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CONFIDENTIAL (FR)

January 31, 1979

SUMMARY AND OUTLOOK

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

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Economic activity continued to expand briskly in the closing months of 1978 with strong gains reported for employment, industrial production, and retail sales. Real GNP is estimated to have increased at a 6 per cent annual rate in the fourth quarter. Over-all, prices continued to rise at a fast pace, although the rate of increase at the retail level moderated in the last two months of the year, due to apparently temporary factors.

Employment rose appreciably further in December, but there was also a rapid expansion in the labor force and the unemployment rate edged up to 5.9 per cent. As in preceding months, employment gains in manufacturing and construction were particularly strong. Industrial production rose by 0.6 per cent--about the same as the average rate of increase throughout 1978. The capacity utilization rate in manufacturing rose to a relatively high 85.9 per cent.

Retail sales rose substantially again in December following large increases in the two preceding months. Sales at general merchandise and furniture and appliance stores were particularly strong. Unit sales of domestic autos strengthened to 9.2 million (annual rate) in December from 8.8 million in the previous month, and maintained this pace through the first 20 days of January; sales of imported cars edged down slightly in December.

Orders for plant and equipment remained at high levels despite declines toward year end. New orders for nondefense capital goods fell about 9 per cent over the last two months of 1978, but buoyed by earlier increases, the level in the fourth quarter averaged 11-1/2 per cent higher than in the third. Bookings of the machinery component of such orders, which are generally indicative of the underlying trend in the demand for equipment, rose 6 per cent in the fourth quarter. The value of contracts for nonresidential construction in the fourth quarter remained around the third quarter nominal level.

Some slowing of investment growth over the course of 1979 is implied by the Commerce Department's recent survey of business spending plans. According to the survey, firms plan to increase plant and equipment spending in 1979 by 11-1/4 per cent in nominal terms, and expect only a 3 per cent rise in real terms. In the last three years this survey has underestimated the actual outcome on average by about 1-1/2 percentage points.

The book value of business inventories in November increased at the fastest rate in over six months. While the ratio of inventories to sales edged up, it remained low on an historical basis. The accumulation in November was quite widespread, but notable increases occurred in durable manufacturing and retail trade where automobile stocks held by dealers rose to 1.8 million units (seasonally adjusted); however, in terms of current selling rate, November auto stocks were still within the range of recent experience.

The pace of housing starts remained quite robust at year end. Total starts in December--at a 2.1 million unit annual rate--reflected strength particularly in the single-family sector, with home sales in November holding at a high level. Housing starts for 1978 as a whole amounted to 2.0 million, virtually the same as in 1977.

A rapid increase of Federal spending in the fourth quarter of 1978 reflected the 5-1/2 per cent Federal pay raise and a jump in Commodity Credit Corporation loans to farmers. State and local government outlays are estimated to have increased only moderately during this period.

Consumer price increases in November and December moderated from the pace of the preceding months, but temporary factors played a role in each month. The advance of prices in November was held down by only a small increase in food prices; however, food prices again accelerated in December, and large price increases at the farm level in January is putting further upward pressure on consumer prices in coming months. In December the decline in California property tax bills--due to Proposition 13--also held down the over-all price increase. Without the California tax reductions, prices for items other than food and energy continued to rise in December at about the same pace as over most of 1978. Energy prices at the retail level continued rising rapidly through year end with large price hikes for gasoline the main factor.

Outlook. Growth in real GNP in the final quarter of 1978 was appreciably larger than had been projected in the last Greenbook. Available information, however, has led to little change in our expectation of real GNP growth in the first quarter, now projected at a 4.0 per cent annual rate. Recent price data, however, suggest a deterioration in the near term price outlook especially for foods. The staff now estimates that the rise in the gross business product fixed-weighted price index will be at nearly a 9 per cent annual rate in the first quarter--half a percentage point more than indicated in the last Greenbook.

The staff projection, which has been extended through the end of 1980, assumes a growth rate of M^{-1} of approximately 3 per cent during 1979 and 4 per cent during 1980. The impact of automatic transfers is projected to be around 3 to 3-1/2 per cent during 1979 and around 2 to 2-1/2 per cent in 1980. Short-term interest rates are expected to change relatively little over the projection period--perhaps edging higher during the next few months and then gradually receding over the remainder of the period.

The President's new budget has been largely incorporated in the staff projection. However, tax rebates associated with real wage insurance have not been included in light of the unsympathetic Congressional reaction. We have assumed that some \$2 billion of spending cuts requiring legislative action will not receive Congressional approval.

Finally, with our economic assumptions, the staff's translation of the budget implies a deficit of \$33 billion in FY 1980, as compared with \$29 billion in the official budget.

The general contour of economic developments projected for 1979 is similar to that shown in the December Greenbook, with the rate of real GNP growth averaging 2 per cent during the four quarters of this year. Growth is projected to taper off steadily during 1979 and then to hold at an annual rate of about 1-1/2 per cent during 1980. The weak pace of economic growth over this period is associated with a reduced level of housing activity and a slowing of gains in business capital spending. Net exports, however, are projected to strengthen due to the lagged effects of the earlier depreciation of the dollar and the faster growth of major foreign economies relative to the United States.

Unfilled orders continue to suggest moderate increases in business fixed investment early in 1979, but a reduction in real growth in this sector is assumed as the year progresses, consistent with recent surveys of business intentions and capital appropriations. The continued slowing of capital spending during 1980 is consistent with the expected sluggishness of overall demands. Housing starts are projected to bottom out at an annual rate of 1.65 million units in late 1979. Underlying demands for housing are projected to remain strong throughout the period, but tightening financial conditions are expected to take their toll at the margin.

In the State and local sector, government purchases are expected to remain sluggish through 1980. Evidence continues to point to cautious attitudes regarding spending initiatives, and Federal grants in real terms are scheduled to decline substantially as counter-cyclical programs are reduced.

These various developments are likely to produce a further slowing of gains in household disposable income. Thus, even though the saving rate is projected to remain quite low on a historical basis, growth in real consumption expenditures is expected to be considerably smaller than earlier in the expansion.

The over-all output projection implies a reduced rate of employment growth and an increase in joblessness. The unemployment rate is projected to approach 6-1/2 per cent by the end of 1979 and to reach 7 per cent in late 1980.

The emerging slack anticipated in capital and labor markets is expected to contribute somewhat to slowing the rate of inflation. Additional costs in 1980 from social security tax increases and minimum wages will be smaller than in the preceding years. The staff's price projection is also favorably influenced by the outlook for somewhat more ample agricultural supplies by late 1979, the diminishing influence of the 1978 dollar devaluation, and some compliance with the voluntary wage-price standards. As measured by the gross business product fixed-weighted price index, inflation is projected to slow to a 7-3/4 per cent rate by year-end 1979 and to a 7 per cent rate by late 1980.

Detailed data for these projections are shown in the tables that follow.

STAFF GNP PROJECTIONS

	Per cent changes, annual rate							
	Nominal GNP		Real GNP		Gross business product fixed-weighted price index		Unemployment rate (per cent)	
	12/13/78	1/31/79	12/13/78	1/31/79	12/13/78	1/31/79	12/13/78	1/31/79
1976 1/	11.2	11.2	5.7	5.7	5.4	5.4	7.7	7.7
1977 1/	11.0	11.0	4.9	4.9	6.2	6.2	7.0	7.0
1978 1/	11.7	11.6	3.9	3.9	7.8	7.8	6.0	6.0
1979	11.4	11.9	3.3	3.6	8.2	8.5	6.1	6.1
1980		9.0		1.4		7.6		6.8
1978-III 1/	10.7	9.6	3.4	2.6	8.2	8.0	6.0	6.0
1978-IV 1/	12.9	14.7	4.4	6.1	8.0	8.3	5.8	5.8
1979-I	12.1	13.3	3.7	4.0	8.3	8.9	5.8	5.8
1979-II	9.3	9.8	2.0	2.0	8.1	8.4	6.0	6.0
1979-III	8.5	8.2	1.5	1.3	7.3	7.6	6.2	6.2
1979-IV	8.9	8.9	1.2	1.2	7.3	7.7	6.4	6.3
1980-I		9.3		1.3		7.8		6.5
1980-II		9.0		1.3		7.6		6.7
1980-III		8.6		1.5		7.1		6.9
1980-IV		9.2		1.6		7.1		7.1
Change:								
77-IV to								
78-IV 1/	12.7	12.9	4.1	4.3	8.8	8.8	-.8	-.8
78-IV to								
79-IV	9.7	10.1	2.1	2.1	7.8	8.1	.6	.5
79-IV to								
80-IV		9.0		1.4		7.4		.8
Memo:								
Growth Over Annual Policy Period:								
78-IV to								
79-IV	9.7	10.1	2.1	2.1	7.8	8.1	.6	.5

1/ Actual.

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SS 11-80MCGROSS NATIONAL PRODUCT AND RELATED ITEMS
(Quarterly figures are seasonally adjusted. Expenditures and income
figures are billions of current dollars at annual rates.)

	1979				1980			
	Projected				I	II	III	IV
	I	II	III	IV				
Gross national product	2281.1	2335.3	2381.8	2433.3	2488.1	2542.1	2595.3	2653.2
Final purchases	2265.2	2316.4	2364.4	2416.9	2473.7	2528.7	2582.9	2641.8
Private	1801.9	1847.0	1883.1	1923.1	1971.2	2016.9	2061.6	2107.4
Excluding net exports	1800.9	1845.6	1883.8	1923.2	1963.6	2005.6	2047.9	2091.3
Personal consumption expenditures	1443.2	1482.5	1515.5	1548.4	1581.4	1615.5	1649.7	1685.2
Goods	782.9	803.2	818.8	834.4	849.3	864.9	881.0	898.0
Services	660.3	679.3	696.7	714.0	732.1	750.6	768.7	787.2
Gross private domestic investment	373.6	382.0	385.7	391.2	396.6	403.5	410.6	417.5
Residential construction	115.5	114.3	113.3	113.8	115.3	117.5	120.0	122.8
Business fixed investment	242.2	248.8	255.0	261.0	266.9	272.6	278.2	283.3
Change in business inventories	15.9	18.9	17.4	16.4	14.4	13.4	12.4	11.4
Nonfarm	15.9	18.9	17.4	16.4	14.4	13.4	12.4	11.4
Net exports of goods and services ^{1/}	1.0	1.4	-0.7	-0.1	7.6	11.3	13.7	16.1
Exports	233.9	242.5	250.4	258.6	269.5	278.3	285.8	293.9
Imports	232.9	241.1	251.1	258.7	261.9	267.0	272.1	277.8
Gov't. purchases of goods and services	463.3	469.4	481.3	493.8	502.5	511.8	521.3	534.4
Federal ^{2/}	164.5	164.0	169.4	175.4	177.3	179.5	181.7	187.4
State and local	298.8	305.4	311.9	318.4	325.2	332.3	339.6	347.0
Gross national product in constant (1972) dollars	1426.2	1433.4	1438.0	1442.3	1447.1	1451.9	1457.3	1462.9
Personal income	1833.0	1878.5	1932.7	1978.2	2018.8	2061.2	2113.5	2160.3
Wage and salary disbursements	1180.4	1206.0	1231.4	1258.8	1285.7	1309.9	1335.2	1365.0
Disposable personal income	1559.5	1597.1	1642.3	1679.4	1713.5	1748.2	1791.9	1829.2
Saving rate (per cent)	5.0	4.7	5.2	5.2	5.1	5.0	5.3	5.2
Corporate profits with I.V.A. and C.C. Adj.	185.4	189.0	185.6	186.4	187.9	192.4	195.1	198.9
Corporate profits before tax	234.3	238.0	232.6	232.9	237.1	242.7	244.4	248.2
Federal government surplus or deficit (-) (N.I.A. basis)	-18.6	-15.2	-26.9	-30.2	-23.6	-20.0	-24.2	-22.6
High employment surplus or deficit (-)	7.0	14.6	8.0	9.0	21.5	30.5	31.5	37.4
State and local government surplus or deficit (-) (N.I.A. basis)	26.2	26.3	25.2	25.0	24.3	23.3	22.3	22.5
Excluding social insurance funds	2.8	2.3	.6	-0.2	-1.5	-3.1	-4.7	-5.1
Civilian labor force (millions)	102.3	102.9	103.5	104.1	104.6	105.1	105.6	106.1
Unemployment rate (per cent)	5.8	6.0	6.2	6.3	6.5	6.7	6.9	7.1
Nonfarm payroll employment (millions)	87.7	88.1	88.5	88.9	89.2	89.5	89.7	90.0
Manufacturing	20.9	21.0	21.0	21.0	21.0	21.0	21.0	21.0
Industrial production (1967=100)	151.7	153.2	154.0	154.6	155.0	155.4	155.9	156.4
Capacity utilization: all mfg. (per cent)	86.2	86.3	85.9	85.4	84.8	84.2	83.7	83.1
Materials (per cent)	87.9	88.1	87.9	87.5	87.1	86.7	86.3	85.9
Housing starts, private (million units, A.R.)	1.95	1.75	1.70	1.65	1.75	1.75	1.80	1.80
New autos sales, (millions, A.R.)	10.95	10.75	10.50	10.35	10.30	10.40	10.40	10.50
Domestic models	9.10	9.00	8.80	8.75	8.70	8.75	8.75	8.80
Foreign models	1.85	1.75	1.70	1.60	1.60	1.65	1.65	1.70

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.

January 31, 1979

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CLASS II FOMCPER CENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS
(Annual rates compounded quarterly)

	1979				1980			
	Projected							
	I	II	III	IV	I	II	III	IV
<u>Constant (1972) dollars</u>								
Gross national product	4.0	2.0	1.3	1.2	1.3	1.3	1.5	1.6
Final purchases	3.5	1.5	1.6	1.4	1.7	1.5	1.7	1.7
Private	4.4	2.2	1.0	1.3	1.9	1.6	1.8	1.8
Excluding net exports	3.2	2.1	1.1	1.0	.8	1.1	1.5	1.5
Personal consumption expenditures	3.2	3.0	1.8	1.4	1.0	1.2	1.6	1.8
Goods	3.1	2.5	1.0	.6	-.1	.4	1.0	1.3
Services	3.5	3.5	2.8	2.4	2.3	2.3	2.2	2.3
Gross private domestic investment	6.4	1.3	-3.7	-1.8	-2.3	-.7	-.7	-.9
Residential structures	-1.1	-13.6	-13.0	-7.5	-4.2	-1.1	.7	1.5
Business fixed investment	4.4	3.2	2.3	1.9	1.5	1.0	.8	.0
Gov't. purchases of goods and services	.1	-1.1	3.8	1.5	.8	1.2	1.3	1.4
Federal	-2.4	-5.4	8.6	2.3	-.5	.4	.3	.7
State and local	1.6	1.4	1.2	1.1	1.5	1.7	1.9	1.9
Disposable personal income	4.3	1.8	4.2	1.8	.6	.7	3.1	1.5
<u>Current dollars</u>								
Gross national product	13.3	9.8	8.2	8.9	9.3	9.0	8.6	9.2
Final purchases	12.7	9.4	8.5	9.2	9.7	9.2	8.9	9.4
Private	14.3	10.4	8.0	8.8	10.4	9.6	9.2	9.2
Excluding net exports	12.2	10.3	8.5	8.6	8.7	8.8	8.7	8.7
Personal consumption expenditures	12.2	11.3	9.2	9.0	8.8	8.9	8.7	8.9
Goods	12.4	10.8	8.0	7.8	7.3	7.6	7.7	7.9
Services	12.0	12.0	10.6	10.3	10.5	10.5	10.0	10.0
Gross private domestic investment	16.1	9.3	3.9	5.8	5.6	7.1	7.2	6.9
Residential structures	11.3	-4.1	-3.5	1.8	5.4	7.9	8.8	9.7
Business fixed investment	12.9	11.4	10.3	9.7	9.4	8.8	8.5	7.5
Gov't. purchases of goods and services	6.9	5.4	10.5	10.8	7.2	7.6	7.6	10.4
Federal	2.7	-1.2	13.8	14.9	4.4	5.1	5.0	13.2
State and local	9.3	9.1	8.8	8.6	8.8	9.0	9.1	9.0
Disposable personal income	13.3	10.0	11.8	9.3	8.4	8.4	10.4	8.6
Personal income	10.8	10.3	12.0	9.7	8.5	8.7	10.5	9.2
Wage and salary disbursements	11.6	9.0	8.7	9.2	8.8	7.7	8.0	9.2
Corporate profits with IVA & C.C. Adj.	15.6	8.0	-7.0	1.7	3.3	9.9	5.7	8.0
Corporate profits before tax	14.5	6.5	-8.7	.4	7.5	9.7	2.9	6.2
Nonfarm payroll employment	3.6	1.8	1.6	1.8	1.5	1.2	1.1	1.0
Manufacturing	5.7	2.1	1.1	-.5	-.8	-.2	.1	.3
Nonfarm business sector								
Output per hour	1.7	.9	.6	.5	.9	1.0	1.1	1.0
Compensation per hour	12.0	8.7	8.6	8.5	9.9	8.3	8.3	8.2
Unit labor costs	10.1	7.7	8.0	8.0	8.9	7.2	7.1	7.1
GNP implicit deflator ^{1/}	8.9	7.7	6.8	7.6	7.9	7.5	7.0	7.6
Gross business product fixed-weighted price index ^{2/}	8.9	8.4	7.6	7.7	7.8	7.6	7.1	7.1
Industrial production	6.0	4.0	2.1	1.6	1.0	1.2	1.2	1.4

^{1/} Excluding Federal pay increase rates of change are: 1979 QI, 8.9 per cent; 1979 QIV, 7.1 per cent; 1980 QI, 7.9 per cent; 1980 QIV, 7.1 per cent.

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

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CLASS II FOMC

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			
	I	II	III	IV	I	II	III	IV
Gross national product	1806.8	1867.0	1916.8	1958.1	1992.0	2087.5	2136.1	2210.8
Final purchases	1796.5	1850.0	1894.9	1945.0	1975.3	2067.4	2122.5	2198.4
Private	1421.5	1461.2	1495.4	1532.5	1558.6	1642.7	1682.7	1742.8
Excluding net exports	1430.0	1467.1	1502.4	1555.7	1582.7	1648.2	1693.4	1749.7
Personal consumption expenditures	1167.7	1188.6	1214.5	1255.2	1276.7	1322.9	1356.9	1402.2
Goods	639.1	649.2	657.1	684.1	684.9	717.1	731.2	760.4
Services	528.6	539.4	557.5	571.1	591.8	605.8	625.8	641.8
Gross private domestic investment	272.5	295.6	309.7	313.5	322.7	345.4	350.1	359.9
Residential construction	81.6	91.4	94.3	100.2	100.3	105.3	109.0	112.5
Business fixed investment	180.6	187.2	193.5	200.3	205.6	220.1	227.5	235.0
Change in business inventories	10.3	17.0	21.9	13.1	16.7	20.1	13.6	12.4
Nonfarm	11.1	16.5	22.0	10.4	16.9	22.1	14.6	13.1
Net exports of goods and services ^{1/}	-8.5	-5.9	-7.0	-23.2	-24.1	-5.5	-10.7	-6.9
Exports	170.9	178.1	180.8	172.1	181.7	205.4	210.1	223.5
Imports	179.4	184.0	187.8	195.2	205.8	210.9	220.8	230.4
Gov't. purchases of goods and services	375.0	388.8	399.5	412.5	416.7	424.7	439.8	455.6
Federal ^{2/}	138.3	142.9	146.8	152.2	151.5	147.2	154.0	163.4
State and local	236.7	245.9	252.7	260.3	265.2	277.6	285.8	292.2
Gross national product in constant (1972) dollar	1306.7	1325.5	1343.9	1354.5	1354.2	1382.6	1391.4	1412.2
Personal income	1470.7	1508.6	1543.7	1593.0	1628.9	1682.4	1731.7	1786.4
Wage and salary disbursements	946.4	973.4	993.6	1021.2	1050.8	1090.2	1113.2	1148.5
Disposable personal income	1248.0	1285.3	1319.1	1359.6	1391.6	1433.3	1468.4	1511.4
Saving rate (per cent)	4.2	5.3	5.6	5.4	5.9	5.3	5.2	4.8
Corporate profits with I.V.A. and C.C. Adj.	129.9	143.7	154.8	148.2	132.6	163.4	165.2	178.8
Corporate profits before tax	164.8	175.1	177.5	178.3	172.1	205.5	205.4	226.5
Federal government surplus or deficit (-) (N.I.A. basis)	-37.3	-40.3	-56.4	-58.6	-52.6	-23.6	-22.8	-19.9
High employment surplus or deficit (-)	1.0	-6.8	-25.8	-27.5	-15.0	4.2	6.6	5.1
State and local government surplus or deficit (-) (N.I.A. basis)	29.5	28.5	31.2	29.0	31.5	29.8	23.4	26.5
Excluding social insurance funds	12.5	10.8	12.8	9.9	11.5	9.3	1.8	3.7
Civilian labor force (millions)	96.2	97.1	97.6	98.5	99.3	100.1	100.8	101.5
Unemployment rate (per cent)	7.4	7.2	6.9	6.6	6.2	6.0	6.0	5.8
Nonfarm payroll employment (millions)	80.8	82.0	82.7	83.5	84.3	85.7	86.1	87.0
Manufacturing	19.4	19.6	19.7	19.9	20.1	20.3	20.3	20.6
Industrial production (1967=100)	133.6	137.0	138.4	139.3	139.6	144.0	147.0	149.5
Capacity utilization: all mfg. (per cent)	81.2	82.7	83.0	82.9	82.1	84.0	85.0	85.7
Materials (per cent)	80.4	82.6	82.3	82.2	81.7	84.5	86.0	87.3
Housing starts, private (million units, A.R.)	1.74	1.94	2.04	2.15	1.72	2.11	2.07	2.13
New autos sales, (millions, A.R.)	11.12	11.70	10.92	10.75	10.80	12.12	11.16	11.07
Domestic models	9.28	9.34	8.88	8.77	8.80	10.01	9.19	9.06
Foreign models	1.84	2.36	2.04	1.98	2.00	2.11	1.98	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.

Components of purchases and total receipts and total expenditures are shown in the Federal Sector Accounts table which follows.

CONFIDENTIAL - FR
CLASS II FOMC

PER CENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS
(Annual rates compounded quarterly)

	1977				1978			
	I	II	III	IV	I	II	III	IV
<u>Constant (1972) dollars</u>								
Gross national product	7.3	5.9	5.7	3.2	-1	8.7	2.6	6.1
Final purchases	5.3	4.6	5.0	4.7	-1.6	8.6	3.7	6.6
Private	6.1	3.7	4.8	4.8	-1.1	11.0	2.8	6.9
Excluding net exports	6.9	3.8	4.3	8.7	-1.0	7.7	3.7	6.3
Personal consumption expenditures	5.1	1.4	4.1	9.0	-1.4	6.0	4.1	6.8
Goods	5.2	1.2	2.4	13.5	-8.1	9.7	2.6	9.9
Services	4.9	1.5	6.1	3.9	7.0	1.9	5.9	3.1
Gross private domestic investment	32.8	25.7	9.7	-2.9	11.3	15.2	-5.1	1.4
Residential structures	10.2	37.8	5.2	11.1	-5.2	2.7	-1.6	1.1
Business fixed investment	19.0	7.5	5.3	5.3	4.2	21.3	3.5	5.4
Gov't. purchases of goods and services	2.4	8.0	5.8	4.2	-3.5	-.2	7.2	5.1
Federal	5.1	10.7	6.4	2.9	-8.9	-15.3	14.3	12.0
State and local	.7	6.3	5.4	5.1	-.1	9.6	3.4	1.3
Disposable personal income	1.7	6.2	5.9	7.8	1.1	3.5	3.6	5.1
<u>Current dollars</u>								
Gross national product	13.7	14.0	11.1	8.9	7.1	20.6	9.6	14.7
Final purchases	11.0	12.5	10.1	11.0	6.4	20.0	11.1	15.1
Private	11.3	11.6	9.7	10.3	7.0	23.4	10.1	15.1
Excluding net exports	14.9	10.8	10.0	15.0	7.1	17.6	11.4	14.0
Personal consumption expenditures	12.5	7.3	9.0	14.1	7.0	15.3	10.7	14.0
Goods	12.1	6.5	5.0	17.5	.5	20.2	8.1	17.0
Services	13.1	8.4	14.1	10.1	15.3	9.8	13.9	10.6
Gross private domestic investment	48.0	38.5	20.5	5.1	12.2	31.3	5.5	11.7
Residential structures	25.1	57.8	13.5	27.3	.5	21.0	14.9	13.5
Business fixed investment	25.9	15.3	14.1	14.8	11.1	31.2	14.3	13.8
Gov't. purchases of goods and services	9.9	15.5	11.5	13.7	4.1	7.9	15.0	15.2
Federal	11.5	14.0	11.3	15.7	-2.0	-10.9	20.0	26.8
State and local	9.0	16.4	11.6	12.5	7.8	19.9	12.4	9.3
Disposable personal income	9.0	12.5	10.9	12.9	9.8	12.5	10.2	12.2
Personal income	11.7	10.7	9.6	13.4	9.3	13.8	12.2	13.2
Wage and salary disbursements	12.0	11.9	8.6	11.6	12.1	15.9	8.7	13.3
Corporate profits with IVA & C.C. Adj.	26.4	49.8	34.7	-16.0	-35.9	130.6	4.5	37.2
Corporate profits before tax	29.1	27.5	5.6	1.8	-13.2	103.3	-.2	47.9
Nonfarm payroll employment	3.9	5.6	3.6	4.0	3.8	6.9	2.1	4.0
Manufacturing	5.2	5.7	1.5	3.2	5.7	3.1	-.2	6.0
Nonfarm business sector								
Output per hour	2.4	-1.4	3.7	.5	-3.1	1.7	2.3	2.3
Compensation per hour	8.3	6.5	8.1	7.6	12.2	8.2	9.6	9.1
Unit labor costs	5.8	8.0	4.2	7.1	15.7	6.4	7.1	6.7
GNP implicit deflator ^{1/}	6.0	7.7	5.1	5.5	7.2	11.0	6.9	8.1
Gross business product fixed-weighted price index ^{2/}	6.7	7.9	4.7	6.3	6.7	12.1	8.0	8.3
Industrial production	6.3	10.5	4.4	2.5	1.0	13.1	8.6	7.0

^{1/} Excluding Federal pay increase rates of change are: 1977 QI, 5.9 per cent; 1977 QIV, 4.8 per cent; 1978 QI, 7.2 per cent; 1978 QIV, 7.6 per cent.

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

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CONFIDENTIAL - FR
CLASS II FORM CGROSS NATIONAL PRODUCT AND RELATED ITEMS
(Expenditures and income figures are billions of current dollars.)

	1973	1974	1975	1976	1977	1978	Projected	
							1979	1980
Gross national product	1306.6	1412.9	1528.8	1700.1	1887.2	2106.6	2357.9	2569.7
Final purchases	1288.6	1404.0	1539.6	1689.9	1871.6	2090.9	2340.7	2556.8
Private	1019.1	1101.3	1201.2	1330.4	1477.6	1655.8	1863.8	2039.3
Excluding net exports	1012.0	1095.3	1180.8	1323.0	1488.7	1667.6	1863.4	2027.1
Personal consumption expenditures	809.9	889.6	979.1	1090.2	1206.5	1339.7	1497.4	1632.9
Goods	457.5	498.3	541.5	599.2	657.4	723.4	809.8	873.3
Services	352.3	391.3	437.5	491.0	549.2	616.3	687.6	759.6
Gross private domestic investment	220.0	214.6	190.9	243.0	297.8	344.5	383.1	407.0
Residential construction	66.1	55.1	51.5	68.2	91.9	106.8	114.2	118.9
Business fixed investment	136.0	150.6	150.2	164.6	190.4	222.0	251.7	275.2
Change in business inventories	17.9	8.9	-10.7	10.2	15.6	15.7	17.1	12.9
Nonfarm	14.7	10.8	-14.3	12.2	15.0	16.7	17.1	12.9
Net exports of goods and services ^{1/}	7.1	6.0	20.4	7.4	-11.1	-11.8	.4	12.2
Exports	101.6	137.9	147.3	163.2	175.5	205.2	246.3	281.9
Imports	94.4	131.9	126.9	155.7	186.6	217.0	245.9	269.7
Gov't. purchases of goods and services	269.5	302.7	338.4	359.5	394.0	434.2	476.9	517.5
Federal ^{2/}	102.2	111.1	123.1	129.9	145.1	154.0	168.3	181.5
State and local	167.3	191.5	215.4	229.6	248.9	280.2	308.6	336.0
Gross national product in constant (1972) dollars	1235.0	1217.8	1202.3	1271.0	1332.7	1385.1	1435.0	1454.8
Personal income	1052.4	1154.9	1255.5	1380.9	1529.0	1707.3	1905.6	2088.5
Wage and salary disbursements	701.3	764.6	805.9	890.1	983.6	1100.7	1219.1	1323.9
Disposable personal income	901.7	984.6	1086.7	1184.4	1303.0	1451.2	1619.6	1770.7
Saving rate (per cent)	7.8	7.3	7.7	5.7	5.1	5.3	5.0	5.1
Corporate profits with I.V.A. and C.C. Adj.	99.1	83.6	95.9	127.0	144.2	160.0	186.6	193.6
Corporate profits before tax	115.8	126.9	120.4	155.9	173.9	202.4	234.5	243.1
Federal government surplus or deficit (N.I.A. basis)	-6.7	-10.7	-70.6	-53.8	-48.1	-29.4	-22.7	-22.6
High employment surplus or deficit (-)	-1.3	14.8	-23.6	-15.9	-14.8	.2	9.6	30.2
State and local government surplus or deficit (-) (N.I.A. basis)	13.0	7.6	6.2	20.7	29.6	27.8	25.7	23.1
Excluding social insurance funds	4.1	-2.9	-6.2	5.5	11.5	6.6	1.4	-3.6
Civilian labor force (millions)	88.7	91.0	92.6	94.8	97.4	100.4	103.2	105.3
Unemployment rate (per cent)	4.9	5.6	8.5	7.7	7.0	6.0	6.1	6.8
Nonfarm payroll employment (millions)	76.8	78.3	76.9	79.4	82.3	85.8	88.3	89.6
Manufacturing	20.2	20.1	18.3	19.0	19.6	20.3	21.0	21.0
Industrial production (1967=100)	129.8	129.3	117.8	129.8	137.1	145.1	153.4	155.7
Capacity utilization: all manufacturing (per cent)	87.5	84.2	73.6	80.2	82.5	84.2	85.9	84.0
Materials (per cent)	92.4	87.7	73.6	80.4	81.9	84.9	87.8	86.5
Housing starts, private (million units, A.R.)	2.05	1.34	1.16	1.54	1.99	2.02	1.76	1.77
New auto sales, (millions, A.R.)	11.42	8.91	8.66	10.12	11.13	11.29	10.64	10.40
Domestic models	9.65	7.49	7.08	8.63	9.07	9.27	8.91	8.75
Foreign models	1.77	1.42	1.58	1.50	2.06	2.02	1.72	1.65

1/ Balance of payments data 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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CONFIDENTIAL - FR
CLASS II FOMCPER CENT CHANGES IN GROSS NATIONAL PRODUCT
AND RELATED ITEMS

	1973	1974	1975	1976	1977	1978	Projected	
							1979	1980
<u>Constant (1972) dollars</u>								
Gross national product	5.5	-1.4	-1.3	5.7	4.9	3.9	3.6	1.4
Final purchases	4.9	-.7	.2	4.3	4.7	3.8	3.6	1.6
Private	6.3	-1.4	-.3	5.5	5.3	4.3	4.0	1.6
Excluding net exports	5.1	-2.3	-1.0	6.4	6.0	4.4	3.5	1.1
Personal consumption expenditures	4.7	-.9	1.8	5.8	4.7	3.9	3.8	1.5
Goods	5.0	-3.4	.7	6.4	5.0	3.3	4.1	.6
Services	4.4	2.3	3.2	5.0	4.4	4.6	3.5	2.5
Gross private domestic investment	10.0	-11.4	-22.3	21.6	13.2	7.0	1.7	-1.6
Residential structures	-3.7	-24.6	-13.9	23.4	20.5	3.6	-4.9	-5.1
Business fixed investment	12.2	-.3	-13.0	4.7	9.1	7.8	4.7	1.5
Gov't. purchases of goods and services	-.2	2.1	1.9	.1	2.4	2.2	2.2	1.4
Federal	-5.4	-.8	.7	.1	5.2	-1.1	2.3	1.1
State and local	3.2	3.8	2.6	.1	.8	4.2	2.1	1.5
Disposable personal income	6.7	-1.5	2.1	3.5	4.1	4.2	3.7	1.7
<u>Current dollars</u>								
Gross national product	11.6	8.1	8.2	11.2	11.0	11.6	11.9	9.0
Final purchases	10.9	8.9	9.7	9.8	10.8	11.7	11.9	9.2
Private	12.2	8.1	9.1	10.8	11.1	12.1	12.5	9.4
Excluding net exports	11.0	8.2	7.8	12.0	12.5	12.0	11.7	8.8
Personal consumption expenditures	10.5	9.8	10.1	11.4	10.7	11.0	11.8	9.1
Goods	11.4	8.9	8.7	10.7	9.7	10.0	11.9	7.8
Services	9.3	11.1	11.8	12.2	11.8	12.2	11.6	10.5
Gross private domestic investment	16.8	-2.5	-11.0	27.3	22.6	15.7	11.2	6.2
Residential structures	6.6	-16.7	-6.5	32.5	34.8	16.2	7.0	4.1
Business fixed investment	16.4	10.8	-.3	9.6	15.7	16.6	13.4	9.3
Gov't. purchases of goods and services	6.5	12.3	11.8	6.2	9.6	10.2	9.8	8.5
Federal	.1	8.7	10.7	5.5	11.7	6.2	9.3	7.8
State and local	10.8	14.5	12.5	6.6	8.4	12.6	10.1	8.9
Disposable personal income	12.5	9.2	10.4	9.0	10.0	11.4	11.6	9.3
Personal income	11.7	9.7	8.7	10.0	10.7	11.7	11.6	9.6
Wage and salary disbursements	10.6	9.0	5.4	10.4	10.5	11.9	10.8	8.6
Corporate profits with IVA & C.C. Adj.	7.6	-15.6	14.7	32.4	13.5	11.0	16.6	3.7
Corporate profits before tax	20.4	9.6	-5.1	29.5	11.5	16.4	15.9	3.7
Nonfarm payroll employment	4.3	1.9	-1.7	3.2	3.6	4.3	3.0	1.5
Manufacturing	5.2	-.4	-8.7	3.7	3.4	3.5	3.2	.0
Nonfarm business sector								
Output per hour	1.7	-2.9	1.9	3.6	1.3	.6	1.5	.8
Compensation per hour	7.8	9.4	9.9	8.5	8.1	9.4	9.6	8.8
Unit labor costs	6.0	12.7	7.9	4.7	6.7	8.8	8.0	7.9
GNP implicit deflator	5.9	9.7	9.6	5.2	5.9	7.9	8.1	7.5
Gross business product fixed-weighted price index ^{1/}	5.7	10.4	9.4	5.4	6.2	7.8	8.5	7.6
Industrial production	8.4	-.4	-8.9	10.2	5.6	5.8	5.7	1.5

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

January 31, 1979

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

	Fiscal Year 1978*	FY 1979 e/		FY 1980 e/		CY 1978*	CY 79 e/ F.R. Board	FRB Staff Estimates								
		Admin. 1/	F.R. Board	Admin. 1/	F.R. Board			Calendar quarters; unadjusted data						1980		
								1978		1979		1980				
								III*	IV*	I	II	III	IV	I	II	III
Unified budget receipts	402.0	456.0	457.1	502.6	505.1	416.9	467.5	106.8	99.5	100.2	138.6	118.8	109.9	109.7	151.8	133.7
Unified budget outlays	450.8	493.4	492.8	531.6	538.1	460.6	502.8	114.9	123.2	122.2	123.2	124.2	133.2	132.9	135.0	137.0
Surplus(+)/Deficit(-), unified budget	-48.8	-37.4	-35.7	-29.0	-33.0	-43.7	-35.3	-8.1	-23.7	-22.0	15.4	-5.4	-23.3	-23.2	16.8	-3.3
Surplus(+)/Deficit(-), off-budget agencies 2/	-10.3	-12.0	-10.7	-12.0	-11.5	-9.1	-11.5	-3.1	-0.1	-3.5	-4.0	-3.0	-1.0	-3.0	-4.0	-3.5
Combined Deficit to be financed	-59.1	-49.4	-46.4	-41.0	-44.5	-52.8	-46.8	-11.2	-23.8	-25.5	11.4	-8.4	-24.3	-26.2	12.8	-6.8
Means of financing combined deficits:																
Net borrowing from public	59.1	40.0	37.0	39.0	42.5	53.6	42.5	15.1	15.2	14.5	-6.6	13.9	20.7	17.6	-6.8	11.0
Decrease in cash operating balance	-3.3	7.4	7.4	0.0	0.0	-4.0	-2.3	-4.9	6.1	8.3	-4.0	-3.0	1.0	6.0	-4.0	-3.0
Other 3/	3.2	2.0	2.0	2.0	2.0	3.2	2.0	1.0	2.6	2.7	-0.8	-2.5	2.6	2.6	-2.0	-1.2
Cash operating balance, end of period	22.4	15.0	15.0	15.0	15.0	16.3	14.0	22.4	16.3	8.0	12.0	15.0	14.0	8.0	12.0	15.0
Memo: Sponsored agency borrowing 4/	19.1	n.a.	19.6	n.a.	14.4	22.0	18.1	6.1	4.9	4.1	5.5	5.1	3.4	3.0	4.0	4.0
NIA Budget								Seasonally adjusted annual rates								
Receipts 6/	413.8	464.3	472.2	513.8	520.1	431.6	484.8	441.7	462.6	469.8	480.2	489.6	499.9	513.2	525.1	536.5
Expenditures 6/	450.6	496.3	495.7	539.2	543.2	461.0	507.6	464.5	482.3	488.4	495.4	516.5	530.1	536.8	545.1	560.7
Purchases (total)	151.1	166.0	165.3	178.2	178.5	154.0	168.3	154.0	163.4	164.5	164.0	169.4	175.4	177.3	179.5	181.7
Defense	98.1	105.1	104.7	115.4	114.3	99.5	107.0	99.6	102.1	103.6	105.6	107.5	111.3	113.3	115.3	117.4
Non-defense	53.0	60.9	60.6	62.8	64.1	54.5	61.3	54.5	61.3	60.9	58.4	61.9	64.1	64.0	64.2	64.3
All other expenditures	299.5	330.3	330.4	361.0	364.7	307.0	339.3	310.5	318.9	323.9	331.4	347.1	354.7	359.5	365.6	379.0
Surplus(+)/Deficit(-) 6/	-36.8	-32.0	-23.4	-25.4	-23.1	-29.4	-22.8	-22.8	-19.7	-18.6	-15.2	-26.9	-30.2	-23.6	-20.0	-24.2
High Employment Surplus(+)/Deficit(-) (NIA basis) 5/	-7.9	n.a.	8.7	n.a.	23.1	0.2	9.6	6.6	5.1	7.0	14.6	8.0	9.0	21.5	30.5	31.5
		* actual	e--estimated	r--revised	n.a.--not available											

1/ The Budget of the United States Government, Fiscal Year 1980, January 1979.

2/ Includes Federal Financing Bank, Postal Service Fund, Rural Electrification and Telephone Revolving Fund, Rural Telephone Bank, and Pension Benefit Guaranty Corporation.

3/ Checks issued less checks paid, accrued items and other transactions.

4/ Includes Federal Home Loan Banks, FNMA, Federal Land Banks, Federal Intermediate Credit Banks, and Banks for Cooperatives.

5/ FRB staff estimates are consistent with the Council's new potential GNP series as reported in the Economic Report of the President, January 1979.

6/ The fiscal year totals as published by the BEA "Fiscal Year 1980 Budget Translation," January 1979, are based on unadjusted data and do not conform to the average of four seasonally adjusted quarters. The FRB staff estimates, therefore, have been adjusted in order to make the BEA and the staff estimates comparable.

Comments on the Federal Sector Outlook

The staff's fiscal projection has been revised this month to reflect new budget information. Federal spending in fiscal year 1980 (unified basis) is expected to be \$538 billion, about \$6-1/2 billion more than the Administration's recommendation. Differences between the staff and Administration's economic forecasts, because of higher projected unemployment, inflation, and interest rates, account for about \$4-1/2 billion of this divergence. In addition, it seems unlikely that Congress will accept all of the President's proposals to reduce spending, especially some proposed cuts in social security benefits.

Receipts are projected at \$505 billion in fiscal year 1980, around \$2-1/2 billion higher than the budget estimate. This reflects several partly offsetting considerations, among them the exclusion of real wage insurance from the staff's fiscal policy assumptions and the impact of the staff's higher projected rates of inflation and nominal income growth on tax receipts. The staff expenditure and revenue estimates indicate a unified budget deficit in fiscal year 1980 of around \$33 billion.

For the current fiscal year, the staff's outlay forecast has been revised upward by \$1-1/2 billion to about \$493 billion. Receipts also have been revised upward and are now expected to be \$457 billion, about \$5 billion above the previous forecast. Higher projected corporate profits are primarily responsible for this increase. The resulting deficit for the current fiscal year is now expected to be almost \$36 billion, and the total deficit to be financed (unified plus off budget) is projected at \$46 billion. The Treasury has already raised \$18 billion during this fiscal year, including \$3 billion since January 1, 1979. Another \$19 to \$20 billion of additional new financing is expected in the market before the April 15 tax date. During the remainder of the second quarter, seasonally high tax receipts should enable the Treasury to pay down \$16 to \$17 billion of marketable debt.

The high employment budget estimates have been revised this month to reflect the Council of Economic Advisers' reassessment of potential GNP. The Council's revisions affect the level of the high employment surplus but have smaller effects on period to period changes in the series. (See also Appendix B in Part II.) The staff and Council projections continue to show a sizable shift toward restraint between fiscal years 1978 and 1979. This trend toward greater restraint continues in fiscal year 1980 when the staff's high employment surplus increases by \$14 billion.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. Open market rates in late January generally were 25 to 75 basis points below their levels at the December FOMC meeting, as overall credit flows diminished. Slow growth in the key monetary aggregates continued despite strength in economic activity. The increases in short-term yields that occurred late in December when the Federal funds rate rose were generally more than reversed by declines in January. Since early January the spread of private rates over shorter-term Treasury bill rates has narrowed significantly, establishing a more normal yield relationship, as foreign official purchases of Treasury bills virtually ceased while sales by the Treasury and the Open Market Trading Desk increased the floating supply.

In contrast, Treasury and municipal bond yields have fallen relatively more than corporate bond yields since year end. By late January, longer-term Treasury and municipal interest rates were 10 to 25 basis points below their mid-December levels. The average rate on S&L commitments to make conventional home mortgage loans rose only slightly over the intermeeting period. Stock prices edged lower in late December, but have rallied by 7 to 10 per cent since year end, as the improvement in the foreign exchange value of the dollar and larger than expected gains in profits at some major corporations buoyed investor sentiment.

Needs for external credit at many nonfinancial corporations were likely reduced last quarter, as profit gains augmented gross internal sources of funds. More moderate growth in short- and intermediate-term business credit in December largely reflected flat business loans at commercial banks,

as commercial paper issuance and borrowing from finance companies by non-financial firms advanced at near the rapid month-earlier pace. Commercial bank business lending evidently resumed growth in January, but growth of nonfinancial commercial paper reportedly slowed. Corporations also curtailed longer-term borrowing, although apparently heavy takedowns of mortgage loans from insurance companies and commercial banks supplemented the light bond and stock financing.

Net domestic offerings of marketable Treasury issues rebounded in January from the reduced December pace, when sales of non-marketable to foreign official institutions and foreign private investors were substantial. In contrast, gross borrowing by State and local governments declined in January, following an increase in December. Federally sponsored credit agencies maintained borrowing at a record high over the two months.

In the household sector, home mortgage and consumer instalment credit apparently expanded somewhat less rapidly in December amid reports of a tightening in non-price terms for both types of borrowing. The household debt burden--measured by the ratio of debt repayments to disposable income--grew during the fourth quarter by a smaller amount than the sharp increases earlier in the year.

M-1 expanded at only 1-3/4 per cent in December and remained flat through mid-January at a level only slightly above the September figure. The cumulative effects of the sharp rises in open market interest rates since last summer apparently have caused demand depositors to economize on their holdings. In addition, the continued transfer of funds from demand deposits to savings deposits with the automatic transfer feature and the introduction

of NOW accounts in New York has lowered the monthly growth rate of M-1 by 3 to 3-1/2 percentage points. Even with these transfers, sizable net outflows of savings deposits have been recorded, more than offsetting inflows to small time accounts associated with sales of money market certificates (MMCs). These developments, combined with a sharply reduced issuance during December and early January of large time deposits included in M-2, produced a marked deceleration in growth of this aggregate. Despite strong growth of MMCs, deposit growth at nonbank thrift institutions has also remained below the reduced November pace, contributing to slower M-3 expansion.

Outlook. Aggregate credit flows into the spring are expected to rise a bit from the reduced pace in December and January but remain below the fourth quarter average. With little change expected in corporate needs for external financing, total business borrowing is likely to be similar to the fourth quarter. Corporations are projected to place more reliance upon longer-term financing than recently. At the short-end, a pick-up in business lending by commercial banks from the recent pace is likely, and banks are expected to further tighten non-price lending terms as their balance sheet positions come under additional pressure.

With deposit growth at nonbank thrift institutions projected to decline further, S&Ls will likely again pare the volume of their new mortgage commitments. FNMA and FHLMC purchase programs should, however, continue to be sizable. Underlying demands for home mortgage funds, meanwhile, promise to remain strong--reflecting projected real income growth, demographic factors, and the attractiveness of houses as a hedge against

inflation. Therefore, some further upward pressure on home mortgage interest rates is likely, which, together with usury ceiling constraints, should result in a reduction in the net volume of home mortgage borrowing over the next few months. A projected moderation in growth of personal consumption expenditures should lower expansion in consumer instalment credit.

Demands on credit markets by governmental units are expected to be relatively strong through early spring. The Treasury is expected to issue about \$18 to \$19 billion of additional debt before the April 15 tax date, with about two-thirds of this total likely to be obtained in the bill market, mainly in cash management bills. Borrowing of Federally-sponsored agencies and State and local governments will likely remain near the levels of recent months.

Demand and supply forces in credit markets are thus not likely to place significant upward pressures on market rates over the next few months. Any resumption of upward rate pressures is likely to depend more on adjustments in expectations or in monetary policy if renewed growth in the monetary aggregates is excessive or if inflation accelerates and the foreign exchange value of the dollar depreciates substantially.

INTERNATIONAL DEVELOPMENTS

Summary. In mid-December, just before the last FOMC meeting, the dollar came under severe pressure in exchange markets in the wake of the announcement of larger-than-expected oil price increases. In the following four days the trade-weighted average value of the dollar fell about 2-1/2 per cent; selling pressure strengthened again toward the end of the year.

Since the turn of the year the dollar's value has tended upward, though some setback occurred when German authorities suggested that their concern about inflation outweighed their concern with their exchange rate.

U.S. authorities purchased (net) a small amount of foreign currencies. The average value of the dollar is now about 8 per cent above its low point last October.

The U.S. merchandise trade deficit in the fourth quarter was close to \$30 billion at an annual rate, about the level maintained since the second quarter. In December the deficit was at about the fourth-quarter rate. During the fourth quarter non-agricultural exports registered a sizable gain in volume, while the growth of non-oil imports decelerated.

Private capital movements reported by banks and securities dealers registered a net outflow of about \$7 billion (not annual rate) in the fourth quarter (based on data for October and November and an estimate for December), compared to a net outflow of under \$1 billion in the third quarter. Net foreign lending by banks was large in November and there are indications that it continued at a substantial rate in December. A sizable part of the outflow was reported as going to foreign non-banks, suggesting that some borrowing may have been for switching into foreign currencies in anticipation of dollar depreciation. Transactions in securities were relatively small, net, in the fourth quarter; U.S. purchases of foreign bonds picked up a bit but a major departure was the sale of the Treasury's \$1.6 billion equivalent German mark issue to private investors in Germany. In January, the Treasury sold a \$1.2 billion equivalent issue denominated in Swiss francs.

Foreign official assets in the U.S. increased substantially in the fourth quarter, including about \$16 billion for G-10 countries and \$1 billion for OPEC countries. This was considerably above the \$5 billion increase in foreign official assets in the United States reported in the third quarter. There was little change in the current account balance between the two quarters, but there was a sharp rise in private capital net outflows and an apparent rise in unrecorded net outflows. U.S. reserve assets in the aggregate were virtually unchanged in the fourth quarter; holdings of convertible foreign currencies rose

by over \$4 billion, with a roughly equivalent reduction in SDR holdings and the U.S. reserve position in the IMF. Large U.S. market intervention was about equal to the proceeds of swap drawings and market borrowing by the Treasury.

Activity in international capital markets was on a greatly increased scale in 1978, with little change between the first and second halves of the year. The increase for the year occurred in announced medium-term Euro-credits by banks, which nearly doubled to a total of \$64 billion. A large part of the increase represented refinancing of outstanding or maturing credits, often on improved terms. However, a number of countries (notably Canada and some of the OPEC countries) raised substantially larger amounts of new funds. Sales of Euro-bonds and foreign bonds, combined, totalled about \$36 billion for the year, up slightly from the 1977 amount.

Economic activity abroad scored moderate gains last year, with Germany in particular stepping up from a slow 1977 pace while Japan registered only a small gain over the 1977 performance. Some acceleration also appeared in the United Kingdom, France, Canada, and Italy, among the major countries. There was a fairly general pattern of deceleration of inflation rates in foreign industrial countries.

Outlook. From the fourth quarter of 1978 to the fourth quarter of 1979 the staff expects the average rate of economic growth abroad to be about 3-1/2 per cent, considerably above the projected U.S.

growth rate for the same period. The pace of price inflation abroad is projected to rise somewhat from current rates, but on average to remain below the U.S. rate. The net effect of these factors, together with the depreciation of the dollar since late 1977, is expected to be a sizable reduction in the trade deficit. Partly offsetting these gains are a likely decline in military and other exports to Iran, and an increase in the cost and volume of oil imports. Taken together, these factors are projected to bring the trade deficit down to \$28 billion in 1979 from the \$35 billion result for 1978, with a further reduction to \$20 billion projected for 1980. The corresponding current account deficit would be about \$9 billion in 1979 (\$17 billion in 1978) and would be eliminated by mid-1980. Given this outlook for the international accounts, the staff does not expect a further change in the dollar's value over the next year or so.

	1978 ^e	1979 ^P	1980 ^P	1978		1979 ^P				1980 ^P			
				III	IV ^e	I	II	III	IV	I	II	III	IV
GNP NET EXPORTS OF GOODS AND SERVICES													
1. International Acct. data	-11.0	1.2	13.2	-9.8	-6.0	1.9	2.3	.2	.8	8.5	12.2	14.6	17.0
2. (GNP account data 1/)	(-11.8)	(.4)	(12.2)	(-10.7)	(-6.9)*	(1.0)	(1.4)	(-.7)	(-.1)	(7.6)	(11.3)	(13.7)	(16.1)
3. a) Merchandise Trade Balance	-34.8	-27.6	-19.5	-32.2	-31.0	-25.6	-26.3	-29.1	-29.4	-23.3	-20.3	-18.3	-16.3
4. Exports (excl. military)	141.9	171.7	198.6	147.7	157.0	162.1	168.1	175.0	181.5	188.5	195.1	202.0	208.8
5. Agricultural	29.9	30.0	31.6	31.7	30.0	30.3	29.7	30.1	30.0	30.8	31.1	31.9	32.5
6. Nonagricultural	112.0	141.7	167.0	116.0	127.0	131.8	138.4	144.9	151.5	157.7	164.0	170.0	176.3
7. Imports	176.7	199.3	218.1	179.9	188.0	187.7	194.4	204.1	210.9	211.8	215.4	220.3	225.1
8. Petroleum and petrol. products	42.8	49.1	54.6	43.3	45.0	42.2	45.8	52.6	55.8	52.6	53.8	55.8	56.9
9. Nonpetroleum	133.9	150.2	163.5	136.6	143.0	145.5	148.6	151.5	155.1	159.2	161.6	165.0	168.2
10. b) Other transactions, net	23.8	28.8	32.7	22.4	25.0	27.5	28.6	29.3	30.2	31.8	32.5	32.9	33.3
11. Investment Income, net 2/	19.9	23.6	25.1	19.1	20.8	23.2	23.5	23.7	23.9	25.0	25.3	25.1	25.0
12. Other, net 3/	3.9	5.2	7.6	3.3	4.2	4.3	5.1	5.6	6.3	6.8	7.2	7.8	8.3
13. U.S. CURRENT ACCOUNT BALANCE	-17.3	-8.5	2.9	-15.3	-13.8	-8.2	-8.2	-9.3	-8.5	-2.1	1.5	4.7	7.4
14. a) GNP net exports (line 1.)	-11.0	1.2	13.2	-9.8	-6.0	1.9	2.3	.2	.8	8.5	12.2	14.6	17.0
15. b) U.S. Govt & private transfers 4/	-6.3	-9.7	-10.3	-5.5	-7.8	-10.1	-10.5	-9.5	-9.3	-10.6	-10.7	-9.9	-9.6
Constant (1972) dollars													
16. Merchandise exports (excl. military)	72.3	80.2	86.3	74.0	76.5	77.8	79.2	81.0	82.8	84.3	85.6	86.9	88.4
17. (% change, annual rates)	(7.9)	(10.9)	(7.6)	(6.1)	(14.3)	(7.4)	(7.0)	(9.5)	(9.5)	(7.4)	(6.6)	(6.1)	(7.0)
18. Merchandise imports	76.1	79.8	81.5	77.1	79.0	77.6	78.7	80.9	81.9	80.8	81.0	81.7	82.3
19. (% change, annual rates)	(7.2)	(4.8)	(2.1)	(17.9)	(10.4)	(-7.0)	(5.7)	(11.7)	(4.9)	(-5.3)	(.8)	(3.2)	(3.2)
Foreign Outlook - Ten Industrial Countries 5/													
20. Real GNP, % change, annual rates	3.6	3.9	3.9	2.9	4.7	3.7	3.9	4.0	4.1	3.9	3.5	3.8	4.0
21. Consumer Prices, 6/ % change, A.R.	5.3	5.8	6.4	4.0	4.5	5.9	6.6	7.0	6.6	6.4	6.1	5.8	5.7

1/ Lines 1 and 2 are defined identically but, data in line 2 differ from Intl. Acct. data (line 1) in that they usually lag the Intl. Acct. data in the inclusion of revisions and new information in published data.
2/ Excluding U.S. Govt. interest payments to foreigners, and reinvested earnings of incorporated affiliates. These are included in line 15.
3/ Includes travel, transportation, fees and royalties, miscellaneous other service transactions, and military transactions.
4/ Includes U.S. Govt. grants, U.S. Govt. interest payments to foreigners, remittances and pensions, exports to Israel financed by U.S. military assistance grants, and reinvested earnings of incorporated affiliates.

5/ Weighted by the shares of Canada, France, Germany, Italy, Japan, United Kingdom, Netherlands, Sweden, Belgium and Switzerland in the sum of the real GNP of the ten countries in dollar terms.
6/ Wholesale prices for Japan.
p/ Projected.
e/ Estimated.
*/ Published data.