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Part 2

January 31, 1979

CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the Federal Open Market Committee

By the staff of the Board of Governors of the Federal Reserve System

TABLE OF CONTENTS

	<u>Section</u>	<u>Page</u>
DOMESTIC NONFINANCIAL DEVELOPMENTS		II
Employment and production.....		1
Personal income and consumer spending.....		4
Business investment.....		6
Residential construction.....		11
Government sector activity.....		16
Prices.....		18
Wages, productivity and costs.....		20
TABLES:		
Changes in employment.....		2
Selected unemployment rates.....		2
Industrial production.....		3
Selected capacity utilization rates.....		3
Personal income.....		5
Retail sales.....		7
Auto sales.....		7
Contracts and orders for plant and equipment.....		8
Survey of plant and equipment expenditures.....		10
Business inventories.....		12
Inventory to sales ratios.....		12
New private housing activity.....		14
Recent changes in producer prices.....		19
Recent changes in consumer prices.....		19
Hourly earnings index.....		22
Major collective bargaining settlements.....		22
Productivity and costs.....		23
CHARTS:		
Inventory to sales ratio.....		13
New private housing starts.....		15
DOMESTIC FINANCIAL DEVELOPMENTS		III
Monetary aggregates.....		2
Bank credit.....		8
Business finance.....		13
Mortgage market and consumer credit.....		16
Government securities markets.....		23

TABLE OF CONTENTS (cont.)

	<u>Section</u>	<u>Page</u>
DOMESTIC FINANCIAL DEVELOPMENTS (cont.)	III	

TABLES:

Selected financial market quotations.....		3
Monetary aggregates.....		4
Commercial bank credit.....		9
Change in commercial paper outstanding.....		14
Change in business credit at finance companies.....		14
Gross offerings of corporate and foreign securities.....		15
Financing pattern of nonfinancial corporations.....		17
Interest rates and supply of mortgage funds at selected S&Ls.....		20
Secondary home mortgage market activity.....		20
Consumer instalment credit.....		21
Government security offerings.....		24

CHARTS:

Money market mutual funds.....		7
Ratio of liquid assets to total liabilities at large banks inside and outside New York City.....		11
Ratio of loans to deposits.....		12
Commercial and industrial mortgage activity at life insurance companies.....		18
Proportion of low-downpayment automobile credit contracts at finance companies.....		22
Average maturity on new-auto contracts at commercial banks and finance companies.....		22

INTERNATIONAL DEVELOPMENTS

IV

Borrowing in international capital markets.....		5
U.S. international transactions.....		9
Foreign international transactions.....		14
Individual country notes.....		19

TABLES:

Borrowing in international capital markets.....		6
U.S. merchandise trade.....		10
U.S. international transactions summary.....		12

TABLE OF CONTENTS (cont.)

	<u>Section</u>	<u>Page</u>
INTERNATIONAL DEVELOPMENTS (cont.)	IV	
TABLES:		
Consumer and wholesale prices in major industrial countries.....		16
Real GNP and industrial production in major industrial countries.....		17
Trade and current account balances of major industrial countries.....		18
CHARTS:		
Weighted average exchange value of the dollar.....		2
Real GNP in major industrial countries.....		15
APPENDIX A: The Federal Budget for Fiscal Year 1980		
APPENDIX B: New Estimates of the High Employment Budget Surplus Deficit		

SELECTED DOMESTIC NONFINANCIAL DATA
AVAILABLE SINCE PRECEDING GREENBOOK
(Seasonally adjusted)

	Period	Latest Data		Per Cent Change from		
		Release Date	Data	Preceding Period	Three Periods Earlier	Year earlier
						(At annual rate)
Civilian labor force	Dec.	1-12-79	101.9	2.8	3.5	3.2
Unemployment rate (%) <u>1/</u>	Dec.	1-12-79	5.9	5.8	5.9	6.3
Insured unemployment rate (%) <u>1/</u>	Dec.	1-12-79	3.1	3.0	3.4	3.7
Nonfarm employment, payroll (mil.)	Dec.	1-12-79	87.3	3.4	5.1	4.2
Manufacturing	Dec.	1-12-79	20.7	7.2	8.6	3.7
Nonmanufacturing	Dec.	1-12-79	66.5	2.3	4.1	4.4
Private nonfarm:						
Average weekly hours (hr.) <u>1/</u>	Dec.	1-12-79	35.8	35.8	35.8	35.9
Hourly earnings (\$) <u>1/</u>	Dec.	1-12-79	5.90	5.86	5.77	5.41
Manufacturing:						
Average weekly hours (hr.) <u>1/</u>	Dec.	1-12-79	40.6	40.7	40.4	40.5
Unit labor cost (1967=100)	Dec.	1-31-79	169.9	5.0	11.4	5.7
Industrial production (1967=100)	Dec.	1-17-79	150.4	7.2	7.0	7.7
Consumer goods	Dec.	1-17-79	150.5	5.6	4.0	3.2
Business equipment	Dec.	1-17-79	169.3	10.0	8.4	9.9
Defense & space equipment	Dec.	1-17-79	87.6	6.9	2.3	10.2
Materials	Dec.	1-17-79	152.9	5.5	8.6	10.2
Consumer prices all items (1967=100)	Dec.	1-24-79	202.9	7.1	7.6	9.1
All items, excluding food & energy	Dec.	1-24-79	195.6	5.5	7.5	8.5
Food	Dec.	1-24-79	219.7	9.4	7.6	11.7
Producer prices: (1967=100)						
Finished goods	Dec.	1-11-79	202.1	10.2	9.9	9.1
Intermediate materials, nonfood	Dec.	1-11-79	224.4	6.5	10.1	8.2
Crude foodstuffs & feedstuffs	Dec.	1-11-79	226.1	-2.1	18.9	18.3
Personal income (\$ bil.) <u>2/</u>	Dec.	1-18-79	1804.8	12.7	13.8	12.2
						(Not at annual rates)
Mfrs. new orders dur. goods (\$ bil.)	Dec.	1-23-79	76.6	-1	5.4	15.7
Capital goods industries	Dec.	1-23-79	24.3	-3.7	2.7	13.7
Nondefense	Dec.	1-23-79	20.3	-1.4	.7	19.5
Defense	Dec.	1-23-79	4.0	-13.9	14.1	-8.7
Inventories to sales ratio: <u>1/</u>						
Manufacturing and trade, total	Nov.	1-23-79	1.39	1.38	1.40	1.44
Manufacturing	Nov.	1-23-79	1.48	1.49	1.51	1.57
Trade	Nov.	1-23-79	1.29	1.28	1.30	1.31
Ratio: Mfrs.' durable goods inventories to unfilled orders <u>1/</u>	Nov.	1-23-79	.570	.575	.596	.637
Retail sales, total (\$ bil.)	Dec.	1-10-79	68.9	1.0	3.8	11.4
GAF <u>3/</u>	Dec.	1-10-79	15.1	.8	3.1	6.7
Auto sales, total (mil. units.) <u>2/</u>	Dec.	1-8-79	11.1	2.1	4.7	1.1
Domestic models	Dec.	1-8-79	9.2	4.2	5.5	3.4
Foreign models	Dec.	1-8-79	1.9	-7.0	.9	-8.5
Plant & Equipment expen. (\$ bil.) <u>4/</u>						
All Industries	1979	1-11-79	170.20	--	--	11.2
Manufacturing	1979	1-11-79	76.99	--	--	13.8
Nonmanufacturing	1979	1-11-79	93.20	--	--	9.1
Housing starts, private (thous.) <u>2/</u>	Dec.	1-17-79	2,125	-1.4	2.4	-3.6
Leading indicators (1967=100)	Dec.	1-31-79	137.3	-5	-6	1.4

1/ Actual data used in lieu of per cent changes for earlier periods.

2/ At annual rate.

3/ Excludes mail order houses.

4/ Planned-Commerce January 1979 Survey.

DOMESTIC NONFINANCIAL DEVELOPMENTS

Economic activity advanced at a brisk pace late in 1978. Employment rose appreciably further in December, industrial production continued upward, and retail sales closed out the year with three consecutive months of strong gains. Housing starts held at the high level that had been sustained since the spring. Capital spending continued strong, but evidence of caution was apparent in longer-term spending plans. Inflationary pressures remain intense despite two months of some relief at retail due to temporary factors.

Employment and Production

Employment continued upward in December following several months of exceptionally strong hiring gains. The labor force also expanded rapidly, however, and the unemployment rate edged up to 5.9 per cent-- remaining in the range that has prevailed since the spring. Jobless rates for most groups of workers were little changed from November. Over the year, adult full-time workers generally experienced sizable declines in unemployment, while the rates for youth fell only slightly.

Nonfarm payroll employment increased 250,000 in December, the third consecutive month of large rise. Labor demand remained especially strong in the goods - producing sector; manufacturers added 125,000 workers to their payrolls with increases again concentrated among producers of durable goods. Outside of manufacturing, a sizable gain occurred in construction.

CHANGES IN EMPLOYMENT ^{1/}
 (Thousands of jobs; based on seasonally adjusted data)

	1977	1978	1978			
			QIII	QIV	Nov.	Dec.
			- - - Average monthly changes - - -			
<u>Nonfarm payroll employment</u> ^{2/}	284	296	56	369	447	250
Manufacturing	66	62	-10	146	164	124
Durable	50	53	19	108	104	81
Nondurable	16	8	-29	38	60	43
Construction	30	38	7	38	27	45
Trade	79	65	45	47	65	-10
Services and finance	82	77	71	79	130	48
State and local government	28	16	-44	15	32	23
Private nonfarm production workers	215	220	69	290	397	184
Manufacturing production workers	52	46	-20	131	148	127
<u>Total employment</u> ^{3/}	342	275	123	282	510	104
Nonagricultural	336	268	129	288	609	-8

^{1/} Changes are from final month of preceding period to final month of period indicated.

^{2/} Survey of establishments. Not strike adjusted.

^{3/} Survey of households.

SELECTED UNEMPLOYMENT RATES
 (Per cent; based on seasonally adjusted data)

	1973	1978					
	Annual average	QI	QII	QIII	QIV	Nov.	Dec.
Total, 16 years and older	4.9	6.2	6.0	6.0	5.8	5.8	5.9
Teenagers	14.5	16.9	16.1	16.1	16.3	16.2	16.5
20-24 years old	7.8	10.2	9.5	9.4	9.0	9.0	9.3
Men, 25 years and older	2.5	3.5	3.3	3.3	3.2	3.1	3.2
Women, 25 years and older	4.0	5.0	5.1	5.2	4.9	4.9	5.0
White	4.3	5.4	5.2	5.2	5.1	5.0	5.2
Black and other	8.9	12.4	12.1	11.7	11.5	11.7	11.5
Fulltime workers	4.3	5.7	5.5	5.5	5.2	5.2	5.3
White collar	2.9	3.6	3.6	3.6	3.3	3.2	3.5
Blue collar	5.3	7.2	6.7	6.8	6.7	6.4	6.8
Craft and kindred	3.7	5.1	4.4	4.4	4.5	4.0	4.7
Operatives, ex. transport	6.1	8.3	8.2	8.4	7.6	7.5	7.7

INDUSTRIAL PRODUCTION
(Percentage change from preceding period, seasonally adjusted)

	1967 Pro- portion	1978					
		I	II	III	IV	Nov.	Dec.
Total	100.0	0.2	3.2	2.1	1.7	.6	.6
Products	60.7	0.2	2.5	1.7	1.3	.7	.7
Final Products	47.8	-0.2	2.9	1.7	1.2	.6	.6
Consumer Goods	27.7	-1.0	2.4	0.8	0.9	.5	.5
Durable	7.9	-2.7	6.1	—	1.0	.4	.1
Automotive Prod.	2.8	-5.5	9.7	-0.3	3.6	1.8	-1.7
Home Goods	5.1	-0.9	3.7	0.3	-0.7	-0.6	1.4
Nondurable	19.8	-0.2	0.7	1.1	1.0	0.6	0.5
Equipment	20.1	1.0	3.9	3.0	1.5	0.6	0.8
Business Equipment	12.6	0.8	3.7	2.9	1.8	0.6	0.8
Intermediate Products	12.9	1.7	1.1	2.1	1.9	0.7	0.8
Construction Supplies	6.4	1.4	1.1	2.9	2.1	0.7	0.9
Business Supplies	6.5	2.1	1.0	1.4	1.6	0.7	0.7
Materials	39.3	0.2	4.2	2.5	2.3	0.6	0.5
Durable	20.4	0.1	4.4	4.4	2.9	0.6	0.8
Nondurable	10.5	1.9	3.3	—	1.8	0.7	0.2
Energy	8.5	-2.3	5.4	1.2	1.3	0.4	0.5

SELECTED CAPACITY UTILIZATION RATES
(Per cent, seasonally adjusted)

	1973-	1948-	1977 Dec.	1978		Dec. 78 less Dec. 77
	1974 High	1977 High		Nov. <u>1/</u>	Dec. <u>2/</u>	
Manufacturing	88.0	91.7	83.0	85.7	85.9	2.9
Primary Processing	93.6	94.4	84.5	88.5	88.6	4.1
Advanced Processing	85.4	91.8	82.2	84.2	84.5	2.3
Materials	93.1	93.1	81.9	87.4	87.6	5.7
Durable Goods Materials	92.5	93.1	80.1	87.1	87.6	7.5 ^{3/}
Basic Iron & Steel	105.2	105.2	77.4	92.8	n.a.	15.4 ^{3/}
Nondurable Goods Materials	94.6	94.6	85.8	88.3	88.2	2.4
Energy Materials	94.6	96.1	81.4	86.4	86.6	5.2
Major Materials	95.9	95.9	84.0	89.1	89.1	5.1

1/ Preliminary

2/ Estimated

3/ November 1978 less December 1977.

Industrial production rose 0.6 per cent in December, about in line with the average monthly increase for 1978 as a whole. Large advances occurred in output of both materials and final products. Production of business equipment continued to rise throughout the fourth quarter, although at a rate of increase less than the unusually strong pace recorded during the spring and summer. Consumer goods production rose at a moderate 3-3/4 per cent annual rate in the fourth quarter--slightly above the third quarter pace.

Capacity utilization in the manufacturing sector reached 85.9 per cent in December, up almost 3 percentage points from a year earlier and only 2 percentage points below the 1973 high. The December rate for materials industries showed somewhat more slack, although rates for some materials, especially in the durable sector, moved up sharply over the last year.

Personal Income and Consumer Spending

Total personal income increased appreciably in November and December. Reflecting the large recent employment gains, advances in private wage and salary disbursements continued to be substantial. Additionally, farm income rose rapidly in December because of Federal price-target deficiency payments to grain farmers. Real personal income rose at a 4-1/2 per cent annual rate in the final quarter of 1978--the largest increase in a year.

PERSONAL INCOME
(Based on seasonally adjusted annual rate data)

	1977	1978	1978			
			QIII	QIV	Nov.	Dec.
- - Average monthly change, in billions of dollars - -						
Total personal income	\$13.5	\$16.3	\$16.3	\$20.0	\$17.6	\$18.9
Nonagricultural income	12.3	15.8	16.0	17.5	16.3	13.7
Agricultural income	1.2	.5	.4	2.5	1.2	5.2
Wage and salary disbursements	8.3	11.0	7.2	12.9	11.7	9.6
Private	7.0	9.8	6.4	11.0	10.4	8.7
Manufacturing	2.7	3.1	1.8	4.7	5.7	3.2
Other income	5.7	6.1	9.5	7.7	6.2	9.7
Transfer payments	1.3	1.5	3.6	1.1	1.7	.9
- - Percentage change, compound annual rates <u>1/</u> - -						
Total personal income						
Current dollars	11.4	12.1	12.2	13.2	11.9	12.7
Constant dollars <u>2/</u>	4.4	2.9	3.3	4.5	5.3	5.5
Wage and salary disbursements						
Current dollars	11.0	12.5	8.7	13.3	12.3	10.0
Constant dollars <u>2/</u>	4.1	3.2	.1	4.5	5.7	2.9

1/ Monthly percentage changes at annual rates, not compounded; 1977 and 1978 percentage changes from QIV to QIV.

2/ Deflated by the CPI for all urban consumers, seasonally adjusted.

Consumer spending also increased strongly throughout the final quarter of 1978. Retail sales excluding autos and mainly nonconsumer items rose 0.8 per cent in December following a 1.9 per cent increase in November; for the fourth quarter as a whole, sales in this grouping advanced at a 3-1/2 per cent rate. Purchases at general merchandise stores increased about 1-1/2 per cent in December, as did sales at furniture and appliance stores. However, apparel and food sales declined following large increases earlier in the quarter.

Sales of domestic autos were at a 9.2 million annual rate in both December and the first twenty days of January, up 350,000, annual rate, from November and at about the same rate as over the July-October period. By size class, only sales of intermediate-sized cars were somewhat reduced from their pace over most of 1978. Imported units sold at a 1.9 million unit rate in December, slightly lower than in November but about the same as over the last two years. During the fourth quarter, foreign units accounted for 18 per cent of total sales, slightly lower than a year earlier.

Business Investment

Near-term business investment spending commitments remained at a high level in the fourth quarter, although there was some weakness in recent orders and contracts following strong increases this past fall. New orders for nondefense capital goods fell about 9 per cent over the final two months of the year; even so, these bookings in the fourth quarter as a whole were 11.4 per cent above the third quarter level.

RETAIL SALES
(Percentage change from previous period;
based on seasonally adjusted data)

	1978				
	QIII	QIV	Oct.	Nov.	Dec.
Total sales	2.0	4.0	1.6	1.2	1.0
(Real) <u>1/</u>	.2	1.9	.9	.5	.2
Total, less auto and nonconsumption items	2.1	3.6	.7	1.9	.8
GAF <u>2/</u>	2.1	3.1	-.4	2.7	.8
<u>Durable</u>	2.8	6.2	3.4	.5	2.9
Auto	.8	5.8	4.2	-.9	3.4
Furniture & appliances	2.8	2.7	-.2	.2	1.4
<u>Nondurable</u>	1.5	2.9	.6	1.5	.1
Apparel	4.6	3.4	-.8	4.2	-2.0
Food	1.1	2.6	1.6	.8	-.4
General merchandise	.9	3.2	-.3	3.1	1.6
Gasoline	-.1	4.7	.7	1.8	1.1

1/ Deflated by all commodities SA consumer price index.

2/ General merchandise, apparel, and furniture and appliance stores.

AUTO SALES
(Seasonally adjusted annual rates; millions of units)

	1978				
	QIII	QIV	Oct.	Nov.	Dec.
Total	11.2	11.1	11.2	10.9	11.1
Imports	2.0	2.0	2.0	2.1	1.9
Domestic	9.2	9.1	9.2	8.8	9.2

CONTRACTS AND ORDERS FOR PLANT AND EQUIPMENT 1/
 (Percentage change from preceding comparable period, seasonally adjusted)

	1978						
	QI	QII	QIII	QIV	Oct.	Nov.	Dec.
<u>Current dollars</u>							
Total	11.8	-4.8	11.6	n.a.	13.5	-8.4	n.a.
Nondefense capital goods orders	5.6	3.5	5.3	11.6	10.3	-7.4	-1.4
Construction contracts <u>2/</u>	50.6	-40.2	57.9	n.a.	33.1	-13.6	n.a.
<u>1972 dollars</u>							
Total	9.7	-5.9	8.8	n.a.	12.1	-9.5	n.a.
Nondefense capital goods orders	3.5	2.4	2.9	n.a.	9.3	-8.7	n.a.
Construction contracts <u>2/</u>	48.8	-42.3	54.1	n.a.	30.3	-13.4	n.a.

1/ The Commerce Department creates this series by adding new orders for nondefense capital goods to the seasonally adjusted sum of new contracts awarded for commercial and industrial buildings and for private nonbuilding projects (e.g., electrical utilities, pipelines, etc.).

2/ FRB staff estimate. Derived by subtracting new orders for nondefense capital goods from the published total for contracts and orders.

Bookings for machinery, which are indicative of the general trend in the demand for equipment, rose 6.4 per cent in the fourth quarter and stood 16 per cent above the year-earlier level. As has been the case throughout the year, gains in the fourth quarter were particularly strong in the nonmachinery category of nondefense capital goods orders, which consists largely of aircraft and ships.

Nonresidential construction contract awards, a series that is quite volatile from month to month, were about the same in the fourth quarter as in the third, largely because of the extremely high level in October. The total value of contracts awarded in 1978 were about 20 per cent above the value awarded in the preceding year.

Surveys of business spending intentions suggest a slowing of outlays later this year. The Commerce Department's annual survey conducted in November and December indicated that business is anticipating only moderate growth in capital spending in 1979. These survey results, which are generally in line with earlier private readings, show business planning to increase capital outlays by 11.2 per cent in 1979, with considerable strength evident in the plans of the manufacturing sector. Respondents expect capital goods prices to rise about 8 per cent in 1979, thus implying only 3 per cent growth in real terms for the year. This survey has been a fairly reliable indicator of future capital spending over its nine year history; in each of the last three years it has underestimated the eventual nominal increase by about 1 to 1-1/2 percentage points.

SURVEY OF PLANT AND EQUIPMENT EXPENDITURES
(Percentage change from prior year)

	Actual ^{1/} 1978	Planned for 1979	
		McGraw-Hill	Commerce
All Business	12.7	9.9	11.2
Manufacturing	12.4	10.3	13.8
Durables	14.3	12.2	16.2
Nondurables	10.8	8.6	11.7
Nonmanufacturing	13.0	9.5	9.1
Mining	7.8	8.0	9.7
Transportation	15.0	13.6	14.9
Utilities	13.0	7.1	11.6
Communications	16.8	10.0	4.0
Commercial and other	10.7	11.0	7.9

^{1/} November Commerce survey, based on actual expenditures for the first three quarters of the year and planned outlays for the fourth quarter.

Inventory investment in book value terms was sizable in November as manufacturing and trade stocks increased at an annual rate of \$49.2 billion. This compares with a \$31-1/2 billion rise in October and was the largest gain since April. The November rise in stocks was accompanied by only a moderate increase in sales, and the ratio of inventory book values to sales for total manufacturing and trade edged up. Nonetheless, the overall stock-sales ratio in book value terms remained low on an historical basis.

Accumulation at manufacturers--\$21.5 billion, annual rate--accounted for almost half of the total November increase and was the largest rise since June. The increase in trade inventories was of the same order of magnitude as in October. Most of this rise was at retailers, particularly at motor vehicle dealers where unit stocks were also up in November but leveled off in December.

Inventory data had indicated the emergence during the fall of excess stocks relative to sales at retailers of general merchandise. However, strong pre-Christmas sales and some adjustments in production have worked toward correcting this imbalance; as a result, the inventory to sales ratio for general merchandisers declined in November for the first time since February.

Residential Construction

Overall housing activity remained surprisingly strong late in 1978. Total private housing starts were at a 2.13 million unit annual rate in December, down only marginally from the November pace. Starts

BUSINESS INVENTORIES
(Annual rate of change in seasonally
adjusted book values; billions of dollars)

	1977			1978				
	QII	QIII	QIV	QI	QII	QIII	Oct. 1/	Nov. 2/
Manufacturing and trade	28.3	25.2	17.8	44.2	44.3	31.3	31.6	49.2
Manufacturing	15.7	10.2	2.8	16.6	22.8	18.0	8.1	21.5
Durable	7.8	7.7	3.8	13.2	15.9	14.0	7.3	18.1
Nondurable	7.9	2.4	-1.0	3.4	6.9	4.1	.8	3.4
Trade, total	12.6	15.0	14.9	27.6	21.5	13.3	23.6	27.7
Wholesale	2.6	4.7	7.5	19.5	11.8	4.8	15.9	8.1
Retail	10.0	10.3	7.4	8.1	9.8	8.5	7.6	19.5
Auto	2.2	1.5	2.9	.9	.2	-.2	4.9	8.4

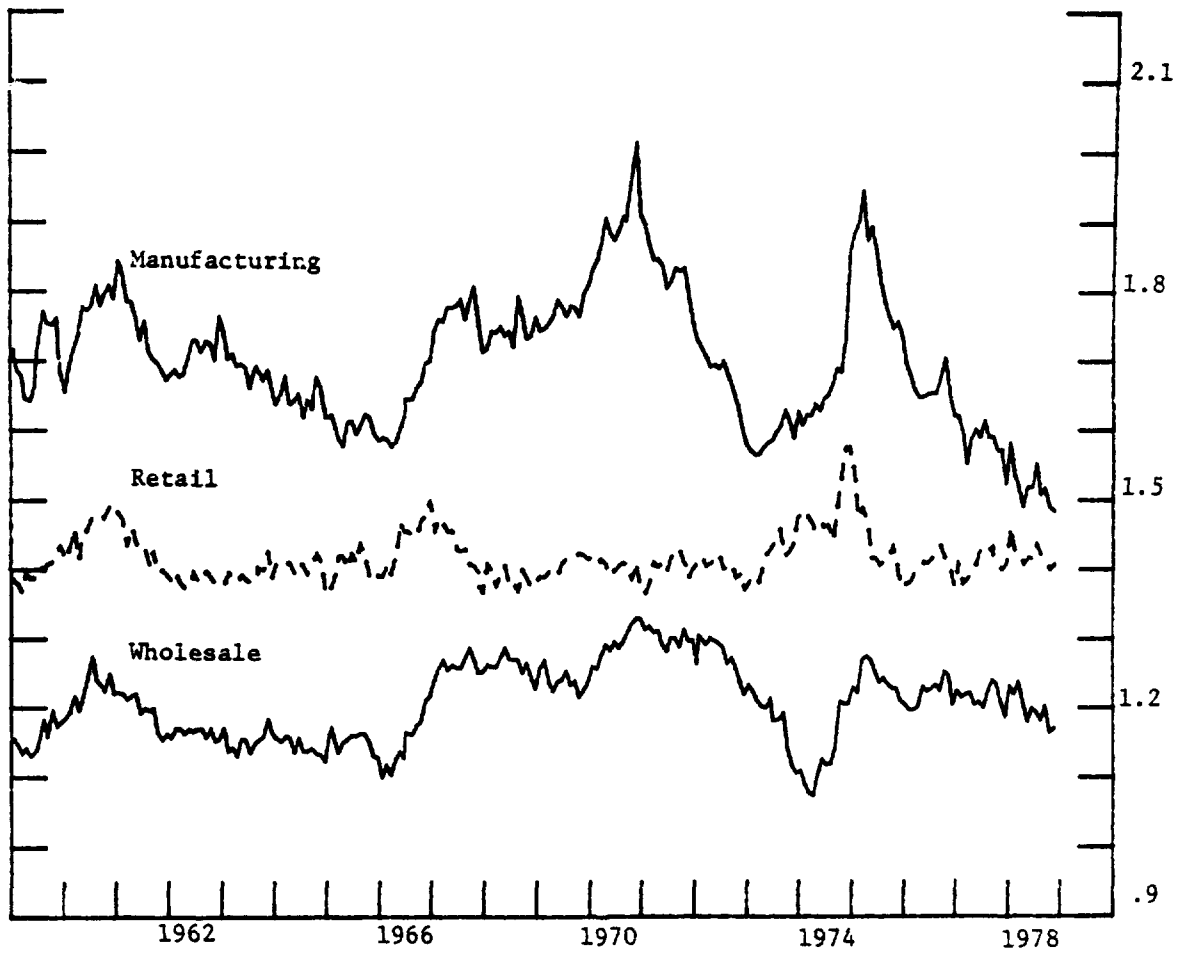
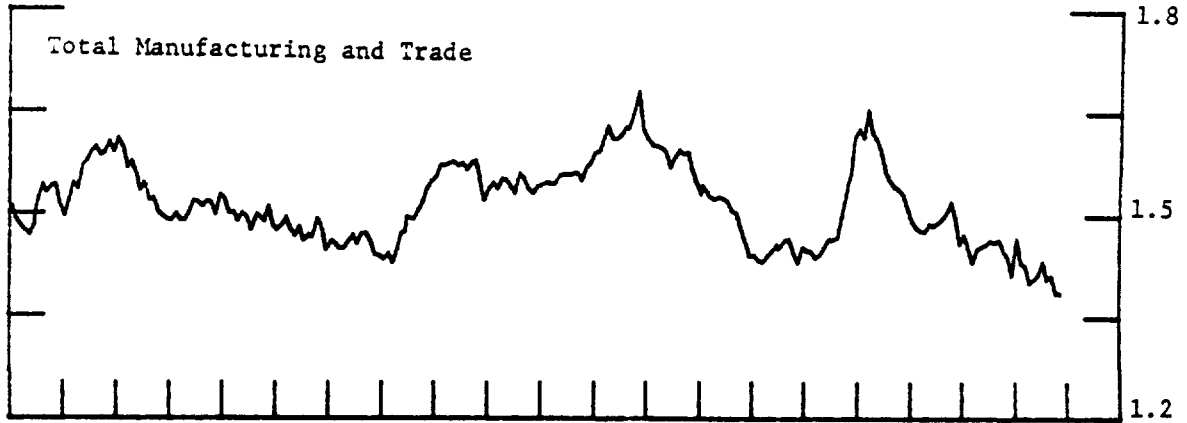
1/ Revised.
2/ Preliminary.

INVENTORY TO SALES RATIOS

	1977			1978				
	QII	QIII	QIV	QI	QII	QIII	Oct. 1/	Nov. 2/
Manufacturing and trade	1.46	1.48	1.44	1.46	1.42	1.43	1.38	1.39
Manufacturing	1.60	1.61	1.56	1.56	1.52	1.54	1.49	1.48
Durable	1.96	1.96	1.90	1.90	1.86	1.87	1.80	1.79
Nondurable	1.22	1.22	1.18	1.17	1.15	1.16	1.13	1.12
Trade, total	1.32	1.35	1.33	1.36	1.31	1.32	1.28	1.29
Wholesale	1.21	1.24	1.23	1.27	1.20	1.20	1.16	1.17
Retail	1.43	1.44	1.42	1.45	1.42	1.43	1.40	1.41

1/ Revised.
2/ Preliminary.

INVENTORY TO SALES RATIO^{1/}
(Book value basis)



^{1/} Last period plotted is November, 1978.

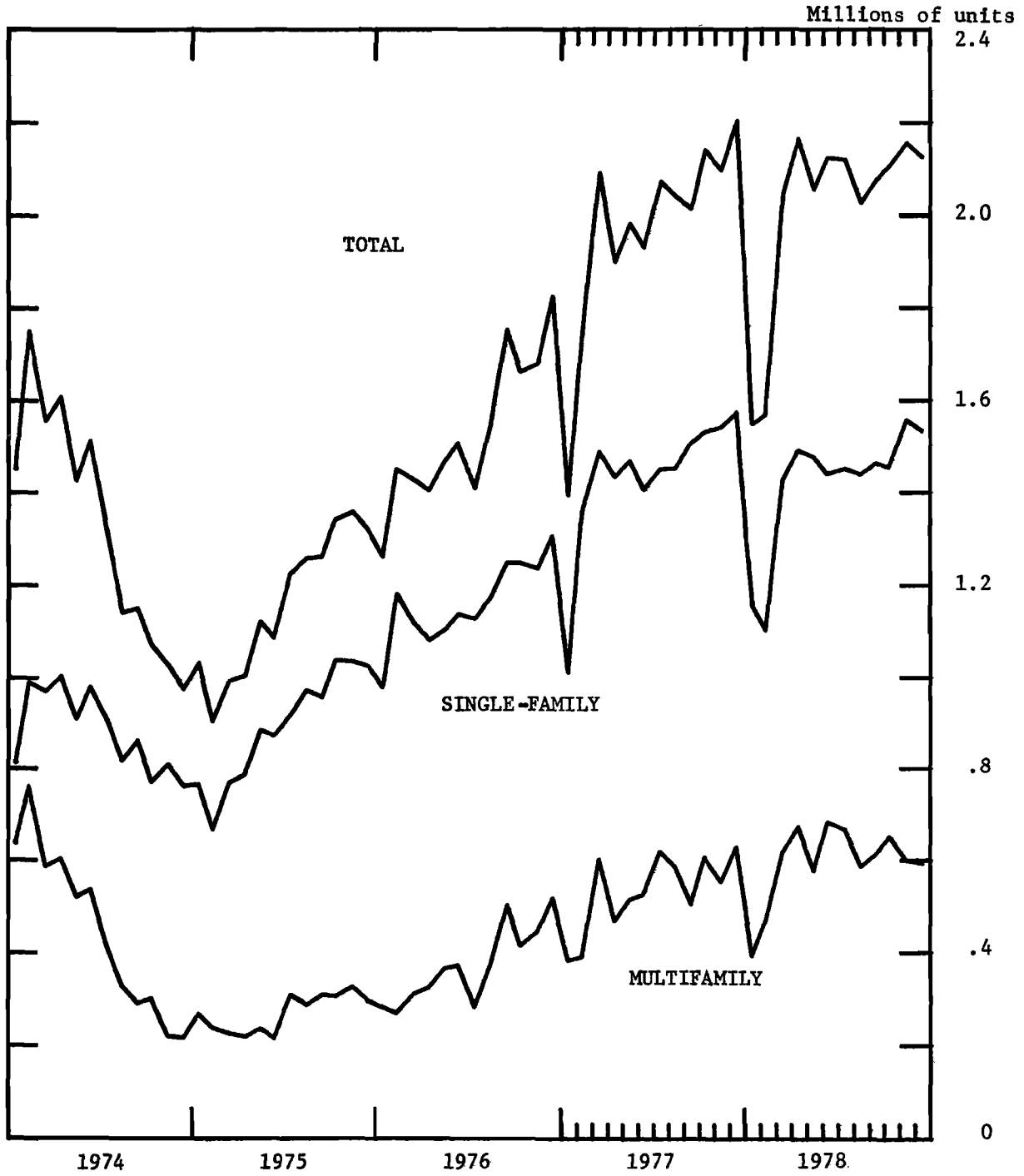
NEW PRIVATE HOUSING ACTIVITY
(Seasonally adjusted annual rates, millions of units)

	1978					
	QII	QIII	QIV	Oct ^{2/}	Nov ^{2/}	Dec ^{1/}
Total						
Permits	1.72	1.64	1.71	1.72	1.72	1.68
Starts	2.11	2.07	2.13	2.11	2.16	2.13
Single-family						
Permits	1.11	1.05	1.13	1.13	1.11	1.16
Starts	1.47	1.45	1.52	1.46	1.56	1.53
Sales						
New homes	.84	.79	n.a.	.98	.81	n.a.
Existing homes	3.81	3.97	n.a.	4.29	4.35	n.a.
Multifamily						
Permits	.61	.59	.58	.59	.61	.52
Starts	.64	.62	.61	.65	.60	.59
Mobile home shipments	.26	.26	.31	.30	.31	.31

^{1/} Preliminary.

^{2/} Revised.

NEW PRIVATE HOUSING STARTS
(Seasonally adjusted annual rates)



have now fluctuated in a narrow band slightly above 2 million units for 10 months.

Much of the strength in the housing sector over the last few months has been in the single-family market where--despite a fractional decline in December--the average rate of starts in November and December was close to the recent series record set in 1977 Q4. Moreover, single-family home sales also remained strong in late 1978. Sales of new homes in November were down from the advanced October rate but about equal to the strong selling pace earlier in 1978. Moreover, sales of existing homes continued their record-setting pace by rising more than 1 per cent in November. However, while sales have remained generally brisk, the median number of months on the market for new homes sold rose to an average of about 4-1/2 months in October and November--up 1/2 month from the rate experienced during most of the first nine months of 1978.

In the multifamily sector, starts declined for the second successive month in December. This recent weakness followed a surge in September and October that was apparently related to the large number of units started around the end of the fiscal year under HUD's Section 8 rental assistance program.

Government Sector Activity

The Federal deficit, on a National Income and Product Accounts basis, is estimated to have been at a \$20 billion annual rate in the fourth quarter of 1978, down from a \$23 billion deficit in the third quarter of the year. In the fourth quarter, a sizable increase in

receipts more than offset a sharp rise in outlays. Purchases of goods and services rose sharply, mainly because of an increase in Commodity Credit Corporation nonrecourse loans and the 5.5 per cent Federal pay raise in October. Outlays for interest also rose sharply in the final quarter of 1978. The gain in receipts--20 per cent at an annual rate--reflected the strong growth in income.

The Administration now estimates spending and receipts in fiscal year 1979 at \$493 billion and \$456 billion (on a Unified Budget basis), respectively. For fiscal year 1980, beginning October 1, 1979, the Administration has proposed a budget with outlays of \$532 billion, receipts of \$503 billion, and a deficit of \$29 billion. (A detailed description of the President's budget is presented in Appendix A.)

Recent data continue to indicate a moderation in growth of total State and local government spending. State and local government employment increased by about 25,000 in December, following a larger gain in November. Nevertheless, these recent gains did not make up for the earlier declines in employment that occurred in the July through October period. The net employment loss is evidently attributable to cutbacks in CETA hirings, which appear to reflect uncertainty among local public sponsors about future federal funding of the program. The value of new construction put-in-place declined by \$1.5 billion in November, but remains at a high level following very strong increases last spring and summer; in real terms, these expenditures were 11 per cent above year-earlier levels.

Prices

Inflation continued at a rapid pace in the final months of 1978. The gross business product fixed-weight price index--a broad measure of prices--rose at an 8-1/4 per cent annual rate in the fourth quarter, and producer prices rose at a 10-1/4 per cent rate. Increases in the consumer price index did slow a bit during the last two months of 1978, but this was mainly a result of factors that appear to be temporary--the November moderation in the advance of food prices and the December decline in California property taxes resulting from Proposition 13.

Increases in retail food prices accelerated again in December. Meat prices rose considerably in both months, but in November the rise was offset partially by declines in prices of fruits and vegetables. Recent developments in agricultural commodity markets indicate a sharp increase in farm prices in January associated in part with adverse weather conditions in the Midwest, Texas, and California.

Energy prices accelerated in the fourth quarter; electricity rates declined on average, but this was more than offset by a faster rise in prices of gasoline and other petroleum-based fuels. Increases in retail gasoline prices averaged about 1-3/4 per cent per month in November and December; since last June gasoline prices have risen at a 17-1/2 per cent annual rate.

Outside the food and energy areas, the December consumer price rise was at about the same rate as earlier in the year, if an adjustment is made for the exceptional cut in property taxes in California resulting

RECENT CHANGES IN PRODUCER PRICES
(Percentage change at compound annual rates; based
on seasonally adjusted data)^{1/}

	Relative importance Dec. 1977	1977	1978	1978			
				HI	QIII	QIV	Dec.
Finished goods	41.2	6.6	9.1	10.5	5.0	10.3	10.2
Consumer foods	10.3	6.6	11.9	17.9	-1.0	13.7	11.2
Consumer nonfoods	18.7	6.1	8.3	8.2	7.6	9.1	10.2
Capital equipment	12.2	7.2	8.0	7.9	6.4	9.9	9.4
Materials:							
Intermediate ^{2/}	45.5	6.4	8.2	7.9	6.7	10.4	6.5
Construction	8.3	8.3	10.8	11.9	8.5	11.1	3.6
Crude nonfood	4.6	6.8	15.7	13.9	12.2	23.1	15.8
Crude food	6.3	1.4	18.3	34.1	-9.4	20.3	-2.1

^{1/} Changes are from final month of preceding period to final month of period indicated. Monthly changes are not compounded.

^{2/} Excludes intermediate materials for food manufacturing and manufactured animal feeds.

RECENT CHANGES IN CONSUMER PRICES
(Percentage change at compound annual rates; based
on seasonally adjusted data) ^{1/}

	Relative importance Dec. 77 ^{2/}	1977	1978	1978			
				HI	QIII	QIV	Dec.
All items	100.0	6.8	9.0	10.4	7.8	7.9	7.1
Food	17.7	8.0	11.8	18.4	3.0	7.8	9.4
Commodities (nonfood)	41.6	4.9	7.7	6.6	7.8	10.1	10.7
Services	40.7	7.9	9.3	10.4	10.3	5.7	2.2
Memoranda:							
All items less food and energy ^{3/}	73.7	6.4	8.5	9.0	8.3	7.7	5.5
Gas and electricity	3.4	8.7	7.9	17.0	4.5	-5.1	2.0
Gasoline	4.2	4.9	8.5	-2	14.0	21.7	22.3
Homeownership	22.8	9.2	12.4	13.3	14.7	8.8	3.0

^{1/} Changes are from final month of preceding period to final month of period indicated. Monthly changes are not compounded.

^{2/} Based on new index for all urban consumers.

^{3/} Energy items excluded: gasoline and motor oil, fuel oil and coal, gas and electricity.

from Proposition 13. This special factor--which reduced the rise in the total CPI for December from 0.8 per cent to 0.6 per cent--contributed to a marked slowing in the increases in the cost of homeownership. The price relief due to this factor is a one-time occurrence, and the resumption of substantial increases in homeownership costs seem likely as recent increases in mortgage rates show up in the CPI. Movements in the mortgage interest rate component of the CPI generally reflect changes in mortgage commitment rates with about a three to four month lag.

From December 1977 to December 1978 consumer prices rose 9 per cent, about 2-1/4 percentage points more than during 1977. Homeownership prices rose about 12-1/2 per cent--over 3 percentage points more than in 1977--and contributed about 3/4 percentage point to the acceleration in the overall CPI increase. The other major contributors to the CPI acceleration in 1978 were food and used cars, which were responsible for nearly 3/4 and 1/2 percentage points of the 1978 acceleration, respectively. Excluding these 3 components, the acceleration in the CPI increase was still about 1/2 percentage point.

Wages, Productivity and Costs

Wages, as measured by the average hourly earnings index, rose almost 8 per cent in the fourth quarter--slightly slower than the rate over the year as whole. Manufacturing wages continued to increase at about the 8-1/4 per cent rate recorded in the first nine months of this year. Major collective bargaining settlements in the fourth quarter

resulted in first year wage-rate adjustments averaging 7-3/4 per cent, similar to those negotiated earlier in the year. In January, the Oil, Atomic and Chemical Workers Union reached a tentative settlement in their wage negotiations with Gulf Oil which appears to comply with the Administration's pay standard. The two-year contract calls for increases in total wages and benefits of 8 per cent in the first year and 5 per cent in the second year; the contract also includes a wage reopening in the second year but stipulates that further adjustments must be consistent with the pay standard.

Labor costs continued to rise at a rapid rate in the fourth quarter. Hourly compensation, which includes both wages and benefits, increased about 9 per cent in the final quarter of 1978 and about 9-3/4 per cent over the four quarters of the year. The rapid growth of output in the fourth quarter was accompanied by a productivity gain of 2-1/4 per cent in the nonfarm business sector; this was the same pace as in the third quarter and a marked improvement from the productivity decline recorded in the first half of the year. Reflecting these movements in compensation and productivity, unit labor costs growth in the fourth quarter slowed somewhat; nevertheless, the increase over the four quarters of 1978 was 9 per cent--the largest four quarters advance in these costs since early 1975.

HOURLY EARNINGS INDEX
(Percentage change at compound annual rates; based on seasonally adjusted data)1/

	1977 <u>2/</u>	1978	1978			
			QI	QII	QIII	QIV
Total private nonfarm	7.5	8.2	9.2	8.4	7.3	7.9
Manufacturing	8.3	8.2	8.6	7.7	8.1	8.3
Contract construction	4.0	7.6	8.1	10.5	6.6	5.5
Transportation and public utilities	9.1	6.8	8.2	7.9	4.5	6.5
Total trade	7.4	9.3	12.3	7.9	8.8	8.3
Services	7.1	7.5	9.6	6.5	5.5	8.5

1/ Excludes the effect of interindustry shifts in employment and fluctuations in overtime pay in manufacturing.

2/ Changes are from final quarter of preceding period to final quarter of period indicated.

MAJOR COLLECTIVE BARGAINING SETTLEMENTS
(Percentage change at annual rates)

	Average adjustment			
	1975	1976	1977	1978
Wage-rate settlements (1,000 or more workers)				
First year adjustments	10.2	8.4	7.8	7.7
Average over life of contracts <u>1/</u>	7.8	6.4	5.8	6.5
Wage and benefit settlements (5,000 or more workers)				
First year adjustments	11.4	8.5	9.6	8.4
Average over life of contracts <u>1/</u>	8.1	6.6	6.2	6.5
Effective wage-rate adjustments (1,000 or more workers)				
Current settlements	2.8	3.2	3.0	2.0
Prior settlements	3.7	3.2	3.2	3.7
Escalator provisions	2.2	1.6	1.7	2.3

1/ Excluding cost-of-living adjustments.

PRODUCTIVITY AND COSTS
 (Percentage change from preceding period at compound annual rates;
 based on seasonally adjusted data) 1/

	1977	1978	1978			
			QI	QII	QIII	QIV
<u>Output per hour</u>						
Total private business	1.5	.5	-4.5	1.2	3.5	2.1
Nonfarm business	1.3	.8	-3.1	1.7	2.3	2.3
Manufacturing	2.9	3.5	-5.1	8.3	10.8	.8
Durable	2.6	3.1	-6.8	11.3	10.2	-1.2
Nondurable	3.5	4.2	-2.6	3.9	11.8	4.2
<u>Compensation per hour</u>						
Total private business	7.5	9.8	12.1	8.1	10.4	8.7
Nonfarm business	7.6	9.8	12.2	8.2	9.6	9.1
Manufacturing	9.0	9.6	11.6	7.4	10.6	9.0
Durable	9.8	9.4	10.4	7.5	10.4	9.2
Nondurable	7.2	9.5	13.6	7.2	9.7	7.6
<u>Unit labor costs</u>						
Total private business	5.8	9.2	17.4	6.8	6.7	6.5
Nonfarm business	6.3	8.9	15.7	6.4	7.1	6.7
Manufacturing	5.9	5.9	17.7	-.8	-.2	8.1
Durable	7.0	6.1	18.5	-3.4	.2	10.5
Nondurable	3.6	5.1	16.6	3.2	-1.9	3.3

1/ Changes are from final quarter of preceding period to final quarter of period indicated.

III-T-1
SELECTED DOMESTIC FINANCIAL DATA

Indicator	Latest data		Net Change from:		
	Period	Level	Month ago	Three months ago	Year ago
<u>Monetary and credit aggregates</u> ^{1/}			<u>Per cent at annual rates</u>		
		<u>\$ billions</u>			
Total reserves	January	41.4pe	-4.7	-0.8	4.9
Nonborrowed reserves	January	40.5pe	-4.3	3.5	4.0
Money supply					
M1	January	361.3pe	0.7	-0.8	5.7
M1+	January	582.6pe	-3.3	-4.2	4.0
M2	January	872.6pe	0.8	2.4	6.9
M3	January	1503.9pe	4.2	5.4	8.5
Time and savings deposits (less CDs)	January	511.4pe	1.2	4.7	7.8
CDs ^{2/}	January	100.7pe	3.7	12.5	24.4
Thrift deposits (S&Ls + MSBs + Credit Unions)	January	631.5pe	9.4	9.7	10.7
Bank credit (end of month)	December	971.1	1.1	5.9	10.9

Indicator	Latest data		Net Change from:			
	Period	Per cent or index	Month ago	Three months ago	Year ago	
<u>Market yields and stock prices</u>						
Federal funds	wk. endg.	1/24/79	10.05	.80	1.27	3.28
Treasury bill (90 day)	"	1/24/79	9.38	.08	1.71	2.92
Commercial paper (90-119 day)	"	1/24/79	10.19	-.33	1.10	3.40
New utility issue Aaa	"	1/19/79	9.54	--	--	.86
Municipal bonds (Bond Buyer) 1 day		1/25/79	6.30	-.31	.09	.60
FNMA auction yield (FHA/VA)		1/23/79	10.73	-.20	-.03	1.51
Dividend price ratio (common stocks)	wk endg.	1/24/79	5.30	-.20	-.03	-.12
NYSE index (12/31/65=50)	end of day	1/29/79	56.85	3.23	4.20	7.40

	Period	Net Change or Gross Offerings			
		Latest Data	Year ago	Year to Date	
				1978	1977
<u>Credit demands</u>					
Business loans at commercial banks ^{1/}	December	-0.1	1.4	26.5	21.7
Consumer instalment credit outstanding ^{1/}	December	3.7e	3.6	43.9	35.0e
Mortgage debt outstanding (major holders) ^{1/3/}	November	10.2	9.4	89.4	80.0
Corporate bonds (public offerings)	December	1.2e	1.5	20.1e	24.2
Municipal long-term bonds (gross offerings)	December	3.6e	3.6	47.9e	46.7
Federally sponsored agcy. (net borrowing)	December	2.1e	0.8	23.4	6.8
U.S. Treasury (net cash borrowing)	January	3.7	6.0	3.7	6.0

^{1/} Seasonally adjusted.

^{2/} \$ billions, not at annual rates

^{3/} Includes comm'l banks, S&Ls, MSBs, life ins. cos, FNMA, and GNMA.

e - Estimated

pe- Partially estimated.

DOMESTIC FINANCIAL DEVELOPMENTS

Credit flows to the private nonfinancial sectors of the economy appear to have been smaller in December and January than during the previous two-month period. During December, more moderate growth in short- and intermediate-term business credit reflected flatness in business loans at commercial banks combined with continued sizable increases in nonfinancial commercial paper and finance company loans. In January, bank business loans seem to have resumed growing, but the issuance of nonfinancial commercial paper has slowed. Longer-term business borrowing diminished in December and January, although the relatively light volume of gross bond and stock financing was supplemented by apparently heavy takedowns of mortgage loans from insurance companies and commercial banks. Among households, consumer instalment credit and mortgage borrowing appear to have weakened somewhat in December. In the public sector, gross borrowing by State and local governments increased in the final month of 1978 but declined in January. In contrast, net offerings of Treasury and sponsored agency securities were lower in December than in the previous month, before expanding early in 1979.

Both M-1 and M-2 grew slowly in December and January. The modest expansion in the broader aggregate reflected further substantial declines in savings deposits together with a moderate expansion in time deposits. Although sales of money market certificates (MMCs) have remained quite brisk, total deposits subject to interest rate ceilings declined in December for the second month in a row. Deposit growth at thrift institutions in December and January is estimated to have been somewhat less than in the preceding several months.

Most money market interest rates have declined 25 to 75 basis points since the last FOMC meeting. Interest rates moved higher following the December meeting as a further rise in the System's Federal funds rate objective into the 10 per cent area became apparent; these increases subsequently were more than reversed for most instruments, due in part to the persistent weakness in the major monetary aggregates and the relative stability in the foreign exchange value of the dollar. Yields on shorter-term Treasury bills are slightly above their levels at the December meeting, however, reflecting sales of bills by the System, an increase in Treasury issuance of 3-month bills, and smaller purchases of bills in January by foreign central banks. Longer-term Treasury and municipal bond yields meanwhile have declined about 10 to 25 basis points, but primary mortgage rates have edged higher. Stock prices fell slightly in late December, and then climbed 7 to 10 per cent in January.

Monetary Aggregates

M-1 expanded at a 1-3/4 per cent pace in December, and it has remained about unchanged on average since year end. Given moderate growth in October and sharp contraction during November, the average level of M-1 was about the same in January as four months earlier. On a quarterly average basis, M-1 grew at only a 4-1/2 per cent annual rate in the final three months of 1978, down from 7-1/2 per cent in the third quarter and its slowest pace in more than two years. The cumulative impact of recent increases in market interest rates probably is responsible for much of the reduction in M-1 growth. In addition, a shift of consumer deposits at commercial banks from demand accounts to savings accounts eligible

III - 3
 SELECTED FINANCIAL MARKET QUOTATIONS
 (per cent)

	1978 1/		1978-1979 2/				Change from:	
	High	Low	Oct. 31	FOMC Nov. 21	FOMC Dec. 19	Jan. 30	Oct. 31	Dec. FOMC
<u>Short-term rates</u>								
Federal funds <u>1/</u>	10.25	6.58	9.29	9.68	9.75	10.05 ^{3/}	+ .76	+ .30
Treasury bills								
3-month	9.30	6.16	8.75	8.83	9.21	9.27	+ .52	+ .06
6-month	9.51	6.45	9.23	9.08	9.61	9.35	+ .12	-.26
1-year	9.62	6.55	9.13	9.09	9.61	9.34	+ .21	-.27
Commercial paper								
1-month	10.56	6.70	9.13	9.79	10.22	9.75	+ .62	-.47
3-month	10.52	6.68	9.40	10.15	10.42	10.02	+ .62	-.40
Large negotiable CDs <u>4/</u>								
3-month	10.96	6.77	10.38	10.54	10.90	10.18	-.20	-.72
6-month	11.52	6.97 ^p	11.25	11.01	11.50	10.61	-.64	-.89
Bank prime rate	11.57	7.75	10.25	11.00	11.50	11.75	+1.50	+ .25
<u>Intermediate- and long-term rates</u>								
Corporate								
New AAA <u>5/</u>	9.30	8.61	9.23	9.25	9.29	--	--	--
Recently offered <u>6/</u>	9.54	8.48	9.24	9.24	9.35	9.46 ^p	+ .22	+ .11
Municipal								
(Bond Buyer) <u>7/</u>	6.67	5.58	6.21	6.11	6.45	6.30	+ .09	-.15
U.S. Treasury (constant maturity)								
3-year	9.59	7.40	9.32	8.89	9.49	9.18	-.14	-.31
7-year	9.22	7.72	9.00	8.76	9.15	8.96	-.04	-.19
20-year	9.00	8.01	8.90	8.70	8.99	8.90	0	-.09
	Low 8/	High 8/	Oct. 31	FOMC Nov. 21	FOMC Dec. 19	Jan. 30	Oct. 31	Dec. FOMC
<u>Stock prices</u>								
Dow-Jones Industrial	742.12	907.74	792.45	804.05	789.85	851.78	+59.33	+61.93
N.Y.S.E. Composite	48.43	60.38	51.67	52.96	52.58	56.60	+4.93	+4.02
AMEX	119.73	176.87	136.75	145.69	146.38	161.26	+24.51	+14.88
Keefe Bank Stock <u>6/</u>	558	694	694	596	600	629	-65	+29

- 1/ Daily averages for statement week, except where noted.
 2/ One-day quotes except as noted.
 3/ Average for first 6 trading days of statement week ending January 31.
 4/ Secondary market.
 5/ Averages for preceding week.
 6/ One-day quotes for preceding Friday.
 7/ One-day quotes for preceding Thursday.
 8/ Calendar week averages.

MONETARY AGGREGATES
(Seasonally adjusted)^{1/}

	1978						Dec. '77	1979
	HI	QIII	QIVP	Oct.	Nov.	Dec. ^P	to Dec. '78 ^P	Jan. ^e
<u>Major monetary aggregates</u>								
1. M-1 (currency plus demand deposits)	8.1	7.6	4.4	3.7	-4.6	1.7	6.7	0.7
2. M-1+ (M-1 plus savings deposits at CBs and checkable deposits at thrift institutions)	5.9	5.3	2.4	1.8	-7.1	-2.3	4.3	-3.3
3. M-2 (M-1 plus time & savings deposits at CBs, other than large CDs)	7.4	8.9	7.5	7.0	4.3	2.1	7.7	0.8
4. M-3 (M-2 plus all deposits at thrift institutions)	7.8	10.1	9.7	9.6	6.6	5.2	8.9	4.4
<u>Bank time and savings deposits</u>								
5. Total	11.7	9.5	12.5	7.9	23.7	5.0	11.5	8.5
6. Other than large negotiable CDs at weekly reporting banks (interest bearing component of M-2)	6.9	10.0	9.6	9.1	10.7	2.4	8.5	1.2
7. Savings deposits	2.1	1.3	-0.9	-1.6	-11.3	-8.7	0.3	-9.3
8. Individuals ^{2/}	2.1	2.5	-0.8	-2.9	-8.6	-8.7	0.7	n.a.
9. Other ^{3/}	1.3	-15.5	-2.7	16.0	-39.5	-16.3	-5.2	n.a.
10. Time deposits	11.1	17.3	18.1	17.7	27.7	10.8	15.5	9.5
11. Small time ^{4/}	5.2	8.5	13.0	23.5	4.7	8.8	8.6	n.a.
12. Large time ^{4/}	22.7	32.7	26.7	8.1	67.8	13.0	28.9	n.a.
13. Time and savings deposits subject to rate ceilings (7+11)	3.4	4.4	5.2	9.4	-4.2	-0.9	3.8	n.a.
<u>Deposits at nonbank thrift institutions ^{5/}</u>								
14. Total	8.3	11.6	13.0	13.6	10.1	9.5	10.6	9.4
15. Savings and loan associations	8.5	12.8	14.5	14.9	12.2	11.5	11.5	11.4
16. Mutual savings banks	4.8	7.1	9.3	11.2	6.9	4.3	6.6	4.2
17. Credit unions	17.4	13.6	n.a.	6.8	2.3	n.a.	n.a.	n.a.
<u>Average monthly changes, billions of dollars</u>								
MEMORANDA:								
18. Total U.S. Govt. deposits ^{6/}	0.0	1.5	-0.1	3.8	0.5	-4.6	0.3	-2.8
19. Total large time deposits ^{7/}	4.2	3.1	4.4	0.8	13.1	2.8	4.0	3.5
20. Nondeposit sources of funds ^{8/}	0.7	1.1	2.3	5.1	-1.9	3.8	1.2	n.a.

p--preliminary. n.a.--not available. e--estimated

^{1/} Quarterly growth rates are computed on a quarterly average basis.

^{2/} Savings deposits held by individuals and nonprofit organizations.

^{3/} Savings deposits of business, government, and others, not seasonally adjusted.

^{4/} Small time deposits are time deposits in denominations less than \$100,000. Large time deposits are time deposits in denominations of \$100,000 and above excluding negotiable CDs at weekly reporting banks.

^{5/} Growth rates computed from monthly levels based on average of current and preceding end-of-month data.

^{6/} Includes Treasury demand deposits at commercial banks and Federal Reserve Banks and Treasury note balances.

^{7/} All large time certificates, negotiable and nonnegotiable, at all CBs.

^{8/} Nondeposit borrowings of commercial banks from nonbank sources include Federal funds purchased and security RPs plus other liabilities for borrowed money (including borrowings from the Federal Reserve), gross Eurodollar borrowings, and loans sold, less interbank borrowings.

for automatic transfer services (ATS) is estimated to have reduced M-1 growth by 3 percentage points in both November and December (and the fourth quarter average by 1 per cent), and additional transfers limited M-1 growth in January. Moreover, inflows to newly authorized NOW accounts in New York State grew sharply in January, further reducing M-1 growth.

Data from the most recent Demand Deposit Ownership Survey indicate weakness in both business and consumer demand deposits during the fourth quarter. At large banks, demand deposits held by financial businesses declined and net inflows to accounts of nonfinancial businesses slowed sharply. In the consumer category, strong growth in October was followed by net outflows after the introduction of ATS on November 1.

Despite the shifting of funds to ATS accounts, net outflows from savings accounts continued in both December and January as the spread between Treasury bill rates and Regulation Q ceilings widened to a record amount. On average for the fourth quarter, total savings accounts at commercial banks contracted by 1 per cent at an annual rate, the first quarterly decline since 1970. Savings deposit outflows were concentrated in accounts held by individuals and nonprofit institutions.

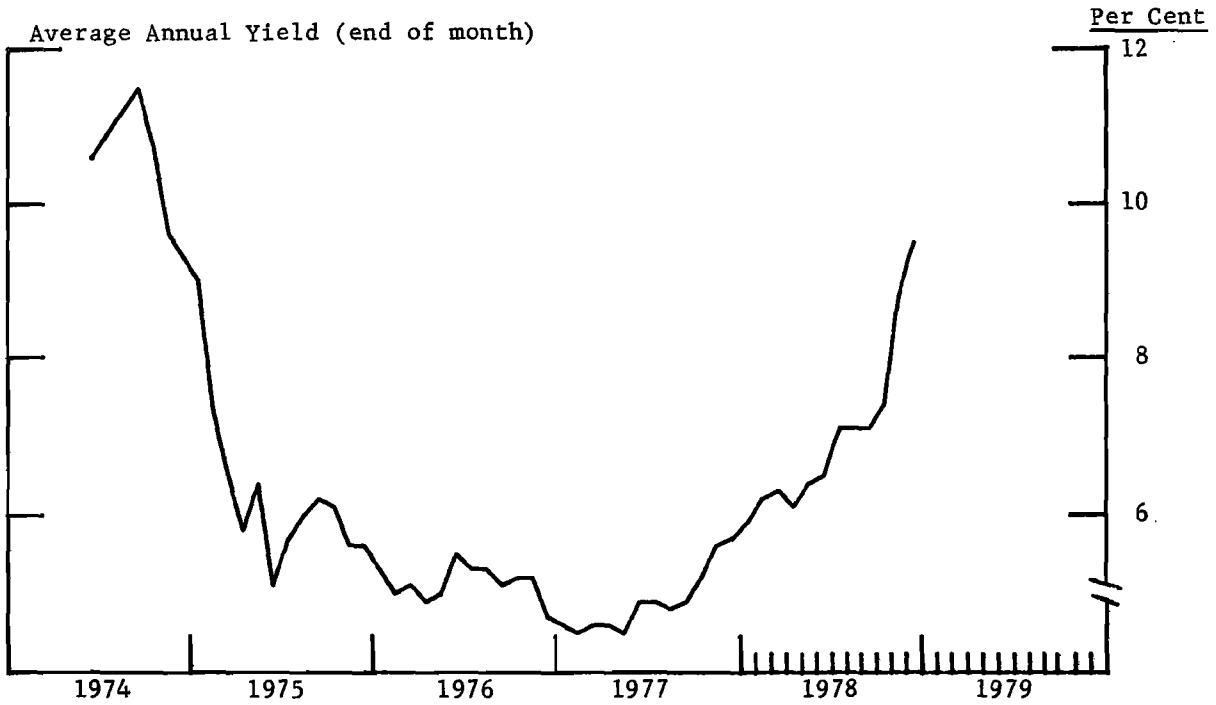
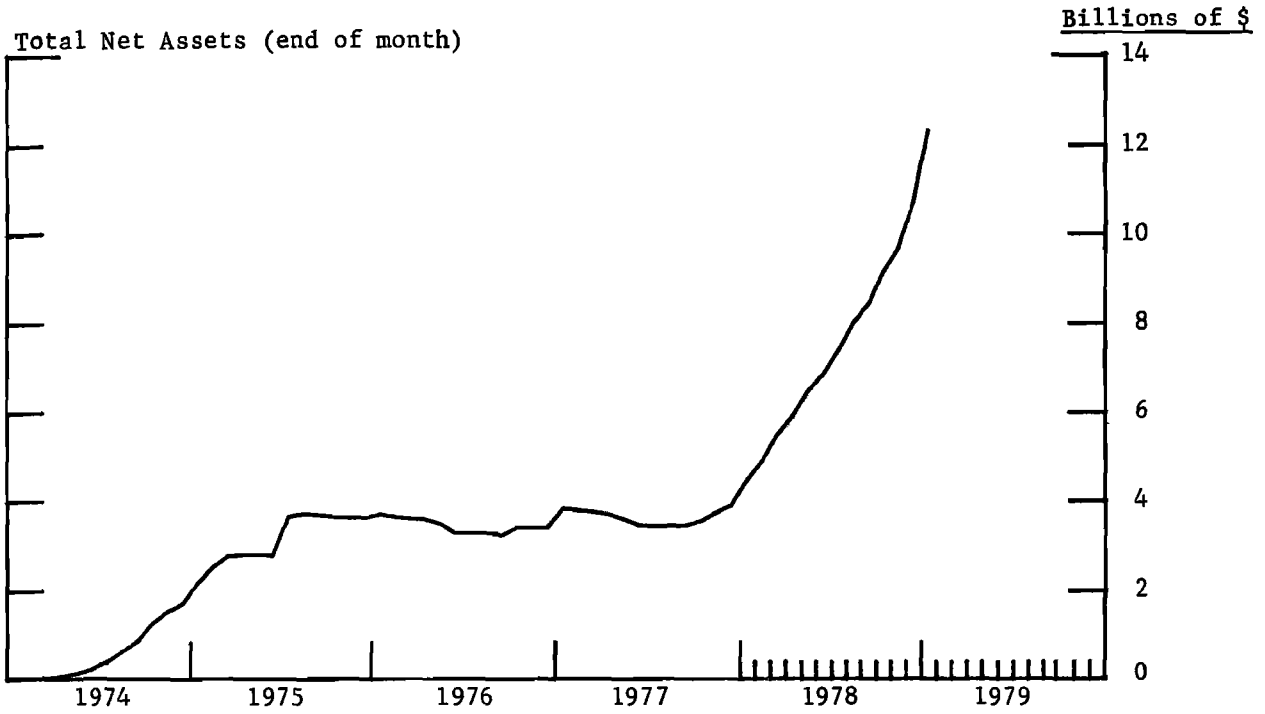
M-2 growth decelerated in both December and January, continuing a trend that began last October. The fourth quarter slowdown in the rate of expansion of M-2 was, however, less pronounced than the deceleration of the narrower monetary aggregates, as inflows of large time deposits included in this aggregate remained strong and the growth of total small-denomination time deposits accelerated. Helping to buoy growth of smaller time deposits was a \$13.3 billion net inflow of MMCs, almost twice the

previous quarter's amount. Other small time deposits maturing in less than 4 years continued to contract, while accounts maturing in 4 years or more were essentially unchanged after growing moderately in the previous quarter.

Deposit growth at S&Ls and MSBs declined to 9.5 per cent in December, its lowest rate since the MMCs were introduced. The combined deposit growth for these institutions in January appears to be about the same as in December, and remains well below the pace recorded in the third quarter. Like commercial banks, S&Ls and MSBs have experienced sharp outflows from savings accounts. But given the further sharp increase in interest rates since early fall, nonbank thrift deposit growth would have been substantially lower without MMCs. Over the fourth quarter, net sales of these certificates totaled \$21.5 billion at S&Ls and \$6.7 billion at MSBs. At year end, outstanding MMC balances at S&Ls and MSBs were \$40.8 and \$12.8 billion, respectively, accounting for more than 9 per cent of total deposits at the institutions compared to 5-1/4 per cent of small-denomination time and savings deposits at commercial banks.

The advance in interest rates during the fourth quarter apparently encouraged the public to economize further on noninterest-earning assets and to seek out more actively assets offering market yields. The combined assets of money market mutual funds, for example, increased by more than \$1 billion to \$10.7 billion in December, and posted further increases of \$2.2 billion in the first three weeks of January (see Chart on page 7). Offerings of short-term unit investment trusts also reappeared in the final quarter of 1978. Sales of these investment companies--

MONEY MARKET MUTUAL FUNDS
(monthly)



Latest data shown: December 1978.

representing interests in fixed CD pools--have totaled more than \$1.1 billion since early November.¹ In addition, noncompetitive tenders have increased somewhat at recent Treasury bill and note auctions.

Bank Credit

Commercial bank credit expanded at an annual rate of only 1.1 per cent in December, the smallest monthly growth recorded last year. Following brisk expansion in the preceding two months, total loan growth decelerated sharply in the final month of 1978 as business loans were about unchanged, securities loans declined, and real estate loans expanded less rapidly. Data for large banks provide some evidence of renewed business loan expansion in January, with most of the strength attributable to non-New York City (NYC) banks. This reverses the pattern that characterized business loans in December: NYC banks recorded strong loan growth, but this was more than offset by loan declines at large non-NYC and small banks.

Banks reduced their portfolios of Treasury securities in December for the fifth consecutive month, while net acquisitions of other securities--mainly State and local issues--remained at about November's reduced pace. The recent decline in holdings of U.S. Government securities at large banks has been concentrated in those maturing in over 1 year. As a result, a downward movement in the ratio of liquid assets to liabilities at these

^{1/} Several major brokerage houses sponsored 11 unit trust offerings in 1974, with units (\$1,000 minimum purchase) representing fractional undivided interests in fixed pools of CDs of domestic commercial banks. The more recent unit trust offerings, on the other hand, have represented interests in fixed pools of CDs of foreign branches of domestic banks, foreign banks, and U.S. branches of foreign banks.

COMMERCIAL BANK CREDIT

(Per cent changes at annual rates, based on seasonally adjusted data)^{1/}

	1978						12 months ending Dec.
	QII	QIII	QIV	Oct.	Nov.	Dec.	
1. Total loans and investments ^{2/}	17.0	8.7	5.9	9.8	6.7	1.1	10.9
2. Investments	11.7	1.1	-10.3	-4.5	-20.0	-6.5	1.9
3. Treasury securities	17.1	-6.1	-36.2	-24.7	-61.8	-25.2	-7.5
4. Other securities	8.5	9.0	4.8	7.1	3.6	3.5	7.5
5. Total loans ^{2/}	19.1	11.7	12.1	15.3	16.8	3.9	14.6
6. Business loans	17.4	10.3	6.7	10.6	10.0	-0.5	13.0
7. Security loans	88.9	-26.8	-43.1	-67.7	-52.2	-13.6	-7.0
8. Real estate loans	19.3	17.6	17.5	16.7	21.1	13.8	19.1
9. Consumer loans	23.7	15.6	n.a.	17.3	20.8	n.a.	n.a.

MEMORANDA:

10. Commercial paper issued by non-financial firms ^{3/}	30.6	18.9	49.7	33.9	52.7	56.8	25.9
11. Business loans at banks net of bank holdings of bankers acceptances	17.9	10.3	8.6	12.4	12.8	0.5	14.1
12. Sum of items 10 & 11	18.8	10.9	11.8	13.9	15.8	5.3	14.9
13. Memo item 12 plus business loans from finance companies	17.4	9.1	14.9 ^e	18.8	17.7	7.8 ^e	14.8 ^e

n.a.--not available. e--estimated

^{1/} Last-Wednesday-of-month series except for June and December, which are adjusted to the last business day of the month.

^{2/} Loans include outstanding amounts of loans reported as sold outright to a bank's own foreign branches, nonconsolidated nonbank affiliates of the bank, the bank's holding company (if not a bank), and nonconsolidated nonbank subsidiaries of the holding company.

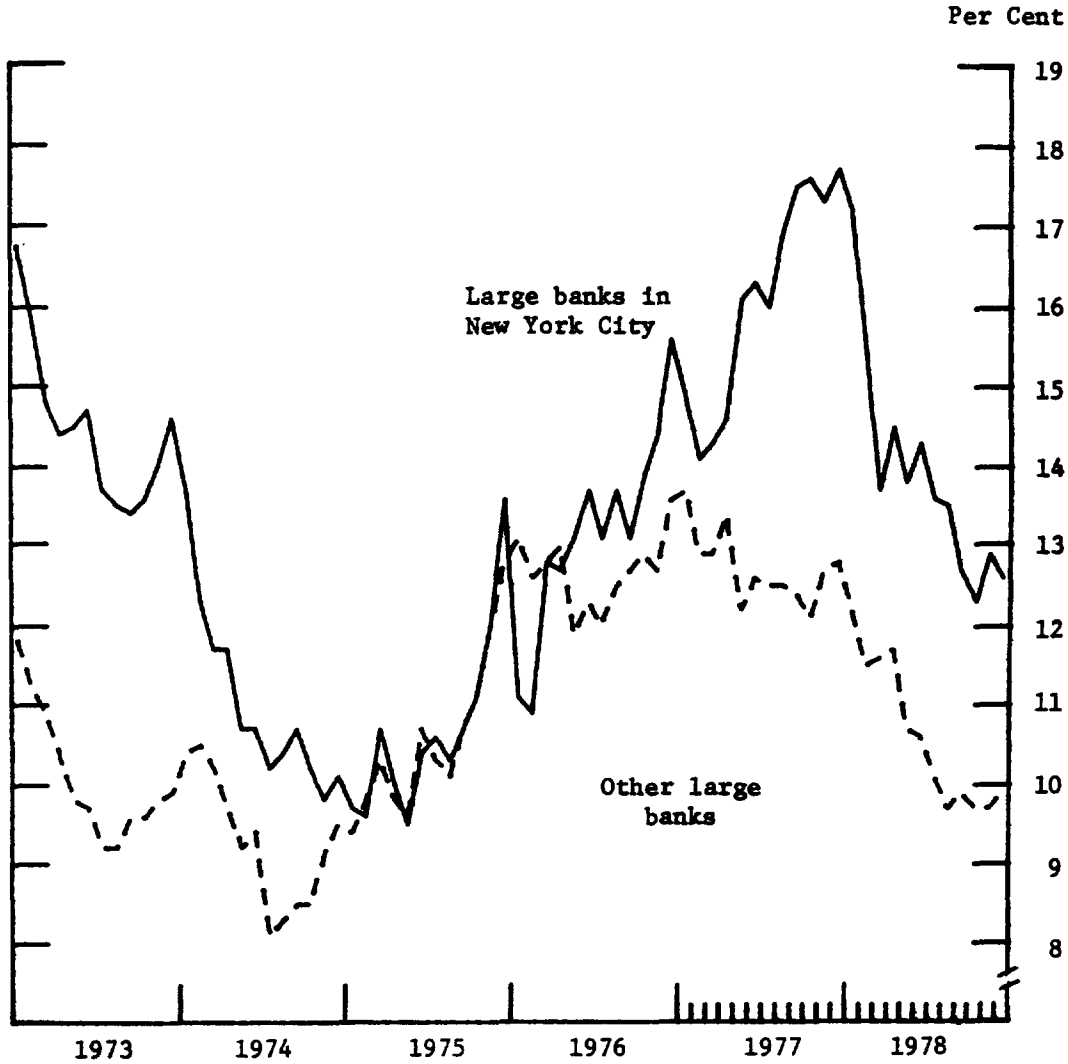
^{3/} Measured from end of month.

banks has slowed and the ratio remains above its low recorded in late 1974 (see Chart on page 11).

Banks also issued large CDs and increased their reliance on nondeposit sources of funds to meet loan demand in December. The greater use of nondeposit sources more than offset the previous month's decline and boosted the fourth quarter net increase to \$7 billion; security RPs and Fed fund purchases from nonbank sources accounted for much of this increase. Gross Eurodollar borrowings from foreign branches also rose over the quarter, but claims on such branches increased by a like amount, resulting in only a small net amount of funds acquired from this source. In addition to these nondeposit sources of funds, banks began acquiring Treasury balances under the new tax and loan account program in early November. These accounts averaged over \$6 billion in the final two months of the year.

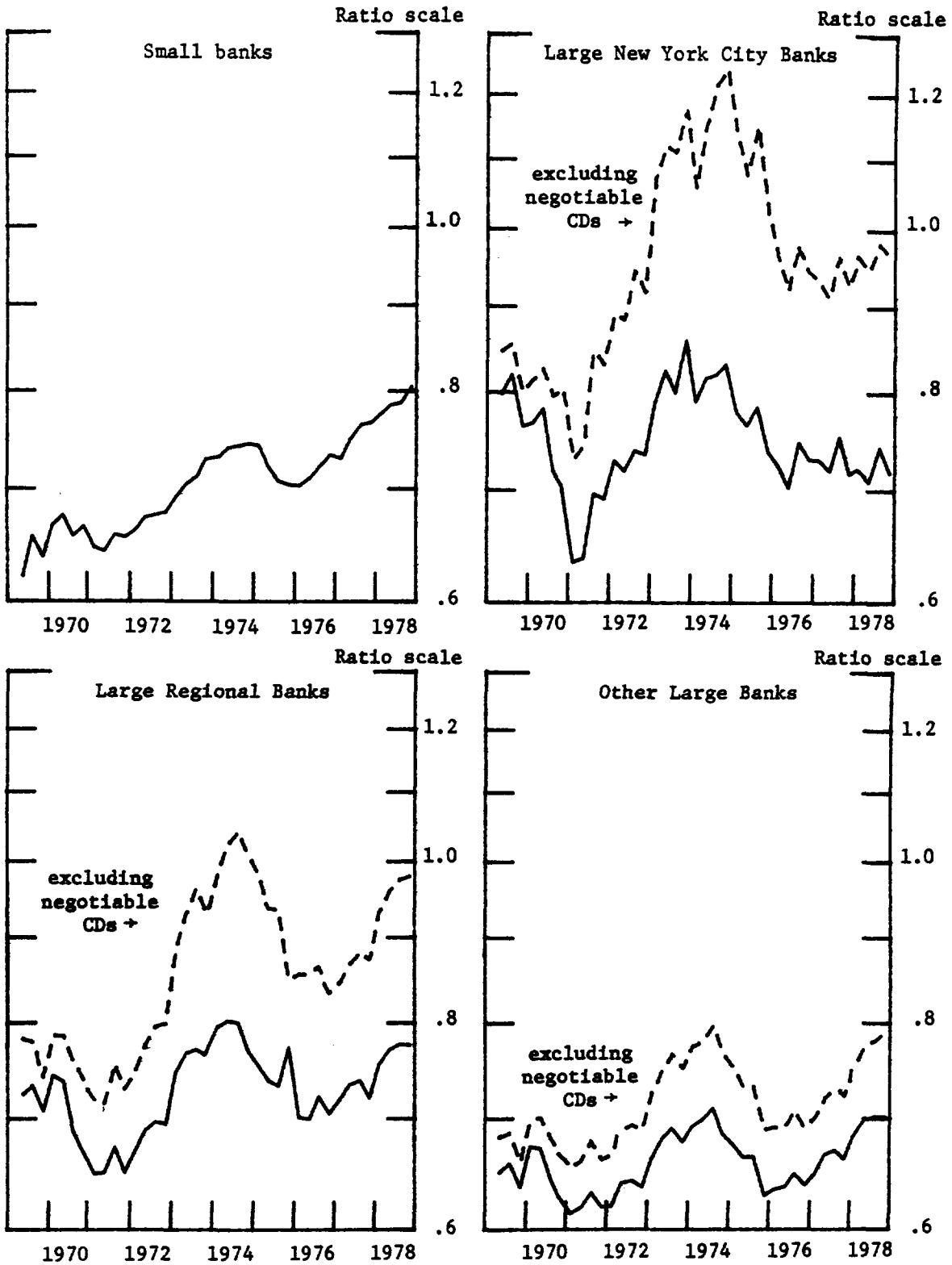
With the further loan growth over the fourth quarter--financed in part by security sales and enlarged use of nondeposit sources of funds--the ratio of loans to deposits for most classes of commercial banks had increased by year end to near or above the 1974 peaks (see Chart on page 12). Only large banks in New York City still maintained ratios substantially below the 1974 levels. The possibility of additional liquidity pressures at large banks is suggested by the most recent data on the growth of loan commitments, which indicate a further sharp rise in unused business loan commitments in November, extending the trend evident for more than three years. This jump apparently reflected efforts by corporate treasurers to augment their credit lines as a hedge against possible reductions in the availability of funds if credit conditions tighten further.

RATIO OF LIQUID ASSETS TO TOTAL LIABILITIES^{1/}
 AT LARGE BANKS INSIDE AND OUTSIDE NEW YORK CITY
 (not seasonally adjusted)



^{1/} The liquidity ratio is calculated as the sum of Treasury and other securities maturing in one year or less, loans to brokers and dealers and domestic commercial banks, holdings of bankers' acceptances and gross sales of Federal funds, all divided by liabilities less capital accounts, valuation reserves, and demand deposits due to banks.

Ratio of Loans to Deposits
(end of quarter, not seasonally adjusted)



Business Finance

Despite the December weakness in business loans at commercial banks, total short- and intermediate-term business credit continued to expand in the month. Commercial paper issued by nonfinancial firms grew \$900 million in December--due in part to a less-than-seasonal runoff at year end by public utilities--and business loans at finance companies are estimated to have increased further. Nonfinancial commercial paper also expanded strongly in the previous two months, increasing a near-record \$2.2 billion for the quarter as a whole.¹ The \$4.1 billion increase in business loans at finance companies in the fourth quarter reflected primarily expansion in automobile-related lending--both retail loans on commercial vehicles and wholesale (or "floorplanning") loans--as well as continued strength in equipment financing.

In longer-term markets, gross public offerings of corporate bonds contracted to \$1.1 billion in January, after totaling only \$1.5 billion in December. The relatively light slate of offerings in December and January was due to reduced public utility financing and a continuing paucity of higher-rated industrial issues.² Major manufacturing and

^{1/} In addition, nonbank-related financial firms boosted their commercial paper outstandings by \$1.8 billion over the quarter. Bank holding company paper grew by a record \$2.8 billion, but sales of loans by banks to their bank holding company affiliates decreased over recent months, so these funds apparently are being passed through to nonbank subsidiaries.

^{2/} Underwriters generally expect the refunding of a large volume of maturing issues of financial corporations to boost bond offerings in 1979. Moody's reported recently that 12 banks or bank holding company issues totaling \$715 million and 14 finance company issues totaling \$900 million will mature and likely be refunded during 1979. Indeed, part of the proceeds from Citicorp's \$500 million, floating-rate note issue offered in late January will be used to redeem \$225 million of notes falling due in 1979 and 1980.

CHANGE IN COMMERCIAL PAPER OUTSTANDING
(Monthly totals or monthly averages, sea. adj., billions of dollars)

	1977	1978					Outstanding 12/31/78
	Year	H1	Q3	Oct.	Nov.	Dec.	
Total commercial paper	1.0	1.6	0.8	0.2	3.4	3.3	83.8
Bank-related ^{1/}	0.1	0.5	0.3	0.8	0.9	1.1	15.8
Nonbank related	0.9	1.1	0.5	-0.6	2.4	2.2	68.0
Financial	0.8	0.9	0.2	-1.1	1.6	1.3	48.1
Dealer placed	0.1	0.2	0.3	-0.8	0.2	0.5	8.8
Directly placed	0.7	0.7	-0.1	-0.3	1.4	0.8	39.3
Nonfinancial	0.2	0.2	0.3	0.5	0.8	0.9	19.9

^{1/} Not seasonally adjusted.

Note: Components may not add to total due to rounding.

CHANGE IN BUSINESS CREDIT AT FINANCE COMPANIES
(Monthly totals or monthly averages, sea. adj., billions of dollars)

	1977	1978					Outstanding 11/30/78
	Year	H1	Q3	Oct.	Nov.	Dec.	
Total business credit	0.9	0.6	0.2	1.8	1.3	1.0 ^{e/}	62.7
Retail automotive (comm'l.)	0.3	0.2	0.2	0.3	0.3		14.4
Wholesale automotive	0.3	--	-0.2	1.0	0.3		12.1
Accounts receivable ^{1/}	--	0.1	--	--	0.2		6.7
Equipment loans & all other	0.3	0.3	0.2	0.5	0.5		29.5

^{1/} Includes factored accounts receivable.

^{e/} Estimated.

GROSS OFFERINGS OF CORPORATE AND FOREIGN SECURITIES
(Monthly totals or monthly averages, in millions of dollars)

	<u>1977</u>	<u>1978</u>				<u>1979</u>	
	Year	H1	QIII	QIV ^{e/}	Dec. ^{e/}	Jan. ^{f/}	Feb. ^{f/}
<u>Seasonally adjusted</u>							
Corporate securities--total	4,518	3,587	4,822	3,586	3,250	2,925	3,100
Publicly offered bonds	2,016	1,489	2,365	1,606	1,500	1,050	1,425
Privately placed bonds	1,501	1,366	1,428	1,333	1,250	1,200	1,200
Stocks	1,001	732	1,029	647	500	675	475
<u>Not seasonally adjusted</u>							
Publicly offered bonds	2,016	1,695	1,761	1,533	1,200	1,275	1,400
By quality <u>1/</u>							
Aaa and Aa	1,089	820	885	908	675	1,025	--
Less than Aa <u>2/</u>	927	875	876	625	525	250	--
By type of borrower							
Utility	692	525	770	640	300	400	--
Industrial <u>3/</u>	700	578	560	418	375	375	--
Financial	624	592	431	475	525	500	--
Foreign securities--total	621	640	328	423	10	821	--
Publicly offered <u>4/</u>	437	466	183	336	10	625	300
Privately placed	184	174	145	87	0	196	--

1/ Bonds categorized according to Moody's bond ratings.

2/ Includes issues not rated by Moody's.

3/ Includes equipment trust certificates.

4/ Classified by original offering date.

e/ Estimated.

f/ Forecast.

industrial corporations generally remain reluctant to issue long-term, call-protected bonds at the relatively high level of current interest rates, relying instead on alternative sources of funds to finance their activities.¹ For example, still substantial takedowns of privately placed bonds by nonfinancial corporations in recent months have been supplemented with a record volume of commercial mortgage financing from insurance companies and commercial banks (see Chart on page 18). Also, the unexpected strength in recent economic activity resulted in relatively strong fourth quarter profits for many corporations; even allowing for dividend increases, gross internal sources of funds probably were significantly augmented at many major corporations.

Mortgage Market and Consumer Credit

Net residential mortgage lending apparently declined somewhat in December, due mainly to a reduced volume of financing at S&Ls. Slower deposit growth at nonbank thrift institutions during the fourth quarter was accompanied by a fall off in S&L commitment activity.² In addition, the cost of mortgage and construction loans increased further and there have been reports of tightening in nonrate lending terms. S&L borrowing from FHLBs was sizable during the quarter--with an especially large increase recorded in December--and advances have remained strong (after

^{1/} Public bond offerings by higher-rated industrial corporations would have been even smaller in recent quarters if some companies had not elected to raise longer-term funds to repay bank loans incurred for the financing of acquisitions. This was the case for the \$300 million, Aa-rated industrial issue in January.

^{2/} The year-end backlog of mortgage commitments outstanding at S&Ls was slightly below its year-earlier level (measured in current dollars).

FINANCING PATTERN OF NONFINANCIAL CORPORATIONS
(Billions of dollars, seasonally adjusted annual rates)

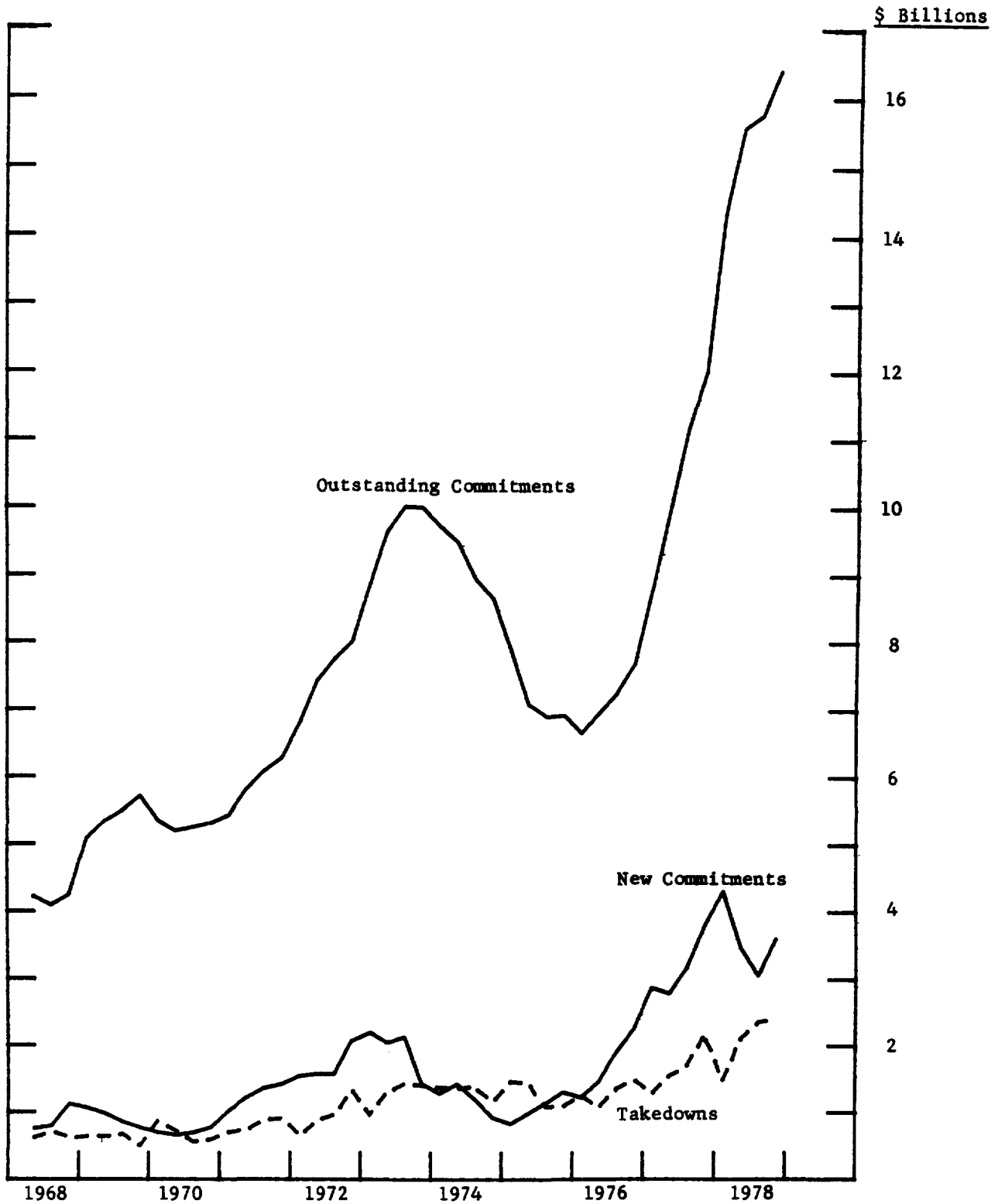
	<u>1977</u>	<u>1978</u>			
	Year	Q1	Q2	Q3	Q4
Capital expenditures	164.6	180.3	200.6	193.7	200.9
Gross internal funds	<u>135.3</u>	<u>127.2</u>	<u>144.1</u>	<u>145.4</u>	<u>152.0</u>
Financing gap	29.3	53.1	56.5	48.3	48.9
Net funds raised in markets	78.7	102.6	82.8	77.4	91.1
Com'l. paper & accept.	2.2	2.6	4.3	3.5	8.2
Finance Co. loans ^{1/}	10.3	8.4	6.3	0.1	12.5
Bank loans n.e.c. ^{1/}	20.0	50.8	18.5	19.3	20.2
Corporate bonds	24.5	17.5	26.5	25.8	21.5
Mortgages	19.0	22.2	26.5	27.9	27.6
Net new equity issues	2.7	1.0	0.7	0.8	1.0
Financial uses of funds, net	49.4	49.5	26.3	31.1	42.2
Liquid assets	0.8	15.0	-8.9	7.2	13.8
Other ^{2/}	48.6	34.5	35.2	23.9	28.4

^{1/} Includes a small amount of loans from U.S. Government.

^{2/} Includes consumer credit, net trade credit, and miscellaneous assets less profit taxes payable and miscellaneous liabilities.

Source: Flow of Funds, January 26, 1979. Data for 1978-Q4 are preliminary.

COMMERCIAL AND INDUSTRIAL MORTGAGE ACTIVITY AT LIFE INSURANCE COMPANIES^{1/}
 (Quarterly data, seasonally adjusted)



^{1/} Reporting companies account for nearly 80 per cent of U.S. life insurance company assets. Fourth quarter 1978 data include estimate for December.

Source: American Council of Life Insurance.

seasonal adjustment) in early January.¹ However, the liquidity ratio at insured S&Ls was a relatively high 9.0 per cent at year end, unchanged from its year-earlier level. In the secondary market for home mortgages, yields have risen further in recent FNMA biweekly forward commitment auctions on an unusually low volume of offerings and acceptances. Mortgage yields have remained about unchanged in the FHLMC weekly auctions, while GNMA security yields--which typically move with bond yields--have edged lower.

Consumer instalment credit is estimated also to have grown somewhat less in December than during the previous month, although its rate of expansion for the fourth quarter as a whole was about in line with growth in the previous quarter. Despite fairly brisk loan growth associated with robust durable goods sales in the fourth quarter, several measures of non-price terms on consumer loans in November (latest available data) suggest that consumer instalment lenders are becoming somewhat more selective. At large finance companies, for example, the proportion of automobile loans made with only minimal downpayment has declined (see Chart on page 22). In addition, the average maturity of new-automobile instalment credit contracts at commercial banks has not lengthened much further in recent quarters, although this is not the case for automobile loan maturities at finance companies. The November Survey of Senior Bank Loan Officer Opinion also suggests a slight decrease in the willingness of commercial banks to make

^{1/} The FHLB Board recently approved applications by two S&Ls to issue unsecured and mortgage-secured commercial paper. Until January, only holding companies of state-regulated, stock-chartered associations could issue these securities.

III - 20
INTEREST RATES AND SUPPLY OF MORTGAGE FUNDS
AT SELECTED S&Ls

Period	Conventional home mortgages			
	Average rate on new commitments for 80% loans (Per cent)	Basis point change from month or week earlier	Spread ^{1/} (basis points)	Per cent of S&Ls ^{2/} with mortgage funds in short supply
1978--High	10.38	--	+10	69
Low	8.98	--	+30	17
1978--Aug.	9.80	+ 5	+100	57
Sep.	9.78	- 2	+ 72	60
Oct.	9.88	+10	+ 65	59
Nov.	10.11	+23	+ 84	59
Dec. 1	10.30	+ 2	+103	61
8	10.35	+ 5	+107	56
15	10.35	0	+106	64
22	10.35	0	--	58
29	10.38	+ 3	--	58
1979--Jan. 5	10.38	0	--	68
12	10.38	0	--	68
19	10.40	+ 2	+85	62
26	10.40	0	--	61

^{1/} Average mortgage rate minus average yield on new issues of Aaa utility bonds.

^{2/} Per cent reporting supply of funds slightly or substantially below normal seasonal patterns.

SECONDARY HOME MORTGAGE MARKET ACTIVITY

	FNMA auctions of forward purchase commitments						Yields on GNMA guaranteed mortgage backed securities for immediate delivery ^{2/}
	Conventional			Govt.-underwritten			
	Amount (\$ millions)		Yield to FNMA ^{1/}	Amount (\$ millions)		Yield to FNMA ^{1/}	
Offered	Accepted	Offered		Accepted			
1978--High	717	363	10.92	1249	605	10.60	9.68
Low	75	48	9.28	130	80	9.13	8.43
Dec 4							9.39
11	262	142	10.77	283	144	10.40	9.43
18							9.65
27	155	79	10.92	344	175	10.60	9.68
Jan 2							9.72
8	71	36	11.02	211	101	10.67	9.71
15							9.70
22	41	22	11.13	94	54	10.73	9.67
29							9.55

^{1/} Average gross yield before deducting fee of 38 basis points for mortgage servicing. Data, based on 4-month FNMA purchase commitments, reflect the average accepted bid yield for home mortgages, assuming a prepayment period of 12 years for 30-year loan without special adjustment for FNMA commitment fees and related stock requirements. Mortgage amounts offered by bidders relate to total eligible bids required.

^{2/} Average net yields to investors assuming prepayment in 12 years on pools of 30-year FHA-VA mortgages carrying the prevailing ceiling rate on such loans.

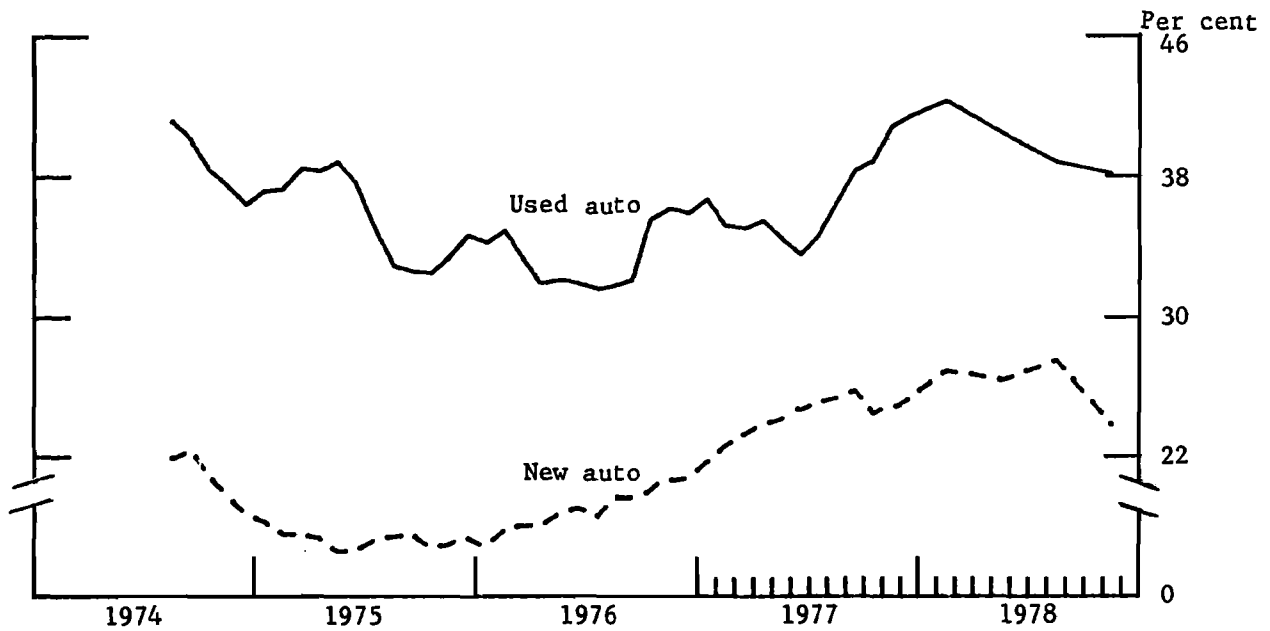
CONSUMER INSTALMENT CREDIT^{1/}

	1976	1977	1978e	1978			
				QIII	QIVe	Nov.	Dec.e
Total							
Change in outstandings							
Billions of dollars	21.1	35.0	44.0	43.1	44.8	49.2	44.8
Per Cent	12.4	18.3	19.2	17.3	17.2	18.7	16.7
Bank share (per cent)	50.2	52.7	53.1	51.9	47.3	47.0	47.0
Extensions							
Billions of dollars	210.0	254.1	298.7	304.9	312.3	314.6	313.3
Bank share (per cent)	46.2	46.4	47.8	48.0	47.5	47.6	47.6
Liquidations							
Billions of dollars	188.9	219.2	254.3	261.8	267.5	265.4	268.5
Ratio to disposable income	15.9	16.8	16.8	17.8	17.7	17.6	17.6
Automobile Credit							
Change in outstandings							
Billions of dollars	10.4	15.3	19.2	19.4	18.9	21.1	19.2
Per cent	18.2	22.6	23.2	20.9	19.4	21.3	19.0
Extensions							
Billions of dollars	63.6	75.8	88.9	91.8	92.0	93.4	92.7

^{1/} Quarterly and monthly dollar figures and related per cent changes are seasonally adjusted annual rates.

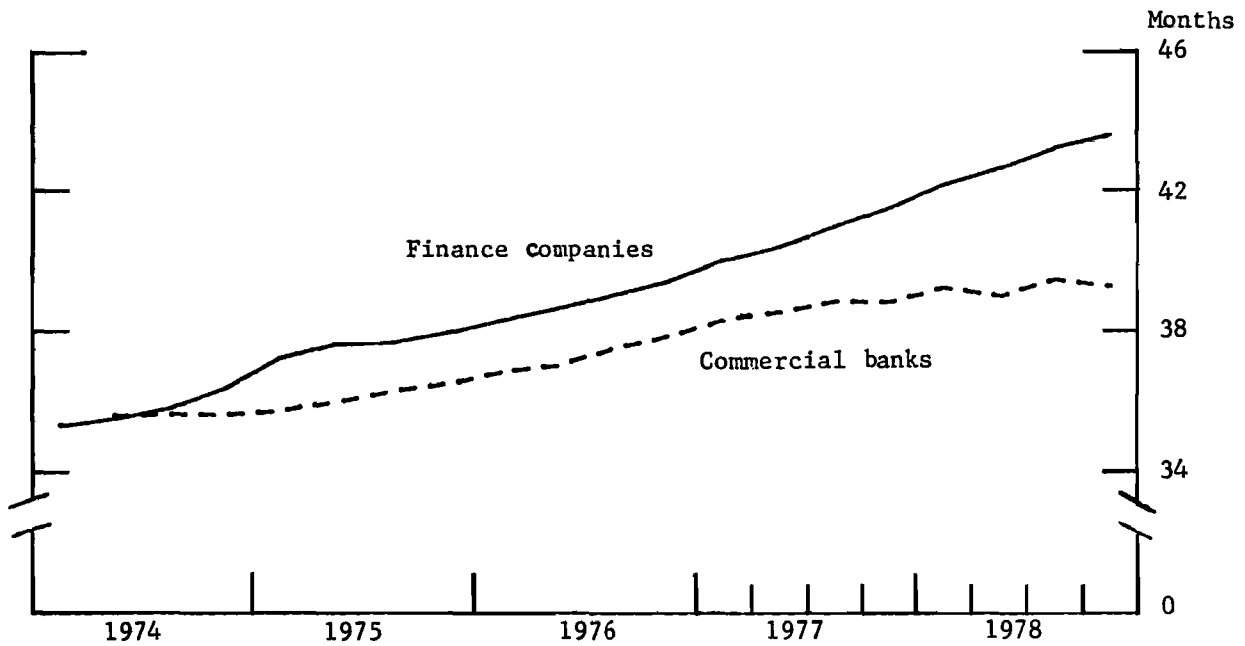
e - Based on early estimate for December.

PROPORTION OF LOW-DOWNPAYMENT AUTOMOBILE
CREDIT CONTRACTS AT FINANCE COMPANIES



Note: Low-downpayment contracts are those for which credit extended equals 100 per cent or more of dealer cost (new) or wholesale value (used).

AVERAGE MATURITY ON NEW-AUTO CONTRACTS
AT COMMERCIAL BANKS AND FINANCE COMPANIES



consumer instalment loans, which may be due in part to the squeeze between statutory ceilings on finance rates in some states and higher costs of funds to the banks.

Government Securities Markets

Gross offerings of tax-exempt bonds declined in January from the large volume in the final two months of 1978. The heavy year-end volume of tax-exempt securities was almost entirely for non-refunding purposes. The upward movement in municipal bond yields throughout most of 1978 and the September 1 IRS revised regulation amending tax-exempt arbitrage restrictions have greatly reduced the attractiveness of issuing new securities for refunding or advance refunding purposes. The Bond Buyer index of tax-exempt bond yields climbed to 6.67 per cent in mid-December--its highest level since July 1976--but it is currently about 35 basis points lower.

Net offerings of marketable Treasury issues totaled about \$2.2 billion in January (not seasonally adjusted). This represents a rebound from the pace of Treasury marketable borrowing in December, when sales of nonmarketable securities to foreign official institutions and foreign private investors were substantial. Since mid-December, sales of nonmarketable issues to foreign official institutions have slowed appreciably, although the Treasury auctioned about \$1.2 billion equivalent of 2-1/2- and 4-year, Swiss franc-denominated notes to private Swiss investors in mid-January. With December's German mark-denominated issue, the total of foreign currency-denominated issues sold by the Treasury in the last two months amounts to \$2.8 billion. The large sales of marketable and nonmarketable securities kept the Treasury's cash balance at a high level.

GOVERNMENT SECURITY OFFERINGS
(Monthly totals or monthly averages, in millions of dollars)

	1978					1979	
	H1	QIII	QIV ^{e/}	Nov.	Dec. ^{e/}	Jan. ^{f/}	Feb. ^{f/}
<u>Seasonally adjusted</u>							
State and local government securities, gross offerings							
Total	5,714	6,421	5,723	5,197	7,283	4,650	4,600
Long-term	3,919	4,403	3,924	4,143	4,583	3,000	2,600
Short-term	1,795	2,018	1,799	1,054	2,700	1,650	2,000
U.S. Government securities, net offerings							
U.S. Treasury ^{1/}	3,654	3,080	-945	-255	1,256	3,056	2,227
Sponsored agencies	2,320	1,641	1,788	3,053	2,003	1,650	2,466
<u>Not seasonally adjusted</u>							
State and local government securities, gross offerings							
Total	6,109	5,963	5,050	5,348	5,700	4,400	4,400
Long-term	4,094	4,195	3,600	4,075	3,600	3,000	2,700
Short-term	2,015	1,768	1,450	1,273	2,100	1,400	1,700
U.S. Government securities, net offerings							
U.S. Treasury ^{1/}	2,382	3,560	1,152	1,700	932	2,151	5,700
Sponsored agencies	2,012	2,130	1,635	2,667	1,542	1,327	1,476

^{1/} Marketable issues only.

^{e/} Estimated.

^{f/} Forecasted.

At the end of 1978, it totaled over \$16 billion, and had declined only to \$15.5 billion at the end of January.¹

Sponsored credit agencies borrowed about \$2 billion, seasonally adjusted, in December, maintaining the record high pace of borrowing established earlier in the year. Nearly all of the December borrowing was by the FHLB and FNMA, in association with a continuation of their strong direct and indirect support of the residential mortgage markets. Housing agency borrowing slowed in January, although this decline was about offset by increased borrowing by the farm credit agencies.

^{1/} The new Treasury tax and loan system has been able to handle these large balances, with the Treasury maintaining its FR balances between \$2.5 and \$3.5 billion. However, some banks in the system occasionally have remitted funds back to the FR Banks when their Treasury balances reached self-imposed ceilings.

RESTRICTED

U.S. International Transactions
(in million of dollars; receipts, or increase in liabilities, +)

January 31, 1979

	1976	1977			1978			Sept.	Oct.	Nov.
	Year	Year	Q4	Q1	Q2	Q3				
1. <u>Trade balance 1/</u>	-9,353	-31,059	-10,170	-11,201	-7,802	-8,045	-2,612	-2,486	-2,436	
2. Merchandise exports	114,694	120,585	29,457	30,664	35,067	36,930	12,924	13,026	13,097	
3. Merchandise imports	-124,047	-151,644	-39,627	-41,865	-42,869	-44,975	-15,536	-15,512	-15,533	
4. <u>Change in net foreign positions of banking offices in U.S. (excl. liab. to foreign official inst.)</u>	-9,935	-3,907	-5,142	-6,211	2,700	688	1,092	-696	-4,596	
Through interbank transactions with										
a) Own offices in foreign countries	-6,282	-2,717	-5,545	-3,526	4/	3,478	6,627	-2,392	151	
b) Unaffiliated banking offices in foreign countries	-3,220	-2,203	-147	-2,369	4/	-976	-3,329	2,012	-2,928	
Through nonbank transactions										
a) Claims on nonbanks in foreign countries (increase, -)	-3,142	-423	-487	-180	4/	-2,649	-986	-990	-1,969	
b) Liabilities to private nonbanks in foreign countries (inc. custody liab.)	2,709	1,436	1,037	-136	4/	635	-420	674	150	
9. <u>Private securities transactions, net (excl. U.S. Treas. Oblig.)</u>	-7,829	-3,050	38	-514	81	53	317	-553	-217	
10. Foreign net purchases of U.S. corp. bonds	415	1,130	206	123	158	407	99	199	50	
11. Foreign net purchases of U.S. corp. stocks	853	1,325	580	341	1,027	108	254	-56	1	
12. U.S. net purchases (-) of foreign securities	-9,097	-5,505	-748	-978	-1,104	-462	-36	-696	-268	
13. <u>Foreign net purchases of U.S. Treasury obligations</u>	2,641	543	-297	881	802	-1,034	621	291	-155	
14. <u>Change in foreign official reserve assets in U.S. (increase +)</u>	13,062	35,456	15,152	14,966	-5,483	4,639	-874	7,250	4,399	
By Area										
G-10 countries and Switzerland	3,922	29,414	14,476	12,327	-3,099	5,259	-477	6,164	5,394	
OPEC	6,802	5,989	757	1,354	-2,389	-1,645	-335	1,250	-713	
All other countries	2,338	53	-81	1,283	5	1,025	-62	-164	-282	
By Type										
U.S. Treasury securities	9,315	30,218	12,900	12,979	-5,728	3,167	1,328	4,661	4,612	
Other 2/	3,747	5,238	2,252	1,985	245	1,472	-2,202	2,589	-213	
20. <u>Change in U.S. reserve assets (increase +)</u>	-2,532	-237	-2	246	328	14	-67	-85	968	
21. <u>All other transactions and statistical discrepancy</u>	13,946	2,254	421	1,835	9,371	3,885	723	-3,721	2,037	
MEMO:										
Current account 3/	4,339	-15,265	-6,959	-6,854	-3,261	n.a.	n.a.	n.a.	n.a.	

1/ International accounts basis, seasonally adjusted.

2/ Includes deposits in banks, commercial paper, bankers' acceptances, and borrowing under repurchase agreements.

3/ Seasonally adjusted.

4/ Data not shown separately because of break in series.

Note: Capital Account data for December are not yet available. Trade data for December, the fourth quarter, and the year 1978 are shown in the text table on page IV-10.

RESTRICTED

INTERNATIONAL DEVELOPMENTS

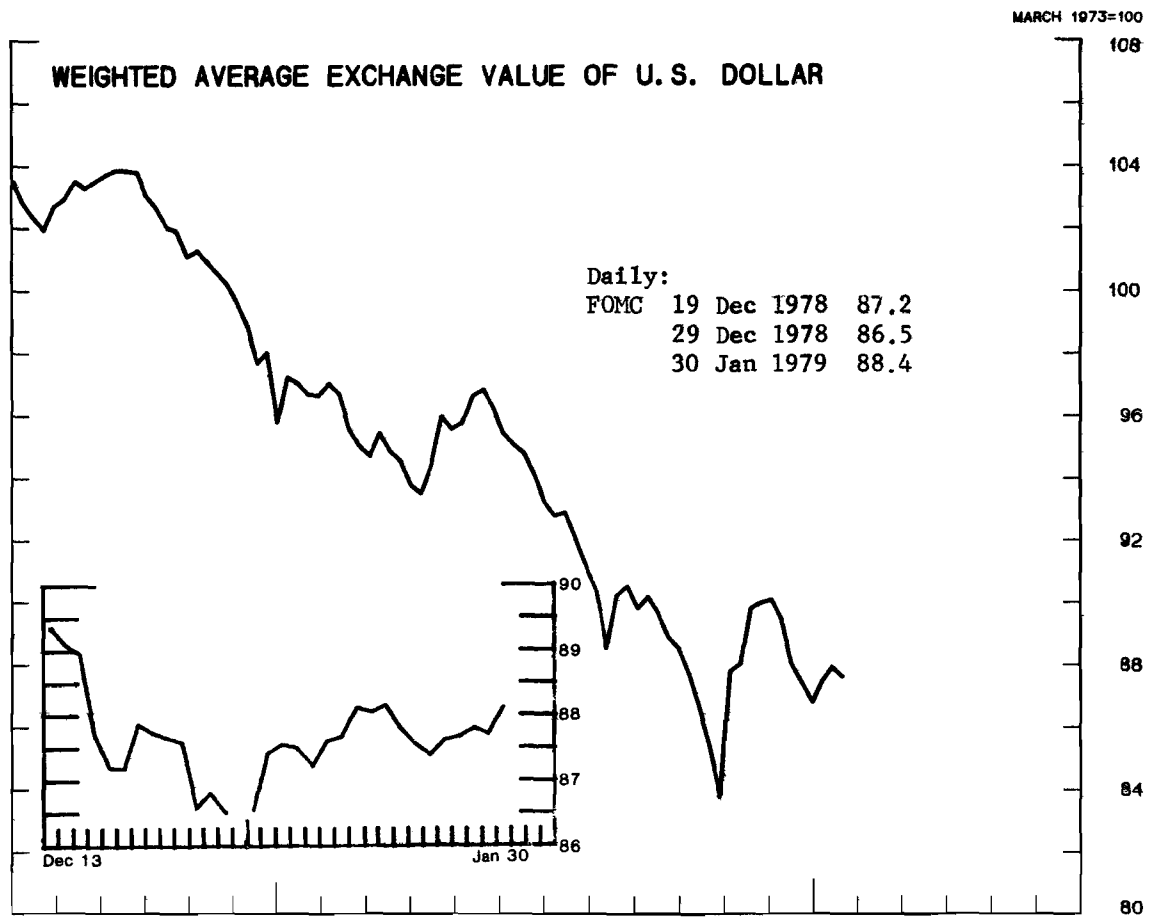
Foreign exchange markets. Since the last green book, the behavior of the dollar's weighted-average exchange value has exhibited two distinct trends, as shown in the Chart.

From mid-December until the end of the month, the dollar's value fell more or less steadily. There was a sharp break around the time of the December 16 OPEC announcement that graduated 1979 price increases would total 14.5 per cent: the dollar's average value fell about 2-1/2 per cent in four days. Additional selling pressure developed toward the end of the month.

Since the turn of the year, however, the dollar's value has been on a generally upward path. The rising trend was broken briefly around mid-month when statements and actions by German officials intimated that authorities there were beginning to re-emphasize the inflationary dangers of large-scale intervention in exchange markets.

U.S. authorities were net purchasers of a small amount of foreign currencies.

Over the seven weeks as a whole, the dollar's average exchange value has fallen about one per cent, and it is now about eight per cent higher than its low point at the end of last October.



The largest net changes in the dollar's value vis-à-vis individual currencies since mid-December were against the mark and other snake currencies and the French franc. The dollar's value declined by about 2-1/2 per cent in terms of each of those currencies. In contrast, the dollar's value rose (by 1-to-2-1/2 per cent) in terms of the yen and the Canadian dollar.

During the period of downward pressure on the dollar's value in the last half of December, the New York Trading Desk sold over \$1-1/2 billion equivalent of marks in about 50-50 proportions for the System and the Treasury. The System financed its share by swap drawings, and the Treasury drew on its mark balances. During late December, the Desk also made small purchases of Swiss francs and yen,

and

sold Swiss francs when necessary to relieve downward pressure on the dollar. As the dollar's value rose during January, the Desk became chiefly a net buyer of marks, Swiss francs, and yen,

. The System's share in those transactions has been used to reduce outstanding System swap drawings by about \$600 million from their peak value of \$5.5 billion (computed using exchange rates prevailing when drawings were made) reached at the end of 1978.

On January 17 the U.S. Treasury marketed the second issue in its planned series of foreign-currency-denominated notes. Swiss franc-denominated notes worth \$1.2 billion were sold in a heavily oversubscribed offering. Maturities of 2-1/2 and 4 years were offered at interest rates of 2.35 and 2.65 per cent respectively.

In January both the Swiss and Japanese governments announced that restrictions on capital inflows to their financial markets from abroad were to be relaxed. Neither action appeared to generate significant upward pressure on the currency involved.

Borrowing in international capital markets. Total borrowing in international capital markets in the second half of 1978 was close to the very high first-half level, raising the total of borrowings for the year to over \$100 billion, an increase of 45 per cent over 1977. Revisions to the Euro-credit data will undoubtedly raise this total further, perhaps by \$2-3 billion. Almost all the increase in total borrowing was in extensions of new medium-term Euro-credits. The increase in outstanding Euro-credits was much less dramatic than the rise in new credit extensions because much of the increase was used to refinance older drawings or maturing debt. Euro-bond issues declined in 1978 but foreign bond issues picked up.

In the market for medium-term Euro-credits, presently available data show \$64 billion of credits completed in the full year 1978, up almost 90 per cent from the 1977 total compared with a 19 per cent rise in 1977 over 1976. Because of the absence of data on repayments it is not possible to estimate precisely the extension of net new credit. However, data on external claims of banks in the G-10 countries suggest that outstanding medium-term credits may not have risen significantly faster in 1978 than in 1977. About \$10 billion of the credits arranged in 1978 (one-third of the increase over 1977) appear to have been refinancings of outstanding debts repaid ahead of schedule to take advantage of better terms available in the market; such refinancings had been negligible in 1977. In addition, repayments of maturing loans that borrowers wished to refinance also increased in 1978.

Borrowing in International Capital Markets
(in billions of dollars)

	1976	1977		1978		
	Year	Year	2nd H	Year	1st H	2nd H
I. Medium-term Euro-credits: total ^{1/}	28.7	34.2	18.8	64.4	34.1	30.3
Developed countries	10.9	13.4	6.3	30.1	15.6	14.5
Canada	.9	.5	.2	6.8	5.6	1.2
France	.7	1.9	.4	2.5	1.3	1.2
Italy	*/	.8	.7	2.7	1.1	1.6
Spain	2.0	1.9	1.2	2.0	1.0	1.0
United Kingdom	2.0	2.5	.5	4.6	1.8	2.9
Other	5.1	5.8	3.3	10.3	4.8	5.4
Oil-exporting countries	3.7	6.0	3.0	9.9	6.3	3.6
Algeria	.7	.4	.4	1.6	.7	.9
Indonesia	.5	.1	.1	1.6	1.1	.5
Iran	.9	1.8	.9	1.2	.8	.4
Nigeria	.0	.0	.0	1.8	1.0	.8
Venezuela	1.1	1.7	.4	1.9	1.7	.3
Other	.5	2.0	1.2	1.8	1.0	.7
Non-oil LDCs	11.0	11.3	7.2	19.4	9.5	10.0
Argentina	.9	.8	.5	1.4	.5	1.0
Brazil	3.3	2.3	1.6	3.9	1.8	2.1
Mexico	2.1	2.9	2.3	5.0	2.5	2.5
Philippines	.9	.7	.4	1.9	1.1	.8
Other	3.8	4.6	2.4	7.2	3.6	3.6
Communist countries	2.5	3.1	2.1	4.5	2.5	2.0
Int'l. org's. and others	.8	.3	.2	.5	.3	.2
II. Euro-bonds: total	15.4	19.3	8.9	16.2	9.2	7.0
By borrower: LDCs	1.0	2.3	1.2	2.9	1.6	1.3
all other	14.4	17.0	7.7	13.3	7.6	5.7
By currency: U.S. dollar	10.0	12.3	5.4	7.7	4.8	3.0
German mark	2.8	5.1	2.8	6.8	3.5	3.3
other	1.6	1.9	.7	1.7	1.0	.7
III. Foreign bonds: total	18.9	15.6	8.5	19.9	10.3	9.6
By borrower: Canada	6.1	3.3	1.7	3.4	1.8	1.6
others	12.8	12.3	6.8	16.5	8.5	8.0
By market: U.S. ^{2/}	10.6	7.5	3.8	6.1	3.7	2.4
Switzerland	5.4	4.7	2.6	6.6	2.8	3.7
Japan	.3	1.4	1.3	4.5	2.4	2.1
other	2.6	2.0	.8	2.7	1.4	1.3
IV. Total borrowing	63.0	69.0	36.2	100.5	53.6	46.9

^{1/} Completed credits of over one-year maturity.

^{2/} Figures may differ from statistics of U.S. international transactions, which are on a drawdowns basis.

*/ Less than \$50 million.

Source: World Bank.

Credits completed in the second half of 1978 were somewhat less than in the first half, mostly because of reduced borrowing by Canada, Venezuela, and several other oil-exporting countries. The United Kingdom and Italy stepped up their borrowing, but in the case of the United Kingdom this was due to the advance refinancing of loans to the Government (\$1.5 billion) and the Electricity Council (\$500 million). Other large refinancings of loans repaid ahead of schedule in the second half were by Denmark (\$1.2 billion) and Sweden (\$1.0 billion). For 1978 as a whole the largest increase in borrowing by country category was in loans to developed countries, notably Canada, Italy and the U.K., but the bulk of the advance refinancings also concerned loans to developed countries. In contrast, advance refinancing was relatively unimportant for the other country categories, where almost every one of the countries individually listed in the table borrowed much more last year than in 1977.

During the second half of 1978, spreads and maturities on Euro-credits generally continued to become more favorable to borrowers, but by the fourth quarter there were signs that the trends were moderating or reversing. While spreads continued to fall on average, by the fourth quarter some borrowers were obtaining terms no finer than those obtained several months earlier. Prime borrowers continued to arrange credits with spreads of 1/2-3/4 per cent over LIBOR. The Bank of England maturity series shows the average maturity of new Euro-credits rising from 8-1/2 years in the second quarter to almost 9 years in the third, then falling back to 8-1/2 years in the fourth quarter.

Fewer bonds were issued in the international bond markets in the second half of last year than in the first. New Euro-bond issues declined about 25 per cent, to \$7.0 billion, primarily because of a drop of almost 40 per cent in U.S. dollar issues. The volume of dollar issues held up fairly well through the third quarter, when they accounted for a little over one-half of total issues, about the same share as in the previous three quarters. But in the wake of the long decline in the exchange rate of the dollar prior to November 1, and with the renewed rise in long-term interest rates in the United States, dollar issues shrank by more than one-half in the fourth quarter; their share of total issues in the market declined to 30 per cent. There was some recovery between October and December but in December dollar issues were still depressed. DM-denominated Euro-bonds rose sharply in volume in the fourth quarter, when their share rose to 60 per cent from 35-40 per cent in the preceding three quarters. For the full year 1978 Euro-bond issues were about 15 per cent below the 1977 volume.

New issues of foreign bonds experienced only a small decrease in the second half. Issues in the U.S. market were down sharply, and a tightening of the Japanese bond market led to some falling off there, but Swiss issues boomed as bond yields in Switzerland continued their decline to record low levels (reached in January 1979). Total foreign bond issues rose 28 per cent in 1978 with much higher volume in Japan (up three-fold) and Switzerland.

U.S. International Transactions. The merchandise trade deficit in December was \$24.5 billion at an annual rate (Census basis), with both exports and imports continuing at about the same levels as during the past several months. The deficit for the fourth quarter, also \$24.5 billion at an annual rate, was only slightly smaller than the deficits in either the second or third quarters. For the year 1978 the deficit was \$28.5 billion.

The trade deficit on a Census basis has been running about \$5-6 billion (annual rate) smaller than the trade deficit on an international accounts basis. About one-fourth of the difference is attributable to incomplete coverage of merchandise transactions in the Census data, particularly on the import side. The rest of the difference occurs because of the exclusion of military sales and purchases from the merchandise lines in the international accounts. These military transactions are included with all other military sales and purchases of goods and services, and are shown separately in the international accounts under "goods and services" transactions. The international accounts basis merchandise trade data are scheduled to be released on Thursday, February 1. The table below shows the trade data on both bases.

Exports increased by about 5 per cent in the fourth quarter with about half of the increase from higher prices. A strong increase in the volume of nonagricultural exports (largely industrial materials and machinery) was partly offset by a drop in the volume of agricultural exports from very high mid-year rates.

U.S. Merchandise Trade
(in billions of dollars, seasonally adjusted annual rates)

	<u>Census Basis</u>			<u>International Accounts Basis</u>		
	<u>Exports</u>	<u>Imports</u>	<u>Balance</u>	<u>Exports</u>	<u>Imports</u>	<u>Balance</u>
1977	121.2	147.7	-26.5	120.6	151.7	-31.1
1978	143.6	172.0	-28.5	n.a.	n.a.	n.a.
<u>1978:</u>						
Qtr. 1	123.4	162.1	-38.7	122.7	167.5	-44.8
Qtr. 2	142.1	168.8	-26.8	140.3	171.5	-31.2
Qtr. 3	150.8	176.0	-25.2	147.7	179.9	-32.2
Qtr. 4	157.7	182.1	-24.5	n.a.	n.a.	n.a.
October	156.1	181.7	-25.5	156.3 ^e	186.1 ^e	-29.8 ^e
November	159.1	182.5	-23.3	157.2 ^e	186.4 ^e	-29.2 ^e
December	157.8	182.3	-24.5	n.a.	n.a.	n.a.

e/ Monthly international accounts data are unpublished estimates and are subject to considerable revision.

Imports rose by about 3 per cent in the fourth quarter. Most of the increase was in non-oil imports, spread over most major commodity categories; about half the increase in non-oil imports was from higher prices. The value of oil imports was about the same in the fourth quarter as in the second and third quarters (including imports into the U.S. Virgin Islands). While the fourth quarter oil import volume was slightly lower (8.85 million barrels per day) than in the previous two quarters, the average import price was slightly higher (\$13.35 per barrel). In December the average import price jumped to nearly \$13.50 per barrel after averaging between \$13.20 and \$13.30 since March.

In the financial sector of the international accounts, there was large-scale U.S. and foreign central bank intervention in the exchange markets in the fourth quarter of 1978. The foreign intervention and the use by the United States of swap drawings for intervention are reflected in the estimated \$16 billion net increase in G-10 countries' reserve assets in the United States. In addition, the U.S. used nearly \$2 billion equivalent of the foreign currency proceeds of market borrowings. Most of the \$16 billion increase in G-10 reserve holdings was invested in U.S. Treasury securities, including nonmarketable issues issued in connection with U.S. - initiated swap drawings.

In January, as intervention activity moderated, the rate of net foreign central bank purchases of Treasury securities also slowed, helping to restore a more normal (narrower) interest-rate differential between short-term Treasury bill rates and other private money-market instruments.

Private capital outflows as reported by banks and securities dealers (including an estimate for December) appear to be about \$7 billion in the fourth quarter, compared to less than \$1/2 billion in the third quarter.

For October-November combined, the most recent period for which data are available, banks reported a net capital outflow of \$5.3 billion, with indications of further substantial outflows in December. A sizeable increase in U.S. bank claims on nonbank foreigners, about \$3 billion in October-November, may have reflected credit demands related to financial positioning in anticipation of a further depreciation of the dollar.

U.S. International Transactions Summary
(in billions of dollars, n.s.a., (-) = outflow)

	1977	1 9 7 8					
	<u>Year</u>	<u>Q-1</u>	<u>Q-2</u>	<u>Q-3</u>	<u>Sept.</u>	<u>Oct.</u>	<u>Nov.</u>
1. Private capital trans. adj. <u>1/</u>	-6.4	-7.6	4.6	-.2	1.8	-.2	-5.0
2. Private capital as rept. net	-6.4	-5.8	3.6	-.5	2.8	-1.0	-5.0
3. Reporting bias <u>2/</u>	--	-1.8	.5	.3	-1.0	.8	--
4. OPEC official net investments	6.0	1.4	-2.4	-1.6	-.3	1.3	-.7
5. Other foreign official assets	29.5	13.6	-3.1	6.3	-.5	6.0	5.1
6. U.S. reserve assets	-.2	.3	.3	*	-.1	-.1	1.0
7. Trade balance, n.s.a. <u>3/</u>	-31.1	-11.1	-7.3	-9.6	-2.6	-2.3	-1.9
8. All Other <u>4/</u>	2.2	3.4	7.9	5.1	1.7	-4.7	1.5
Memoranda: (seasonally adjusted annual rates)							
9. Trade balance	-31.1	-44.8	-31.2	-32.2	-31.3	-29.8	-29.2
10. GNP net exports of goods and services	-10.9	-24.1	-5.5	-10.7	n.a.	n.a.	n.a.
11. Current account balance	-15.3	-27.4	-12.4	-15.3	n.a.	n.a.	n.a.

1/ Includes bank-reported capital, foreign purchases of U.S. Treasury securities, and other private securities transactions.

2/ Adjusted for reporting bias in bank-reported data associated with week-end transactions. See page IV 10-11 in the June 1976 greenbook.

3/ International accounts basis. For seasonally-adjusted number see line 9.

4/ Includes service transactions, unilateral transfers, U.S. government capital, direct investment, nonbank capital transactions, and statistical discrepancy.

*/ Less than \$50 million.

NOTE: Capital account data for December are not yet available. Trade data for December, fourth quarter, and the year 1978 are shown in the text table on page IV-10.

A large part of the increase in claims on nonbanks apparently took the form of financing through bankers' acceptances. Bankers' acceptances are a convenient vehicle for accelerating the conversion of the proceeds of dollar-denominated trade receivables into foreign currencies.

OPEC banking and security holdings in the United States are estimated to have increased by slightly more than \$1 billion in the fourth quarter. For the year as a whole, OPEC holdings in the United States are estimated to have fallen by almost \$1.5 billion.

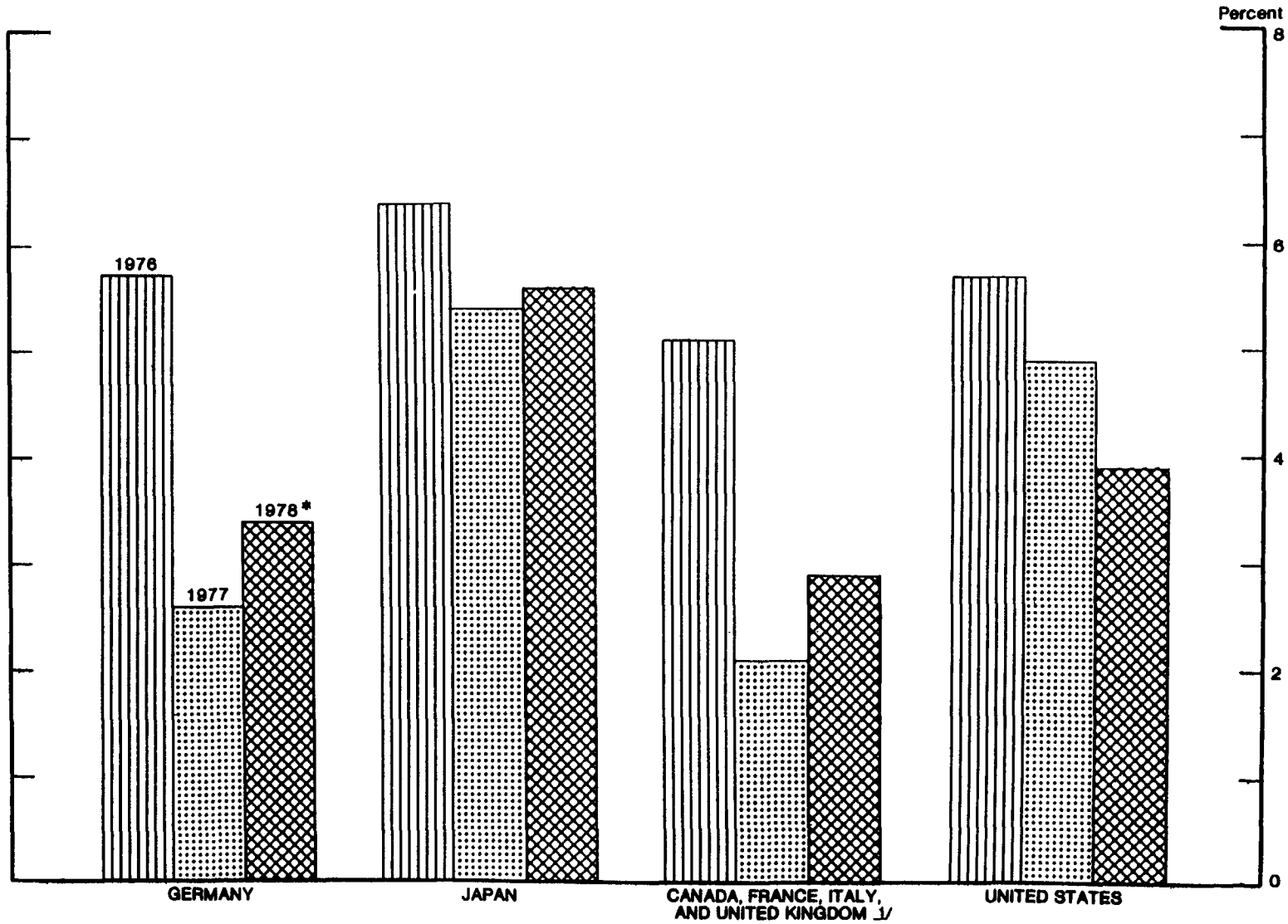
Foreign private purchases (net) of U.S. corporate stocks were negligible in November, bringing the total for 11 months to \$1.5 billion, most of which occurred in the rising market in the second quarter. U.S. net purchases of foreign securities were about \$250 million in November, bringing the total for 11 months to \$3½ billion, considerably less than the \$5½ billion for the year 1977. The decline in U.S. purchases of foreign securities in 1978 largely reflects foreign borrowers' reluctance to finance with fixed-interest U.S. dollar-denominated long-term debt.

Foreign Economic Developments. A major factor in foreign economic growth performance continues to be the pace of economic activity in Germany and Japan. As shown in the accompanying chart, there was a pickup in GNP growth in both of these key countries in 1978, albeit only a modest one in Japan. Similarly, there also was an acceleration of growth in Canada, France, Italy, and the United Kingdom in 1978.

According to provisional data, German GNP rose by about 3-1/2 per cent between 1977 and 1978. This figure implies that between the third and fourth quarters of 1978 GNP increased by nearly 6 per cent (s.a.a.r.) if the first three quarters of the year are not revised. Data on Japanese industrial production in the 3-month period ending in December indicates a rate of growth of 9 per cent (s.a.a.r.) over the previous 3-month period. If the pace of activity indicated by the latest German GNP and Japanese industrial production data is sustained, other foreign countries' export and output performances can be expected to be enhanced.

During the course of last year, there was a fairly general pattern of decline in price inflation rates in the major foreign industrialized countries. As measured by the change between the latest 3-month period and the previous 3-month period, inflation rates are very low in Germany and Japan, and of the major countries, only Italy has a rate of consumer-price inflation that exceeds 10 per cent.

Real GNP in Major Industrial Countries
Percentage Change from Previous Year



IV - 15

* 1978 figures for Japan, Canada, France, Italy, and the United Kingdom are estimates.

^{1/} Weighted average

Consumer and Wholesale Prices in Major Industrial Countries
(percentage change, from previous period or as indicated)

									Latest 3 Months from:		
	1976	1977	1978	1977	1978				Previous 3 Months (at Ann. Rate)	Year Ago	Latest Month
				Q4	Q1	Q2	Q3	Q4			
Canada: CPI	7.5	8.0	8.9	2.2	1.8	2.4	2.5	1.6	6.5	8.4	December
WPI	4.3	9.1	n.a.	1.1	2.7	3.0	1.5	n.a.	16.6	11.0	November
France: CPI	9.6	9.5	9.2	1.9	1.6	2.9	2.7	2.1	8.5	9.4	December
WPI	7.4	5.6	4.3	0.0	1.2	2.0	1.8	3.1	12.8	8.3	December
Germany: CPI	4.6	3.9	2.6	0.2	1.3	0.9	0.0	0.1	0.3	2.3	December
WPI	5.8	1.8	-0.3	-0.9	1.0	0.3	-0.6	0.0	0.2	0.8	December
Italy: CPI	16.8	18.4	12.1	3.3	2.6	3.0	2.4	3.0	12.6	11.5	December
WPI	22.9	17.4	8.4	2.0	2.1	2.3	1.8	2.3	9.3	8.8	December
Japan: CPI	9.7	8.3	4.3	0.8	0.9	2.0	0.8	0.2	0.6	3.9	December
WPI	5.0	1.9	-2.5	-0.7	-0.5	-0.3	-1.7	-0.6	-2.5	-3.2	December
United Kingdom: CPI	16.6	15.8	8.3	1.5	1.7	2.7	1.7	1.7	6.9	8.1	December
WPI	17.3	19.8	9.1	1.4	2.3	1.8	1.9	1.7	6.8	7.9	December
United States: CPI	5.7	6.5	7.6	1.1	1.7	2.6	2.4	2.0	8.3	9.0	December
WPI	4.6	6.1	7.8	1.1	2.4	3.0	1.5	2.3	9.7	9.6	December

Real GNP and Industrial Production in Major Industrial Countries
(percentage change from previous period, seasonally adjusted)

		1976	1977	1978	1978				1978			
					Q1	Q2	Q3	Q4	September	October	November	December
Canada:	GNP	5.5	2.7	n.a.	0.7	1.0	0.9	n.a.	*	*	*	*
	IP	5.1	4.0	n.a.	0.6	1.4	1.8	n.a.	3.3	0.1	0.5	n.a.
France:	GDP	5.8	2.0	n.a.	1.8	0.3	n.a.	n.a.	*	*	*	*
	IP	9.4	1.4	n.a.	3.0	0.8	-0.3	n.a.	1.6	-0.8	1.6	n.a.
Germany:	GNP	5.7	2.6	3.4	-0.1	2.1	0.6	1.5	*	*	*	*
	IP	7.9	2.7	n.a.	0.0	-0.6	3.2	n.a.	1.7	0.0	0.8	n.a.
Italy:	GDP	5.7	1.7	n.a.	2.0	0.0	0.7	n.a.	*	*	*	*
	IP	12.4	1.1	n.a.	5.5	-2.2	1.0	n.a.	4.6	3.6	0.0	n.a.
Japan:	GNP	6.4	5.4	n.a.	2.3	1.0	1.0	n.a.	*	*	*	*
	IP	11.1	4.2	6.1	2.9	1.7	0.5	2.2	1.2	-0.2	1.3	1.0
United Kingdom:	GDP	2.9	1.9	n.a.	0.2	1.8	0.8	n.a.	*	*	*	*
	IP	1.9	3.8	n.a.	1.2	3.7	0.4	n.a.	-1.0	-1.6	0.8	n.a.
United States:	GNP	5.7	4.9	3.9	0.0	2.1	0.6	1.5	*	*	*	*
	IP	10.1	5.6	5.8	0.2	3.1	2.1	1.7	0.5	0.6	0.6	0.6

* GNP data are not published on monthly basis.

Trade and Current-Account Balances of Major Industrial Countries^{a/}
(billions of U.S. dollars; seasonally adjusted)

	1977	1978	1977		1978				1978			
			Q3	Q4	Q1	Q2	Q3	Q4	Sept.	Oct.	Nov.	Dec.
Canada: Trade	2.7	3.1	0.5	1.0	1.2	0.6	0.6	0.6	0.5	0.1	0.4	0.1
Current Account	-3.9	n.a.	-1.2	-0.7	-0.6	-1.0	-1.2	n.a.	*	*	*	*
France: Trade	-2.2	0.5	-0.5	0.1	-0.1	0.3	0.3	0.0	0.3	0.2	0.1	-0.2
Current Account	-3.3	n.a.	-0.8	-0.4	0.0	1.4	0.9	n.a.	*	*	*	*
Germany: Trade	16.5	20.4	3.7	4.8	4.3	5.0	5.5	n.a. ^{c/}	2.3	2.2	1.9	n.a. ^{c/}
Current Account ^{b/}	3.8	8.3	-2.0	3.8	1.6	2.0	-0.8	5.5	0.2	1.9	2.0	1.6
Italy: Trade	-2.5	n.a.	-0.2	-0.2	-0.1	0.5	-0.8	n.a.	0.1	0.3	-0.1	n.a.
Current Account ^{b/}	2.3	n.a.	2.3	0.7	0.3	1.8	n.a.	n.a.	*	*	*	*
Japan: Trade	17.3	24.7	4.2	4.6	7.4	6.8	6.7	3.9	2.4	0.8	1.6	1.4
Current Account	10.9	16.6	2.7	3.1	5.5	4.8	4.5	1.7	1.6	0.2	0.8	0.8
United Kingdom: Trade	-2.9	-2.0	-0.1	0.1	-1.1	-0.3	-0.6	0.1	-0.5	0.2	-0.4	0.3
Current Account	0.8	0.2	1.0	1.1	-0.8	0.2	0.0	0.8	-0.3	0.4	-0.1	0.5
United States: Trade	-31.1	n.a.	-7.3	-10.2	-11.2	-7.8	-8.0	n.a.	-2.6	-2.5	-2.4	n.a.
Current Account	-15.3	n.a.	-2.9	-7.0	-6.9	-3.1	-3.8	n.a.	*	*	*	*

^{a/} The current account includes goods, services, and private and official transfers.

^{b/} Not seasonally adjusted.

^{c/} Seasonally-adjusted data for December are not yet available; 1978 total is based on unadjusted data.

* Comparable monthly current-account data are not published.

The German trade surplus in 1978 was some \$20-1/2 billion, up \$4 billion from its 1977 level. For Japan, the 1978 trade surplus was about \$25 billion, over \$7 billion more than the 1977 level. Japanese trade volumes seem to be responding to the yen's appreciation, and the mark's strength appears to be having a similar effect on German trade volumes. There has been a dramatic improvement in the trade balances of France, Italy, and the United Kingdom, especially compared to the 1976 outcomes of \$4 - 6-1/2 billion deficits in each of those countries.

Individual country notes. The new government in Japan appears to be placing less emphasis than its predecessor on expansion of the domestic economy as a way of reducing Japan's current-account surplus. At the end of 1978, the government abandoned Japan's summit commitment of 7 per cent growth for the fiscal year ending March 1979. On January 11, the Japanese cabinet approved an only moderately expansionary budget for fiscal year 1979. The new budget calls for an increase of about 12 per cent in general account expenditure over last year's total (including both the original budget and the September supplementary budget), and the government's fiscal investment and loan program is to be increased by about 8 per cent. According to official Japanese projections, the ratio of government deficit to government expenditures is expected to approach 40 per cent.

Although the 1978 current-account surplus reached \$16-1/2 billion (compared with \$11 billion in 1977), the adjustment of trade volumes to past exchange rate changes as well as to special programs (such as emergency imports) is continuing and in the fourth quarter the current-account surplus fell to \$7 billion (s.a.a.r.). Average export volume in the 3 months ending in November was nearly 3 per cent below its level a year earlier; over the same period import volume rose by 12 per cent. The growth in the volume of manufactured imports was especially strong.

Despite the weakening external sector, activity in the domestic economy has strengthened somewhat in recent months. Official Japanese forecasts of 6 per cent GNP growth in the year ending March 1979 imply growth of about 9 per cent (s.a.a.r.) in the last 2 quarters of that year. Conditions in the labor market are virtually unchanged, however, with unemployment at high levels. Neither the consumer price nor the wholesale price index indicates much inflationary pressure in Japan.

In Germany, recently released provisional data on real GNP indicate a rate of growth of about 3-1/2 per cent between 1977 and 1978, which confirms earlier evidence of a strengthening in economic activity since last summer. The rate of unemployment declined gradually throughout most of 1978 and the average number of unemployed was below 1 million for the first time since 1974.

The current-account surplus of DM 16 billion ($\$8\frac{1}{4}$ billion) for the year exceeded most expectations and is the largest surplus since 1974. Similarly, the 1978 trade surplus is second only to the record 1974 surplus. However, in constant (1970) prices, the trade surplus for the first 3 quarters of 1978 was DM 18 billion, compared to DM 38 billion in 1974 and DM 20 billion in 1977. This decrease in the trade volume surplus may be attributable to the recent appreciation of the mark.

One area of concern for the Bundesbank has been the relatively rapid expansion of the money supply. Central bank money in 1978 increased by nearly 12 per cent, exceeding the Bundesbank's target of 8 per cent. Furthermore, the rate of increase accelerated in late 1978 and is currently 13 per cent (fourth quarter over third quarter, s.a.a.r.). In December the Bundesbank set its 1979 target to be a 6-9 per cent rate of growth for central bank money between the fourth quarter of 1978 and the fourth quarter of 1979. Since the announcement of the target, the Bundesbank has reduced rediscount quotas by DM 5 billion, raised reserve requirements by 5 per cent, and increased the Lombard rate from $3\frac{1}{2}$ to 4 per cent.

Recent economic developments in France have been marked by a sharp recovery of the trade and current accounts, both of which moved into surplus in 1978 following large deficits in 1976 and 1977. Improvements on trade in food, automobiles, and energy products account for the bulk of the gains. Domestic activity has shown few signs of

strength in recent months, with the level of industrial production in November about the same as it had been earlier in the year. However, recent business surveys indicate an improvement in the business climate. In response to rapid increases in recent years in the social insurance system's deficit (about a third of the overall public sector deficit), the government has announced an increase in most of the system's charges and revisions in some benefits, effective this month.

In the United Kingdom, real GDP increased by 3-1/2 per cent (s.a.a.r.) between the second and third quarters of 1978. Contributing to this growth was an 11 per cent (s.a.a.r.) increase in real private consumption expenditures, while the volume of gross fixed capital formation and government spending was virtually unchanged. Data on retail sales and provisional data on consumption indicate that consumer spending may have leveled off in the fourth quarter of 1978. Industrial production figures for the 3 months ending in November -- 6-1/4 per cent (s.a.a.r.) below the previous 3 months' level -- do not indicate much strength in U.K. domestic output.

The source of the strength in British consumer demand has been a surge in real personal disposable income, attributable primarily to wage increases that have outstripped price increases. In the 12 months ending November 1978, average earnings rose by 14-1/2 per cent while consumer prices increased by 8 per cent. The rate of growth in wages has created some concern about the outlook for the U.K. economy. The government was forced by Parliament in

mid-December to abandon most of the measures it had been using in its attempt to enforce its (nonstatutory) 5 per cent limit to wage increases. In January, the United Kingdom was hit by several strikes in support of pay claims far in excess of the government's 5 per cent limit. Nevertheless, a substantial number of British workers have agreed to pay increases within the government's guidelines, and so it is difficult to tell at this stage what the future course of average wages will be.

Industrial production in Canada in the latest 3 months has increased by nearly 13 per cent (s.a.a.r.) over the previous 3-month period. Reflective of this growth in output, the Canadian Conference Board's most recent quarterly survey of business attitudes showed an increased willingness to invest due to higher profits and capacity utilization rates. However, concern was expressed about the effect on future investment of rising interest rates -- the Bank of Canada's bank rate was raised from 10-3/4 to 11-1/4 per cent at the beginning of January and short-term money market rates subsequently rose an equivalent amount.

Economic activity in Italy has rebounded strongly after the spring and summer pause; industrial production in September-November 1978 was 26 per cent (s.a.a.r.) higher than in the previous 3 months. The main sources of strength appear to be consumer spending and exports; at the same time, investment continues to lag. The strength of exports -- in September-November the value of exports (customs basis, s.a.) rose by 17 per cent (quarterly rate)

over the previous 3 months -- has enabled the external sector to continue in substantial surplus, despite a sharp rise in imports reflecting the upsurge in activity. The strong trade performance, plus a large services surplus due mainly to tourism, is expected to produce a current-account surplus of about \$5 billion in 1978, more than twice the 1977 surplus.

The Italian government has completed work on its 3-year economic plan, the Pandolfi Plan, which has goals similar to those announced last year -- higher growth of output, employment, and investment and a reduction of the inflation rate and the public-sector deficit (as a percentage of GDP). A crucial aspect of the plan is the assumption that real wages will be stable; however, the trade unions' demands in the current round of negotiations of the 3-year contract renewals would entail a significant real wage increase. In line with the government's intention to raise investment by providing more credit for the private sector, the Bank of Italy announced on January 18 that it is relaxing the existing ceiling on bank lending for the period ending March 31.

The Swiss National Bank announced on January 10 that it will not set a money supply growth target for 1979, thereby indicating that exchange-rate considerations will continue to dominate monetary policy. Intervention to hold down the value of the Swiss franc led to an M1 growth of about 17 per cent in 1978, more than

triple the 5 per cent target rate. A recent cantonal bond issue set a coupon of 2-3/4 per cent -- equal to the post-war low -- as the very high money-market liquidity continues to depress Swiss interest rates.

APPENDIX A*
THE FEDERAL BUDGET FOR FISCAL YEAR 1980

Overview

On January 22, 1979, President Carter submitted his fiscal year 1980 budget to Congress. As the President promised last fall, his new budget imposes considerable restraint in the growth of Federal spending and reduces the size of the Federal deficit in fiscal years 1979 and 1980. For fiscal year 1980, the budget calls for unified outlays of \$531.6 billion and projects receipts at \$502.6 billion, and the resulting unified budget deficit for the fiscal year is expected to be \$29.0 billion (see Table 1), significantly less than the \$37.4 billion deficit estimated for fiscal year 1979.

The reduction in the fiscal year 1980 deficit understates the degree of fiscal restraint proposed in the budget. The high-employment budget, which measures discretionary changes in fiscal policy, is projected to shift toward surplus by more than \$10 billion between fiscal years 1979 and 1980. The most severe restraint is expected to occur in the second and third quarters of fiscal year 1980, when previously legislated social security tax increases and the President's spending curbs begin to take effect.

The combined deficit--unified plus off-budget--is expected to be \$49 billion in the current fiscal year and \$41 billion in fiscal year 1980. The Treasury is expected to finance the fiscal year 1979 deficit by drawing down its cash balance and by issuing \$40 billion in securities to the public. In fiscal year 1980, the Administration does not plan a further drawdown in the cash balance; hence, borrowing from the public is expected to remain about the same as in fiscal year 1979.

Economic Assumptions

The new budget estimates for both fiscal years 1979 and 1980 are based on the assumption (see Table 2) that real GNP grows--fourth quarter over fourth quarter--by 2.2 per cent during 1979 and 3.2 per cent during 1980. The unemployment rate is expected to edge up to 6.2 per cent at the end of calendar year 1979, and to remain there through 1980. The average rate of inflation--as measured by the GNP deflator--is projected by the Administration to be 7.4 per cent in the final quarter of 1979 and 6.4 per cent in the final quarter of 1980. These economic assumptions are somewhat more optimistic than those advanced by a number of private forecasters.

* Prepared by Kevin Riper, Research Assistant, Government Finance Section, Division of Research and Statistics.

Table 1
Selected Measures of the Federal Budget
for Recent Fiscal Years
(Billions of dollars)

	<u>1977</u>	<u>1978</u>	<u>1979e</u>	<u>1980e</u>
<u>Unified Budget</u>				
Receipts	357.8	402.0	456.0	502.6
Outlays	<u>402.8</u>	<u>450.8</u>	<u>493.4</u>	<u>531.6</u>
Deficit (-)	-45.0	-48.8	-37.4	-29.0
<u>Off-Budget Outlays</u>				
	8.7	10.3	12.0	12.0
<u>Combined Federal Deficit (-)</u>				
	-53.7	-59.1	-49.4	-41.0
<u>NIA Budget 1/</u>				
Receipts	365.3	413.8	464.3	513.8
Expenditures	412.0	450.6	496.3	539.2
Deficit (-)	-46.7	-36.8	-32.0	-25.4
<u>High-Employment Budget 2/</u>				
Receipts	379	417	469	521
Expenditures	398	448	492	529
Deficit (-)	-19	-31	-23	-8
Memo:				
Per Cent Increase in:				
Unified Budget Receipts	19.3	12.4	13.4	10.2
Unified Budget Outlays	9.9	11.9	9.4	7.7
NIA Budget Receipts	16.4	13.3	12.2	10.7
NIA Budget Outlays	10.9	9.4	10.1	8.6

e/ Estimated.

1/ Federal budget measured on the National Income and Product Accounts basis.

2/ NIPA receipts and outlays for the economy at a 5.1 per cent unemployment rate.

Table 2
 Economic Assumptions in the Budget
 (Calendar years; dollar amounts in billions)

	Forecast		
	1978	1979	1980
GNP:			
Current dollars:			
Amount	2,106	2,343	2,565
Per cent change, year over year	11.6	11.3	9.5
Per cent change, fourth over fourth	12.7	9.8	9.8
Constant (1972) dollars:			
Amount	1,384	1,430	1,466
Per cent change, year over year	3.9	3.3	2.5
Per cent change, fourth over fourth	4.0	2.2	3.2
Price level:			
GNP implicit price deflator:			
Level (1972 = 100), annual average	152.1	163.9	175.0
Per cent change, year over year	7.4	7.7	6.8
Per cent change, fourth over fourth	8.4	7.4	6.4
Unemployment rate:			
Total, annual average	6.0	6.0	6.2

Receipts

There are few major new initiatives on the receipts side of the President's budget aside from the President's real wage insurance proposal. The Administration's insurance proposal is designed to increase compliance with the President's wage standard and thereby reduce inflationary pressures. Under the proposal, certain groups of employees whose compensation increases from October 1978 to October 1979 are within the guidelines would be eligible for a tax credit on their 1979 income tax returns, if the rate of inflation exceeds 7 per cent. Such workers would receive a tax credit (as a per cent of wages up to \$20,000) equal to the difference between the percentage increase in the Consumer Price Index and 7 per cent. The maximum tax credit is 3 per cent even if the inflation rate exceeds 10 per cent. Given the Administration's assumed inflation rate of 7.5 per cent, the cost of the program is estimated by the Administration at \$2.5 billion. Most of this amount would appear as a reduction in individual taxes, and \$0.2 billion would be a cash grant to those wage earners whose real wage insurance credit exceeds their tax liabilities.

A small increase in railroad retirement taxes and an oil pollution levy also are proposed by the Administration. This recommendation would add \$0.3 billion to receipts in fiscal year 1980. Thus, the President's tax initiatives would reduce revenues by a net \$2.0 billion from the current services level of \$504.5 billion (see Table 3). The resulting \$502.6 billion in fiscal 1980 receipts represents an increase of 10.2 per cent over the previous fiscal year. Receipts are expected to amount to 20.1 per cent of projected GNP, compared to the 19.9 rate expected for fiscal year 1979.

Outlays

The rate of growth of Federal spending is expected to decline from the current fiscal year's 9.4 per cent pace to 7.7 per cent in fiscal year 1980. This is the smallest percentage increase since fiscal year 1973, as Table 4 shows. Federal spending as a percentage of GNP is scheduled to continue its decline from 22.6 per cent in fiscal year 1976 to an estimated 21.6 per cent by fiscal year 1979 and 21.2 per cent in fiscal year 1980.

In real terms, the Administration's budget proposes growth in fiscal year 1980 expenditures of 0.7 per cent, as compared with 3.9 per cent in fiscal year 1978. Total spending for national

Table 3
Effects of Administration Proposals on Receipts
(billions of dollars)

	<u>Fiscal Year 1980</u>
Current services receipts estimates	504.5
Real wage insurance	-2.3
Increase in railroad retirement payroll tax	.2
Oil pollution liability and compensation	<u>.1</u>
Total proposed changes	-2.0
 Proposed receipts, President's budget	 502.6

Table 4
Comparative Changes in Federal Outlays
Fiscal Years 1970-1980

Fiscal Year	Unified Budget Outlays (\$ billions)	Change in Outlays from Previous Fiscal Year		Unified Budget Outlays as a Per Cent of GNP
		(\$ billions)	Per Cent	
1970	196.6	12.1	6.6	20.5
1971	211.4	14.8	7.5	20.7
1972	232.0	20.6	9.7	20.9
1973	247.1	15.1	6.5	20.0
1974	269.6	22.5	9.1	19.8
1975	326.2	56.6	21.0	22.4
1976	366.4	40.2	12.3	22.6
1977	402.8	36.4	7.8 ^{1/}	22.0
1978	450.8	48.0	11.9	22.1
1979 ^{e/}	493.4	42.6	9.4	21.6
1980 ^{e/}	531.6	38.2	7.7	21.2

^{1/} Takes into account the Transition Quarter (August-September 1976).

^{e/} Estimated.

defense is projected to grow at a 3 per cent rate in real terms in fiscal year 1980, in line with the President's May 1977 pledge to NATO members. Similarly, payments to individuals are expected to register a gain of 4.3 per cent in real terms. Offsetting these increases is a sharp decline of 7.0 per cent in real nondefense purchases and grants to states and localities.

The Administration's budget outlays may be examined in terms of current service expenditures, that is, spending that would occur if all Federal programs were carried on as currently legislated and if there were no new policy initiatives. The Administration's estimate of "current services" takes into account inflation adjustments that are mandatory under current law or that reflect a Congressional intent to cover costs; the estimates also allow for such items as expected changes in the number of beneficiaries in Federal programs. In other instances, the OMB estimate does not adjust its spending programs for inflation. In fiscal year 1980, the Administration projects the current services outlay total at \$536.1 billion, up \$44.8 billion, or 9.1 per cent from fiscal year 1979. If OMB were to adjust all spending programs for the extra cost of inflation, then the current service or policy outlays would be \$544 billion.

Proposed Expenditure Increases From Current Service Levels

In order to achieve his goal of a 3 per cent rise in real defense outlays in fiscal year 1980, the President has asked for across-the-board program increases of \$2.2 billion above the current services level. This increase emphasizes procurement, research and development. These recommendations are expected to push fiscal year 1980 defense outlays to \$125.8 billion, 9.9 per cent up from a projected \$114.5 billion in fiscal year 1979.

Similarly, fiscal year 1980 outlays for income security are budgeted to rise 12.7 per cent to \$179.1 billion from an estimated \$158.9 billion in fiscal year 1979. Proposed increases from current services spending levels also include \$0.7 billion for less stringent food stamp eligibility requirements, \$0.2 billion for the real wage insurance program, \$0.4 billion for improved medicaid health care to children and pregnant women, and \$0.3 billion for more effective educational services for children of low income families (see Table 5).

Other budget requests for funding in excess of current services projections include: \$0.3 billion for a greater U. S.

Table 5
Differences Between Administration's Fiscal Year 1980 Budget
Request and Current Services Levels
(billions of dollars)

	<u>Fiscal Year 1980</u>
Current Services Estimate	<u>536.1</u>
Proposed Increases (Total)	<u>7.0</u>
National Defense (excluding pay)	2.2
Food Stamps	.7
Real Wage Insurance	.2
Health Services (Medicaid)	.4
Elementary and Secondary Education	.3
Multilateral Development Banks	.3
National Development Bank	.2
Veteran's Compensation	.5
All Other	2.2
Proposed Decreases (Total)	<u>-11.5</u>
Cap on Federal Pay Raises (civilian and military)	-3.0
Public Service Employment	-.5
Summer Jobs	-.3
Impact Aid	-.2
Medicare and Medicaid	-1.7
Social Security	-.7
Veteran's Benefits	-.3
Agricultural Price Supports (CCC)	-.7
Strategic Petroleum Reserve	-.3
Railroads	-.5
Education	-.4
All Other	-2.9
President's Request (Total)	531.6

contribution to multilateral development banks; \$0.2 billion for the National Development Bank, part of the President's urban initiative; and \$0.5 billion for a 7.8 per cent increase in veteran's compensation benefits. In all, the budget for fiscal year 1980 proposes \$7.0 billion in spending increases relative to current service levels, as shown in Table 5.

Proposed Expenditure Reductions From Current Service Levels

The largest spending cut from current services results from a 5.5 per cent limit on pay raises for all Federal employees--military and civilian--instead of the 10.25 per cent pay raise that would occur under present law. This is expected to save \$3.0 billion in 1980. In the grants category, the Administration proposes reduced spending of \$0.5 billion as countercyclical public service employment jobs are cut from 625,000 at the end of fiscal year 1979 to 467,000 at the end of fiscal year 1980. In addition, \$0.3 billion is cut from the summer jobs program for economically disadvantaged youths and \$0.2 billion is cut from impact aid.

The Administration also will ask Congress for three pieces of legislation which would cut current services outlays in fiscal year 1980: (1) hospital cost containment, which, if passed, presumably would reduce Medicare and Medicaid spending by \$1.7 billion; (2) Social Security program changes which would eliminate the \$255 lump sum burial payment, phase out benefits for students 18 to 21 and tighten eligibility requirements under the disability program (total estimated savings \$0.7 billion); (3) reform in the veteran's program which would tighten eligibility requirements for certain medical care reimbursements and educational benefits (estimated savings \$0.3 billion). Other reductions in current services spending levels are anticipated for agricultural price supports (\$0.7 billion), strategic petroleum reserve (\$0.3 billion), railroads (\$0.5 billion), and education (\$0.4 billion).

The proposed decreases total \$11.5 billion but these reductions are offset by the \$7 billion in proposed increases described earlier. The net change is a decrease of \$4.5 billion and this yields the President's final spending proposal of \$531.6 billion in fiscal year 1980. (See Table 5).

The Administration's success in attaining the goals set forth in this budget will depend as much on prevailing economic conditions as on programmatic decisions within the Administration's control. A higher-than-expected unemployment rate, for example, would

automatically trigger greater outlays for unemployment insurance. Rapid increases in the price level would imply greater spending for those programs indexed for inflation such as social security benefits. (On the other hand, higher nominal incomes would increase receipts, as inflation pushes wage earners into higher tax brackets.)

In addition, continued high interest rates would result in higher than estimated interest outlays. It should be noted that OMB has changed its estimating assumptions for interest rates. Until recently, the interest rate assumed throughout the forecast period was the same as the interest rate prevailing at the time estimates were made. Starting with this budget, however, the interest outlay projection rests on the assumption that the 91-day bill rate will decline in conformance with reductions in the rate of inflation. The average level of the bill rate in calendar year 1979 is assumed to be 8.8 per cent and to be 7.6 per cent in calendar year 1980. Had the old method been used, fiscal year 1980 interest outlays would have been \$2.0 billion higher than the figure presented in this year's budget.

APPENDIX B*

NEW ESTIMATES OF THE HIGH EMPLOYMENT BUDGET SURPLUS/DEFICIT

The high employment budget surplus/deficit (HES/D) presents estimates of the Federal government budget surplus or deficit (NIPA basis) that would be recorded if the economy were operating at its potential level of output. The official estimates of potential output--made by the Council of Economic Advisers--have recently been revised and these new estimates have been incorporated into our estimates, and projections, of the HES/D.

The subsequent discussion (1) explains the nature of the revision in the estimates of potential GNP, (2) briefly describes how the HES/D is calculated, and (3) compares the staff's new and old estimates of the level and change in the HES/D.

Revision in Estimates of Potential GNP by Council

Potential GNP is defined as the level of real output that the economy could produce at high rates of resource utilization. The Council of Economic Advisers has revised its estimates of GNP and the (full employment) unemployment rate associated with it. 1/ Potential real GNP is now estimated to have grown at a 3 per cent annual rate since 1973; this compares with the previous estimate of about 3-1/2 per cent over the preceding five years. (See Table 1.) With the downward revision in the growth of potential GNP, the level of potential GNP was also revised down somewhat. In determining what is a high level of resource utilization, the Council has raised its estimate of the full employment unemployment rate--for 1978 and 1979--from 4.9 per cent to 5.1 per cent.

The slowing in the rate of productivity growth in recent years, particularly in both 1977 and 1978, was the primary factor responsible for the revisions in high employment potential GNP. An important--but not sole--contributor to the lower rate of productivity growth has been the slowdown in

1/ The Annual Report of the Council of Economic Advisers, pp. 72-76.

* Prepared by Darrel Cohen, Economist, Government Finance Section.

capital investment relative to the expansion of the labor force. Because of this experience, the estimated potential rate of growth of productivity for the 1973 to 1978 period has been revised downward from over 1.5 per cent to around 1 per cent a year--about equal to the average rate of increase since 1973. The underlying growth rate of the labor force is still estimated to have been 2-1/2 per cent per year, and the workweek to have declined 0.5 per cent per year. Taken together these components of potential growth yield growth in potential GNP of 3 per cent per year for the 1973 to 1978 period. This same rate of growth is projected to hold during the next few years (1978-1983), as a projected fall in labor force growth is estimated to be offset by a pickup of productivity growth.

Calculating and Interpreting the HES/D

The HES/D is an attempt to measure discretionary fiscal activity alone. It has long been recognized that the actual Federal surplus or deficit is not a satisfactory measure of discretionary fiscal policy; because changes in revenues and, to some extent, expenditures reflect not only new policy initiatives but also the impact of economic fluctuations on the budget. The HES/D seeks to abstract from the influence of such fluctuations by estimating what the budget position would be if there were no business cycle, and if the economy were growing along a path of relatively full capacity output. Given such estimates of the level of the HES/D, one can determine the degree of discretionary fiscal restraint or stimulus over a period by examining changes in the HES/D. A positive change (or increase) in the HES/D is normally an indication of fiscal restraint while a negative change (or decrease) is an indication of fiscal stimulus.

The method employed by the staff and most other analysts to estimate the high employment budget is rather straight forward. High employment receipts are estimated by (1) defining a high employment rate of resource utilization and calculating the hypothetical level of real GNP consistent with that rate, (2) computing nominal potential GNP by multiplying real potential GNP by the rate of inflation observed or assumed in the actual

economy 2/, (3) estimating three income components of nominal potential GNP--corporate profits, personal income, and wages and salaries, and (4) applying the appropriate tax rates on these income components in order to derive the high employment NIPA receipts estimate. The difference between the receipts that result from the high employment potential output and actual receipts measures the effect of economic fluctuations on tax collections.

Estimating high employment expenditures is somewhat less complicated. It is assumed that only unemployment compensation responds to changes in the level of economic activity, 3/ and thus, high employment expenditures simply equal actual (or budgeted) expenditures adjusted for cyclically related unemployment compensation.

The Staff's Estimate of the HES/D

The new potential GNP estimates result in lower potential tax receipts, and a reduction in both the level and the change in the high employment surplus. A comparison of the new and old estimates of the HES/D for fiscal years 1974-1980 is found in Table 2. 4/

2/ This inflation assumption obviously is crude and should be kept in mind by the user of the data.

3/ This assumption may not be realistic given that the food-stamp program, veteran's benefits, social security payments, and public assistance grants also respond to changes in the level of economic activity. These items are not included in the expenditures adjustment due to the difficulty of separating cyclically related increases in spending from their normal program growth.

4/ It should be noted that the new estimates of the HES/D for fiscal years 1979 and 1980 found in Table 2 differ from the estimates found in Part 1 of the Greenbook. This is because the estimates in Table 2 allow only for the changes in potential GNP whereas the estimates in Part 1 allow for other changes in fiscal policy assumptions as well.

The difference in the new and old estimates of the high employment surplus is \$1.3 billion in fiscal year 1974; almost \$23 billion in fiscal year 1980. The new estimates fall increasingly short of the old ones because of the lowering of the growth rate of potential GNP. For the same reason, the difference between the new and old estimates of the change in the HES/D grows over time, although in not nearly so pronounced a way.

As discussed earlier, the change in the HES/D is much better than the level as a measure of discretionary fiscal policy. Examination of the changes in the HES/D shows that both the new and old estimates yield a qualitatively identical view of the stance of fiscal policy. For example, both estimates show that fiscal policy was expansionary in fiscal years 1975 and 1976. Fiscal restraint was indicated in fiscal years 1977 and 1978, while increasing restraint is shown through 1980.

APPENDIX B

Table 1

COMPARISON OF OLD AND NEW POTENTIAL GNP ESTIMATES
(Billions of dollars, except as noted)

Fiscal Year	Old High Employment Benchmark Unemployment rate (%)	New High Employment Benchmark Unemployment rate (%)	Real Potential GNP		% Growth in Real Potential GNP	
			Old	New	Old	New
1974	4.8	5.0	1,249.8	1,243.9	3.5	3.0
1975	4.8	5.1	1,294.1	1,281.2	3.5	3.0
1976	4.8	5.1	1,340.0	1,319.6	3.5	3.0
1977	4.8	5.1	1,399.7	1,369.3	3.5	3.0
1978	4.9	5.1	1,449.4	1,410.3	3.5	3.0
1979	4.9	5.1	1,500.8	1,452.7	3.5	3.0
1980	4.8	5.0	1,554	1,496	3.5	3.0

Source: Council of Economic Advisers and Economic Report of the President,
January 1979.

APPENDIX B

Table 2

THE FRB HIGH EMPLOYMENT SURPLUS/DEFICIT (HES/D)
(Billions of dollars)

Fiscal Year	HES/D		Change in HES/D	
	Old 1/	New	Old 1/	New
1974	8.1	6.8		
1975	.2	-3.0	-7.9	-9.8
1976	-14.5	-19.8	-14.7	-16.8
1977	-3.0	-11.8	11.5	8.0
1978	5.2	-7.2	8.2	4.6
1979	16.8	-.4	11.6	6.8
1980	37.8	15.0	21.0	15.4

1/ Old estimates are those found in the December, 1978 Greenbook and an extraoplation for 1980.