
Gov't. purchases of goods and services	6.8	8.3	6.5	12.3	12.0	6.6	9.3	10.2
Federal	.6	6.1	.1	8.7	11.0	5.5	11.8	8.3
State and local	11.6	9.8	10.8	14.5	12.6	7.2	8.0	11.3
Disposable personal income	8.3	7.9	12.5	9.2	10.1	9.4	10.4	11.5
Personal income	7.2	9.7	11.7	9.7	8.5	10.3	11.1	11.5
Wage and salary disbursements	6.0	9.4	10.6	9.0	5.4	10.7	11.0	11.6
Corporate profits with IVA & C.C. Adj.	13.7	19.3	7.6	-15.6	18.8	29.0	9.1	5.6
Corporate profits before tax	14.7	17.3	20.4	9.6	-2.7	27.0	9.4	11.8
Nonfarm payroll employment	.4	3.5	4.3	2.0	-1.7	3.1	3.4	3.8
Manufacturing	-4.0	2.8	5.1	-.1	-8.5	3.3	3.2	3.6
Nonfarm business sector								
Output per hour	2.9	3.0	1.7	-2.9	1.6	4.1	2.2	1.4
Compensation per hour	6.6	5.8	7.8	9.4	9.6	8.7	8.8	9.1
Unit labor costs	3.5	2.7	6.0	12.7	7.9	4.5	6.4	7.8
GNP implicit deflator	5.1	4.1	5.9	9.7	9.6	5.3	5.5	6.8
Gross business product fixed-weighted price index ^{1/}	4.4	3.3	5.7	10.3	9.5	5.5	5.9	6.7
Industrial production	1.7	9.2	8.4	-.4	-8.9	10.2	5.6	5.1

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

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

June 14, 1978

	FY 1977*	FY 1978 e/		FY 1979 e/			CY 1977*	CY78e/ F.R. Board	F.R. Staff Estimates							
		Admin. 1/	F.R. Board	Admin. 1/	F.R. Board	Cong. 2/			Calendar quarters; unadjusted data							
									1977				1978			
								IV*	I*	II	III	IV	I	II	III	
Unified budget receipts	356.9	400.5	400.3	439.8	448.9	447.9	365.2	412.9	84.5	84.9	125.4	105.4	97.2	98.7	136.2	116.8
Unified budget outlays	401.9	453.5	452.4	499.4	498.0	498.8	416.1	461.9	113.3	110.7	111.9	116.5	122.8	121.3	124.5	129.5
Surplus(+)/Deficit(-), unified budget	-45.0	-53.0	-52.1	-59.6	-49.1	-50.9	-50.9	-49.0	-28.8	-25.8	13.5	-11.1	-25.6	-22.6	11.7	-12.7
Surplus(+)/Deficit(-), off-budget agencies 3/	-8.7	-11.5	-12.2	-12.5	-11.5	n.a.	-10.4	-12.6	-1.3	-3.6	-2.4	-4.9	-1.7	-3.9	-1.3	-4.6
Means of financing combined deficits:																
Net borrowing from public	53.5	57.2	53.7	74.7	63.6	n.a.	56.8	59.6	20.7 ^{8/}	20.8	0.4	11.8	26.6	25.5	-8.5	20.0
Decrease in cash operating balance	-1.7	n.a.	8.0	0	-0.9	n.a.	-0.6	0.3	6.8 ^{8/}	5.9	-9.6	4.9	-0.9	0	0	0
Other 4/	1.9	n.a.	2.8	-2.6	-2.0	n.a.	5.3	1.8	2.6	2.8	-1.9	-0.7	1.6	1.0	-1.9	-2.7
Cash operating balance, end of period	19.1	12.0	11.1	12.0	12.0	n.a.	12.3	12.0	12.3	6.4	16.0	11.1	12.0	12.0	12.0	12.0
Memo: Sponsored agency borrowing 5/	5.2	n.a.	19.3	n.a.	12.3	n.a.	6.8	20.6	2.0	4.5	6.1	6.7	3.3	1.0	3.5	4.5
NIA Budget									Seasonally adjusted annual rates							
Receipts	361.9 ^{6/}	410.9	406.0 ^{6/}	451.6 ^{9/}	n.e.	n.a.	373.9	423.0	386.3	395.1	416.7	433.2	447.1	453.0	466.6	n.e.
Expenditures	411.9	457.0	457.2	503.4	501.9	n.a.	423.4	467.7	446.3	450.8	458.5	473.1	488.2	495.8	504.8	519.0
Purchases (total)	140.6	156.0	154.8	171.4	170.0	n.a.	145.5	157.5	153.8	152.7	154.7	158.1	164.5	168.1	171.8	175.6
Defense	91.8	99.3	100.0	107.6	107.9	n.a.	94.3	101.6	98.5	99.5	100.6	101.5	104.6	105.5	109.0	111.5
Non-defense	48.8	56.7	54.8	63.8	62.1	n.a.	51.2	55.9	55.3	53.2	54.1	56.6	59.9	61.6	62.8	64.1
All other expenditures	271.4 ^{6/}	301.0	302.4 ^{6/}	332.0	331.9	n.a.	278.0	310.2	292.5	298.1	303.8	315.0	323.7	327.7	333.0	349.6
Surplus(+)/Deficit(-)	-50.0 ^{6/}	-46.1	-51.2 ^{6/}	-51.8	n.e.	n.a.	-49.5	-44.7	-60.0	-55.7	-41.8	-39.9	-41.1	-42.8	-38.2	n.e.
High Employment Surplus(+)/Deficit(-) (NIA basis) 7/	-5.0	n.a.	-9.2	n.a.	2.4	n.a.	-8.7	-3.5	-22.1	-9.7	-3.8	-1.2	0.5	-0.8	4.6	5.3
	actual	e--estimated	r--revised		n.e.--not estimated				n.a.--not available				p--preliminary			

- 1/ The Budget of the United States Government, Fiscal Year 1979, January 1978 and OMB Current Budget Estimates, March 1978. The Administration has not yet published official fiscal year 1979 estimates that are consistent with its revised tax proposal.
- 2/ Congress' First Concurrent Resolution on the Budget (May 17, 1978).
- 3/ Includes Federal Financing Bank, Postal Service, U.S. Railway Association, Rural Electrification and Telephone Revolving fund, Housing for the Elderly or Handicapped Fund (until October 1977), 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 \$1.7 billion for fiscal year 1977 and by \$1.8 billion for fiscal year 1978 due to spreading of wage base effect over calendar year.
- 7/ Estimated by F.R.B. staff.
- 8/ Includes \$2.5 billion of borrowing from the Federal Reserve on September 30 which was repaid October 4.
- 9/ NIA estimates consistent with the March Update. The Survey of Current Business, March 1978.

Comments on the Federal Sector Outlook

This month's fiscal policy assumptions have been revised to reflect the Administration's decision to scale back and to delay its earlier tax-cut proposal. The current forecast assumes a tax cut of around \$19 billion for calendar year 1979 and includes:

- (1) A reduction in personal tax rates--beginning January 1, 1979--that will reduce revenues by \$13 billion (annual rate);
- (2) A corporate tax cut, effective January 1, 1979, that will lower the tax rate from 48 per cent to 45.5 per cent on taxable income over \$50,000 (estimated net annual revenue loss, \$2.5 billion);
- (3) A liberalization of the investment tax credit, retroactive to January 1, 1978, that will permit firms to offset 90 per cent of their tax liability with the credit instead of the current 50 per cent and that will extend the present tax credit to structures built by industrial firms and utilities (estimated annual revenue loss of \$2.3 billion);*
- (4) Elimination of the 4 per cent telephone excise tax effective January 1, 1979 (estimated annual revenue loss, \$1 billion).

These revised assumptions, when combined with the staff income forecasts and tax rate estimates, raise the fiscal year 1979 revenue projection by \$9 billion--to \$449 billion. Outlays for the fiscal year beginning in October now are forecast at \$498 billion, and the resulting deficit is projected at \$49 billion, just slightly below the deficit set recently by Congress in its "First Concurrent Budget Resolution."

* This assumption is unchanged from last month.

For the current fiscal year (1978), the staff's outlay forecast has been lowered by \$1-1/2 billion to about \$452 billion due to an estimated \$500 million shortfall in Federal spending during the current quarter and the expectation of further shortfalls in the third quarter (1978:Q3). The receipts forecast for the current fiscal year is essentially unchanged from last month at \$400 billion.^{1/} The resulting unified deficit in fiscal year 1978 is expected to be around \$52 billion, while the total deficit to be financed (unified plus off-budget) is projected at \$64 billion--each about \$2 billion below last month's forecast.

Despite the reduction in the projected deficits for both fiscal years 1978 and 1979 the financing requirements of the Federal Government are likely to remain at a high \$38 billion during the second half of 1978. Credit demands of this magnitude will probably necessitate the issuance of both bills and coupon securities.

The high employment budget, which attempts to measure changes in discretionary fiscal policy, continues to show a shift toward deficit during fiscal year 1978. During fiscal year 1979, however, the increased receipts resulting from the interaction of inflation and the progressive tax structure, together with the scheduled increases in social security taxes, more than offset the Administration's proposed tax reduction. As a consequence, the high employment budget is expected to shift from a \$9 billion deficit in fiscal year 1978 to a \$2 billion surplus in fiscal year 1979.

^{1/} The staff has moved the effective date of the proposed energy program forward from July 1 to October 1, 1978 because of continued legislative delays. The FY 1978 revenue loss from this delay was offset by the added revenue resulting from higher projected incomes.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. Since the last FOMC meeting, the Federal funds rate has edged up about one-eighth of a percentage point to around 7-1/2 per cent, and other short-term interest rates have risen 10 to 50 basis points. Long-term rates have generally risen 5 to 20 basis points over this period, apparently in response to increasing concern over future inflation and heightened expectations of further increases in short-term rates. As interest rates have continued to rise, yield spreads between higher- and lower-rated corporate bonds have been widening since early spring.

M-1 growth moderated to a 6-1/4 per cent annual rate in May, following the 18-3/4 per cent surge in April, which was associated in part with special tax-related factors. Since the reversal of these special factors tended to constrain M-1 growth in May, strong underlying transactions demands for money remained evident, associated with the continued expansion of nominal economic activity at a rapid pace. With the deceleration of M-1 growth, M-2 and M-3 expansion also slowed, as total interest-bearing deposits included in these aggregates increased only slightly faster than their relatively sluggish April rate.

In the face of slackening demand deposit inflows and an advance in loans at their strongest monthly pace since the current economic upturn began in 1975, commercial banks increased their reliance in May on managed liabilities (especially large negotiable CDs). The primary source of loan strength came from a remarkable 33 per cent surge in business loan demand.

This bulge was concentrated at large banks, including those in New York City, and was widely diffused by industry. At the same time, relatively high long-term rates were in part responsible for heavy short-term financing and continued moderate bond and stock financing by nonfinancial corporations. Thus, the advance in business loans at banks caused a further rise in the ratio of short to long-term corporate debt.

Treasury borrowing picked up slightly in recent weeks but remained seasonally light. The three-month bill rate was quoted most recently at 6.60 per cent, up about 25 basis points since the previous Committee meeting. However, bill rates remain below other short-term rates by an unusually large amount because of continued relative scarcity of bills.

Borrowing by sponsored Federal agencies, especially those involved in the mortgage market, stepped up markedly in May. Similarly, State and local government bond issuance reached the second highest monthly volume on record last month. This surge was attributable to an acceleration in refundings in advance of the May 16 effective date of IRS regulations restricting issues with invested sinking fund provisions.

Mortgage market conditions tightened further as continued strong demands for credit pressed against the generally reduced availability of funds at private institutions. Interest rates on new commitments at S&Ls moved up 15 basis points since the last FOMC meeting and field reports indicate more stringent nonrate terms in most regions. Yields in the secondary mortgage market have also risen. While growth of mortgage

loans at commercial banks in May exceeded the average pace in 1977, such lending at nonbank thrift institutions apparently continued well below the record pace of late 1977. Two new types of time accounts designed to sustain deposit inflows and help maintain mortgage lending were permitted at banks and thrifts on June 1. While data on aggregate inflows to such deposits are not yet available, the six-month certificate has generally been vigorously promoted and most institutions are offering the ceiling rates.

Outlook. Short-term interest rates are expected to continue rising in the months ahead. Short- and intermediate-term business credit demand is likely to remain robust, inducing banks to rely more heavily on increasingly costly borrowed funds as their liquidity positions come under added pressure. In addition, strong demand for M-1 can be expected in association with growth of nominal GNP, which will be relatively rapid, even with its projected deceleration in the second half of the year. Efforts by the Federal Reserve to restrain monetary growth would involve further increases in the Federal funds rate.

The likely increases in short-term interest rates in the coming months may be expected to exert less-than-normal pressure on long-term rates. Since rising short-term rates are generally expected, they have probably already been incorporated into the term structure of rates on longer-maturity market instruments. Moreover, certain developments will partially counteract remaining upward pressures on long-term rates. The Administration has reduced and postponed for three months its tax cut

proposal and has apparently resolved to hold down Federal spending, which will restrain Treasury borrowing needs. Public offerings of corporate bonds are likely to remain moderate in the next few months. State and local governments are likely to reduce their longer-term offerings below levels of recent months as the amount of advance refundings declines, though the effects on interest rates will be effectively offset since their purchases of nonmarketable Treasury securities would fall commensurately. With regard to mortgage rates, the new six-month certificate is expected to discourage deposit withdrawals and also to attract new loanable funds, especially at nonbank depository institutions, thereby working to moderate increases in mortgage rates. Any further acceleration of inflationary expectations would of course tend to offset these moderating influences on long-term interest rate increases.

INTERNATIONAL DEVELOPMENTS

Summary. After reaching a peak toward the end of May, the dollar's trade weighted average value has fallen approximately 1-1/2 per cent -- to about its level at the beginning of the year but still above the low of mid-April. Market behavior was generally quiet over the past month with most currencies registering gradual gains against the dollar. Renewed pressure seemed to stem from the continuation of large reported U.S. trade deficits and foreign surpluses and a high U.S. inflation rate relative to trends in other countries. Relative interest rates had moved in favor of the dollar in earlier weeks and some further advance has occurred more recently.

Both the Canadian dollar and sterling required some market support over the past five weeks. Repayments of swap drawings were effected by the System (\$457 equivalent of DM and \$27 million equivalent of Swiss francs) and the Treasury (\$311 million DM).

In April the U.S. merchandise trade deficit was at a \$41 billion annual rate -- about the same as in March but somewhat less than the high first-quarter average. Exports of non-agricultural goods showed a relatively strong gain, with machinery exports scoring their third monthly

Economic activity abroad still shows only sporadic signs of upward momentum. Some evidence of an increased pace of economic activity showed up in the U.K. and France in the period to April, with consumer expenditures and stockbuilding mainly responsible. In both Germany and Japan there are some encouraging indicators, but gains still seem to be tentative. The economies of both countries continued to benefit from large trade surpluses -- a combined annual rate of about \$42 billion in April.

Rates of consumer price increase have continued to decelerate in major foreign industrial countries, dropping to about 7 per cent (year-over-year) in the first quarter of this year from a rate of about 13 per cent in the first quarter of 1975.

Outlook. There has been no change since last month in our estimate of a \$39 billion U.S. trade deficit for 1978; both exports and imports are expected to be a little larger based on the higher levels of March and April. However, the deficit rate in the first half of 1979 is now projected at about \$38 billion -- about \$2 billion above a month ago. A strengthening in economic activity abroad is still anticipated in the period ahead, but the effects on the U.S. trade balance are likely to be partly offset by a higher U.S. inflation rate. Given trade deficits greater than the market anticipates, together with a relative worsening of the U.S. inflation rate, the staff continues to expect a further decline in the average value of the dollar in addition to the decline that has already occurred from the May peak.

increase to a level 12 per cent above the 1977 average. Coal shipments were up sharply in April following low deliveries during the strike.

Imports of both oil and other products also rose considerably in April. Petroleum import volumes were up to about the rate of last year, after declining in the first quarter. Non-oil imports in April held at the high March level, about 12 per cent above the fourth-quarter rate. Much of the rise in imports this year has reflected higher prices. There were also somewhat larger deliveries of industrial supplies (especially a bulge in steel imports), autos, and consumer goods.

Net private capital inflows in April, adjusted for reporting bias, were about \$4-1/2 billion, reversing over half of the first quarter net outflow. Bank-reported flows dominated, with much of the net inflow reflecting seasonal or special factors as well as some further relative rise in U.S. interest rates. Net securities transactions with foreigners were small, with unusually large foreign net purchases of U.S. corporate stocks (about \$600 million for the month) about offset by foreign sales of U.S. Treasury issues and net U.S. purchases of foreign securities.

Foreign official assets in the United States (other than OPEC holdings) were reduced by \$3 billion in April, reflecting some foreign intervention as the dollar began to strengthen, but mainly resulting from U.K. repayments to the IMF and a shift of Japanese official funds to banks in Japan.

June 14, 1978

	1976	1977 ^F	1978 ^P	1977 ^F				1978 ^P				1979 ^P	
				I	II	III	IV	I	II	III	IV	I	II
1. <u>GNP NET EXPORTS</u> - Intl Acct. data	7.8	-10.5	-13.5	-7.4	-4.5	-6.4	-23.6	-20.5	-14.3	-9.6	-9.6	-9.7	-9.4
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(7.8)	(-10.9)	(-17.6)	(-8.2)	(-9.7)	(-7.5)	(-18.6)	(-24.6)*	(-18.4)	(-13.8)	(-13.7)	(-13.8)	(-13.5)
3. a) Merchandise Trade Balance	-9.3	-31.4	-39.1	-28.0	-26.4	-29.7	-41.5	-44.5*	-39.5	-35.8	-36.5	-38.1	-38.2
4. Exports (excl. military)	114.7	120.5	134.1	117.9	122.5	123.9	117.7	122.7*	132.3	137.9	143.6	151.0	157.1
5. Agricultural	23.4	24.4	26.8	24.9	26.1	23.8	22.6	26.0*	28.0	26.5	26.5	27.0	27.0
6. Nonagricultural	91.3	96.1	107.3	93.0	96.4	100.1	95.1	96.7*	104.3	111.4	117.1	124.0	130.1
7. Imports	124.0	151.9	173.2	146.0	149.0	153.6	159.2	167.2*	171.8	173.7	180.1	189.1	195.3
8. Petroleum and petrol. products	34.6	45.0	44.6	46.3	46.1	45.2	42.2	39.8*	43.8	45.7	49.1	50.7	52.1
9. Nonpetroleum	89.4	107.0	128.6	99.7	102.8	108.4	117.0	127.4*	128.0	128.0	131.0	138.4	143.2
10. b) Military transactions, net <u>2/</u>	--	1.0	2.6	1.7	.8	1.8	-.2	2.1	2.4	2.8	3.1	3.5	3.6
11. c) Investment income, net <u>3/</u>	14.3	17.4	20.3	17.6	18.9	18.2	15.2	19.3	20.1	20.7	20.9	22.1	22.2
12. d) Other services, net <u>4/</u>	2.7	2.5	2.7	1.4	2.2	3.3	2.9	2.6	2.7	2.7	2.9	2.8	2.9
13. <u>U.S. CURRENT ACCOUNT BALANCE</u>	-1.4	-20.4	-28.5	-16.6	-14.1	-16.7	-34.1	-34.6	-28.9	-24.6	-25.8	-27.0	-27.3
14. a) GNP net exports (line 1.)	7.8	-10.5	-13.5	-7.4	-4.5	-6.4	-23.6	-20.5	-14.3	-9.6	-9.6	-9.7	-9.4
15. b) U.S. Govt & private transfers <u>5/</u>	-9.2	-9.9	-15.0	-9.2	-9.6	-10.3	-10.5	-14.1	-14.6	-15.0	-16.2	-17.3	-17.9
<u>Constant (1972) dollars</u>													
16. Merchandise exports (excl. military)	66.7	67.0	69.4	66.2	67.7	68.9	65.0	65.7	69.1	70.6	72.2	74.3	76.0
17. (% change, annual rates)	(3.4)	(0.4)	(3.6)	(-7.0)	(10.0)	(7.0)	(-24.8)	(4.5)	(22.9)	(8.2)	(9.5)	(12.6)	(9.1)
18. Merchandise imports	62.8	71.2	74.9	70.1	69.9	71.1	73.5	74.4	75.1	74.6	75.6	77.5	78.9
19. (% change, annual rates)	(22.5)	(13.4)	(5.2)	(26.7)	(-1.2)	(7.4)	(14.3)	(4.9)	(3.7)	(-2.8)	(6.1)	(10.4)	(7.4)
<u>Foreign Outlook - Major Industrial Countries <u>6/</u></u>													
20. Real GNP, % change, annual rates	5.2	2.9	3.8	5.2	.6	1.2	3.6	4.6	4.7	4.1	4.2	4.8	4.5
21. Wholesale Prices, % change, A.R. <u>7/</u>	9.4	8.7	4.9	10.6	7.4	3.6	2.6	5.3	5.9	5.8	5.7	5.7	5.9

1/ Differs from 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, remittances and pensions, and exports to Israel financed by U.S. military assistance grants.

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.

NOTE: 1977 trade data include revised seasonal factors which have not yet been published.