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CONFIDENTIAL (FR)

January 11, 1978

SUMMARY AND OUTLOOK

By the Staff
Board of Governors
of the Federal Reserve System

SUMMARY AND OUTLOOK

DOMESTIC NONFINANCIAL DEVELOPMENTS

Summary. Final sales gathered substantial momentum toward year-end, particularly in the consumer sector. Residential construction activity apparently strengthened and outlays on plant and equipment picked up as well. But overall growth was damped in the final quarter as inventory accumulation moderated considerably from the third quarter pace. Nonfarm payroll employment rose strongly during the quarter and unemployment declined, particularly in December. Growth of industrial production was probably quite modest, however, as auto assemblies were reduced and coal output fell due to the UMW strike.

Retail sales exclusive of autos and nonconsumption items edged down slightly in December after rising very sharply in October and November. For the fourth quarter as a whole, such sales rose 3.7 per cent--the largest quarterly advance in over a decade. Strength was evident at most types of stores with particularly large gains for general merchandise and apparel outlets. In December, unit sales of domestic automobiles increased to an 8.9 million rate, still well below the pace in the early part of the year.

Nonfarm payroll employment rose by over 300,000 in December (strike-adjusted), about as much as in November. Jobs in the service-producing industries continued on a sustained upward trend, and factory employment rose strongly. The average factory workweek declined, in part reflecting a shorter workweek in the auto industry where

assemblies were reduced in December. With employment growth strong and the labor force essentially unchanged from November, the unemployment rate fell in December to 6.4 per cent. The reported reduction of joblessness was widespread among the demographic and economic groups.

The combination of several months of modest production gains--reflecting the sluggish pace of consumer demand earlier in the year--and a surprisingly strong year-end surge of retail sales apparently has resulted in a significantly reduced rate of inventory accumulation. In November, the book value of manufacturers' inventories rose at a \$3.7 billion annual rate, half the October rise and less than one-third the average pace over the first three quarters of the year. The inventory-sales ratio for all manufacturing was unchanged in November at a comparatively low level.

Capital goods outlays apparently rose further in the final quarter as shipments of nondefense capital goods in October and November averaged 3-1/2 per cent above the advanced third quarter rate. On the other hand, new orders for nondefense capital goods declined in November. Such orders have traced an uneven path in recent months but generally have risen at a much slower pace since spring than they had early in the year. Construction contracts for commercial and industrial buildings rebounded in November, but the dollar value of contract awards was still below the monthly average for the third quarter.

The recent acceleration in the overall price indices mainly reflects developments in farm and food sectors. Consumer prices rose half a per cent in November, as food prices recorded a much larger increase than during the June to October period. Increases in services prices continued comparatively moderate but prices of new cars rose markedly in November. Wholesale prices of farm and food products were up sharply in November for the second consecutive month, pushing the overall Wholesale Price Index up 0.7 per cent. Wholesale prices of finished goods rose 0.4 per cent in November.

Outlook. Real GNP is now estimated to have risen at a 4-1/2 per cent annual rate in the fourth quarter--about one-half percentage point less than in the third quarter. The slowdown primarily reflected a reduced rate of inventory investment. Real final sales are estimated to have advanced at a 6-1/2 per cent annual rate--up from a 4-1/2 per cent gain in the third quarter. Personal consumption expenditures and outlays on residential structures were particularly strong in the fourth quarter.

The staff projection, which has been extended through the first half of 1979, is based on substantially modified monetary and fiscal assumptions. Our fiscal policy assumptions now incorporate a \$25 billion tax cut to become effective October 1, 1978. The tax package we have assumed parallels the fiscal proposals the Administration

reportedly will present to Congress later this month. About two-thirds of the assumed cut is in personal income taxes, mainly in the form of reduced tax rates.

The bulk of the \$8 billion projected cut in business taxes would result from a reduction in the maximum corporate tax rate from 48 to 45 per cent effective October 1. In an effort to bolster investment spending, modifications of investment tax credit would be retroactive to January 1, 1978. The present temporary provisions of the investment tax credit would be made permanent, and, at a cost of about \$2 billion, the portion of taxable profits eligible for offset would be increased and spending on new structures would become eligible for the credit. Because of continued legislative delays the assumed effective date of the energy package has been shifted from February 15, 1978 to July 1, 1978. The staff continues to assume that most of the revenues from taxes in the energy package will be rebated to individuals and businesses.

The staff has assumed that M_1 growth will average 5-1/4 per cent over the next six quarters. Given that rate of growth, short-term interest rates would be expected to rise appreciably further, with the bulk of the increase occurring by mid-1978. With inflows to thrift institutions slowing and higher short-and intermediate term interest rates now in prospect, it is also assumed that Federal agencies will raise interest rate ceilings on small denomination time deposits to help maintain thrift inflows and to support residential construction activity.

The staff had earlier been projecting a deceleration of activity during 1978, under the assumption of no new fiscal initiatives. Gains were projected to slow because of the sluggish behavior of business fixed investment and a moderate decline expected in residential construction activity. Economic developments of the past few weeks have not significantly altered that underlying outlook.

In the new projection, which incorporates a tax cut, growth of real GNP is projected at close to a 5 per cent annual rate during 1978--more than half a percentage point above last month's projection. In the first quarter, real GNP growth is expected to be bolstered by increased inventory accumulation following the reduced pace late last year. Growth is expected to moderate somewhat in the two middle quarters although investment spending should begin to respond to the retroactive investment tax credit. Growth is projected to be strengthened in the last quarter by increased consumer outlays reflecting the heavy weighting of the tax reduction toward personal taxes. Not all of the personal income tax cut is expected to be spent initially, and the saving rate is projected to rise sharply in late 1978 and early 1979--the first few quarters after taxes are cut. Real output growth over the first half of 1979 also is projected to be at about a 5 per cent annual rate--more than 1 percentage point greater than it would have been in the absence of the tax cut.

The projected rise in real GNP should bring the unemployment rate down to about 6 per cent by mid-1979. Increased demand for labor and large minimum wage increases in both 1978 and 1979, are likely to result in an accelerated rate of wage growth but this should be about offset on the cost side by slightly faster productivity growth normally associated with stronger gains in output. Because of the large increases in payroll taxes in 1978 and those scheduled for 1979, however, pressures of costs on prices are expected to be somewhat greater over the projection period than over the period just ended. As a result, the fixed-weighted price index is projected to rise at an annual rate of 6-1/2 per cent over the projection period, up about one-half per cent from the rate over the six quarters ending in the fourth quarter of 1977.

Details of the staff 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)	
	12/14/77	1/11/78	12/14/77	1/11/78	12/14/77	1/11/78	12/14/77	1/11/78
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	10.9	10.8	5.0	5.0	6.1	6.0	7.1	7.1
1978	11.3	11.6	4.7	4.9	6.4	6.2	6.6	6.4
1977-III	10.0	10.2	4.7	5.1	5.1	5.0	7.0	7.0
IV	12.4	11.6	5.1	4.5	6.2	6.0	6.9	6.8
1978-I	11.2	12.5	4.6	5.4	6.7	6.6	6.7	6.5
1978-II	11.0	11.0	4.4	4.5	6.7	6.3	6.7	6.4
1978-III	10.4	10.9	4.1	4.4	6.2	6.6	6.6	6.4
1978-IV	11.3	12.3	4.1	5.1	6.3	6.3	6.6	6.3
1979-I		11.9		5.1		6.6		6.1
1979-II		10.8		4.5		6.4		6.0
Change:								
76-IV to 77-IV	12.3	12.2	5.9	5.8	6.4	6.3	-1.0	-1.1
77-II to 78-II	11.1	11.3	4.7	4.9	6.2	5.9	-.3	-.6
77-IV to 78-IV	11.0	11.7	4.3	4.8	6.4	6.5	-.3	-.5
78-II to 79-II		11.5		4.8		6.5		-.4

^{1/} Actual.

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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				1979	
	III	IV	I	II	Projected		I	II
Gross National Product	1915.9	1969.0	2027.9	2081.7	2136.3	2199.4	2262.2	2321.1
Final purchases	1892.2	1954.0	2009.9	2060.2	2113.3	2174.4	2232.5	2289.6
Private	1491.3	1541.3	1586.3	1625.3	1667.5	1714.7	1762.0	1808.7
Excluding net exports	1498.8	1551.5	1591.9	1631.6	1674.4	1720.8	1767.5	1815.0
Personal consumption expenditures	1218.9	1258.5	1287.5	1318.5	1352.6	1390.6	1429.0	1467.7
Goods	659.4	683.0	698.0	715.0	733.7	755.6	775.3	795.8
Services	559.5	575.5	589.5	603.5	618.9	635.0	653.7	671.9
Gross private domestic investment	303.6	308.0	322.4	334.6	344.8	355.2	368.2	378.8
Residential construction	92.5	99.3	105.1	107.6	110.1	112.1	113.6	115.1
Business fixed investment	187.5	193.7	199.3	205.5	211.7	218.1	224.9	232.2
Change in business inventories	23.6	15.0	18.0	21.5	23.0	25.0	29.7	31.5
Nonfarm	23.1	13.5	17.0	21.0	23.0	25.0	29.7	31.5
Net exports of goods and services ^{1/}	-7.5	-10.2	-5.6	-6.3	-6.9	-6.1	-5.5	-6.3
Exports	179.9	179.0	190.3	197.6	204.2	210.4	217.1	223.3
Imports	187.4	189.2	195.9	203.9	211.1	216.5	222.6	229.6
Gov't. purchases of goods and services	400.9	412.7	423.6	434.9	445.8	459.7	470.5	480.9
Federal ^{2/}	148.1	152.3	155.6	159.6	163.2	169.9	173.0	175.8
State and local	252.9	260.4	268.0	275.3	282.6	289.8	297.5	305.1
Gross national product in constant (1972) dollars	1347.4	1362.4	1380.3	1395.7	1410.9	1428.5	1446.4	1462.5
Personal income	1549.8	1597.9	1641.0	1684.2	1731.8	1782.6	1835.6	1882.3
Wage and salary disbursements	998.9	1026.3	1056.3	1081.9	1108.6	1139.5	1175.6	1204.3
Disposable income	1323.8	1362.7	1402.9	1437.4	1474.3	1529.9	1575.7	1612.5
Saving rate (per cent)	5.5	5.3	5.9	5.9	5.9	6.8	7.0	6.6
Corporate profits with I.V.A. and C.C. Adj.	149.0	155.2	160.1	161.0	161.7	170.5	167.1	167.8
Corporate profits before tax	172.8	185.2	192.4	193.5	194.2	203.0	199.6	200.3
Federal government surplus or deficit (-) (N.I.A. basis)	-58.9	-55.9	-56.5	-51.3	-47.9	-63.8	-63.2	-54.7
High employment surplus or deficit (-)	-20.3	-18.3	-19.3	-13.1	-9.5	-27.6	-26.5	-17.3
State and local government surplus or deficit (-) (N.I.A. basis)	32.9	30.8	29.6	28.7	26.7	26.0	24.1	22.6
Excluding social insurance funds	17.4	13.7	12.1	10.7	8.2	7.0	4.6	2.6
Civilian labor force (millions)	97.6	98.7	99.3	99.8	100.4	101.0	101.6	102.1
Unemployment rate (per cent)	7.0	6.8	6.5	6.4	6.4	6.3	6.1	6.0
Nonfarm payroll employment (millions)	82.5	83.2	83.8	84.4	85.0	85.7	86.4	87.0
Manufacturing	19.6	19.8	20.0	20.2	20.4	20.7	21.0	21.2
Industrial production (1967=100)	138.5	139.6	142.4	144.7	147.0	150.0	153.0	155.5
Capacity utilization: all manufacturing (per cent)	83.0	82.9	83.9	84.3	84.8	85.7	86.4	86.8
Materials (per cent)	82.4	82.8	83.8	84.4	85.0	86.0	86.8	87.3
Housing starts, private (millions, A.R.)	2.06	2.13	2.10	2.05	2.00	1.95	1.90	1.90
Sales new autos, (millions, A.R.)	10.92	10.74	11.10	10.95	10.90	11.05	11.10	10.95
Domestic models	8.88	8.77	9.10	9.00	9.90	9.10	9.15	9.10
Foreign models	2.04	1.97	2.00	1.95	1.90	1.95	1.95	1.85

^{1/} Balance of payments data and projection underlying these estimates are shown in the International Development 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				1979	
	III	IV	I	Projected		I	II	
				III	IV			
	-----Billions of dollars-----							
Gross National Product	46.0	53.1	58.9	53.8	54.6	63.1	62.8	58.9
Inventory change	1.9	-8.6	3.0	3.5	1.5	2.0	4.7	1.8
Final purchases	44.0	61.8	55.9	50.3	53.1	61.1	58.1	57.1
Private	33.7	50.0	45.0	39.0	42.2	47.2	47.3	46.7
Net exports	2.2	-2.7	4.6	-7	-6	.8	.6	-8
Excluding net exports	31.5	52.7	40.4	39.7	42.8	46.4	46.7	47.5
Personal consumption expenditures	24.9	39.6	29.0	31.0	34.1	38.0	38.4	38.7
Goods	6.4	23.6	15.0	17.0	18.7	21.9	19.7	20.5
Services	18.4	16.0	14.0	14.0	15.4	16.1	18.7	18.2
Residential fixed investment	1.7	6.8	5.8	2.5	2.5	2.0	1.5	1.5
Business fixed investment	5.1	6.2	5.6	6.2	6.2	6.4	6.8	7.3
Government	10.3	11.8	10.9	11.3	10.9	13.9	10.8	10.4
Federal	4.5	4.2	3.3	4.0	3.6	6.7	3.1	2.8
State and local	5.9	7.5	7.6	7.3	7.3	7.2	7.7	7.6
GNP in constant (1972) dollars	16.7	15.0	17.9	15.4	15.3	17.5	18.0	16.1
Final purchases	14.3	20.6	16.2	13.3	14.3	16.4	15.2	15.0
Private	10.3	18.9	13.0	10.0	11.3	14.4	13.0	12.9
	-----In Per Cent Per Year ^{1/} -----							
Gross National Product	10.2	11.6	12.5	11.0	10.9	12.3	11.9	10.8
Final purchases	9.9	13.7	11.9	10.4	10.7	12.1	11.1	10.6
Private	9.6	14.1	12.2	10.2	10.8	11.8	11.5	11.0
Personal consumption expenditures	8.6	13.6	9.5	10.0	10.8	11.7	11.5	11.3
Goods	4.0	15.1	9.1	10.1	10.9	12.5	10.8	11.0
Services	14.3	11.9	10.1	9.8	10.6	10.8	12.3	11.6
Business fixed investment	12.4	5.9	20.1	16.0	12.8	12.6	15.5	12.0
Residential structures	7.7	32.8	25.5	9.9	9.6	7.5	5.5	5.4
Business fixed investment	11.6	13.9	12.1	13.0	12.6	12.7	13.1	13.6
Gov't. purchases of goods and services	11.0	12.3	11.0	11.1	10.4	13.1	9.7	9.1
Federal	12.9	12.0	9.0	10.7	9.3	17.5	7.5	6.6
State and local	9.9	12.5	12.2	11.3	11.0	10.6	11.1	10.6
GNP in constant (1972) dollars	5.1	4.5	5.4	4.5	4.4	5.1	5.1	4.5
Final purchases	4.4	6.4	4.9	3.9	4.2	4.8	4.4	4.3
Private	4.0	7.4	4.9	3.7	4.2	5.3	4.7	4.6
GNP implicit deflator ^{2/}	4.8	6.7	6.8	6.2	6.2	6.9	6.5	6.0
Gross business product fixed-weighted price index ^{3/}	5.0	6.0	6.6	6.3	6.6	6.3	6.6	6.4
Personal income	8.9	13.0	11.2	11.0	11.8	12.3	12.4	10.6
Wage and salary disbursements	7.5	11.4	12.2	10.1	10.2	11.6	13.3	10.1
Disposable income	10.0	12.3	12.3	10.2	10.7	15.9	12.5	9.7
Corporate profits before tax	-2.7	31.8	16.5	2.3	1.5	19.3	-6.5	1.3
Nonfarm payroll employment	3.3	3.2	3.1	2.8	2.9	3.3	3.3	2.9
Manufacturing	1.3	4.0	4.0	4.0	4.5	5.5	6.0	4.5
Nonfarm business sector								
Output per hour	2.9	2.0	3.0	2.3	2.3	2.4	2.5	2.1
Compensation per hour	7.6	7.9	11.7	7.8	7.9	7.9	11.3	8.0
Unit labor costs	4.5	5.9	8.7	5.5	5.6	5.5	8.8	5.9
Industrial production	4.5	3.3	8.5	6.5	6.5	8.3	8.3	6.6
Housing starts, private	36.6	14.5	-5.5	-9.2	-9.4	-9.6	-9.9	.0
Sales new autos	-24.1	-6.2	13.6	-5.3	-1.8	5.6	1.8	-5.3
Domestic models	-18.4	-4.8	15.8	-4.3	.0	4.5	2.2	-2.2
Foreign models	-43.9	-12.3	4.7	-9.6	-9.9	10.9	.0	-19.0

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

^{2/} Excluding Federal pay increases rates of change are: 1977-IV, 6.0 per cent; 1978-I, 6.7 per cent; 1978-IV, 6.3 per cent; 1979-I, 6.4 per cent.
Using expenditures in 1972 as weights.

January 11, 1978

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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	1412.9	1528.8	1706.5	1891.4	2111.3
Final purchases	1057.1	1161.7	1288.6	1404.0	1540.3	1693.1	1872.9	2089.4
Private	823.4	908.6	1019.1	1101.3	1201.4	1331.	1478.1	1648.4
Excluding net exports	821.8	911.9	1012.0	1095.3	1181.0	1323.9	1487.0	1654.7
Personal consumption expenditures	668.2	733.0	809.9	889.6	980.4	1093.9	1210.9	1337.3
Goods	374.8	410.5	457.5	498.3	542.2	601.6	659.7	725.6
Services	293.4	322.4	352.3	391.3	438.2	492.3	551.2	611.7
Gross private domestic investment	160.0	188.3	220.0	214.6	189.1	243.3	294.6	339.2
Residential construction	49.6	62.0	66.1	55.1	51.5	68.0	90.9	108.7
Business fixed investment	104.1	116.8	136.0	150.6	149.1	161.9	185.2	208.6
Change in business inventories	6.4	9.4	17.9	8.9	-11.5	13.3	18.5	21.9
Nonfarm	5.1	8.8	14.7	10.8	-15.1	14.9	18.3	21.5
Net exports of goods and services	1.6	-3.3	7.1	6.0	20.4	7.8	-8.9	-6.2
Exports	65.6	72.7	101.6	137.9	147.3	162.9	176.8	200.6
Imports	64.0	75.9	94.4	131.9	126.9	155.1	185.7	206.8
Gov't. purchases of goods and services	233.7	253.1	269.5	302.7	338.9	361.4	394.8	441.0
Federal	96.2	102.1	102.2	111.1	123.3	130.1	145.1	162.1
State and local	137.5	151.0	167.3	191.5	215.6	231.2	249.7	278.9
Gross national product in constant (1972) dollars	1107.5	1171.1	1235.0	1217.8	1202.1	1274.7	1337.9	1403.8
Personal income	859.1	942.5	1052.4	1154.9	1253.4	1382.7	1535.4	1709.9
Wage and salary disbursements	579.4	633.8	701.3	764.6	805.7	891.8	989.3	1096.6
Disposable income	742.8	801.3	901.7	984.6	1084.4	1185.8	1307.9	1461.1
Saving rate (per cent)	7.7	6.2	7.8	7.3	7.4	5.6	5.1	6.1
Corporate profits with I.V.A. and C.C. Adj.	77.2	92.1	99.1	83.6	99.3	128.1	142.5	163.3
Corporate profits before tax	82.0	96.2	115.8	126.9	123.5	156.9	173.4	195.8
Federal government surplus or deficit (-) (N.I.A. basis)	-22.0	-17.3	-6.7	-10.7	-70.2	-54.0	-48.5	-54.9
High employment surplus or deficit (-)	-5.3	-5.9	-7	17.1	-20.3	-10.4	-7.8	-17.4
State and local government surplus or deficit (-) (N.I.A. basis)	3.7	13.7	13.0	7.5	5.9	18.4	29.1	27.7
Excluding social insurance funds	-3.8	5.6	4.1	-2.9	-6.2	3.9	13.3	9.5
Civilian labor force (millions)	84.1	86.5	88.7	91.0	92.6	94.8	97.4	100.0
Unemployment rate (per cent)	6.0	5.6	4.9	5.6	8.5	7.7	7.1	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	20.3
Industrial production (1967=100)	109.6	119.7	129.8	129.3	117.8	129.8	137.2	146.0
Capacity utilization: all manufacturing (per cent)	78.0	83.1	87.5	84.2	73.6	80.2	82.5	84.7
Materials (per cent)	83.1	88.0	92.4	87.7	73.6	80.4	82.1	84.8
Housing starts, private (millions, A.R.)	2.05	2.36	2.05	1.34	1.16	1.54	1.96	2.02
Sales new autos (millions, A.R.)	10.24	10.93	11.42	8.91	8.66	10.12	11.13	11.00
Domestic models	8.68	9.32	9.65	7.49	7.08	8.63	9.07	9.05
Foreign models	1.56	1.61	1.77	1.42	1.58	1.50	2.06	1.95

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CHANGES 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	106.3	115.9	177.7	184.9	219.9
Inventory change	2.6	3.0	8.5	-9.0	-20.4	24.8	5.2	3.4
Final purchases	78.5	104.6	126.9	115.4	136.3	152.8	179.8	216.5
Private	63.7	85.2	110.5	82.2	100.1	130.3	146.4	170.3
Net exports	-2.3	-4.9	10.4	-1.1	14.4	-12.6	-16.7	2.7
Excluding net exports	66.0	90.1	100.1	83.3	85.7	142.9	163.1	167.6
Personal consumption expenditures	49.4	64.8	76.9	79.7	90.8	113.5	117.0	126.4
Goods	25.2	35.7	47.0	40.8	43.9	59.4	58.2	65.8
Services	24.3	29.0	29.9	39.0	46.9	54.1	22.9	17.8
Residential fixed investment	13.0	12.4	4.1	-11.0	-3.6	16.5	23.3	23.5
Business fixed investment	3.6	12.7	19.2	14.6	-1.5	12.8	33.4	46.2
Government	14.8	19.4	16.4	33.2	36.2	22.5	15.0	17.0
Federal	.6	5.9	.1	8.9	12.2	6.8	18.5	29.2
State and local	14.3	13.5	16.3	24.2	24.1	15.6		
GNP in constant (1972) dollars	32.2	63.6	63.9	-17.2	-15.7	72.6	63.2	66.0
Final purchases	29.9	60.8	56.8	-8.6	2.1	54.2	59.5	64.1
Private	30.7	57.1	57.4	-13.8	-3.2	52.8	53.2	51.5
----- In Per Cent Per Year -----								
Gross National Product	8.2	10.1	11.6	8.1	8.2	11.6	10.8	11.6
Final purchases	8.0	9.9	10.9	8.9	9.7	9.9	10.6	11.6
Private	8.4	10.3	12.2	8.1	9.1	10.8	11.0	11.5
Personal consumption expenditures	8.0	9.7	10.5	9.8	10.2	11.6	10.7	10.4
Goods	7.2	9.5	11.4	8.9	8.8	11.0	9.7	10.0
Services	9.0	9.9	9.3	11.1	12.0	12.4	12.0	11.0
Residential fixed investment	13.6	17.7	16.8	-2.5	-11.9	28.7	21.1	15.2
Business fixed investment	35.5	25.1	6.6	-16.7	-6.5	32.2	33.2	19.6
Business fixed investment	3.6	12.3	16.4	10.8	-1.0	8.6	14.4	12.7
Gov't. purchases of goods and services	6.8	8.3	6.5	12.3	12.0	6.6	9.2	11.7
Federal	.6	6.1	.1	8.7	11.0	5.5	11.5	11.7
State and local	11.6	9.8	10.8	14.5	12.6	7.2	8.0	11.7
GNP in constant (1972) dollars	3.0	5.7	5.5	-1.4	-1.3	6.0	5.0	4.9
Final purchases	2.8	5.5	4.9	-.7	.2	4.5	4.7	4.8
Private	3.7	6.7	6.3	-1.4	-.3	5.6	5.3	4.9
GNP implicit deflator	5.1	4.1	5.8	9.7	9.6	5.3	5.6	6.4
Gross business product fixed-weighted index ^{1/}	4.4	3.3	5.7	10.4	9.5	5.4	6.0	6.2
Personal income	7.2	9.7	11.7	9.7	8.5	10.3	11.0	11.4
Wage and salary disbursements	6.0	9.4	10.7	9.0	5.4	10.7	10.9	10.8
Disposable income	8.3	7.9	12.5	9.2	10.1	9.4	10.3	11.7
Corporate profits before tax	14.7	17.3	20.4	9.6	-2.7	27.0	10.5	12.9
Nonfarm payroll employment	.4	3.5	4.3	2.0	-1.7	3.1	3.4	3.2
Manufacturing	-4.0	2.8	5.1	-.1	-8.5	3.3	3.2	3.9
Nonfarm business sector								
Output per hour	2.9	3.0	1.7	-2.9	1.6	4.1	2.1	2.5
Compensation per hour	6.6	5.8	7.8	9.4	9.6	8.7	8.7	8.8
Unit labor costs	3.5	2.7	6.0	12.7	7.9	4.5	6.5	6.3
Industrial production	1.7	9.2	8.4	-.4	-8.9	10.2	5.7	6.4
Housing starts	43.1	14.9	-13.2	-34.6	-13.3	32.6	27.6	2.9
Sales new autos	21.9	6.8	-4.7	-14.5	-2.8	16.9	9.9	-1.1
Domestic models	21.9	7.4	3.5	-22.4	-5.5	21.9	5.1	-.2
Foreign models	21.8	3.1	9.7	-19.9	11.4	-5.1	37.2	-5.2

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

FEDERAL SECTOR ACCOUNTS
(billions of dollars)

January 11, 1978

	Fiscal Year 1977*	FY 78 e/			CY 1976 *	CY 77 e/		CY 78 e/		F.R.B. staff estimates							
		Admin. est. 1/	F.R. Board	Cong. est. 2/		F.R. Board	F.R. Board	Calendar quarters; unadjusted data									
								1977								1978	
							I*	II*	III*	IV	I	II	III	IV			
Unified budget receipts	356.9	401.4	393.0	397.0	317.6	365.2	399.0	79.0	110.5	91.3	84.5	83.1	121.4	104.0	90.5		
Unified budget outlays	401.9	459.8	456.5	458.3	374.2	415.2	466.2	97.6	101.8	103.4	112.4	111.4	115.2	117.6	122.0		
Surplus(+)/Deficit(-), unified budget	-45.0	-58.5	-63.5	-61.3	-56.6	-50.0	-67.2	-18.7	8.6	-12.2	-27.9	-28.3	6.2	-13.6	-31.5		
Surplus(+)/Deficit(-), off- budget agencies 3/	-8.7	n.a.	-10.7	n.a.	-5.7	-10.8	-10.7	-4.3	.1	-4.9	-1.7	-3.1	-1.0	-4.9	-1.7		
Means of financing combined deficits:																	
Net borrowing from public	53.5	n.a.	64.9	n.a.	69.0	56.6	n.e.	17.6	-1.1	19.6 ^{8/}	20.6 ^{8/}	28.8	-3.7	19.2	n.e.		
Decrease in cash operating balance	-1.7	n.a.	7.1	n.a.	-3.2	-0.6	n.e.	2.6	-7.2	-2.8 ^{8/}	6.8 ^{8/}	0.3	0	0	n.e.		
Other 4/	1.9	n.a.	2.3	n.a.	-3.5	4.9	n.e.	2.7	-0.4	0.4	2.2	2.3	-1.5	-0.7	n.e.		
Cash operating balance, end of period	19.1	n.a.	12.0	n.a.	11.7	12.3	n.e.	9.0	16.3	19.1 ^{8/}	12.3	12.0	12.0	12.0	n.e.		
Memo: Sponsored agency borrowing 5/	6.1	n.a.	15.0	n.a.	2.9	7.6	n.e.	0.7	3.0	2.0	2.0	4.4	4.0	4.5	n.e.		
NIA Budget								Seasonally adjusted annual rates									
Receipts	361.7 ^{6/}	n.a.	407.3 ^{6/}	n.a.	332.3	374.7	419.6	364.9	371.2	373.2	389.3	401.8	413.4	431.7	431.4		
Outlays	411.9	465.6	462.0	n.a.	386.3	423.1	474.5	403.7	411.5	432.1	445.2	458.3	464.7	479.6	495.3		
Purchases (total)	140.6	160.1	157.7	n.a.	130.1	145.1	162.1	136.3	143.6	148.1	152.3	155.6	159.6	163.2	169.9		
Defense	91.8	102.4	102.2	n.a.	86.8	94.6	104.6	89.7	93.4	95.6	99.6	101.3	103.0	104.8	109.1		
Non-defense	48.8	57.7	55.5	n.a.	43.3	50.5	57.5	46.7	50.2	52.5	52.7	54.3	56.6	58.4	60.8		
All other outlays	271.4	305.5	304.3	n.a.	256.2	278.0	312.4	267.4	267.9	284.0	292.9	302.7	305.1	316.4	325.4		
Surplus(+)/Deficit(-)	-50.2 ^{6/}	n.a.	-54.7 ^{6/}	n.a.	-54.0	-48.4	-54.9	-38.8	-40.3	-58.9	-55.9	-56.5	-51.3	-47.9	-63.9		
High Employment Surplus(+)/Deficit (NIA basis) 7/	-5.1	n.a.	-15.1	n.a.	-10.4	-7.8	-17.4	7.4	-0.2	-20.3	-18.3	-19.3	-13.1	-9.5	-27.6		
	*--actual	e--estimated	r--revised	n.e.--not estimated	n.a.--not available	p--preliminary											

1/ OMB Revised 1978 Budget Outlay Estimates, (November 11, 1977).

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

3/ Includes Federal Financing Bank, Postal Service, U.S. Railway Association, Rural Electrification and Telephone Revolving fund, Housing for the Elderly or Handicapped Fund (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 \$1.8 billion for FY 1977 and FY 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.

Comments on the Federal Sector Outlook

Since the last Greenbook, the staff's fiscal policy assumptions have been modified to include a \$25 billion tax reduction and a further delay in the passage of the President's energy program. The staff's assumed tax package includes:

- (1) cuts in personal tax rates--beginning October 1, 1978-- that will reduce revenues by \$16 billion (annual rate)
- (2) a liberalization of the investment tax credit, effective January 1, 1978, that (a) will permit firms to offset 90 per cent of their current tax liability with the credit instead of the present 50 per cent and (b) will extend the current 10 per cent credit to structures built by industrial firms and utilities (estimated annual revenue loss, \$2 billion)
- (3) a corporate tax reduction, effective October 1, 1978, that would lower the maximum rate from 48 to 45 per cent on income over \$50,000 (estimated annual revenue loss, \$6 billion)
- (4) elimination of the 4 per cent telephone excise tax effective October 1, 1978 (estimated annual revenue loss, \$1 billion)
- (5) a reduction from 0.7 to 0.5 per cent in the tax on payrolls contributed by firms to the unemployment insurance fund, effective January 1, 1979 (estimated annual revenue loss, about \$1 billion)
- (6) miscellaneous business tax reforms (estimated annual revenue gain around \$1 billion).

The details of the energy tax program embodied in the staff's forecast remain unchanged from last month, but as a result of continued legislative delays, we have now assumed that the effective date of the program will be moved forward from February 15 to July 1, 1978. This

delay and some further weakness in Federal tax collections during December have resulted in a lowering of the fiscal year 1978 receipts projection from \$395 billion to \$393 billion. Outlays continue to be forecast at \$456-1/2 billion and the resulting deficit now is projected at \$63-1/2 billion.

The combined deficit (unified plus off-budget) for fiscal year 1978 is estimated at \$74 billion; of this total, \$31 billion will have to be financed in the current quarter. After allowing for anticipated sales of nonmarketable securities (\$3 billion) and for other miscellaneous sources of financing (\$2.3 billion), marketable borrowing by the Treasury in the first quarter is expected to be \$26 billion. Borrowing requirements of this magnitude probably will necessitate the issuance of Treasury bills late in the quarter in order to augment the cash raised through the regular 2- and 4-year note cycle as well as any new cash raised in the mid-quarter refunding.

Last month's high employment budget showed that the deficit was expected to decline from \$14 billion in 1978:1 to \$5 billion in 1978:4. This movement reflected the absence of any new fiscal initiatives as well as the continued growth in receipts. The current forecast--with its liberalized investment credits, delayed energy program, and October 1, 1978 tax reductions--now shows a high employment budget deficit of \$19 billion in 1978:1 and \$28 billion in 1978:4. During

the first half of 1979, the increased receipts resulting from the recently enacted social security bill and from the progressive nature of the tax system, more than offset the full impact of the \$25 billion tax package. As a consequence, the high employment deficit declines to \$17 billion by the end of the forecast period.

DOMESTIC FINANCIAL DEVELOPMENTS

Summary. Short-term interest rates have risen sharply in response to the January 6 action raising the discount rate from 6 to 6-1/2 per cent and to subsequent indications that the System has raised its Federal funds rate objective. Since the last Committee meeting, rates on Treasury bills have increased about 40 to 65 basis points. Rate advances of smaller magnitude have been posted on private short-term instruments, and bank prime rates have generally been raised 25 basis points to 8 per cent. Bond market yields have also increased over the past few days and show gains of as much as 25 basis points since the December FOMC meeting.

Stock prices increased in the last half of December, but then began to decline in early January in response to uncertainty with regard to the status of the dollar and have dropped further in the current week. On balance, prices are off substantially from their mid-December levels.

Business demands for credit appear to have moderated in December, but over the fourth quarter were generally strong. Corporate issuance of long-term bonds in the public market fell off more than seasonally in December, as industrial issues continued to remain relatively light. At the same time, demands for loan accommodation at banks, which had been quite strong in the earlier months of the fourth quarter, apparently moderated. Borrowing by nonfinancial firms

in the commercial paper market, however, increased markedly in December, so that total short-term borrowing was off only slightly from November.

State and local governments issued a further sizable volume of long-term bonds in December--a considerable part of which once again was to prerefund outstanding debt. The Treasury raised substantial new money in late December through auctions of 2-year notes and 15-year bonds. Mortgage indebtedness rose sharply in November, and, with commitments continuing to increase in that month, it is likely that a further sizable expansion of mortgage loans occurred in December. Consumer instalment debt also continued to expand rapidly in November, as a decline in extensions was more than offset by a drop-off in repayments.

With market interest rates exceeding offering rates on shorter-term consumer-type time and savings deposits at commercial banks, balances in these accounts are estimated to have stayed about unchanged in December after declining slightly in November. The combined flow of funds into accounts at S&Ls and mutual savings banks slowed to about an 8-3/4 per cent annual rate in December, down slightly from the rate of advance recorded in November. This is about half as rapid as the growth recorded over the summer months when S&Ls appeared to be capturing a large part of the funds from maturing wild card accounts at banks.

Despite the recent slowing in growth of consumer-type deposits, both banks and nonbank thrift institutions appear to have been able to meet customer credit demands with little difficulty. Commercial banks have continued to liquidate security holdings and have raised further substantial sums through sales of negotiable and nonnegotiable large-denomination CDs and increases of nondeposit liabilities. Nonbank thrift institutions have been borrowing heavily from Federal Home Loan Banks and have also been obtaining funds from other non-deposit sources.

Outlook. Aggregate credit flows in the early months of 1978 appear likely to continue at the strong pace of the latter part of 1977. The Treasury's needs for new money in the current quarter are quite large, and sponsored Federal housing agencies are expected to step up their borrowing to provide increased support for the mortgage market. State and local government issuance of bonds is expected to continue at about the same strong pace established in the latter half of 1977. Private credit demands, while moderating somewhat, are also expected to remain strong. Given expected conditions in the mortgage market, household borrowing may slacken. Business needs for external funds, however, should about match those recorded over the latter part of last year.

Following their recent sharp increases, market interest rates may tend to remain around current levels over the next few weeks. By late winter or early spring, however, additional upward rate

pressures may develop in response to a cumulation of monetary and credit demands. Federal Reserve efforts to restrain money growth are likely to impinge mainly on short-term interest rates. But mortgage market yields may also begin to come under stronger upward pressure than in recent months. The very recent rise in short- and intermediate-term market rates is likely to lead to some further slowing of inflows of time and savings deposits at thrift institutions, and any further market rate increases will intensify such pressures. As thrift institutions are forced to turn increasingly to relatively expensive borrowing from Home Loan Banks, primary mortgage market rates are likely to begin rising more noticeably.

Any further increase in yields on corporate and municipal bonds between now and spring will be tempered by the extent to which the market has already discounted future rate increases. In addition, upward pressures on yields will be moderated by strong demands for bonds from traditional long-term investors such as fire and casualty insurance companies and pension funds that are expected to continue receiving large amounts of investable funds.

INTERNATIONAL DEVELOPMENTS

Summary. The dollar continued under heavy downward pressure in foreign exchange markets after mid-December, especially around the turn of the year. Market concerns about the dollar continued to center on the prospect of large U.S. trade deficits, the lack of measures that might reduce demand for imported oil, and the naming of a new chairman of the Federal Reserve Board. However, the dollar rose sharply immediately after the announcement on January 4 that the Treasury would join with the Federal Reserve and other central banks in exchange market intervention. Thereafter the dollar eased in the market, though the Federal Reserve's action in raising the discount rate by 1/2 per cent on January 6 resulted in some firming of the rate. Since the announcement of January 4 the dollar's average rate has risen about 1.7 per cent.

Over the four-week period since mid-December the weighted average exchange rate for the dollar depreciated about 1.4 per cent, despite

sales of \$898 million equivalent of marks by the System and the Treasury. For the year 1977, the average value of the dollar declined 6-3/4 per cent,

In the past year monetary developments abroad have tended to aid the dollar, with interest rates abroad now well below rates

prevailing a year ago. The shift in the interest-rate differential on short-term assets has been sizable; since the fourth quarter of 1976 rate declines in other industrial countries have ranged from 1 percentage point (Switzerland) to more than 3 percentage points (the United Kingdom), while U.S. rates are up nearly 2 percentage points. For foreign industrial countries an easing of credit conditions was consistent with developments in their domestic economies, but in some cases reductions in lending rates were also aimed at easing upward pressures on their currencies and avoiding an increase in liquidity from central banks intervention in the exchange markets. In Belgium and the Netherlands, however, exchange market pressures have recently led to interest rate increases.

Developments in the U.S. trade balance have been obscured to some extent by the gyrations in data caused by the October-November dock strike. However, the November deficit of \$34 billion (annual rate) was probably not greatly affected on balance by the strike, and suggests that the fourth-quarter deficit rate was slightly above the third-quarter rate of \$30 billion.

Available data on U.S. capital account transactions in November indicate a relatively small net private capital outflow through banks, and near-balance in private transactions in securities.

By far the largest increases in foreign assets in the United States over the past year came from official intervention.

Official foreign assets in the United States, apart from OPEC, rose by \$5.1 billion in November, bringing the total rise for the year through November to about \$26 billion. Assets of OPEC official accounts in the United States increased \$6.4 billion in the 11-month period, close to the rate of inflow in 1976.

Outlook. In the latest projection of the U.S. international accounts, the U.S. trade deficit expected for this year has been trimmed by \$4 billion to \$31 billion, about the same result as in 1977, and that rate of deficit is expected to be maintained in the first half of 1979. Projections of net service receipts have not been changed, and the current account deficit is expected to hold fairly steady at close to \$18 billion during the period to mid-1979. The reduction in the projected trade deficit results primarily from a lower estimate of imports. Non-oil imports have not risen in volume terms since early 1977, and this slowdown is now associated with the likelihood that supply capacity is lower than previously estimated for industrial countries abroad in the light of their lower rate of investment in recent years. Other factors taken into account are the recent sharp depreciation of the dollar and a reduction in projected oil import prices and volumes. On the other hand, the staff continues to expect that economic activity abroad will expand at about the same rate as projected for the United States.

Given the sharp recent decline in the value of the dollar against most foreign currencies, and the somewhat improved outlook for the trade balance, the staff consensus is for a slight rise in the average value of the dollar in the year ahead from its present level of about 84 per cent of the May 1970 value.

	1976	1977 ^P	1978 ^P	1977				1978 ^P				1979 ^P	
				I	II	III	IV ^P	I	II	III	IV	I	II
1. <u>GNP NET EXPORTS</u> - Intl Acct. data	7.7	-8.2	-6.1	-7.4	-9.0	-6.6	-9.7	-5.4	-6.2	-7.0	-5.8	-5.4	-6.0
2. (GNP net exports - GNP Acct. data) <u>1/</u>	(7.8)	(-8.9)	(-6.2)	(-8.2)	(-9.7)	(-7.5)	(-10.2)	(-5.6)	(-6.3)	(-6.9)	(-6.1)	(-5.5)	(-6.3)
3. a) Merchandise Trade Balance	-9.3	-30.4	-30.9	-28.4	-31.0	-30.0	-32.5	-29.0	-30.5	-32.4	-31.5	-31.0	-31.6
4. Exports (excl. military)	114.7	121.3	137.8	117.8	122.4	123.5	121.4	129.7	135.4	140.6	145.9	151.8	157.0
5. Agricultural	23.4	24.3	23.8	24.5	26.8	24.1	21.9	23.1	23.7	24.1	24.3	25.1	25.4
6. Nonagricultural	91.3	97.0	114.1	93.4	95.6	99.4	99.5	106.6	111.7	116.5	121.6	126.7	131.6
7. Imports	124.0	151.7	168.7	146.2	153.4	153.5	153.9	158.7	165.9	173.0	177.4	182.8	188.6
8. Petroleum and petrol. products	34.6	45.6	47.4	44.1	47.7	45.8	45.0	43.9	46.5	49.4	49.9	50.7	51.9
9. Nonpetroleum	89.4	106.1	121.3	102.1	105.7	107.7	108.9	114.8	119.4	123.6	127.5	132.1	136.7
10. b) Military transactions, net <u>2/</u>	--	1.5	1.6	1.7	.8	1.9	1.5	1.6	1.6	1.6	1.6	1.6	1.6
11. c) Investment income, net <u>3/</u>	14.3	18.7	21.2	17.9	19.1	18.4	19.3	20.2	20.9	21.8	21.9	21.8	21.8
12. d) Other services, net <u>4/</u>	2.7	2.1	2.0	1.4	2.1	3.1	2.0	1.8	1.8	2.0	2.2	2.2	2.2
13. <u>U.S. CURRENT ACCOUNT BALANCE</u> <u>2/</u>	-1.0	-17.9	-18.6	-16.5	-17.8	-17.1	-20.1	-17.4	-18.6	-19.6	-18.4	-18.0	-18.6
14. a) GNP net exports (line 1.)	7.7	-8.2	-6.1	-7.4	-9.0	-6.6	-9.7	-5.4	-6.2	-7.0	-5.8	-5.4	-6.0
15. b) U.S. Govt & private transfers <u>5/</u>	-8.7	-9.7	-12.5	-9.0	-8.9	-10.5	-10.4	-12.0	-12.4	-12.6	-12.6	-12.6	-12.6
<u>Constant (1972) dollars</u>													
16. Merchandise exports (excl. military)	66.7	67.5	73.1	66.1	67.7	68.7	67.5	71.1	72.5	73.8	75.1	76.8	78.1
17. (% change, annual rates)	(3.4)	(1.2)	(8.3)	(-7.4)	(9.5)	(6.1)	(-7.0)	(22.9)	(8.2)	(7.4)	(7.4)	(9.1)	(7.0)
18. Merchandise imports	62.8	71.0	74.3	70.2	71.9	71.1	70.8	72.0	74.0	75.4	75.9	76.4	77.3
19. (% change, annual rates)	(22.5)	(13.1)	(4.7)	(27.2)	(10.0)	(-4.9)	(-1.6)	(7.0)	(11.7)	(7.8)	(2.9)	(2.5)	(4.9)
<u>Foreign Outlook - Major Industrial Countries</u> <u>6/</u>													
20. Real GNP, % change, annual rates	5.2	2.9	4.0	5.3	.8	1.6	4.5	4.9	4.9	4.5	4.5	4.5	4.5
21. Wholesale Prices, % change, A.R. <u>7/</u>	9.4	8.7	5.3	10.4	7.4	3.7	3.7	5.7	6.1	6.1	6.1	6.1	6.1

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

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

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

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

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

6/ Weighted by the shares of Canada, France, Germany, Italy, Japan and the United Kingdom in the sum of the real GNP of the six countries in dollar terms.

7/ Data are largely manufactured goods prices.

P/ Projected

e/ Estimated

* Published data.